FIRST COMMUNITY CORP /SC/
Form 10-K
March 14, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

x **Annual Report under Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended December 31, 2018
Or
o **Transition Report under Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from to
Commission file number: 000-28344

First Community Corporation

(Exact name of registrant as specified in its charter)

South Carolina	**57-1010751**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
5455 Sunset Blvd., **Lexington, South Carolina**	**29072**
(Address of principal executive offices)	(Zip Code)

803-951-2265

Registrant's telephone number, including area code

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

Title of each class	**Name of each exchange on which registered**
Common stock, $1.00 par value per share	The NASDAQ Capital Market

Securities registered pursuant to Section 12(g) of the Act: **None**

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

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

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 past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically 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). Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large accelerated filer o Accelerated filer x Non-accelerated filer o Smaller reporting company x Emerging growth company o
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

As of June 30, 2018, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was $178,249,487 based on the average of the bid and ask price of $25.08 on June 30, 2018, as reported on The NASDAQ Capital Market. 7,663,494 shares of the issuer's common stock were issued and outstanding as of March 14, 2019.

Documents Incorporated by Reference

Portions of the registrant's Definitive Proxy Statement for its 2019 Annual Meeting of Shareholders are incorporated by reference into Part III, Items 10-14 of this Form 10-K.

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CAUTIONARY STATEMENT REGARDING

FORWARD-LOOKING STATEMENTS

This report, including information included or incorporated by reference in this document, contains statements which constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. 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," "as "intend," "plan," "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 this Annual Report on Form 10-K for the year ended December 31, 2018 as filed with the Securities and Exchange Commission (the "SEC") and the following:

- credit losses as a result of, among other potential factors, declining real estate values, increasing interest rates, increasing unemployment, or changes in customer 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, write-down assets, or take other actions;
- 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;
- changes in deposit flows;
- changes in technology;
- our current and future products, services, applications and functionality and plans to promote them;
- changes in monetary and tax policies;
- changes in accounting standards, policies, estimates and practices;

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- our assumptions and estimates used in applying critical accounting policies, which may prove unreliable, inaccurate or not predictive of actual results;
- 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, including levels of capital required under the capital rules implementing Basel III;
- our ability to successfully execute our business strategy;
- 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;
- disruptions due to flooding, severe weather or other natural disasters; and
- other risks and uncertainties described under "Risk Factors" below.

Because of these and other risks and uncertainties, our actual future results may be materially different from the results indicated by any forward-looking statements. For additional information with respect to factors that could cause actual results to differ from the expectations stated in the forward-looking statements, see "Risk Factors" under Part I, Item 1A of this Annual Report on Form 10-K. In addition, our past results of operations do not necessarily indicate our future results. Therefore, we caution you not to place undue reliance on our forward-looking information and statements.

All forward-looking statements in this report are based on information available to us as of the date of this report. Although we believe that the expectations reflected in our forward-looking statements are reasonable, we cannot guarantee you that these expectations will be achieved. We undertake no obligation to publicly update or otherwise revise any forward-looking statements, whether as a result of new information, future events, or otherwise, except as required by applicable law.

PART I

Item 1. Business.

General

First Community Corporation, a bank holding company registered under the Bank Holding Company Act of 1956, was incorporated under the laws of South Carolina in 1994 primarily to own and control all of the capital stock of First Community Bank, which commenced operations in August 1995. The Bank's primary federal regulator is the Federal Deposit Insurance Corporation (the "FDIC"). The Bank is also regulated and examined by the South Carolina Board of Financial Institutions (the "S.C. Board").

Unless otherwise mentioned or unless the context requires otherwise, references herein to "First Community," the "Company" "we," "us," "our" or similar references mean First Community Corporation and its consolidated subsidiaries. References to the "Bank" means First Community Bank.

We engage in a commercial banking business from our main office in Lexington, South Carolina and our 20 full-service offices located in: the Midlands of South Carolina, which include Lexington County (6 offices), Richland County (4 offices), Newberry County (2 offices) and Kershaw County (1 office); the Upstate of South Carolina which include Greenville County (2 offices), Anderson County (1 office) and Pickens County (1 office); and the Central Savannah River area which include Aiken County, South Carolina (1 office) and Augusta (Richmond County), Georgia (2 offices). In addition, we conduct business from a mortgage loan production office in Richland County, South Carolina. At December 31, 2018, we had approximately $1.1 billion in assets, $718.5 million in loans, $925.5 million in deposits, and $112.5 million in shareholders' equity.

On October 20, 2017, we acquired all of the outstanding common stock of Cornerstone Bancorp headquartered in Easley, South Carolina ("Cornerstone") the bank holding company for Cornerstone National Bank ("CNB"), in a cash and stock transaction. The total purchase price was approximately $27.1 million, consisting of $7.8 million in cash and 877,364 shares of our common stock valued at $19.3 million based on a provision in the merger agreement that 30% of the outstanding shares of Cornerstone common stock be exchanged for cash and 70% of the outstanding shares of Cornerstone common stock be exchanged for shares of our common stock. The value of our common stock issued was determined based on the closing price of the common stock on October 19, 2017 as reported by NASDAQ, which was $22.05. Cornerstone common shareholders received 0.54 shares of our common stock in exchange for each share of Cornerstone common stock, or $11.00 per share, subject to the limitations discussed above.

We offer a wide-range of traditional banking products and services for professionals and small-to medium-sized businesses, including consumer and commercial, mortgage, brokerage and investment, and insurance services. We also offer online banking to our customers. We have grown organically and through acquisitions.

Our stock trades on The NASDAQ Capital Market under the symbol "FCCO".

Available Information

We provide our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act") on our website at www.firstcommunitysc.com/ under the About section, under the Investors link. These filings are made accessible as soon as reasonably practicable after they have been filed electronically with the Securities and Exchange Commission (the "SEC"). These filings are also accessible on the SEC's website at www.sec.gov. In addition, we make available under our Investor Relations section on our website the following, among other things: (i) Code of Business Conduct and Ethics, which applies to our directors and all employees and (ii) the charters of the Audit and Compliance, Human Resources and Compensation, and Nominations and Corporate Governance Committees of our board of directors. These materials are available to the general public on our website free of charge. Printed copies of these materials are also available free of charge to shareholders who request them in writing. Please address your request to: Investor Relations, First Community Corporation, 5455 Sunset Boulevard, Lexington, South Carolina 29072. Statements of beneficial ownership of equity securities filed by directors, officers, and 10% or greater shareholders under Section 16 of the Exchange Act are also available through our website. The information on our website is not incorporated by reference into this report.

Location and Service Area

The Bank is engaged in a general commercial and retail banking business, emphasizing the needs of small-to-medium sized businesses, professional concerns and individuals. We have a total of 13 full-service offices located in Richland, Lexington, Kershaw and Newberry Counties of South Carolina and the surrounding areas. We refer to these counties as the "Midlands" region of South Carolina. Lexington County is home to six of our Bank's branch offices. Richland County, in which we have four branches as well as a mortgage loan production office, is the second largest county in South Carolina. Columbia is located within Richland County and is South Carolina's capital city and is geographically positioned in the center of the state between the industrialized Upstate region of South Carolina and the coastal city of

Charleston, South Carolina. Intersected by three major interstate highways (I-20, I-77, and I-26), Columbia's strategic location has contributed greatly to its commercial appeal and growth. With the acquisition of Savannah River Banking Company in 2014, we added a branch in Aiken, South Carolina and a branch in Augusta, Georgia (Richmond County). In 2016, we opened a loan production office in Greenville County, which we converted into a full service office in February 2019. With the acquisition of Cornerstone National Bank in 2017, we added a branch in each of Greenville, Pickens, and Anderson Counties of South Carolina. We refer to this three-county area as the "Upstate" region of South Carolina. In 2018 we opened a de novo branch in downtown Augusta, Georgia. We refer to the three-county area of Aiken County (South Carolina), Richmond County (Georgia) and Columbia County (Georgia) as the "CSRA" region.

The following table shows data as to deposits, market share and population for our three market areas (deposits in thousands):

	Total Offices		Estimated **Population**[(1)]	Total Market Deposits (2) June 30, 2018	Our Market Deposits (2) **June 30, 2018**	Market Share	
Midlands Region	14	(3)	805,758	$ 19,578,000	$ 712,437	3.64	%
CSRA Region	3		521,558	$ 7,707,000	$ 100,370	1.30	%
Upstate Region	4	(4)	829,075	$ 16,432,000	$ 125,337	0.76	%

(1) All population data is derived from July 2017 estimates based on survey changes to the 2010 U. S. Census data.
(2) All deposit data as of June 30, 2018 is derived from the most recent data published by the FDIC.
(3) Midlands Region consist of 13 full service offices and a mortgage loan production office that does not receive deposits.
(4) As of June 30, 2017, the Upstate Region consisted of three full service branches and a loan production office that did not receive deposits. On February 14, 2019 the loan production office was relocated and converted into a full service branch

We believe that we serve attractive banking markets with long-term growth potential and a well-educated employment base that helps to support our diverse and relatively stable local economy. According to U.S. Census Data, median household incomes for each of the counties in the regions noted above were as follows for 2017:

Richland County, SC	$52,082
Lexington County, SC	$57,482
Newberry County, SC	$39,600
Kershaw County SC	$46,565
Greenville County, SC	$53,739
Anderson County, SC	$45,551
Pickens County SC	$45,332
Aiken County SC	$47,713
Richmond County, GA	$39,430
Columbia County, GA	$74,162

The county estimates noted above compare to 2017 statewide median household income estimates of $48,781 and $52,977 for South Carolina and Georgia, respectively. The principal components of the economy within our market areas are service industries, government and education, and wholesale and retail trade. The largest employers in the Midlands market area, each of which employs in excess of 3,000 people, include Fort Jackson Army Base, the University of South Carolina, Palmetto Health Alliance, Blue Cross Blue Shield and Lexington Medical Center. The largest employers in our CSRA market area, each of which employs in excess of 3,000 people, include Fort Gordon Army Base, Georgia Regents University, Georgia Regents Health System, University Hospital and Savannah River Nuclear Solutions. The Upstate region major employers include, among others, Greenville Health Systems, Bon Secours St. Francis Health System, Michelin North America Inc., BMW Manufacturing Corporation and GE Power and Water. We believe that this diversified economic base has reduced, and will likely continue to reduce, economic volatility in our market areas. Our markets have experienced steady economic and population growth over the past 10 years, and we expect that the area, as well as the service industry needed to support it, will continue to grow.

Banking Services

We offer a full range of deposit services that are typically available in most banks and thrift institutions, including checking accounts, NOW accounts, savings accounts and other time deposits of various types, ranging from daily money market accounts to longer-term certificates of deposit. The transaction accounts and time certificates are tailored to our principal market area at rates competitive to those offered in the area. In addition, we offer certain retirement account services, such as individual retirement accounts (“IRAs”). All deposit accounts are insured by the FDIC up to the maximum amount allowed by law (currently, $250,000, subject to aggregation rules).

We also offer a full range of commercial and personal loans. Commercial loans include both secured and unsecured loans for working capital (including inventory and receivables), business expansion (including acquisition of real estate and improvements), and the purchase of equipment and machinery. Consumer loans include secured and unsecured loans for financing automobiles, home improvements, education, and personal investments. We also make real estate construction and acquisition loans. We originate fixed and variable rate mortgage loans, substantially all of which are sold into the secondary market. Our lending activities are subject to a variety of lending limits imposed by federal law. While differing limits apply in certain circumstances based on the type of loan or the nature of the borrower (including the borrower's relationship to the bank), in general, we are subject to a loans-to-one-borrower limit of an amount equal to 15% of the Bank's unimpaired capital and surplus, or 25% of the unimpaired capital and surplus if the excess over 15% is approved by the board of directors of the Bank and is fully secured by readily marketable collateral. As a result, our lending limit will increase or decrease in response to increases or decreases in the Bank's level of capital. Based upon the capitalization of the Bank at December 31, 2018, the maximum amount we could lend to one borrower is $17.1 million. In addition, we may not make any loans to any director, officer, employee, or 10% shareholder of the Company or the Bank unless the loan is approved by our board of directors and is made on terms not more favorable to such person than would be available to a person not affiliated with the Bank.

Other bank services include internet banking, cash management services, safe deposit boxes, travelers checks, direct deposit of payroll and social security checks, and automatic drafts for various accounts. We offer non-deposit investment products and other investment brokerage services through a registered representative with an affiliation through LPL Financial. We are associated with Nyce, Star, and Plus networks of automated teller machines and MasterCard debit cards that may be used by our customers throughout South Carolina and other regions. We also offer VISA and MasterCard credit card services through a correspondent bank as our agent.

We currently do not exercise trust powers, but we can begin to do so with the prior approval of our primary banking regulators, the FDIC and the S.C. Board.

Competition

The banking business is highly competitive. We compete as a financial intermediary with other commercial banks, savings and loan associations, credit unions and money market mutual funds operating in our market areas. As of June 30, 2018, there were 23 financial institutions operating approximately 177 offices in the Midlands market, 17 financial institutions operating 103 branches in the CSRA market, and 35 financial institutions operating 225 branches in the Upstate market. The competition among the various financial institutions is based upon a variety of factors, including interest rates offered on deposit accounts, interest rates charged on loans, credit and service charges, the quality of services rendered, the convenience of banking facilities and, in the case of loans to large commercial borrowers, relative lending limits. Size gives larger banks certain advantages in competing for business from large corporations. These advantages include higher lending limits and the ability to offer services in other areas of South Carolina and Georgia. As a result, we do not generally attempt to compete for the banking relationships of large corporations, but concentrate our efforts on small-to-medium sized businesses and individuals. We believe we have competed effectively in this market by offering quality and personal service. In addition, many of our non-bank competitors are not subject to the same extensive federal regulations that govern bank holding companies and federally insured banks.

Employees

As of December 31, 2018, we had 226 full-time employees. We believe that we have good relations with our employees.

Executive Officers of First Community Corporation

Executive officers of First Community Corporation are elected by the board of directors annually and serve at the pleasure of the board of directors. The executive officer, and persons chosen to become executive officers, and their ages, positions over the past five years, and terms of office as of March 14, 2019, are as follows:

Name (age)	Position and Five Year History	With the Company Since
Michael C. Crapps (60)	Chief Executive Officer and President, Director	1994
John T. Nissen (57)	Chief Commercial and Retail Banking Officer	1995
David K. Proctor (62)	Chief Credit Officer	1995
Joseph G. Sawyer (68)	Chief Financial Officer	1995
Robin D. Brown (51)	Chief Human Resources and Marketing Officer	1994
Tanya A. Butts (60)	Chief Operations Officers/Chief Risk Officer	2017

None of the above officers are related and there are no arrangements or understandings between them and any other person pursuant to which any of them was elected as an officer, other than arrangements or understandings with the directors or officers of the Company acting solely in their capacities as such.

SUPERVISION AND REGULATION

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

We own 100% of the outstanding capital stock of the Bank, and, therefore, we are considered to be a bank holding company under the federal Bank Holding Company Act of 1956 (the “Bank Holding Company Act”). As a result, we are primarily subject to the supervision, examination and reporting requirements of the Board of Governors of the Federal Reserve (the “Federal Reserve”) under the Bank Holding Company Act and its regulations promulgated there under. Moreover, as a bank holding company of a bank located in South Carolina, we also are subject to the South Carolina Banking and Branching Efficiency Act.

2018 Regulatory Reform. In May 2018, the Economic Growth, Regulatory Reform and Consumer Protection Act (“Regulatory Relief Act”), was enacted to modify or remove certain financial reform rules and regulations, including some of those implemented under The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). While the Regulatory Relief Act maintains most of the regulatory structure established by the Dodd-Frank Act, it amends certain aspects of the regulatory framework for small depository institutions with assets of less than $10 billion and for large banks with assets of more than $50 billion. Many of these changes could result in meaningful regulatory changes for the Company and the Bank.

The Regulatory Relief Act, among other things, expands the definition of qualified mortgages a financial institution may hold and simplifies the regulatory capital rules for financial institutions and their holding companies with total consolidated assets of less than $10 billion by instructing the federal banking regulators to establish a single “community bank leverage ratio” of between 8% and 10%. Any qualifying depository institution or its holding company that exceeds this community bank leverage ratio will be exempt from other generally applicable leverage and risk-based regulatory requirements. Further, any qualifying depository institution that exceeds the new ratio will be considered to be “well capitalized” for purposes of the prompt corrective action rules. The Regulatory Relief Act also expanded the category of holding companies that may rely on the “Small Bank Holding Company and Savings and Loan Holding Company Policy Statement” by raising the maximum amount of assets a qualifying holding company may have from $1 billion to $3 billion. This expansion also excludes such holding companies from the minimum capital requirements of the Dodd-Frank Act. In addition, the Regulatory Relief Act includes regulatory relief for community banks regarding regulatory examination cycles, call reports, the proprietary trading prohibitions in the Volcker Rule, mortgage disclosures, and risk weights for certain high-risk commercial real estate loans.

It is difficult at this time to predict when or how new standards under the Regulatory Relief Act will be implemented by regulations and ultimately be applied to the Company or the Bank or what specific impact the Regulatory Relief Act and the yet-to-be-written implementation rules and regulations will have on the Company or the Bank.

The Dodd-Frank Wall Street Reform and Consumer Protection Act. The Dodd-Frank Act was signed into law in July 2010. The Dodd-Frank Act impacted financial institutions in numerous ways, including:

- Created the Financial Stability Oversight Council responsible for monitoring and managing systemic risk,
- Granted additional authority to the Federal Reserve to regulate certain types of nonbank financial companies,
- Granted new authority to the FDIC as liquidator and receiver,
- Changed the manner in which deposit insurance assessments are made,
- Required regulators to modify capital standards,
- Established the Bureau of Consumer Financial Protection (the “CFPB”),
- Capped interchange fees that banks with assets of $10 billion or more charge merchants for debit card transactions,
- Imposed more stringent requirements on mortgage lenders, and
- Limited banks’ proprietary trading activities.

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

Basel Capital Standards. In July of 2013, the U.S. federal banking agencies approved the implementation of the Basel III regulatory capital reforms in pertinent part, and, at the same time, promulgated rules effecting certain changes required by the Dodd-Frank Act (the "Basel III Rule"). The Basel III Rule was released in the form of enforceable regulations by each of the applicable federal bank regulatory agencies. The Basel III Rule is applicable to all banking organizations that are subject to minimum capital requirements, including federal and state banks and savings and loan associations, as well as to bank and savings and loan holding companies, other than "small bank holding companies." A small bank holding company is generally a qualifying bank holding company or savings and loan holding company with less than $3.0 billion in consolidated assets. More stringent requirements are imposed on "advanced approaches" banking organizations—generally those organizations with $250 billion or more in total consolidated assets, $10 billion or more in total foreign exposures applicable to advanced approaches banking organizations.

Based on the foregoing, as a small bank holding company, we are generally not subject to the capital requirements at the holding company level unless otherwise advised by the Federal Reserve; however, our Bank remains subject to the capital requirements.

The FDIC's final capital rules included new risk-based capital and leverage ratios and refined the definition of what constitutes "capital" for purposes of calculating those ratios. The minimum capital-level requirements applicable to the Bank under the final rule are:

- a new Common Equity Tier 1 risk-based capital ratio of 4.5%;
- a Tier 1 risk-based capital ratio of 6% (increased from the former 4% requirement);
- a total risk-based capital ratio of 8% (unchanged from the former requirement); and
- a leverage ratio of 4% (also unchanged from the former requirement).

The final rules also established a "capital conservation buffer" above the new regulatory minimum capital requirements, which must consist entirely of Common Equity Tier 1 capital, which was phased in over several years. The phase-in of the capital conservation buffer began on January 1, 2016, at a level of 0.625% of risk-weighted assets for 2016 and increased to 1.250% for 2017, and 1.875% for 2018. The fully phased-in capital conservation buffer of 2.500%, which became effective on January 1, 2019, resulted in the following effective minimum capital ratios beginning in 2019: (i) a Common Equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. Under the final rules, institutions are subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if their capital levels fall below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

Under the rules, Tier 1 capital is redefined to include two components: Common Equity Tier 1 capital and additional Tier 1 capital. The new and highest form of capital, Common Equity Tier 1 capital, consists solely of common stock (plus related surplus), retained earnings, accumulated other comprehensive income, and limited amounts of minority interests that are in the form of common stock. Additional Tier 1 capital includes other perpetual instruments historically included in Tier 1 capital, such as noncumulative perpetual preferred stock. The rules permit bank holding companies with less than $15.0 billion in total consolidated assets to continue to include trust preferred securities and cumulative perpetual preferred stock issued before May 19, 2010 in Tier 1 capital, but not in Common Equity Tier 1 capital, subject to certain restrictions. Tier 2 capital consists of instruments that currently qualify in Tier 2 capital plus instruments that the rules have disqualified from Tier 1 capital treatment. Cumulative perpetual preferred stock, formerly includable in Tier 1 capital, is now included only in Tier 2 capital. Accumulated other comprehensive income ("AOCI") is presumptively included in Common Equity Tier 1 capital and often would operate to reduce this category of capital. The rules provided a one-time opportunity at the end of the first quarter of 2015 for covered banking organizations to opt-out of much of this treatment of AOCI. We made this opt-out election and, as a result, retain the pre-existing treatment for AOCI.

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

Volcker Rule. Section 619 of the Dodd-Frank Act, known as the “Volcker Rule,” originally prohibited any bank, bank holding company, or affiliate (referred to collectively as “banking entities”) from engaging in two types of activities: “proprietary trading” and the ownership or sponsorship of private equity or hedge funds that are referred to as “covered funds.” Proprietary trading is, in general, trading in securities on a short-term basis for a banking entity’s own account. Funds subject to the ownership and sponsorship prohibition are those not required to register with the SEC because they have only accredited investors or no more than 100 investors. In December 2013, our primary federal regulators, the Federal Reserve and the FDIC, together with other federal banking agencies, the SEC and the Commodity Futures Trading Commission, finalized a regulation to implement the Volcker Rule; however, in 2018, the Regulatory Relief Act exempted banking entities with less than $10 billion in total consolidated assets, such as us, from the Volcker Rule.

Tax Cuts and Jobs Act. On December 22, 2017, the Tax Cuts and Jobs Act (the “Tax Act”) was signed into law. The Tax Act includes a number of provisions that impact us, including the following:

- Tax Rate. The Tax Act replaced the graduated corporate tax rates applicable under prior law, which imposed a maximum tax rate of 35%, with a reduced 21% flat tax rate. Although the reduced tax rate generally should be favorable to us by resulting in increased earnings and capital, it will decrease the value of our existing deferred tax assets. Generally accepted accounting principles (“GAAP”) requires that the impact of the provisions of the Tax Act be accounted for in the period of enactment. Accordingly, the incremental income tax expense recorded by the Company in the fourth quarter of 2017 related to the Tax Act was $1.2 million, resulting primarily from a remeasurement of deferred tax assets of $3.2 million.
- Employee Compensation. A “publicly held corporation” is not permitted to deduct compensation in excess of $1 million per year paid to certain employees. The Tax Act eliminates certain exceptions to the $1 million limit applicable under prior to law related to performance-based compensation, such as equity grants and cash bonuses that are paid only on the attainment of performance goals. As a result, our ability to deduct certain compensation that may be paid to our most highly compensated employees will now be limited.
- Business Asset Expensing. The Tax Act allows taxpayers immediately to expense the entire cost (instead of only 50%, as under prior law) of certain depreciable tangible property and real property improvements acquired and placed in service after September 27, 2017 and before January 1, 2023 (with an additional year for certain property). This 100% “bonus” depreciation is phased out proportionately for property placed in service on or after January 1, 2023 and before January 1, 2027 (with an additional year for certain property).
- Interest Expense. The Tax Act limits a taxpayer’s annual deduction of business interest expense to the sum of (i) business interest income and (ii) 30% of “adjusted taxable income,” defined as a business’s taxable income without taking into account business interest income or expense, net operating losses, and, for 2018 through 2021, depreciation, amortization and depletion. Because we generate significant amounts of net interest income, we do not expect to be impacted by this limitation.

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

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

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

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

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

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

Change in Control. Two statutes, the Bank Holding Company Act and the Change in Bank Control Act, together with regulations promulgated under them, require some form of regulatory review before any company may acquire "control" of a bank or a bank holding company. Under the Bank Holding Company Act, control is deemed to exist if a company acquires 25% or more of any class of voting securities of a bank holding company; controls the election of a majority of the members of the board of directors; or exercises a controlling influence over the management or policies of a bank or bank holding company. In guidance issued in 2008, the Federal Reserve stated that an investor generally will not be viewed as having a controlling influence over a bank holding company when the investor holds, in aggregate, less than 33% of the total equity of a bank or bank holding company (voting and nonvoting equity), provided such investor's ownership does not include 15% or more of any class of voting securities. Prior Federal Reserve approval is necessary before an entity acquires sufficient control to become a bank holding company. Natural persons, certain non-business trusts, and other entities are not treated as companies (or bank holding companies), and their acquisitions are not subject to review under the Bank Holding Company Act. State laws generally, including South Carolina law, require state approval before an acquirer may become the holding company of a state bank.

Under the Change in Bank Control Act, a person or company is generally required to file a notice with the Federal Reserve if it will, as a result of the transaction, own or control 10% or more of any class of voting securities or direct the management or policies of a bank or bank holding company and either if the bank or bank holding company has registered securities or if the acquirer would be the largest holder of that class of voting securities after the acquisition. For a change in control at the holding company level, both the Federal Reserve and the subsidiary bank's primary federal regulator must approve the change in control; at the bank level, only the bank's primary federal regulator is involved. Transactions subject to the Bank Holding Company Act are exempt from Change in Control Act requirements. For state banks, state laws, including those of South Carolina, typically require approval by the state bank regulator as well.

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

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

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

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

Any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

Capital Requirements. The Federal Reserve imposes certain capital requirements on a bank holding company under the Bank Holding Company Act, including a minimum leverage ratio and a minimum ratio of "qualifying" capital to risk-weighted assets. These requirements are essentially the same as those that apply to the Bank and are described below under "First Community Bank—Capital Regulations." However, because the Company currently qualifies as a small bank holding company, these capital requirements do not currently apply to the Company. Subject to certain restrictions, we are able to borrow money to make a capital contribution to the Bank, and these loans may be repaid from dividends paid from the Bank to the Company. Our ability to pay dividends depends on, among other things, the Bank's ability to pay dividends to us, which is subject to regulatory restrictions as described below in "First Community Bank—Dividends." We are also able to raise capital for contribution to the Bank by issuing securities without having to receive regulatory approval, subject to compliance with federal and state securities laws.

Dividends. 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. The Federal Reserve has issued a policy statement regarding the payment of dividends by bank holding companies. In general, the Federal Reserve'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'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 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 described below in “First Community Bank – Dividends.”

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

First Community Bank

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

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

- security devices and procedures;
- adequacy of capitalization and loss reserves;
- loans;
- investments;
- borrowings;
- deposits;
- mergers;
- issuances of securities;
- payment of dividends;
- interest rates payable on deposits;
- interest rates or fees chargeable on loans;
- establishment of branches;
- corporate reorganizations;
- maintenance of books and records; and
- adequacy of staff training to carry on safe lending and deposit gathering practices.

These agencies, and the federal and state laws applicable to the Bank’s operations, extensively regulate various aspects of our banking business, including, among other things, permissible types and amounts of loans, investments and other activities, capital adequacy, branching, interest rates on loans and on deposits, the maintenance of reserves on demand deposit liabilities, and the safety and soundness of our banking practices.

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

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

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

- Well Capitalized — The institution exceeds the required minimum level for each relevant capital measure. A well capitalized institution (i) has a total risk-based capital ratio of 10% or greater, (ii) has a Tier 1 risk-based capital ratio of 8% or greater, (iii) has a common equity Tier 1 risk-based capital ratio of 6.5% or greater, (iv) has a leverage capital ratio of 5% or greater, and (v) is not subject to any order or written directive to meet and maintain a specific capital level for any capital measure.
- Adequately Capitalized — The institution meets the required minimum level for each relevant capital measure. No capital distribution may be made that would result in the institution becoming undercapitalized. An adequately capitalized institution (i) has a total risk-based capital ratio of 8% or greater, (ii) has a Tier 1 risk-based capital ratio of 6% or greater, (iii) has a common equity Tier 1 risk-based capital ratio of 4.5% or greater, and (iv) has a leverage capital ratio of 4% or greater.
- Undercapitalized — The institution fails to meet the required minimum level for any relevant capital measure. An undercapitalized institution (i) has a total risk-based capital ratio of less than 8%, (ii) has a Tier 1 risk-based capital ratio of less than 6%, (iii) has a common equity Tier 1 risk-based capital ratio of less than 4.5% or greater, or (iv) has a leverage capital ratio of less than 4%.
- Significantly Undercapitalized — The institution is significantly below the required minimum level for any relevant capital measure. A significantly undercapitalized institution (i) has a total risk-based capital ratio of less than 6%, (ii) has a Tier 1 risk-based capital ratio of less than 4%, (iii) has a common equity Tier 1 risk-based capital ratio of less than 3% or greater, or (iv) has a leverage capital ratio of less than 3%.
- Critically Undercapitalized — The institution fails to meet a critical capital level set by the appropriate federal banking agency. A critically undercapitalized institution has a ratio of tangible equity to total assets that is equal to or less than 2%.

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

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

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

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

As of December 31, 2018, the Bank was deemed to be “well capitalized.”

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

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

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

- internal controls;
- information systems and audit systems;
- loan documentation;

- credit underwriting;
- interest rate risk exposure; and
- asset quality.

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

Section 23A of the Federal Reserve Act places limits on the amount of loans or extensions of credit by a bank to any affiliate, including its holding company, and on a bank's investments in, or certain other transactions with, affiliates and on the amount of advances to third parties collateralized by the securities or obligations of any affiliates of the bank. Section 23A also applies to derivative transactions, repurchase agreements and securities lending and borrowing transactions that cause a bank to have credit exposure to an affiliate. The aggregate of all covered transactions is limited in amount, as to any one affiliate, to 10% of the Bank's capital and surplus and, as to all affiliates combined, to 20% of the Bank's capital and surplus. Furthermore, within the foregoing limitations as to amount, each covered transaction must meet specified collateral requirements. The Bank is forbidden to purchase low quality assets from an affiliate.

Section 23B of the Federal Reserve Act, among other things, prohibits an institution from engaging in certain transactions with certain affiliates unless the transactions are on terms substantially the same, or at least as favorable to such institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies. If there are no comparable transactions, a bank's (or one of its subsidiaries') affiliate transaction must be on terms and under circumstances, including credit standards, that in good faith would be offered to, or would apply to, nonaffiliated companies. These requirements apply to all transactions subject to Section 23A as well as to certain other transactions.

The affiliates of a bank include any holding company of the bank, any other company under common control with the bank (including any company controlled by the same shareholders who control the bank), any subsidiary of the bank that is itself a bank, any company in which the majority of the directors or trustees also constitute a majority of the directors or trustees of the bank or holding company of the bank, any company sponsored and advised on a contractual basis by the bank or an affiliate, and any mutual fund advised by a bank or any of the bank's affiliates. Regulation W generally excludes all non-bank and non-savings association subsidiaries of banks from treatment as affiliates, except to the extent that the Federal Reserve decides to treat these subsidiaries as affiliates.

The Bank is also subject to certain restrictions on extensions of credit to executive officers, directors, certain principal stockholders, and their related interests. Extensions of credit include derivative transactions, repurchase and reverse repurchase agreements, and securities borrowing and lending transactions to the extent that such transactions cause a bank to have credit exposure to an insider. Any extension of credit to an insider (i) must be made on substantially the same terms, including interest rates and collateral requirements, as those prevailing at the time for comparable transactions with unrelated third parties and (ii) must not involve more than the normal risk of repayment or present other unfavorable features.

Dividends. Our principal source of cash flow, including cash flow to pay dividends to its shareholders, is dividends it receives from the Bank. Statutory and regulatory limitations apply to the Bank's payment of dividends to the Company. 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 S.C. Board, 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 S.C. Board. 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.

Branching. Federal legislation permits out-of-state acquisitions by bank holding companies, interstate branching by banks, and interstate merging by banks. The Dodd-Frank Act removed previous state law restrictions on de novo interstate branching in states such as South Carolina and Georgia. This change effectively permits out of state banks to open de novo branches in states where the laws of such state would permit a bank chartered by that sate to open a de novo branch.

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

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

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

Financial Subsidiaries. Under the GLBA, subject to certain conditions imposed by their respective banking regulators, national and state-chartered banks are permitted to form "financial subsidiaries" that may conduct financial or incidental activities, thereby permitting bank subsidiaries to engage in certain activities that previously were impermissible. The GLBA imposes several safeguards and restrictions on financial subsidiaries, including that the parent bank's equity investment in the financial subsidiary be deducted from the bank's assets and tangible equity for purposes of calculating the bank's capital adequacy. In addition, the GLBA imposes new restrictions on transactions between a bank and its financial subsidiaries similar to restrictions applicable to transactions between banks and non-bank affiliates.

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

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

The deposit operations of the Bank also are subject to:

- the FDIA, which, among other things, limits the amount of deposit insurance available per account to $250,000 and imposes other limits on deposit-taking;
- the Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- the Electronic Funds Transfer Act and Regulation E, which governs automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services; and
- the Truth in Savings Act and Regulation DD, which requires depository institutions to provide disclosures so that consumers can make meaningful comparisons about depository institutions and accounts.

The Consumer Financial Protection Bureau (the "CFPB") is an independent regulatory authority housed within the Federal Reserve. The CFPB has broad authority to regulate the offering and provision of consumer financial products. The CFPB has the authority to supervise and examine depository institutions with more than $10 billion in assets for compliance with federal consumer laws. The authority to supervise and examine depository institutions with $10 billion or less in assets, such as the Bank, for compliance with federal consumer laws remains largely with those institutions' primary regulators. However, the CFPB may participate in examinations of these smaller institutions on a "sampling basis" and may refer potential enforcement actions against such institutions to their primary regulators. As such, the CFPB may participate in examinations of the Bank.

The CFPB has issued a number of significant rules that impact nearly every aspect of the lifecycle of a residential mortgage loan. These rules implement Dodd-Frank Act amendments to the Equal Credit Opportunity Act, TILA and the Real Estate Settlement Procedures Act ("RESPA"). Among other things, the rules adopted by the CFPB require banks to: (i) develop and implement procedures to ensure compliance with a "reasonable ability-to-repay" test; (ii) implement new or revised disclosures, policies and procedures for originating and servicing mortgages, including, but not limited to, pre-loan counseling, early intervention with delinquent borrowers and specific loss mitigation procedures for loans secured by a borrower's principal residence, and mortgage origination disclosures, which integrate existing requirements under TILA and RESPA; (iii) comply with additional restrictions on mortgage loan originator hiring and compensation; and (iv) comply with new disclosure requirements and standards for appraisals and certain financial products.

Bank regulators take into account compliance with consumer protection laws when considering approval of a proposed expansionary proposals.

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

Anti-Money Laundering. Financial institutions must maintain anti-money laundering programs that include established internal policies, procedures, and controls; a designated compliance officer; an ongoing employee training program; and testing of the program by an independent audit function. The Company and the Bank are also prohibited from entering into specified financial transactions and account relationships and must meet enhanced standards for due diligence and "knowing your customer" in their dealings with foreign financial institutions and foreign customers. Financial institutions must take reasonable steps to conduct enhanced scrutiny of account relationships to guard against money laundering and to report any suspicious transactions, and recent laws provide law enforcement authorities with increased access to financial information maintained by banks. Anti-money laundering obligations have been substantially strengthened as a result of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (which we refer to as the "USA PATRIOT Act"), enacted in 2001 and renewed through 2019. Bank regulators routinely examine institutions for compliance with these obligations and are required to consider compliance in connection with the regulatory review of applications. The regulatory authorities have been active in imposing cease and desist orders and money penalty sanctions against institutions that have not complied with these requirements.

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

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

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

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

Recent cyber attacks against banks and other institutions that resulted in unauthorized access to confidential customer information have prompted the Federal banking agencies to issue several warnings and extensive guidance on cyber security. The agencies are likely to devote more resources to this part of their safety and soundness examination than they have in the past.

In addition, pursuant to the Fair and Accurate Credit Transactions Act of 2003 (the "FACT Act") and the implementing regulations of the federal banking agencies and Federal Trade Commission, the Bank is required to have in place an "identity theft red flags" program to detect, prevent and mitigate identity theft. The Bank has implemented an identity theft red flags program designed to meet the requirements of the FACT Act and the joint final rules. Additionally, the FACT Act amends the Fair Credit Reporting Act to generally prohibit a person from using information received from an affiliate to make a solicitation for marketing purposes to a consumer, unless the consumer is given notice and a reasonable opportunity and a reasonable and simple method to opt out of the making of such solicitations.

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

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

As an FDIC-insured bank, the Bank must pay deposit insurance assessments to the FDIC based on its average total assets minus its average tangible equity. The Bank's assessment rates are currently based on its risk classification (i.e., the level of risk it poses to the FDIC's deposit insurance fund). Institutions classified as higher risk pay assessments at higher rates than institutions that pose a lower risk. In addition, following the fourth consecutive quarter (and any applicable phase-in period) where an institution's total consolidated assets equal or exceed $10 billion, the FDIC will use a performance score and a loss-severity score to calculate an initial assessment rate. In calculating these scores, the FDIC uses an institution's capital level and regulatory supervisory ratings and certain financial measures to assess an institution's ability to withstand asset-related stress and funding-related stress. The FDIC also has the ability to make discretionary adjustments to the total score based upon significant risk factors that are not adequately captured in the calculations. In addition to ordinary assessments described above, the FDIC has the ability to impose special assessments in certain instances.

The FDIC's deposit insurance fund is currently underfunded, and the FDIC has raised assessment rates and imposed special assessments on certain institutions during recent years to raise funds. Under the Dodd-Frank Act, the minimum designated reserve ratio for the deposit insurance fund is 1.35% of the estimated total amount of insured deposits. In October 2010, the FDIC adopted a restoration plan to ensure that the fund reserve ratio reaches 1.35% by September 30, 2020, as required by the Dodd-Frank Act. At least semi-annually, the FDIC updates its loss and income projections for the fund and, if needed, will increase or decrease assessment rates, following notice-and-comment rulemaking if required. Because the reserve ratio has reached 1.35%, two deposit insurance assessment changes occurred under FDIC regulations: (1) surcharges on insured depository institutions with total consolidated assets of $10 billion or more (large institutions) will cease; and (2) banks with assets of less than $10 billion, such as us, will receive assessment credits for the portion of their assessments that contributed to the growth in the reserve ratio from between 1.15% and 1.35%, to be applied when the reserve ratio is at or above 1.38%, with credits starting March 31, 2019.

In addition, FDIC insured institutions are required to pay a Financing Corporation assessment to fund the interest on bonds issued to resolve thrift failures in the 1980s. The Financing Corporation quarterly assessment for the fourth quarter of 2014 equaled 1.725 basis points for each $100 of average consolidated total assets minus average tangible equity. These assessments, which may be revised based upon the level of deposits, will continue until the bonds mature in the years 2017 through 2019. The amount assessed on individual institutions is in addition to the amount, if any, paid for deposit insurance according to the FDIC's risk-related assessment rate schedules. Assessment rates may be adjusted quarterly to reflect changes in the assessment base.

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

Incentive Compensation. There have been a number of developments in recent years focused on incentive compensation plans sponsored by bank holding companies and banks, reflecting recognition by the bank regulatory agencies and Congress that flawed incentive compensation practices in the financial industry were one of many factors contributing to the global financial crisis. Layered on top of that are the abuses in the headlines dealing with product cross-selling incentive plans. The result is interagency guidance on sound incentive compensation practices and proposed rulemaking by the agencies required under Section 956 of the Dodd-Frank Act.

The interagency guidance recognized three core principles; effective incentive plans are required to: (i) provide employees incentives that appropriately balance risk and reward; (ii) be compatible with effective controls and risk-management; and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors. Much of the guidance addresses large banking organizations and, because of the size and complexity of their operations, the regulators expect those organizations to maintain systematic and formalized policies, procedures, and systems for ensuring that the incentive compensation arrangements for all executive and non-executive employees covered by this guidance are identified and reviewed, and appropriately balance risks and rewards. Smaller banking organizations like the Company that use incentive compensation arrangements are expected to be less extensive, formalized, and detailed than those of the larger banks.

Section 956 of the Dodd-Frank Act required the banking agencies, the National Credit Union Administration, the SEC and the Federal Housing Finance Agency to jointly prescribe regulations that prohibit types of incentive-based compensation that encourage inappropriate risk taking and to disclose certain information regarding such plans. On

June 10, 2016, the agencies released an updated proposed rule for comment. Section 956 will only apply to banking organizations with assets of greater than $1 billion. The Company has consolidated assets greater than $1 billion and less than $50 billion and the Company is considered a Level 3 banking organization under the proposed rules. The proposed rules contain mostly general principles and reporting requirements for Level 3 institutions so there are no specific prescriptions or limits, deferral requirements or claw-back mandates. Risk management and controls are required, as is board or committee level approval and oversight. No final rule has been issued yet.

Concentrations in Commercial Real Estate. Concentration risk exists when FDIC-insured institutions deploy too many assets to any one industry or segment. A concentration in commercial real estate is one example of regulatory concern. The interagency Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices guidance ("CRE Guidance") provides supervisory criteria, including the following numerical indicators, to assist bank examiners in identifying banks with potentially significant commercial real estate loan concentrations that may warrant greater supervisory scrutiny: (i) total non-owner-occupied commercial real estate loans, including loans secured by apartment buildings, investor commercial real estate, and construction and land loans, represent 300% or more of an institution's total risk-based capital and the outstanding balance of the commercial real estate loan portfolio has increased by 50% or more in the preceding three years or (ii) construction and land development loans exceed 100% of capital. The CRE Guidance does not limit banks' levels of commercial real estate lending activities, but rather guides institutions in developing risk management practices and levels of capital that are commensurate with the level and nature of their commercial real estate concentrations. On December 18, 2015, the federal banking agencies issued a statement to reinforce prudent risk-management practices related to commercial real estate lending, having observed substantial growth in many commercial real estate asset and lending markets, increased competitive pressures, rising commercial real estate concentrations in banks, and an easing of commercial real estate underwriting standards. The federal bank agencies reminded FDIC-insured institutions to maintain underwriting discipline and exercise prudent risk-management practices to identify, measure, monitor and manage the risks arising from commercial real estate lending. In addition, FDIC-insured institutions must maintain capital commensurate with the level and nature of their commercial real estate concentration risk. Based on the Bank's loan portfolio as of December 31, 2018, its non-owner occupied commercial loans and its construction and land development loans were approximately 260% and 69% of total risk-based capital, respectively. Management will continue to monitor the level of the concentration in commercial real estate loans within the bank's loan portfolio.

Item 1A. Risk Factors.

There are risks, many beyond our control, which could cause our results to differ significantly from management's expectations. Some of these risk factors are described below. Any factor described in this Annual Report on Form 10-K could, by itself or together with one or more other factors, adversely affect our business, results of operations and/or financial condition. Additional risks and uncertainties not currently known to us or that we currently consider to not be material also may materially and adversely affect us. In assessing these risks, you should also refer to other information disclosed in our SEC filings, including the financial statements and notes thereto. The risks discussed below also include forward-looking statements, and actual results may differ substantially from those discussed or implied in these forward-looking statements.

General Business Risks

Our business may be adversely affected by economic conditions.

Our financial performance generally, and in particular the ability of borrowers to pay interest on and repay principal of outstanding loans and the value of collateral securing those loans, as well as demand for loans and other products and services we offer, is highly dependent upon the business environment in the primary markets where we operate and in the U.S. as a whole. Unfavorable or uncertain economic and market conditions can be caused by declines in economic growth, business activity or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; increases in inflation or interest rates; high unemployment, natural disasters; or a combination of these or other factors. While economic conditions in our local markets in South Carolina and Georgia have continued to improve since the end of the economic recession, concerns still exist over the federal deficit, government spending, as well as the potential for rapid changes in local and global economic conditions. A return of recessionary conditions and/or negative developments in the domestic and international credit markets may significantly affect the markets in which we do business, the value of our loans and investments, and our ongoing operations, costs and profitability. Declines in real estate value and sales volumes and high unemployment levels may result in higher than expected loan delinquencies and a decline in demand for our products and services. These negative events may cause us to incur losses and may adversely affect our capital, liquidity, and financial condition.

Furthermore, the Federal Reserve, in an attempt to help the overall economy, has among other things, kept interest rates low through its targeted federal funds rate and the purchase of U.S. Treasury and mortgage-backed securities. The Federal Reserve increased the target range for the federal funds rate by 75 basis points in 2017 and by a total of 100 basis points during 2018 and has indicated a patient approach in evaluating increases in the target rate depending on the economic outlook. As the federal funds rate increases, market interest rates will likely rise, which may negatively impact the housing markets and the U.S. economic recovery.

Our decisions regarding credit risk and reserves for loan losses may materially and adversely affect our business.

Making loans and other extensions of credit is an essential element of our business. Although we seek to mitigate risks inherent in lending by adhering to specific underwriting practices, our loans and other extensions of credit may not be repaid. The risk of nonpayment is affected by a number of factors, including:

- the duration of the credit;
- credit risks of a particular customer;
- changes in economic and industry conditions; and
- in the case of a collateralized loan, risks resulting from uncertainties about the future value of the collateral.

We attempt to maintain an appropriate allowance for loan losses to provide for potential losses in our loan portfolio. We periodically determine the amount of the allowance based on consideration of several factors, including:

- an ongoing review of the quality, mix, and size of our overall loan portfolio;
- our historical loan loss experience;
- evaluation of economic conditions;
- regular reviews of loan delinquencies and loan portfolio quality; and
- the amount and quality of collateral, including guarantees, securing the loans.

There is no precise method of predicting credit losses; therefore, we face the risk that charge-offs in future periods will exceed our allowance for loan losses and that additional increases in the allowance for loan losses will be required. Additions to the allowance for loan losses would result in a decrease of our net income, and possibly our capital.

Federal and state regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs, based on judgments different than those of our management. Any increase in the amount of our provision or loans charged-off as required by these regulatory agencies could have a negative effect on our operating results.

We may have higher loan losses than we have allowed for in our allowance for loan losses.

Our actual loan losses could exceed our allowance for loan losses. Our average loan size continues to increase and reliance on our historic allowance for loan losses may not be adequate. As of December 31, 2018, approximately 87.1% of our loan portfolio (excluding loans held for sale) is composed of construction (8.1%), commercial mortgage (71.5%) and commercial loans (7.5%). Repayment of such loans is generally considered more subject to market risk than residential mortgage loans. Industry experience shows that a portion of loans will become delinquent and a portion of loans will require partial or entire charge-off. Regardless of the underwriting criteria utilized, losses may be experienced as a result of various factors beyond our control, including among other things, changes in market conditions affecting the value of loan collateral and problems affecting the credit of our borrowers.

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

A significant portion of our loan portfolio is secured by real estate. As of December 31, 2018, approximately 91.1% of our loans (excluding loans held for sale) had real estate as a primary or secondary component of collateral. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. While economic conditions and real estate in our local markets in South Carolina and Georgia have improved since the end of the economic recession, there can be no assurance that our local markets will not experience another economic decline. Deterioration in the real estate market could cause us to adjust our opinion of the level of credit quality in our loan portfolio. Such a determination may lead to an additional increase in our provisions for loan losses, which could also adversely affect our business, financial condition, and results of operations. Natural disasters, including hurricanes, tornados, earthquakes, fires and floods, which could be exacerbated by potential climate change, may cause uninsured damage and other loss of value to real estate that secures these loans and may also negatively impact our financial condition.

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

As of December 31, 2018, we had approximately $561.4 million in loans outstanding to borrowers whereby the collateral securing the loan was commercial real estate, representing approximately 78.1% of our total loans outstanding as of that date. Approximately 40.0%, or $212.4 million, of this real estate is owner-occupied properties. Commercial real estate loans are generally viewed as having more risk of default than residential real estate loans.

They are also typically larger than residential real estate loans and consumer loans and depend on cash flows from the owner’s business or the property to service the debt. Cash flows may be affected significantly by general economic conditions, and a downturn in the local economy or in occupancy rates in the local economy where the property is located could increase the likelihood of default. Because our loan portfolio contains a number of commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in our level of non-performing loans. An increase in non-performing loans could result in a loss of earnings from these loans, an increase in the related provision for loan losses and an increase in charge-offs, all of which could have a material adverse effect on our financial condition and results of operations.

Our commercial real estate loans have grown 14.2% or $69.8 million, since December 31, 2018. The banking regulators are giving commercial real estate lending greater scrutiny, and may require banks with higher levels of commercial real estate loans to implement more stringent underwriting, internal controls, risk management policies and portfolio stress testing, as well as possibly higher levels of allowances for losses and capital levels as a result of commercial real estate lending growth and exposures.

Imposition of limits by the bank regulators on commercial and multi-family real estate lending activities could curtail our growth and adversely affect our earnings.

In 2006, the FDIC, the Federal Reserve and the Office of the Comptroller of the Currency issued joint guidance entitled “Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices” (the “CRE Guidance”). Although the CRE Guidance did not establish specific lending limits, it provides that a bank’s commercial real estate lending exposure could receive increased supervisory scrutiny where (i) total non-owner-occupied commercial real estate loans, including loans secured by apartment buildings, investor commercial real estate, and construction and land loans, represent 300% or more of an institution’s total risk-based capital, and the outstanding balance of the commercial real estate loan portfolio has increased by 50% or more during the preceding 36 months, or (ii) construction and land development loans exceed 100% of capital. Our total non-owner-occupied commercial real estate loans represented 260% of the Bank’s total risk-based capital at December 31, 2018, and our construction and land development loans represented 69% of the Bank’s capital at December 31, 2018.

In December 2015, the regulatory agencies released a new statement on prudent risk management for commercial real estate lending (the “2015 Statement”). In the 2015 Statement, the regulatory agencies, among other things, indicated their intent to continue “to pay special attention” to commercial real estate lending activities and concentrations going forward. If the FDIC, our primary federal regulator, were to impose restrictions on the amount of commercial real estate loans we can hold in our portfolio, for reasons noted above or otherwise, our earnings would be adversely affected.

Repayment of our commercial business loans is often dependent on the cash flows of the borrower, which may be unpredictable, and the collateral securing these loans may fluctuate in value.

At December 31, 2018, commercial business loans comprised 7.5% of our total loan portfolio. Our commercial business loans are originated primarily based on the identified cash flow and general liquidity of the borrower and secondarily on the underlying collateral provided by the borrower and/or repayment capacity of any guarantor. The borrower’s cash flow may be unpredictable, and collateral securing these loans may fluctuate in value. Although commercial business loans are often collateralized by equipment, inventory, accounts receivable, or other business assets, the liquidation of collateral in the event of default is often an insufficient source of repayment because accounts receivable may be uncollectible and inventories may be obsolete or of limited use. In addition, business assets may depreciate over time, may be difficult to appraise, and may fluctuate in value based on the success of the business. Accordingly, the repayment of commercial business loans depends primarily on the cash flow and credit worthiness of the borrower and secondarily on the underlying collateral value provided by the borrower and liquidity of the guarantor.

Changes in the financial markets could impair the value of our investment portfolio.

Our investment securities portfolio is a significant component of our total earning assets. Total investment securities averaged $271.6 million in 2018, as compared to $265.7 million in 2017. This represents 27.7% and 30.9% of the average earning assets for the years ended December 31, 2018 and 2017, respectively. At December 31, 2018, the portfolio was 25.7% of earning assets. Turmoil in the financial markets could impair the market value of our investment portfolio, which could adversely affect our net income and possibly our capital.

As of December 31, 2018 and 2017, securities which have unrealized losses were not considered to be “other than temporarily impaired,” and we believe it is more likely than not we will be able to hold these until they mature or recover our current book value. We currently maintain substantial liquidity which supports our ability to hold these investments until they mature, or until there is a market price recovery. However, if we were to cease to have the ability and intent to hold these investments until maturity or the market prices do not recover, and we were to sell these securities at a loss, it could adversely affect our net income and possibly our capital.

Economic challenges, especially those affecting the local markets in which we operate, may reduce our customer base, our level of deposits, and demand for financial products such as loans.

Our success depends significantly on growth, or lack thereof, in population, income levels, deposits and housing starts in the geographic markets in which we operate. The local economic conditions in these areas have a significant impact on our commercial, real estate and construction loans, the ability of borrowers to repay these loans, and the value of the collateral securing these loans. Unlike larger financial institutions that are more geographically diversified, we are a community banking franchise. Adverse changes in the economic conditions of the Southeast United States in general or in our primary markets in South Carolina and Georgia could negatively affect our financial condition, results of operations and profitability. While economic conditions in the states of South Carolina and Georgia, along with the U.S. have improved since the economic recession, there can be no assurance that these markets will not experience another economic decline. A return of recessionary conditions could result in the following consequences, any of which could have a material adverse effect on our business:

- loan delinquencies may increase
- problem assets and foreclosures may increase;
- demand for our products and services may decline; and
- collateral for loans that we make, especially real estate, may decline in value, in turn reducing a customer's borrowing power, and reducing the value of assets and collateral associated with the our loans.

Our focus on lending to small to mid-sized community-based businesses may increase our credit risk.

Most of our commercial business and commercial real estate loans are made to small business or middle market customers. These businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities and have a heightened vulnerability to economic conditions. If general economic conditions in the markets in which we operate negatively impact this important customer sector, our results of operations and financial condition and the value of our common stock may be adversely affected. Moreover, a portion of these loans have been made by us in recent years and the borrowers may not have experienced a complete business or economic cycle. Furthermore, the deterioration of our borrowers' businesses may hinder their ability to repay their loans with us, which could have a material adverse effect on our financial condition and results of operations.

If we fail to effectively manage credit risk and interest rate risk, our business and financial condition will suffer.

We must effectively manage credit risk. There are risks inherent in making any loan, including risks with respect to the period of time over which the loan may be repaid, risks relating to proper loan underwriting and guidelines, risks resulting from changes in economic and industry conditions, risks inherent in dealing with individual borrowers and risks resulting from uncertainties as to the future value of collateral. There is no assurance that our credit risk monitoring and loan approval procedures are or will be adequate or will reduce the inherent risks associated with lending. Our credit administration personnel, policies and procedures may not adequately adapt to changes in economic or any other conditions affecting customers and the quality of our loan portfolio. Any failure to manage such credit risks may materially adversely affect our business and our consolidated results of operations and financial condition.

Our deposit insurance premiums could be substantially higher in the future, which could have a material adverse effect on our future earnings.

The FDIC insures deposits at FDIC-insured depository institutions, such as the bank, up to applicable limits. The amount of a particular institution's deposit insurance assessment is based on that institution's risk classification under an FDIC risk-based assessment system. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to its regulators. Market developments and bank failures during and after the recession significantly depleted the FDIC's Deposit Insurance Fund and reduced the ratio of reserves to insured deposits. As a result of such economic conditions and the enactment of the Dodd-Frank Act, banks were assessed deposit insurance premiums based on the bank's average consolidated total assets, and the FDIC has modified certain risk-based adjustments, which increase or decrease a bank's overall assessment rate. This resulted in increases to the deposit insurance assessment rates and thus raised deposit premiums for many insured depository institutions. Because the reserve ratio has reached 1.35%, two deposit insurance assessment changes occurred under FDIC regulations: (1) surcharges on insured depository institutions with total consolidated assets of $10 billion or more (large institutions) will cease; and (2) banks with assets of less than $10 billion, such as us, will receive assessment credits for the portion of their assessments that contributed to the growth in the reserve ratio from between 1.15% and 1.35%, to be applied when the reserve ratio is at or above 1.38%, with credits starting March 31, 2019. If the Deposit Insurance Fund fails to meet its funding requirements, further special assessments or increases in deposit insurance premiums may be required. We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. If there are additional bank or financial institution failures, we may be required to pay even higher FDIC premiums than the recently increased levels. Any future additional assessments, increases or required prepayments in FDIC insurance premiums could reduce our profitability, may limit our ability to pursue certain business opportunities or otherwise negatively impact our operations.

Changes in prevailing interest rates may reduce our profitability.

Our results of operations depend in large part upon the level of our net interest income, which is the difference between interest income from interest- earning assets, such as loans and mortgage-backed securities ("MBSs"), and interest expense on interest-bearing liabilities, such as deposits and other borrowings. Depending on the terms and maturities of our assets and liabilities, we believe a significant change in interest rates could potentially have a material adverse effect on our profitability. Many factors cause changes in interest rates, including governmental monetary policies and domestic and international economic and political conditions. While we intend to manage the effects of changes in interest rates by adjusting the terms, maturities, and pricing of our assets and liabilities, our efforts may not be effective and our financial condition and results of operations could suffer.

We will face risks with respect to expansion through future acquisitions or mergers.

From time to time, we may seek to acquire other financial institutions or parts of those institutions. We may also expand into new markets or lines of business or offer new products or services. These activities would involve a number of risks, including:

- the potential inaccuracy of the estimates and judgments used to evaluate credit, operations, management, and market risks with respect to a target institution;
- Regulatory approvals could be delayed, impeded, restrictively conditioned or denied due to existing or new regulatory issues we have, or may have, with regulatory agencies, including, without limitation, issues related to anti-money laundering/Bank Secrecy Act compliance, fair lending laws, fair housing laws, consumer protection laws, unfair, deceptive, or abusive acts or practices regulations, Community Reinvestment Act issues, and other similar laws and regulations;
- the time and costs of evaluating new markets, hiring or retaining experienced local management, and opening new offices and the time lags between these activities and the generation of sufficient assets and deposits to support the costs of the expansion;
- the incurrence and possible impairment of goodwill associated with an acquisition and possible adverse effects on our results of operations; and
- the risk of loss of key employees and customers.

We may be exposed to difficulties in combining the operations of acquired businesses into our own operations, which may prevent us from achieving the expected benefits from our acquisition activities.

We may not be able to fully achieve the strategic objectives and operating efficiencies that we anticipate in our acquisition activities. Inherent uncertainties exist in integrating the operations of an acquired business. In addition, the markets and industries in which we and our potential acquisition targets operate are highly competitive. We may lose customers or the customers of acquired entities as a result of an acquisition. We also may lose key personnel from the acquired entity as a result of an acquisition. We may not discover all known and unknown factors when examining a company for acquisition during the due diligence period. These factors could produce unintended and unexpected consequences for us. Undiscovered factors as a result of acquisition, pursued by non-related third party entities, could bring civil, criminal, and financial liabilities against us, our management, and the management of those entities acquired. These factors could contribute to us not achieving the expected benefits from its acquisitions within desired time frames.

New or acquired banking office facilities and other facilities may not be profitable.

We may not be able to identify profitable locations for new banking offices. The costs to start up new banking offices or to acquire existing branches, and the additional costs to operate these facilities, may increase our non-interest expense and decrease our earnings in the short term. If branches of other banks become available for sale, we may acquire those offices. It may be difficult to adequately and profitably manage our growth through the establishment or purchase of additional banking offices and we can provide no assurance that any such banking offices will successfully attract enough deposits to offset the expenses of their operation. In addition, any new or acquired banking offices will be subject to regulatory approval, and there can be no assurance that we will succeed in securing such approval.

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

Michael C. Crapps, our president and chief executive officer, has extensive and long-standing ties within our primary market area and substantial experience with our operations, and he has contributed significantly to our business. If we lose the services of Mr. Crapps, he would be difficult to replace and our business and development could be materially and adversely affected.

Our success also depends, in part, on our continued ability to attract and retain experienced loan originators, as well as other management personnel. Competition for personnel is intense, and we may not be successful in attracting or retaining qualified personnel. Our failure to compete for these personnel, or the loss of the services of several of such key personnel, could adversely affect our business strategy and seriously harm our business, results of operations, and financial condition.

Our historical operating results may not be indicative of our future operating results.

We may not be able to sustain our historical rate of growth, and, consequently, our historical results of operations will not necessarily be indicative of our future operations. Various factors, such as economic conditions, regulatory and legislative considerations, and competition, may also impede our ability to expand our market presence. If we experience a significant decrease in our historical rate of growth, our results of operations and financial condition may be adversely affected because a high percentage of our operating costs are fixed expenses.

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

We face substantial competition in all areas of our operations from a variety of different competitors, both within and beyond our principal markets, many of which are larger and may have more financial resources. Such competitors primarily include national, regional, community and internet banks within the various markets in which we operate. We also face competition from many other types of financial institutions, including, without limitation, savings and loans, credit unions, finance companies, brokerage firms, insurance companies, and other financial intermediaries. The financial services industry could become even more competitive as a result of legislative and regulatory changes and continued consolidation. In addition, as customer preferences and expectations continue to evolve, technology has lowered barriers to entry and made it possible for banks to offer products and services in more areas in which they do not have a physical location and for nonbanks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Banks, securities firms, and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting), and merchant banking. Also, technology has lowered barriers to entry and made it possible for nonbanks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of our competitors have fewer regulatory constraints and may have lower cost structures. Additionally, due to their size, many competitors may be able to achieve economies of scale and, as a result, may offer a broader range of products and services as well as better pricing for those products and services than we can.

Our ability to compete successfully depends on a number of factors, including, among other things:

- the ability to develop, maintain, and build upon long-term customer relationships based on top quality service, high ethical standards, and safe, sound assets;
- the ability to expand our market position;
- the scope, relevance, and pricing of products and services offered to meet customer needs and demands;
- the rate at which we introduce new products and services relative to our competitors;
- customer satisfaction with our level of service; and
- industry and general economic trends.

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Failure to perform in any of these areas could significantly weaken our competitive position, which could adversely affect our growth and profitability, which, in turn, could have a material adverse effect on our financial condition and results of operations.

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

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

Failure to keep pace with technological change could adversely affect our business.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. In addition, we depend on internal and outsourced technology to support all aspects of our business operations. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

New lines of business or new products and services may subject us to additional risk.

From time to time, we may implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or new products and services, we may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business and/or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business and/or new products or services could have a material adverse effect on our business and, in turn, our financial condition and results of operations.

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

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

Our underwriting decisions may materially and adversely affect our business.

While we generally underwrite the loans in our portfolio in accordance with our own internal underwriting guidelines and regulatory supervisory guidelines, in certain circumstances we have made loans which exceed either our internal underwriting guidelines, supervisory guidelines, or both. As of December 31, 2018, approximately $12.3 million of our loans, or 10.76% of our Bank's regulatory capital, had loan-to-value ratios that exceeded regulatory supervisory guidelines, of which only one loan totaling approximately $26 thousand had loan-to-value ratios of 100% or more. In addition, supervisory limits on commercial loan-to-value exceptions are set at 30% of our Bank's capital. At December 31, 2018, $5.2 million of our commercial loans, or 4.54% of our Bank's regulatory capital, exceeded the supervisory loan to value ratio. The number of loans in our portfolio with loan-to-value ratios in excess of supervisory guidelines, our internal guidelines, or both could increase the risk of delinquencies and defaults in our portfolio.

We depend on the accuracy and completeness of information about clients and counterparties and our financial condition could be adversely affected if we rely on misleading information.

In deciding whether to extend credit or to enter into other transactions with clients and counterparties, we may rely on information furnished to us by or on behalf of clients and counterparties, including financial statements and other financial information, which we do not independently verify. We also may rely on representations of clients and counterparties as to the accuracy and completeness of that information and, with respect to financial statements, on reports of independent auditors. For example, in deciding whether to extend credit to clients, we may assume that a customer's audited financial statements conform with GAAP and present fairly, in all material respects, the financial condition, results of operations and cash flows of the customer. Our financial condition and results of operations could be negatively impacted to the extent we rely on financial statements that do not comply with GAAP or are materially misleading.

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

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

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

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

Our use of third party vendors and our other ongoing third party business relationships are subject to increasing regulatory requirements and attention.

We regularly use third party vendors as part of our business. We also have substantial ongoing business relationships with other third parties. These types of third party relationships are subject to increasingly demanding regulatory requirements and attention by our federal bank regulators. Recent regulation requires us to enhance our due diligence, ongoing monitoring and control over our third party vendors and other ongoing third party business relationships. We expect that our regulators will hold us responsible for deficiencies in our oversight and control of our third party relationships and in the performance of the parties with which we have these relationships. As a result, if our regulators conclude that we have not exercised adequate oversight and control over our third party vendors or other ongoing third party business relationships or that such third parties have not performed appropriately, we could be subject to enforcement actions, including civil money penalties or other administrative or judicial penalties or fines as well as requirements for customer remediation, any of which could have a material adverse effect our business, financial condition or results of operations.

We are at risk of increased losses from fraud.

Criminals committing fraud increasingly are using more sophisticated techniques and in some cases are part of larger criminal rings, which allow them to be more effective.

The fraudulent activity has taken many forms, ranging from check fraud, mechanical devices attached to ATM machines, social engineering and phishing attacks to obtain personal information or impersonation of our clients through the use of falsified or stolen credentials. Additionally, an individual or business entity may properly identify themselves, particularly when banking online, yet seek to establish a business relationship for the purpose of perpetrating fraud. Further, in addition to fraud committed against us, we may suffer losses as a result of fraudulent activity committed against third parties. Increased deployment of technologies, such as chip card technology, defray and reduce aspects of fraud; however, criminals are turning to other sources to steal personally identifiable information, such as unaffiliated healthcare providers and government entities, in order to impersonate the consumer to commit fraud. Many of these data compromises are widely reported in the media. Further, as a result of the increased sophistication of fraud activity, we have increased our spending on systems and controls to detect and prevent fraud. This will result in continued ongoing investments in the future.

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

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

Legal and Regulatory Risks

We are subject to extensive regulation that could restrict our activities, have an adverse impact on our operations, and impose financial requirements or limitations on the conduct of our business.

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

Further, changes in laws, regulations and regulatory practices affecting the financial services industry could subject us to increased capital, liquidity and risk management requirements, create additional costs, limit the types of financial services and products we may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could also result in heightened regulatory scrutiny and in sanctions by regulatory agencies (such as a memorandum of understanding, a written supervisory agreement or a cease and desist order), civil money penalties and/or reputation damage. Any of these consequences could restrict our ability to expand our business or could require us to raise additional capital or sell assets on terms that are not advantageous to us or our shareholders and could have a material adverse effect on our business, financial condition and results of operations. While we have policies and procedures designed to prevent any such violations, such violations may occur despite our best efforts.

The final Basel III capital rules generally require insured depository institutions and their holding companies to hold more capital, which could adversely affect our financial condition and operations.

In July 2013, the federal bank regulatory agencies issued a final rule that revised their risk based capital requirements and the method for calculating risk weighted assets to make them consistent with agreements that were reached by Basel III and certain provisions of the Dodd Frank Act. This rule substantially amended the regulatory risk based capital rules applicable to us. The requirements in the rule began to phase in on January 1, 2015 for the Company and the Bank and are now fully phased in as of January 1, 2019.

The rule included certain new and higher risk-based capital and leverage requirements than those previously in place. Specifically, the following minimum capital requirements:

- a new common equity Tier 1 risk-based capital ratio of 4.5%;
- a Tier 1 risk-based capital ratio of 6% (increased from the former 4% requirement);
- a total risk-based capital ratio of 8% (unchanged from the former requirement); and
- a leverage ratio of 4% (also unchanged from the former requirement).

The Basel III Rule is applicable to all banking organizations that are subject to minimum capital requirements, including federal and state banks and savings and loan associations, as well as to bank and savings and loan holding companies, other than “small bank holding companies.” A small bank holding company is generally a qualifying bank holding company or savings and loan holding company with less than $3.0 billion in consolidated assets. More stringent requirements are imposed on “advanced approaches” banking organizations—generally those organizations with $250 billion or more in total consolidated assets, $10 billion or more in total foreign exposures.

Based on the foregoing, as a small bank holding company, we are generally not subject to the capital requirements unless otherwise advised by the Federal Reserve; however, our Bank remains subject to the capital requirements.

Under the Basel III Rule, Tier 1 capital is redefined to include two components: Common Equity Tier 1 capital and additional Tier 1 capital. The new and highest form of capital, Common Equity Tier 1 capital, consists solely of common stock (plus related surplus), retained earnings, accumulated other comprehensive income, and limited amounts of minority interests that are in the form of common stock. Additional Tier 1 capital includes other perpetual instruments historically included in Tier 1 capital, such as noncumulative perpetual preferred stock. Tier 2 capital consists of instruments that currently qualify in Tier 2 capital plus instruments that the rule has disqualified from Tier 1 capital treatment. Cumulative perpetual preferred stock, formerly includable in Tier 1 capital, is now included only in Tier 2 capital. Accumulated other comprehensive income (“AOCI”) is presumptively included in Common Equity Tier 1 capital and often would operate to reduce this category of capital. The rule provided a one-time opportunity at the end of the first quarter of 2015 for covered banking organizations to opt out of much of this treatment of AOCI. We made this opt-out election and, as a result, retained the pre-existing treatment for AOCI.

In order to avoid restrictions on capital distributions or discretionary bonus payments to executives, a covered banking organization must maintain a “capital conservation buffer” on top of its minimum risk-based capital requirements. This buffer must consist solely of Tier 1 Common Equity, but the buffer applies to all three measurements (Common Equity Tier 1, Tier 1 capital and total capital). The capital conservation buffer was phased in incrementally over time and became fully effective on January 1, 2019.

In general, the rules have had the effect of increasing capital requirements by increasing the risk weights on certain assets, including high volatility commercial real estate, certain loans past due 90 days or more or in nonaccrual status, mortgage servicing rights not includable in Common Equity Tier 1 capital, equity exposures, and claims on securities firms, that are used in the denominator of the three risk-based capital ratios.

In addition, bank regulators may impose capital requirements that are more stringent than those required by applicable existing regulations. The application of more stringent capital requirements for us could, among other things, result in lower returns on equity, require the raising of additional capital, and result in regulatory actions if we are unable to comply with such requirements. Implementation of changes to asset risk weightings for risk based capital calculations, items included or deducted in calculating regulatory capital or additional capital conservation buffers, could result in management modifying our business strategy and could limit our ability to make distributions, including paying dividends or buying back our shares.

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

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

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

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

Changes in accounting standards could materially affect our financial statements.

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. From time to time, the Financial Accounting Standards Board (the “FASB”), the SEC and our bank regulators change the financial accounting and reporting standards, or the interpretation thereof, and guidance that govern the preparation and disclosure of external financial statements. For example, in 2016, the FASB issued a standard on accounting for credit losses. The standard will replace multiple existing impairment models, including replacing an “incurred loss” model for loans with an “expected loss” model. The FASB has indicated an effective date of January 1, 2020. These changes are beyond our control, can be hard to predict and could materially impact how we report and disclose our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retrospectively, or apply an existing standard differently, also retrospectively, which under some circumstances could potentially result in a need to revise or restate prior period financial statements.

The Federal Reserve may require us to commit capital resources to support the Bank.

The Federal Reserve requires a bank holding company to act as a source of financial and managerial strength to a subsidiary bank and to commit resources to support such subsidiary bank. Under the “source of strength” doctrine, the Federal Reserve may require a bank holding company to make capital injections into a troubled subsidiary bank and may charge the bank holding company with engaging in unsafe and unsound practices for failure to commit resources to such a subsidiary bank. In addition, the Dodd-Frank Act directs the federal bank regulators to require that all companies that directly or indirectly control an insured depository institution serve as a source of strength for the institution. Under these requirements, in the future, we could be required to provide financial assistance to our Bank if the Bank experiences financial distress.

A capital injection may be required at times when we do not have the resources to provide it, and therefore we may be required to borrow the funds. In the event of a bank holding company's bankruptcy, the bankruptcy trustee will assume any commitment by the holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank. Moreover, bankruptcy law provides that claims based on any such commitment will be entitled to a priority of payment over the claims of the holding company's general unsecured creditors, including the holders of its note obligations. Thus, any borrowing that must be done by the holding company in order to make the required capital injection becomes more difficult and expensive and will adversely impact the holding company's cash flows, financial condition, results of operations and prospects.

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

In August 2011, Standard & Poor's Ratings Services lowered its long-term sovereign credit rating on the U.S. from "AAA" to "AA+". If U.S. debt ceiling, budget deficit or debt concerns, domestic or international economic or political concerns, or other factors were to result in further downgrades to the U.S. government's sovereign credit rating or its perceived creditworthiness, it could adversely affect the U.S. and global financial markets and economic conditions. A downgrade of the U.S. government's credit rating or any failure by the U.S. government to satisfy its debt obligations could create financial turmoil and uncertainty, which could weigh heavily on the global banking system. It is possible that any such impact could have a material adverse effect on our business, results of operations and financial condition.

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

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

We are party to various claims and lawsuits incidental to our business. Litigation is subject to many uncertainties such that the expenses and ultimate exposure with respect to many of these matters cannot be ascertained.

From time to time, we, our directors and our management are or may be the subject of various claims and legal actions by customers, employees, shareholders and others. Whether such claims and legal actions are legitimate or unfounded, if such claims and legal actions are not resolved in our favor, they may result in significant financial liability and/or adversely affect the market perception of us and our products and services as well as impact customer demand for those products and services. In light of the potential cost, reputational damage and uncertainty involved in litigation, we have in the past and may in the future settle matters even when we believe we have a meritorious defense. Certain claims may seek injunctive relief, which could disrupt the ordinary conduct of our business and operations or increase our cost of doing business. Our insurance or indemnities may not cover all claims that may be asserted against us. Any judgments or settlements in any pending litigation or future claims, litigation or investigation could have a material adverse effect on our business, reputation, financial condition and results of operations.

Our ability to realize deferred tax assets may be reduced, which may adversely impact our results of operations.

Deferred tax assets are reported as assets on our balance sheet and represent the decrease in taxes expected to be paid in the future because of net operating losses ("NOLs") and tax credit carryforwards and because of future reversals of temporary differences in the bases of assets and liabilities as measured by enacted tax laws and their bases as reported in the financial statements. As of December 31, 2018, we had net deferred tax assets of $2.3 million, which included deferred tax assets for a federal net operating loss carryforward of $854 thousand that is expected to expire in 2037. Realization of deferred tax assets is dependent upon the generation of sufficient future taxable income during the periods in which existing deferred tax assets are expected to become deductible for federal income tax purposes. Based on projections of future taxable income in periods in which deferred tax assets are expected to become deductible, management determined that the realization of our net deferred tax asset was more likely than not. As a result, we did not recognize a valuation allowance on its net deferred tax asset as of December 31, 2018 or December 31, 2017. If it becomes more likely than not that some portion or the entire deferred tax asset will not be realized, a valuation allowance must be recognized. In December 2017, the Tax Cuts and Jobs Act was enacted, which reduced the corporate federal income tax rate to 21% and resulted in an approximate $1.2 million write-down of our deferred tax asset in the fourth quarter of 2017, through income tax expense. These tax rate changes, in conjunction with our net income in 2017 and 2018, have resulted in a significant reduction of the deferred tax asset over the last two years. Our deferred tax asset may be further reduced in the future if estimates of future income or our tax planning strategies do not support the amount of the deferred tax assets. Charges to establish a valuation allowance with respect to our deferred tax asset could have a material adverse effect on our financial condition and results of operations.

New accounting standards will likely require us to increase our allowance for loan losses and may have a material adverse effect on our financial condition and results of operations.

The measure of our allowance for loan losses is dependent on the adoption and interpretation of accounting standards. The FASB has issued a new credit impairment model, the Current Expected Credit Loss, or CECL model, which will become applicable to us in 2020. Under the CECL model, we will be required to present certain financial assets carried at amortized cost, such as loans held for investment and held-to-maturity debt securities, at the net amount expected to be collected. The measurement of expected credit losses is to be based on information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This measurement will take place at the time the financial asset is first added to the balance sheet and periodically thereafter. This differs significantly from the "incurred loss" model currently required under GAAP, which delays recognition until it is probable a loss has been incurred. Accordingly, we expect that the adoption of the CECL model will materially affect how we determine our allowance for loan losses and could require us to significantly increase our allowance. Moreover, the CECL model may create more volatility in the level of our allowance for loan losses. If we are required to materially increase our level of allowance for loan losses for any reason, such increase could adversely affect our business, financial condition and results of operations.

There is uncertainty surrounding the potential legal, regulatory and policy changes by the current presidential administration in the U.S. that may directly affect financial institutions and the global economy.

The current presidential administration has implemented certain financial reform regulations, including reform regulations affecting the Dodd-Frank Act, which has resulted in increased regulatory uncertainty, and we are assessing the potential impact on financial and economic markets and on our business. Changes in federal policy and at regulatory agencies are expected to occur over time through policy and personnel changes, which could lead to changes involving the level of oversight and focus on the financial services industry. The nature, timing and economic and political effects of potential changes to the current legal and regulatory framework affecting financial institutions remain highly uncertain. At this time, it is unclear what additional laws, regulations and policies may change and whether future changes or uncertainty surrounding future changes will adversely affect our operating environment and therefore our business, financial condition and results of operations.

Risks Related to an Investment in Our Common Stock

Our ability to pay cash dividends is limited, and we may be unable to pay future dividends even if we desire to do so.

The Federal Reserve has issued a policy statement regarding the payment of dividends by bank holding companies. In general, the Federal Reserve'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'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 our ability to pay dividends or otherwise engage in capital distributions.

Our ability to pay cash dividends may be limited by regulatory restrictions, by our Bank's ability to pay cash dividends to us and by our need to maintain sufficient capital to support our operations. 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 S.C. Board, 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 S.C. Board. If our Bank is not permitted to pay cash dividends to us, it is unlikely that we would be able to pay cash dividends on our common stock. Moreover, holders of our common stock are entitled to receive dividends only when, and if declared by our board of directors. Although we have historically paid cash dividends on our common stock, we are not required to do so and our board of directors could reduce or eliminate our common stock dividend in the future.

Our stock price may be volatile, which could result in losses to our investors and litigation against us.

Our stock price has been volatile in the past and several factors could cause the price to fluctuate substantially in the future. These factors include but are not limited to: actual or anticipated variations in earnings, changes in analysts' recommendations or projections, our announcement of developments related to our businesses, operations and stock performance of other companies deemed to be peers, new technology used or services offered by traditional and non-traditional competitors, news reports of trends, irrational exuberance on the part of investors, new federal banking regulations, and other issues related to the financial services industry. Our stock price may fluctuate significantly in the future, and these fluctuations may be unrelated to our performance. General market declines or market volatility in the future, especially in the financial institutions sector, could adversely affect the price of our common stock, and the current market price may not be indicative of future market prices. Stock price volatility may make it more difficult for you to resell your common stock when you want and at prices you find attractive. Moreover, in the past, securities class action lawsuits have been instituted against some companies following periods of volatility in the market price of its securities. We could in the future be the target of similar litigation. Securities litigation could result in substantial costs and divert management's attention and resources from our normal business.

Future sales of our stock by our shareholders or the perception that those sales could occur may cause our stock price to decline.

Although our common stock is listed for trading on The NASDAQ Capital Market, the trading volume in our common stock is lower than that of other larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of our common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the relatively low trading volume of our common stock, significant sales of our common stock in the public market, or the perception that those sales may occur, could cause the trading price of our common stock to decline or to be lower than it otherwise might be in the absence of those sales or perceptions.

Economic and other circumstances may require us to raise capital at times or in amounts that are unfavorable to us. If we have to issue shares of common stock, they will dilute the percentage ownership interest of existing shareholders and may dilute the book value per share of our common stock and adversely affect the terms on which we may obtain additional capital.

We may need to incur additional debt or equity financing in the future to make strategic acquisitions or investments or to strengthen our capital position. Our ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of our control and our financial performance. We cannot provide assurance that such financing will be available to us on acceptable terms or at all, or if we do raise additional capital that it will not be dilutive to existing shareholders.

If we determine, for any reason, that we need to raise capital, subject to applicable NASDAQ rules, our board generally has the authority, without action by or vote of the shareholders, to issue all or part of any authorized but unissued shares of stock for any corporate purpose, including issuance of equity-based incentives under or outside of our equity compensation plans. Additionally, we are not restricted from issuing additional common stock or preferred stock, including any securities that are convertible into or exchangeable for, or that represent the right to receive, common stock or preferred stock or any substantially similar securities. The market price of our common stock could decline as a result of sales by us of a large number of shares of common stock or preferred stock or similar securities in the market or from the perception that such sales could occur. If we issue preferred stock that has a preference over the common stock with respect to the payment of dividends or upon liquidation, dissolution or winding-up, or if we issue preferred stock with voting rights that dilute the voting power of the common stock, the rights of holders of the common stock or the market price of our common stock could be adversely affected. Any issuance of additional shares of stock will dilute the percentage ownership interest of our shareholders and may dilute the book value per share of our common stock. Shares we issue in connection with any such offering will increase the total number of shares and may dilute the economic and voting ownership interest of our existing shareholders.

An investment in our common stock is not an insured deposit.

Our common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund or by any other public or private entity. An investment in our common stock is inherently risky for the reasons described in this “Risk Factors” section and elsewhere in this report and is subject to the same market forces that affect the price of common stock in any company. As a result, if you acquire our common stock, you may lose some or all of your investment.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

Our principal place of business as well as the Bank's is located at 5455 Sunset Boulevard, Lexington, South Carolina 29072. In addition, we currently operate 20 full-service offices located in the South Carolina counties of Lexington County (6 offices), Richland County (4 offices), Newberry County (2 offices), Kershaw County (1 office), Aiken County (1 office), Greenville County (2 offices), Anderson County (1 office), Pickens County (1 office), and in Richmond County, Georgia (2 offices), as well as a mortgage loan production office located in Richland County, South Carolina. All of these properties are owned by the Bank except for the Downtown Augusta, Georgia (Richmond County) and Greenville, South Carolina full service branch offices, which are leased by the Bank. Although the properties owned are generally considered adequate, we have a continuing program of modernization, expansion and, when necessary, occasional replacement of facilities.

Item 3. Legal Proceedings.

In the ordinary course of operations, we may be a party to various legal proceedings from time to time. We do not believe that there is any pending or threatened proceeding against us, which, if determined adversely, would have a material effect on our business, results of operations, or financial condition.

Item 4. Mine Safety Disclosures.

None.

PART II

Item 5. Market for Registrant's Common Equity, Related Shareholder Matters, and Issuer Purchases of Equity Securities.

As of February 28, 2019, there were approximately 1,576 shareholders of record of our common stock. Our common stock trades on The NASDAQ Capital Market under the trading symbol of "FCCO." The following table sets forth the high and low sales price information as reported by NASDAQ for the periods indicated, and the dividends per share declared on our common stock in each such quarter. All information has been adjusted for any stock splits and stock dividends effected during the periods presented.

	High	Low	Dividends
2018			
Quarter ended March 31, 2018	$23.50	$20.56	$ 0.10
Quarter ended June 30, 2018	$26.25	$21.95	$ 0.10
Quarter ended September 30, 2018	$26.25	$23.30	$ 0.10
Quarter ended December 31, 2018	$24.38	$18.54	$ 0.10
2017			
Quarter ended March 31, 2017	$23.55	$16.10	$ 0.09
Quarter ended June 30, 2017	$22.45	$18.50	$ 0.09
Quarter ended September 30, 2017	$22.20	$19.50	$ 0.09
Quarter ended December 31, 2017	$24.87	$20.65	$ 0.09

Notwithstanding the foregoing, our future dividend policy is subject to the discretion of the board of directors and will depend upon a number of factors, including future earnings, financial condition, cash requirements, and general business conditions. Our ability to pay dividends is generally limited by the ability of the Bank to pay dividends to us. 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 S.C. Board, 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 S.C. Board.

Pursuant to our 2006 Non-Employee Director Deferred Compensation Plan, non-employee directors may elect to defer all or any part of annual retainer fees payable in respect of the following calendar year to the director for his or her service on the board of directors or any committee of the board of directors. During the year, a number of deferred stock units are credited to the director's account at the time such compensation would otherwise have been payable absent the election to defer equal to (i) the otherwise payable amount divided by (ii) the fair market value of a share of our common stock on the last trading day preceding the credit date. In general, a director's vested account balance will be distributed in a lump sum of our common stock on the 30th day following termination of service on the board and on the board of directors of all of our subsidiaries, including termination of service as a result of death or disability. During the year ended December 31, 2018, we credited an aggregate of 5,904 deferred stock units to accounts for directors who elected to defer monthly fees or annual retainer fees for 2018. The deferred stock units were issued pursuant to an exemption from registration under the Securities Act of 1933 in reliance upon Section 4(a)(2) of the Securities Act of 1933.

Item 6. Selected Financial Data

	As of or For the Years Ended December 31,				
(Dollars in thousands except per share amounts)	**2018**	**2017**	**2016**	**2015**	**2014**
Balance Sheet Data:					
Total assets	$1,091,595	$1,050,731	$914,793	$862,734	$812,363
Loans held for sale	3,223	5,093	5,707	2,962	4,124
Loans	718,462	646,805	546,709	489,191	443,844
Deposits	925,523	888,323	766,622	716,151	669,583
Total common shareholders' equity	112,497	105,663	81,861	79,038	74,528
Total shareholders' equity	112,497	105,663	81,861	79,038	74,528
Average shares outstanding, basic	7,581	6,849	6,617	6,558	6,538
Average shares outstanding, diluted	7,731	6,998	6,787	6,719	6,607
Results of Operations:					
Interest income	$39,729	$32,156	$29,506	$28,649	$27,298
Interest expense	3,981	2,762	3,047	3,396	3,567
Net interest income	35,748	29,394	26,459	25,253	23,731
Provision for loan losses	346	530	774	1,138	881
Net interest income after provision for loan losses	35,402	28,864	25,685	24,115	22,850
Non-interest income (1)	10,986	9,239	8,339	8,611	8,031
Securities gains (losses) (1)	(342)	400	601	355	182
Non-interest expenses	32,123	29,358	25,776	24,678	23,960
Income before taxes	13,923	9,145	8,849	8,403	7,103
Income tax expense	2,694	3,330	2,167	2,276	1,982
Net income	11,229	5,815	6,682	6,127	5,121
Net income available to common shareholders	11,229	5,815	6,682	6,127	5,121
Per Share Data:					
Basic earnings per common share	$1.48	$0.85	$1.01	$0.93	$0.78
Diluted earnings per common share	1.45	0.83	0.98	0.91	0.78
Book value at period end	14.74	13.93	12.24	11.81	11.18
Tangible book value at period end (non-GAAP)	12.56	11.66	11.31	10.84	10.25
Dividends per common share	0.40	0.36	0.32	0.28	0.24
Asset Quality Ratios:					
Non-performing assets to total assets (3)	0.37%	0.51%	0.57%	0.85%	1.17%
Non-performing loans to period end loans	0.39%	0.52%	0.75%	0.99%	1.48%
Net charge-offs (recoveries) to average loans	(0.02)%	(0.01)%	0.03%	0.14%	0.22%
Allowance for loan losses to period-end total loans	0.87%	0.89%	0.94%	0.94%	0.93%
Allowance for loan losses to non-performing assets	155.14%	79.52%	99.35%	62.98%	43.37%
Selected Ratios:					
Return on average assets	1.04%	0.62%	0.75%	0.73%	0.73%
Return on average common equity:	10.48%	6.56%	8.08%	7.94%	8.13%
Return on average tangible common equity (non-GAAP):	12.44%	7.22%	8.76%	8.68%	8.88%
Efficiency Ratio (non-GAAP) (1)	68.06%	74.34%	72.27%	71.25%	74.14%
Noninterest income to operating revenue (2)	22.94%	24.69%	25.26%	26.20%	25.71%
Net interest margin (tax equivalent)	3.69%	3.52%	3.35%	3.38%	3.40%
Equity to assets	10.31%	10.06%	8.95%	9.16%	9.17%
Tangible common shareholders' equity to tangible assets (non-GAAP)	8.92%	8.56%	8.33%	8.47%	8.48%
Tier 1 risk-based capital (Bank) (4)	13.19%	13.40%	13.84%	14.72%	15.39%

Total risk-based capital (Bank) (4)	13.96	%	14.18	%	14.66	%	15.54	%	16.21	%
Leverage (Bank) (4)	9.98	%	9.66	%	9.77	%	9.73	%	9.56	%
Average loans to average deposits (5)	75.01	%	73.08	%	69.62	%	68.75	%	69.14	%

(1) The efficiency ratio is a key performance indicator in our industry. The ratio is computed by dividing non-interest expense by the sum of net interest income on a tax equivalent basis and non-interest income, net of any securities gains or losses. The efficiency ratio is a measure of the relationship between operating expenses and earnings.

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(2) Operating revenue is defined as net interest income plus noninterest income.

(3) Includes non-accrual loans, loans > 90 days delinquent and still accruing interest and other real estate owned ("OREO").

(4) As a small bank holding company, we are generally not subject to the capital requirements at the holding company level unless otherwise advised by the Federal Reserve: however, our Bank remains subject to capital requirements.

(5) Includes loans held for sale.

Certain financial information presented above is determined by methods other than in accordance with GAAP. These non-GAAP financial measures include "efficiency ratio," "tangible book value at period end," "return on average tangible common equity" and "tangible common shareholders' equity to tangible assets." The "efficiency ratio" is defined as non-interest expense, divided by the sum of net interest income on a tax equivalent basis and non-interest income, net of any securities gains or losses and OTTI on securities. The efficiency ratio is a measure of the relationship between operating expenses and earnings. "Tangible book value at period end" is defined as total equity reduced by recorded intangible assets divided by total common shares outstanding. "Tangible common shareholders' equity to tangible assets" is defined as total common equity reduced by recorded intangible assets divided by total assets reduced by recorded intangible assets. Our management believes that these non-GAAP measures are useful because they enhance the ability of investors and management to evaluate and compare our operating results from period-to-period in a meaningful manner. Non-GAAP measures have limitations as analytical tools, and investors should not consider them in isolation or as a substitute for analysis of our results as reported under GAAP.

The table below provides a reconciliation of non-GAAP measures to GAAP for the five years ended December 31:

Tangible book value per common share	2018	2017	2016	2015	2014
Tangible common equity per common share (non-GAAP)	$12.56	$11.66	$11.31	$10.84	$10.25
Effect to adjust for intangible assets	2.18	2.27	0.93	0.97	0.93
Book value per common share (GAAP)	$14.74	$13.93	$12.24	$11.81	$11.18
Return on average tangible common equity					
Return on average tangible common equity (non-GAAP)	12.44%	7.22 %	8.76 %	8.68 %	8.88 %
Effect to adjust for intangible assets	(1.96)%	(0.66)%	(0.68)%	(0.74)%	(0.75)%
Return on average common equity (GAAP)	10.48%	6.56 %	8.08 %	7.94 %	8.13 %
Tangible common shareholders' equity to tangible assets					
Tangible common equity to tangible assets (non-GAAP)	8.92 %	8.56 %	8.33 %	8.47 %	8.48 %
Effect to adjust for intangible assets	1.39 %	1.50 %	0.62 %	0.69 %	0.69 %
Common equity to assets (GAAP)	10.31%	10.06%	8.95 %	9.16 %	9.17 %

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

Overview

We are headquartered in Lexington, South Carolina and serve as the bank holding company for the Bank. We operate from our main office in Lexington, South Carolina, and our 20 full-service offices located in the South Carolina counties of Lexington County (6 offices), Richland County (4 offices), Newberry County (2 offices), Kershaw County (1 office), Aiken County (1 office), Greenville County (2 offices), Anderson County (1 office), and Pickens County (1 office), and in Richmond County, Georgia (2 offices). In addition, we operate a mortgage loan production office in Richland County, South Carolina. We engage in a general commercial and retail banking business characterized by personalized service and local decision making, emphasizing the banking needs of small to medium-sized businesses, professional concerns and individuals.

The following discussion describes our results of operations for 2018, as compared to 2017 and 2016, and also analyzes our financial condition as of December 31, 2018, as compared to December 31, 2017. Like most community banks, we derive most of our income from interest we receive on our loans and investments. A 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.

We have included a number of tables to assist in our description of these measures. For example, the "Average Balances" table shows the average balance during 2018, 2017 and 2016 of each category of our assets and liabilities, as well as the yield we earned or the rate we paid with respect to each category. A review of this table shows that our loans typically provide higher interest yields than do other types of interest earning assets, which is why we intend to channel a substantial percentage of our earning assets into our loan portfolio. Similarly, the "Rate/Volume Analysis" table helps demonstrate the impact of changing interest rates and changing volume of assets and liabilities during the years shown. We also track the sensitivity of our various categories of assets and liabilities to changes in interest rates, and we have included a "Sensitivity Analysis Table" to help explain this. Finally, we have included a number of tables that provide detail about our investment securities, our loans, and our deposits and other borrowings.

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

In addition to earning interest on our loans and investments, we earn income through fees and other expenses we charge to our customers. We describe the various components of this noninterest income, as well as our noninterest expense, in the following discussion. The 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 notes to our consolidated financial statements in this report.

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.

<u>Allowance for Loan Losses</u>

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.

Goodwill and Other Intangibles

Goodwill represents the excess of the purchase price over the sum of the estimated fair values of the tangible and identifiable intangible assets acquired less the estimated fair value of the liabilities assumed. Goodwill has an indefinite useful life and its evaluated for impairment annually or more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. Qualitative factors are assessed to first determine if it is more likely than not (more than 50%) that the carrying value of goodwill is less than fair value. These qualitative factors include but are not limited to overall deterioration in general economic conditions, industry and market conditions, and overall financial performance. If determined that it is more likely than not that there has been a deterioration in the fair value of the carrying value than the first of a two-step process would be performed. The first step, used to identify potential impairment, involves comparing each reporting unit's estimated fair value to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment.

If required, the second step involves calculating an implied fair value of goodwill for each reporting unit for which the first step indicated impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. An impairment loss cannot exceed the carrying value of goodwill assigned to a reporting unit, and the loss establishes a new basis in the goodwill. Subsequent reversal of goodwill impairment losses is not permitted. Management has determined that we have four reporting units (See Note 24 to the Consolidated Financial Statements).

Core deposit intangibles represent the estimated value of long-term deposit relationships acquired in bank or branch acquisition transactions. These costs are amortized over the estimated useful lives of the deposit accounts acquired on a method that we believe reasonably approximates the anticipated benefit stream from the accounts. The estimated useful lives are periodically reviewed for reasonableness.

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Income Taxes and Deferred Tax Assets and Liabilities

Income taxes are provided for the tax effects of the transactions reported in our consolidated financial statements and consist of taxes currently due plus deferred taxes related to differences between the tax basis and accounting basis of certain assets and liabilities, including available-for-sale securities, allowance for loan losses, write downs of OREO properties, accumulated depreciation, net operating loss carry forwards, accretion income, deferred compensation, intangible assets, and pension plan and post-retirement benefits. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred tax assets and liabilities are reflected at income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. A valuation allowance is recorded when it is “more likely than not” that a deferred tax asset will not be realized. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The 2017 Tax Cuts and Jobs Act reduced corporate income taxes which resulted in an adjustment of our deferred tax asset in 2017 (See Note 14 to the Consolidated financial statements for the impact of the change). We file a consolidated federal income tax return for our Bank. At December 31, 2018, we are in a net deferred tax asset position.

Other-Than-Temporary Impairment

We evaluate securities for other-than-temporary impairment at least on a quarterly basis. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) the outlook for receiving the contractual cash flows of the investments, (4) the anticipated outlook for changes in the general level of interest rates, and (5) our intent and ability to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value or for a debt security whether it is more-likely-than-not that we will be required to sell the debt security prior to recovering its fair value (See Note 4 to the Consolidated Financial Statements).

Business Combinations, Method of Accounting for Loans Acquired

We account for acquisitions under FASB ASC Topic 805, *Business Combinations*, which requires the use of the acquisition method of accounting. All identifiable assets acquired, including loans, are recorded at fair value. No allowance for loan losses related to the acquired loans is recorded on the acquisition date because the fair value of the loans acquired incorporates assumptions regarding credit risk.

Acquired credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality, found in FASB ASC Topic 310-30, *Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality* and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loans. Loans acquired in business combinations with evidence of credit deterioration are considered impaired. Loans acquired through business combinations that do not meet the specific criteria of FASB ASC Topic 310-30, but for which a discount is attributable, at least in part to credit quality, are also accounted for under this guidance. Certain acquired loans, including performing loans and revolving lines of credit (consumer and commercial), are accounted for in accordance with FASB ASC Topic 310-20, where the discount is accreted through earnings based on estimated cash flows over the estimated life of the loan.

Results of Operations

On October 20, 2017, we completed the acquisition of Cornerstone. Therefore, the results for the year ended December 31, 2018 include the impact of this acquisition for the entire year. For the year ended December 31, 2017, the impact of the acquisition includes the period from October 20, 2017 through December 31, 2017. See Note 3 to the consolidated financial statements for additional information related to the Cornerstone acquisition.

Net income was $11.2 million, or $1.45 diluted earnings per common share, for the year ended December 31, 2018, as compared to net income $5.8 million, or $0.85 diluted earnings per common share, for the year ended December 31, 2017. During the year ended 2017, we recognized a tax expense adjustment resulting from the change in corporate tax rates enacted in the Tax Cuts and Jobs Act passed on December 22, 2017. The lowering of the corporate tax rate to 21% required that we make an approximate $1.2 million tax expense charge to adjust the value of our deferred tax asset. As a result of the enacted lower tax rates, we recovered substantially all of this charge through the lower effective tax rate in the year ended December 31, 2018. We expect to continue to benefit in future periods as a result of the lower effective corporate tax rate. Another factor impacting net income during 2017 included expenses of approximately $300 thousand related to our conversion to a new operating system and $903 thousand in expenses related to the acquisition of Cornerstone. During 2018, we had no merger or conversion related expenses. Interest income increased from $32.2 million in 2017 to $39.7 million in 2018. This was a result of an increase in average earning assets of $121.7 million in 2018 as compared to 2017. In addition, our net interest margin on a fully taxable equivalent basis improved by 17 basis points in 2018 as compared to 2017. Net interest spread, the difference between the yield on earning assets and the rate paid on interest-bearing liabilities, was 3.49% in 2018 as compared to 3.31% in 2017. The provision for loan losses was $346 thousand in 2018 as compared to $530 thousand in 2017. Increases in salary and benefit, occupancy and information technology expenses, were the largest contributors to the overall increase in non-interest expense (see discussion “Non-interest Income and Non-interest Expense”). A substantial percentage of these increases relates to the inclusion of Cornerstone expenses for the entire year of 2018 whereas in

2017 they were included for approximately 2 ½ months.

Net income was $5.8 million, or $0.85 diluted earnings per common share, for the year ended December 31, 2017, as compared to net income $6.7 million, or $0.98 diluted earnings per common share, for the year ended December 31, 2016. The primary reason for the decrease in net income is the tax expense adjustment of approximately $1.2 million in 2017 resulting from the change in corporate tax rate noted previously. Another factor contributing to lower net income during 2017 as compared to 2016 included expenses of approximately $300 thousand related to our conversion to a new operating system and $903 thousand in expenses related to the acquisition of Cornerstone. The impact of these increases in non-recurring expenses were partially offset by an increase in net interest income of $2.9 million, as a result of an improvement in net interest margin and a higher level of earning assets. Net interest spread, the difference between the yield on earning assets and the rate paid on interest-bearing liabilities, was 3.31% in 2017 as compared to 3.13% in 2016. The provision for loan losses was $774 thousand in 2016 as compared to $530 thousand in 2017. Excluding the non-recurring expenses noted previously, increases in salary and benefit expense as well as debit card/ATM processing cost were the largest contributors to the overall increase in non-interest expense in 2017 as compared to 2016 (see discussion “Non-interest Income and Non-interest Expense”).

Net Interest Income

Net interest income is our primary source of revenue. Net interest income is the difference between income earned on assets and interest paid on deposits and borrowings used to support such assets. Net interest income is determined by the rates earned on our interest-earning assets and the rates paid on our interest-bearing liabilities, the relative amounts of interest-earning assets and interest-bearing liabilities, and the degree of mismatch and the maturity and repricing characteristics of its interest-earning assets and interest-bearing liabilities.

Net interest income totaled $35.7 million in 2018, $29.4 million in 2017 and $26.5 million in 2016. The yield on earning assets was 4.05%, 3.74%, and 3.62% in 2018, 2017 and 2016, respectively. The rate paid on interest-bearing liabilities was 0.55%, 0.43%, and 0.49% in 2018, 2017, and 2016, respectively. The fully taxable equivalent net interest margin was 3.69% in 2018, 3.52% in 2017 and 3.35% in 2016. Our loan to deposit ratio on average during 2018 was 75.0%, as compared to 73.1% during 2017 and 69.6% during 2016. Loans typically provide a higher yield than other types of earning assets and, thus, one of our goals continues to be growing the loan portfolio as a percentage of earning assets in order to improve the overall yield on earning assets and the net interest margin. At December 31, 2018, the loan (including held for sale) to deposit ratio was 78.0%.

The net interest margin increased 22 basis points in 2018 as compared to 2017. The yield on earning assets increased by 31 basis points while our cost of interest-bearing liabilities increased by 12 basis points in 2018 as compared to 2017. The increase in net interest margin in 2018 as compared to 2017 was partially a result of the Federal Reserve increasing the federal funds target rate. In 2018, this rate was increased four times. These increases positively impact our yield on variable rate assets in the loan and investment portfolios as well as our short term investments. The yield on our earning assets increased from 3.74% to 4.05% in 2018 as compared to 2017. The average loan balance as a percentage of earning assets was 70.0% in 2018 as compared to 67.2% in 2017. This increase in earning asset mix along with the increases in short term rates noted previously accounted for the improved yield on our earning assets. Our lower cost funding sources include non-interest bearing transaction accounts, interest-bearing transaction accounts, money-market accounts and savings deposits. During 2017, the average balance in these accounts represented 77.7% of total deposits whereas in 2018 they represented 79.5%. Our average other borrowings, which are typically a higher cost funding source, decreased $5.0 million in 2017 as compared to 2018. Throughout 2018, the treasury yield curve continued to flatten with short-term rates increasing as noted above while longer term rates, including five year to 10 year treasury rates, remaining relatively unchanged or increasing at a lower rate than the shorter term rates. Over time, this can negatively impact net interest margins as shorter term funding rates increase while our fixed rate loan and investment portfolio yields do not increase to the same extent. Managing this interest rate risk continues to be a primary focus of management (see discussion of Market Rate and Interest Rate Sensitivity discussion below).

The net interest margin increased 18 basis points in 2017 as compared to 2016. The yield on earning assets increased by 12 basis points while our cost of funds decreased by six basis points in 2017 as compared to 2016. The increase in net interest margin in 2017 as compared to 2016 was partially a result of the Federal Reserve increasing the federal funds target rate in late 2015. From December 2015 through December 2017, the rate was increased in 25 basis point increments from a range of 0.00% to 0.25% to a range of 1.25% to 1.50%. The yield on our earning assets increased from 3.62% to 3.74% in 2017 as compared to 2016. The percentage of average loans to average total earning assets was 67.2% in 2017 as compared to 63.1% in 2016. The change in our earning asset mix, along with the impact of rising short-term rates are the primary contributors in the 12 basis point improvement in our yield on earning assets. During 2016, the average balance in our lower cost deposit account funding sources, as noted above, represented 75.6% of total deposits whereas in 2017 they represented 77.7%. Also our average borrowings, which are typically a higher cost funding source, decreased $8.4 million in 2017 as compared to 2016. This change in funding mix was primarily responsible for the decrease in our cost of interest bearing liabilities from 0.49% in 2016 to 0.43% in 2017.

Average Balances, Income Expenses and Rates. The following table depicts, for the periods indicated, certain information related to our average balance sheet and our average yields on assets and average costs of liabilities. Such yields are derived by dividing income or expense by the average balance of the corresponding assets or liabilities. Average balances have been derived from daily averages.

	Year ended December 31,								
	2018			**2017**			**2016**		
(Dollars in thousands)	**Average Balance**	**Income/ Expense**	**Yield/ Rate**	**Average Balance**	**Income/ Expense**	**Yield/ Rate**	**Average Balance**	**Income/ Expense**	**Yield/ Rate**
Assets									
Earning assets									
Loans(1)	$686,438	$32,789	4.78%	$577,730	$26,134	4.52%	$514,766	$23,677	4.60%
Securities	271,621	6,522	2.40%	265,751	5,859	2.20%	283,585	5,724	2.02%
Other short-term investments(2)	23,156	419	1.81%	15,972	163	1.02%	17,512	105	0.60%
Total earning assets	981,215	39,729	4.05%	859,453	32,156	3.74%	815,863	29,506	3.62%
Cash and due from banks	13,446			11,571			10,903		
Premises and equipment	34,905			31,850			30,084		
Intangible assets	16,881			8,128			6,334		
Other assets	36,299			32,160			29,922		
Allowance for loan losses	(6,075)			(5,479)			(4,866)		
Total assets	$1,076,671			$937,683			$888,240		
Liabilities									
Interest-bearing liabilities(2)									
Interest-bearing transaction accounts	192,420	443	0.23%	163,870	190	0.12%	152,936	173	0.11%
Money market accounts	184,413	869	0.47%	170,296	435	0.26%	164,826	426	0.26%
Savings deposits	106,752	143	0.13%	80,807	94	0.12%	69,178	82	0.12%
Time deposits	188,023	1,450	0.77%	176,358	1,106	0.63%	180,447	1,137	0.63%
Other borrowings	46,155	1,076	2.34%	51,171	937	1.83%	59,569	1,229	2.06%
Total interest-bearing liabilities	717,763	3,981	0.55%	642,502	2,762	0.43%	626,956	3,047	0.49%
Demand deposits	243,530			199,169			171,968		
Other liabilities	8,200			7,306			6,663		
Shareholders' equity	107,178			88,706			82,653		
Total liabilities and shareholders' equity	$1,076,671			$937,683			$888,240		
Net interest spread			3.49%			3.31%			3.13%
Net interest income/margin		$35,748	3.64%		$29,394	3.42%		$26,459	3.24%
Net interest margin (tax equivalent)(3)			3.69%			3.52%			3.35%

(1) All loans and deposits are domestic. Average loan balances include non-accrual loans and loans held for sale.

(2) The computation includes federal funds sold, securities purchased under agreement to resell and interest bearing deposits.

(3) Based on a 21.0% marginal tax rate for 2018 and a 32.5% marginal tax rate for 2017 and 2016.

The following table presents the dollar amount of changes in interest income and interest expense attributable to changes in volume and the amount attributable to changes in rate. The combined effect related to volume and rate which cannot be separately identified, has been allocated proportionately, to the change due to volume and the change due to rate.

	2018 versus 2017			**2017 versus 2016**		
	Increase (decrease) due to			**Increase (decrease) due to**		
(In thousands)	**Volume**	**Rate**	**Net**	**Volume**	**Rate**	**Net**
Assets						
Earning assets						
Loans	$ 5,129	$ 1,526	$ 6,655	$ 2,854	$ (397)	$ 2,457
Investment securities	132	531	663	(373)	508	135
Other short-term investments	94	161	255	(10)	68	58
Total earning assets	4,792	2,781	7,573	1,610	1,040	2,650
Interest-bearing liabilities						
Interest-bearing transaction accounts	37	215	252	13	4	17
Money market accounts	38	397	435	14	(5)	9
Savings deposits	33	16	49	14	(2)	12
Time deposits	77	267	344	(26)	(5)	(31)
Other short-term borrowings	(98)	237	139	(162)	(130)	(292)
Total interest-bearing liabilities	351	870	1,219	74	(359)	(285)
Net interest income			$ 6,354			$ 2,935

Market Risk and Interest Rate Sensitivity

Market risk reflects the risk of economic loss resulting from adverse changes in market prices and interest rates. The risk of loss can be measured in either diminished current market values or reduced current and potential net income. Our primary market risk is interest rate risk. We have established an Asset/Liability Management Committee (the “ALCO”) to monitor and manage interest rate risk. The ALCO monitors and manages the pricing and maturity of its assets and liabilities in order to diminish the potential adverse impact that changes in interest rates could have on our 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 us is the measurement of our 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. Simulation modeling is performed to assess the impact varying interest rates and balance sheet mix assumptions will have on net interest income. We model the impact on net interest income for several different changes, to include a flattening, steepening and parallel shift in the yield curve. For each of these scenarios, we model the impact on net interest income in an increasing and decreasing rate environment of 100 and 200 basis points. We also periodically stress certain assumptions such as loan prepayment rates, deposit decay rate and interest rate betas to evaluate our overall sensitivity to changes in interest rates. Policies have been established in an effort to maintain the maximum anticipated negative impact of these modeled changes in net interest income at no more than 10% and 15%, respectively, in a 100 and 200 basis point change in interest rates over a 12-month period. 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. Neither the “gap” analysis or asset/liability modeling are precise indicators of our interest sensitivity position due to the many factors that affect net interest income including, the timing, magnitude and frequency of interest rate changes as well as changes in the volume and mix of earning assets and interest-bearing liabilities.

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The following table illustrates our interest rate sensitivity at December 31, 2018.

Interest Sensitivity Analysis

(Dollars in thousands)	**Within One Year**	**One to Three Years**	**Three to Five Years**	**Over Five Years**	**Total**
Assets					
Earning assets					
Loans(1)	$ 289,692	$ 245,945	$ 122,099	$ 58,112	$ 715,848
Loans Held for Sale	3,223	—	—	—	3,223
Securities(2)	73,824	37,316	43,724	101,158	256,022
Federal funds sold, securities purchased under agreements to resell and other earning assets	13,691	3,000	250	—	16,941
Total earning assets	380,430	286,261	166,073	159,270	992,034
Liabilities					
Interest bearing liabilities					
Interest bearing deposits					
Interest checking accounts	80,158	—	—	121,778	201,936
Money market accounts	119,243	—	—	72,294	191,537
Savings deposits	24,910	—	—	83,459	108,369
Time deposits	108,168	55,771	15,238	($ 182)	178,995
Total interest-bearing deposits	332,479	55,771	15,238	$ 277,349	680,837
Other borrowings	43,184	33	—	—	43,217
Total interest-bearing liabilities	375,663	55,804	15,238	277,349	724,054
Period gap	$ 5,767	$ 230,456	$ 150,835	($ 119,078)	$ 267,980
Cumulative gap	$ 5,767	$ 236,223	$ 387,058	$ 267,980	$ 267,980
Ratio of cumulative gap to total earning assets	1.51 %	35.38 %	46.42 %	27.01 %	27.01 %

(1) Loans classified as non-accrual as of December 31, 2018 are not included in the balances.
(2) Securities based on amortized cost.

Based on the many factors and assumptions used in simulating the effect of changes in interest rates, the following table estimates the hypothetical percentage change in net interest income at December 31, 2018 and 2017 over the subsequent 12 months. At December 31, 2018, we are slightly liability sensitive over the first three month period and over the balance of a 12-month period are asset sensitive on a cumulative basis. As a result, our modeling reflects modest decline in our net interest income in a rising rate environment over the first 12 months. This negative impact of rising rates reverses and net interest income is favorably impacted over a 24-month period. In a declining rate environment, the model reflects a decline in net interest income. This 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, respectively, reflected in the table below assume a simultaneous and parallel change in interest rates along the entire yield curve.

Net Interest Income Sensitivity

Change in short-term interest rates	**Hypothetical percentage change in net interest income December 31,**			
	2018		2017	
+200bp	-3.54	%	-2.26	%
+100bp	-1.58	%	-0.85	%
Flat	—		—	
-100bp	-0.34	%	-2.54	%
-200bp	-4.37	%	-7.71	%

We 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 December 31, 2018 and 2017, the PVE exposure in a plus 200 basis point increase in market interest rates was estimated to be (1.56)% and (0.09)%, respectively.

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Provision and Allowance for Loan Losses

At December 31, 2018, the allowance for loan losses amounted to $6.3 million, or 0.87% of loans (excludes loans held for sale), as compared $5.8 million, or 0.90% of loans, at December 31, 2017. Loans that were acquired in the acquisition of Cornerstone in 2017 and Savannah River Financial Corp. ("Savannah River") in 2014 are accounted for under FASB Accounting Standard Codification ("ASC") 310-30. These acquired loans are initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loans. The credit component on loans related to cash flows not expected to be collected is not subsequently accreted (non-accretable difference) into interest income. Any remaining portion representing the excess of a loan's or pool's cash flows expected to be collected over the fair value is accreted (accretable difference) into interest income. Subsequent to the acquisition date, increases in cash flows expected to be received in excess of our initial estimates are reclassified from non-accretable difference to accretable difference and are accreted into interest income on a level-yield basis over the remaining life of the loan. Decreases in cash flows expected to be collected are recognized as impairment through the provision for loan losses. During 2018 and 2017, there were no adjustments to our initial estimates or impairments recorded on purchased loans. The recorded investment in loans acquired in the Cornerstone and Savannah River transactions at December 31, 2018 and 2017 amounted to approximately $64.5 million and $101.8 million, respectively. At December 31, 2018 and 2017, the credit component on loans attributable to these acquired loans was $660 thousand and $1.5 million, respectively.

Our provision for loan loss was $346 thousand for the year ended December 31, 2018, as compared to $530 thousand and $774 thousand for the years ended December 31, 2017 and 2016, respectively. The 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, economic conditions 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. 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, especially considering the overall weakness in the commercial real estate market in our market areas.

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 (See Note 5 – Loans). The annualized weighted average loss ratios over the last 36 months for loans classified substandard, special mention and pass have been approximately 0.23%, 0.33% and 0.01%, respectively. 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. Our percentage of non-performing assets to total assets has shown continued improvement in the last several years. Non-performing assets were $4.0 million (0.37% of total assets) at December 31, 2018, $5.3 million (0.51% of total assets) at December 31, 2017, and $5.2 million (0.57% of total assets) at December 31, 2016. We believe these ratios are favorable in comparison to current industry results nationally and specifically in our local markets. The allocated portion of the allowance is 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 are adjusted as conditions change to be directionally consistent with these changes. The unallocated portion of the allowance is composed of factors based on management's evaluation of various conditions that are not directly measured in the estimation of probable losses through the experience formula or specific allowances. As noted below in the "Allocation of the Allowance for Loan Losses" table, the unallocated portion of the allowance as a percentage of the total allowance decreased as a percentage of the total allowance in 2018 and 2017. The overall risk as measured in our three-year lookback, both quantitatively and qualitatively, does not encompass a full economic cycle. The U.S. economy has been in an extended period of recovery. The period at which we may revert back to a slowing economy is not determinable. Net charge-offs in the 2009 to 2011 period averaged 63 basis points annualized in our loan portfolio. Over the most recent three-year period they have experienced a modest net recovery. We believe the unallocated portion of our allowance represents potential risk associated throughout a full economic cycle. As a result of national and global economic uncertainty, management does not believe it would be judicious to reduce substantially the overall level of the allowance at this time. The percentage of the unallocated portion of the allowance decreased from 27.9% at December 31, 2016 to 27.5% at December 31, 2017 and at December 31, 2018 is at 10.3%. The decline in the unallocated portion of the reserve reflects lower provisioning as a result of continued improvement in overall loan performance. Management also continually evaluates the underlying qualitative factors applied to the evaluation of the adequacy of the allowance for loan losses.

We have a significant portion of our loan portfolio with real estate as the underlying collateral. At December 31, 2018 and 2017, approximately 91.1% and 90.4%, respectively, of the loan portfolio had real estate as underlying collateral (see Note 15 to financial statements for concentrations of credit). When loans, whether commercial or personal, are granted, they are based on the borrower's ability to generate repayment cash flows from income sources sufficient to service the debt. Real estate is generally taken to reinforce the likelihood of the ultimate repayment and as a secondary source of repayment. We work closely with all our borrowers that experience cash flow or other economic problems, and we believe that we have the appropriate processes in place to monitor and identify problem credits. 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.

At December 31, 2018, 2017, and 2016, we had non-accrual loans in the amount of $2.5 million (0.35% of total loans), $3.4 million (0.52% of total loans) and $4.0 million (0.75% of total loans), respectively. Nonaccrual loans at December 31, 2018 consisted of 28 loans. All of these loans are considered to be impaired, are substantially all real estate-related, and have been measured for impairment under the fair value of the collateral method. We consider a loan to be impaired when, based upon current information and events, it is believed that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Such fair values are obtained using independent appraisals, which we consider to be level 3 inputs. The aggregate amount of impaired loans was $4.4 million and $5.2 million for the years ended December 31, 2018 and 2017, respectively. The non-accrual loans range in size from $1 thousand to $776 thousand. The largest of these loans is in the amount of $776 thousand and is secured by commercial non-owner occupied real estate located in Aiken, South Carolina.

In addition to the non-accrual loans that are considered to be impaired, we have six loans totaling $1.8 million that are classified as troubled debt restructurings but are accruing loans as of December 31, 2018. The largest relationship consists of one loan totaling $1.1 million with a mortgage on a commercial property located in the Midlands of South Carolina. There were $1.8 million, $2.1 million, and $1.8 million in loans delinquent 30 to 89 days at December 31, 2018, 2017 and 2016, respectively. There were loans in the amount of $31 thousand, $32 thousand and $53 thousand delinquent greater than 90 days and still accruing at December 31, 2018, 2017 and 2016, respectively.

Our management continuously monitors non-performing, classified and past due loans to identify deterioration regarding the condition of these loans. We have not identified any relationships that are current as to principal and interest at December 31, 2018 and not included in non-performing assets that could be a potential problem loans. Loans are identified as potential problems based on our review that their traditional sources of cash flow may have been impacted and that they may ultimately not be able to service the debt. These loans are continually monitored and are considered in our overall evaluation of the adequacy of our allowance for loan losses.

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

Allowance for Loan Losses

(Dollars in thousands)	**2018**	**2017**	**2016**	**2015**	**2014**
Average loans and loans held for sale outstanding	$686,438	$577,730	$514,766	$ 473,367	$ 439,174
Loans and loans held for sale outstanding at period end	$721,685	$651,898	$552,416	$ 492,153	$ 447,968
Total nonaccrual loans	$2,545	$3,342	$4,049	$ 4,839	$ 6,585
Loans past due 90 days and still accruing	$31	$32	$53	$ —	$ —
Beginning balance of allowance	$5,797	$5,214	$4,596	$ 4,132	$ 4,219
Loans charged-off:					
1-4 family residential mortgage	1	—	25	50	52
Non-farm non-residential mortgage	—	30	92	626	879
Multifamily residential	—	—	31	—	—
Home equity	23	7	19	—	17
Commercial	—	5	—	69	54
Installment & other	137	112	60	13	67
Overdrafts	3	19	12	49	42
Total loans charged-off	164	173	239	807	1,111
Recoveries:					
1-4 family residential mortgage	83	46	41	7	10
Multifamily residential	4	5	—	—	—
Non-farm non-residential mortgage	127	126	21	33	—
Home equity	6	24	3	3	6
Commercial	3	5	5	6	110
Installment & other	59	19	2	66	6
Overdrafts	2	1	11	18	11
Total recoveries	284	226	83	133	143
Net loans recovered (charged off)	120	53	(156)	(774)	(968)
Provision for loan losses	346	530	774	1,138	881
Balance at period end	$6,263	$5,797	$5,214	$ 4,596	$ 4,132
Net charge -offs to average loans and loans held for sale	(0.02%)	(0.01%)	0.03%	0.16%	0.22%
Allowance as percent of total loans	0.87%	0.89%	0.94%	0.94%	0.93%
Non-performing loans as % of total loans	0.77%	0.52%	0.75%	0.99%	1.48%
Allowance as % of non-performing loans	112.32%	171.81%	127.11%	95.00%	62.75%

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The following table presents an allocation of the allowance for loan losses at the end of each of the past five years. The allocation is calculated on an approximate basis and is not necessarily indicative of future losses or allocations. The entire amount is available to absorb losses occurring in any category of loans.

Allocation of the Allowance for Loan Losses

	2018		2017		2016		2015		2014	
(Dollars in thousands)	Amount	% of loans in category	Amount	% of loans in category	Amount	% of loans in category	Amount	% of loans in category	Amount	% of loans in category
Commercial, Financial and Agricultural	$320	7.5 %	$221	7.9 %	$145	7.8 %	$75	7.7 %	$67	7.5 %
Real Estate Construction	130	8.1 %	101	7.0 %	104	8.4 %	51	7.3 %	45	6.2 %
Real Estate Mortgage:										
Commercial	2,658	71.6 %	3,077	71.2 %	2,793	67.9 %	2,036	66.9 %	1,572	66.1 %
Residential	318	7.3 %	461	7.2 %	438	8.7 %	223	10.0 %	179	10.9 %
Consumer	2,191	5.5 %	343	6.7 %	280	7.2 %	164	8.1 %	178	9.3 %
Unallocated	646	N/A	1,594	N/A	1,454	N/A	2,047	N/A	2,091	N/A
Total	$6,263	100.0 %	$5,797	100.0 %	$5,214	100.0 %	$4,596	100.0 %	$4,132	100.0 %

Loans acquired in the Cornerstone transaction are excluded from our evaluation of the adequacy of the allowance as they were measured at fair value at acquisition. The assumptions used in this evaluation included a credit component and an interest rate component. At December 31, 2018 and 2017, these loans amounted to approximately $40.4 million and $58.9 million at December 31, 2018 and 2017, respectively.

Accrual of interest is discontinued on loans when we believe, 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 Expense

Non-interest Income. A significant source of noninterest income is service charges on deposit accounts. We also originate and sell residential loans on a servicing released basis in the secondary market. These loans are fixed rate residential loans that are originated in our name. The loans have locked in price commitments to be purchased by investors at the time of closing. Therefore, these loans present very little market risk for us. We typically deliver to, and receive funding from, the investor within 30 days. Other sources of noninterest income are derived from investment advisory fees and commissions on non-deposit investment products, ATM/debit card fees, commissions on check sales, safe deposit box rent, wire transfer and official check fees. Non-interest income was & 10.6 million and $9.6 million in 2018 and 2017, respectively. The deposit service charges increased by $283 thousand or 19.0% in comparing 2018 to 2017. Average transaction accounts (deposits accounts excluding time deposits) increased 18.4% during the year ended December 31, 2018 as compared to the same period for 2017. The addition of Cornerstone accounts in the fourth quarter of 2017 as well as organic growth accounted for the increase in deposit service charges. Mortgage banking income increased $117 thousand in 2018, as compared to 2017. Mortgage loan production was $119.7 million in 2018 (including construction perm loans to be sold upon completion of construction) as compared to $108.6 million in 2017. Revenue from increased production was slightly offset by a decreased average yield recognized on 2018 production as compared to 2017. Investment advisory fees and non-deposit commissions increased by $392 thousand in 2018 compared to 2017. Total assets under management ("AUM") at December 31, 2018 were $288.5 million as compared to $269.2 million at December 31, 2017. The quarterly average AUM in 2018 increased approximately $44.0 million as compared to 2017. The ending AUM at December 31, 2018 was impacted by an overall decline in the markets in late December 2018. The net gain on sale of securities for 2017 amounted to $400 thousand as compared to a loss of $342 thousand in 2018. The sales in 2018 and 2017 resulted from modest restructurings of the investment portfolio. These sales are made after evaluating specific investments and comparing them to an alternative asset or liability strategy. We recognized a gain on sale of other real estate of $235 thousand in 2017 as compared to $24 thousand in 2018. During 2017, we prepaid $13.0 million FHLB advances and incurred prepayment penalties of $447 thousand. We did not prepay any FHLB advances in 2018. ATM debit card income increased by $239 thousand or 14.9% in 2018 as compared to 2017. The increase in transaction accounts mentioned previously accounts for the overall increase in ATM debit card fees. Income on bank owned life insurance ("BOLI") increased from $623 thousand in 2017 to $722 thousand in 2018. This increase results from approximately $4.0 million in additional BOLI acquired in 2017, $2.5 million of which was acquired in the Cornerstone transaction. This BOLI was outstanding for the full year of 2018 and only part of the year in 2017. Non-interest income other increased from $271 thousand in 2017 to $535 thousand in 2018. This increase results from the impact of Cornerstone being included for the entire year of 2018 and only a part of the year in 2017. In addition, the Bank received proceeds of approximately $102 thousand related to a death benefit on BOLI which was credited to "Non-interest income—Other".

Non-interest income was $9.6 million and $8.9 million in 2017 and 2016, respectively. The deposit service charges increased slightly in comparing 2017 to 2016. This increase primarily relates to the organic increase in transaction accounts as well as the addition of Cornerstone accounts in the fourth quarter of 2017. Mortgage banking income increased $396 thousand in 2017, as compared to 2016. We added two additional mortgage originators in 2017. Mortgage loan production was $108.6 million in 2017 as compared to $102.5 million in 2016. Investment advisory fees and non-deposit commissions increased by $156 thousand in 2017 compared to 2016. Total assets under management at December 31, 2017 were $269.2 million as compared to $200.6 million at December 31, 2016. The net gain on sale of securities for 2017 amounted to $400 thousand as compared to $601 thousand in 2016. These sales result from modest restructurings of the investment portfolio. As noted above these sales are made after evaluating specific investments and comparing them to an alternative asset or liability strategy. We recognized $235 thousand in gains on sale of real estate owned in 2017 as compared to a loss of $33 thousand in 2016. Although our other real estate owned balance increased at December 31, 2017 as compared to December 31, 2016, the increase was a result of approximately $1.2 million in repossessed real estate acquired in the Cornerstone transaction. Improving real estate values have resulted in the gains recognized in 2017. During 2017 and 2016, we prepaid $13.0 million and $11.4 million, respectively, in FHLB advances and incurred prepayment penalties of $447 thousand and $459 thousand, respectively.

The following table sets forth for the periods indicated the primary components of other noninterest income:

	Year ended December 31,		
(In thousands)	2018	2017	2016
ATM debit card income	$1,844	$1,605	$1,519
Income on bank owned life insurance	722	623	604
Rental income	280	216	273
Loan late charges	96	64	114
Safe deposit fees	58	50	45
Wire transfer fees	80	67	54
Other	535	271	300
Total	$3,615	$2,896	$2,909

Non-interest Expense. In the very competitive financial services industry, we recognize the need to place a great deal of emphasis on expense management and continually evaluate and monitor growth in discretionary expense categories in order to control future increases. Non-interest expense increased $2.8 million in 2018 as compared to 2017, from $29.4 million in 2017 to $32.1 million in 2018. In 2017, we undertook two major projects. The first was to convert our core processing system from an in-house solution to an outsourced solution which included changing vendors. This cost of the conversion accounted for approximately $300 thousand in increased non-interest expense in 2017. The second was the acquisition of Cornerstone, which was completed in the fourth quarter of 2017 in which we incurred $903 thousand in merger related expenses. As noted earlier, the impact of the Cornerstone transaction impacts non-interest expense for the full year of 2018 whereas, only approximately 2 ½ months in 2017. Salary and benefit expense increased $2.6 million from $16.9 million in the 2017 to $19.5 million in 2018. We had 226 and 224 full time equivalent employees at December 31, 2018 and 2017, respectively. The increase in salary and benefit expense is primarily a result of the normal salary adjustments, as well as the addition of the employees as a result of the Cornerstone acquisition for the entire year of 2018. Occupancy expense increased $214 thousand from $2.2 million in 2017 to $2.4 million in 2018. The increase in occupancy expense of $214 thousand in 2018 as compared to 2017 is primarily a result of the addition of the three offices acquired in the Cornerstone transaction as well as the opening of our new office in downtown Augusta, Georgia in March of 2018. As noted above in June of 2017, we moved our core data processing system from an in-house environment to an outsourcing environment. As a result certain costs associated with data processing prior to the conversion were captured in the furniture fixtures and equipment category, as well as other categories such as postage. This resulted in a decrease in furniture and equipment expense of $258 thousand in 2018 as compared to 2017. Data processing expense increased by $888 thousand in 2018 compared to 2017. This, along with adding the Cornerstone accounts, is the reason for the overall increase in ATM/debit card, bill payment and data processing expenses category. FDIC assessments increased by $63 thousand in 2018 as compared to 2017. This is a result of our overall asset growth which is the assessment base for calculating the FDIC premium. Amortization of intangibles increased $220 thousand in 2018 as compared to 2017. This increase is a result of the amortization of core deposit intangible acquired in the Cornerstone transaction. Total core deposit intangible in this transaction amounted to approximately $1.8 million. The amortization is being recognized on a 150% declining balance method over ten years.

Non-interest expense increased $3.6 million in 2017 as compared to 2016, from $25.8 million in 2016 to $29.4 million in 2017. Merger expenses in the amount of $903 thousand accounted for part of the overall increase in non-interest expense in 2017 as compared to 2016. Salary and benefit expense increased $1.6 million from $15.3 million in the 2016 to $16.9 million in 2017. We had 224 and 202 full-time equivalent employees at December 31, 2017 and 2016, respectively. The acquisition of Cornerstone in the fourth quarter, along with the addition of former Cornerstone employees, accounts for approximately $122 thousand of the increase in salary and benefit expense. Additional overtime and part-time staff during the previously mentioned conversion accounted for another $125 thousand increase in this expense category. New staff additions in the last half of 2016 and early in 2017 included eight new positions, including a Chief Operations Officer, loan operations staff, additional lending staff as well as a new financial advisor position. The staff additions along with normal salary increases and increased medical benefit premiums along with the conversion and merger salary related cost account for the overall increase in salary and employee benefits in 2017. Data processing expense increased by $614 thousand in 2017 compared to 2016. The conversion to the outsourced data processing system in June 2017 is the primary reason for this increase. Previously, certain of these costs were included in equipment maintenance expense when we operated on the in-house system. As part of the data processing system conversion, we consolidated our core, card, ATM and bill payment processing into one vendor and all of these costs are now captured in the data processing expense line. FDIC assessments decreased by $100 thousand in 2017 as compared to 2016. As of July 2016, the FDIC adjusted the assessment calculations and at the time we estimated the new formula would reduce our overall annual assessment by approximately 40%. Other real estate expense decreased $159 thousand in 2017 as compared to 2016. This reflects the overall decrease in the level of our repossessed real estate assets between the two periods excluding the properties acquired in the Cornerstone acquisition in the fourth quarter of 2017. Legal and professional fees increased $253 thousand. Included in the increase of legal and professional fees are consulting fees associated with our core processing conversion of $72 thousand, $60 thousand in audit and accounting fees and $55 thousand related to a mortgage origination process improvement engagement. As of June 30, 2016, our market capitalization crossed the threshold which resulted in requiring an internal control audit by our independent auditors under the Sarbanes Oxley 404 legislation. Crossing this threshold has also added the need to outsource certain internal audit procedures as more of the internal resources are dedicated to documenting and testing to insure compliance with the requirements of Section 404 of The Sarbanes Oxley Act of 2002. Non-interest expense “Other” increased by $444 thousand in 2017 as compared to 2016. In the fourth quarter of 2017, we acquired a South Carolina rehabilitation tax credit of $205 thousand. The cost of this credit of $164 thousand is included in non -interest expense “Other”.

The following table sets forth for the periods indicated the primary components of noninterest expense:

	Year ended December 31,		
(In thousands)	2018	2017	2016
Salary and employee benefits	$19,515	$16,951	$15,323
Occupancy	2,380	2,166	2,167
Furniture and Equipment	1,513	1,771	1,728
Marketing and public relations	919	901	865
ATM/debit card and data processing*	2,300	1,412	798
Supplies	142	165	130
Telephone	422	378	349
Courier	149	106	95
Correspondent services	270	227	237
Subscriptions	199	135	146
FDIC/FICO premium	375	312	412
Insurance	254	394	291
Other real estate expenses including OREO write downs	98	42	201

Legal and Professional fees	864	991	738
Loss on limited partnership interest	60	161	172
Postage	56	113	182
Director fees	366	378	391
Amortization of intangibles	563	343	318
Shareholder expense	173	131	172
Merger expense	—	945	—
Other	1,504	1,336	1,061
	$32,122	$29,358	$25,776

*Data processing includes core processing, bill payment, online banking, and remote deposit capture

Income Tax Expense

Income tax expense for 2018 was $2.7 million as compared to income tax expense for the year ended December 31, 2017 of $3.3 million and $2.2 million for the year ended December 31, 2016 (see Note 14 "Income Taxes" to the Consolidated Financial Statements for additional information). As noted previously, the lower tax rates as a result of the passing of the Tax Cut and Jobs Act on December 22, 2017 required that we adjust our deferred tax asset for the lower effective corporate tax rate. This adjustment was made as of the date of enactment of the new legislation and increased our tax expense by approximately $1.2 million in 2017. The lower corporate tax rate of 21% versus the previous rate of 34% resulted in our effective tax rates being 19.3% in 2018 whereas historically it has been in the 25% to 27% range. We recognize deferred tax assets for future deductible amounts resulting from differences in the financial statement and tax bases of assets and liabilities and operating loss carry forwards. The deferred tax assets are established based on the amounts expected to be paid/recovered at existing tax rates. A valuation allowance is established to reduce the deferred tax asset to the level that it is more likely than not that the tax benefit will be realized. In 2017 and 2018, we purchased a $205 thousand South Carolina rehabilitation tax credit. The cost of this credit for each year was $164 thousand and is included in "Other" non-interest expense. Effective for years beginning after December 15, 2016, the accounting for share-based compensation changed the recognition of the tax effects of deductions for tax purposes of compensation cost not recognized in the income statement. Previously, the income tax effects of these deductions were recorded directly to equity. Beginning in 2017, all of the tax effects of share-based compensation are recognized in the income statement. The tax benefit is recognized at the time of settlement of the share-based payments. During the first quarter of each of 2018 and 2017, the recognition of settled share-based payments reduced our tax expense by approximately$14 thousand and $115 thousand, respectively. As a result, of our current level of tax exempt securities in our investment portfolio and our BOLI holdings, assuming the current corporate rate remains unchanged, our effective tax rate is expected to be approximately 20.5% to 21.0%.

Financial Position

Assets totaled $1.09 billion at December 31, 2018 as compared to $1.05 billion at December 31, 2017, an increase of $41.0 million. We funded approximately $146.1 million in loan production during 2018. Net of pay-downs, this resulted in organic loan growth of approximately $71.7 million (excluding loans held for sale), or 11.1%, from December 31, 2017 to December 31, 2018. At December 31, 2018, loans (excluding loans held for sale) accounted for 72.2% of earning assets, as compared to 67.9% at December 31, 2017. The loan-to-deposit ratio (including loans held for sale) at December 31, 2018 was 78.0% as compared to 73.4% at December 31, 2017. Loans originated and held for sale are generally held for less than 30 days and have locked in purchase commitments by investors prior to closing. At December 31, 2018, loans held for sale amounted to $3.2 million as compared to $5.1 at December 31, 2017. Investment securities were $256.0 million at December 31, 2018 as compared to $284.4 million at December 31, 2017. At December 31, 2018 and 2017, we had $16.2 million and $17.0 million, respectively, in securities classified as held-to-maturity, all of which are municipal securities. We continue to evaluate the intent for classification purposes on a security-by-security basis. At December 31, 2018, we had no securities rated below investment grade on our balance sheet (see Note 4, Investment Securities, for further information). Short-term federal funds sold, and interest-bearing bank balances were $17.9 million at December 31, 2018 compared to $15.8 million at December 31, 2017. Total deposits grew $37.2 million from $888.3 million at December 31, 2017 to $925.5 million at December 31, 2018. The growth in deposits as well as the decrease in investment securities funded substantially all of the loan growth in 2018. We continue attempting to control our pricing on time deposits as we have experienced continued growth in pure deposits (deposits excluding time deposits). Pure deposits grew $50.9 million in 2018 and time deposits decreased by $13.7 million in 2018. At December 31, 2018 and 2017, we had no brokered deposits. FHLB advances decreased from $14.3 million at December 31, 2017 to $231 thousand at December 31, 2018.

Shareholders' equity totaled $112.5 million at December 31, 2018, as compared to $105.7 million at December 31, 2017. The increase in shareholder's equity includes is primarily attributable to retention of earnings less dividends paid during the year totaling approximately $3.0 million.

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Earning Assets

Loans and loans held for sale

Loans typically provide higher yields than the other types of earning assets. During 2018, loans accounted for 70.0% of average earning assets. The loan portfolio (including held-for-sale) averaged $686.4 million in 2018 as compared to $577.7 million in 2017. Quality loan portfolio growth continued to be a strategic focus in 2018. Associated with the higher loan yields are the inherent credit and liquidity risks, which we attempt to control and counterbalance. One of our goals as a community bank 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. In 2018, we funded new loans (excluding loans originated for sale) of approximately $146.1 million, as compared to $144.2 million in 2017. We remain committed to meeting the credit needs of our local markets. However, adverse national and local economic conditions, as well as deterioration of our asset quality, could significantly impact our ability to grow our loan portfolio. Significant increases in regulatory capital expectations beyond the traditional "well capitalized" ratios and significantly increased regulatory burdens could impede our ability to leverage our balance sheet and expand the loan portfolio.

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

	December 31,				
(In thousands)	2018	2017	2016	2015	2014
Commercial, financial & agricultural	$53,933	$51,040	$42,704	$37,809	$33,403
Real estate:					
Construction	58,440	45,401	45,746	35,829	27,545
Mortgage—residential	52,764	46,901	47,472	49,077	48,510
Mortgage—commercial	513,833	460,276	371,112	326,978	293,186
Consumer:					
Home equity	29,583	32,451	31,368	30,906	33,000
Other	9,909	10,736	8,307	8,592	8,200
Total gross loans	718,462	646,805	546,709	489,191	443,844
Allowance for loan losses	(6,263)	(5,797)	(5,214)	(4,596)	(4,132)
Total net loans	$712,199	$641,008	$541,495	$484,595	$439,712

In the context of this discussion, a real estate mortgage loan is defined as any loan, other than loans for construction purposes, secured by real estate, regardless of the purpose of the loan. We follow the common practice of financial institutions in our market area 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%. The principal components of our loan portfolio at year-end 2018 and 2017 were commercial mortgage loans in the amount of $513.8 million and $460.3 million, respectively, representing 71.5% and 71.2% of the portfolio, respectively, excluding loans held for sale. Significant portions of these commercial mortgage loans are made to finance owner-occupied real estate. We continue to maintain a conservative philosophy regarding our underwriting guidelines, and believe it will reduce the risk elements of the loan portfolio through strategies that diversify the lending mix.

The repayment of loans in the loan portfolio as they mature is a source of liquidity. The following table sets forth the loans maturing within specified intervals at December 31, 2018.

Loan Maturity Schedule and Sensitivity to Changes in Interest Rates

(In thousands)	December 31, 2018			
	One Year or Less	Over one Year Through Five Years	Over five years	Total
Commercial, financial and agricultural	$17,232	$ 20,572	$16,129	$53,933
Real Estate/Construction	90,665	227,652	336,303	654,620
All other loan	1,745	6,126	2,038	9,909
	$109,642	$ 254,350	$354,470	$718,462

Loans maturing after one year with:

Variable Rate	$116,054
Fixed Rate	492,766
	$608,820

The information presented in the above table is based on the contractual maturities of the individual loans, including loans which may be subject to renewal at their contractual maturity. Renewal of such loans is subject to review and credit approval, as well as modification of terms upon their maturity.

Investment Securities

The investment securities portfolio is a significant component of our total earning assets. Total investment securities averaged $271.6 million in 2018, as compared to $265.8 million in 2017. This represents 27.7% and 30.9% of the average earning assets for the years ended December 31, 2018 and 2017, respectively. At December 31, 2018 and 2017, our investment securities portfolio amounted to $256.0 million and $284.4 million, respectively.

At December 31, 2018, the estimated weighted average life of the investment portfolio was approximately 4.9 years, duration of approximately 3.7, and a weighted average tax equivalent yield of approximately 2.81%. At December 31, 2017, the estimated weighted average life of the investment portfolio was approximately 4.8 years, duration of approximately 3.7, and a weighted average tax equivalent yield of approximately 2.68%.

We held no debt securities rated below investment grade at December 31, 2018.

The following table shows the investment portfolio composition.

	December 31,		
(Dollars in thousands)	2018	2017	2016
Securities available-for-sale at fair value:			
U.S. Treasury	15,457	$1,505	$1,520
U.S. Government sponsored enterprises	1,100	1,109	997
Small Business Administration pools	55,336	61,588	50,184
Mortgage-backed securities	115,475	143,768	144,298
State and local government	50,506	56,004	54,534
Preferred stock	—	—	1,000
Other	19	850	861
	$237,893	$264,824	$253,394
Securities held-to-maturity at amortized cost:			
State and local government	$16,174	$17,012	$17,193
Total	$254,067	$281,836	$270,587

We hold other investments carried at cost which represents our investment in FHLB stock. This investment amounted to $2.0 million and $2.6 million at December 31, 2018 and 2017, respectively.

Investment Securities Maturity Distribution and Yields

The following table shows, at amortized cost, the expected maturities and average yield of securities held at December 31, 2018:

(In thousands)

Available-for-sale:	Within One Year Amount	Yield	After One But Within Five Years Amount	Yield	After Five But Within Ten Years Amount	Yield	After Ten Years Amount	Yield
US Treasury	$ 8,365	2.33 %	$ 7,123	2.46 %	$ —	—	$ —	—
Government sponsored enterprises	—		1,096	2.81 %	—	—	—	—
Small Business Administration pools	635	0.73 %	32,254	2.25 %	21,545	3.61 %	1,350	3.77 %
Mortgage-backed securities	5,738	2.51 %	73,516	2.45 %	33,406	2.60 %	5,202	3.32 %
State and local government	322	1.20 %	7,136	2.78 %	42,144	3.15 %	997	2.69 %
Other	—	—	10	3.70 %	—	—	9	3.70 %
Total investment securities available-for-sale	$ 15,060	2.31 %	$ 121,135	2.42 %	$ 97,095	3.06 %	$ 7,558	3.31 %

(In thousands)

Held-to-maturity:	Within One Year Amount	Yield	After One But Within Five Years Amount	Yield	After Five But Within Ten Years Amount	Yield	After Ten Years Amount	Yield
State and local government	$ —	—	$ 491	2.81 %	$ 8,674	2.21 %	$ 7,009	2.35 %
Total investment securities Held-to-maturity:	$ —	—	$ 491	2.81 %	$ 8,674	2.21 %	$ 7,009	2.35 %

(1) Yield calculated on tax equivalent basis

Short-Term Investments

Short-term investments, which consist of federal funds sold, securities purchased under agreements to resell and interest bearing deposits, averaged $23.2 million in 2018, as compared to $16.0 million in 2017. We maintain the majority of our short term overnight investments in our account at the Federal Reserve rather than in federal funds at various correspondent banks due to the lower regulatory capital risk weighting. At December 31, 2018, short-term investments including funds on deposit at the Federal Reserve totaled $17.9 million. These funds are an immediate source of liquidity and are generally invested in an earning capacity on an overnight basis.

Deposits and Other Interest-Bearing Liabilities

Deposits. Average deposits were $915.1 million during 2018, compared to $790.5 million during 2017. Average interest-bearing deposits were $671.6 million during 2018, as compared to $591.3 million during 2017.

The following table sets forth the deposits by category:

	December 31, 2018		2017		2016	
(In thousands)	Amount	% of Deposits	Amount	% of Deposits	Amount	% of Deposits
Demand deposit accounts	$244,686	26.4 %	$226,546	25.5 %	$182,915	23.9 %
Interest bearing checking accounts	201,936	21.8 %	189,034	21.3 %	161,106	21.0 %
Money market accounts	191,537	20.7 %	175,325	19.7 %	166,353	21.7 %
Savings accounts	108,369	11.7 %	104,756	11.8 %	75,012	9.8 %
Time deposits less than $100,000	93,480	10.1 %	100,531	11.3 %	90,332	11.8 %
Time deposits more than $100,000	85,515	9.3 %	92,131	10.4 %	90,904	11.8 %
	$925,523	100.0 %	$888,323	100.0 %	$766,622	100.0 %

Large certificate of deposit customers, whom we identify as those of $100 thousand or more, tend to be extremely sensitive to interest rate levels, making these deposits less reliable sources of funding for liquidity planning purposes than core deposits. Core deposits, which exclude time deposits of $100 thousand or more, provide a relatively stable funding source for the loan portfolio and other earning assets. Core deposits were $840.0 million and $796.2 million at December 31, 2018 and 2017, respectively. Time deposits greater than $250 thousand, the FDIC deposit insurance coverage limit, amounted to $27.8 million and $36.1 million at December 31, 2018 and December 31, 2017, respectively.

A stable base of deposits is expected to continue to be the primary source of funding to meet both our short-term and long-term liquidity needs in the future. The maturity distribution of time deposits is shown in the following table

Maturities of Certificates of Deposit and Other Time Deposit of $100,000 or more

	December 31, 2018				
(In thousands)	Within Three Months	After Three Through Six Months	After Six Through Twelve Months	After Twelve Months	Total
Time deposits of $100,000 or more	$11,126	$ 17,293	$21,648	$35,448	$85,515

Borrowed funds. Borrowed funds consist of securities sold under agreements to repurchase, FHLB advances and long-term debt as a result of issuing $15.0 million in trust preferred securities. Short-term borrowings in the form of securities sold under agreements to repurchase averaged $27.0 million, $19.2 million and $21.4 million during 2018, 2017 and 2016, respectively. The maximum month-end balances during 2018, 2017 and 2016 were $33.4 million, $21.3 million and $23.7 million, respectively. The average rates paid during these periods were 1.08%, 0.37% and 0.19%, respectively. The balances of securities sold under agreements to repurchase were $28.0 million and $19.3 million at December 31, 2018 and 2017, respectively. The repurchase agreements all mature within one to four days and are generally originated with customers that have other relationships with us and tend to provide a stable and predictable source of funding. As a member of the FHLB, the Bank has access to advances from the FHLB for various terms and amounts. During 2018 and 2017, the average outstanding advances amounted to $4.1 million and $17.0 million, respectively.

The following is a schedule of the maturities for FHLB Advances as of December 31, 2018 and 2017:

(In thousands)	December 31, 2018		2017	
Maturing	Amount	Rate	Amount	Rate
2018	$—	—	$14,000	1.41%
2019	—	—	—	—
2020	231	1.00%	250	1.00%
	$231	1.00%	$14,250	1.40%

In addition to the above borrowings, we issued $15.5 million in trust preferred securities on September 16, 2004. During the fourth quarter of 2015, we redeemed $500 thousand of these securities. The securities accrue and pay distributions quarterly at a rate of three month LIBOR plus 257 basis points. The remaining debt may be redeemed in full anytime with notice and matures on September 16, 2034.

Capital Adequacy and Dividends

Total shareholders' equity as of December 31, 2018 was $112.5 million as compared to $105.7 million as of December 31, 2017. In 2018, the retention of earnings less dividend payments on our common stock accounted for the majority of the change in shareholders' equity. In 2016, we paid a dividend of $0.08 per share each quarter. During each quarter of 2017, we paid a dividend on our common stock of $0.09 per share. In 2018, we paid a $0.10 per share dividend on our common stock each quarter.

In addition, a dividend reinvestment plan was implemented in the third quarter of 2003. The plan allows existing shareholders the option of reinvesting cash dividends as well as making optional purchases of up to $5,000 in the purchase of common stock per quarter.

The following table shows the return on average assets (net income divided by average total assets), return on average equity (net income divided by average equity), and equity to assets ratio for the three years ended December 31, 2018.

	2018	2017	2016
Return on average assets	1.04 %	0.62 %	0.75 %
Return on average common equity	10.48%	6.56 %	8.08 %
Equity to assets ratio	10.31%	10.06%	8.95 %
Dividend Payout Ratio	27.02%	42.35%	31.68%

In July 2013, the federal bank regulatory agencies issued a final rule that revised the risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with certain standards in Basel III and certain provisions of the Dodd-Frank Act. See "Supervision and Regulation—Basel Capital Standards" for additional information on Basel III and the Dodd-Frank Act. The rules became effective as of January 1, 2015 and were fully phased-in as of January 1, 2019. While the Company is currently a small bank holding company and so generally is not subject to these capital requirements, our Bank remains subject to these capital requirements. As of December 31, 2018, the Company and the Bank meet all capital adequacy requirements under the Basel III rules on a fully phased-in basis as if such requirements had been effective at that time. The Company and the Bank exceeded the regulatory capital ratios at December 31, 2018 and 2017, as set forth in the following table:

(In thousands)	Required Amount	%	Actual Amount	%	Excess Amount	%
The Bank (1):						
December 31, 2018						
Risk Based Capital						
Tier 1	$49,043	6.0%	$107,806	13.2%	$58,764	7.2%
Total Capital	65,390	8.0%	114,069	14.0%	48,679	6.0%
CET1	36,782	4.5%	107,806	13.2%	71,024	8.7%
Tier 1 Leverage	43,198	4.0%	107,806	10.0%	64,608	6.0%
December 31, 2017						
Risk Based Capital						
Tier 1	$44,396	6.0%	$99,118	13.4%	$54,722	7.4%
Total Capital	59,195	8.0%	104,915	14.2%	45,720	6.2%
CET1	33,297	4.5%	99,118	13.4%	65,821	8.9%
Tier 1 Leverage	41,030	4.0%	99,118	9.7 %	58,088	5.7%

(1) As a small bank holding company, we are generally not subject to the capital requirements unless otherwise advised by the Federal Reserve.

Since we are a bank holding company, our ability to declare and pay dividends is dependent on certain federal and state regulatory considerations, including the guidelines of the Federal Reserve. The Federal Reserve has issued a policy statement regarding the payment of dividends by bank holding companies. In general, the Federal Reserve'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'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 our ability to pay dividends or otherwise engage in capital distributions.

In addition, since we are a legal entity separate and distinct from the Bank and do not conduct stand-alone operations, our ability to pay dividends depends on the ability of the Bank to pay dividends to us, 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 S.C. Board, 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 S.C. Board. 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.

Liquidity Management

Liquidity management involves monitoring sources and uses of funds in order to meet our day-to-day cash flow requirements while maximizing profits. Liquidity represents our ability to convert assets into cash or cash equivalents without significant loss and to raise additional funds by increasing liabilities. Liquidity management is made more complicated because different balance sheet components are subject to varying degrees of management control. For example, the timing of maturities of the investment portfolio is very predictable and subject to a high degree of control at the time investment decisions are made. However, net deposit inflows and outflows are far less predictable and are not subject to nearly the same degree of control. Asset liquidity is provided by cash and assets which are readily marketable, or which can be pledged, or which will mature in the near future. Liability liquidity is provided by access to core funding sources, principally the ability to generate customer deposits in our market area. In addition, liability liquidity is provided through the ability to borrow against approved lines of credit (federal funds purchased) from correspondent banks and to borrow on a secured basis through securities sold under agreements to repurchase. The Bank is a member of the FHLB and has the ability to obtain advances for various periods of time. These advances are secured by securities pledged by the Bank or assignment of loans within the Bank's portfolio.

We anticipate that the Bank will remain a well-capitalized institution for at least the next 12 months. Total shareholders' equity was 10.31% of total assets at December 31, 2018 and 10.06% at December 31, 2017. Funds sold and short-term interest bearing deposits are our primary source of immediate liquidity and averaged $23.2 million and $16.0 million during the year ended December 31, 2018 and 2018, respectively. The Bank maintains federal funds purchased lines with two financial institutions each in the amount of $10.0 million. The FHLB 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 our liquidity position and have implemented internal policies establishing guidelines for sources of asset based liquidity and limit the total amount of purchased funds used to support the balance sheet and funding from non-core 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.

We believe our liquidity remains adequate to meet operating and loan funding requirements and 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.

Off-Balance Sheet Arrangements

In the normal course of operations, we engage in a variety of financial transactions that, in accordance with GAAP, are not recorded in the financial statements, or are recorded in amounts that differ from the notional amounts. These transactions involve, to varying degrees, elements of credit, interest rate, and liquidity risk. Such transactions are used by the company for general corporate purposes or for customer needs. Corporate purpose transactions are used to help manage credit, interest rate, and liquidity risk or to optimize capital. Customer transactions are used to manage customers' requests for funding. Please refer to Note 15 of our financial statements for a discussion of our off-balance sheet arrangements.

Impact of Inflation

Unlike most industrial companies, the assets and liabilities of financial institutions such as the company and the bank are primarily monetary in nature. Therefore, interest rates have a more significant effect on our performance than do the effects of changes in the general rate of inflation and change in prices. In addition, interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. As discussed previously, we continually seek to manage the relationships between interest sensitive assets and liabilities in order to protect against wide interest rate fluctuations, including those resulting from inflation.

Item 7A. Quantitative and Qualitative Disclosure About Market Risk

Not Applicable

Item 8. Financial Statements and Supplementary Data.

Additional information required under this Item 8 may be found under the accompanying Financial Statements and Notes to Financial Statements under Note 21.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, our principal executive and principal financial officers and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal controls over financial reporting as of December 31, 2018. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control—Integrated Framework issued in 2013.

Based on that assessment, we believe that, as of December 31, 2018, our internal control over financial reporting is effective based on those criteria.

The effectiveness of the internal control structure over financial reporting as of December 31, 2018 has been audited by Elliott Davis, LLC, an independent registered public accounting firm, as stated in their report included in this Annual Report on Form 10-K, which expresses an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2018.

/s/ Michael C. Crapps	/s/ Joseph G. Sawyer
Chief Executive Officer and President	*Executive Vice President and Chief Financial Officer*

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of First Community Corporation:

Opinion on the Internal Control Over Financial Reporting

We have audited First Community Corporation and its subsidiary's (the "Company") internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in 2013. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018 and the related notes to the consolidated financial statement based on criteria established in COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheets as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2018, of the Company and our report dated March 14, 2019 expressed an unqualified opinion.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that *(1)* pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; *(2)* provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and *(3)* provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Elliott Davis, LLC

Columbia, South Carolina

March 14, 2019

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of First Community Corporation:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of First Community Corporation and its subsidiary (the "Company") as of December 31, 2018 and 2017 and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2018, and the related notes to the consolidated financial statements and schedules (collectively, the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (the "PCAOB"), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated March 14, 2019 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Elliott Davis, LLC

We have served as the Company's auditor since 2006.

Columbia, South Carolina

March 14, 2019

FIRST COMMUNITY CORPORATION

Consolidated Balance Sheets

	December 31,	
(Dollars in thousands, except par values)	2018	2017
ASSETS		
Cash and due from banks	$14,328	$14,803
Interest-bearing bank balances	17,883	15,186
Federal funds sold and securities purchased under agreements to resell	57	602
Investments held-to-maturity	16,174	17,012
Investment securities available-for-sale	237,893	264,824
Other investments, at cost	1,955	2,559
Loans held for sale	3,223	5,093
Loans	718,462	646,805
Less, allowance for loan losses	6,263	5,797
Net loans	712,199	641,008
Property, furniture and equipment - net	34,987	36,103
Bank owned life insurance	25,754	25,413
Other real estate owned	1,460	1,934
Intangible assets	2,006	2,569
Goodwill	14,637	14,589
Other assets	9,039	9,036
Total assets	$1,091,595	$1,050,731
LIABILITIES		
Deposits:		
Non-interest bearing demand	$244,686	$226,546
Interest bearing	680,837	661,777
Total deposits	925,523	888,323
Securities sold under agreements to repurchase	28,022	19,270
Federal Home Loan Bank Advances	231	14,250
Junior subordinated debt	14,964	14,964
Other liabilities	10,358	8,261
Total liabilities	979,098	945,068
Commitments and Contingencies (Note 15)		
SHAREHOLDERS' EQUITY		
Preferred stock, par value $1.00 per share; 10,000,000 shares authorized; 0 issued and outstanding	—	—
Common stock, par value $1.00 per share; 10,000,000 shares authorized; issued and outstanding 7,638,681 at December 31, 2018 and 7,587,938 at December 31, 2017	7,639	7,588
Common stock warrants issued	31	46
Nonvested restricted stock	(149)	(109)
Additional paid in capital	95,048	94,516
Retained earnings	12,262	4,066

Accumulated other comprehensive loss	(2,334)	(444)
Total shareholders' equity	112,497	105,663
Total liabilities and shareholders' equity	$1,091,595	$1,050,731

See Notes to Consolidated Financial Statements

FIRST COMMUNITY CORPORATION

Consolidated Statements of Income

	Year Ended December 31,		
(Dollars in thousands except per share amounts)	2018	2017	2016
Interest income:			
Loans, including fees	$32,789	$26,134	$23,677
Investment securities - taxable	4,755	4,001	3,819
Investment securities - non taxable	1,767	1,858	1,905
Other short term investments	418	163	105
Total interest income	39,729	32,156	29,506
Interest expense:			
Deposits	2,905	1,825	1,818
Securities sold under agreement to repurchase	293	73	42
Other borrowed money	783	864	1,187
Total interest expense	3,981	2,762	3,047
Net interest income	35,748	29,394	26,459
Provision for loan losses	346	530	774
Net interest income after provision for loan losses	35,402	28,864	25,685
Non-interest income:			
Deposit service charges	1,769	1,486	1,405
Mortgage banking income	3,895	3,778	3,382
Investment advisory fees and non-deposit commissions	1,683	1,291	1,135
Gain (loss) on sale of securities	(342)	400	601
Gain (loss) on sale of other assets	24	235	(33)
Loss on early extinguishment of debt	—	(447)	(459)
Other	3,615	2,896	2,909
Total non-interest income	10,644	9,639	8,940
Non-interest expense:			
Salaries and employee benefits	19,515	16,951	15,323
Occupancy	2,380	2,166	2,167
Equipment	1,513	1,771	1,728
Marketing and public relations	919	901	865
FDIC Insurance assessments	375	312	412
Other real estate expense	98	3	201
Amortization of intangibles	563	343	318
Merger expenses	—	903	—
Other	6,760	6,008	4,762
Total non-interest expense	32,123	29,358	25,776
Net income before tax	13,923	9,145	8,849
Income tax expense	2,694	3,330	2,167
Net income	$11,229	$5,815	$6,682

Basic earnings per common share	$1.48	$0.85	$1.01
Diluted earnings per common share	$1.45	$0.83	$0.98

See Notes to Consolidated Financial Statements

FIRST COMMUNITY CORPORATION

Consolidated Statements of Comprehensive Income

(Dollars in thousands)	Year ended December 31,		
	2018	2017	2016
Net income	$11,229	$5,815	$6,682
Adjustment to AOCI related to tax legislation	—	(149)	—
Other comprehensive income (loss):			
Unrealized gain (loss) during the period on available for sale securities, net of tax of $930, ($623) and $860, respectively	(2,160)	1,206	(1,670)
Less: Reclassification adjustment for loss (gain) included in net income, net of tax of ($72), $121, and $204, respectively	270	(264)	(397)
Other comprehensive income (loss)	(1,890)	793	(2,067)
Comprehensive income	$9,339	$6,608	$4,615

See Notes to Consolidated Financial Statements

FIRST COMMUNITY CORPORATION

Consolidated Statements of Changes in Shareholders' Equity

(Dollars and shares in thousands)	Common Stock Number Shares Issued	Common Stock	Common Stock Warrants	Additional Paid-in Capital	Nonvested Restricted Stock	Retained Earnings (deficit)	Accumulated Other Comprehensive Income (loss)	Total
Balance, December 31, 2015	6,690	$6,690	$46	$75,761	$(297)	$(3,992)	$830	$79,038
Net income						6,682		6,682
Other comprehensive loss net of tax of $1,064							(2,067)	(2,067)
Issuance of restricted stock	22	22		275	(297)			—
Restricted stock shares surrendered	(26)	(26)		(327)				(353)
Amortization of compensation on restricted stock					374			374
Issuance of common stock	1	1		13				14
Dividends: Common ($0.32 per share)						(2,117)		(2,117)
Dividend reinvestment plan	21	21		269				290
Balance, December 31, 2016	6,708	$6,708	$46	$75,991	$(220)	$573	$(1,237)	$81,861
Net income						5,815		5,815
Other comprehensive income net of tax of $487							942	942
Adjustment to AOCI related to tax legislation						149	(149)	—
Issuance of restricted stock	5	5		100	(105)			—
Shares forfeited	(2)	(2)		(27)	9			(20)
Shares retired	(19)	(19)		(369)				(388)
Amortization of compensation on restricted stock					207			207
Issuance of common stock	877	877		18,468				19,345
Dividends: Common ($0.36 per share)						(2,471)		(2,471)
Dividend reinvestment plan	19	19		353				372
Balance, December 31, 2017	7,588	$7,588	$46	$94,516	$(109)	$4,066	$(444)	$105,663
Net income						11,229		11,229
Other comprehensive loss net of tax of $858							(1,890)	(1,890)
Issuance of restricted stock	11	11		233	(244)			—
Exercise of stock warrants	25	25	(15)	(10)				—
Shares retired	(2)	(2)		(55)				(57)
Exercise of deferred compensation	1	1		18				19
Amortization of compensation on restricted stock					204			204
Dividends: Common ($0.40 per share)						(3,033)		(3,033)
Dividend reinvestment plan	16	16		346				362
Balance, December 31, 2018	7,639	$7,639	$31	$95,048	$(149)	$12,262	$(2,334)	$112,497

See Notes to Consolidated Financial Statements

FIRST COMMUNITY CORPORATION

Consolidated Statements of Cash Flows

(Amounts in thousands)	Year Ended December 31,		
	2018	2017	2016
Cash flows from operating activities:			
Net income	$11,229	$5,815	$6,682
Adjustments to reconcile net income to net cash provided in operating activities			
Depreciation	1,519	1,448	1,333
Net premium amortization	2,447	3,270	4,040
Provision for loan losses	346	530	774
Writedowns of other real estate owned	—	39	76
Loss (gain) loss on sale of other real estate owned	4	(235)	33
Originations of HFS loans	(114,959)	(104,200)	(96,489)
Sales of HFS loans	116,829	104,814	93,744
Amortization of intangibles	563	343	318
Gain on sale of securities	342	(400)	(601)
Accretion on acquired loans	(620)	(262)	(880)
Writedown of land held for sale	42	90	25
Loss on early extinguishment of debt	—	447	459
(Gain) loss on sale of fixed assets	(123)	—	—
(Increase) decrease in other assets	441	6,495	(5,404)
Increase in accounts payable	2,097	157	1,025
Net cash provided in operating activities	20,157	18,351	5,135
Cash flows from investing activities:			
Proceeds from sale of securities available-for-sale	44,299	25,368	33,215
Proceeds from sale of securities held-to-maturity	655	—	—
Purchase of investment securities available-for-sale	(64,146)	(30,626)	(66,359)
Purchase of investment securities held-to-maturity	—	—	—
Maturity/call of investment securities available-for-sale	41,564	35,452	38,034
Proceeds from sale of other investments	604	250	486
Increase in loans	(71,266)	(39,944)	(57,456)
Net cash received in business combination	—	22,385	—
Proceeds from sale of other real estate owned	816	684	1,781
Proceeds from sale of fixed assets	1,145	—	—
Purchase of property and equipment	(1,465)	(3,072)	(1,237)
Purchase of BOLI	—	(1,500)	—
Net cash provided (used) in investing activities	(47,794)	8,997	(51,536)
Cash flows from financing activities:			
Increase (decrease) in deposit accounts	37,290	(4,868)	50,403
Advances from the Federal Home Loan Bank	79,000	26,000	73,593
Repayment of advances from the Federal Home Loan Bank	(93,019)	(36,273)	(74,865)
Increase (decrease) in securities sold under agreements to repurchase	8,752	(1,106)	(1,506)
Deferred compensation shares	19	—	—
Restricted shares surrendered	(57)	(408)	(353)
Issuance of common stock	—	—	14
Dividend reinvestment plan	362	372	290
Dividends paid on Common Stock	(3,033)	(2,471)	(2,117)
Net cash (used) provided in financing activities	29,314	(18,756)	45,459

Net increase (decrease) in cash and cash equivalents	1,677	8,592	(942)
Cash and cash equivalents at beginning of year	30,591	21,999	22,941
Cash and cash equivalents at end of year	$32,268	$30,591	$21,999
Supplemental disclosure:			
Cash paid during the period for: Interest	$3,592	$2,796	$3,097
Income Taxes	$2,215	$1,895	$1,345
Non-cash investing and financing activities:			
Unrealized (loss) gain on securities available-for-sale, net of tax	$(1,890)	$942	$(2,067)
Transfer of loans to other real estate owned	$346	$1,275	$579

See Notes to Consolidated Financial Statements

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FIRST COMMUNITY CORPORATION

Notes to Consolidated Financial Statements

Note 1—ORGANIZATION AND BASIS OF PRESENTATION

The consolidated financial statements include the accounts of First Community Corporation (the "Company") and its wholly owned subsidiary, First Community Bank (the "Bank"). The Company owns all of the common stock of FCC Capital Trust I. All material intercompany transactions are eliminated in consolidation. The Company was organized on November 2, 1994, as a South Carolina corporation, and was formed to become a bank holding company. The Bank opened for business on August 17, 1995. FCC Capital Trust I is an unconsolidated special purpose subsidiary organized for the sole purpose of issuing trust preferred securities.

Note 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. These principles require management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses. The estimation process includes management's judgment as to future losses on existing loans based on an internal review of the loan portfolio, including an analysis of the borrower's current financial position, the consideration of current and anticipated economic conditions and the effect on specific borrowers. In determining the collectability of loans management also considers the fair value of underlying collateral. Various regulatory agencies, as an integral part of their examination process, review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination. Because of these factors it is possible that the allowance for loan losses could change materially.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, due from banks, interest-bearing bank balances, federal funds sold and securities purchased under agreements to resell. Generally federal funds are sold for a one-day period and securities purchased under agreements to resell mature in less than 90 days.

Investment Securities

Investment securities are classified as either held-to-maturity, available-for-sale or trading securities. In determining such classification, securities that the Company has the positive intent and ability to hold to maturity are classified as held-to maturity and are carried at amortized cost. Securities classified as available-for-sale are carried at estimated fair values with unrealized gains and losses included in shareholders' equity on an after tax basis. Trading securities are carried at estimated fair value with unrealized gains and losses included in non-interest income (See Note 4).

Gains and losses on the sale of available-for-sale securities and trading securities are determined using the specific identification method. Declines in the fair value of individual held-to-maturity and available-for-sale securities below their cost that are judged to be other than temporary are written down to fair value and charged to income in the Consolidated Statement of Income.

Premiums and discounts are recognized in interest income using the interest method over the period to maturity.

*Mortgage Loans Held for S*ale

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 primarily 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.

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Note 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Company usually delivers to, and receives funding from, the investor within 30 days. Commitments to sell these loans to the investor are considered derivative contracts and are sold to investors on a "best efforts" basis. The Company is not obligated to deliver a loan or pay a penalty if a loan is not delivered to the investor. As a result of the short-term nature of these derivative contracts, the fair value of the mortgage loans held for sale in most cases is the same as the value of the loan amount at its origination. These loans are classified as Level 2.

Loans and Allowance for Loan Losses

Loan receivables that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal balance adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest is recognized over the term of the loan based on the loan balance outstanding. Fees charged for originating loans, if any, are deferred and offset by the deferral of certain direct expenses associated with loans originated. The net deferred fees are recognized as yield adjustments by applying the interest method.

The allowance for loan losses is maintained at a level believed to be adequate by management to absorb potential losses in the loan portfolio. Management's determination of the adequacy of the allowance is based on an evaluation of the portfolio, past loss experience, economic conditions and volume, growth and composition of the portfolio.

The Company considers a loan to be impaired when, based upon current information and events, it is believed that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans that are considered impaired are accounted for at the lower of carrying value or fair value. The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due, generally when a loan becomes 90 days past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received first to principal and then to interest income.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the asset's estimated useful life. Estimated lives range up to 39 years for buildings and up to 10 years for furniture, fixtures and equipment.

Goodwill and Other Intangible Assets

Goodwill represents the cost in excess of fair value of net assets acquired (including identifiable intangibles) in purchase transactions. Other intangible assets represent premiums paid for acquisitions of core deposits (core deposit intangibles). Core deposit intangibles are being amortized on a straight-line basis over seven years. Goodwill and identifiable intangible assets are reviewed for impairment annually or whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. The annual valuation is performed on September 30 of each year.

Other Real Estate Owned

Other real estate owned includes real estate acquired through foreclosure. Other real estate owned is carried at the lower of cost (principal balance at date of foreclosure) or fair value minus estimated cost to sell. Any write-downs at the date of foreclosure are charged to the allowance for loan losses. Expenses to maintain such assets, subsequent changes in the valuation allowance, and gains or losses on disposal are included in other expenses.

Comprehensive Income (loss)

The Company reports comprehensive income (loss) in accordance with Accounting Standards Codification ("ASC") 220, "Comprehensive Income." ASC 220 requires that all items that are required to be reported under accounting standards as comprehensive income (loss) be reported in a financial statement that is displayed with the same prominence as other financial statements. The disclosures requirements have been included in the Company's consolidated statements of comprehensive income.

Note 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Mortgage Origination Fees

Mortgage origination fees relate to activities comprised of accepting residential mortgage applications, qualifying borrowers to standards established by investors and selling the mortgage loans to the investors under pre-existing commitments. The related fees received by the Company for these services are recognized at the time the loan is closed.

Advertising Expense

Advertising and public relations costs are generally expensed as incurred. External costs incurred in producing media advertising are expensed the first time the advertising takes place. External costs relating to direct mailing costs are expensed in the period in which the direct mailings are sent. Advertising expense totaled $919 thousand, $901 thousand and $820 thousand for the years ended December 31, 2018, 2017, and 2016, respectively.

Income Taxes

A deferred income tax liability or asset is recognized for the estimated future effects attributable to differences in the tax bases of assets or liabilities and their reported amounts in the financial statements as well as operating loss and tax credit carry forwards. The deferred tax asset or liability is measured using the enacted tax rate expected to apply to taxable income in the period in which the deferred tax asset or liability is expected to be realized.

In 2006, the FASB issued guidance related to Accounting for Uncertainty in Income Taxes. This guidance clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB ASC Topic 740-10, "Income Taxes." It also prescribes a recognition threshold and measurement of a tax position taken or expected to be taken in an enterprise's tax return.

Stock Based Compensation Cost

The Company accounts for stock based compensation under the fair value provisions of the accounting literature. Compensation expense is recognized in salaries and employee benefits.

The fair value of each grant is estimated on the date of grant using the Black-Sholes option pricing model. No options were granted in 2018, 2017 or 2016.

Earnings Per Common Share

Basic earnings per common share ("EPS") excludes dilution and is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS is computed by dividing net income available to common shareholders by the weighted average number of shares of common stock and common stock equivalents. Common stock equivalents consist of stock options and warrants and are computed using the treasury stock method.

Business Combinations and Method of Accounting for Loans Acquired

The Company accounts for its acquisitions under FASB ASC Topic 805, "*Business Combinations*," which requires the use of the acquisition method of accounting. All identifiable assets acquired, including loans, are recorded at fair value. No allowance for loan losses related to the acquired loans is recorded on the acquisition date because the fair value of the loans acquired incorporates assumptions regarding credit risk. Loans acquired are recorded at fair value in accordance with the fair value methodology prescribed in FASB ASC Topic 820, "*Fair Value Measurements and Disclosures.*"

Note 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Acquired credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality, found in FASB ASC Topic 310-30, "*Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality,"* formerly American Institute of Certified Public Accountants ("AICPA") Statement of Position ("SOP") 03-3, "*Accounting for Certain Loans or Debt Securities Acquired in a Transfer*," and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loans. Loans acquired in business combinations with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered to be credit impaired. Evidence of credit quality deterioration as of purchase dates may include information such as past-due and nonaccrual status, borrower credit scores and recent loan to value percentages. The Company considers expected prepayments and estimates the amount and timing of expected principal, interest and other cash flows for each loan or pool of loans meeting the criteria above, and determines the excess of the loan's scheduled contractual principal and contractual interest payments over all cash flows expected to be collected at acquisition as an amount that should not be accreted (nonaccretable difference). The remaining amount, representing the excess of the loan's or pool's cash flows expected to be collected over the fair value for the loan or pool of loans, is accreted into interest income over the remaining life of the loan or pool (accretable difference). Subsequent to the acquisition date, increases in cash flows expected to be received in excess of the Company's initial estimates are reclassified from nonaccretable difference to accretable difference and are accreted into interest income on a level-yield basis over the remaining life of the loan. Decreases in cash flows expected to be collected are recognized as impairment through the provision for loan losses.

Segment Information

ASC Topic 280-10, "*Segment Reporting*," requires selected segment information of operating segments based on a management approach. The Company's four reportable segments represent the distinct product lines the Company offers and are viewed separately for strategic planning by management (see Note 24, Reportable Segments, for further information).

Recently Issued Accounting Standards

In May 2014, the FASB issued guidance (ASU 2014-09) to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance is effective for the Company as of January 1, 2018. The Company evaluated the overall impact on affected revenue streams and any related contracts, including asset management fees, gains and losses on the sale of real estate, deposit related fees and interchange fees. Based on this evaluation, the Company determined that ASU 2014-09 did not materially change the method in which revenue from impacted revenue streams was previously being recognized. The Company applied the guidance using a modified retrospective approach. This approach requires the application of the new guidance to uncompleted contracts at the date of adoption. Periods prior to the date of adoption were not retrospectively revised as the impact on uncompleted contracts at the date of adoption was not material.

In January 2016, the FASB amended the Financial Instruments topic of the Accounting Standards Codification (ASU 2016-01) to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments were effective for the Company on January 1, 2018. The guidance affects the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure of financial instruments. The amendments related to equity securities without readily determinable fair values were applied prospectively to equity investments that exist as of the date of adoption of the amendments. ASU 2016-01 requires the use of exit price rather than entrance price in determining the fair value of loans not measured at fair value on a non-recurring basis in the consolidated balance sheets. See Note 6 - Fair Value of Financial Instruments for information regarding the change in the valuation of these loans. The adoption of ASU 2016-01 did not have a material impact on the Company's financial statements.

In June 2016, the FASB issued guidance to change the accounting for credit losses and modify the impairment model for certain debt securities. The amendments will be effective for the Company for reporting periods beginning after December 15, 2019. Early adoption is permitted for all organizations for periods beginning after December 15, 2018. The Company is currently evaluating the effect that implementation of the new standard will have on its financial position, results of operations, and cash flows.

In August 2016, the FASB amended the Statement of Cash Flows topic of the ASC to clarify how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments are effective for the Company for fiscal years beginning after December 15, 2017 including interim periods within those fiscal years. These amendments had no material effect on the Company's financial statements.

Note 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In January 2017, the FASB issued guidance to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendment to the Business Combinations Topic is intended to address concerns that the existing definition of a business has been applied too broadly and has resulted in many transactions being recorded as business acquisitions that in substance are more akin to asset acquisitions. The guidance was effective for the Company for reporting periods beginning after December 15, 2017. These amendments had no material effect on the Company's financial statements.

In January 2017, the FASB amended the Goodwill and Other Topic of the ASC to simplify the accounting for goodwill impairment for public business entities and other entities that have goodwill reported in their financial statements and have not elected the private company alternative for the subsequent measurement of goodwill. The amendment removes Step 2 of the goodwill impairment test. Goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The effective date and transition requirements for the technical corrections will be effective for the Company for reporting periods beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect these amendments to have a material effect on its financial statements.

In March 2017, the FASB amended the requirements in the Receivables—Nonrefundable Fees and Other Costs Topic of the ASC related to the amortization period for certain purchased callable debt securities held at a premium. The amendments shorten the amortization period for the premium to the earliest call date. The amendments became effective for the Company for interim and annual periods beginning after December 15, 2018. The Company does not expect these amendments to have a material effect on its financial statements.

In September 2017, the FASB updated the Revenue from Contracts with Customers and the Leases Topics of the ASC. The amendments incorporate into the ASC recent SEC guidance about certain public business entities (PBEs) electing to use the non-PBE effective dates solely to adopt the FASB's new standards on revenue and leases. The amendments were effective upon issuance and did not have a material effect on the Company's financial statements.

In November 2017, the FASB updated the Income Statement and Revenue from Contracts with Customers Topics of the ASC. The amendments incorporate into the ASC recent SEC guidance related to revenue recognition. The amendments were effective upon issuance and did not have a material effect on the Company's financial statements.

In March 2018, the FASB updated the Debt Securities and the Regulated Operations Topics of the ASC. The amendments incorporate into the Accounting Standards Codification recent SEC guidance which was issued in order to make the relevant interpretive guidance consistent with current authoritative accounting and auditing guidance and

SEC rules and regulations. The amendments were effective upon issuance and did not have a material effect on the financial statements.

In March 2018, the FASB updated the Income Taxes Topic of the ASC. The amendments incorporate into the ASC recent SEC guidance related to the income tax accounting implications of the Tax Cuts and Jobs Act. The amendments were effective upon issuance and did not have a material effect on the Company's financial statements.

In May 2018, the FASB amended the Financial Services—Depository and Lending Topic of the ASC to remove outdated guidance related to Circular 202. The amendments were effective upon issuance and did not have a material effect on the Company's financial statements.

In July 2018, the FASB amended the Leases Topic of the ASC to make narrow amendments to clarify how to apply certain aspects of the new leases standard. Additionally, amendments were made to give entities another option for transition and to provide lessors with a practical expedient. The amendments are effective for reporting periods beginning after December 15, 2018. The Company does not expect these amendments to have a material effect on its financial statements.

Note 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In August 2018, the FASB amended the Fair Value Measurement Topic of the ASC. The amendments remove, modify, and add certain fair value disclosure requirements based on the concepts in the FASB Concepts Statement, Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements. The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted. An entity is permitted to early adopt any removed or modified disclosures upon issuance of this ASU and delay adoption of the additional disclosures until their effective date. The Company does not expect these amendments to have a material effect on its financial statements.

In August 2018, the FASB amended the Intangibles—Goodwill and Other Topic of the ASC to align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The amendments will be effective for the Company for fiscal years beginning after December 15, 2019. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In October 2018, the FASB amended the Derivatives and Hedging Topic of the ASC to expand the list of U.S. benchmark interest rates permitted in the application of hedge accounting. The amendments will be effective for the Company for fiscal years beginning after December 15, 2018. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In October 2018, the FASB amended the Consolidation topic of the ASC for determining whether a decision-making fee is a variable interest. The amendments require organizations to consider indirect interests held through related parties under common control on a proportional basis rather than as the equivalent of a direct interest in its entirety. The amendments will be effective for the Company for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted. The Company will apply a full retrospective approach in which financial statements for each individual prior period presented and the opening balances of the earliest period presented are adjusted to reflect the period-specific effects of applying the amendments. The Company does not expect these amendments to have a material effect on its financial statements.

In November 2018, the FASB amended the Collaborative Arrangements Topic of the ASC to clarify the interaction between the guidance for certain collaborative arrangements and the new revenue recognition financial accounting and reporting standard. The amendments will be effective for the Company for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In December 2018, the FASB issued guidance that providing narrow-scope improvements for lessors, that provides relief in the accounting for sales, use and similar taxes, the accounting for other costs paid by a lessee that may benefit a lessor, and variable payments when contracts have lease and non-lease components. The amendments became effective for the Company for reporting periods beginning after December 15, 2018. The Company does not expect these amendments to have a material effect on its financial statements.

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

Risk and Uncertainties

In the normal course of business, the Company encounters two significant types of risks: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different speeds, or on a different basis, than its interest-earning assets. Credit risk is the risk of default on the Company's loan and investment portfolios that results from borrowers' or issuer's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans and investments and the valuation of real estate held by the Company.

The Company is subject to regulations of various governmental agencies (regulatory risk). These regulations can and do change significantly from period to period. The Company also undergoes periodic examinations by the regulatory agencies, which may subject it to further changes with respect to asset valuations, amounts of required loan loss allowances and operating restrictions from regulators' judgments based on information available to them at the time of their examination.

Reclassifications

Certain captions and amounts in the 2016 and 2017 consolidated financial statements were reclassified to conform to the 2018 presentation.

Note 3—MERGERS AND ACQUISITIONS

On October 20, 2017, the Company acquired all of the outstanding common stock of Cornerstone Bancorp headquartered in Easley, South Carolina ("Cornerstone") the bank holding company for Cornerstone National Bank ("CNB"), in a cash and stock transaction. The total purchase price was approximately $27.1 million, consisting of $7.8 million in cash and 877,364 shares of the Company's common stock valued at $19.3 million based on a provision in the merger agreement that 30% of the outstanding shares of Cornerstone common stock be exchanged for cash and 70% of the outstanding shares of Cornerstone common stock be exchanged for shares of the Company's common stock. The value of the Company's common stock issued was determined based on the closing price of the common stock on October 19, 2017 as reported by NASDAQ, which was $22.05. Cornerstone common shareholders received 0.54 shares of the Company's common stock in exchange for each share of Cornerstone common stock, or $11.00 per share, subject to the limitations discussed above. The Company issued 877,364 shares of its common stock in connection with the merger.

The Cornerstone transaction was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at estimated fair value on the acquisition date based on a third party valuation of significant accounts. Fair values are subject to refinement for up to a year.

The following table presents the assets acquired and liabilities assumed as of October 20, 2017 as recorded by the Company on the acquisition date and initial fair value adjustments.

(Dollars in thousands, except per share data)	As Recorded by Cornerstone	Fair Value Adjustments		As Recorded by the Company
Assets				
Cash and cash equivalents	$ 30,060	$ —		$ 30,060
Investment securities	44,018	(358	)(a)	43,660
Loans	60,835	(734	)(b)	60,101
Premises and equipment	4,164	573	(c)	4,737
Intangible assets	—	1,810	(d)	1,810
Bank owned life insurance	2,384	—		2,384
Other assets	3,082	(452	)(e)	2,630
Total assets	$ 144,543	$ 839		$ 145,382

Liabilities				
Deposits:				
Noninterest-bearing	$ 27,296	$ —		$ 27,296
Interest-bearing	99,152	150	(f)	99,302
Total deposits	126,448	150		126,598
Securities sold under agreements to repurchase	849	—		849
Other liabilities	320	96	(g)	416
Total liabilities	127,617	246		127,863
Net identifiable assets acquired over liabilities assumed	16,926	593		17,519
Goodwill	—	9,558		9,558
Net assets acquired over liabilities assumed	$ 16,926	$ 10,151		$ 27,077

Consideration:	
First Community Corporation common shares issued	877,364
Purchase price per share of the Company’s common stock	$ 22.05
	$ 19,346
Cash exchanged for stock and fractional shares	7,731
Fair value of total consideration transferred	$ 27,077

Explanation of fair value adjustments

(a)—Adjustment reflects marking the securities portfolio to fair value as of the acquisition date.

(b)—Adjustment reflects the fair value adjustments based on the Company’s evaluation of the acquired loan portfolio and excludes the allowance for loan losses recorded by Cornerstone.

(c)—Adjustment reflects the fair value adjustments based on the Company’s evaluation of the acquired premises and equipment.

(d)—Adjustment reflects the recording of the core deposit intangible on the acquired deposit accounts.

(e)—Adjustment reflects the deferred tax adjustment related to fair value adjustments at 34%.

(f)—Adjustment reflects the fair value adjustment on interest-bearing deposits.

Note 3—MERGERS AND ACQUISITIONS (Continued)

The operating results of the Company for the period ended December 31, 2017 include the operating results of the acquired assets and assumed liabilities for the 72 days subsequent to the acquisition date of October 20, 2017. Merger-related charges related to the Cornerstone acquisition of $945 thousand are recorded in the consolidated statement of income and include incremental costs related to closing the acquisition, including legal, accounting and auditing, investment banker, travel, printing, supplies and other costs.

The following table discloses the impact of the merger with Cornerstone (excluding the impact of merger-related expenses) since the acquisition on October 20, 2017 through December 31, 2017. The table also presents certain pro forma information as if Cornerstone had been acquired on January 1, 2017 and January 1, 2016. These results combine the historical results of Cornerstone in the Company’s consolidated statement of income and, while certain adjustments were made for the estimated impact of certain fair value adjustments and other acquisition-related activity, they are not indicative of what would have occurred had the acquisition taken place on January 1, 2017 or January 1, 2016.

(Dollars in thousands)	Pro Forma Twelve Months Ended December 31, 2017	Pro Forma Twelve Months Ended December 31, 2016
Total revenues *(net interest income plus noninterest income)*	$ 43,602	$ 41,300
Net income	$ 6,791	$ 7,750

Note 4—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
December 31, 2018				
US Treasury securities	$ 15,488	$ 9	$ 40	$ 15,457
Government Sponsored Enterprises	1,096	6	2	1,100
Mortgage-backed securities	117,862	73	2,460	115,475
Small Business Administration pools	55,784	247	695	55,336
State and local government	50,599	619	712	50,506
Corporate and other securities	19	—	—	19
	$ 240,848	$ 954	$ 3,909	$ 237,893

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2017				
US Treasury securities	$ 1,529	$ —	$ 24	$ 1,505
Government Sponsored Enterprises	1,085	24	—	1,109
Mortgage-backed securities	145,185	285	1,702	143,768
Small Business Administration pools	61,544	374	330	61,588
State and local government	55,111	1,309	416	56,004
Corporate and other securities	932	—	82	850
	$ 265,386	$ 1,992	$ 2,554	$ 264,824

Note 4—INVESTMENT SECURITIES (Continued)

HELD-TO-MATURITY

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2018				
State and local government	$ 16,174	$ 50	$ 40	$ 16,184
	$ 16,174	$ 50	$ 40	$ 16,184

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2017				
State and local government	$ 17,012	$ 223	$ 15	$ 17,220
	$ 17,012	$ 223	$ 15	$ 17,220

At December 31, 2018, corporate and other securities available-for-sale included the following at fair value: mutual funds at $7.1 thousand and foreign debt of $10.0 thousand. At December 31, 2017, corporate and other securities available-for-sale included the following at fair value: mutual funds at $790.0 thousand and foreign debt of $60.0 thousand. Other investments, at cost, include Federal Home Loan Bank ("FHLB") stock in the amount of $955.0 thousand and corporate stock in the amount of $1.0 million at December 31, 2018. The Company held $1.6 million of FHLB stock and $1.0 million in corporate stock at December 31, 2017.

For the year ended December 31, 2018, proceeds from the sale of securities available-for-sale amounted to $44.3 million, gross realized gains amounted to $274 thousand and gross realized losses amounted to $616 thousand. For the year ended December 31, 2018, the Company received proceeds of $655 thousand and gross unrealized loss of $4.0 thousand for the sale of an investment security held-to-maturity. For the year ended December 31, 2017, proceeds from the sale of securities available-for-sale amounted to $25.3 million, gross realized gains amounted to $422 thousand and gross realized losses amounted to $22 thousand. For the year ended December 31, 2016, proceeds from the sale of securities available-for-sale amounted to $32.2 million, gross realized gains amounted to $601 thousand and there were no gross realized losses. The tax (benefit) provision applicable to the net realized gain was approximately ($72) thousand, $121 thousand, and $204 thousand for 2018, 2017 and 2016, respectively.

Note 4—INVESTMENT SECURITIES (Continued)

The amortized cost and fair value of investment securities at December 31, 2018, by expected maturity, follow. Expected maturities differ from contractual maturities because borrowers may have the right to call or prepay the obligations with or without prepayment penalties. Mortgage-backed securities are included in the year corresponding with the remaining expected life.

(Dollars in thousands)	Available-for-sale		Held-to-maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$15,060	$15,035	$—	$—
Due after one year through five years	121,134	119,721	491	491
Due after five years through ten years	97,095	95,656	8,674	8,676
Due after ten years	7,559	7,481	7,009	7,017
	$240,848	$237,893	$16,174	$16,184

Securities with an amortized cost of $118.4 million and fair value of $116.2 million at December 31, 2018 were pledged to secure FHLB advances, public deposits, and securities sold under agreements to repurchase. Securities with an amortized cost of $101.2 million and fair value of $100.2 million at December 31, 2017 were pledged to secure FHLB advances, public deposits, and securities sold under agreements to repurchase.

The following tables show 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 December 31, 2018 and December 31, 2017.

December 31, 2018 (Dollars in thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Available-for-sale securities:						
US Treasury	$ 8,355	$ 10	$1,488	$ 30	$9,843	$ 40
Government Sponsored Enterprise	—	—	122	2	122	2
Mortgage-Backed Securities	13,917	120	89,870	2,339	103,787	2,459
Small Business Administration pools	16,400	211	20,330	484	36,730	695
State and local government	9,517	52	15,598	660	25,115	712
Corporate bonds and other	7	1	—	—	7	1
Total	$ 48,196	$ 394	$127,408	$ 3,515	$175,604	$ 3,909

December 31, 2018 (Dollars in thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Held-to-maturity securities:						
State and local government	$ 2,843	$ 14	$ 4,899	$ 26	$7,742	$ 40
Total	$ 2,843	$ 14	$ 4,899	$ 26	$7,742	$ 40

Note 4—INVESTMENT SECURITIES (Continued)

December 31, 2017 (Dollars in thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Available-for-sale securities:						
US Treasury	$ —	$ —	$ 1,505	$ 24	$ 1,505	$ 24
Government Sponsored Enterprise mortgage-backed securities	50,377	420	46,071	1,282	96,448	1,702
Small Business Administration pools	17,607	164	16,311	166	33,918	330
State and local government	3,639	15	12,990	401	16,629	416
Corporate bonds and other	—	—	790	82	790	82
Total	$ 71,623	$ 599	$ 77,667	$ 1,955	$ 149,290	$ 2,554

December 31, 2017 (Dollars in thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Held-to-maturity securities:						
State and local government	$ 2,899	$ 15	$ —	$ —	$ 2,899	$ 15
Total	$ 2,899	$ 15	$ —	$ —	$ 2,899	$ 15

Government Sponsored Enterprise, Mortgage-Backed Securities: The Company owned mortgage-backed securities (“MBSs”), including collateralized mortgage obligations (“CMOs”), issued by government sponsored enterprises (“GSEs”) with an amortized cost of $117.9 million and $145.0 million and approximate fair value of $115.5 million and $143.6 million at December 31, 2018 and December 31, 2017, respectively. As of December 31, 2018 and December 31, 2017, 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 December 31, 2018.

Non-agency Mortgage Backed Securities: The Company holds private label mortgage-backed securities (“PLMBSs”), including CMOs, at December 31, 2017 with an amortized cost of $199.9 thousand and approximate fair value of $204.1 thousand. The Company held private label mortgage-backed securities (“PLMBSs”), including CMOs, at December 31, 2017 with an amortized cost of $143.7 thousand and approximate fair value of $144.4 thousand. 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 years ended December 31, 2018, December 31, 2017 and December 31, 2016, no OTTI charges were recorded in earnings for the PLMBS portfolio. At December 31, 2018 the Company does not own any securities rated below investment grade.

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

December 31, 2018 and December 31, 2017.

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Note 5—LOANS

Loans summarized by category are as follows:

	December 31,	
(Dollars in thousands)	2018	2017
Commercial, financial and agricultural	$53,933	$51,040
Real estate:		
Construction	58,440	45,401
Mortgage-residential	52,764	46,901
Mortgage-commercial	513,833	460,276
Consumer:		
Home equity	29,583	32,451
Other	9,909	10,736
Total	$718,462	$646,805

Activity in the allowance for loan losses was as follows:

	Years ended December 31,		
(Dollars in thousands)	2018	2017	2016
Balance at the beginning of year	$5,797	$5,214	$4,596
Provision for loan losses	346	530	774
Charged off loans	(164)	(173)	(239)
Recoveries	284	226	83
Balance at end of year	$6,263	$5,797	$5,214

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Note 5—LOANS (Continued)

The detailed activity in the allowance for loan losses and the recorded investment in loans receivable as of and for the years ended December 31, 2018, December 31, 2017 and December 31, 2016 follows:

(Dollars in thousands)

		Real estate	Real estate Mortgage	Real estate Mortgage	Consumer	Consumer		
	Commercial	Construction	Residential	Commercial	Home equity	Other	Unallocated	Total
2018								
Allowance for loan losses:								
Beginning balance	$ 221	$ 101	$ 461	$ 3,077	$ 308	$ 35	$ 1,594	$ 5,797
Charge-offs	—	—	(1)	—	(23)	(140)	—	(164)
Recoveries	3	—	4	210	6	61	—	284
Provisions	206	(12)	(33)	1,031	(30)	132	(948)	346
Ending balance	$ 430	$ 89	$ 431	$ 4,318	$ 261	$ 88	$ 646	$ 6,263
Ending balances:								
Individually evaluated for impairment	$ —	$ —	$ —	$ 14	$ —	$ —	$ —	$ 14
Collectively evaluated for impairment	430	89	431	4,304	261	88	646	6,249
Loans receivable:								
Ending balance-total	$ 53,933	$ 58,440	$ 52,764	$ 513,833	$ 29,583	$ 9,909	$ —	$ 718,462
Ending balances:								
Individually evaluated for impairment	—	—	322	4,030	29	—	—	4,381
Collectively evaluated for impairment	53,933	58,440	52,442	509,803	29,554	9,909	—	714,081

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Note 5—LOANS (Continued)

(Dollars in thousands)

	Commercial	Real estate Construction	Real estate Mortgage Residential	Real estate Mortgage Commercial	Consumer Home equity	Consumer Other	Unallocated	Total
2017								
Allowance for loan losses:								
Beginning balance	$ 145	$ 104	$ 438	$ 2,793	$ 153	$ 127	$ 1,454	$ 5,214
Charge-offs	(5)	—	—	(30)	(7)	(131)	—	(173)
Recoveries	5	—	5	172	24	20	—	226
Provisions	76	(3)	18	142	138	19	140	530
Ending balance	$ 221	$ 101	$ 461	$ 3,077	$ 308	$ 35	$ 1,594	$ 5,797
Ending balances:								
Individually evaluated for impairment	$ —	$ —	$ 2	$ 25	$ —	$ —	$ —	$ 27
Collectively evaluated for impairment	221	101	459	3,052	308	35	1,594	5,770
Loans receivable:								
Ending balance-total	$ 51,040	$ 45,401	$ 46,901	$ 460,276	$ 32,451	$ 10,736	$ —	$ 646,805
Ending balances:								
Individually evaluated for impairment	—	—	413	4,742	—	—	—	5,155
Collectively evaluated for impairment	51,040	45,401	46,488	455,534	32,451	10,736	—	641,650

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Note 5—LOANS (Continued)

(Dollars in thousands)

	Commercial	Real estate Construction	Real estate Mortgage Residential	Real estate Mortgage Commercial	Consumer Home equity	Consumer Other	Unallocated	Total
2016								
Allowance for loan losses:								
Beginning balance	$ 75	$ 51	$ 223	$ 2,036	$ 127	$ 37	$ 2,047	$ 4,596
Charge-offs	—	—	(11)	(136)	(20)	(72)	—	(239)
Recoveries	5	—	40	21	3	14	—	83
Provisions	65	53	186	872	43	148	(593)	774
Ending balance	$ 145	$ 104	$ 438	$ 2,793	$ 153	$ 127	$ 1,454	$ 5,214
Ending balances:								
Individually evaluated for impairment	$ —	$ —	$ 2	$ 4	$ —	$ —	$ —	$ 6
Collectively evaluated for impairment	145	104	436	2,789	153	127	1,454	5,208
Loans receivable:								
Ending balance-total	$ 42,704	$ 45,746	$ 47,472	$ 371,112	$ 31,368	$ 8,307	$ —	$ 546,709
Ending balances:								
Individually evaluated for impairment	—	—	639	5,124	56	—	—	5,819
Collectively evaluated for impairment	42,704	45,746	46,833	365,988	31,312	8,307	—	540,890

At December 31, 2018, $57.3 million of loans acquired in the Cornerstone acquisition were excluded in the evaluation of the adequacy of the allowance for loan losses. These loans were recorded at fair value at acquisition which included a credit component of approximately $1.5 million. Loans acquired prior to 2017 have been included in the evaluation of the allowance for loan losses.

Note 5—LOANS (Continued)

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. The following table presents related party loan transactions for the years ended December 31, 2018 and December 31, 2017.

(Dollars in thousands)	For the years ended December 31,	
	2018	2017
Balance, beginning of year	$ 5,938	$ 6,492
New Loans	778	545
Less loan repayments	779	1,099
Balance, end of year	$ 5,937	$ 5,938

The following table presents at December 31, 2018, 2017 and 2016, loans individually evaluated and considered impaired under FASB ASC 310 "Accounting by Creditors for Impairment of a Loan." Impairment includes performing troubled debt restructurings.

	December 31,		
(Dollars in thousands)	2018	2017	2016
Total loans considered impaired at year end	$4,381	$5,155	$5,819
Loans considered impaired for which there is a related allowance for loan loss:			
Outstanding loan balance	$453	$1,696	$224
Related allowance	$14	$27	$6
Loans considered impaired and previously written down to fair value	$3,928	$3,485	$5,595
Average impaired loans	$4,128	$5,513	$8,727
Amount of interest earned during period of impairment	$160	$132	$112

Note 5—LOANS (Continued)

The following tables are by loan category and present at December 31, 2018, December 31, 2017 and December 31, 2016 loans individually evaluated and considered impaired under FASB ASC 310, "Accounting by Creditors for Impairment of a Loan." Impairment includes performing troubled debt restructurings.

(Dollars in thousands) December 31, 2018	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no allowance recorded:					
Commercial	$ —	$ —	$ —	$ —	$ —
Real estate:					
Construction	—	—	—	—	—
Mortgage-residential	322	371	—	483	9
Mortgage-commercial	3,577	6,173	—	3,232	128
Consumer:					
Home Equity	29	30	—	33	2
Other	—	—	—	—	—
With an allowance recorded:					
Commercial	—	—	—	—	—
Real estate:					
Construction	—	—	—	—	—
Mortgage-residential	—	—	—	—	—
Mortgage-commercial	453	453	14	380	21
Consumer:					
Home Equity	—	—	—	—	—
Other	—	—	—	—	—
Total:					
Commercial	—	—	—	—	—
Real estate:					
Construction	—	—	—	—	—
Mortgage-residential	322	371	—	483	9
Mortgage-commercial	4,030	6,626	14	3,612	149
Consumer:					
Home Equity	29	30	—	33	2
Other	—	—	—	—	—
	$ 4,381	$ 7,027	$ 14	$ 4,128	$ 160

Note 5—LOANS (Continued)

(Dollars in thousands) December 31, 2017	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no allowance recorded:					
Commercial	$ —	$ —	$ —	$ —	$ —
Real estate:					
Construction	—	—	—	—	—
Mortgage-residential	371	437	—	399	—
Mortgage-commercial	3,087	5,966	—	3,420	13
Consumer:					
Home Equity	—	—	—	—	—
Other	—	—	—	—	—
With an allowance recorded:					
Commercial	—	—	—	—	—
Real estate:					
Construction	—	—	—	—	—
Mortgage-residential	42	42	2	43	2
Mortgage-commercial	1,654	2,261	25	1,652	117
Consumer:					
Home Equity	—	—	—	—	—
Other	—	—	—	—	—
Total:					
Commercial	—	—	—	—	—
Real estate:					
Construction	—	—	—	—	—
Mortgage-residential	413	479	2	442	2
Mortgage-commercial	4,742	8,227	25	5,072	130
Consumer:					
Home Equity	—	—	—	—	—
Other	—	—	—	—	—
	$ 5,155	$ 8,706	$ 27	$ 5,513	$ 132

Note 5—LOANS (Continued)

(Dollars in thousands) December 31, 2016	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no allowance recorded:					
Commercial	$ —	$ —	$ —	$ —	$ —
Real estate:					
Construction	—	—	—	—	—
Mortgage-residential	593	603	—	660	—
Mortgage-commercial	4,946	6,821	—	7,777	98
Consumer:					
Home Equity	56	56	—	56	—
Other	—	—	—	—	—
With an allowance recorded:					
Commercial	—	—	—	—	—
Real estate:					
Construction	—	—	—	—	—
Mortgage-residential	46	46	2	48	2
Mortgage-commercial	178	178	4	186	12
Consumer:					
Home Equity	—	—	—	—	—
Other	—	—	—	—	—
Total:					
Commercial	—	—	—	—	—
Real estate:					
Construction	—	—	—	—	—
Mortgage-residential	639	649	2	708	2
Mortgage-commercial	5,124	6,999	4	7,963	110
Consumer:					
Home Equity	56	56	—	56	—
Other	—	—	—	—	—
	$ 5,819	$ 7,704	$ 6	$ 8,727	$ 112

Note 5—LOANS (Continued)

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by 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.

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 December 31, 2018 and December 31, 2017, 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 December 31, 2018 and December 31, 2017, no loans were classified as doubtful.

(Dollars in thousands)

December 31, 2018	Pass	Special Mention	Substandard	Doubtful	Total
Commercial, financial & agricultural	$53,709	$ 224	$ —	$ —	$53,933
Real estate:					
Construction	58,440	—	—	—	58,440
Mortgage – residential	51,286	633	845	—	52,764
Mortgage – commercial	505,493	5,176	3,164	—	513,833
Consumer:					
Home Equity	28,071	1,197	315	—	29,583
Other	9,907	—	2	—	9,909
Total	$706,906	$ 7,230	$ 4,326	$ —	$718,462

(Dollars in thousands)

December 31, 2017	Pass	Special Mention	Substandard	Doubtful	Total
Commercial, financial & agricultural	$50,680	$179	$ 181	$ —	$51,040
Real estate:					
Construction	45,401	—	—	—	45,401
Mortgage – residential	45,343	720	838	—	46,901
Mortgage – commercial	446,531	7,698	6,047	—	460,276
Consumer:					
Home Equity	30,618	1,524	309	—	32,451
Other	10,731	—	5	—	10,736
Total	$629,304	$10,121	$ 7,380	$ —	$646,805

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Note 5—LOANS (Continued)

At December 31, 2018 and 2017, non-accrual loans totaled $2.5 million and $3.3 million, respectively. The gross interest income which would have been recorded under the original terms of the non-accrual loans amounted to $218 thousand and $230 thousand in 2018 and 2017, respectively. Interest recorded on non-accrual loans in 2018 and 2017 amounted to $38 thousand and $8 thousand, respectively.

Troubled debt restructurings ("TDRs") that are still accruing are included in impaired loans at December 31, 2018 and 2017 amounted to $2.0 million and $1.8 million, respectively. Interest earned during 2018 and 2017 on these loans amounted to $132 thousand and $132 thousand, respectively.

There were loans of $31.2 thousand and $32.0 thousand that were greater than 90 days delinquent and still accruing interest as of December 31, 2018 and December 31, 2017, respectively.

The following tables are by loan category and present loans past due and on non-accrual status as of December 31, 2018 and December 31, 2017:

(Dollars in thousands) December 31, 2018	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days and Accruing	Nonaccrual	Total Past Due	Current	Total Loans
Commercial	$ 18	$ 8	$ —	$ —	$ 26	$53,907	$ 53,933
Real estate:							
Construction	—	—	—	—	—	58,440	58,440
Mortgage-residential	110	163	—	284	557	52,207	52,764
Mortgage-commercial	1,302	—	—	2,232	3,534	510.299	513,833
Consumer:							
Home equity	146	11	31	29	217	29,366	29,583
Other	14	55	—	—	69	9,840	9,909
Total	$ 1,590	$ 237	$ 31	$ 2,545	$ 4,403	$714,059	$ 718,462

(Dollars in thousands) December 31, 2017	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days and Accruing	Nonaccrual	Total Past Due	Current	Total Loans
Commercial	$ 26	$ —	$ 32	$ —	$ 58	$50,982	$ 51,040
Real estate:							
Construction	—	—	—	—	—	45,401	45,401
Mortgage-residential	109	38	—	371	518	46,383	46,901
Mortgage-commercial	290	828	—	2,971	4,089	456,187	460,276
Consumer:							
Home equity	805	36	—	—	841	31,610	32,451
Other	1	5	—	—	6	10,730	10,736
Total	$ 1,231	$ 907	$ 32	$ 3,342	$ 5,512	$641,293	$ 646,805

Note 5—LOANS (Continued)

There were no loans determined to be TDR's during the twelve month period ended December 31, 2018. The following table, by loan category, presents loans determined to be TDRs during the twelve month period ended December 31, 2017. There were no loans determined to be TDRs during the twelve month periods ended December 31, 2016.

Troubled Debt Restructurings	For the twelve months ended December 31, 2017		
(Dollars in thousands)	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
TDRs			
Mortgage-Commercial	1	$ 189	$ 189
Total TDRs	1	$ 189	$ 189

During the twelve month period ended December 31, 2017, the Company determined one loan to be a TDR and lowered the rate due to borrower financial hardship.

There were no loans determined to be TDRs in the twelve months ended December 31, 2018, December 31, 2017 and December 31, 2016 that had subsequent payment defaults. Defaulted loans are those loans that are greater than 90 days past due.

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. All non-accrual loans are written down to its corresponding collateral value. All TDR accruing loans where the loan balance 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 Bank will be unable to collect all amounts due including both principal and interest according to the contractual terms of the loan agreement.

Note 5—LOANS (Continued)

Acquired credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality, found in FASB ASC Topic 310-30, (*Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality)*, and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loans. Loans acquired in business combinations with evidence of credit deterioration are considered impaired. Loans acquired through business combinations that do not meet the specific criteria of FASB ASC Topic 310-30, but for which a discount is attributable, at least in part to credit quality, are also accounted for under this guidance. Certain acquired loans, including performing loans and revolving lines of credit (consumer and commercial), are accounted for in accordance with FASB ASC Topic 310-20, where the discount is accreted through earnings based on estimated cash flows over the estimated life of the loan.

A summary of changes in the accretable yield for PCI loans for the years ended December 31, 2018, 2017 and 2016 follows:

(Dollars in thousands)	Year Ended December 31, 2018	Year Ended December 31, 2017	Year Ended December 31, 2016
Accretable yield, beginning of period	$ 21	$ 34	$ 92
Additions	—	10	—
Accretion	(256)	(67)	(170)
Reclassification of nonaccretable difference due to improvement in expected cash flows	284	44	112
Other changes, net	104	—	—
Accretable yield, end of period	$ 153	$ 21	$ 34

At December 31, 2018 and 2017 the recorded investment in purchased impaired loans was $112 thousand and $733 thousand respectively. The unpaid principal balance was $205 thousand and $1.0 million at December 31, 2018 and 2017, respectively. At December 31, 2018 and 2017 these loans were all secured by commercial real estate.

Note 6—FAIR VALUE MEASUREMENT

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 1	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.

Note 6—FAIR VALUE MEASUREMENT (Continued)

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 at December 31, 2018 were measured using an exit price methodology. Prior to adoption of ASU 2016-01, the Company measured fair value using an entry price notion. The entry price notion used a discounted cash flow method to calculate the present future value of expected 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. The exit price uses this methodology but also incorporates other assumptions such as market factors, illiquidity risk and enhanced credit risk. These added assumptions are intended to approximate the fair value that a market participant would realize in a hypothetical orderly transaction. In estimating the fair value, the Company's portfolio is segmented using the six categories in Note 5 – Loans. Loans which are deemed to be impaired are primarily valued on a nonrecurring basis at the fair value of the underlying real estate collateral. Prior to adoption of ASU 2016-01 loans other than impaired loans were classified as a Level 2 measurement, as of December 31, 2018 all loans are classified as a Level 3 measurement.

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.

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

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.

Note 6—FAIR VALUE MEASUREMENT (Continued)

The carrying amount and estimated fair value by classification Level of the Company's financial instruments as of December 31, 2018 and December 31, 2017 are as follows:

	December 31, 2018				
		Fair Value			
(Dollars in thousands)	Carrying Amount	Total	Level 1	Level 2	Level 3
Financial Assets:					
Cash and short term investments	$32,268	$32,268	$32,268	$—	$—
Held-to-maturity securities	16,174	16,184	—	16,184	—
Available-for-sale securities	237,893	237,893	1,642	235,560	691
Other investments, at cost	1,955	1,955	—	—	1,955
Loans held for sale	3,223	3,223	—	3,223	—
Net loans receivable	712,199	697,432	—	693,065	4,367
Accrued interest	3,579	3,579	3,579	—	—
Financial liabilities:					
Non-interest bearing demand	$244,686	$244,686	$—	$244,686	$—
Interest bearing demand deposits and money market accounts	393,473	393,473	—	393,4738	—
Savings	108,368	108,368	—	108,368	—
Time deposits	178,996	177,797	—	177,797	—
Total deposits	925,523	925,849	—	925,849	—
Federal Home Loan Bank Advances	231	231	—	231	—
Short term borrowings	28,022	28,022	—	28,022	—
Junior subordinated debentures	14,964	14,178	—	12,791	—
Accrued interest payable	861	861	861	—	—

Note 6—FAIR VALUE MEASUREMENT (Continued)

	December 31, 2017				
		Fair Value			
(Dollars in thousands)	Carrying Amount	Total	Level 1	Level 2	Level 3
Financial Assets:					
Cash and short term investments	$30,591	$30,591	$30,591	$—	$—
Held-to-maturity securities	17,012	17,220	—	17,220	—
Available-for-sale securities	264,824	264,824	790	264,034	—
Other investments, at cost	2,559	2,559	—	—	2,559
Loans held for sale	5,093	5,093	—	5,093	—
Net loans receivable	641,008	639,489	—	634,361	5,128
Accrued interest	3,489	3,489	3,489	—	—
Financial liabilities:					
Non-interest bearing demand	$226,546	$226,546	$—	$226,546	$—
NOW and money market accounts	364,358	364,358	—	364,358	—
Savings	104,756	104,756	—	104,756	—
Time deposits	192,663	192,186	—	192,186	—
Total deposits	888,323	887,846	—	887,846	—
Federal Home Loan Bank Advances	14,250	14,248	—	14,248	—
Short term borrowings	19,270	19,270	—	19,270	—
Junior subordinated debentures	14,964	15,025	—	15,025	—
Accrued interest payable	562	562	562	—	—