FIRST BANCORP /NC/
Form 10-K
March 14, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2015

Commission File Number 0-15572

FIRST BANCORP

(Exact Name of Registrant as Specified in its Charter)

North Carolina	56-1421916
(State of Incorporation)	(I.R.S. Employer Identification Number)
300 SW Broad Street, Southern Pines, North Carolina	28387
(Address of Principal Executive Offices)	(Zip Code)
Registrant's telephone number, including area code:	(910) 246-2500

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, No Par Value	The Nasdaq Global Select 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 of 1933. [ ] YES [X] NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934. [ ] YES [X] NO

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. [X] YES [ ] NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). [X] YES [ ] NO

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

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

[ ] Large Accelerated Filer [X] Accelerated Filer [ ] Non-Accelerated Filer [ ] Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). [ ] YES [X] NO

The aggregate market value of the Common Stock, no par value, held by non-affiliates of the registrant, based on the closing price of the Common Stock as of June 30, 2015 as reported by The NASDAQ Global Select Market, was approximately $311,995,897.

The number of shares of the registrant's Common Stock outstanding on February 29, 2016 was 19,750,969.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement to be filed pursuant to Regulation 14A are incorporated herein by reference into Part III.

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* Information called for by Part III (Items 10 through 14) is incorporated herein by reference to the Registrant’s definitive Proxy Statement for the 2016 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission on or before April 29, 2016.

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FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 and the Private Securities Litigation Reform Act of 1995, which statements are inherently subject to risks and uncertainties. Forward-looking statements are statements that include projections, predictions, expectations or beliefs about future events or results or otherwise are not statements of historical fact. Further, forward-looking statements are intended to speak only as of the date made. Such statements are often characterized by the use of qualifying words (and their derivatives) such as "expect," "believe," "estimate," "plan," "project," or other statements concerning our opinions o judgment about future events. 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. Factors that could influence the accuracy of such forward-looking statements include, but are not limited to, the financial success or changing strategies of our customers, our level of success in integrating acquisitions, actions of government regulators, the level of market interest rates, and general economic conditions. For additional information about factors that could affect the matters discussed in this paragraph, see the "Risk Factors" section in Item 1A of this report.

PART I

Item 1. Business

General Description

First Bancorp (the "Company") is a bank holding company. Our principal activity is the ownership and operation of First Bank (the "Bank"), a state-chartered bank with its main office in Southern Pines, North Carolina. The Company is also the parent to a series of statutory business trusts organized under the laws of the State of Delaware that were created for the purpose of issuing trust preferred debt securities. Our outstanding debt associated with these trusts was $46.4 million at December 31, 2015 and 2014.

The Company was incorporated in North Carolina on December 8, 1983, as Montgomery Bancorp, for the purpose of acquiring 100% of the outstanding common stock of the Bank through a stock-for-stock exchange. On December 31, 1986, the Company changed its name to First Bancorp to conform its name to the name of the Bank, which had changed its name from Bank of Montgomery to First Bank in 1985.

The Bank was organized in 1934 and began banking operations in 1935 as the Bank of Montgomery, named for the county in which it operated. Until September 2013, the Bank's main office was in Troy, North Carolina, located in the center of Montgomery County. In September 2013, the Company and the Bank moved their main offices approximately 45 miles to Southern Pines, North Carolina, in Moore County. As of December 31, 2015, we conducted business from 88 branches covering a geographical area from Florence, South Carolina to the southeast, to Wilmington, North Carolina to the east, to Kill Devil Hills, North Carolina to the northeast, to Salem, Virginia to the north, to Abingdon, Virginia to the northwest, and to Asheville, North Carolina to the west. We also have loan production offices in Greenville, North Carolina and Charlotte, North Carolina. Of the Bank's 88 branches, 75 branches are in North Carolina, six branches are in South Carolina and seven branches are in Virginia (where we operate under the name "First Bank of Virginia"). Ranked by assets, the Bank was the sixth largest bank headquartered in North Carolina as of December 31, 2015.

As of December 31, 2015, the Bank had two wholly owned subsidiaries, First Bank Insurance Services, Inc. ("First Bank Insurance") and First Troy SPE, LLC. First Bank Insurance's primary business activity is the placement of property and casualty insurance coverage. First Troy SPE, LLC, which was organized in December 2009, is a holding entity for certain foreclosed properties.

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Our principal executive offices are located at 300 SW Broad Street, Southern Pines, North Carolina, 28387, and our telephone number is (910) 246-2500. Unless the context requires otherwise, references to the "Company," "we," "our," or "us" in this annual report on Form 10-K shall mean collectively First Bancorp and its consolidated subsidiaries.

General Business

We engage in a full range of banking activities, with the acceptance of deposits and the making of loans being our most basic activities. We offer deposit products such as checking, savings, and money market accounts, as well as time deposits, including various types of certificates of deposits (CDs) and individual retirement accounts (IRAs). We provide loans for a wide range of consumer and commercial purposes, including loans for business, agriculture, real estate, personal uses, home improvement and automobiles. We also offer credit cards, debit cards, letters of credit, safe deposit box rentals and electronic funds transfer services, including wire transfers. In addition, we offer internet banking, mobile banking, cash management and bank-by-phone capabilities to our customers, and are affiliated with ATM networks that give our customers access to 67,000 ATMs, with no surcharge fee. We also offer a mobile check deposit feature for our mobile banking customers that allows them to securely deposit checks via their smartphone. For our business customers, we offer remote deposit capture, which provides them with a method to electronically transmit checks received from customers into their bank account without having to visit a branch. We are a member of the Certificate of Deposit Account Registry Service (CDARS), which gives our customers the ability to obtain FDIC insurance on deposits of up to $50 million, while continuing to work directly with their local First Bank branch.

Because the majority of our customers are individuals and small to medium-sized businesses located in the counties we serve, management does not believe that the loss of a single customer or group of customers would have a material adverse impact on the Bank. There are no seasonal factors that tend to have any material effect on the Bank's business, and we do not rely on foreign sources of funds or income. Because we operate primarily within North Carolina, southwestern Virginia and northeastern South Carolina, the economic conditions of these areas could have a material impact on the Company. See additional discussion below in the section entitled "Territory Served and Competition."

Beginning in 1999, First Bank Insurance began offering non-FDIC insured investment and insurance products, including mutual funds, annuities, long-term care insurance, life insurance, and company retirement plans, as well as financial planning services (the "investments division"). In May 2001, First Bank Insurance added to its product line when it acquired two insurance agencies that specialized in the placement of property and casualty insurance. In October 2003, the "investments division" of First Bank Insurance became a part of the Bank and the primary activity of First Bank Insurance became the placement of property and casualty insurance products. On January 1, 2016, First Bank Insurance acquired Bankingport, Inc., an insurance agency based in Sanford, North Carolina, which provides First Bank Insurance with economies of scale and a larger platform for leveraging insurance services throughout the First Bank branch network.

First Bancorp Capital Trust II and First Bancorp Capital Trust III were organized in December 2003 for the purpose of issuing $20.6 million in debt securities ($10.3 million was issued from each trust). These borrowings are due on

January 23, 2034 and are also structured as trust preferred capital securities in order to qualify as regulatory capital. These debt securities are callable by the Company at par on any quarterly interest payment date beginning on January 23, 2009. The interest rate on these debt securities adjusts on a quarterly basis at a weighted average rate of three-month LIBOR plus 2.70%.

First Bancorp Capital Trust IV was organized in April 2006 for the purpose of issuing $25.8 million in debt securities. These borrowings are due on June 15, 2036 and are also structured as trust preferred capital

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securities that qualify as regulatory capital. These debt securities are callable by the Company at par on any quarterly interest payment date beginning on June 15, 2011. The interest rate on these debt securities adjusts on a quarterly basis at a rate of three-month LIBOR plus 1.39%.

Territory Served and Competition

Our headquarters are located in Southern Pines, Moore County, North Carolina, where we also have our highest concentration of deposits. At the end of 2015, we served primarily the south central region (sometimes called the Piedmont region), the central mountain region and the eastern coastal region of North Carolina, with additional operations in northeastern South Carolina and southwestern Virginia. The following table presents, for each county where we operated as of December 31, 2015, the number of bank branches operated by the Company within the county, the approximate amount of deposits with the Company in the county as of December 31, 2015, our approximate deposit market share at June 30, 2015, and the number of bank competitors located in the county at June 30, 2015.

County	Number of Branches	Deposits (in millions)	Market Share	Number of Competitors
Anson, NC	1	$ 13	5.3 %	4
Beaufort, NC	2	46	4.8 %	7
Bladen, NC	1	26	9.4 %	5
Brunswick, NC	4	113	6.6 %	11
Buncombe, NC	3	86	1.8 %	16
Cabarrus, NC	2	38	1.9 %	11
Carteret, NC	2	36	3.2 %	8
Chatham, NC	2	64	9.6 %	10
Chesterfield, SC	1	43	12.4%	6
Columbus, NC	2	38	5.0 %	5
Cumberland, NC	1	4	0.0 %	14
Dare, NC	1	20	2.0 %	9
Davidson, NC	2	88	3.2 %	10
Dillon, SC	3	67	24.3%	3
Duplin, NC	3	132	16.7%	6
Florence, SC	2	38	1.6 %	12
Guilford, NC	1	70	0.7 %	20
Harnett, NC	3	106	11.8%	9
Iredell, NC	2	33	1.3 %	20
Lee, NC	3	161	22.5%	9
Montgomery, NC	4	118	39.2%	2
Montgomery, VA	3	66	3.9 %	13
Moore, NC	10	462	25.5%	10
New Hanover, NC	5	143	2.9 %	18
Onslow, NC	2	45	3.9 %	10

Randolph, NC	3	74	4.8 %	12
Richmond, NC	2	42	10.8%	5
Roanoke, VA	1	5	0.4 %	12
Robeson, NC	4	182	19.1%	9
Rockingham, NC	1	25	2.7 %	10
Rowan, NC	1	69	4.4 %	13
Scotland, NC	2	69	21.1%	6
Stanly, NC	4	96	10.5%	6
Wake, NC	2	32	0.1 %	30
Washington, VA	1	19	1.7 %	16
Wythe, VA	2	66	11.5%	11
Brokered & Internet Deposits	-	76		
Total	88	$ 2,811		

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Our branches and facilities are primarily located in small communities whose economies are based primarily on services, manufacturing and light industry. Although our market is predominantly small communities and rural areas, the market area is not dependent on agriculture. Textiles, furniture, mobile homes, electronics, plastic and metal fabrication, forest products, food products, and chicken hatcheries are among the leading manufacturing industries in the trade area. Leading producers of lumber and rugs are located in Montgomery County, North Carolina. The Pinehurst area within Moore County, North Carolina, is a widely known golf resort and retirement area. The High Point, North Carolina, area is widely known for its furniture market. New Hanover and Brunswick Counties, located in the southeastern coastal region of North Carolina, are popular with tourists and have significant retirement populations. Buncombe County, located in the western region of North Carolina, is a highly diverse area with industries in manufacturing, service, and tourism. Additionally, several of the communities served by the Company are “bedroom” communities of large cities like Charlotte, Raleigh and Greensboro, while several branches are located in medium-sized cities such as Albemarle, Asheboro, Fayetteville, Jacksonville, High Point, Southern Pines and Sanford. We also have branches in small communities such as Bennett, Polkton, Vass, and Harmony.

In addition to the branches shown above, in the second half of 2013, we established a loan production office in Greenville, North Carolina, and in the second half of 2015, we established a loan production office in Charlotte, North Carolina. In early 2016, in connection with the hiring of five bankers from a local community bank competitor, we established loan production offices in Greensboro and Raleigh, North Carolina. These are new, yet contiguous, markets to our branch footprint, and are consistent with our recent branch expansion strategy of focusing on larger, higher growth markets.

In March 2016, we announced we had reached an agreement to exchange our seven bank branches located in Virginia for six North Carolina bank branches of a community bank that is headquartered in Virginia, with a similar amount of loans and deposits. Four of the six branches we expect to assume are in Winston-Salem, with the other two branches being in the Charlotte-metro markets of Mooresville and Huntersville. According to the agreement, it is expected that substantially all deposits and certain loans assigned to the branches will transfer. Currently, our branches in Virginia have approximately $150 million in deposits, while the branches we expect to assume have approximately $130 million in deposits. It is estimated that the amount of loans that will be transferred between the two banks will be up to $175 million. We entered Virginia in 2001 with a branch in Wytheville and had grown that presence to a total of seven branches. The distant proximity to our core market and the opportunity to assume what is essentially a banking franchise in markets where we have recently invested in human capital were the primary factors we considered in entering into the exchange agreement.

Approximately 16% of our deposit base is in Moore County. Accordingly, material changes in competition, the economy or population of Moore County could materially impact the Company. No other county comprises more than 10% of our deposit base.

We compete in our various market areas with, among others, several large interstate bank holding companies. These large competitors have substantially greater resources than our Company, including broader geographic markets, higher lending limits and the ability to make greater use of large-scale advertising and promotions. A significant number of interstate banking acquisitions have taken place in the past decade, thus further increasing the size and financial resources of some of our competitors, some of which are among the largest bank holding companies in the nation. In many of our markets, we also compete against smaller, local banks. With interest rates on investment securities at historic lows and banks of all sizes attempting to maximize yields on earning assets, the competition for high-quality loans has become intense. Accordingly, loan rates in our markets are under competitive pressure. The pricing competition for deposits has lessened, but at any given time in many of our markets, there are frequently smaller banks offering higher rates on deposits than we are willing to match. This has resulted in our bank losing the deposits of some price-sensitive customers, which has been primarily responsible for the declines in our time deposit accounts that are discussed below in Management’s Discussion and Analysis of Financial Condition and Results of Operation. Moore County, which as noted above comprises a disproportionate share of our deposits, is a particularly competitive market, with at least ten other financial institutions having a physical presence within the county.

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We compete not only against banking organizations, but also against a wide range of financial service providers, including federally and state-chartered savings and loan institutions, credit unions, investment and brokerage firms and small-loan or consumer finance companies. One of the credit unions in our market area is among the largest in the nation. Competition among financial institutions of all types is virtually unlimited with respect to legal ability and authority to provide most financial services. We also experience competition from internet banks, particularly in the area of time deposits.

Despite the competitive market, we believe we have certain advantages over our competition in the areas we serve. We are large enough to be able to more easily absorb higher costs being experienced in the banking industry, particularly regulatory costs and technology costs, than the smaller banks we compete with. We are also able to originate significantly larger loans than many of our smaller bank competitors. At the same time, we attempt to maintain a banking culture associated with smaller banks – a culture that has a personal and local flavor that appeals to many retail and small business customers. Specifically, we seek to maintain a distinct local identity in each of the communities we serve and we actively sponsor and participate in local civic affairs. Most lending and other customer-related business decisions can be made without the delays often associated with larger institutions. Additionally, employment of local managers and personnel in various offices and low turnover of personnel enable us to establish and maintain long-term relationships with individual and corporate customers.

Lending Policy and Procedures

Conservative lending policies and procedures and appropriate underwriting standards are high priorities of the Bank. Loans are approved under our written loan policy, which provides that lending officers, principally branch managers, have authority to approve loans of various amounts up to $350,000 with lending limits varying depending upon the experience of the lending officer and whether the loan is secured or unsecured. We have seven senior lending officers that have authority to approve secured loans up to $500,000 and each of our three Regional Presidents has authority to approve secured loans up to $1,000,000. Loans up to $3,000,000 are approved by the Bank’s Regional Credit Officers through our Credit Administration Department. The Bank’s Chief Credit Officer has authority to approve loans up to $6,000,000, while the Chief Credit Officer and the Bank’s President have joint authority to approve loans up to $8,000,000. The Bank’s board of directors maintains loan authority up to the Bank’s in-house limit of $25,000,000 and generally approves loans through its Executive Loan Committee. All lending authorities are based on the borrower’s Total Credit Exposure (“TCE”), which is an aggregate of the Bank’s lending relationship to the borrower. TCE is based on the borrower’s total credit exposure with the Bank either directly or indirectly through loan guarantees or other borrowing entities related to the borrower through control or ownership.

The Executive Loan Committee reviews and approves loans that exceed management’s lending authority, loans to executive officers, directors, and their affiliates and, in certain instances, other types of loans. New credit extensions are reviewed daily by our senior management and the Credit Administration Department.

We continually monitor our loan portfolio to identify areas of concern and to enable us to take corrective action. Lending and credit administration officers and the board of directors meet periodically to review past due loans and portfolio quality, while assuring that the Bank is appropriately meeting the credit needs of the communities it serves. Individual lending officers are responsible for monitoring any changes in the financial status of borrowers and pursuing collection of early-stage past due amounts. For certain types of loans that exceed our established parameters of past due status, the Bank’s Asset Resolution Group assumes the management of the loan, and in some cases we engage a third-party firm to assist in collection efforts.

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The Bank has an internal Loan Review Department that conducts on-going and targeted reviews of the Bank's loan portfolio and assesses the Bank's adherence to loan policies, risk grading and accrual policies. Reports are generated for management based on these activities and findings are used to adjust risk grades as deemed appropriate. In addition, these reports are shared with the Company's board of directors. The Loan Review Department also provides training assistance to the Bank's Training and Credit Administration departments.

To further assess the Bank's loan portfolio and as a secondary review of the Bank's Loan Review Department, we also contract with an independent consulting firm to review new loan originations meeting certain criteria, as well as to assign risk grades to existing credits meeting certain thresholds. The consulting firm's observations, comments, and risk grades, including variances with the Bank's risk grades, are shared with the audit committee of the Company's board of directors and are considered by management in setting Bank policy, as well as in evaluating the adequacy of our allowance for loan losses. For additional information, see "Allowance for Loan Losses and Loan Loss Experience" under Item 7 below.

Investment Policy and Procedures

We have adopted an investment policy designed to maximize our income from funds not needed to meet loan demand, in a manner consistent with appropriate liquidity and risk objectives. Pursuant to this policy, we may invest in federal, state and municipal obligations, federal agency obligations, public housing authority bonds, industrial development revenue bonds, Federal Home Loan Bank bonds, Fannie Mae bonds, Government National Mortgage Association bonds, Freddie Mac bonds, Small Business Administration bonds, and, to a limited extent, corporate bonds. We may also invest up to $60 million in time deposits with other financial institutions. Time deposit purchases from any one financial institution exceeding FDIC insurance coverage limits are evaluated as a corporate bond and are subject to the same due diligence requirements as corporate bonds (described below).

In making investment decisions, we do not solely rely on credit ratings to determine the credit-worthiness of an issuer of securities, but we use credit ratings in conjunction with other information when performing due diligence prior to the purchase of a security. Securities that are not rated investment grade will not be purchased. Securities rated below Moody's BAA or Standard and Poor's BBB generally will not be purchased. Securities rated below A are periodically reviewed for credit-worthiness. We may purchase non-rated municipal bonds only if such bonds are in our general market area and we determine these bonds have a credit risk no greater than the minimum ratings referred to above. Industrial development authority bonds, which normally are not rated, are purchased only if they are judged to possess a high degree of credit soundness to assure reasonably prompt sale at a fair value. We are also authorized by our board of directors to invest a portion of our securities portfolio in high quality corporate bonds, with the amount of such bonds not to exceed 15% of the entire securities portfolio. Prior to purchasing a corporate bond, the Company's management performs due diligence on the issuer of the bond, and the purchase is not made unless we believe that the purchase of the bond bears no more risk to the Company than would an unsecured loan to the same company.

Our Chief Investment Officer implements the investment policy, monitors the investment portfolio, recommends portfolio strategies and reports to the Company’s Investment Committee. The Investment Committee generally meets on a quarterly basis to review investment activity and to assess the overall position of the securities portfolio. The Investment Committee compares our securities portfolio with portfolios of other companies of comparable size. In addition, reports of all purchases, sales, issuer calls, net profits or losses and market appreciation or depreciation of the securities portfolio are reviewed by our board of directors. Once a quarter, our interest rate risk exposure is evaluated by our board of directors. Each year, the written investment policy is approved by the board of directors.

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Mergers and Acquisitions

As part of our operations, we have pursued an acquisition strategy over the years to augment our internal growth. We regularly evaluate the potential acquisition of, or merger with, various financial institutions. Our acquisitions have generally fallen into one of three categories - 1) an acquisition of a financial institution or branch thereof within a market in which we operate, 2) an acquisition of a financial institution or branch thereof in a market contiguous or nearly contiguous to a market in which we operate, or 3) an acquisition of a company that has products or services that we do not currently offer. Historically, we have paid for our acquisitions with cash and/or common stock and any operating income or loss has been fully borne by the Company beginning on the closing date of the acquisition.

In 2009, FDIC-assisted acquisitions began to occur frequently as banking regulators closed problem banks. In FDIC-assisted transactions, the acquiring bank often does not pay any consideration for the failed bank, and in some cases receives cash from the FDIC as part of the transaction. In addition, the acquiring bank usually enters into one or more loss share agreements with the FDIC, which affords the acquiring bank significant loss protection. As discussed below, we completed FDIC-assisted transactions in 2009 and 2011.

We believe that we can enhance our earnings by pursuing these types of acquisition opportunities through any combination or all of the following: 1) achieving cost efficiencies, 2) enhancing the acquiree’s earnings or gaining new customers by introducing a more successful banking model with more products and services to the acquiree’s market base, 3) increasing customer satisfaction or gaining new customers by providing more locations for the convenience of customers, and 4) leveraging the customer base by offering new products and services. There is also the possibility, especially in a FDIC-assisted transaction, to record a gain on the acquisition date arising from the difference between the purchase price and the acquisition date fair value of the acquired assets and liabilities.

Since becoming a public company in 1987, we have completed numerous acquisitions in each of the three categories described above. We have completed several whole-bank traditional acquisitions in our existing and contiguous markets; we have purchased numerous bank branches from other banks (both in existing market areas and in contiguous/nearly contiguous markets) and we have acquired several insurance agencies, which has provided us with the ability to offer property and casualty insurance coverage.

In addition to the traditional acquisitions discussed above, in both 2009 and 2011 we acquired the operations of failed banks in FDIC-assisted transactions. On June 19, 2009, we acquired substantially all of the assets and liabilities of Cooperative Bank in a FDIC-assisted transaction. Cooperative Bank operated through twenty-one branches in North Carolina and three branches in South Carolina in the same markets in which the Bank was already operating, as well as in several new, mostly contiguous markets. In connection with the acquisition, the Bank assumed assets with a book value of $959 million, including $829 million in loans and $706 million in deposits. See the Company’s 2009 Annual Report on Form 10-K for more information on this acquisition.

On January 21, 2011, we acquired substantially all of the assets and liabilities of The Bank of Asheville in a FDIC-assisted transaction. The Bank of Asheville operated through five branches in or near Asheville, North Carolina. This market was a new market for the Bank. In connection with the acquisition, the Bank assumed assets with a book value of $190 million, including $154 million in loans and $192 million in deposits. See the Company’s 2011 Annual Report on Form 10-K for more information on this acquisition.

The following paragraphs describe the other acquisitions that we have completed in the past three years.

On March 22, 2013, we completed the purchase of two branches from Four Oaks Bank & Trust Company located in Southern Pines and Rockingham, North Carolina. We acquired $57 million in deposits and $16 million in loans in the acquisition. We purchased the Rockingham branch building, but did not purchase the Southern Pines branch building and instead transferred the acquired accounts to one of the Company's nearby existing branches.

In January 2016, we acquired Bankingport, Inc., an insurance agency based in Sanford, North Carolina. Although not material to the Company's consolidated operations, the acquisition provided us with the opportunity to enhance our product offerings, as well as expand our insurance agency operations into a significant banking market for our Company. Also this acquisition provides us a larger platform for leveraging insurance services throughout our bank branch network.

As noted previously, in March 2016, we announced we had reached an agreement to exchange our seven bank branches located in Virginia for six North Carolina bank branches of a community bank that is headquartered in Virginia, with a similar amount of loans and deposits. Four of the six branches we expect to assume are in Winston-Salem, with the other two branches being in the Charlotte-metro markets of Mooresville and Huntersville. According to the agreement, it is expected that substantially all deposits and certain loans assigned to the branches will transfer. Currently, our branches in Virginia have approximately $150 million in deposits, while the branches we expect to assume have approximately $130 million in deposits. It is estimated that the amount of loans that will be transferred between the two banks will be up to $175 million. We entered Virginia in 2001 with a branch in Wytheville and had grown that presence to a total of seven branches. The distant proximity to our core market and the opportunity to assume what is essentially a banking franchise in markets where we have recently invested in human capital were the primary factors we considered in entering into the exchange agreement.

There are many factors that we consider when evaluating how much to offer for potential acquisition candidates (including FDIC-assisted transactions) with a few of the more significant factors being projected impact on earnings per share, projected impact on capital, and projected impact on book value and tangible book value. Significant assumptions that affect this analysis include the estimated future earnings stream of the acquisition candidate, estimated credit and other losses to be incurred, the amount of cost efficiencies that can be realized, and the interest rate earned/lost on the cash received/paid. In addition to these primary factors, we also consider other factors including (but not limited to) marketplace acquisition statistics, location of the candidate in relation to our expansion strategy, market growth potential, management of the candidate, potential integration issues (including corporate culture), and the size of the acquisition candidate.

We plan to continue to evaluate acquisition opportunities that could potentially benefit the Company and its shareholders. These opportunities may include acquisitions that do not fit the categories discussed above.

For a further discussion of recent acquisition activity, see "Merger and Acquisition Activity" under Item 7 below.

Employees

As of December 31, 2015, we had 783 full-time and 57 part-time employees. We are not a party to any collective bargaining agreements, and we consider our employee relations to be good.

Supervision and Regulation

As a bank holding company, we are subject to supervision, examination and regulation by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") and the North Carolina Office of the Commissioner of Banks (the "Commissioner"). The Bank is subject to supervision and examination by the Federal Reserve Board ("FRB") and the Commissioner. Until April 22, 2015, the Bank was regulated by the Federal Deposit Insurance Corporation ("FDIC"). Effective April 22, 2015, the Bank became a member of the Federal Reserve System, and therefore, the FRB replaced the FDIC as the Bank's primary federal regulator. For additional information, see Note 16 to the consolidated financial statements.

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Supervision and Regulation of the Company

The Company is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended. The Company is also regulated by the Commissioner under the North Carolina Bank Holding Company Act of 1984.

A bank holding company is required to file quarterly reports and other information regarding its business operations and those of its subsidiaries with the Federal Reserve Board ("FRB"). It is also subject to examination by the FRB and is required to obtain FRB approval prior to making certain acquisitions of other institutions or voting securities. The FRB requires the Company to maintain certain levels of capital - see "Capital Resources and Shareholders' Equity" under Item 7 below. The FRB also has the authority to take enforcement action against any bank holding company that commits any unsafe or unsound practice, or violates certain laws, regulations or conditions imposed in writing by the FRB. The FRB generally prohibits a bank holding company from declaring or paying a cash dividend that would impose undue pressure on the capital of subsidiary banks or would be funded only through borrowing or other arrangements which might adversely affect a bank holding company's financial position. Under the FRB policy, a bank holding company is not permitted to continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition.

The Commissioner is empowered to regulate certain acquisitions of North Carolina banks and bank holding companies, issue cease and desist orders for violations of North Carolina banking laws, and promulgate rules necessary to effectuate the purposes of the North Carolina Bank Holding Company Act of 1984.

Regulatory authorities have cease and desist powers over bank holding companies and their nonbank subsidiaries where their actions would constitute a serious threat to the safety, soundness or stability of a subsidiary bank. Those authorities may compel holding companies to invest additional capital into banking subsidiaries upon acquisitions or in the event of significant loan losses or rapid growth of loans or deposits.

The United States Congress and the North Carolina General Assembly have periodically considered and adopted legislation that has impacted the Company.

Supervision and Regulation of the Bank

Federal banking regulations applicable to all depository financial institutions, among other things: (i) provide federal bank regulatory agencies with powers to prevent unsafe and unsound banking practices; (ii) restrict preferential loans by banks to “insiders” of banks; (iii) require banks to keep information on loans to major shareholders and executive officers and (iv) bar certain director and officer interlocks between financial institutions.

As a state-chartered bank, the Bank is subject to the provisions of the North Carolina banking statutes and to regulation by the Commissioner. The Commissioner has a wide range of regulatory authority over the activities and operations of the Bank, and the Commissioner’s staff conducts periodic examinations of the Bank and its affiliates to ensure compliance with state banking regulations and to assess the safety and soundness of the Bank. Among other things, the Commissioner regulates the merger and consolidation of state-chartered banks, the payment of dividends, loans to officers and directors, recordkeeping, types and amounts of loans and investments, and the establishment of branches. The Commissioner also has cease and desist powers over state-chartered banks for violations of state banking laws or regulations and for unsafe or unsound conduct that is likely to jeopardize the interest of depositors.

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The dividends that may be paid by the Bank to the Company are subject to legal limitations under North Carolina law. In addition, under FRB regulations, a dividend cannot be paid by the Bank if it would be less than well-capitalized after the dividend. The FRB may also prevent the payment of a dividend by the Bank if it determines that the payment would be an unsafe and unsound banking practice. The ability of the Company to pay dividends to its shareholders is largely dependent on the dividends paid to the Company by the Bank.

The FRB is authorized to approve conversions, mergers, consolidations and assumptions of deposit liability transactions between insured banks and uninsured banks or institutions, and to prevent capital or surplus diminution in such transactions if the resulting, continuing, or assumed bank is an insured member bank. The FRB also conducts periodic examinations of the Bank to assess its safety and soundness and its compliance with banking laws and regulations, and it has the power to implement changes to, or restrictions on, the Bank's operations if it finds that a violation is occurring or is threatened. In addition, the FRB monitors the Bank's compliance with several banking statutes, such as the Depository Institution Management Interlocks Act and the Community Reinvestment Act of 1977.

Small Business Lending Fund

In December 2010, the U.S. Treasury announced the creation of the Small Business Lending Fund (SBLF) program, which was established under the Small Business Jobs Act of 2010. The SBLF was created to encourage lending to small businesses by providing capital to qualified community banks at favorable rates.

Interested financial institutions were required to submit an application and a small business lending plan. Less than half of the financial institutions that applied for the SBLF were approved. We were one of the institutions approved, and on September 1, 2011, we completed the sale of $63.5 million of Series B Preferred Stock to the Treasury under the SBLF ("SBLF stock"). Under the terms of the stock purchase agreement, the Treasury received 63,500 shares of Series B non-cumulative perpetual preferred stock with a liquidation value of $1,000 per share, in exchange for $63.5 million. The initial dividend rate on SBLF stock was 5%. The terms of the stock provided that our dividend rate could decrease to as low as 1% for a period of time depending on our success in meeting certain loan growth targets to small businesses. Based on our increases in small business lending, we achieved the minimal dividend rate of 1% as of March 31, 2013. The increase in the amount of small business loans remained at a level corresponding to a 1% dividend rate at September 30, 2013, at which point the terms of the preferred stock provided that the dividend rate remained fixed until March 1, 2016. On March 1, 2016, the contractual dividend rate was set to increase to 9%. The Company redeemed $32 million of the SBLF stock in June 2015 and the remaining $31.5 million in October 2015, which ended our participation in the SBLF. See Note 19 to the consolidated financial statements for more information.

FDIC Insurance

As a member of the FDIC, the Bank's deposits are insured by the FDIC up to a maximum amount, which is currently $250,000 per depositor. For this protection, each member bank pays a quarterly statutory assessment (which is based on average total assets less average tangible equity) and is subject to the rules and regulations of the FDIC.

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We recognized approximately $2.4 million, $4.0 million, and $2.8 million in FDIC insurance expense in 2015, 2014, and 2013, respectively. FDIC insurance expense includes deposit insurance assessments and Financing Corporation ("FICO") assessments related to outstanding FICO bonds.

Legislative and Regulatory Developments

The most significant recent legislative and regulatory developments impacting the Company are 1) the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and 2) Basel III, which are discussed below.

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

On July 21, 2010, the Dodd-Frank Act became law. The Dodd-Frank Act has had and will continue to have a broad impact on the financial services industry, including significant regulatory and compliance changes including, among other things,

- enhanced authority over troubled and failing banks and their holding companies;
- increased capital and liquidity requirements;
- increased regulatory examination fees;
- specific provisions designed to improve supervision and safety and soundness by imposing restrictions and limitations on the scope and type of banking and financial activities.

In addition, the Dodd-Frank Act established a new framework for systemic risk oversight within the financial system that will be enforced by new and existing federal regulatory agencies, including the Financial Stability Oversight Council (FSOC), the FRB, the Office of Comptroller of the Currency, the FDIC, and the Consumer Financial Protection Bureau (CFPB). The following description briefly summarizes aspects of the Dodd-Frank Act that could impact the Company, both currently and prospectively.

Deposit Insurance. The Dodd-Frank Act made permanent the $250,000 deposit insurance limit for insured deposits, which was an increase from the previous limit of $100,000. Amendments to the Federal Deposit Insurance Act also revised the assessment base against which an insured depository institution's deposit insurance premiums paid to the FDIC's Deposit Insurance Fund (DIF) will be calculated. Under the amendments, which became effective on April 1, 2011, the FDIC assessment base is no longer the institution's deposit base, but rather its average consolidated total assets less its average tangible equity. The Dodd-Frank Act also changed the minimum designated reserve ratio of the DIF, increasing the minimum from 1.15% to 1.35% of the estimated amount of total insured deposits, and eliminating the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds by September 30, 2020.

Trust Preferred Securities. The Dodd-Frank Act prohibits bank holding companies from including in their regulatory Tier I capital hybrid debt and equity securities issued on or after May 19, 2010. Among the hybrid debt and equity securities included in this prohibition are trust preferred securities, which we have issued in the past in order to raise additional Tier I capital and otherwise improve our regulatory capital ratios. Although we may continue to include our existing trust preferred securities as Tier I capital because they were issued prior to May 18, 2010, the prohibition on the use of these securities as Tier I capital may limit our ability to raise capital in the future.

The Consumer Financial Protection Bureau. The Dodd-Frank Act created a new, independent federal agency called the Consumer Financial Protection Bureau (CFPB), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, the Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act and certain other statutes. The CFPB has examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Depository institutions with less than $10 billion in assets, such as the Bank, are subject to rules promulgated by the CFPB but will continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB will have authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products.

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The Dodd-Frank Act also authorized the CFPB to establish certain minimum standards for the origination of residential mortgages, including a determination of the borrower's ability to repay. 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 and identify whether a loan meets a new definition for a "qualified mortgage," in which case a rebuttable presumption exists that the creditor extending the loan has satisfied the 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; (iii) comply with additional restrictions on mortgage loan originator hiring and compensation; (iv) comply with new disclosure requirements and standards for appraisals and certain financial products; and (v) maintain escrow accounts for higher-priced mortgage loans for a longer period of time. 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.

The Dodd-Frank Act also permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorney generals to enforce compliance with both the state and federal laws and regulations. Compliance with any such new regulations established by the CFPB and/or states could reduce our revenue, increase our cost of operations, and limit our ability to expand into certain products and services.

Debit Card Interchange Fees. The Dodd-Frank Act gave the FRB the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over $10 billion and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer. Effective October 1, 2011, the FRB set new caps on interchange fees at $0.21 per transaction, plus an additional five basis-point charge per transaction to help cover fraud losses. An additional $0.01 per transaction is allowed if certain fraud-monitoring controls are in place. While we are not directly subject to these rules so long as our assets do not exceed $10 billion, our activities as a debit card issuer may nevertheless be indirectly impacted by the change in the applicable debit card market caused by these regulations, which may require us to match any new lower fee structure implemented by larger financial institutions in order to remain competitive in the future. Nevertheless, to date, the Company has not noted any significant indirect negative effects of the interchange fee caps that are applicable to the larger financial institutions.

Increased Capital Standards and Enhanced Supervision. The Dodd-Frank Act required the federal banking agencies to establish minimum leverage and risk-based capital requirements for banks and bank holding companies. These new standards are to be no less strict than existing regulatory capital and leverage standards applicable to insured depository institutions and may, in fact, become higher once the agencies promulgate the new standards. Compliance with heightened capital standards may reduce our ability to generate or originate revenue-producing assets and thereby restrict revenue generation from banking and non-banking operations. See discussion of the new capital requirements established by the federal banking agencies under "Recent Amendments to Regulatory Capital Requirement under Basel III" below.

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Transactions with Affiliates. The Dodd-Frank Act enhances the requirements for certain transactions with affiliates under Section 23A and 23B of the Federal Reserve Act, including an expansion of the definition of “covered transactions,” and an increase in the amount of time for which collateral requirements regarding covered transactions must be maintained.

Transactions with Insiders. The Dodd-Frank Act expands insider transaction limitations through the strengthening of loan restrictions to insiders and the expansion of the types of transactions subject to the various limits, including derivative transactions, repurchase agreements, reverse repurchase agreements and securities lending and borrowing transactions. The Dodd-Frank Act also places restrictions on certain asset sales to and from an insider of an institution, including requirements that such sales be on market terms and, in certain circumstances, receive the approval of the institution’s board of directors.

Enhanced Lending Limits. The Dodd-Frank Act strengthens the existing limits on a depository institution’s credit exposure to one borrower. Federal banking law limits a national bank’s ability to extend credit to one person or group of related persons to an amount that does not exceed certain thresholds. The Dodd-Frank Act expands the scope of these restrictions to include credit exposure arising from derivative transactions, repurchase agreements and securities lending and borrowing transactions. It also will eventually prohibit state-chartered banks, including the Bank, from engaging in derivative transactions unless the state lending limit laws take into account credit exposure to such transactions.

Corporate Governance. The Dodd-Frank Act addresses many corporate governance and executive compensation matters that will affect most U.S. publicly traded companies, including the Company. The Dodd-Frank Act:

- grants shareholders of U.S. publicly traded companies an advisory vote on executive compensation;
- enhances independence requirements for compensation committee members;
- requires companies listed on national securities exchanges to adopt clawback policies for incentive-based compensation plans applicable to executive officers; and
- provides the SEC with authority to adopt proxy access rules that would allow shareholders of publicly traded companies to nominate candidates for election as directors and require such companies to include such nominees in its proxy materials.

The Volcker Rule. Section 619 of the Dodd-Frank Act, known as the “Volcker Rule,” prohibits 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 Securities and Exchange Commission because they have only accredited investors or no more than 100 investors. In December 2013, our primary federal regulator, the FRB, together with other federal banking agencies, the FEDIC, the SEC and the Commodity Futures Trading Commission, finalized a regulation to implement the Volcker Rule. At December 31, 2015, the Company has evaluated our securities portfolio and has determined that we do not hold any covered funds.

Many of the requirements of the Dodd-Frank Act remain subject to implementation over the course of several years. While we do not currently expect the final requirements of the Dodd-Frank Act to have a material adverse impact on the Company, we do expect them to negatively impact our profitability, require changes to certain of our business practices, including limitations on fee income opportunities, and impose more stringent capital, liquidity and leverage requirements upon the Company. These changes may also require us to invest significant management attention and resources to evaluate and make any changes necessary to comply with the new statutory and regulatory requirements.

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Recent Amendments to Regulatory Capital Requirement under Basel III

In July 2013, the federal banking agencies approved amendments to their regulatory capital rules to conform U.S. regulatory capital rules with the international regulatory standards agreed to by the Basel Committee on Banking Supervision in the accord referred to as "Basel III." The revisions establish new higher capital ratio requirements, narrow the definitions of capital, impose new operating restrictions on banking organizations with insufficient capital buffers and increase the risk weighting of certain assets. The new capital requirements apply to all banks, savings associations, bank holding companies with more than $500 million in assets, such as the Company and the Bank, and all savings and loan holding companies regardless of asset size. The rules became effective for institutions with assets over $250 billion and internationally active institutions in January 2014 and became effective for all other institutions in January 2015. The following discussion summarizes the changes we believe are most likely to affect the Company and the Bank.

- *New and Increased Capital Requirements.* The regulations establish a new capital measure called "Common Equity Tier I Capital" consisting of common stock and related surplus, retained earnings, accumulated other comprehensive income and, subject to certain adjustments, minority common equity interests in subsidiaries. Unlike the current rules which exclude unrealized gains and losses on available-for-sale debt securities from regulatory capital, the amended rules generally require accumulated other comprehensive income to flow through to regulatory capital unless a one-time, irrevocable opt-out election is made in the first regulatory reporting period under the new rule. Depository institutions and their holding companies were required to maintain Common Equity Tier I Capital equal to 4.5% of risk-weighted assets starting in 2015.

The regulations also increase the required ratio of Tier I Capital to risk-weighted assets from 4% to 6% effective January 1, 2015. Tier I Capital consists of Common Equity Tier I Capital plus Additional Tier I Capital which includes non-cumulative perpetual preferred stock. Cumulative preferred stock (other than cumulative preferred stock issued to the U.S. Treasury under the TARP Capital Purchase Program or the Small Business Lending Fund) no longer qualifies as Additional Tier I Capital. Trust preferred securities and other non-qualifying capital instruments issued prior to May 19, 2010 by bank and savings and loan holding companies with less than $15 billion in assets as of December 31, 2009, such as the Company, may continue to be included in Tier I Capital, but these instruments will be phased out over 10 years beginning in 2016 for all other banking organizations. These non-qualified capital instruments, however, may be included in Tier II Capital which could also include qualifying subordinated debt.

- *Changes to Prompt Corrective Action Capital Categories.* The Prompt Corrective Action rules, effective January 1, 2015, incorporated the Common Equity Tier I Capital requirement and raised the capital requirements for certain capital categories. In order to be adequately capitalized for purposes of the prompt corrective action rules, a banking organization is now required to have at least an 8% Total Risk-Based Capital Ratio, a 6% Tier I Risk-Based Capital Ratio, a 4.5% Common Equity Tier I Risk Based Capital Ratio and a 4% Tier I Leverage Ratio. To be well capitalized, a banking organization is required to have at least a 10% Total Risk-Based Capital Ratio, an 8% Tier I Risk-Based Capital Ratio, a 6.5% Common Equity Tier I Risk-Based Capital Ratio and a 5% Tier I Leverage Ratio.

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Capital Buffer Requirement. In addition to increased capital requirements, depository institutions and their holding companies will be required to maintain a capital buffer of at least 2.5% of risk-weighted assets over and above the minimum risk-based capital requirements. Institutions that do not maintain the required capital buffer will become subject to progressively more stringent limitations on the percentage of earnings that can be paid out in dividends or used for stock repurchases and on the payment of discretionary bonuses to senior executive management. The capital buffer requirement will be phased in over a four-year period beginning in 2016. The capital buffer requirement effectively raises the minimum required risk-based capital ratios to 7% Common Equity Tier I Capital, 8.5% Tier I Capital and 10.5% Total Capital on a fully phased-in basis. The capital buffer requirement for the Company begins to be phased in beginning January 1, 2016, at 0.625% of risk-weighted assets, increasing each year until fully implemented at 2.5% on January 1, 2019.

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Additional Deductions from Capital. Banking organizations are required to deduct goodwill and certain other intangible assets, net of associated deferred tax liabilities, from Common Equity Tier I Capital. Deferred tax assets arising from temporary timing differences that cannot be realized through net operating loss ("NOL") carrybacks will continue to be deducted. Deferred tax assets that can be realized through NOL carrybacks are now not deducted but will be subject to 100% risk weighting. Defined benefit pension fund assets, net of any associated deferred tax liability, are now deducted from Common Equity Tier I Capital unless the banking organization has unrestricted and unfettered access to such assets. Reciprocal cross-holdings of capital instruments in any other financial institutions are now deducted from capital, not just holdings in other depository institutions. For this purpose, financial institutions are broadly defined to include securities and commodities firms, hedge and private equity funds and non-depository lenders. Banking organizations are now also required to deduct non-significant investments (less than 10% of outstanding stock) in other financial institutions to the extent these exceed 10% of Common Equity Tier I Capital subject to a 15% of Common Equity Tier I Capital cap. Greater than 10% investments must be deducted if they exceed 10% of Common Equity Tier I Capital. If the aggregate amount of certain items excluded from capital deduction due to a 10% threshold exceeds 17.65% of Common Equity Tier I Capital, the excess must be deducted.

Changes in Risk-Weightings. The amended regulations continue to follow the current capital rules which assign a 50% risk-weighting to "qualifying mortgage loans" which generally consist of residential first mortgages with an 80% loan-to-value ratio (or which carry mortgage insurance that reduces the bank's exposure to 80%) that are not more than 90 days past due. All other mortgage loans continue to have a 100% risk weight. The revised regulations apply a 250% risk-weighting to mortgage servicing rights, deferred tax assets that cannot be realized through NOL carrybacks and investments in the capital instruments of other financial institutions that are not deducted from capital. The revised regulations also created a new 150% risk-weighting category for nonaccrual loans and loans that are more than 90 days past due and for "high volatility commercial real estate loans," which are credit facilities for the acquisition, construction or development of real property other than for certain community development projects, agricultural land and one- to four-family residential properties or commercial real projects where: (i) the loan-to-value ratio is not in excess of interagency real estate lending standards; and (ii) the borrower has contributed capital equal to not less than 15% of the real estate's "as completed" value before the loan was made.

The final rules became effective for the Company and the Bank on January 1, 2015.

We believe that both the Company and the Bank would meet all capital adequacy requirements under the fully phased-in final rules.

See "Capital Resources and Shareholders' Equity" under Item 7 below for further discussion of regulatory capital requirements.

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Liquidity Requirements

Historically, the regulation and monitoring of bank and bank holding company liquidity has been addressed as a supervisory matter, without required formulaic measures. Liquidity risk management has become increasingly important since the financial crisis. The Basel III liquidity framework requires banks and bank holding companies to measure their liquidity against specific liquidity tests that, although similar in some respects to liquidity measures historically applied by banks and regulators for management and supervisory purposes, going forward would be required by regulation. One test, referred to as the liquidity coverage ratio ("LCR"), is designed to ensure that the banking entity maintains an adequate level of unencumbered high-quality liquid assets equal to the entity's expected net cash outflow for a 30-day time horizon (or, if greater, 25% of its expected total cash outflow) under an acute liquidity stress scenario. The other test, referred to as the net stable funding ratio ("NSFR"), is designed to promote more medium- and long-term funding of the assets and activities of banking entities over a one-year time horizon. These requirements will incent banking entities to increase their holdings of U.S. Treasury securities and other sovereign debt as a component of assets and increase the use of long-term debt as a funding source.

In September 2014, the federal bank regulators approved final rules implementing the LCR for advanced approaches banking organizations (i.e., banking organizations with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance sheet foreign exposure) and a modified version of the LCR for bank holding companies with at least $50 billion in total consolidated assets that are not advanced approach banking organizations, neither of which would apply to the Company or the Bank. The federal bank regulators have not yet proposed rules to implement the NSFR or addressed the scope of bank organizations to which it will apply.

Financial Privacy and Cybersecurity

The federal banking regulators have adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to non-affiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a non-affiliated third party. These regulations affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. In addition, consumers may also prevent disclosure of certain information among affiliated companies that is assembled or used to determine eligibility for a product or service, such as that shown on consumer credit reports and asset and income information from applications. Consumers also have the option to direct banks and other financial institutions not to share information about transactions and experiences with affiliated companies for the purpose of marketing products or services.

In March 2015, federal regulators issued two related statements regarding cybersecurity. One statement indicates that financial institutions should design multiple layers of security controls to establish lines of defense and to ensure that their risk management processes also address the risk posed by compromised customer credentials, including security measures to reliably authenticate customers accessing Internet-based services of the financial institution. The other statement indicates that a financial institution's management is expected to maintain sufficient business continuity planning processes to ensure the rapid recovery, resumption and maintenance of the institution’s operations after a cyber-attack involving destructive malware. A financial institution is also expected to develop appropriate processes to enable recovery of data and business operations and address rebuilding network capabilities and restoring data if the institution or its critical service providers fall victim to this type of cyber-attack. First Bancorp has multiple Information Security Programs that reflect the requirements of this guidance. If, however, we fail to observe the regulatory guidance in the future, we could be subject to various regulatory sanctions, including financial penalties.

Neither the Company nor the Bank can predict what other legislation might be enacted or what other regulations or assessments might be adopted.

Available Information

We maintain a corporate Internet site at www.LocalFirstBank.com, which contains a link within the “Investor Relations” section of the site to each of our filings with the Securities and Exchange Commission, including our annual reports on Form 10-K, our quarterly reports on Form 10-Q, our 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. These filings are available, free of charge, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. These filings can also be accessed at the Securities and Exchange Commission’s website located at www.sec.gov. Information included on our Internet site is not incorporated by reference into this annual report.

Item 1A. Risk Factors

An investment in our common stock involves certain risks. Before you invest in our common stock, you should be aware that there are various risks, including those described below, which could affect the value of your investment in the future. The trading price of our common stock could decline due to any of these risks, and you may lose all or part of your investment. The risk factors described in this section, as well as any cautionary language in this report, provide examples of risks, uncertainties and events that could have a material adverse effect on our business, including our operating results and financial condition. In addition to the risks and uncertainties described below, other risks and uncertainties not currently known to us, or that we currently deem to be immaterial, also may materially or adversely affect our business, financial condition, and results of operations. The value or market price of our common stock could decline due to any of these identified or other unidentified risks.

Unfavorable economic conditions could adversely affect our business.

Our business is subject to periodic fluctuations based on national, regional and local economic conditions. These fluctuations are not predictable, cannot be controlled, and may have a material adverse impact on our operations and financial condition. Our banking operations are locally oriented and community-based. Our retail and commercial banking activities are primarily concentrated within the same geographic footprint. Our markets include most of North Carolina, the southwest area of Virginia and parts of South Carolina. Worsening economic conditions within our markets could have a material adverse effect on our financial condition, results of operations and cash flows. Accordingly, we expect to continue to be dependent upon local business conditions as well as conditions in the local residential and commercial real estate markets we serve. Unfavorable changes in unemployment, real estate values, interest rates and other factors could weaken the economies of the communities we serve. In recent years, economic growth and business activity across a wide range of industries has been slow and uneven and there can be no assurance that economic conditions will continue to improve, and these conditions could worsen. In addition, oil price volatility, the level of U.S. debt and global economic conditions have had a destabilizing effect on financial markets. Weakness in any of our market areas could have an adverse impact on our earnings, and consequently our financial condition and capital adequacy.

If our goodwill becomes impaired, we may be required to record a significant charge to earnings.

We have goodwill recorded on our balance sheet as an asset with a carrying value as of December 31, 2015 of $65.8 million. Under generally accepted accounting principles, goodwill is required to be tested for impairment at least annually and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The test for goodwill impairment involves comparing the fair value of a company's reporting units to their respective carrying values. For our company, our community banking operation is our only material reporting unit. The price of our common stock is one of several measures available for estimating the fair value of our community banking operations. Although the price of our common stock is currently trading above the book value, for most of the last several years, it has traded below the book value of our company. Subject to the results of other valuation techniques, if this situation were to return and persist, it could indicate that our goodwill is impaired. Accordingly, we may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill is determined, which could have a negative impact on our results of operations.

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New capital rules that were recently issued generally require insured depository institutions and their holding companies to hold more capital. The impact of the new rules on our financial condition and operations is uncertain but could be materially adverse.

In July 2013, the federal banking agencies approved amendments to their regulatory capital rules to conform U.S. regulatory capital rules with the international regulatory standards agreed to by the Basel Committee on Banking Supervision in the accord referred to as "Basel III." The new rules substantially amended the regulatory risk-based capital rules applicable to us. The rules became effective on January 1, 2015 for the Company and the Bank and will be fully phased in by January 1, 2019.

The rules include certain new and higher risk-based capital and leverage requirements than those previously in place. Specifically, the following minimum capital requirements apply to us at December 31, 2015:

- a new common equity Tier 1 risk-based capital ratio of 4.5% (fully phased-in requirement of 7%);
- a Tier 1 risk-based capital ratio of 6% (increased from the former 4% requirement; fully phased-in requirement of 8.5%);
- a total risk-based capital ratio of 8% (unchanged from the former requirement; fully phased-in requirement of 10%); and
- a leverage ratio of 4% (also unchanged from the former requirement).

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, in the current economic and regulatory environment, 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 were to be 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.

We might be required to raise additional capital in the future, but that capital may not be available or may not be available on terms acceptable to us when it is needed.

We are required to maintain adequate capital levels to support our operations. In the future, we might need to raise additional capital to support growth, absorb loan losses, or meet more stringent capital requirements. Our ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside our control, and on our financial performance. Accordingly, we cannot be certain of our ability to raise additional capital in the future if needed or on terms acceptable to us. If we cannot raise additional capital when needed, our ability to conduct our business could be materially impaired.

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The soundness of other financial institutions could adversely affect us.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services companies are interrelated as a result of trading, clearing, counterparty or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, and investment banks. Defaults by, or even rumors or questions about, one or more financial services companies, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. We can make no assurance that any such losses would not materially and adversely affect our business, financial condition or results of operations.

We are subject to extensive regulation, which could have an adverse effect on our operations.

We are subject to extensive regulation and supervision from the North Carolina Commissioner of Banks and the Federal Reserve Board. This regulation and supervision is intended primarily for the protection of the FDIC insurance fund and our depositors and borrowers, rather than for holders of our equity securities. In the past, our business has been materially affected by these regulations. This trend is likely to continue in the future.

Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on operations, the classification of our assets and the determination of the level of allowance for loan losses. Changes in the regulations that apply to us, or changes in our compliance with regulations, could have a material impact on our operations.

Financial reform legislation enacted by the U.S. Congress, and further changes in regulation to which we are exposed, will result in additional new laws and regulations that are expected to increase our costs of operations.

The Dodd-Frank Act has and will continue to significantly change bank regulatory structure and affect lending, deposit, investment, and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies are given significant discretion in drafting and implementing the rules and regulations, and consequently, many of the details and much of the impact of the Dodd-Frank Act may not be known for many months or years. See "Legislative and Regulatory Developments – Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010" above for additional information regarding the Dodd-Frank Act.

The Dodd-Frank Act also created the Consumer Financial Protection Bureau (CFPB) and gave it broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. Additionally, the CFPB has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets.

Proposals for further regulation of the financial services industry are continually being introduced in the United States Congress. The agencies regulating the financial services industry also periodically adopt changes to their regulations. It is possible that additional legislative proposals may be adopted or regulatory changes may be made that would have an adverse effect on our business. In addition, it is expected that such regulatory changes will increase our operating and compliance cost. We can provide no assurance regarding the manner in which new laws and regulations will affect us.

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We are subject to interest rate risk, which could negatively impact earnings.

Net interest income is the most significant component of our earnings. Our net interest income results from the difference between the yields we earn on our interest-earning assets, primarily loans and investments, and the rates that we pay on our interest-bearing liabilities, primarily deposits and borrowings. When interest rates change, the yields we earn on our interest-earning assets and the rates we pay on our interest-bearing liabilities do not necessarily move in tandem with each other because of the difference between their maturities and repricing characteristics. This mismatch can negatively impact net interest income if the margin between yields earned and rates paid narrows. Interest rate environment changes can occur at any time and are affected by many factors that are outside our control, including inflation, recession, unemployment trends, the Federal Reserve’s monetary policy, domestic and international disorder and instability in domestic and foreign financial markets.

Our allowance for loan losses may not be adequate to cover actual losses.

Like all financial institutions, we maintain an allowance for loan losses to provide for probable losses caused by customer loan defaults. The allowance for loan losses may not be adequate to cover actual loan losses, and in this case additional and larger provisions for loan losses would be required to replenish the allowance. Provisions for loan losses are a direct charge against income.

We establish the amount of the allowance for loan losses based on historical loss rates, as well as estimates and assumptions about future events. Because of the extensive use of estimates and assumptions, our actual loan losses could differ, possibly significantly, from our estimate. We believe that our allowance for loan losses is adequate to provide for probable losses, but it is possible that the allowance for loan losses will need to be increased for credit reasons or that regulators will require us to increase this allowance. Either of these occurrences could materially and adversely affect our earnings and profitability.

In addition, the measure of our allowance for loan losses is dependent on the adoption of new accounting standards. The Financial Accounting Standards Board recently issued a proposed Accounting Standards Update that presents a new credit impairment model, the Current Expected Credit Loss ("CECL") model, which would require financial institutions to estimate and develop a provision for credit losses at origination for the lifetime of the loan, as opposed to reserving for probable incurred losses up to the balance sheet date. Under the CECL model, credit deterioration would be reflected in the income statement in the period of origination or acquisition of the loan, with changes in expected credit losses due to further credit deterioration or improvement reflected in the periods in which the expectation changes. Accordingly, the CECL model could require financial institutions like the Bank to increase their allowances for loan losses. Moreover, the CECL model likely would create more volatility in our level of allowance for loan losses.

In the normal course of business, we process large volumes of transactions involving millions of dollars. If our internal controls fail to work as expected, if our systems are used in an unauthorized manner, or if our employees subvert our internal controls, we could experience significant losses.

We process large volumes of transactions on a daily basis and are exposed to numerous types of operational risk. Operational risk includes the risk of fraud by persons inside or outside the Company, the execution of unauthorized transactions by employees, errors relating to transaction processing and systems and breaches of the internal control system and compliance requirements. This risk also includes potential legal actions that could arise as a result of an operational deficiency or as a result of noncompliance with applicable regulatory standards.

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We establish and maintain systems of internal operational controls that provide us with timely and accurate information about our level of operational risk. Although not foolproof, these systems have been designed to manage operational risk at appropriate, cost-effective levels. Procedures exist that are designed to ensure that policies relating to conduct, ethics, and business practices are followed. From time to time, losses from operational risk may occur, including the effects of operational errors. We continually monitor and improve our internal controls, data processing systems, and corporate-wide processes and procedures, but there can be no assurance that future losses will not occur.

We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

The federal Bank Secrecy Act, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (which we refer to as the "Patriot Act") and other laws and regulations require financial institutions, among other duties, to institute and maintain effective anti-money laundering programs and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network, established by the U.S. Treasury Department to administer the Bank Secrecy Act, is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. There is also increased scrutiny of compliance with the rules enforced by the OFAC. Federal and state bank regulators also have begun to focus on compliance with Bank Secrecy Act and anti-money laundering regulations. If our policies, procedures and systems are deemed deficient or the policies, procedures and systems of the financial institutions that we have already acquired or may acquire in the future are deficient, we would be subject to liability, including fines and regulatory actions such as restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans, which would negatively impact our business, financial condition and results of operations. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us.

Federal, state and local consumer lending laws restrict our ability to originate certain mortgage loans and increase our risk of liability with respect to such loans and 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. Over the course of 2013, the CFPB issued several rules on mortgage lending, notably a rule requiring all home mortgage lenders to determine a borrower's ability to repay the loan. 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. 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.

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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 Community Reinvestment Act 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.

Negative public opinion regarding our company and the financial services industry in general, could damage our reputation and adversely impact our earnings.

Reputation risk, or the risk to our business, earnings and capital from negative public opinion regarding our company and the financial services industry in general, is inherent in our business. Negative public opinion can result from 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 have taken steps to minimize reputation risk in dealing with our clients and communities, this risk will always be present given the nature of our business.

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 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 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;

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- 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.

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.

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. 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.

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Our reported financial results are impacted by management's selection of accounting methods and certain assumptions and estimates.

Our accounting policies and methods are fundamental to the way we record and report our financial condition and results of operations. Our management must exercise judgment in selecting and applying many of these accounting policies and methods so they comply with generally accepted accounting principles and reflect management's judgment of the most appropriate manner to report our financial condition and results. In some cases, management must select the accounting policy or method to apply from two or more alternatives, any of which may be reasonable under the circumstances, yet may result in reporting materially different results than would have been reported under a different alternative.

Certain accounting policies are critical to presenting our financial condition and results. They require management to make difficult, subjective or complex judgments about matters that are uncertain. Materially different amounts could be reported under different conditions or using different assumptions or estimates. These critical accounting policies include: the allowance for loan losses; intangible assets; and the fair value and discount accretion of loans acquired in FDIC-assisted transactions.

There can be no assurance that we will continue to pay cash dividends.

Although we have historically paid cash dividends, there is no assurance that we will continue to pay cash dividends. Future payment of cash dividends, if any, will be at the discretion of our board of directors and will be dependent upon our financial condition, results of operations, capital requirements, economic conditions, and such other factors as the board may deem relevant.

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 in The NASDAQ Global Select Market under the symbol FBNC, 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.

Our business continuity plans or data security systems could prove to be inadequate, resulting in a material interruption in, or disruption to, our business and a negative impact on our results of operations.

We rely heavily on communications and information systems to conduct our business. Our daily operations depend on the operational effectiveness of our technology. We rely on our systems to accurately track and record our assets and liabilities. Any failure, interruption or breach in security of our computer systems or outside technology, whether due to severe weather, natural disasters, acts of war or terrorism, criminal activity, cyber-attacks or other factors, could result in failures or disruptions in general ledger, deposit, loan, customer relationship management, and other systems leading to inaccurate financial records. This could materially affect our business operations and financial condition. While we have disaster recovery and other policies and procedures designed to prevent or limit the effect of any 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. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our results of operations.

In addition, the Bank provides its customers the ability to bank online and through mobile banking. The secure transmission of confidential information over the Internet is a critical element of online and mobile banking. While we use qualified third party vendors to test and audit our network, our network could become vulnerable to unauthorized access, computer viruses, phishing schemes and other security issues. The Bank may be required to spend significant capital and other resources to alleviate problems caused by security breaches or computer viruses. To the extent that the Bank's activities or the activities of its customers involve the storage and transmission of confidential information, security breaches and viruses could expose the Bank to claims, litigation, and other potential liabilities. Any inability to prevent security breaches or computer viruses could also cause existing customers to lose confidence in the Bank's systems and could adversely affect its reputation and its ability to generate deposits.

Additionally, we outsource the processing of our core data system, as well as other systems such as online banking, to third party vendors. Prior to establishing an outsourcing relationship, and on an ongoing basis thereafter, management monitors key vendor controls and procedures related to information technology, which includes reviewing reports of service auditor's examinations. If our third party provider encounters difficulties or if we have difficulty in communicating with such third party, it will significantly affect our ability to adequately process and account for customer transactions, which would significantly affect our business operations.

We rely on certain external vendors.

We are reliant upon certain external vendors to provide products and services necessary to maintain our day-to-day operations. Accordingly, our operations are exposed to risk that these vendors will not perform in accordance with applicable contractual arrangements or service level agreements. We maintain a system of policies and procedures designed to monitor vendor risks including, among other things, (i) changes in the vendor's organizational structure, (ii) changes in the vendor's financial condition and (iii) changes in the vendor's support for existing products and services. While we believe these policies and procedures help to mitigate risk, and our vendors are not the sole source of service, the failure of an external vendor to perform in accordance with applicable contractual arrangements or the service level agreements could be disruptive to our operations, which could have a material adverse impact on the our business and its financial condition and results of operations.

Our potential inability to integrate companies we may acquire in the future could expose us to financial, execution, and operational risks that could negatively affect our financial condition and results of operations. Acquisitions may be dilutive to common shareholders and FDIC-assisted transactions have additional compliance risk that other acquisitions do not have.

On occasion, we may engage in a strategic acquisition when we believe there is an opportunity to strengthen and expand our business. In addition, such acquisitions may involve the issuance of stock, which may have a dilutive effect on earnings per share. To fully benefit from such acquisition, however, we must integrate the administrative, financial, sales, lending, collections, and marketing functions of the acquired company. If we are unable to successfully integrate an acquired company, we may not realize the benefits of the acquisition, and our financial results may be negatively affected. A completed acquisition may adversely affect our financial condition and results of operations, including our capital requirements and the accounting treatment of the acquisition. Completed acquisitions may also lead to exposure from potential asset quality issues, losses of key employees or customers, difficulty and expense of integrating operations and systems, and significant unexpected liabilities after the consummation of these acquisitions. In addition, if we were to conclude that the value of an acquired business had decreased and that the related goodwill had been impaired, that conclusion would result in a goodwill impairment charge, which would adversely affect our results of operations.

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We may have opportunities to acquire the assets and liabilities of failed banks in FDIC-assisted transactions. Although these transactions typically provide for FDIC assistance to an acquirer to mitigate certain risks, such as sharing exposure to loan losses and providing indemnification against certain liabilities of the failed institution, we are (and would be in future transactions) subject to many of the same risks we would face in acquiring another bank in a negotiated transaction, including risks associated with maintaining customer relationships and failure to realize the anticipated acquisition benefits in the amounts and within the time frames we expect. In addition, ongoing compliance risk under the loss-share agreement with the FDIC is considerable and the event of noncompliance could result in coverage under the loss-share being disallowed, thus increasing the actual losses to the Bank. Our inability to overcome these risks could have a material adverse effect on our business, financial condition and results of operations.

Our FDIC loss share agreement related to a high risk loan portfolio acquired in a failed-bank acquisition expires on March 31, 2016, and therefore we will bear the full risk of losses for assets currently under that agreement subsequent to that date.

On January 21, 2011, we acquired The Bank of Asheville in a FDIC failed-bank acquisition. As part of the terms of the acquisition, we entered into two loss share agreements with the FDIC – 1) a loss share agreement related to single-family home loans, which has a ten year term, and 2) a loss share agreement for all non-single family loans, which has a five year term. The loss share agreements generally provide us with an 80% reimbursement for all losses incurred and thus they limit our risk. The non-single family loss share agreement related to The Bank of Asheville expires on March 31, 2016. The assets covered by the non-single family portfolio include a high percentage of commercial real estate and land development loans, loan types which experienced high loss rates during the economic downturn.

At December 31, 2015, the carrying value of the assets covered by The Bank of Asheville non-single family loss-share agreement was approximately $18 million in loans, of which $3 million were on nonaccrual status because of collection problems, and $0.3 million in foreclosed properties. Accounting regulations require us to record losses as they occur, and thus we believe that we have recorded all probable losses associated with that portfolio as of each period end. However, the value of the underlying collateral for many of the loans, as well as the foreclosed properties, is volatile and has experienced significant declines in recent years. Beginning April 1, 2016, we will incur 100% of the loss related to further deterioration of The Bank of Asheville non-single family assets.

Our ability to receive benefits under FDIC loss share agreements is subject to compliance with certain requirements, oversight and interpretation, and contractual term limitations.

We receive benefits under loss share agreements with the FDIC in connection with the FDIC-assisted acquisitions of Cooperative Bank in June 2009 and The Bank of Asheville in January 2011. Under these loss share agreements, the FDIC agreed to cover 80% of most loan and foreclosed real estate losses. We are subject to certain obligations under these agreements that prescribe and specify how to manage, service, report, and request reimbursement for losses incurred on covered assets. Our obligations under the loss share agreements are extensive, and failure to comply with any obligations could result in a specific asset, or group of assets, losing loss share coverage. Requests for reimbursement are subject to FDIC review and may be delayed or disallowed if we are not in compliance with our obligations. Losses projected to occur during the loss share term may not be realized until after the expiration of the applicable agreement; consequently, those losses may have a material adverse impact on our results of operations. In addition, we are subject to FDIC audits to ensure compliance with the loss share agreements. The loss share agreements are subject to interpretation by us and the FDIC; therefore, disagreements may arise regarding the coverage of losses, expenses, and contingencies.

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Item 1B. Unresolved Staff Comments

None

Item 2. Properties

The main offices of the Company and the Bank are owned by the Bank and are located in a three-story building in the central business district of Southern Pines, North Carolina. The building houses administrative facilities. The Bank's Operations Division, including customer accounting functions, offices for information technology operations, and offices for loan operations, are housed in two one-story steel frame buildings in Troy, North Carolina. Both of these buildings are owned by the Bank. The Company operates 88 bank branches. The Company owns all of its bank branch premises except 10 branch offices for which the land and buildings are leased and eight branch offices for which the land is leased but the building is owned. The Company also leases two loan production offices. There are no options to purchase or lease additional properties. The Company considers its facilities adequate to meet current needs and believes that lease renewals or replacement properties can be acquired as necessary to meet future needs.

Item 3. Legal Proceedings

Various legal proceedings may arise in the ordinary course of business and may be pending or threatened against the Company and its subsidiaries. Neither the Company nor any of its subsidiaries is involved in any pending legal proceedings that management believes are material to the Company or its consolidated financial position. If an exposure were to be identified, it is the Company's policy to establish and accrue appropriate reserves during the accounting period in which a loss is deemed to be probable and the amount is determinable.

There were no tax shelter penalties assessed by the Internal Revenue Service against the Company during the year ended December 31, 2015.

Item 4. Mine Safety Disclosure

Not applicable.

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PART II

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

Our common stock trades on The NASDAQ Global Select Market under the symbol FBNC. Table 22, included in "Management's Discussion and Analysis" below, sets forth the high and low market prices of our common stock as traded by the brokerage firms that maintain a market in our common stock and the dividends declared for the periods indicated. We paid a cash dividend of $0.08 per share for each quarter of 2015. For the foreseeable future, it is our current intention to continue to pay regular cash dividends on a quarterly basis. See "Business - Supervision and Regulation" above and Note 16 to the consolidated financial statements for a discussion of other regulatory restrictions on the Company's payment of dividends. As of December 31, 2015, there were approximately 2,300 shareholders of record and another 3,100 shareholders whose stock is held in "street name."

There were no sales of unregistered securities during the year ended December 31, 2015.

Additional Information Regarding the Registrant's Equity Compensation Plans

At December 31, 2015, the Company had three equity-based compensation plans. The Company's 2014 Equity Plan is the only one of three plans under which new grants of equity-based awards are possible.

The following table presents information as of December 31, 2015 regarding shares of the Company's stock that may be issued pursuant to the Company's equity based compensation plans. At December 31, 2015, the Company had no warrants or stock appreciation rights outstanding under any compensation plans.

	As of December 31, 2015		
	(a)	(b)	(c)
Plan category	Number of securities to be issued	Weighted-average exercise price of outstanding options, warrants and	Number of securities available for future issuance under equity compensation plans (excluding

	upon exercise of outstanding options, warrants and rights	rights	securities reflected in column (a))
Equity compensation plans approved by security holders (1)	117,408	$ 18.12	919,659
Equity compensation plans not approved by security holders	—	—	—
Total	117,408	$ 18.12	919,659

(1) Consists of (A) the Company's 2014 Equity Plan, which is currently in effect; (B) the Company's 2007 Equity Plan; and (C) the Company's 2004 Stock Option Plan, each of which was approved by our shareholders.

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Performance Graph

The performance graph shown below compares the Company’s cumulative total return to shareholders for the five-year period commencing December 31, 2010 and ending December 31, 2015, with the cumulative total return of the Russell 2000 Index (reflecting overall stock market performance of small-capitalization companies), and an index of banks with between $1 billion and $5 billion in assets, as constructed by SNL Securities, LP (reflecting changes in banking industry stocks). The graph and table assume that $100 was invested on December 31, 2010 in each of the Company’s common stock, the Russell 2000 Index, and the SNL Bank Index, and that all dividends were reinvested.

First Bancorp

Comparison of Five-Year Total Return Performances (1)

Five Years Ending December 31, 2015

	Total Return Index Values (1)					
	December 31,					
	2010	2011	2012	2013	2014	2015
First Bancorp	$100.00	74.98	88.77	117.63	133.07	137.48
Russell 2000	100.00	95.82	111.49	154.78	162.35	155.18
SNL Index-Banks between $1 billion and $5 billion	100.00	91.20	112.45	163.52	170.98	191.39

Notes:

(1) Total return indices were provided from an independent source, SNL Securities LP, Charlottesville, Virginia, and assume initial investment of $100 on December 31, 2010, reinvestment of dividends, and changes in market values. Total return index numerical values used in this example are for illustrative purposes only.

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Issuer Purchases of Equity Securities

Pursuant to authorizations by the Company's board of directors, the Company has from time to time repurchased shares of common stock in private transactions and in open-market purchases. The most recent board authorization was announced on July 30, 2004 and authorized the repurchase of 375,000 shares of the Company's stock. The Company did not repurchase any shares of its common stock during the quarter ended December 31, 2015.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased (2)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs (1)
Month #1 (October 1, 2015 to October 31, 2015)	—	$ —	—	214,241
Month #2 (November 1, 2015 to November 30, 2015)	—	—	—	214,241
Month #3 (December 1, 2015 to December 31, 2015)	—	—	—	214,241
Total	—	$ —	—	214,241

Footnotes to the Above Table

(1) All shares available for repurchase are pursuant to publicly announced share repurchase authorizations. On July 30, 2004, the Company announced that its board of directors had approved the repurchase of 375,000 shares of the Company's common stock. The repurchase authorization does not have an expiration date. There are no plans or programs the Company has determined to terminate prior to expiration, or under which the Company does not intend to make further purchases.

(2) The table above does not include shares that were used by option holders to satisfy the exercise price of the call options issued by the Company to its employees and directors pursuant to the Company's stock option plans. There were no such exercises during the three months ended December 31, 2015.

Item 6. Selected Consolidated Financial Data

Table 1 on page 75 of this report sets forth the selected consolidated financial data for the Company.

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

Management’s Discussion and Analysis is intended to assist readers in understanding our results of operations and changes in financial position for the past three years. This review should be read in conjunction with the consolidated financial statements and accompanying notes beginning on page 94 of this report and the supplemental financial data contained in Tables 1 through 22 included with this discussion and analysis.

Overview - 2015 Compared to 2014

We reported net income per diluted common share of $1.30 in 2015, a 9.2% increase compared to 2014. The increased earnings were primarily due to lower provisions for loan losses. Total assets increased by 4.5% year over year.

Financial Highlights *($ in thousands except per share data)*	2015	2014	Change
Earnings			
Net interest income	$119,747	131,609	-9.0 %
Provision for loan losses - non-covered	2,008	7,087	-71.7%
Provision (reversal) for loan losses - covered	(2,788)	3,108	n/m
Noninterest income	18,764	14,368	30.6 %
Noninterest expenses	98,131	97,251	0.9 %
Income before income taxes	41,160	38,531	6.8 %
Income tax expense	14,126	13,535	4.4 %
Net income	27,034	24,996	8.2 %
Preferred stock dividends	(603)	(868)	
Net income available to common shareholders	$26,431	24,128	9.5 %
Net income per common share			
Basic	$1.34	1.22	9.8 %
Diluted	1.30	1.19	9.2 %
Balances At Year End			
Assets	$3,362,065	3,218,383	4.5 %
Loans	2,518,926	2,396,174	5.1 %
Deposits	2,811,285	2,695,906	4.3 %
Ratios			
Return on average assets	0.82 %	0.75 %	
Return on average common equity	8.04 %	7.73 %	
Net interest margin (taxable-equivalent)	4.13 %	4.58 %	

n/m – not meaningful

The following is a more detailed discussion of our results for 2015 compared to 2014:

For the year ended December 31, 2015, we reported net income available to common shareholders of $26.4 million, or $1.30 per diluted common share, an increase of 9.5% compared to the $24.1 million, or $1.19 per diluted common share, for the year ended December 31, 2014. The higher earnings were primarily the result of lower provisions for loan losses.

Net interest income for the year ended December 31, 2015 amounted to $119.7 million, a 9.0% decrease from the $131.6 million recorded in 2014. The lower net interest income in 2015 was primarily due to a decrease in the amount of discount accretion recorded on loans purchased in failed bank acquisitions. For the full year of 2015, loan discount accretion amounted to $4.8 million compared to $16.0 million for 2014. The lower amount of accretion is due to the continued winding down of the unaccreted discount amount that resulted from failed-bank acquisitions in 2009 and 2011. As discussed below, the impact of the changes in discount accretion on pretax income is generally 20% of the gross amount of the change. Also, see the section entitled "Net Interest Income" for additional information.

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Our net interest margin (tax-equivalent net interest income divided by average earning assets) was 4.13% for 2015 compared to 4.58% for 2014. The lower margin in 2015 compared to 2014 was primarily due to lower amounts of discount accretion on loans purchased in failed-bank acquisitions. Partially offsetting the effects of lower discount accretion was a decline in our cost of funds, which declined from 0.29% in 2014 to 0.24% in 2015.

We recorded negative total provisions for loan losses (reduction of the allowance for loan losses) on our covered and non-covered loans of $0.8 million in 2015 compared to provision for loan losses of $10.2 million for 2014 – see discussion of the term “covered” below. The provision for loan losses on non-covered loans amounted to $2.0 million in 2015 compared to $7.1 million for 2014. The lower provision recorded in 2015 was primarily a result of continued favorable credit quality trends and generally improving economic trends. For the year ended December 31, 2015, we recorded a negative provision for loan losses on covered loans of $2.8 million compared to a $3.1 million provision for loan losses in 2014. The negative provision in 2015 primarily resulted from lower levels of covered nonperforming loans, declining levels of total covered loans, and net loan recoveries (recoveries, net of charge-offs) of $2.3 million that were realized during the year ended December 31, 2015.

Our non-covered nonperforming assets declined 19.0% during 2015, amounting to $77.2 million at December 31, 2015 (2.37% of total non-covered assets) compared to $95.3 million at December 31, 2014 (3.09% of total non-covered assets). The decline in non-covered nonperforming assets is primarily due to on-going resolution of nonperforming assets and improving credit quality.

Total covered nonperforming assets also declined in 2015, amounting to $12.1 million at December 31, 2015 compared to $18.7 million at December 31, 2014. We continue to have success resolving our covered loans, and property sales along the North Carolina coast remain strong, which is where most of the Company’s covered assets are located.

For the year ended December 31, 2015, noninterest income amounted to $18.8 million compared to $14.4 million for the year ended December 31, 2014. The increase in 2015 was primarily the result of lower FDIC indemnification asset expense, which is recorded as a reduction to noninterest income. FDIC indemnification asset expense amounted to $8.6 million in 2015, a $4.2 million decrease from the $12.8 million recorded in 2014, with the lower expense being due to a lower amount of write-offs of the FDIC indemnification asset, which is associated with the continued winding down of our loss share assets.

Noninterest expenses for the year ended December 31, 2015 amounted to $98.1 million, which was relatively unchanged from the $97.3 million recorded in 2014.

Total assets at December 31, 2015 amounted to $3.4 billion, a 4.5% increase from a year earlier. Total loans at December 31, 2015 amounted to $2.5 billion, a 5.1% increase from a year earlier, and total deposits amounted to $2.8

billion at December 31, 2015, a 4.3% increase from a year earlier.

Non-covered loans amounted to $2.42 billion at December 31, 2015, an increase of $147.7 million, or 6.5% from December 31, 2014, as a result of ongoing internal initiatives to drive loan growth. Loans covered by FDIC loss share agreements declined 19.6% in 2015 as those loans continued to pay down.

The increase in total deposits at December 31, 2015 compared to December 31, 2014 was primarily due to increases in checking, money market and savings accounts, which increased in total by $236.5 million, or 12.6%, during 2015. Those increases were partially offset by decreases in time deposits, which declined a total of $121.1 million, or 14.7%, during 2015. Time deposits are generally one of our most expensive funding sources, and thus the shift from this category has reduced our overall cost of funds.

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On June 25, 2015, we redeemed $32 million (32,000 shares) of the outstanding Non-Cumulative Perpetual Preferred Stock, Series B ("SBLF Stock") that had been issued to the United States Secretary of the Treasury in September 2011 related to our participation in the Small Business Lending Fund. On October 16, 2015, the remaining $31.5 million of SBLF Stock was redeemed, which ended our participation in the Small Business Lending Fund.

We note that our results of operation discussed above are significantly affected by the on-going accounting for two FDIC-assisted failed bank acquisitions. In the discussion in this document, the term "covered" is used to describe assets included as part of FDIC loss share agreements, which generally result in the FDIC reimbursing the Company for 80% of losses incurred on those assets. The term "non-covered" refers to our legacy assets, which are not included in any type of loss share arrangement.

For covered loans that deteriorate in terms of repayment expectations, we record immediate allowances through the provision for loan losses. For covered loans that experience favorable changes in credit quality compared to what was expected at the acquisition date, including loans that payoff, we record positive adjustments to interest income over the life of the respective loan – also referred to as loan discount accretion. For covered foreclosed properties that are sold at gains or losses or that are written down to lower values, we record the gains/losses within noninterest income.

The adjustments discussed above are recorded within the income statement line items noted without consideration of the FDIC loss share agreements. Because favorable changes in covered assets result in lower expected FDIC claims, and unfavorable changes in covered assets result in higher expected FDIC claims, the FDIC indemnification asset is adjusted to reflect those expectations. The net increase or decrease in the indemnification asset is reflected within noninterest income.

The adjustments noted above can result in volatility within individual income statement line items. Because of the FDIC loss share agreements and the associated indemnification asset, pretax income resulting from amounts recorded as provisions for loan losses on covered loans, discount accretion, and losses from covered foreclosed properties is generally only impacted by 20% of these amounts due to the corresponding adjustments made to the indemnification asset.

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Overview - 2014 Compared to 2013

We reported net income per diluted common share of $1.19 in 2014, a 21.4% increase compared to 2013. The increased earnings were primarily due to lower provisions for loan losses. Total assets increased by 1% year over year.

Financial Highlights *($ in thousands except per share data)*	2014	2013	Change
Earnings			
Net interest income	$131,609	136,526	-3.6%
Provision for loan losses - non-covered	7,087	18,266	-61.2%
Provision for loan losses - covered	3,108	12,350	-74.8%
Noninterest income	14,368	23,489	-38.8%
Noninterest expenses	97,251	96,619	0.7%
Income before income taxes	38,531	32,780	17.5%
Income tax expense	13,535	12,081	12.0%
Net income	24,996	20,699	20.8%
Preferred stock dividends	(868)	(895)	
Net income available to common shareholders	$24,128	19,804	21.8%
Net income per common share			
Basic	$1.22	1.01	20.8%
Diluted	1.19	0.98	21.4%
Balances At Year End			
Assets	$3,218,383	3,185,070	1.0%
Loans	2,396,174	2,463,194	-2.7%
Deposits	2,695,906	2,751,019	-2.0%
Ratios			
Return on average assets	0.75%	0.62%	
Return on average common equity	7.73%	6.78%	
Net interest margin (taxable-equivalent)	4.58%	4.92%	

The following is a more detailed discussion of our results for 2014 compared to 2013:

For the year ended December 31, 2014, we reported net income available to common shareholders of $24.1 million, or $1.19 per diluted common share, an increase of 21.8% compared to the $19.8 million, or $0.98 per diluted common share, for the year ended December 31, 2013. The higher earnings were primarily the result of lower provisions for loan losses.

Net interest income for the year ended December 31, 2014 amounted to $131.6 million, a 3.6% decrease from the $136.5 million recorded in 2013. The lower net interest income in 2014 was primarily due to a decrease in the amount of discount accretion on loans purchased in failed bank acquisitions. Loan discount accretion amounted to $16.0 million in 2014 compared to $20.2 million in 2013, a decrease of $4.2 million. The impact of the changes in discount accretion on pretax income is generally 20% of the gross amount of the change.

Our net interest margin (tax-equivalent net interest income divided by average earning assets) was 4.58% for 2014 compared to 4.92% for 2013. The lower margin realized in 2014 was primarily due to lower amounts of discount accretion on loans purchased in failed-bank acquisitions and lower average asset yields. Partially offsetting the effects of lower discount accretion and lower average asset yields was a decline in our cost of funds, which declined from 0.39% in 2013 to 0.29% in 2014.

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We recorded total provisions for loan losses on our covered and non-covered loans of $10.2 million in 2014 compared to $30.6 million for 2013. The provision for loan losses on non-covered loans amounted to $7.1 million in 2014 compared to $18.3 million for 2013. The lower provision recorded in 2014 was primarily a result of stable asset quality trends and a decline in non-covered loan balances (excluding the transfer of $39.7 million in loans from covered status to non-covered status on July 1, 2014 – see discussion below). For the year ended December 31, 2014, the provision for loan losses on covered loans amounted to $3.1 million compared to $12.4 million for 2013. The decrease in 2014 was primarily due to lower levels of covered nonperforming loans during the period and stabilization in the underlying collateral values of nonperforming loans.

Our non-covered nonperforming assets amounted to $95.3 million at December 31, 2014 (3.09% of total non-covered assets) compared to $82.0 million at December 31, 2013 (2.78% of total non-covered assets). The increase in 2014 was due to the Company transferring $14.8 million in nonperforming assets from covered status to non-covered status on July 1, 2014 upon the scheduled expiration of a loss sharing agreement with the FDIC associated with those assets – see discussion below.

Total covered nonperforming assets have declined in the past year, amounting to $18.7 million at December 31, 2014 compared to $70.6 million at December 31, 2013. During 2014 we resolved a significant amount of covered loans and experienced strong property sales along the North Carolina coast, which is where most of our covered assets are located. Also, as discussed in the preceding paragraph, on July 1, 2014 the Company transferred $14.8 million in nonperforming assets from covered status to non-covered status upon the expiration of a loss sharing agreement.

For the year ended December 31, 2014, noninterest income amounted to $14.4 million compared to $23.5 million for 2013. The decrease in 2014 was primarily the result of higher FDIC indemnification asset expense, which is recorded as a reduction to noninterest income. FDIC indemnification expense amounted to $12.8 million in 2014, an increase from $6.8 million in 2013, with the higher expense being primarily the result of write-offs of the FDIC indemnification asset due to lower expected FDIC reimbursements resulting from lower expectations of loss claims. Also contributing to lower noninterest income in 2014 were higher levels of foreclosed property losses compared to 2013.

Noninterest expenses for the year ended December 31, 2014 amounted to $97.3 million, which was relatively unchanged from the $96.6 million recorded in 2013.

Total assets at December 31, 2014 amounted to $3.2 billion, a 1.0% increase from a year earlier. Total loans at December 31, 2014 amounted to $2.4 billion, a 2.7% decrease from a year earlier, and total deposits amounted to $2.7 billion at December 31, 2014, a 2.0% decrease from a year earlier.

Investment securities totaled $342.7 million at December 31, 2014 compared to $227.0 million at December 31, 2013. In the fourth quarter of 2014, the Company used a portion of its excess cash balances to purchase approximately $125 million in investment securities in order to earn higher yields.

Non-covered loans amounted to $2.3 billion at December 31, 2014, an increase of $15.7 million from December 31, 2013. The increase was due to the reclassification of $39.7 million in loans from covered status to non-covered status in connection with the July 1, 2014 expiration of a loss sharing agreement – see discussion below. Loan growth was impacted by a relatively slow economic recovery in many of our market areas, as well as temporary pressures from new internal loan processes designed to enhance loan quality. Covered loans declined by $82.7 million in 2014 due to the continued resolution of this portfolio and due to the reclassification discussed above.

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The lower amount of deposits at December 31, 2014 compared to December 31, 2013 was primarily due to declines in time deposits, with increases in checking accounts offsetting a large portion of the decline.

Other noteworthy events occurring in 2014 were:

- As noted above, a loss-sharing agreement with the FDIC covering non-single family loans and foreclosed properties that were assumed in a failed bank acquisition in 2009 expired on July 1, 2014. We bear all future losses on these assets; however, at present, management does not expect such losses will be materially in excess of related loan loss allowances. The following presents information related to these assets as of July 1, 2014, which were transferred to the "non-covered" categories on that date.

o Loans outstanding:	39.7 million
o Nonaccrual loans:	$9.7 million
o Troubled debt restructurings - accruing:	$2.1 million
o Allowance for loan losses:	$1.7 million
o Foreclosed properties:	$3.0 million

We continue to have three loss-sharing agreements with the FDIC in place. The next agreement that expires does so on April 1, 2016.

- In December 2014, we completed the planned closure and consolidation of nine of our branches. All branches were consolidated with other branches near the closing location. We recorded approximately $1.0 million in expense related to the branch consolidations.

Outlook for 2016

The interest rate environment remains challenging. Historically, the interest rates we charge loan customers are correlated with long-term interest rates in the marketplace. While the Federal Reserve increased short-term interest rates by 25 basis points in late 2015, long-term interest rates remain at historic lows. Additionally, interest rates on loans continue to be impacted downward by intense competition, and we expect continued declines in our loan discount accretion as our covered loan portfolios continue to wind down. Accordingly, we expect our overall loan yield to continue to decline. As it relates to our funding costs, the yields on many of our deposits are already very low and the ability to lower them further is limited. Accordingly, we believe that a continued compression of our net interest margin is likely.

With three consecutive years of significantly improved trends of nonperforming assets and lower loan charge-offs compared to the recession years, we recorded low levels of provisions for loan losses in 2015, which brought our overall allowance for loan loss level down to a more normalized level following the elevated amounts we maintained during and immediately following the recession. In 2016, we expect it is likely that we will record a higher provision for loan losses than we did in 2015, as we provide for on-going loan charge-offs and expected new loan growth.

Our local economies are generally improving, and we experienced solid loan and deposit growth in 2015. Additionally, over the past twelve months we have hired a number of experienced bankers who have brought us business, and we expect they will continue to do so. Accordingly, we expect to experience continued loan and deposit growth in 2016.

In late 2015 and early 2016, we began implementing plans to grow in larger and higher growth markets in North Carolina. It is likely the expected benefit to revenue and earnings will lag the initial and ongoing expense outlay as we develop business. However, we believe we will achieve growth in these new markets that will benefit our company in a long-term horizon.

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Consistent with the plan noted above and as previously discussed, in March 2016, we announced an agreement to exchange bank branches with another community bank that will result in our assumption of six bank branches in the Winston-Salem and Charlotte-metro markets of North Carolina, in return for our seven branches in southwestern Virginia.

Critical Accounting Policies

The accounting principles we follow and our methods of applying these principles conform with accounting principles generally accepted in the United States of America and with general practices followed by the banking industry. Certain of these principles involve a significant amount of judgment and may involve the use of estimates based on our best assumptions at the time of the estimation. The allowance for loan losses, intangible assets, and the fair value and discount accretion of loans acquired in FDIC-assisted transactions

are three policies we have identified as being more sensitive in terms of judgments and estimates, taking into account their overall potential impact to our consolidated financial statements.

Allowance for Loan Losses

Due to the estimation process and the potential materiality of the amounts involved, we have identified the accounting for the allowance for loan losses and the related provision for loan losses as an accounting policy critical to our consolidated financial statements. The provision for loan losses charged to operations is an amount sufficient to bring the allowance for loan losses to an estimated balance considered adequate to absorb losses inherent in the portfolio.

Our determination of the adequacy of the allowance is based primarily on a mathematical model that estimates the appropriate allowance for loan losses. This model has two components. The first component involves the estimation of losses on individually evaluated "impaired loans". A loan is considered to be impaired when, based on current information and events, it is probable we will be unable to collect all amounts due according to the contractual terms of the loan agreement. A loan is specifically evaluated for an appropriate valuation allowance if the loan balance is above a prescribed evaluation threshold (which varies based on credit quality, accruing status, troubled debt restructured status, and type of collateral) and the loan is determined to be impaired. The estimated valuation allowance is the difference, if any, between the loan balance outstanding and the value of the impaired loan as determined by either 1) an estimate of the cash flows that we expect to receive from the borrower discounted at the loan's effective rate, or 2) in the case of a collateral-dependent loan, the fair value of the collateral.

The second component of the allowance model is an estimate of losses for all loans not considered to be impaired loans ("general reserve loans"). General reserve loans are segregated into pools by loan type and risk grade and estimated loss percentages are assigned to each loan pool based on historical losses. The historical loss percentage is then adjusted for any environmental factors used to reflect changes in the collectability of the portfolio not captured by historical data.

The reserves estimated for individually evaluated impaired loans are then added to the reserve estimated for general reserve loans. This becomes our “allocated allowance.” The allocated allowance is compared to the actual allowance for loan losses recorded on our books and any adjustment necessary for the recorded allowance to absorb losses inherent in the portfolio is recorded as a provision for loan losses. The provision for loan losses is a direct charge to earnings in the period recorded. Any remaining difference between the allocated allowance and the actual allowance for loan losses recorded on our books is our “unallocated allowance.”

Loans covered under loss share agreements (referred to as "covered loans") are recorded at fair value at acquisition date. Therefore, amounts deemed uncollectible at acquisition date become a part of the fair value calculation and are excluded from the allowance for loan losses. Subsequent decreases in the amount expected to be collected result in a provision for loan losses with a corresponding increase in the allowance for loan losses. Subsequent increases in the amount expected to be collected are accreted into income over the life of the loan. Proportional adjustments are also recorded to the FDIC indemnification asset.

Although we use the best information available to make evaluations, future material adjustments may be necessary if economic, operational, or other conditions change. In addition, various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses. Such agencies may require us to recognize additions to the allowance based on the examiners' judgment about information available to them at the time of their examinations.

For further discussion, see "Nonperforming Assets" and "Summary of Loan Loss Experience" below.

Intangible Assets

Due to the estimation process and the potential materiality of the amounts involved, we have also identified the accounting for intangible assets as an accounting policy critical to our consolidated financial statements.

When we complete an acquisition transaction, the excess of the purchase price over the amount by which the fair market value of assets acquired exceeds the fair market value of liabilities assumed represents an intangible asset. We must then determine the identifiable portions of the intangible asset, with any remaining amount classified as goodwill. Identifiable intangible assets associated with these acquisitions are generally amortized over the estimated life of the related asset, whereas goodwill is tested annually for impairment, but not systematically amortized. Assuming no goodwill impairment, it is beneficial to our future earnings to have a lower amount assigned to identifiable intangible assets and higher amount of goodwill as opposed to having a higher amount considered to be identifiable intangible assets and a lower amount classified as goodwill.

The primary identifiable intangible asset we typically record in connection with a whole bank or bank branch acquisition is the value of the core deposit intangible, whereas when we acquire an insurance agency, the primary identifiable intangible asset is the value of the acquired customer list. Determining the amount of identifiable intangible assets and their average lives involves multiple assumptions and estimates and is typically determined by performing a discounted cash flow analysis, which involves a combination of any or all of the following assumptions: customer attrition/runoff, alternative funding costs, deposit servicing costs, and discount rates. We typically engage a third party consultant to assist in each analysis. For the whole bank and bank branch transactions recorded to date, the core deposit intangibles have generally been estimated to have a life ranging from seven to ten years, with an accelerated rate of amortization. For insurance agency acquisitions, the identifiable intangible assets related to the customer lists were determined to have a life of ten to fifteen years, with amortization occurring on a straight-line basis.

Subsequent to the initial recording of the identifiable intangible assets and goodwill, we amortize the identifiable intangible assets over their estimated average lives, as discussed above. In addition, on at least an annual basis, goodwill is evaluated for impairment by comparing the fair value of our reporting units to their related carrying value, including goodwill (our community banking operation is our only material reporting unit). If the carrying value of a reporting unit were ever to exceed its fair value, we would determine whether the implied fair value of the goodwill, using a discounted cash flow analysis, exceeded the carrying value of the goodwill. If the carrying value of the goodwill exceeded the implied fair value of the goodwill, an impairment loss would be recorded in an amount equal to that excess. Performing such a discounted cash flow analysis would involve the significant use of estimates and assumptions.

In our 2015 goodwill impairment evaluation, we engaged a consulting firm that used various valuation techniques to assist us in concluding that our goodwill was not impaired.

We review identifiable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Our policy is that an impairment loss is recognized, equal to the difference between the asset's carrying amount and its fair value, if the sum of the expected undiscounted future cash flows is less than the carrying amount of the asset. Estimating future cash flows involves the use of multiple estimates and assumptions, such as those listed above.

Fair Value and Discount Accretion of Loans Acquired in FDIC-Assisted Transactions

We consider the determination of the initial fair value of loans acquired in FDIC-assisted transactions, the initial fair value of the related FDIC indemnification asset, and the subsequent discount accretion of the purchased loans to involve a high degree of judgment and complexity. We determine fair value accounting estimates of newly assumed assets and liabilities in accordance with relevant accounting guidance. However, the amount that we realize on these assets could differ materially from the carrying value reflected in our financial statements, based upon the timing of collections on the acquired loans in future periods. To the extent the actual values realized for the acquired loans are different from the estimates, the FDIC indemnification asset will generally be impacted in an offsetting manner due to the loss-sharing support from the FDIC.

Because of the inherent credit losses associated with the acquired loans in a failed bank acquisition, the amount that we record as the fair values for the loans is generally less than the contractual unpaid principal balance due from the borrowers, with the difference being referred to as the "discount" on the acquired loans. We have applied the cost recovery method of accounting to all purchased impaired loans due to the uncertainty as to the timing of expected cash flows. This will generally result in the recognition of interest income on these impaired loans only when the cash payments received from the borrower exceed the recorded net book value of the related loans.

For nonimpaired purchased loans, we accrete the discount over the lives of the loans in a manner consistent with the guidance for accounting for loan origination fees and costs.

Merger and Acquisition Activity

In 2013, we completed an acquisition of two branches with $57 million in deposits and $16 million in loans. In the 2013 acquisition, we purchased one of the branch buildings, while transferring the accounts of the other branch to an existing branch located nearby. The results of each acquired company/branch are included in our financial statements beginning on their respective acquisition dates. We did not complete any acquisitions in 2014 or 2015. See Note 2 to the consolidated financial statements for additional information regarding these acquisitions.

As previously discussed, on January 1, 2016, we acquired an insurance agency in Sanford, North Carolina, and on March 4, 2016, we announced we had agreed to exchange our seven bank branches located in Virginia to another community bank in return for six of their branches.

FDIC Indemnification Asset

As previously discussed, on June 19, 2009 and January 21, 2011, we acquired substantially all of the assets and liabilities of Cooperative Bank and The Bank of Asheville, respectively, in FDIC-assisted transactions. For each transaction, we entered into two loss share agreements with the FDIC, which provided First Bank significant loss protection from losses experienced on the loans and foreclosed real estate. Under the Cooperative Bank loss share agreements, the FDIC covers 80% of covered loan and foreclosed real estate losses up to $303 million, and 95% of losses in excess of that amount. Under The Bank of Asheville loss share agreements, the FDIC covers 80% of all covered loan and foreclosed real estate losses. For both transactions, the loss share reimbursements are applicable for ten years for single family home loans and five years for all other loans. As previously discussed, one of the loss share agreements related to the Cooperative Bank acquisition expired on July 1, 2014.

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We recorded a FDIC indemnification asset related to the two transactions to account for payments that we expect to receive from the FDIC related to the loss share agreements. The carrying value of this receivable at each period end is the sum of: 1) actual claims that have been incurred and are in the process of submission to the FDIC for reimbursement, but have not yet been received and 2) our estimated amount of claimable loan and other real estate losses covered by the agreements multiplied by the FDIC reimbursement percentage.

At December 31, 2015 and 2014, the FDIC indemnification asset was comprised of the following components:

($ in thousands)	2015	2014
Receivable (payable) related to claims incurred (recoveries), not yet received (paid), net	$(633)	6,899
Receivable related to estimated future claims on loans	8,675	14,933
Receivable related to estimated future claims on foreclosed real estate	397	737
FDIC indemnification asset	$8,439	22,569

As of each acquisition date, based on the losses inherent in the covered assets and what we estimated we would receive as payments from the FDIC, we recorded a "FDIC Indemnification Asset." Since that time, we have recorded adjustments to the indemnification asset as discussed below.

The FDIC indemnification asset has generally been adjusted in the following circumstances:

1) Deterioration of credit quality of covered loans – As of the acquisition dates, we recorded the loans acquired from Cooperative Bank and The Bank of Asheville on our books at a fair value that was $227.9 million and $51.7 million, respectively, less than the contractual amounts due from the borrowers, which was our estimate of the loan losses inherent in the portfolio. As the credit quality of these portfolios change and better information is obtained about likely losses, some loans have better repayment expectations than we originally projected and some loans have worse repayment expectations than originally projected. For loans with worse repayment expectations, we generally record provisions for loan losses with corresponding increases to the FDIC indemnification asset by recording noninterest income in proportion to the reimbursement percentage. In 2014 and 2013, we recorded total provisions for loan losses on covered loans amounting to $3.1 million and $12.4 million, respectively, which resulted in upward adjustments to the FDIC indemnification asset of $1.4 million and $9.6 million, respectively. We also record some provisions for loan losses without corresponding increases to the indemnification asset because we believe certain loan losses will occur after the expiration of the loss share agreements. In 2014 and 2013, we recorded provisions for loan losses on covered loans without a corresponding increase to the indemnification asset of $1.4 million and $0.3 million, respectively. In 2015, we recorded a negative provision for loan losses on covered loans amounting to $2.8 million, which resulted in downward adjustments to the FDIC indemnification asset of $2.2 million. The negative provision in 2015 was primarily the result of loan recoveries that exceeded charge-offs by $2.3 million.

2) Write-downs and losses on foreclosed properties – When we foreclose on delinquent borrowers, we initially record the foreclosed property at the lower of book or fair value (based on current appraisals), with any deficiency recorded as a loan charge-off. Subsequent to the foreclosure, we periodically review the fair value of the property through updated appraisals or independent market pricing, and if the appraisal or market pricing indicates a fair value lower than our carrying value, we must write the property down. We also sell foreclosed properties that frequently result in losses. Each of these situations generally results in the Company recording losses on foreclosed properties with a corresponding increase to the FDIC indemnification asset by recording noninterest income in proportion to the reimbursement percentage. If we sell a foreclosed property that results in a gain, then we generally record a corresponding decrease to the FDIC indemnification asset to reflect the fact that we must reimburse the FDIC 80% of any gains that relate to prior claims. In 2015, we recorded net gains on covered foreclosed properties amounting to $1.0 million, which resulted in a downward adjustment to the FDIC indemnification asset of $0.4 million. In 2014, we recorded net losses and write-downs on covered foreclosed properties amounting to $1.9 million, which resulted in an upward adjustment to the FDIC indemnification asset of $1.5 million. In 2013, we recorded net gains on covered foreclosed properties amounting to $0.4 million, which resulted in a downward adjustment to the FDIC indemnification asset of $0.3 million.

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3) Expenses incurred related to collection activities on covered assets – As a result of our collection efforts, we incur expenses such as legal fees, property taxes and appraisal costs. Many of these expenses are reimbursable by the FDIC. These expenses are recorded as “other” noninterest expenses and a corresponding increase is made to increase the FDIC indemnification asset by reducing the gross collection expenses by the amount expected to be reimbursed by the FDIC for eligible expenses. In 2015, 2014, and 2013, we incurred $1.2 million, $3.1 million, and $6.5 million, in gross collection expenses related to covered assets, respectively, and reduced that amount by $1.2 million, $3.9 million, and $5.4 million in FDIC reimbursements, respectively.

4) Receipt of cash from the FDIC related to claims submitted – On at least a quarterly basis, we submite eligible loss share claims to the FDIC. After reviewing and approving the claims, the FDIC wires us cash, which reduces the amount of the FDIC indemnification asset. In 2015, 2014, and 2013, we received $6.7 million, $17.7 million, and $49.6 million in FDIC reimbursements, respectively.

5) Accretion of discount on acquired loans – As noted above, we recorded the acquired loans of the two transactions on our books at a fair value that was $280 million (in total) less than the contractual amounts due from the borrowers (the “discount”), which was our estimate of the loan losses inherent in the portfolio. As the credit quality of this portfolio changes and better information is obtained about likely losses, some loans have better repayment expectations than we originally projected and some loans have worse repayment expectations than originally projected (as discussed above). For loans with improved repayment expectations, we are systematically reducing the discount over the life of the loan. For some loans, we have received complete payoffs at the contractual balance and the discount must be reduced to zero. When we reduce/accrete the discount, we do so by recognizing interest income in that same amount. When the expected losses become less than the original estimate, our expected reimbursement from the FDIC declines as well. Accordingly, we generally reduce the FDIC indemnification asset in correlation to the accretion of the loan discount. In 2015, 2014, and 2013, we recorded discount accretion of $4.8 million, $16.0 million, and $20.2 million, respectively, which resulted in reductions to the FDIC indemnification asset and indemnification expense of $5.6 million, $15.3 million, and $16.2 million, respectively.

In summary, circumstances that result in adjustments to the FDIC indemnification asset are recorded within the income statement line items noted without consideration of the FDIC loss share agreements. Because favorable changes in covered assets result in lower expected FDIC claims, and unfavorable changes in covered assets generally result in higher expected FDIC claims, the FDIC indemnification asset is adjusted to reflect those expectations. The net increase or decrease in the indemnification asset is reflected within noninterest income.

The adjustments can result in volatility within individual income statement line items. Because of the FDIC loss share agreements and the associated indemnification asset, amounts recorded as provisions for loan losses, discount accretion, and losses from foreclosed properties generally only impact pretax income by 20% of those amounts, due to the corresponding adjustments made to the indemnification asset.

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The following presents a rollforward of the FDIC indemnification asset since the date of the Cooperative Bank acquisition on June 19, 2009 and includes additions related to The Bank of Asheville acquisition in 2011.

($ in thousands)

Balance at June 19, 2009	$185,112
Decrease related to favorable change in loss estimates	(1,516)
Increase related to reimbursable expenses	1,300
Cash received	(40,500)
Accretion of loan discount	(1,175)
Balance at December 31, 2009	143,221
Increase related to unfavorable change in loss estimates	30,419
Increase related to reimbursable expenses	2,900
Cash received	(46,721)
Accretion of loan discount	(6,100)
Balance at December 31, 2010	123,719
Increase related to acquisition of The Bank of Asheville	42,218
Increase related to unfavorable change in loss estimates	29,814
Increase related to reimbursable expenses	5,725
Cash received	(69,339)
Accretion of loan discount	(9,278)
Other	(1,182)
Balance at December 31, 2011	121,677
Increase related to unfavorable change in loss estimates	16,984
Increase related to reimbursable expenses	6,947
Cash received	(29,796)
Accretion of loan discount	(13,173)
Other	(80)
Balance at December 31, 2012	102,559
Increase related to unfavorable change in loss estimates	9,312
Increase related to reimbursable expenses	5,352
Cash received	(49,572)
Accretion of loan discount	(16,160)
Other	(2,869)
Balance at December 31, 2013	48,622
Increase related to unfavorable change in loss estimates	2,923
Increase related to reimbursable expenses	3,925
Cash received	(17,724)
Accretion of loan discount	(15,281)
Other	104
Balance at December 31, 2014	22,569
Increase (decrease) related to unfavorable (favorable) changes in loss estimates	(3,031)
Increase related to reimbursable expenses	1,232
Cash received	(6,673)

Accretion of loan discount	(5,584)
Decrease related to settlement of disputed claims	(406)
Other	332
Balance at December 31, 2015	$8,439

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The following table presents additional information regarding our covered loans, loan discounts, allowances for loan losses and the corresponding FDIC indemnification asset:

($ in thousands)	Cooperative Single Family Loss Share Loans	Bank of Asheville Single Family Loss Share Loans	Bank of Asheville Non-Single Family Loss Share Loans
At December 31, 2015			
Expiration of loss share agreement	6/30/2019	3/31/2021	3/31/2016
Nonaccrual covered loans			
Unpaid principal balance	$5,265	780	6,295
Carrying value prior to loan discount*	5,104	610	4,276
Loan discount	570	389	1,215
Net carrying value	4,534	221	3,061
Allowance for loan losses	251	6	171
Indemnification asset recorded	511	232	245
All other covered loans			
Unpaid principal balance	85,824	6,458	15,860
Carrying value prior to loan discount*	85,685	6,379	15,847
Loan discount	11,528	1,099	459
Net carrying value	74,157	5,280	15,388
Allowance for loan losses	1,092	55	224
Indemnification asset recorded	6,815	804	77
All covered loans			
Unpaid principal balance	91,089	7,238	22,155
Carrying value prior to loan discount*	90,789	6,989	20,123
Loan discount	12,098	1,488	1,674
Net carrying value	78,691	5,501	18,449
Allowance for loan losses	1,343	61	395
Indemnification asset recorded	7,326	1,036	322
Foreclosed Properties			
Net carrying value	512	—	294
Indemnification asset recorded	365	—	32
For the Year Ended December 31, 2015			
Loan discount accretion recognized	1,969	812	1,970
Indemnification asset expense associated with the loan discount accretion recognized	2,848	680	2,056

* Reflects partial charge-offs

** A present value adjustment of $9 reduces the carrying value of this asset to $8,675

Our loss share agreement related to Cooperative Bank’s non-single family assets expired on June 30, 2014. On July 1, 2014, the remaining balances associated with the Cooperative non-single family loans and foreclosed properties were transferred from the covered portfolio to the non-covered portfolio. We bear all future losses on this portfolio of loans and foreclosed properties. Immediately prior to the transfer, this portfolio of loans had a carrying value of $39.7 million and the portfolio of foreclosed properties had a carrying value of $3.0 million, and both portfolios were classified as covered. Of the $39.7 million in loans that lost loss share protection, approximately $9.7 million of these loans were on nonaccrual status and $2.1 million of these loans were classified as accruing troubled debt restructurings as of July 1, 2014. Additionally, approximately $1.7 million in allowance for loan losses that related to this portfolio of loans was transferred to the allowance for loan losses for non-covered loans on July 1, 2014. As of July 1, 2014, there was no remaining loan discount or indemnification asset related to the Cooperative non-single family loss share loans or foreclosed properties.

As noted in the table above, our loss share agreement related to Bank of Asheville’s non-single family assets expires in March 2016. We continue to make progress in winding down this portfolio, and we do not currently expect its expiration will have a material impact on our Company.

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Loan discount accretion and corresponding indemnification asset expense continue to be recorded on the three portfolios covered by loss share agreements. Because of the continued decline in the amount of remaining unaccreted discount, the amount of loan discount accretion and corresponding indemnification asset expense is expected to continue to decline in future periods.

ANALYSIS OF RESULTS OF OPERATIONS

Net interest income, the “spread” between earnings on interest-earning assets and the interest paid on interest-bearing liabilities, constitutes the largest source of our earnings. Other factors that significantly affect operating results are the provision for loan losses, noninterest income such as service fees and noninterest expenses such as salaries, occupancy expense, equipment expense and other overhead costs, as well as the effects of income taxes.

Net Interest Income

Net interest income on a reported basis amounted to $119.7 million in 2015, $131.6 million in 2014, and $136.5 million in 2013. For internal purposes and in the discussion that follows, we evaluate our net interest income on a tax-equivalent basis by adding the tax benefit realized from tax-exempt securities to reported interest income. Net interest income on a tax-equivalent basis amounted to $121.4 million in 2015, $133.1 million in 2014, and $138.0 million in 2013. Management believes that analysis of net interest income on a tax-equivalent basis is useful and appropriate because it allows a comparison of net interest amounts in different periods without taking into account the different mix of taxable versus non-taxable investments that may have existed during those periods. The following is a reconciliation of reported net interest income to tax-equivalent net interest income.

	Year ended December 31,		
($ in thousands)	2015	2014	2013
Net interest income, as reported	$119,747	131,609	136,526
Tax-equivalent adjustment	1,634	1,502	1,511
Net interest income, tax-equivalent	$121,381	133,111	138,037

Table 2 analyzes net interest income on a tax-equivalent basis. Our net interest income on a tax-equivalent basis decreased by 8.8% in 2015 and decreased by 3.6% in 2014. There are two primary factors that cause changes in the amount of net interest income we record - 1) our net interest margin (tax-equivalent net interest income divided by average interest-earning assets), and 2) changes in our loans and deposits balances.

The decreases in net interest income in 2015 and 2014 were primarily due to decreases in our net interest margin during 2015 and 2014. “Net interest margin” is a ratio we use to measure the spread between the yield on our earning assets and the cost of our funding and is calculated by taking tax-equivalent net interest income and dividing by average earning assets. Our net interest margin decreased from 4.92% in 2013 to 4.58% in 2014 to 4.13% in 2015.

Lower asset yields have been the primary factor causing the decline in the net interest margin. From 2013 to 2015, the yield we earned on our interest-earning assets declined from 5.31% in 2013 to 4.86% in 2014 to 4.37% in 2015. The biggest factor causing our lower net interest margin in 2015 compared to 2014 was lower discount accretion on loans purchased in failed bank acquisitions (see discussion below). Additionally, for the past several years, the interest rate environment has remained at low levels with maturing assets originated in prior periods generally repricing at progressively lower interest rates at renewal/maturity. Also impacting the decline in 2014 was our decision, in anticipation of higher loan growth and expectation of higher interest rates, to maintain a higher mix of our earnings assets in liquid cash accounts that earned relatively little interest. Late in the fourth quarter of 2014, in order to improve yields and in expectation that interest rate increases were further off than originally projected, we elected to invest a portion of our excess cash. Accordingly we purchased approximately $125 million of investment securities, which helped lessen the impact of lower loan yields in 2015.

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The declines in asset yields were partially offset by lower liability costs. We have been able to lower interest rates on maturing time deposits that were originated in prior periods, and we have also been able to progressively lower interest rates on various types of interest-bearing checking, savings, and money market accounts. The average interest rate paid on our interest bearing deposits declined from 0.43% in 2013 to 0.32% in 2014 to 0.26% in 2015. Also, the funding mix of our liabilities had a positive impact on our net interest margin. As calculated from Table 2, the average amount of our lower cost deposits, comprised of checking accounts (non-interest bearing and interest bearing), money market accounts and savings accounts, steadily increased from $1.7 billion in 2013 to $2.0 billion in 2015, an increase of 15%, while the average amount of our higher cost funding, comprised of time deposits and borrowings, decreased from $1.1 billion to $0.9 billion over that same period, a decline of 21%.

The net interest margin for all periods benefited, by varying amounts, from the net accretion of purchase accounting premiums/discounts associated with the Cooperative Bank acquisition in June 2009 and, to a lesser degree, The Bank of Asheville acquisition in January 2011. As can be seen in the table below, we recorded $4.8 million in 2015, $15.9 million in 2014, and $19.8 million in 2013, in net accretion of purchase accounting premiums/discounts that increased net interest income.

($ in thousands)	Year Ended December 31, 2015	Year Ended December 31, 2014	Year Ended December 31, 2013
Interest income – reduced by premium amortization on loans	$ —	(98)	(386)
Interest income – increased by accretion of loan discount	4,751	16,009	20,200
Interest expense – reduced by premium amortization of deposits	—	7	29
Impact on net interest income	$ 4,751	15,918	19,843

The biggest component of the purchase accounting adjustments in each year was loan discount accretion, which amounted to $4.8 million in 2015, $16.0 million in 2014, and $20.2 million in 2013. In 2015 and 2014, lower amounts of remaining unaccreted loan discount resulted in lower amounts of loan discount accretion – unaccreted loan discount amounted to $15 million, $21 million, and $40 million at December 31, 2015, 2014 and 2013, respectively. We expect loan discount accretion to continue to decline as a result of the continued decline in remaining unaccreted discount.

Table 3 presents additional detail regarding the estimated impact that changes in loan and deposit volumes and changes in the interest rates we earned/paid had on our net interest income in 2014 and 2015. For both years, changes in interest rates was the primary factor affecting net interest income. Table 3 indicates that in 2015, changes in interest rates reduced interest income by $15.3 million, while interest expense was only reduced by $0.7 million due to rates. Thus, the disparate impact of lower interest rates was the primary reason that net interest income decreased by $11.7 million during the year. Similarly in 2014, the impact of the lower rates reduced interest income by $8.7 million, while interest expense was only reduced by $2.7 million due to rates. Thus, lower interest rates were the primary reason that net interest income decreased by $4.9 million during the year.

See additional information regarding net interest income in the section entitled “Interest Rate Risk.”

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Provision for Loan Losses

The provision for loan losses charged to operations is an amount sufficient to bring the allowance for loan losses to an estimated balance considered appropriate to absorb probable losses inherent in our loan portfolio. Management's determination of the adequacy of the allowance is based on our level of loan growth, an evaluation of the loan portfolio, current economic conditions, historical loan loss experience and other risk factors.

For 2015, we recorded total negative provisions for loan losses (reduction of allowance for loan losses) of $0.8 million. For 2014 and 2013, our total provisions for loan losses were $10.2 million and $30.6 million, respectively. The total provision for loan losses is comprised of provision for loan losses for non-covered loans and provision for loan losses for covered loans, as discussed in the following paragraphs.

We recorded $2.0 million, $7.1 million, and $18.3 million in provisions for loan losses related to non-covered loans for the years ended December 31, 2015, 2014, and 2013, respectively. The lower provision in 2015 compared to 2014 was primarily the result of stable asset quality trends. Non-covered loan growth for 2015 was $148 million compared to a decline of $24 million in 2014, which resulted in a larger incremental provision for the loan losses attributable to loan growth. However, offsetting this larger incremental provision were favorable trends in our asset quality. Our non-covered classified and nonaccrual loans decreased from $125.4 million at December 31, 2014 to $101.9 million at December 31, 2015. Additionally, our allowance for loan loss model, which dictates the provisions for loan losses that we record, utilizes the net charge-offs experienced in the most recent years as a significant component of estimating the current allowance for loan losses that is necessary. Thus, older years (and parts thereof) systematically age out and are excluded from the analysis as time goes on. The final periods of high net charge-offs we experienced during the peak of the recession dropped out of the analysis in 2015 and were replaced by the more modest levels of net charge-offs recently experienced. The fourth quarter of 2015 marked our twelfth consecutive quarter of annualized net charge-offs related to non-covered loans being less than 1.00%, whereas at the peak of the recession, that ratio was frequently over 1.00%. Accordingly, the relatively low provision recorded in 2015 resulted in our non-covered allowance for loan loss declining to a more normalized level following the elevated amounts we maintained during and immediately following the recession. In 2016, it is likely that we will record a higher amount of provision for loan losses than we did in 2015, as we provide for on-going loan charge-offs and expected new loan growth.

The same general factors discussed above that resulted in a lower provision for loan losses in 2015 also resulted in the provision for loan losses being lower in 2014 compared to 2013.

As it relates to covered loans, we recorded a negative provision for loan losses (reduction of allowance for loan losses) of $2.8 million in 2015. The negative provision resulted from lower levels of covered nonperforming loans, declining levels of total covered loans, and several large recoveries received that resulted in having net loan recoveries (recoveries, net of charge-offs) of $2.3 million for 2015.

We recorded provisions for loan losses on covered loans of $3.1 million and $12.4 million during 2014 and 2013, respectively. These provisions were necessary to provide for loans that showed signs of collection problems during the respective periods, as well as to provide for collateral dependent nonaccrual loans for which we received updated appraisals during the year that reflected lower collateral valuations. The decline in the provision for loan losses on covered loans from 2013 to 2014 was primarily due to lower levels of covered nonperforming loans during the period and stabilization in the underlying collateral values of nonperforming loans. Because of the FDIC loss share agreements in place for these loans, the FDIC indemnification asset was adjusted upwards as a result of claimable losses associated with these loans.

Total net charge-offs (covered and non-covered) for the years ended December 31, 2015, 2014, and 2013, were $11.3 million, $18.1 million, and $28.5 million, respectively.

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Net-charge offs of non-covered loans were $13.6 million, $14.7 million, and $15.6 million for 2015, 2014, and 2013, respectively. The ratio of net charge-offs to average non-covered loans was 0.58%, 0.65%, and 0.72% for 2015, 2014, and 2013, respectively. The declining amount of non-covered net-charge offs in recent years is reflective of improving economic conditions and lower levels of our highest-risk loans.

Net charge-offs (recoveries) of covered loans were ($2.3 million), $3.3 million and $12.9 million in 2015, 2014, and 2013, respectively. During 2015, we realized covered recoveries of $3.6 million, which more than offset our gross charge-offs of $1.3 million. In 2014 we realized a recovery of $1.9 million related to a covered loan that was the subject of a significant charge-off in 2013, which reduced net charge-offs for 2014. The lower levels of net charge-offs is also reflective of lower amounts of nonperforming covered loans.

As seen in Tables 14 and 14a, in 2015, net charge-offs were highest in the loans classified as “real estate – mortgage – residential (1-4 family) first mortgages.” Charge-offs of residential first mortgage loans reflect continued challenging economic conditions in some of our more rural market areas. In 2014 and 2013, net charge-offs were highest in loans classified as “real estate – construction, land development & other land loans.” This category of loans is primarily comprised of land acquisition and development loans and other types of lot loans. These types of loans were particularly hard hit by the decline in real estate development and property values that occurred in the recession.

See “Nonperforming Assets” below for further discussion of our asset quality, which impacts our provisions for loan losses.

See the section entitled “Allowance for Loan Losses and Loan Loss Experience” below for a more detailed discussion of the allowance for loan losses. The allowance is monitored and analyzed regularly in conjunction with our loan analysis and grading program, and adjustments are made to maintain an adequate allowance for loan losses.

Noninterest Income

Our noninterest income amounted to $18.8 million in 2015, $14.4 million in 2014, and $23.5 million in 2013.

As shown in Table 4, core noninterest income excludes gains from acquisitions, foreclosed property write-downs and losses, indemnification asset income (expense), securities gains or losses, and other miscellaneous gains and losses. Core noninterest income amounted to $29.3 million in 2015, a 3.8% decrease from the $30.5 million recorded in 2014. The 2014 core noninterest income of $30.5 million was 8.0% higher than the $28.2 million recorded in 2013.

See Table 4 and the following discussion for an understanding of the components of noninterest income.

Service charges on deposit accounts amounted to $11.6 million, $13.7 million, and $12.8 million in 2015, 2014 and 2013, respectively. After the elimination of free checking for most customers with low balances in late 2013 which resulted in a strong increase in service charges in the first half of 2014, monthly fees earned on deposit accounts gradually declined thereafter as a result of more customers meeting the requirements to have the monthly service charge waived. Fewer instances of fees earned from customers overdrawing their accounts also impacted this line item in 2015.

Other service charges, commissions and fees amounted to $10.9 million in 2015, an 8.9% increase from the $10.0 million earned in 2014. The 2014 amount of $10.0 million was 7.5% higher than the $9.3 million earned in 2013. This category of noninterest income includes items such as electronic payment processing revenue (which includes fees related to credit card transactions by merchants and customers and fees earned from debit card transactions), ATM charges, safety deposit box rentals, fees from sales of personalized checks, and check cashing fees. The growth in this category for both years was primarily attributable to increased debit card usage by our customers, as we earn a small fee each time our customers make a debit card transaction. Interchange income from credit cards has also increased due to growth in the number and usage of credit cards, which we believe is a result of increased promotion of this product.

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Fees from presold mortgages amounted to $2.5 million in 2015, $2.7 million in 2014, and $2.9 million in 2013. Lower refinancing activity resulted in slight decreases in these fees in 2015 and 2014. Also, a portion of the decline in 2015 was due to our decision to hold more loans for investment in 2015 compared to 2014 in order to offset declines in our residential mortgage loan portfolio.

Commissions from sales of insurance and financial products amounted to $2.6 million in 2015, $2.7 million in 2014, and $2.1 million in 2013. This line item includes commissions we receive from three sources - 1) sales of credit life insurance associated with new loans, 2) commissions from the sales of investment, annuity, and long-term care insurance products, and 3) commissions from the sale of property and casualty insurance. The following table presents the contribution of each of the three sources to the total amount recognized in this line item:

($ in thousands)	For the year ended December 31,		
	2015	2014	2013
Commissions earned from:			
Sales of credit life insurance	$ 26	43	58
Sales of investments, annuities, and long term care insurance	1,934	2,028	1,353
Sales of property and casualty insurance	620	662	721
Total	$ 2,580	2,733	2,132

As can be seen in the above table, sales of investments, annuities and long term care insurance declined slightly in 2015 compared to 2014 resulting from lower commissions earned on sales of investments. The increase from 2013 to 2014 was the result of hiring more employees in our investment division in the years leading up to 2014.

Table 4 shows earnings from bank owned life insurance income were $1.7 million in 2015, $1.3 million in 2014, and $1.1 million in 2013. In 2015, 2014, and 2013, we purchased $15.0 million, $10.0 million, and $15.0 million, respectively, in bank-owned life insurance on certain officers of our company, which increased our income for this line item.

Noninterest income not considered to be “core” resulted in net reductions to total noninterest income of $10.6 million in 2015, $16.1 million in 2014, and $4.7 million in 2013. The components of non-core noninterest income are shown in Table 4 and the significant components thereof are discussed below.

We recorded net losses on non-covered foreclosed properties of $2.5 million in 2015 and $1.9 million in 2014 compared to net gains of $1.3 million in 2013. In 2015 and 2014, in order to dispose of certain of our foreclosed properties that we had held for an extended period of time, it became necessary to accept sales offers that resulted in losses. In 2013, we experienced miscellaneous gains from sales of properties following stabilization in real estate market values and lower carrying values following significant write-downs recorded in 2012.

We recorded $1.0 million of net gains on covered foreclosed properties in 2015, $1.9 million of net losses on covered foreclosed properties in 2014, and $0.4 million of net gains on covered foreclosed properties in 2013. Gains and losses on covered foreclosed properties have generally been lower in recent years than in the years immediately following our failed bank acquisitions, as we are holding significantly lower levels of covered foreclosed properties and real estate prices have stabilized. As discussed earlier and illustrated in the table below, when gains or losses are realized on covered foreclosed properties, there is generally a corresponding entry to indemnification asset income (expense) amounting to 80% of the losses (gains) recorded.

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Indemnification asset expense amounted to $8.6 million, $12.8 million, and $6.8 million, for the three years ended December 31, 2015, respectively. Indemnification asset income (expense) is recorded to reflect additional (decreased) amounts expected to be received from the FDIC during the period related to covered assets. The three primary items that result in recording indemnification asset income (expense) are 1) loan discount accretion resulting from improved borrower repayment prospects, which generally results in indemnification expense, 2) provisions (reversals) for loan losses on covered loans, which result in indemnification income (expense) and 3) foreclosed property gains (losses) on covered assets, which result in indemnification expense related to gains and indemnification income related to losses. The lower indemnification asset expense in 2015 is primarily correlated with significantly lower loan discount accretion income recorded in 2015. The higher indemnification asset expense in 2014 is primarily related to fewer loan losses, which resulted in lower indemnification income to offset the other sources of indemnification expense. The following table presents the sources of indemnification income (expense) for the periods noted.

	For the year ended December 31,		
($ in millions)	2015	2014	2013
Indemnification asset expense associated with loan discount accretion income	$ (5.6)	(15.3)	(16.2)
Indemnification asset income (expense) associated with loan losses (recoveries), net	(2.3)	1.4	9.6
Indemnification asset income (expense) associated with foreclosed property losses (gains)	(0.4)	1.5	(0.3)
Other sources of indemnification asset income (expense)	(0.3)	(0.4)	0.1
Total indemnification asset income (expense)	$ (8.6)	(12.8)	(6.8)

Securities gains (losses) were insignificant for 2015. We recorded $0.8 million and $0.5 million in securities gains during 2014 and 2013, respectively, related to sales of $47.5 million and $12.9 million in available for sale securities, respectively.

The line item "Other gains (losses)" was negatively impacted in 2015 by a $0.4 million write-off of a FDIC claim associated with a dispute settlement (see Note 6 of the consolidated financial statements for additional discussion), whereas in 2014, the net loss included losses on sales of vacated branch buildings. The amount for 2013 was insignificant.

Noninterest Expenses

Total noninterest expenses totaled $98.1 million, $97.3 million, and $96.6 million for 2015, 2014 and 2013, respectively. Table 5 presents the components of our noninterest expense during the past three years. Line items with the largest fluctuations are discussed below.

Total personnel expense increased from $55.2 million in 2014 to $56.8 million in 2015, an increase of $1.6 million, or 3.0%. Within personnel expense, salaries expense increased $1.6 million, of which $0.9 million related to higher amounts of incentive compensation expense earned by employees in 2015. Also, we recorded $0.6 million in stock-based compensation expense in 2015 compared to $0.1 million in 2014, primarily related to retention-based stock grants made in 2015. Employee benefits expense for 2015 remained unchanged from 2014 at $9.1 million.

In comparing 2014 to 2013, total personnel expense increased from $54.8 million in 2013 to $55.2 million in 2014, an increase of $0.4 million, or 0.7%. Within personnel expense, salaries expense increased $1.0 million, which relates to higher amounts of incentive compensation as a result of higher earnings in 2014, as well as lower amounts of salary expense deferred and recognized as a loan yield adjustment, as a result of fewer new loan originations. The increase in salaries expense in 2014 was largely offset by a decrease in employee benefits expense. Employee benefits expense decreased by $0.6 million, or 5.8%, in comparing 2014 to 2013, which is primarily attributable to the pension income we recorded in 2014 related to investment income from our pension plan's assets. Pension income for the year ended December 31, 2014 was $1.1 million in comparison to pension income of $0.6 million recorded in 2013.

Net occupancy expenses have remained relatively stable over the past three years, amounting to $7.4 million in 2015, $7.4 million in 2014, and $7.1 million in 2013.

Equipment related expenses were $3.7 million, $3.9 million, and $4.4 million, in 2015, 2014, and 2013, respectively. During the fourth quarter of 2013, we outsourced certain data processing activities to a third-party provider, which resulted in a reduction in depreciation expense and machine maintenance expense associated with the computer equipment and software that is no longer being used for data processing.

FDIC insurance expense amounted to $2.4 million in 2015, $4.0 million in 2014, and $2.8 million in 2013. The insurance premium rate charged by the FDIC is based on several variable factors that can result in fluctuations from year to year.

Collection expenses related to non-covered assets have remained relatively unchanged over the past three years, amounting to $2.2 million in 2015, $2.1 million in 2014, and $2.2 million in 2013.

Collection expenses on covered assets, net of FDIC reimbursements, amounted to a net reimbursement of $0.1 million in 2015, a net reimbursement of $0.9 million in 2014 and expense of $1.1 million in 2013. This expense has generally declined in recent years due to the declining levels of covered nonperforming assets. Additionally, in the fourth quarter of 2014, we determined that approximately $1.0 million in collection expenses incurred in prior years associated with covered assets were eligible to be claimed for reimbursement with the FDIC. We expect collection expenses on covered assets, net of FDIC reimbursements, to be minimal in 2016.

Telephone and data line expense amounted to $2.1 million in 2015 and $2.0 million in 2014, compared to $1.5 million in 2013. The higher levels in 2014 and 2015 compared to 2013 were due to costs associated with upgrades in the quality of our data lines at many of our branches.

As discussed above, in December 2013 we began outsourcing our core data processing to a large, reputable processor. We previously processed our data in-house, and expenses related to these activities were included in various line items of our Consolidated Statements of Income. We recorded $1.7 million in data processing expense in 2014 and $1.9 million in 2015 compared to none in 2013.

Legal and audit expense amounted to $1.7 million in 2015 and $2.0 million in 2014, compared to $1.2 million in 2013. The increase from 2013 to 2014 is primarily a result of our decision to outsource the internal audit function in late 2013.

Outside consultant expense was $1.7 million in each of 2015 and 2014 compared to $2.5 million in 2013. An efficiency project using outside consultants that began in 2012 wound down in 2014, which resulted in a decline in this line item in 2014.

In 2014, we also recorded $1.0 million in expenses related to the consolidation and closure of nine of our branches. The branches that were consolidated were generally smaller in size with relatively low staff counts.

We recorded $0.2 million and $0.5 million in severance expenses in 2015 and 2014, respectively. In 2013, we recorded $1.9 million in severance expenses due primarily to the separation from service of our former chief executive officer.

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Income Taxes

Table 6 presents the components of income tax expense and the related effective tax rates. We recorded income tax expense of $14.1 million in 2015, $13.5 million in 2014, and $12.1 million in 2013. Our effective tax rates was 34.3% for 2015, 35.1% for 2014 and 36.9% for 2013. The progressively lower effective tax rate has been due to higher amounts of tax-exempt income, primarily bank-owned life insurance income, and lower statutory income tax rates in North Carolina. Effective January 1, 2014, North Carolina implemented decreases to its state income tax rate for corporations from 6.9% in 2013 to 6.0% in 2014 to 5.0% in 2015. The North Carolina state income tax rate further declines to 4% in 2016, and thus we expect our effective tax rate will decline to approximately 34.0% in 2016. Our effective tax rate in 2013 was unfavorably impacted by the change in the North Carolina state tax rates, as we recorded incremental tax expense of $0.5 million to reduce the value of our deferred tax asset due to the lower future rates.

Stock-Based Compensation

We recorded stock-based compensation expense of $0.7 million, $0.3 million, and $0.2 million for the years ended December 31, 2015, 2014, and 2013, respectively. The higher expense in 2015 was due to retention-based restricted stock grants made to certain officers during the year. See Note 15 to the consolidated financial statements for more information regarding stock-based compensation.

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ANALYSIS OF FINANCIAL CONDITION AND CHANGES IN FINANCIAL CONDITION

Overview

At December 31, 2015, our total assets amounted to $3.4 billion, a 4.5% increase from 2014. The following table presents detailed information regarding the nature of changes in our loans and deposits in 2014 and 2015:

($ in thousands)	Balance at beginning of period	Internal growth, net (1)	Growth from Acquisitions	Transfer due to Expiration of Loss Share Agreement	Balance at end of period	Total percentage growth	Internal percentage growth (1)
2015							
Loans – Non-covered	$2,268,580	147,705	—	—	2,416,285	6.5%	6.5%
Loans – Covered	127,594	(24,953)	—	—	102,641	-19.6%	-19.6%
Total loans	2,396,174	122,752	—	—	2,518,926	5.1%	5.1%
Deposits – Noninterest-bearing	560,230	98,808	—	—	659,038	17.6%	17.6%
Deposits – Interest-bearing checking	583,903	42,975	—	—	626,878	7.4%	7.4%
Deposits – Money market	548,255	88,437	—	—	636,692	16.1%	16.1%
Deposits – Savings	180,317	6,299	—	—	186,616	3.5%	3.5%
Deposits – Brokered time	88,375	(11,963)	—	—	76,412	-13.5%	-13.5%
Deposits – Internet time	747	(747)	—	—	—	-100.0%	-100.0%
Deposits – Time >$100,000 – retail	384,127	(54,308)	—	—	329,819	-14.1%	-14.1%
Deposits – Time <$100,000 – retail	349,952	(54,122)	—	—	295,830	-15.5%	-15.5%
Total deposits	$2,695,906	115,379	—	—	2,811,285	4.3%	4.3%
2014							
Loans – Non-covered	$2,252,885	(23,978)	—	39,673	2,268,580	0.7%	-1.1%
Loans – Covered	210,309	(43,042)	—	(39,673)	127,594	-39.3%	-20.5%
Total loans	2,463,194	(67,020)	—	—	2,396,174	-2.7%	-2.7%
Deposits – Noninterest-bearing	482,650	77,580	—	—	560,230	16.1%	16.1%
Deposits – Interest-bearing checking	557,413	26,490	—	—	583,903	4.8%	4.8%
Deposits – Money market	547,556	699	—	—	548,255	0.1%	0.1%
Deposits – Savings	169,023	11,294	—	—	180,317	6.7%	6.7%
Deposits – Brokered time	116,087	(27,712)	—	—	88,375	-23.9%	-23.9%
Deposits – Internet time	1,319	(572)	—	—	747	-43.4%	-43.4%
Deposits – Time >$100,000 – retail	451,741	(67,614)	—	—	384,127	-15.0%	-15.0%
Deposits – Time <$100,000 – retail	425,230	(75,278)	—	—	349,952	-17.7%	-17.7%
Total deposits	$2,751,019	(55,113)	—	—	2,695,906	-2.0%	-2.0%

(1) Excludes the impact of the transfer of loans from covered status to non-covered status on July 1, 2014 due to the expiration of one of our loss-sharing agreements, but includes growth or declines in these loans after date of transfer. Also, excludes the impact of acquisitions in the year of acquisition, but includes growth or declines in acquired operations after the date of acquisition.

In 2015, as derived from the table above, our total loans increased by $123 million, or 5.1%. During that period, we experienced internal growth in our non-covered loan portfolio of $148 million, or 6.5%, while our covered loans declined by $25 million, or 19.6%. We expect continued growth in our non-covered loan portfolio in 2016, as we have recently expanded into higher growth market areas, and we had experienced bankers join our company over the past twelve months. We expect our covered loans to continue to decline as a result of normal pay-downs, foreclosures, and charge-offs.

In 2014, as derived from the table above, our total loans decreased by $67 million, or 2.7%. The increase in the ending balance of our non-covered loan portfolio was due to the transfer of $39.7 million of loans from covered status to non-covered status on July 1, 2014 upon the scheduled expiration of one of our loss-sharing agreements on June 30, 2014. Excluding that transfer, we experienced a net decline in our non-covered loan portfolio of $24 million, or 1.1%, which we believe was due to slow economic recovery in many of the our market areas, as well as temporary pressures from new internal loan processes that we implemented in 2014 designed to enhance loan quality. Covered loans declined by $82.7 million during 2014, with approximately half of the decline due to the aforementioned transfer of loans to non-covered status and the other half as a result of normal pay-downs, foreclosures, and charge-offs.

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During 2015, we experienced a net increase in total deposits of $115.4 million, or 4.3%, which resulted from significant growth in our low-cost core deposit accounts (checking, money market and savings) offsetting declines in our time deposit accounts. We experienced growth of $236.5 million in our core deposit accounts, compared to declines of $121.1 million in time deposits. As previously discussed, our net interest margin benefited from this shift.

During 2014, we experienced a net decline in total deposits of $55.1 million. Growth of $116 million in our core deposit accounts was more than offset by a $171 million decline in time deposits. With the low loan growth experienced in 2014, we were able to maintain pricing discipline on our rate sensitive deposits, which resulted in the loss of some of those balances.

Our overall liquidity decreased slightly in 2015 compared to 2014, primarily as a result of loan growth and the redemption of $63.5 million of our SBLF preferred stock. Our liquid assets (cash and securities) as a percentage of our total deposits and borrowings decreased from 21.2% at December 31, 2014 to 19.7% at December 31, 2015.

Our capital ratios declined in 2015 primarily as a result of the aforementioned repayment of $63.5 million in SBLF stock. Earnings of $27 million during 2015 partially offset the impact of the repayment. All of our capital ratios have significantly exceeded the regulatory thresholds for “well-capitalized” status for all periods covered by this report. Our tangible common equity ratio was 8.13% at December 31, 2015, compared to 7.90% at December 31, 2014 and 7.46% at December 31, 2013.

At December 31, 2015, our non-covered nonperforming assets to total non-covered assets was 2.37% compared to 3.09% at December 31, 2014. The decrease is primarily due to on-going resolution of nonperforming assets and improving credit quality.

As it relates to our covered assets, it has now been over six years since we acquired Cooperative Bank and five years since we acquired The Bank of Asheville in failed bank acquisitions, and we have worked through many of the problem assets related to these acquisitions. Our covered nonperforming assets have steadily declined over the past two years from $71 million at December 31, 2013 to $19 million at December 31, 2014 to $12 million at December 31, 2015.

Distribution of Assets and Liabilities

Table 7 sets forth the percentage relationships of significant components of our balance sheet at December 31, 2015, 2014, and 2013.

Our balance sheet mix has remained relatively stable over the past three years. On the asset side, our interest-earning assets have increased while the FDIC indemnification asset and foreclosed real estate percentages have decreased. In 2015, we experienced growth in loans that resulted in loans increasing from 73% of total assets to 74% of total assets. In 2014, we experienced a net decline in loans resulting in loans decreasing from 76% of total assets to 73% of total assets. In 2014, we used a portion of our excess cash to invest in held to maturity securities, which increased from 2% of total assets to 6% of total assets.

On the liability side, as previously discussed, in 2015, we experienced a net increase in total deposits and continued to experience shifts from time deposits to our transaction accounts. We also obtained $70 million additional borrowings in 2015 to help fund the loan growth that we experienced during the year. In 2014, we experienced a net decline in total deposits. We also obtained $70 million in additional borrowings in 2014 to enhance our cash position and in anticipation of future loan growth, which resulted in borrowings increasing from 1% of total assets to 4% of total assets.

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Shareholders’ equity decreased from 12% of total liabilities and shareholders’ equity at December 31, 2014 to 10% at December 31, 2015 as a result of redeeming $63.5 million in SBLF stock during the year.

Securities

Information regarding our securities portfolio as of December 31, 2015, 2014, and 2013 is presented in Tables 8 and 9.

The composition of the investment securities portfolio reflects our investment strategy of maintaining an appropriate level of liquidity while providing a relatively stable source of income. The investment portfolio also provides a balance to interest rate risk and credit risk in other categories of the balance sheet while providing a vehicle for the investment of available funds, furnishing liquidity, and supplying securities to pledge as required collateral for certain deposits. We obtain fair values for the vast majority of our investment securities from a third-party investment recordkeeper, who specializes in securities purchases and sales, recordkeeping, and valuation. This recordkeeper provides us with a third-party report that contains an evaluation of internal controls that includes testwork of securities valuation. We further test the values we receive by comparing the values for a significant sample of securities to another third-party valuation service on a quarterly basis.

Total securities amounted to $320.2 million, $336.7 million, and $223.1 million at December 31, 2015, 2014, and 2013, respectively. The decrease in securities in 2015 was primarily due to securities paydowns, maturities, and calls. The increase in securities during 2014 was the result of our late-2014 decision to invest approximately $125 million of excess cash into securities in an effort to increase our earning asset yield. The $125 million investment was made in the form of government enterprise mortgage-backed securities that had an average yield of 2.43%, an average life of 7.1 years and an average duration of 6.1 years. These securities were classified in the held to maturity category.

The majority of our “government-sponsored enterprise” securities carry one maturity date, often with an issuer call feature. At December 31, 2015, of the $19.0 million (carrying value) in government-sponsored enterprise securities, $7.0 million were issued by the Federal Home Loan Bank system, $9.0 million were issued by Freddie Mac/Fannie Mae, and the remaining $3.0 million were issued by the Federal Farm Credit Bank system.

Our $224.1 million in total mortgage-backed securities have all been issued by Freddie Mac, Fannie Mae, Ginnie Mae, or the Small Business Administration, each of which are government-sponsored corporations. We have no “private label” mortgage-backed securities. Mortgage-backed securities vary in their repayment in correlation with the underlying pools of mortgage loans.

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At December 31, 2015, our $24.9 million investment in corporate bonds was comprised of the following:

($ in thousands)

Issuer	Issuer Ratings		Maturity Date	Amortized Cost	Market Value
Bank of America	BBB+	(1)	1/11/2023	$ 5,021	4,939
Goldman Sachs	BBB+	(1)	1/22/2023	5,126	5,074
JP Morgan Chase	A-	(1)	1/25/2023	5,031	5,001
Citigroup	BBB+	(1)	3/1/2023	5,038	5,012
Financial Institutions, Inc.	BBB-	(2)	4/15/2030	4,000	3,980
First Citizens Bancorp (South Carolina) Trust Preferred Security	Not Rated		6/15/2034	1,000	940
Total investment in corporate bonds				$ 25,216	24,946

(1) Ratings issued by S&P
(2) Rating issued by Kroll Bond Rating (KBRA)

We have concluded that any unrealized losses associated with our corporate bonds are due to coupon rate considerations and not due to credit concerns.

We held $154.6 million in securities held to maturity at December 31, 2015, which had a fair value that exceeded their carrying value by $2.5 million. Approximately $102.5 million of the securities held to maturity are mortgage-backed securities that have been issued by either Freddie Mac or Fannie Mae. The remaining $52.1 million in securities held to maturity are comprised almost entirely of municipal bonds issued by state and local governments throughout our market area. We have only two municipal bonds with a denomination of $2 million or greater and we have no significant concentration of bond holdings from one government entity, with the single largest exposure to any one entity being $3.6 million. Management evaluated any unrealized losses on individual securities at each year end and determined them to be of a temporary nature and caused by fluctuations in market interest rates, not by concerns about the ability of the issuers to meet their obligations.

At December 31, 2015, 2014 and 2013, net unrealized losses of $1.2 million, $0.7 million and $2.0 million, respectively, were included in the carrying value of securities classified as available for sale. Management evaluated any unrealized losses on individual securities at each year end and determined them to be of a temporary nature and caused by fluctuations in market interest rates and the overall economic environment, not by concerns about the ability of the issuers to meet their obligations. Net unrealized losses, net of applicable deferred income taxes, of $0.7 million, $0.4 million, and $1.2 million have been reported as part of a separate component of shareholders' equity (accumulated other comprehensive income) as of December 31, 2015, 2014, and 2013, respectively.

The weighted average taxable-equivalent yield for the securities available for sale portfolio was 2.23% at December 31, 2015. The expected weighted average life of the available for sale portfolio using the call date for above-market callable bonds, the maturity date for all other non-mortgage-backed securities, and the expected life for mortgage-backed securities, was 5.5 years.

The weighted average taxable-equivalent yield for the securities held to maturity portfolio was 3.24% at December 31, 2015. The expected weighted average life of the held to maturity portfolio using the call date for above-market callable bonds, the expected life for mortgage-backed securities, and the maturity date for all other securities, was 4.0 years.

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The following table provides the names of issuers for which the Company has investment securities totaling in excess of 10% of shareholders' equity and the fair value and amortized cost of these investments as of December 31, 2015. All of these securities are issued by government sponsored corporations.

($ in thousands)

Issuer	Amortized Cost	Fair Value	% of Shareholders' Equity
Freddie Mac	$ 80,835	80,525	23.6 %
Fannie Mae	62,717	62,301	18.3 %
Small Business Administration	46,592	45,864	13.6 %
Ginnie Mae	43,838	43,623	12.8 %
Total	$ 233,982	232,313	

Loans

Table 10 provides a summary of the loan portfolio composition of our total loans at each of the past five year ends.

The loan portfolio is the largest category of our earning assets and is comprised of commercial loans, real estate mortgage loans, real estate construction loans, and consumer loans. We restrict virtually all of our lending to our 32 county market area, which is located in western, central and eastern North Carolina, four counties in southern Virginia and three counties in northeastern South Carolina. The diversity of the region's economic base has historically provided a stable lending environment.

As previously discussed, in our acquisitions of Cooperative Bank and The Bank of Asheville, we entered into loss share agreements with the FDIC, which afforded us significant protection from losses on all loans and other real estate acquired in those acquisitions. Because of the loss protection provided by the FDIC, the financial risk of the Cooperative Bank and The Bank of Asheville loans became significantly different from assets not covered under the loss share agreements. Accordingly, we present separately loans subject to the FDIC loss share agreements as "covered loans" and loans that are not subject to the loss share agreements as "non-covered loans." Table 10a presents a breakout of covered and non-covered loans as of December 31, 2015.

On July 1, 2014, one of the Company's loss share agreements with the FDIC expired. The agreement that expired related to the non-single family assets of Cooperative Bank, a failed bank acquisition from June 2009. Accordingly, the remaining balances associated with these loans and foreclosed real estate were transferred from the covered portfolio to the non-covered portfolio on July 1, 2014. The Company will bear all future losses on this portfolio of loans and foreclosed real estate. Immediately prior to the transfer to non-covered status, the loans in this portfolio had a carrying value of $39.7 million and the foreclosed real estate in this portfolio had a carrying value of $3.0 million. Of the $39.7 million in loans that lost loss share protection, approximately $9.7 million were on nonaccrual status and $2.1 million were classified as accruing troubled debt restructurings as of July 1, 2014. Additionally, approximately $1.7 million in allowance for loan losses associated with this portfolio of loans was transferred to the allowance for loan losses for non-covered loans on July 1, 2014.

In 2015, loans outstanding increased $122.8 million, or 5.1% to $2.5 billion. The 2015 increase was primarily due to improved loan demand in our market areas, as well as the hiring of several experienced bankers during the year. In 2014, total loans outstanding decreased $67.0 million, or 2.7% to $2.4 billion. We believe that 2014 loan growth was impacted by a relatively slow economic recovery in many of the Company's market areas, as well as temporary pressures from new internal loan processes that we implemented in 2014 designed to enhance loan quality. Additionally, total covered loans declined by $82.7 million in 2014 (see discussion above regarding a transfer to non-covered status).

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The majority of our loan portfolio over the years has been real estate mortgage loans, with loans secured by real estate consistently comprising 90% to 91% of our outstanding loan balances. Except for real estate construction, land development and other land loans, the majority of our "real estate" loans are personal and commercial loans where cash flow from the borrower's occupation or business is the primary repayment source, with the real estate pledged providing a secondary repayment source.

Table 10 presents a five year history of loans outstanding by type. Real estate construction loans peaked at 23% of total loans in 2007 prior to the recession. These loans experienced the highest losses during the recession and, we, like many banks, tightened underwriting criteria for those loans during that period. As a result, our percentage of real estate construction loans to total loans steadily declined to 12% by December 31, 2013, where it has remained at each year end since. Residential real estate loans have declined from 34% of total loans at December 31, 2013 to 31% of total loans at December 31, 2015, as many customers have taken advantage of the historically low level of interest rates and refinanced their home loans with long-term fixed rate loans, which we typically sell in the secondary market. Commercial real estate loans as a percentage of total loans has increased steadily over the past five years and amounted to 38% of all loans at December 31, 2015. We participated in the Small Business Fund beginning in 2011, which provided monetary incentives for our bank to originate small business loans, which we typically secure with real estate collateral. Additionally, during 2015, we hired several experienced community bankers who originated a significant amount of business loans secured by real estate. Our emphasis on this type of loan is consistent with our community banking strategy.

Table 11 provides a summary of scheduled loan maturities over certain time periods, with fixed rate loans and adjustable rate loans shown separately. Approximately 14% of our accruing loans outstanding at December 31, 2015 mature within one year and 58% of total loans mature within five years. As of December 31, 2015, the percentages of variable rate loans and fixed rate loans as compared to total performing loans were 33% and 67%, respectively. We intentionally make a blend of fixed and variable rate loans so as to reduce interest rate risk. The mix of fixed rate loans has steadily increased over the past several years because many borrowers desire to lock in an interest rate during the historically low interest rate environment that has been in effect. While this presents risk to our company if interest rates rise, we measure our interest rate risk closely and, as discussed in the section "Interest Rate Risk" below, we do not believe that an increase in interest rates would materially negatively impact our net interest income.

Nonperforming Assets

Nonperforming assets include nonaccrual loans, troubled debt restructurings, loans past due 90 or more days and still accruing interest, nonperforming loans held for sale, and foreclosed real estate. As a matter of policy we place all loans that are past due 90 or more days on nonaccrual basis, and thus there were no loans at any of the past five year ends that were 90 days past due and still accruing interest.

Nonaccrual loans are loans on which interest income is no longer being recognized or accrued because management has determined that the collection of interest is doubtful. Placing loans on nonaccrual status negatively impacts earnings because (i) interest accrued but unpaid as of the date a loan is placed on nonaccrual status is reversed and deducted from interest income, (ii) future accruals of interest income are not recognized until it becomes probable that both principal and interest will be paid and (iii) principal charged-off, if appropriate, may necessitate additional provisions for loan losses that are charged against earnings. In some cases, where borrowers are experiencing financial difficulties, loans may be restructured to provide terms significantly different from the originally contracted terms.

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Table 12 summarizes our nonperforming assets at the dates indicated. Because of the loss protection provided by the FDIC, we present separately nonperforming assets subject to the loss share agreements as “covered” and nonperforming assets that are not subject to the loss share agreements as “non-covered.”

Due largely to the economic downturn that began in late 2007 and continued to worsen over succeeding years, we experienced significant increases in our non-covered nonperforming assets, with total non-covered nonperforming assets rising steadily from $11 million at December 31, 2007 to a peak of $146 million at September 30, 2012.

In order to reduce our level of nonperforming assets and lower our overall risk profile, in the fourth quarter of 2012, we identified approximately $68 million of non-covered higher-risk loans, including both performing and non-performing loans, that we targeted for a sale to a third party investor. Based on an offer to purchase these loans that was received in December 2012, we wrote-down the loans by approximately $38 million to their estimated liquidation value of approximately $30 million and reclassified them as “loans held for sale.” Of the $68 million in loans targeted for sale, approximately $38 million had been classified as nonaccrual loans, $11 million had been classified as accruing troubled debt restructurings and the remaining $19 million performing classified loans. The completion of the sale of these loans occurred in January 2013 with sales proceeds of approximately $30 million being received. In the fourth quarter of 2012, we also recorded write-downs totaling $10.6 million on substantially all of our non-covered foreclosed properties in connection with efforts to accelerate the sale of these assets.

As a result of the above actions, our non-covered nonperforming assets decreased from their peak level of $146 million at September 30, 2012 to $106 million at December 31, 2012, which reflects the write-downs of the loans and foreclosed properties, to $83 million at March 31, 2013, which reflects the completion of the January 2013 loan sale. Non-covered nonperforming assets amounted to $95 million at December 31, 2014 compared to $82 million at December 31, 2013. As discussed above, during 2014, we transferred approximately $15 million in nonperforming assets from covered status to non-covered status, which caused the increase from 2013 to 2014. At December 31, 2015, non-covered nonperforming assets amounted to $77.2 million, a decrease of $18.1 million from December 31, 2014. The decline in non-covered nonperforming assets is primarily due to on-going resolution of nonperforming assets and improving credit quality. At December 31, 2015, the ratio of non-covered nonperforming assets to total non-covered assets was 2.37% compared to 3.09% and 2.78% at December 31, 2014 and 2013, respectively.

Total covered nonperforming assets have significantly declined during the past two years, amounting to $12.1 million at December 31, 2015 compared to $18.7 million and $70.6 million at December 31, 2014 and 2013, respectively, with $15 million of the 2014 decline attributable to the transfer to non-covered status. Within this category, foreclosed real estate has declined to $0.8 million compared to $2.4 million at December 31, 2014 and $24.5 million at December 31, 2013. The Company continues to experience good property sales activity, particularly along the North Carolina coast, where most of the Company’s covered foreclosed properties are located.

Table 12a presents our nonperforming assets at December 31, 2015 by general geographic region and further segregated into “covered” nonperforming assets and “non-covered” nonperforming assets.

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The following is the composition, by loan type, of all of our nonaccrual loans at each period end, as classified for regulatory purposes:

($ in thousands)	At December 31, 2015 (1)	At December 31, 2014 (1)
Commercial, financial, and agricultural	$ 2,964	3,575
Real estate – construction, land development, and other land loans	4,704	10,079
Real estate – mortgage – residential (1-4 family) first mortgages	23,829	26,916
Real estate – mortgage – home equity loans/lines of credit	3,525	4,214
Real estate – mortgage – commercial and other	12,571	15,190
Installment loans to individuals	217	600
Total nonaccrual loans	$ 47,810	60,574

(1) Includes both covered and non-covered loans.

The following segregates our nonaccrual loans at December 31, 2015 into covered and non-covered loans, as classified for regulatory purposes:

($ in thousands)	Covered Nonaccrual Loans	Non-covered Nonaccrual Loans	Total Nonaccrual Loans
Commercial, financial, and agricultural	$ —	2,964	2,964
Real estate – construction, land development, and other land loans	52	4,652	4,704
Real estate – mortgage – residential (1-4 family) first mortgages	5,007	18,822	23,829
Real estate – mortgage – home equity loans/lines of credit	383	3,142	3,525
Real estate – mortgage – commercial and other	2,374	10,197	12,571
Installment loans to individuals	—	217	217
Total nonaccrual loans	$ 7,816	39,994	47,810

The following segregates our nonaccrual loans at December 31, 2014 into covered and non-covered loans, as classified for regulatory purposes:

($ in thousands)	Covered Nonaccrual Loans	Non-covered Nonaccrual Loans	Total Nonaccrual Loans
Commercial, financial, and agricultural	$ 104	3,471	3,575
Real estate – construction, land development, and other land loans	1,140	8,939	10,079
Real estate – mortgage – residential (1-4 family) first mortgages	7,724	19,192	26,916
Real estate – mortgage – home equity loans/lines of credit	339	3,875	4,214

Real estate – mortgage – commercial and other	1,201	13,989	15,190
Installment loans to individuals	—	600	600
Total nonaccrual loans	$ 10,508	50,066	60,574

The nonaccrual tables above generally indicate that we experienced decreases in all categories of nonaccrual loans, with the "real estate – construction" category experiencing the largest decline. The decline in nonaccrual loans is due to our on-going focus to resolve our nonperforming loans and improving credit quality.

Management routinely monitors the status of certain large loans that, in management's opinion, have credit weaknesses that could cause them to become nonperforming loans. In addition to the nonperforming loan amounts discussed above, management believes that an estimated $5 million of non-covered loans and $1 million of covered loans that were performing in accordance with their contractual terms at December 31, 2015 have the potential to develop problems depending upon the particular financial situations of the borrowers and economic conditions in general. Management has taken these potential problem loans into consideration when evaluating the adequacy of the allowance for loan losses at December 31, 2015 (see discussion below).

Loans classified for regulatory purposes as loss, doubtful, substandard, or special mention that have not been disclosed in the problem loan amounts and the potential problem loan amounts discussed above do not represent or result from trends or uncertainties that management reasonably expects will materially impact future operating results, liquidity, or capital resources, or represent material credits about which management is aware of any information that causes management to have serious doubts as to the ability of such borrowers to comply with the loan repayment terms.

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We provide additional information regarding the classification status of our loans in tables contained in Note 4 to our consolidated financial statements. As it relates to non-covered loans, those tables indicate that from December 31, 2014 to December 31, 2015 our asset quality improved, with total non-covered classified and nonaccrual loans decreasing from $125 million at December 31, 2014 to $102 million at December 31, 2015.

Foreclosed real estate includes primarily foreclosed properties. Non-covered foreclosed real estate amounted to $9.2 million, $9.8 million, and $12.3 million at December 31, 2015, 2014, and 2013, respectively. Foreclosed property levels have steadily declined in a manner consistent with our strategy implemented in 2012 to accelerate the disposition of foreclosed properties.

At December 31, 2015, 2014 and 2013, we also held $0.8 million, $2.4 million, and $24.5 million, respectively, in foreclosed real estate subject to loss share agreements with the FDIC. The declines in 2014 and 2015 were primarily due to sales of these foreclosed properties as a result of increased property sales activity, particularly along the North Carolina coast, where most of our covered foreclosed properties are located.

The following table presents the detail of our foreclosed real estate at each of the past two year ends:

	At December 31, 2015 (1)	At December 31, 2014 (1)
Vacant land	$ 3,867	4,964
1-4 family residential properties	3,789	2,878
Commercial real estate	2,338	4,279
Total foreclosed real estate	$ 9,994	12,121

(1) Includes both covered and non-covered real estate.

The following segregates our foreclosed real estate at December 31, 2015 into covered and non-covered:

	Covered Foreclosed Real Estate	Non-covered Foreclosed Real Estate	Total Foreclosed Real Estate
Vacant land	$ 277	3,590	3,867
1-4 family residential properties	247	3,542	3,789
Commercial real estate	282	2,056	2,338
Total foreclosed real estate	$ 806	9,188	9,994

The following segregates our foreclosed real estate at December 31, 2014 into covered and non-covered:

	Covered Foreclosed Real Estate	Non-covered Foreclosed Real Estate	Total Foreclosed Real Estate
Vacant land	$ 639	4,325	4,964
1-4 family residential properties	866	2,012	2,878
Commercial real estate	845	3,434	4,279
Total foreclosed real estate	$ 2,350	9,771	12,121

Allowance for Loan Losses and Loan Loss Experience

The allowance for loan losses is created by direct charges to operations (known as a “provision for loan losses” for the period in which the charge is taken). Losses on loans are charged against the allowance in the period in which such loans, in management’s opinion, become uncollectible. The recoveries realized during the period are credited to this allowance. We consider our procedures for recording the amount of the allowance for loan losses and the related provision for loan losses to be a critical accounting policy. See the heading “Critical Accounting Policies” above for further discussion.

The factors that influence management’s judgment in determining the amount charged to operating expense include recent loan loss experience, composition of the loan portfolio, evaluation of probable inherent losses and current economic conditions.

We use a loan analysis and grading program to facilitate our evaluation of probable inherent loan losses and the adequacy of our allowance for loan losses. In this program, credit risk grades are assigned by management and tested by an independent third party consulting firm. The testing program includes an evaluation of a sample of new loans, loans we identify as having potential credit weaknesses, loans past due 90 days or more, loans originated by new loan officers, nonaccrual loans and any other loans identified during previous regulatory and other examinations.

We strive to maintain our loan portfolio in accordance with what management believes are conservative loan underwriting policies that result in loans specifically tailored to the needs of our market areas. Every effort is made to identify and minimize the credit risks associated with such lending strategies. We have no foreign loans, few agricultural loans and do not engage in significant lease financing or highly leveraged transactions. Commercial loans are diversified among a variety of industries. The majority of loans captioned in the tables discussed below as “real estate” loans are personal and commercial loans where real estate provides additional security for the loan. Collateral for virtually all of these loans is located within our principal market area.

The allowance for loan losses amounted to $28.6 million at December 31, 2015 compared to $40.6 million at December 31, 2014 and $48.5 million at December 31, 2013. At December 31, 2015, 2014, and 2013, $1.8 million, $2.3 million, and $4.2 million, respectively, of the allowance for loan losses is attributable to covered loans that have exhibited credit quality deterioration due to lower collateral valuations, while the allowance for loan losses for non-covered loans amounted to $26.8 million, $38.3 million, and $44.3 million, respectively, at those dates.

Our allowance for loan loss model utilizes the net charge-offs experienced in the most recent years as a significant component of estimating the current allowance for loan losses that is necessary. Thus, older years (and parts thereof) systematically age out and are excluded from the analysis as time goes on. The final periods of high net charge-offs we experienced during the peak of the recession dropped out of the analysis in 2015 and were replaced by the more modest levels of net charge-offs now being experienced. The fourth quarter of 2015 marked our twelfth consecutive quarter of annualized net charge-offs related to non-covered loans being less than 1.00%, whereas at the peak of the recession, that ratio was frequently over 1.00%. Accordingly, the relatively low provision for non-covered loans recorded in 2015 resulted in our non-covered allowance for loan loss declining to a more normalized level following the elevated amounts we maintained during and immediately following the recession. In 2016, we expect that it is likely we will record a higher amount of provision for loan losses than we did in 2015, as we provide for on-going loan charge-offs and expected new loan growth.

The ratio of the allowance for non-covered loan losses to non-covered loans was 1.11%, 1.69%, and 1.96%, as of December 31, 2015, 2014, and 2013, respectively. The decline in this ratio during 2015 was the result of $13.6 million in net charge-offs recorded that reduced the allowance for loan losses and which significantly exceeded the $2.0 million added to the allowance for loan losses via provisions for loan losses.

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Table 13 sets forth the allocation of the allowance for loan losses at the dates indicated. The amount of the unallocated portion of the allowance for loan losses did not vary materially at any of the past three year ends. The allowance for loan losses is available to absorb losses in all categories. Table 13a segregates the allocation of the allowance for loan losses as of December 31, 2015 and 2014 into covered and non-covered categories.

Management considers the allowance for loan losses adequate to cover probable loan losses on the loans outstanding as of each reporting date. It must be emphasized, however, that the determination of the allowance using our procedures and methods rests upon various judgments and assumptions about economic conditions and other factors affecting loans. No assurance can be given that we will not in any particular period sustain loan losses that are sizable in relation to the amount reserved or that subsequent evaluations of the loan portfolio, in light of conditions and factors then prevailing, will not require significant changes in the allowance for loan losses or future charges to earnings.

In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses and losses on foreclosed real estate. Such agencies may require us to recognize additions to the allowance based on the examiners' judgments about information available to them at the time of their examinations.

For the years indicated, Table 14 summarizes our balances of loans outstanding, average loans outstanding, and a detailed rollforward of the allowance for loan losses.

Table 14a presents a detailed rollforward of the 2015 and 2014 activity for the allowance for loan losses segregated into covered and non-covered activity.

Net loan charge-offs of non-covered loans amounted to $13.6 million in 2015, $14.7 million in 2014, and $15.6 million in 2013. Net non-covered charge-offs as a percentage of average non-covered loans represented 0.58%, 0.65%, and 0.72% during 2015, 2014, and 2013, respectively. The trend of lower net charge-offs is associated with lower levels of nonperforming loans that have been impacted with improvements in the economy and real estate prices.

We recorded ($2.3 million), $3.3 million, and $12.9 million in net charge-offs (recoveries) of covered loans during 2015, 2014, and 2013, respectively. In 2015, we received recoveries of $3.6 million, which more than offset charge-offs of $1.3 million. The significant improvements in 2015 and 2014 were primarily a result of lower levels of classified covered loans.

Deposits

At December 31, 2015, deposits outstanding amounted to $2.811 billion, an increase of $115 million from the $2.696 billion at December 31, 2014. During 2015 we experienced strong growth in our noninterest-bearing and interest-bearing checking accounts, and declines in our higher cost time deposits, including brokered time deposits and internet time deposits.

At December 31, 2014, deposits outstanding amounted to $2.696 billion, a decrease of $55 million from the $2.751 billion at December 31, 2013. Similar to 2015, during 2014, we experienced strong growth in our noninterest-bearing and interest-bearing checking accounts. However, these increases were offset by declines in our higher cost time deposits, including brokered time deposits and internet time deposits. We were able to lessen our reliance on higher-cost time deposits due to the continued growth in our transaction accounts and cash generated from our FDIC loss-share reimbursements and sales of foreclosed properties.

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The nature of our deposit growth is illustrated in the table on page 55. The following table reflects the mix of our deposits at each of the past three year ends:

	2015	2014	2013
Noninterest-bearing checking accounts	23%	21%	18%
Interest-bearing checking accounts	22%	22%	20%
Money market deposits	23%	20%	20%
Savings deposits	7%	7%	6%
Brokered deposits	3%	3%	4%
Internet deposits	0%	0%	0%
Time deposits > $100,000 – retail	12%	14%	16%
Time deposits < $100,000 – retail	10%	13%	16%
Total deposits	100%	100%	100%

Our deposit mix has shifted over the past few years to a heavier concentration in transaction accounts and less concentration in time deposits. The percentages for retail time deposits have declined because of a combination of 1) customers shifting their matured time deposits into checking accounts because of a steadily shrinking gap between the interest rates that the two products pay and 2) because of satisfactory levels of liquidity, we have chosen not to match certain promotional time deposit interest rates being offered by local competitors.

We routinely engage in activities designed to grow and retain deposits, such as (1) emphasizing relationship banking to new and existing customers, where borrowers are encouraged and normally expected to maintain deposit accounts with us, (2) pricing deposits at rate levels that will attract and/or retain deposits, and (3) continually working to identify and introduce new products that will attract customers or enhance our appeal as a primary provider of financial services.

Table 15 presents the average amounts of our deposits and the average yield paid for those deposits for the years ended December 31, 2015, 2014, and 2013.

As of December 31, 2015, we held approximately $403.5 million in time deposits of $100,000 or more. Table 16 is a maturity schedule of time deposits of $100,000 or more as of December 31, 2015. This table shows that 81% of our time deposits greater than $100,000 mature within one year.

At each of the past three year ends, we have no deposits issued through foreign offices, nor do we believe that we held any deposits by foreign depositors.

Borrowings

Our borrowings outstanding totaled $186.4 million at December 31, 2015, $116.4 million at December 31, 2014 and $46.4 million at December 31, 2013. In 2015, we obtained new borrowings of $70 million from a low cost funding source to help support our loan growth experienced during the year. In 2014, we obtained new borrowings of $70 million from a low cost funding source in order to enhance our cash position and in anticipation of future loan growth.

Table 2 shows that average borrowings were $149.8 million in 2015, $99.4 million in 2014, and $46.4 million in 2013.

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At December 31, 2015, the Company had four sources of readily available borrowing capacity – 1) an approximately $589 million line of credit with the FHLB, of which $140 million and $70 million was outstanding at December 31, 2015 and 2014, respectively, 2) a $50 million overnight federal funds line of credit with a correspondent bank, of which none was outstanding at December 31, 2015 or 2014, and 3) a $35 million federal funds line of credit with a correspondent bank, of which none was outstanding at December 31, 2015, and 4) an approximately $88 million line of credit through the Federal Reserve Bank of Richmond's (FRB) discount window, of which none was outstanding at December 31, 2015 or 2014.

Our line of credit with the FHLB can be structured as either short-term or long-term borrowings, depending on the particular funding or liquidity need, and is secured by our FHLB stock and a blanket lien on most of our real estate loan portfolio. For the year ended December 31, 2015, the average amount of FHLB borrowings outstanding was approximately $103 million with a weighted average interest rate for the year of 0.54%. The maximum amount of short-term FHLB borrowings outstanding at any month-end during 2015 was $180 million. For the year ended December 31, 2014, the average amount of FHLB borrowings outstanding was approximately $53 million with a weighted average interest rate for the year of 0.27%. The maximum amount of short-term FHLB borrowings outstanding at any month-end during 2014 was $70 million.

In addition to any outstanding borrowings from the FHLB that reduce the available borrowing capacity of the line of credit, our borrowing capacity was further reduced by $193 million at both December 31, 2015 and 2014, as a result of our pledging letters of credit backed by the FHLB for public deposits at each of those dates.

Our two correspondent bank relationships allow us to purchase up to $50 million and $35 million in federal funds on an overnight, unsecured basis (federal funds purchased). We had no borrowings under these lines at December 31, 2015 or 2014. There were no federal funds purchased outstanding at any month-end during 2015 or 2014.

We also have a line of credit with the FRB discount window. This line is secured by a blanket lien on a portion of our commercial and consumer loan portfolio (excluding real estate loans). Based on the collateral that we owned as of December 31, 2015, the available line of credit was approximately $88 million. At December 31, 2015 and 2014, we had no borrowings outstanding under this line. The maximum amount of FRB borrowings outstanding at any month-end during 2015 or 2014 was $0 and $20 million, respectively.

In addition to the lines of credit described above, we also had a total of $46.4 million in trust preferred security debt outstanding at December 31, 2015 and 2014. We have initiated three trust preferred security issuances since 2002 totaling $67.0 million, with one of those issuances for $20.6 million being redeemed in 2007. These borrowings each have 30 year final maturities and were structured in a manner that allows them to qualify as capital for regulatory capital adequacy requirements. We may call these debt securities at par on any quarterly interest payment date five years after their issue date. We issued $20.6 million of this debt on October 29, 2002 (which we called in 2007), an additional $20.6 million on December 19, 2003, and $25.8 million on April 13, 2006. The interest rate on these debt securities adjusts on a quarterly basis at a rate of three-month LIBOR plus 2.70% for the securities issued in 2003, and three-month LIBOR plus 1.39% for the securities issued in 2006.

Liquidity, Commitments, and Contingencies

Our liquidity is determined by our ability to convert assets to cash or to acquire alternative sources of funds to meet the needs of our customers who are withdrawing or borrowing funds, and our ability to maintain required reserve levels, pay expenses and operate the Company on an ongoing basis. Our primary liquidity sources are net income from operations, cash and due from banks, federal funds sold and other short-term investments. Our securities portfolio is comprised almost entirely of readily marketable securities which could also be sold to provide cash.

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As noted above, in addition to internally generated liquidity sources, at December 31, 2015, we had the ability to obtain borrowings from the following three sources – 1) an approximately $589 million line of credit with the FHLB, 2) a $50 million overnight federal funds line of credit with a correspondent bank, 3) a $35 million federal funds line with a correspondent bank, and 4) an approximately $88 million line of credit through the FRB's discount window.

Our overall liquidity decreased slightly in 2015 compared to 2014 due primarily to loan growth and the redemption of the $63.5 million in SBLF stock. Our liquid assets (cash and securities) as a percentage of our total deposits and borrowings decreased from 21.2% at December 31, 2014 to 19.7% at December 31, 2015.

We continue to believe our liquidity sources, including unused lines of credit, are at an acceptable level and remain adequate to meet our operating needs in the foreseeable future. We will continue to monitor our liquidity position carefully and will explore and implement strategies to increase liquidity if deemed appropriate.

In the normal course of business we have various outstanding contractual obligations that will require future cash outflows. In addition, there are commitments and contingent liabilities, such as commitments to extend credit, that may or may not require future cash outflows.

Table 18 reflects our contractual obligations and other commercial commitments outstanding as of December 31, 2015. Any of our $140 million in outstanding borrowings with the FHLB may be accelerated immediately by the FHLB in certain circumstances, including material adverse changes in our condition or if our qualifying collateral is less than the amount required under the terms of the borrowing agreement.

In the normal course of business there are various outstanding commitments and contingent liabilities such as commitments to extend credit, which are not reflected in the financial statements. The following table presents a summary of our outstanding loan commitments as of December 31, 2015:

($ in millions)

Type of Commitment	Fixed Rate	Variable Rate	Total
Outstanding closed-end loan commitments	$ 81	156	237
Unfunded commitments on revolving lines of credit, credit cards and home equity loans	69	218	287
Total	$ 150	374	524

At December 31, 2015 and 2014, we also had $13.1 million and $14.1 million, respectively, in standby letters of credit outstanding. We had no carrying amount for these standby letters of credit at either of those dates. The nature of the standby letters of credit is that of a guarantee made on behalf of our customers to suppliers of the customers to guarantee payments owed to the supplier by the customer. The standby letters of credit are generally for terms of one year, at which time they may be renewed for another year if both parties agree. The payment of the guarantees would generally be triggered by a continued nonpayment of an obligation owed by the customer to the supplier. The maximum potential amount of future payments (undiscounted) we could be required to make under the guarantees in the event of nonperformance by the parties to whom credit or financial guarantees have been extended is represented by the contractual amount of the financial instruments discussed above. In the event that we are required to honor a standby letter of credit, a note, already executed by the customer, becomes effective providing repayment terms and any collateral. Over the past two years, we have had to honor only a few standby letters of credit, none of which resulted in any loss to the Company. We expect any draws under existing commitments to be funded through normal operations.

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It has been our experience that deposit withdrawals are generally able to be replaced with new deposits when needed. Based on that assumption, management believes that it can meet its contractual cash obligations and existing commitments from normal operations.

We are not involved in any legal proceedings that, in management's opinion, are likely to have a material effect on the consolidated financial position of the Company.

Capital Resources and Shareholders' Equity

Shareholders' equity at December 31, 2015 amounted to $342.2 million compared to $387.7 million at December 31, 2014 and $371.9 million at December 31, 2013. The two basic components that typically have the largest impact on our shareholders' equity are net income, which increases shareholders' equity, and dividends declared, which decreases shareholders' equity. Additionally, any stock issuances (redemptions) can significantly increase (decrease) shareholders' equity.

In 2015, the most significant factors that impacted our equity were 1) the $63.5 million redemption of our Series B Preferred Stock issued to the U.S. Treasury in 2011 under the Small Business Lending Fund, which reduced equity (see Note 19 to our consolidated financial statements), 2) the $27.0 million net income reported for 2015, which increased equity, 3) common stock dividends declared of $6.3 million, which reduced equity. Another factor negatively impacting equity in 2015 was a $2.7 million decrease in accumulated other comprehensive income that was caused primarily by an increase in our pension liability. The increase in the pension liability was primarily due to underperformance of our pension plan assets during 2015 (see Note 12 to the consolidated financial statements). See the Consolidated Statements of Shareholders' Equity within the consolidated financial statements for disclosure of other less significant items affecting shareholders' equity.

In 2014, the most significant factors that impacted our equity were 1) the $25.0 million net income reported for 2014, which increased equity, 2) common stock dividends declared of $6.3 million, which reduced equity, 3) preferred stock dividends declared of $0.9 million, which reduced equity. Another significant factor negatively impacting equity in 2014 was a $3.3 million decrease in accumulated other comprehensive income that was caused by an increase in our pension liability. The increase in the pension liability was primarily due to the impact of lower interest rates on the actuarial calculations involved in determining the liability. Our policy is to use the Citigroup Pension Index yield curve in the computation of the pension liability. At December 31, 2014, that index had a weighted average rate of 3.82%, which was a decline from the rate of 4.78% at December 31, 2013 (see Note 12 to the consolidated financial statements). See the Consolidated Statements of Shareholders' Equity within the consolidated financial statements for disclosure of other less significant items affecting shareholders' equity.

In 2013, the most significant factors that impacted our equity were 1) the $20.7 million net income reported for 2013, which increased equity, 2) common stock dividends declared of $6.3 million, which reduced equity, 3) preferred stock dividends declared of $0.9 million, which reduced equity, and 4) a $3.1 million increase in equity primarily related to unrealized gains experienced in our two pension plans (see Note 12), which was offset by a $1.0 million decrease in equity related to unrealized losses in our securities portfolio. See the Consolidated Statements of Shareholders' Equity within the consolidated financial statements for disclosure of other less significant items affecting shareholders' equity.

At December 31, 2014 and 2013, we had $63.5 million in Series B Preferred Stock that was issued in 2011 to the U.S. Treasury. This stock qualified as Tier I capital under all current and proposed regulatory rules. For 2013 and 2014, we paid preferred dividends on that stock at an annual rate of 1%. In June 2015, we redeemed $32.5 million in the Series B Preferred Stock and in October 2015, we redeemed the remaining $31 million outstanding (see additional discussion in Note 19 to the consolidated financial statements).

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In addition to shareholders' equity, we have supplemented our capital in past years with trust preferred security debt issuances, which because of their structure qualify as regulatory capital. This was necessary in past years because our balance sheet growth outpaced the growth rate of our capital. Additionally, we have frequently purchased bank branches over the years that resulted in our recording intangible assets, which negatively impacted regulatory capital ratios. As discussed in "Borrowings" above, we currently have $46.4 million in trust preferred securities outstanding, all of which qualify as Tier I capital under both current and forthcoming regulatory standards.

We are not aware of any recommendations of regulatory authorities or otherwise which, if they were to be implemented, would have a material effect on our liquidity, capital resources, or operations.

The Company and the Bank must comply with regulatory capital requirements established by the Federal Reserve System (the "FED"). Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements.

In 2013, the FED approved final rules implementing the Basel Committee on Banking Supervision capital guidelines, referred to a "Basel III." The final rules established a new "Common Equity Tier I" ratio; new higher capital ratio requirements, including a capital conservation buffer; narrowed the definitions of capital; imposed new operating restrictions on banking organizations with insufficient capital buffers; and increased the risk weighting of certain assets. The final rules became effective January 1, 2015 for the Company.

Common Equity Tier I capital ("CET1") is comprised of common stock and related surplus, plus retained earnings, and is reduced by goodwill and other intangible assets, net of associated deferred tax liabilities. Tier I capital is comprised of Common Equity Tier I capital plus Additional Tier I capital, which for the Company includes non-cumulative perpetual preferred stock and trust preferred securities. Total capital is comprised of Tier I capital plus certain adjustments, the largest of which for the Company and the Bank is the allowance for loan losses. Risk-weighted assets refer to the on- and off-balance sheet exposures of the Company and the Bank, adjusted for their related risk levels using formulas set forth in FRB regulations.

Under the Basel III Capital Rules, the following are the initial minimum capital ratios applicable to the Company and the Bank as of January 1, 2015:

- 4.5% CET1 to risk-weighted assets;
- 6.0% Tier I capital (that is, CET1 plus Additional Tier I capital) to risk-weighted assets;
- 8.0% total capital (that is, Tier I capital plus Tier II capital) to risk-weighted assets; and
- 4.0% Tier I leverage ratio (that is Tier I capital to quarterly average total assets.

The Basel III Capital Rules also introduce a new "capital conservation buffer," composed entirely of CET1, on top of these minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall. The implementation of the capital conservation buffer began on January 1, 2016 at 0.625% and will be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019). Thus, when fully phased-in on January 1, 2019, the Company and the Bank will be required to maintain this additional capital conservation buffer of 2.5% of CET1, resulting in the following minimum capital ratios:

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- 4.5% CET1 to risk-weighted assets, plus the capital conservation buffer, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7%;
- 6.0% Tier I capital to risk-weighted assets, plus the capital conservation buffer, effectively resulting in a minimum Tier I capital ratio of at least 8.5%;
- 8.0% total capital to risk-weighted assets, plus the capital conservation buffer, effectively resulting in a minimum total capital ratio of at least 10.5%; and
- 4.0% Tier I leverage ratio

In addition to the minimum capital requirements described above, the regulatory framework for prompt corrective action also contains specific capital guidelines for a bank's classification as "well capitalized." The specific guidelines as of January 1, 2015 are as follows –

- Common Equity Tier I Capital Ratio of at least 6.50%;
- Tier I Capital Ratio of at least 8.00%;
- Total Capital Ratio of at least 10.00%; and a
- Leverage Ratio of at least 5.00%

If a bank falls below "well capitalized" status in any of these three ratios, it must ask for FDIC permission to originate or renew brokered deposits. The Bank's regulatory ratios exceeded the threshold for "well-capitalized" status at December 31, 2015, 2014, and 2013 – see Note 16 to the consolidated financial statements for a table that presents the Bank's regulatory ratios.

Table 21 presents our regulatory capital ratios as of December 31, 2015, 2014, and 2013. All of our capital ratios have significantly exceeded the minimum regulatory thresholds for all periods covered by this report.

In this economic environment, our goal is to maintain our capital ratios at levels at least 200 basis points higher than the "well-capitalized" thresholds set for banks. At December 31, 2015, our total risk-based capital ratio was 14.45% compared to the 10.00% "well-capitalized" threshold.

In addition to regulatory capital ratios, we also closely monitor our ratio of tangible common equity to tangible assets ("TCE Ratio"). Our TCE ratio was 8.13% at December 31, 2015 compared to 7.90% at December 31, 2014.

See "Supervision and Regulation" under "Business" above and Note 16 to the consolidated financial statements for discussion of other matters that may affect our capital resources.

Off-Balance Sheet Arrangements and Derivative Financial Instruments

Off-balance sheet arrangements include transactions, agreements, or other contractual arrangements pursuant to which we have obligations or provide guarantees on behalf of an unconsolidated entity. We have no off-balance sheet arrangements of this kind other than letters of credit and repayment guarantees associated with our trust preferred securities.

Derivative financial instruments include futures, forwards, interest rate swaps, options contracts, and other financial instruments with similar characteristics. We have not engaged in significant derivatives activities through December 31, 2015 and have no current plans to do so.

Return on Assets and Equity

Table 20 shows return on average assets (net income available to common shareholders divided by average total assets), return on average common equity (net income available to common shareholders divided by average common shareholders' equity), dividend payout ratio (dividends per share divided by net income per common share) and shareholders' equity to assets ratio (average total shareholders' equity divided by average total assets) for each of the years in the three-year period ended December 31, 2015.

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Interest Rate Risk (Including Quantitative and Qualitative Disclosures About Market Risk – Item 7A.)

Net interest income is our most significant component of earnings. Notwithstanding changes in volumes of loans and deposits, our level of net interest income is continually at risk due to the effect that changes in general market interest rate trends have on interest yields earned and paid with respect to our various categories of earning assets and interest-bearing liabilities. It is our policy to maintain portfolios of earning assets and interest-bearing liabilities with maturities and repricing opportunities that will afford protection, to the extent practical, against wide interest rate fluctuations. Our exposure to interest rate risk is analyzed on a regular basis by management using standard GAP reports, maturity reports, and an asset/liability software model that simulates future levels of interest income and expense based on current interest rates, expected future interest rates, and various intervals of "shock" interest rates. Over the years, we have been able to maintain a fairly consistent yield on average earning assets (net interest margin). Over the past five calendar years, our net interest margin has ranged from a low of 4.13% (realized in 2015) to a high of 4.92% (realized in 2013). During that five year period, the prime rate of interest has consistently remained at 3.25% (the rate increased to 3.50% on December 17, 2015). The consistency of the net interest margin is aided by the relatively low level of long-term interest rate exposure that we maintain. At December 31, 2015, approximately 76% of our interest-earning assets are subject to repricing within five years (because they are either adjustable rate assets or they are fixed rate assets that mature) and substantially all of our interest-bearing liabilities reprice within five years.

Table 17 sets forth our interest rate sensitivity analysis as of December 31, 2015, using stated maturities for all fixed rate instruments except mortgage-backed securities (which are allocated in the periods of their expected payback) and securities and borrowings with call features that are expected to be called (which are shown in the period of their expected call). As illustrated by this table, at December 31, 2015, we had $961 million more in interest-bearing liabilities that are subject to interest rate changes within one year than earning assets. This generally would indicate that net interest income would experience downward pressure in a rising interest rate environment and would benefit from a declining interest rate environment. However, this method of analyzing interest sensitivity only measures the magnitude of the timing differences and does not address earnings, market value, or management actions. Also, interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. In addition to the effects of "when" various rate-sensitive products reprice, market rate changes may not result in uniform changes in rates among all products. For example, included in interest-bearing liabilities subject to interest rate changes within one year at December 31, 2015 are deposits totaling $1.45 billion comprised of checking, savings, and certain types of money market deposits with interest rates set by management. These types of deposits historically have not repriced with, or in the same proportion, as general market indicators.

Overall, we believe that in the near term (twelve months), net interest income will not likely experience significant downward pressure from rising interest rates. Similarly, we would not expect a significant increase in near term net interest income from falling interest rates. Generally, when rates change, our interest-sensitive assets that are subject to adjustment reprice immediately at the full amount of the change, while our interest-sensitive liabilities that are subject to adjustment reprice at a lag to the rate change and typically not to the full extent of the rate change. In the short-term (less than six months), this results in us being asset-sensitive, meaning that our net interest income benefits from an increase in interest rates and is negatively impacted by a decrease in interest rates. However, in the twelve-month horizon, the impact of having a higher level of interest-sensitive liabilities lessens the short-term effects of changes in interest rates.

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The general discussion in the foregoing paragraph applies most directly in a “normal” interest rate environment in which longer-term maturity instruments carry higher interest rates than short-term maturity instruments, and is less applicable in periods in which there is a “flat” interest rate curve. A “flat yield curve” means that short-term interest rates are substantially the same as long-term interest rates. As a result of the prolonged negative/fragile economic environment, the Federal Reserve took steps to suppress long-term interest rates in an effort to boost the housing market, increase employment, and stimulate the economy, which resulted in a flat interest rate curve. A flat interest rate curve is an unfavorable interest rate environment for many banks, including the Company, as short-term interest rates generally drive our deposit pricing and longer-term interest rates generally drive loan pricing. When these rates converge, the profit spread we realize between loan yields and deposit rates narrows, which pressures our net interest margin.

While there have been periods in the last few years that the yield curve has steepened somewhat, it currently remains relatively flat. This flat yield curve and the intense competition for high-quality loans in our market areas have limited our ability to charge higher rates on loans, and thus we continue to experience downward pressure on our loan yields and net interest margin.

As it relates to deposits, the Federal Reserve made no changes to the short term interest rates it sets directly from 2008 until mid-December 2015, and since that time we have been able to reprice many of our maturing time deposits at lower interest rates. We have also been able to generally decrease the rates we paid on other categories of deposits as a result of declining short-term interest rates in the marketplace and an increase in liquidity that lessened our need to offer premium interest rates. However, as short-term rates are already near zero and with the Federal Reserve recently increasing short-term interest rates by 25 bps, it is unlikely that we will be able to continue the trend of reducing our funding costs in the same proportion as experienced in recent years.

As previously discussed in the section “Net Interest Income,” our net interest income has been impacted by certain purchase accounting adjustments related primarily to our acquisitions of Cooperative Bank and The Bank of Asheville. The purchase accounting adjustments related to the premium amortization on loans, deposits and borrowings are based on amortization schedules and are thus systematic and predictable. The accretion of the loan discount on loans acquired from Cooperative Bank and The Bank of Asheville, which amounted to $4.8 million and $16.0 million for 2015 and 2014, respectively, is less predictable and can be materially different among periods. This is because of the magnitude of the discounts that were initially recorded ($280 million in total) and the fact that the accretion being recorded is dependent on both the credit quality of the acquired loans and the impact of any accelerated loan repayments, including payoffs. If the credit quality of the loans declines, some, or all, of the remaining discount will cease to be accreted into income. If the underlying loans experience accelerated paydowns or improved performance expectations, the remaining discount will be accreted into income on an accelerated basis. In the event of total payoff, the remaining discount will be entirely accreted into income in the period of the payoff. Each of these factors is difficult to predict and susceptible to volatility. However, with the remaining loan discount on accruing loans having naturally declined since inception, amounting to only $13.1 million at December 31, 2015 (compared to $17.6 million a year earlier), we expect that loan discount accretion, and the related indemnification asset expense associated with the accretion, will again decline in 2016. If that occurs, our net interest margin will be negatively impacted and our noninterest income will be positively impacted (due to the lower indemnification asset expense).

Based on our most recent interest rate modeling, which assumes no changes in interest rates for 2016 (federal funds rate = 0.50%, prime = 3.50%), we project that our net interest margin for 2016 will experience additional compression. We expect loan yields to continue to trend downwards, while many of our deposit products already have interest rates near zero.

We have no market risk sensitive instruments held for trading purposes, nor do we maintain any foreign currency positions. Table 19 presents the expected maturities of our other than trading market risk sensitive financial instruments. Table 19 also presents the estimated fair values of market risk sensitive instruments as estimated in accordance with relevant accounting guidance. Our assets and liabilities have estimated fair values that do not materially differ from their carrying amounts.

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See additional discussion regarding net interest income, as well as discussion of the changes in the annual net interest margin, in the section entitled "Net Interest Income" above.

Inflation

Because the assets and liabilities of a bank are primarily monetary in nature (payable in fixed determinable amounts), the performance of a bank is affected more by changes in interest rates than by inflation. Interest rates generally increase as the rate of inflation increases, but the magnitude of the change in rates may not be the same. The effect of inflation on banks is normally not as significant as its influence on those businesses that have large investments in plant and inventories. During periods of high inflation, there are normally corresponding increases in the money supply, and banks will normally experience above average growth in assets, loans and deposits. Also, general increases in the price of goods and services will result in increased operating expenses.

Current Accounting Matters

We prepare our consolidated financial statements and related disclosures in conformity with standards established by, among others, the Financial Accounting Standards Board (the "FASB"). Because the information needed by users of financial reports is dynamic, the FASB frequently issues new rules and proposes new rules for companies to apply in reporting their activities. See Note 1(u) to our consolidated financial statements for a discussion of recent rule proposals and changes.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

The information responsive to this Item is found in Item 7 under the caption "Interest Rate Risk."

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Table 1 Selected Consolidated Financial Data

($ in thousands, except per share and nonfinancial data)	Year Ended December 31, 2015	2014	2013	2012	2011
Income Statement Data					
Interest income	$126,655	139,832	147,511	152,520	155,768
Interest expense	6,908	8,223	10,985	17,320	23,565
Net interest income	119,747	131,609	136,526	135,200	132,203
Provision (reversal) for loan losses	(780)	10,195	30,616	79,672	41,301
Net interest income after provision	120,527	121,414	105,910	55,528	90,902
Noninterest income	18,764	14,368	23,489	1,389	26,216
Noninterest expense	98,131	97,251	96,619	97,275	96,106
Income (loss) before income taxes	41,160	38,531	32,780	(40,358)	21,012
Income taxes (benefit)	14,126	13,535	12,081	(16,952)	7,370
Net income (loss)	27,034	24,996	20,699	(23,406)	13,642
Preferred stock dividends	(603)	(868)	(895)	(2,809)	(3,234)
Accretion of preferred stock discount	—	—	—	—	(2,932)
Net income (loss) available to common shareholders	26,431	24,128	19,804	(26,215)	7,476
Earnings (loss) per common share – basic	1.34	1.22	1.01	(1.54)	0.44
Earnings (loss) per common share – diluted	1.30	1.19	0.98	(1.54)	0.44
Per Share Data (Common)					
Cash dividends declared – common	$0.32	0.32	0.32	0.32	0.32
Market Price					
High	19.92	19.65	17.39	13.40	16.89
Low	15.00	15.55	11.98	7.68	8.05
Close	18.74	18.47	16.62	12.82	11.15
Stated book value – common	16.96	16.08	15.30	14.51	16.66
Tangible book value – common	13.56	12.63	11.81	11.00	12.53
Selected Balance Sheet Data (at year end)					
Total assets	$3,362,065	3,218,383	3,185,070	3,244,910	3,290,474
Loans – non-covered	2,416,285	2,268,580	2,252,885	2,094,143	2,069,152
Loans – covered	102,641	127,594	210,309	282,314	361,234
Total loans	2,518,926	2,396,174	2,463,194	2,376,457	2,430,386
Allowance for loan losses	28,583	40,626	48,505	46,402	41,418
Intangible assets	67,171	67,893	68,669	68,943	69,732
Deposits	2,811,285	2,695,906	2,751,019	2,821,360	2,755,037
Borrowings	186,394	116,394	46,394	46,394	133,925
Total shareholders' equity	342,190	387,699	371,922	356,117	345,150
Selected Average Balances					

Assets	$3,230,302	3,219,915	3,208,458	3,311,289	3,315,045
Loans – non-covered	2,320,503	2,274,554	2,175,023	2,114,489	2,051,677
Loans – covered	114,099	159,777	244,656	322,508	410,318
Total loans	2,434,602	2,434,331	2,419,679	2,436,997	2,461,995
Earning assets	2,936,624	2,907,098	2,805,112	2,857,541	2,834,938
Deposits	2,687,381	2,723,758	2,779,032	2,809,357	2,758,022
Interest-bearing liabilities	2,218,246	2,294,330	2,380,747	2,553,175	2,606,450
Shareholders' equity	376,287	383,055	362,770	345,981	353,588
Ratios					
Return on average assets	0.82%	0.75%	0.62%	(0.79%)	0.23%
Return on average common equity	8.04%	7.73%	6.78%	(9.29%)	2.59%
Net interest margin (taxable-equivalent basis)	4.13%	4.58%	4.92%	4.78%	4.72%
Tangible common equity to tangible assets	8.13%	7.90%	7.46%	6.81%	6.58%
Loans to deposits at year end	89.60%	88.88%	89.54%	84.23%	88.22%
Allowance for loan losses to total loans	1.13%	1.70%	1.97%	1.95%	1.70%
Allowance for loan losses to total loans – non-covered	1.11%	1.69%	1.96%	1.99%	1.72%
Nonperforming assets to total assets at year end	2.66%	3.54%	4.79%	6.24%	8.00%
Nonperforming assets to total assets – non-covered	2.37%	3.09%	2.78%	3.64%	4.30%
Net charge-offs to average total loans	0.46%	0.74%	1.18%	3.06%	2.00%
Net charge-offs to average total loans – non-covered	0.58%	0.65%	0.72%	3.02%	1.52%
Nonfinancial Data – number of branches	88	87	96	97	97
Nonfinancial Data – number of employees (FTEs)	812	798	855	831	830

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Table 2 Average Balances and Net Interest Income Analysis

	Year Ended December 31,							
	2015			2014			2013	
	Average Volume	Avg. Rate	Interest Earned or Paid	Average Volume	Avg. Rate	Interest Earned or Paid	Average Volume	Avg. Rate
($ in thousands)								
Assets								
Loans (1) (2)	$2,434,602	4.84%	$117,872	$2,434,331	5.49%	$133,641	$2,419,679	5.85%
Taxable securities	296,181	2.13%	6,296	167,844	2.06%	3,461	175,184	1.95%
Non-taxable securities (3)	52,449	6.60%	3,463	53,888	6.28%	3,383	54,785	6.22%
Short-term investments, primarily overnight funds	153,392	0.43%	658	251,035	0.34%	849	155,464	0.38%
Total interest-earning assets	2,936,624	4.37%	128,289	2,907,098	4.86%	141,334	2,805,112	5.31%
Cash and due from banks	61,212			81,290			80,659	
Bank premises and equipment, net	75,452			76,463			77,252	
Other assets	157,014			155,064			245,435	
Total assets	$3,230,302			$3,219,915			$3,208,458	
Liabilities and Equity								
Interest-bearing checking accounts	$568,329	0.06%	$335	$535,738	0.06%	$322	$530,566	0.09%
Money market accounts	582,407	0.13%	765	552,940	0.11%	630	560,809	0.16%
Savings accounts	184,821	0.05%	92	176,362	0.05%	88	166,388	0.07%
Time deposits >$100,000	410,692	0.70%	2,856	542,303	0.81%	4,373	607,028	0.96%
Other time deposits	322,205	0.39%	1,271	387,607	0.43%	1,659	469,562	0.56%
Total interest-bearing deposits	2,068,454	0.26%	5,319	2,194,950	0.32%	7,072	2,334,353	0.43%
Borrowings	149,792	1.06%	1,589	99,380	1.16%	1,151	46,394	2.21%
Total interest-bearing liabilities	2,218,246	0.31%	6,908	2,294,330	0.36%	8,223	2,380,747	0.46%
Noninterest-bearing checking accounts	618,927			528,808			444,679	
Other liabilities	16,842			13,722			20,262	
Shareholders' equity	376,287			383,055			362,770	
Total liabilities and shareholders' equity	$3,230,302			$3,219,915			$3,208,458	
Net yield on interest-earning assets and net interest income		4.13%	$121,381		4.58%	$133,111		4.92%
Interest rate spread		4.06%			4.50%			4.85%
Average prime rate		3.26%			3.25%			3.25%

(1) Average loans include nonaccruing loans, the effect of which is to lower the average rate shown. Interest earned includes recognized net loan fees (costs) in the amounts of ($39,000), $143,700, and ($192,900) for 2015, 2014, and 2013, respectively.

(2)

Includes accretion of discount on covered loans of $4,751,000, $16,009,000, and $20,200,000 in 2015, 2014, and 2013, respectively.

(3) Includes tax-equivalent adjustments of $1,634,000, $1,502,000, and $1,511,000 in 2015, 2014, and 2013, respectively, to reflect the federal and state tax benefit of the tax-exempt securities (using a 39% combined tax rate), reduced by the related nondeductible portion of interest expense.

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Table 3 Volume and Rate Variance Analysis

	Year Ended December 31, 2015			Year Ended December 31, 2014		
	Change Attributable to			Change Attributable to		
($ in thousands)	Changes in Volumes	Changes in Rates	Total Increase (Decrease)	Changes in Volumes	Changes in Rates	Total Increase (Decrease)
Interest income (tax-equivalent):						
Loans	$ 14	(15,783)	(15,769)	831	(8,806)	(7,975)
Taxable securities	2,687	148	2,835	(147)	198	51
Non-taxable securities	(93)	173	80	(56)	29	(27)
Short-term investments, primarily overnight funds	(375)	184	(191)	342	(79)	263
Total interest income	2,233	(15,278)	(13,045)	970	(8,658)	(7,688)
Interest expense:						
Interest-bearing checking accounts	19	(6)	13	4	(158)	(154)
Money market accounts	36	99	135	(11)	(259)	(270)
Savings accounts	4	—	4	6	(35)	(29)
Time deposits >$100,000	(988)	(529)	(1,517)	(572)	(880)	(1,452)
Other time deposits	(269)	(119)	(388)	(406)	(577)	(983)
Total interest-bearing deposits	(1,198)	(555)	(1,753)	(979)	(1,909)	(2,888)
Borrowings	559	(121)	438	892	(766)	126
Total interest expense	(639)	(676)	(1,315)	(87)	(2,675)	(2,762)
Net interest income (tax-equivalent)	$ 2,872	(14,602)	(11,730)	1,057	(5,983)	(4,926)

Changes attributable to both volume and rate are allocated equally between rate and volume variances.

Table 4 Noninterest Income

	Year Ended December 31,		
($ in thousands)	2015	2014	2013
Service charges on deposit accounts	$ 11,648	13,706	12,752
Other service charges, commissions, and fees	10,906	10,019	9,318
Fees from presold mortgages	2,532	2,726	2,907
Commissions from sales of insurance and financial products	2,580	2,733	2,132
Bank owned life insurance income	1,665	1,311	1,120
Total core noninterest income	29,331	30,495	28,229
Foreclosed property gains (losses) – non-covered	(2,504)	(1,924)	1,333
Foreclosed property gains (losses) – covered	1,018	(1,919)	367
FDIC Indemnification asset income (expense), net	(8,615)	(12,842)	(6,824)

Securities gains (losses), net	(1)	786	532
Other gains (losses), net	(465)	(228)	(148)
Total	$18,764	14,368	23,489

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Table 5 Noninterest Expenses

($ in thousands)	Year Ended December 31, 2015	2014	2013
Salaries	$47,660	46,071	45,120
Employee benefits	9,134	9,086	9,644
Total personnel expense	56,794	55,157	54,764
Occupancy expense	7,358	7,362	7,123
Equipment related expenses	3,749	3,931	4,364
Amortization of intangible assets	722	777	860
FDIC insurance expense	2,394	3,988	2,803
Repossession and collection expenses – non-covered	2,167	2,092	2,216
Repossession and collection expenses – covered, net of FDIC reimbursements	(54)	(861)	1,142
Telephone and data lines	2,133	1,988	1,489
Stationery and supplies	2,039	1,710	2,0