FIRST RELIANCE BANCSHARES INC
Form 10-K
March 31, 2010

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

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

For the fiscal year ended December 31, 2009
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number 000-49757

FIRST RELIANCE BANCSHARES, INC.
(Exact Name of Registrant as Specified in its Charter)

South Carolina	80-0030931
(State of Incorporation)	(I.R.S. Employer Identification No.)

2170 W. Palmetto Street, Florence, South Carolina	29501
(Address of Principal Executive Offices)	(Zip Code)

(843) 656-5000
(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act:
None

Securities Registered Pursuant to Section 12(g) of the Act:
Common Stock, $0.01 Par Value

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes ¨ No x

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

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

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

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 "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company x

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

The aggregate market value of the registrant's outstanding common stock held by nonaffiliates of the registrant as of June 30, 2009 was approximately $11.0 million, based on the registrant's closing sales price of $3.50 as reported on the Over-the Counter Bulletin Board on June 30, 2009. There were 3,582,691 shares of the registrant's common stock outstanding as of March 24, 2010.

DOCUMENTS INCORPORATED BY REFERENCE

Document	Parts Into Which Incorporated
Annual Report to Shareholders for the Year Ended December 31, 2009	Part II
Proxy Statement for the Annual Meeting of Shareholders to be held June 17, 2010	Part III

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PART I

ITEM 1. BUSINESS

Special Cautionary Notice Regarding Forward-Looking Statements

This Report contains statements that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Various matters discussed in this document and in documents incorporated by reference herein, including matters discussed under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” may constitute forward-looking statements for purposes of the Securities Act and the Exchange Act. These forward-looking statements are based on many assumptions and estimates and are not guarantees of future performance, and may involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of First Reliance Bancshares, Inc. (the “Company”) or its wholly owned subsidiary, First Reliance Bank (the “Bank”), to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. The words “expect,” “anticipate,” “intend,’ “plan,” “believe,” “seek,’ “estimate,” and similar expressions are intended to identify such forward-looking statements. The Company’s and the Bank’s actual results may differ materially from the results anticipated in these forward-looking statements due to a variety of factors, including, without limitation:

- significant increases in competitive pressure in the banking and financial services industries;
- changes in the interest rate environment that could reduce anticipated or actual margins;
- changes in political conditions or the legislative or regulatory environment;
- general economic conditions, either nationally or regionally and especially in our primary service area, becoming less favorable than expected resulting in, among other things, a deterioration in credit quality;
- changes occurring in business conditions and inflation;
- changes in technology;
- changes in monetary and tax policies;
- the level of allowance for loan loss;
- the rate of delinquencies and amounts of charge-offs;
- the rates of loan growth;
- adverse changes in asset quality and resulting credit risk-related losses and expenses;
- changes in the securities markets; and
- other risks and uncertainties detailed from time to time in our filings with the Securities and Exchange Commission (the “SEC”).

All written or oral forward-looking statements attributable to the Company are expressly qualified in their entirety by these cautionary statements.

General

The Company was incorporated under the laws of the State of South Carolina on April 12, 2001 to be the holding company for the Bank, and the Company acquired all of the shares of the Bank on April 1, 2002 in a statutory share exchange. The Bank, a South Carolina banking corporation, is the Company's only subsidiary, and the Company conducts no business other than through its ownership of the Bank. The Company has no indirect subsidiaries or special purpose entities. The Bank commenced operations in August 1999 and currently operates out of its main office and five branch offices. The Bank serves the Florence, Lexington, Charleston, and West Columbia areas in South Carolina as an independent, community-oriented commercial bank emphasizing high-quality, responsive and personalized service. The Bank provides a broad range of consumer and business banking services, concentrating on individuals and small and medium-sized businesses desiring a high level of personalized services.

The Company's stock is traded on the OTC Bulletin Board under the symbol "FSRL." Information about the Company is available on our website at www.firstreliance.com. Information on the Company's website is not incorporated by reference and is not a part of this Report.

Location and Service Area

The executive or main office facilities of the Company and the Bank are located at 2170 W. Palmetto Street, Florence, South Carolina 29501. The Bank also has branches located at 411 Second Loop Road, Florence, South Carolina; 801 North Lake Drive, Lexington, South Carolina; 800 South Shelmore Boulevard, Mount Pleasant, South Carolina; 25 Cumberland Street, Suite 101, Charleston, South Carolina; and 2805A Sunset Boulevard, West Columbia, South Carolina. The Bank's primary market areas are the cities of Florence, Lexington, West Columbia, and Charleston, and the surrounding areas.

According to United States Census Bureau estimates, in 2008, Florence County had an estimated population of 132,800. Florence County, which covers approximately 805 square miles, is located in the eastern portion of South Carolina and is bordered by Darlington, Marlboro, Dillon, Williamsburg, Marion, Clarendon, Sumter, and Lee Counties. Florence County has a number of large employers, including, Wellman, Inc., Honda, Nan Ya Plastics, ESAB, McLeod Regional Medical Center, and Carolinas Medical Center. The principal components of the economy of Florence County are the wholesale and retail trade sector, the manufacturing sector, the services sector and the financial, insurance and real estate sector.

According to the United States Census Bureau, Lexington County had an estimated population in 2008 of 248,518. The primary market area is the City of Lexington and the surrounding areas of Lexington County, South Carolina. Lexington County is centrally located in the Midlands of South Carolina just outside the capital city in Columbia and is bordered by Richland, Newberry, Saluda, Aiken, Orangeburg, and Calhoun Counties. Lexington County has a number of large employers, including, Westinghouse Electric Corporation, Michelin North America, Winnsboro Assembly Opera, Amick Farms, Inc., and Bose Corporation. Lexington County is a major transportation crossroads for the Midlands with I-26, I-77, and I-20 bordering or running through the county. The Columbia Metropolitan Airport is located in Lexington County, just 10 miles from the town of Lexington, and is the Southeastern hub for the United Parcel Service. The principal components of the economy of Lexington County are the wholesale and retail trade sector, the manufacturing sector, the government sector, the services sector and the financial, insurance and real estate sector.

The United States Census Bureau estimates that in 2008, Charleston County had a population of 348,046 and the Metro Area had a population of 644,506. Charleston is located on the central and southern east coast surrounded by Berkley and Dorchester counties. Major employers in the area include the United States Navy, the Medical University of South Carolina, and the Charleston Air Force Base.

Our Business Strategy

The Bank's goal is to be the largest, most profitable bank in South Carolina. First Reliance is committed to earning customer loyalty by providing customers with products and services that fit their individual needs through differentiated banking services, convenience, and programs in the market place. The customer experience in all these areas is delivered through our marketing tag line "Easy to Do Business With." The Bank also focuses on three primary customers segments, Middle America, Gen "Y," and small business. As customer loyalty grows, customer actions drive growth and profitability. Customers who do more business with the Bank provide a cost effective source of new business as customers refer family and friends.

Our business strategy also involves the following:

- Focus on our communities:
  - Founded in 1999, First Reliance is one of the only locally owned and operated banks in Florence, South Carolina;

- We are one of the fastest-growing banks in South Carolina, with assets of nearly $700 million, and over 145 highly talented employees;
- We are headquartered in Florence, and span the Columbia, Lexington and Charleston regions of South Carolina; and
- Our hallmarks are exceptional customer service, convenience, and custom-designed programs that fit the needs of the communities we serve.

• Strong leadership:

- First Reliance has a well-seasoned, veteran leadership team, with an average of 30 years of banking experience;
- Our board of directors is composed of successful professionals, businesspeople, and entrepreneurs – all of whom live in markets served and have a vital interest in the Bank’s long-term success; and
- The Bank has a board of advisors comprised of well-known professionals and community leaders who contribute to our growth through referrals and networking.

• A belief that “There’s More to Banking than Money,”™ meaning:

- Banking is not just about dollars and cents, it is about customer service;
- We serve hard-working Americans who prefer to bank with people who understand their needs, and who are committed to helping them achieve their financial goals; and
- We are deeply committed to this brand promise and, as a result, we have earned a consistent customer satisfaction rating of 98%.

• An intent to capitalize on opportunities arising from adversity:

- We recognized the economic downturn early in 2008 and developed a strategic plan to ensure that First Reliance would remain a safe and sound institution;
- During six months of 2009, First Reliance had achieved a 17% growth in total customer households compared to 2.8% customer household growth for the overall banking industry; and
- Our growth has been the result of referrals from our customers to friends or family, our strong brand, and our unique programs.

• Building and maintaining a strong capital base:

- First Reliance is capitalized above minimum regulatory requirements;
- During the later part of 2008 and early 2009, when the economy was in turmoil and there was limited access to the capital markets, we applied for and received $15.3 million in Troubled Assets Relief Program (“TARP”) funding; and
- Now, as capital markets have started to free up, we believe we have an opportunity to raise capital on terms attractive to us and to new investors.

• Increasing deposit market share through local core funding:

- Strong levels of liquidity allow us to meet our customer loan demands;
- Keeping our deposit gathering local is important to reduce the risk exposure associated with wholesale funding sources; and
- Our strategic initiatives to attract local deposits and decrease dependence on non-local funding sources have resulted in our attaining the No. 1 deposit market share in the City of Florence and increasing market share in our Lexington and Charleston markets.

- Consider opportunistic acquisition opportunities in markets with favorable growth characteristics where we have identified experienced bankers to help execute our growth strategy, including:

  - o Healthy whole bank and branch acquisitions; and
  - o Subject to regulatory approval, FDIC-assisted purchases of failed bank assets and liabilities.

- Focus on profitability:

  - o We implemented several process redesign initiatives in 2008 and 2009 to streamline work flow, ensure higher service quality and provide better risk controls, scale processes and lower operating costs;
  - o Our management team is focused on measuring the return on every dollar spent; and
  - o As we manage expenses, we expect our profitability to improve.

Lending Activities

General. The Bank offers a full range of commercial and consumer loans, as well as real estate, construction, and acquisition loans. Commercial loans are extended primarily to small and middle market customers. Such loans include both secured and unsecured loans for working capital needs (including loans secured by inventory and accounts receivable), business expansion (including acquisition of real estate and improvements), asset acquisition and agricultural purposes. Commercial term loans generally will not exceed a five-year maturity and may be based on a ten or fifteen-year amortization. The extensions of term loans are based upon (1) the ability and stability of current management; (2) earnings and trends in cash flow; (3) earnings projections based on reasonable assumptions; (4) the financial strength of the industry and the business itself; and (5) the value and marketability of the collateral. In considering loans for accounts receivable and inventory, the Bank generally uses a declining scale for advances based on an aging of the accounts receivable or the quality and utility of the inventory. With respect to loans for the acquisition of equipment and other assets, the terms depend on the economic life of the respective assets.

Loan Limits and Approval. The Bank's lending activities are subject to a variety of lending limits imposed by federal law. Under South Carolina law, loans by the Bank to a single customer may not exceed 7.5% of the Bank's unimpaired capital, except that by two-thirds vote of the directors of the Bank such limit may be increased to 15% of the Bank's unimpaired capital. The Bank's Board of Directors has approved that increase in its lending limit. Based on the Bank's unimpaired capital as of December 31, 2009, the Bank's lending limit to a single customer is approximately $8.7 million. Even with the increase, the size of the loans that the Bank is able to offer to potential customers is less than the size of the loans that the Bank's competitors with larger lending limits are able to offer. This limit affects the ability of the Bank to seek relationships with the area's larger businesses. However, the Bank may request other banks to participate in loans to customers when requested loan amounts exceed the Bank's legal lending limit.

Allowance for Loan Losses. We maintain an allowance for loan losses, which has been established through a provision for loan losses charged against income. We charge loans against this allowance when we believe that the collectibility of the loan is unlikely. The allowance is an estimated amount that we believe is adequate to absorb losses inherent in the loan portfolio based on evaluations of its collectibility. As of December 31, 2009, our allowance for loan losses equaled approximately 2.38% of the average outstanding balance of our loans. Over time, we will base the loan loss reserves on our evaluation of factors including: changes in the nature and volume of the loan portfolio, overall portfolio quality, specific problem loans and commitments, and current anticipated economic conditions that may affect the borrower's ability to pay.

Loan Distribution. As of December 31, 2009, the composition of our loan portfolio by category was approximately as follows :

Industry Categories	Percentage (%)
Real estate secured	86.41%
Commercial and industrial	11.28%
Consumer loans	1.95%
Other loans	0.36%
Total	100%

Real Estate Secured. The Bank has established a mortgage loan division through which it has broadened the range of services that it offers to its customers. The mortgage loan division originates secured real estate loans to purchase existing or to construct new homes and to refinance existing mortgages. The following are the types of real estate loans originated by the Bank and the general loan-to-value limits set by the Bank with respect to each type.

• Raw Land	65%
• Land Development	75%
• Commercial, multifamily and other nonresidential construction	80%
• One to four family residential construction	85%
• Improved property	85%
• Owner occupied, one to four family and home equity	90% (or less)
• Commercial property	80% (or less)

As of December 31, 2009, total loans secured by first or second mortgages on real estate comprised approximately 86.4% of the Bank's loan portfolio, and the classification of the mortgage loans of the Bank and the respective percentage of the Bank's total loan portfolio of each are as follows (dollars in thousands):

Description	Total Amount as of December 31, 2009	Percentage of Total Loan Portfolio
Residential 1-4 family	$ 57,539	14.15%

Multifamily	$	9,963	2.45%
Commercial	$	169,993	41.79%
Construction	$	77,567	19.08%
Second mortgage	$	4,747	1.16%
Equity lines of credit	$	31,596	7.77%

Of the loan types listed above, commercial real estate loans are generally more risky because they are the most difficult to liquidate. Construction loans also involve risks due to weather delays and cost overruns.

The Bank generates additional fee income by selling most of its mortgage loans in the secondary market and cross-selling other products and services to its mortgage customers. In 2009, the Bank sold mortgage loans in a total amount of approximately $162.1 million, or 97.9% of the total number of mortgage loans originated by the Bank. The Bank does not originate or hold subprime residential mortgage loans that were originally intended for sale on the secondary mortgage market.

All Federal Housing Agency (“FHA”), Veterans Administration (“VA”) and South Carolina State Housing Finance and Development Authority (“State Housing”) loans sold by the Bank involve the right to recourse. The FHA and VA loans are subject to recourse if the loan shows 60 days or more past due in the first four months or goes in to foreclosure within the first 12 months. The State Housing loans are subject to recourse if the loan becomes delinquent prior to purchase by State Housing or if final documentation is not delivered within 90 days of purchase. All investors have a right to require the Bank to repurchase a loan in the event the loan involved fraud. In 2009, of the 933 loans sold by the Bank, 277 were FHA or VA loans and 53 were State Housing Loans, compared to 2008 where, of the 692 loans sold by the Bank, 53 were FHA or VA loans and 69 were State Housing loans. Such loans represented 29.7% of the dollar volume or 25.6% of the total number of loans sold by the Bank in 2009.

In addition, an increase in interest rates may decrease the demand for consumer and commercial credit, including real estate loans. Gross fees from residential mortgage originations were $2.0 million in 2009.

Commercial and Industrial. As of December 31, 2009, $45.9 million, or 11.28% of the Bank’s total loan portfolio, was comprised of commercial and industrial loans. Commercial loans involve significant risk because there is generally a small market available for an asset held as collateral that needs to be liquidated. Commercial loans for working capital needs are typically difficult to monitor. We focus our efforts on commercial loans of less than $3 million. Working capital loans typically have terms not exceeding one year and are usually secured by accounts receivable, inventory, or personal guarantees of the principals of the business. For loans secured by accounts receivable or inventory, principal is typically repaid as the assets securing the loan are converted into cash, and in other cases principal is typically due at maturity.

Consumer. The Bank makes a variety of loans to individuals for personal and household purposes, including secured and unsecured installment loans and revolving lines of credit such as credit cards. Installment loans typically carry balances of less than $50,000 and are amortized over periods up to 60 months. Consumer loans are offered on a single maturity basis where a specific source of repayment is available. Revolving loan products typically require monthly payments of interest and a portion of the principal.

As of December 31, 2009, the classification of the consumer loans of the Bank and the respective percentage of the Bank’s total loan portfolio of each were as follows (dollars in thousands):

Description	Total Outstanding as of December 31, 2009	Percentage of Total Loan Portfolio
Individuals (household, personal, single pay, installment and other)	$ 7,295	0.02%
Individuals (household, family, personal credit cards and overdraft protection)	$ 648	0.001%
All other consumer loans	$ —	—%

The risks associated with consumer lending are largely related to economic conditions and increase during economic downturns. Other major risk factors relating to consumer loans include high debt to income ratios and poor loan-to-value ratios. All of the consumer loans set forth above require a debt service income ratio of no greater than 36% based on gross income.

Deposit Services

The Bank offers a full range of deposit services that are typically available in most banks and savings and loan associations, including checking accounts, NOW accounts, savings accounts and other time deposits of various types, ranging from money market accounts to longer-term certificates of deposit. The transaction accounts and time certificates are tailored to the Bank's principal market area at rates competitive to those offered by other banks in the area. In addition, the Bank offers certain retirement account services, such as Individual Retirement Accounts ("IRAs"). The Bank also offers free courier service for business accounts and offers remote deposit capture. The Bank solicits deposit accounts from individuals, businesses, associations and organizations and, governmental authorities. All deposit accounts are insured by the FDIC up to the maximum amount allowed by law. See "Supervision and Regulation."

Other Banking Services

The Bank focuses heavily on personal customer service and offers a full range of financial services. Personal products include free checking, and savings accounts, money market accounts, CDs and IRAs, and personal mortgage loans, while business products include free checking and savings accounts, commercial lending services, money market accounts, cash management services including remote deposit capture and business deposit courier service. The Bank also offers wholesale mortgage, title insurance and provides Internet banking and e-statements, electronic bill paying services, free ATMs, free coin machines at all branches, and an overdraft privilege to its customers.

Investments

In addition to its loan operations, the Bank makes other investments primarily in obligations of the United States or obligations guaranteed as to principal and interest by the United States and other taxable and nontaxable securities. The Bank also invests in certificates of deposits in other financial institutions. The amount invested in such time deposits, as viewed on an institution by institution basis, does not exceed $250,000. Therefore, the amounts invested in certificates of deposit are fully insured by the FDIC. No investment held by the Bank exceeds any applicable limitation imposed by law or regulation. The Bank’s finance committee reviews the investment portfolio on an ongoing basis to ascertain investment profitability and to verify compliance with investment policies.

Other Services

In addition to its banking and investment services, the Bank offers securities brokerage services and life insurance products to its customers through a networking arrangement with an independent registered broker-dealer firm.

Competition

The Bank faces strong competition for deposits, loans, and other financial services from numerous other banks, thrifts, credit unions, other financial institutions, and other entities that provide financial services, some of which are not subject to the same degree of regulation as the Bank. Because South Carolina law permits statewide branching by banks and savings and loan associations, many financial institutions in the state have extensive branch networks. In addition, subject to certain conditions, South Carolina law permits interstate banking. Reflecting this opportunity provided by law plus the growth prospects of the Charleston, Florence, and Lexington markets, all of the five largest (in terms of local deposits) commercial banks in our market are branches of or affiliated with regional or super-regional banks.

According to the FDIC, as of June 30, 2009, 30 banks and 6 savings institutions operated 262 offices within Charleston, Florence, and Lexington Counties. All of these institutions aggressively compete for business in the Bank’s market area. Some of these competitors have been in business for many years have established customer bases, are larger than the Bank, have substantially higher lending limits than the Bank has and are able to offer certain services, including trust and international banking services, that the Bank is able to offer only through correspondents, if at all.

The Bank currently conducts business principally through its six branches in Charleston, Florence, and Lexington Counties, South Carolina. Based upon data available on the FDIC’s website as of June 30, 2009, the Bank’s total deposits ranked sixth among financial institutions in our market area, representing approximately 4.51% of the total deposits in our market area. The table below shows our deposit market share in the counties we serve according to data from the FDIC website as of June 30, 2009.

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Market	Number of Branches	Our Market Deposits (in millions)	Total Market Deposits	Ranking	Market Share Percentage
South Carolina (by county):					
Charleston County	2	$ 72	$ 7,693	16	0.94%
Florence County	2	395	2,126	2	18.57
Lexington County	2	110	2,971	8	3.71
First Reliance Bank (statewide)	6	$ 580	$ 69,795	17	0.83%

The Bank competes based on providing its customers with high-quality, prompt, and knowledgeable personalized service at competitive rates, which is a combination that the Bank believes customers generally find lacking at larger institutions. The Bank offers a wide variety of financial products and services at fees that it believes are competitive with other financial institutions.

Employees

On December 31, 2009, the Bank had 118 full-time employees and 25 part-time employees. The executive officers of the Company also serve as executive officers of and are compensated by the Bank. The Company has no employees.

Legal Proceedings

Neither the Company nor any of its properties are subject to any material legal proceedings.

SUPERVISION AND REGULATION

We are subject to extensive state and federal banking regulations that impose restrictions on and provide for general regulatory oversight of our operations. These laws generally are intended to protect depositors and not shareholders. Legislation and regulations authorized by legislation influence, among other things:

- how, when and where we may expand geographically;
- into what product or service market we may enter;
- how we must manage our assets; and
- under what circumstances money may or must flow between the parent bank holding company and the subsidiary bank.

Set forth below is an explanation of the major pieces of legislation affecting our industry and how that legislation affects our actions. The following summary is qualified by reference to the statutory and regulatory provisions discussed. Changes in applicable laws or regulations may have a material effect on our business and prospects, and legislative changes and the policies of various regulatory authorities may significantly affect our operations. We cannot predict the effect that fiscal or monetary policies, or new federal or state legislation may have on our business and earnings in the future.

First Reliance Bancshares, Inc.

Because we own all of the capital stock of First Reliance Bank, we are a bank holding company under the federal Bank Holding Company Act of 1956. As a result, we are primarily subject to the supervision, examination and reporting requirements of the Bank Holding Company Act and the regulations of the Board of Governors of the Federal Reserve System (the “Federal Reserve”). As a bank holding company located in South Carolina, the SC State Board of Financial Institutions also regulates and monitors all significant aspects of our operations.

Acquisitions of Banks. The Bank Holding Company Act requires every bank holding company to obtain the prior approval of the Federal Reserve before:

- acquiring direct or indirect ownership or control of any voting shares of any bank if, after the acquisition, the bank holding company will directly or indirectly own or control more than 5% of the bank’s voting shares;
- acquiring all or substantially all of the assets of any bank; or
- merging or consolidating with any other bank holding company.

Additionally, the Bank Holding Company Act provides that the Federal Reserve may not approve any of these transactions if it would result in or tend to create a monopoly or, substantially lessen competition or otherwise function as a restraint of trade, unless the anti-competitive effects of the proposed transaction are clearly outweighed by the public interest in meeting the convenience and needs of the community to be served. The Federal Reserve is also required to consider the financial and managerial resources and future prospects of the bank holding companies and banks concerned and the convenience and needs of the community to be served. The Federal Reserve’s consideration of financial resources generally focuses on capital adequacy, which is discussed below.

Under the Bank Holding Company Act, if adequately capitalized and adequately managed, the Company or any other bank holding company located in South Carolina may purchase a bank located outside of South Carolina. Conversely, an adequately capitalized and adequately managed bank holding company located outside of South Carolina may purchase a bank located inside South Carolina. In each case, however, restrictions may be placed on the acquisition of a bank that has only been in existence for a limited amount of time or will result in specified concentrations of deposits. For example, South Carolina law prohibits a bank holding company from acquiring control of a financial

institution until the target financial institution has been incorporated for five years.

Additionally, in July 1994, South Carolina enacted legislation which effectively provided that, after June 30, 1996, out-of-state bank holding companies could acquire other banks or bank holding companies in South Carolina, subject to certain conditions. Accordingly, effective July 1, 1996, South Carolina law was amended to permit interstate branching but not de novo branching by an out-of-state bank. The Company believes that the foregoing legislation has increased takeover activity of South Carolina financial institutions by out-of-state financial institutions.

Change in Bank Control. Subject to various exceptions, the Bank Holding Company Act and the Change in Bank Control Act, together with related regulations, require Federal Reserve approval prior to any person or company acquiring "control" of a bank holding company. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of the bank holding company. Control is rebuttably presumed to exist if a person or company acquires 10% or more, but less than 25%, of any class of voting securities and either:

- the bank holding company has registered securities under Section 12 of the Securities Act of 1934; or
- no other person owns a greater percentage of that class of voting securities immediately after the transaction.

Our common stock is registered under Section 12 of the Securities Exchange Act of 1934. The regulations provide a procedure for challenging rebuttable presumptions of control.

Permitted Activities. The Bank Holding Company Act has generally prohibited a bank holding company from engaging in activities other than banking or managing or controlling banks or other permissible subsidiaries and from acquiring or retaining direct or indirect control of any company engaged in any activities other than those determined by the Federal Reserve to be closely related to banking or managing or controlling banks as to be a proper incident thereto. Provisions of the Gramm-Leach-Bliley Act have expanded the permissible activities of a bank holding company that qualifies as a financial holding company. Under the regulations implementing the Gramm-Leach-Bliley Act, a financial holding company may engage in additional activities that are financial in nature or incidental or complementary to financial activities. Those activities include, among other activities, certain insurance and securities activities.

To qualify to become a financial holding company, the Bank and any other depository institution subsidiary of the Company must be well capitalized and well managed and must have a Community Reinvestment Act rating of at least "satisfactory." Additionally, the Company must file an election with the Federal Reserve to become a financial holding company and must provide the Federal Reserve with 30 days' written notice prior to engaging in a permitted financial activity. While the Company meets the qualification standards applicable to financial holding companies, the Company has not elected to become a financial holding company at this time.

Support of Subsidiary Institutions. Under Federal Reserve policy, the Company is expected to act as a source of financial strength for the Bank and to commit resources to support the Bank. This support may be required at times when, without this Federal Reserve policy, the Company might not be inclined to provide it. In addition, any capital loans made by the Company to the Bank will be repaid only after its deposits and various other obligations are repaid in full. In the unlikely event of the Company's bankruptcy, any commitment by it to a federal bank regulatory agency to maintain the capital of the Bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

South Carolina Law. As a bank holding company with its principal offices in South Carolina, the Company is subject to limitations on sale or merger and to regulation by the South Carolina State Board of Financial Institutions (the "SC State Board"). The Company must receive the approval of the SC State Board prior to acquiring control of a bank or bank holding company or all or substantially all of the assets of a bank or a bank holding company. The Company also must file with the SC State Board periodic reports with respect to its financial condition, operations and management, and the intercompany relationships between the Company and its subsidiaries.

TARP Participation. On October 14, 2008, the U.S. Treasury announced the capital purchase component of TARP. This program was instituted by the U.S. Treasury pursuant to the Emergency Economic Stabilization Act of 2008, which provides up to $700 billion to the U.S. Treasury to, among other things, take equity ownership positions in financial institutions. The TARP capital purchase program is intended to encourage financial institutions to build capital and thereby increase the flow of financing to businesses and consumers. We participated in the capital purchase component of TARP.

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Use of TARP Proceeds. On March 6, 2009, the Company received an investment of $15.3 million under the Troubled Asset Relief Program-Capital Purchase Program ("CPP"). The CPP funds were initially placed in the Company's demand deposit account with the Bank, providing liquidity to the Bank while preserving the Company's flexibility in how to best support the Bank, including the Bank's lending efforts. On March 20, 2009, the Company contributed $7.8 million to the Bank as capital, increasing the Bank's capital level from 10.75% of total risk weighted assets to 12.23% of total risk weighted assets. Due to the Bank's capital policy, which requires the Bank to maintain no less than 10% capital, the CPP proceeds enabled the Bank to increase its lending capacity by approximately $78 million. The Company is ready to contribute additional funds as capital to the Bank to support further increases in lending when and if loan demand increases. We believe the CPP funds have strengthened the Bank's capacity to respond to the legitimate credit needs of our customers and communities. We have advised our customers, employees and community of our commitment to support our communities' growth and of our receipt of CPP funds, which strengthens our ability to make loans. By protecting our capital ratios with the CPP injection we have not found it necessary to send good customers away. We are in a recession and loan demand is lower than in recent years, but we remain committed to supporting the future growth of our markets. The CPP proceeds give us the flexibility and strength to pursue these and other legitimate credit requests. CPP funds have not only provided us with additional lending capacity, but have also permitted us to strengthen our balance sheet. That strength allows us the flexibility to offer innovative programs, such as Hometown Heroes checking account with embedded loan program offers. We also received statewide recognition for lending performance in 2009, receiving Lender of the Year honors from the South Carolina Finance and Housing Authority.

First Reliance Bank

Because the Bank is a commercial bank chartered under the laws of the State of South Carolina, it is primarily subject to the supervision, examination and reporting requirements of the FDIC and the SC State Board. The FDIC and the SC State Board regularly examine the Bank's operations and have the authority to approve or disapprove mergers, the establishment of branches and similar corporate actions. Both regulatory agencies have the power to prevent the continuance or development of unsafe or unsound banking practices or other violations of law. Additionally, the Bank's deposits are insured by the FDIC to the maximum extent provided by law. The Bank is also subject to numerous state and federal statutes and regulations that affect our business, activities and operations.

South Carolina Law. Commercial banks chartered in South Carolina have only those powers granted by law or the regulations of the SC State Board. State law sets specific requirements for bank capital and regulates deposits in and loans and investments by banks, including the amounts, types and, in some cases, rates. In addition, the SC State Board regulates, among other activities, the payment of dividends, the opening of branches, loans to officers and directors, record keeping and the use of automated teller machines. The SC State Board periodically examines state banks to determine their compliance with the law and regulations, and state banks must make periodic reports of their condition to the SC State Board.

Prompt Corrective Action. The Federal Deposit Insurance Corporation Improvement Act of 1991 establishes a system of prompt corrective action to resolve the problems of undercapitalized financial institutions. Under this system, the federal banking regulators have established five capital categories (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized) in which all institutions are placed. Federal banking regulators are required to take various mandatory supervisory actions and are authorized to take other discretionary actions with respect to institutions in the three undercapitalized categories. The severity of the action depends upon the capital category in which the institution is placed. Generally, subject to a narrow exception, the banking regulator must appoint a receiver or conservator for an institution that is critically undercapitalized. The federal banking agencies have specified by regulation the relevant capital level for each category. As of December 31, 2009, the Bank qualified for the well-capitalized category.

A "well-capitalized" bank is one that significantly exceeds all of its capital requirements, which include maintaining a total risk-based capital ratio of at least 10%, a tier 1 risk-based capital ratio of at least 6%, and a tier 1 leverage ratio of at least 5%. Generally, a classification as well capitalized will place a bank outside of the regulatory zone for purposes of prompt corrective action. However, a well-capitalized bank may be reclassified as "adequately capitalized" based on criteria other than capital, if the federal regulator determines that a bank is in an unsafe or unsound condition, or is engaged in unsafe or unsound practices and has not corrected the deficiency.

FDIC Insurance Assessments. The FDIC is an independent agency of the United States government that uses the Deposit Insurance Fund to protect against the loss of insured deposits if an FDIC-insured bank or savings association fails. The FDIC must maintain the Deposit Insurance Fund within a range between 1.15 percent and 1.50 percent of all insured deposits. The FDIC has adopted a risk-based assessment system for insured depository institutions that accounts for the risks attributable to different categories and concentrations of assets and liabilities. The system is designed to assess higher rates on those institutions that pose greater risks to the Deposit Insurance Fund. The FDIC places each institution in one of four risk categories using a two-step process based first on capital ratios (the capital group assignment) and then on other relevant information (the supervisory group assignment). Within the lowest risk category, Risk Category I, rates vary based on each institution's CAMELS component ratings, certain financial ratios, and long-term debt issuer ratings, if any.

Capital group assignments are made quarterly and an institution is assigned to one of three capital categories: (1) well capitalized, (2) adequately capitalized, or (3) undercapitalized. These three categories are substantially similar to the prompt corrective action categories described above, with the "undercapitalized" category including institutions that are undercapitalized, significantly undercapitalized, and critically undercapitalized for prompt corrective action purposes. The FDIC also assigns an institution to one of three supervisory subgroups based on a supervisory evaluation that the institution's primary federal banking regulator provides to the FDIC and information that the FDIC determines to be relevant to the institution's financial condition and the risk posed to the deposit insurance funds.

For 2008, assessments ranged from 5 to 43 cents per $100 of deposits, depending on the institution's risk category. Institutions in the lowest risk category, Risk Category I, were charged a rate between 5 and 7 cents per $100 of deposits. Risk Categories II, III, and IV were charged 10 basis points, 28 basis points and 43 basis points, respectively.

Because the Deposit Insurance Fund reserve fell below 1.15 percent as of June 30, 2008, and was expected to remain below 1.15 percent, the Federal Deposit Insurance Reform Act of 2005 required the FDIC to establish and implement a restoration plan to restore the reserve ratio to no less than 1.15 percent within five years, absent extraordinary circumstances.

On December 16, 2008, the FDIC adopted, as part of its restoration plan, a uniform increase to the assessment rates by 7 basis points (annualized) for the first quarter 2009 assessments. As a result, institutions in Risk Category I will be charged a rate between 12 and 14 cents per $100 of deposits. Risk Categories II, III, and IV will be charged 17 basis points, 35 basis points, and 50 basis points, respectively.

On February 27, 2009, the FDIC amended its restoration plan to extend the period for restoration to seven years and further revised the risk-based assessment system. Starting with the second quarter of 2009, institutions in Risk Category I will have a base assessment rate between 12 and 16 cents per $100 of deposits. Risk Categories II, III, and IV will be have base assessment rates of 22 basis points, 32 basis points, and 45 basis points, respectively. These base assessments will be subject to adjustments based on each institution's unsecured debt, secured liabilities, and use of brokered deposits. As a result of these adjustments, institutions in Risk Category I will be charged rate between 7 and 24 cents per $100 of deposits. Risk Categories II, III, and IV will be charged between 17 and 43 basis points, 27 and 58 basis points, and 40 and 77.5 basis points, respectively.

Under a final rule adopted on May 22, 2009, the FDIC imposed an emergency special assessment of 5 basis points of a bank's assets, less tier 1 capital, as of June 30, 2009, up to a maximum of 10 basis points times the bank's deposits. The FDIC may impose additional emergency special assessments of up to 5 basis points of a bank's assets, less tier 1 capital, thereafter if the reserve ratio is estimated to fall to a level that the FDIC believes would adequately affect public confidence or to a level that is close to zero or negative at the end of a calendar quarter.

On November 12, 2009, the FDIC announced that nearly all FDIC-insured depositor-institutions would be required to prepay their DIF assessments for the next three years on December 30, 2009. This did not affect the Bank's reporting of net income, but did have a negative effect on the Bank's cash flow. The FDIC has indicated that the prepayment of DIF assessments would be in lieu of additional special assessments.

The FDIC may, without further notice-and-comment, adopt rates that are higher or lower than the stated base assessment rates, provided that the FDIC cannot (i) increase or decrease the total rates from one quarter to the next by more than three basis points, or (ii) deviate by more than three basis points from the stated assessment rates. The FDIC has proposed maintaining current assessment rates through December 31, 2010, followed by a uniform increase in risk-based assessment rates of three basis points effective January 1, 2011.

The FDIC may terminate its insurance of deposits if it finds that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order, or condition imposed by the FDIC.

FDIC Temporary Liquidity Guarantee Program. On October 14, 2008, the FDIC announced that its Board of Directors, under the authority to prevent “systemic risk” in the banking system of the United States, approved the Temporary Liquidity Guarantee Program (“TLGP”). The purpose of the TLGP is to strengthen confidence and encourage liquidity in the banking system. The TLGP is composed of two components, the Debt Guarantee Program and the Transaction Account Guarantee Program, and institutions had the opportunity, prior to December 5, 2008, to opt-out of either or both components of the TLGP.

The Debt Guarantee Program: Under the TLGP, the FDIC is permitted to guarantee certain newly issued senior unsecured debt issued through October 31, 2009 by participating financial institutions. The annualized fee that the FDIC will assess to guarantee the senior unsecured debt varies by the length of maturity of the debt. For debt with a maturity of 180 days or less (excluding overnight debt), the fee is 50 basis points; for debt with a maturity between 181 days and 364 days, the fee is 75 basis points, and for debt with a maturity of 365 days or longer, the fee is 100 basis points. The Bank did not opt-out of the Debt Guarantee component of the TLGP.

The Transaction Account Guarantee Program: Under the TLGP, the FDIC is permitted to fully insure non-interest bearing deposit accounts held at participating FDIC-insured institutions, regardless of dollar amount. The temporary guarantee was initially set to expire on December 31, 2009, but on August 26, 2009, the FDIC announced that the program would be extended through June 30, 2010. For the eligible noninterest-bearing transaction deposit accounts (including accounts swept from a noninterest bearing transaction account into an noninterest bearing savings deposit account), through December 31, 2009, a 10 basis point annual rate surcharge was applied to noninterest-bearing transaction deposit amounts over $250,000. Starting on January 1, 2010, the assessment will range from 15 to 25 basis points depending on an institution’s Risk Category rating. Institutions will not be assessed on amounts that are otherwise insured. The Bank did not opt-out of the Transaction Account Guarantee component of the TLGP for the initial or extension periods.

Community Reinvestment Act. The Community Reinvestment Act requires that, in connection with examinations of financial institutions within their respective jurisdictions, the federal banking regulators shall evaluate the record of each financial institution in meeting the credit needs of its local community, including low and moderate-income neighborhoods. These facts are also considered in evaluating mergers, acquisitions and applications to open a branch or facility. Failure to adequately meet these criteria could impose additional requirements and limitations on the Bank. Additionally, we must publicly disclose the terms of various Community Reinvestment Act-related agreements.

Allowance for Loan and Lease Losses. The Allowance for Loan and Lease Losses (the “ALLL”) represents one of the most significant estimates in the Bank’s financial statements and regulatory reports. Because of its significance, the Bank has developed a system by which it develops, maintains and documents a comprehensive, systematic and consistently applied process for determining the amounts of the ALLL and the provision for loan and lease losses. The Interagency Policy Statement on the Allowance for Loan and Lease Losses, issued on December 13, 2006, encourages all banks to ensure controls are in place to consistently determine the ALLL in accordance with GAAP, the Bank’s stated policies and procedures, management’s best judgment and relevant supervisory guidance. Consistent with supervisory guidance, the Bank maintains a prudent and conservative, but not excessive, ALLL, that is at a level that is appropriate to cover estimated credit losses on individually evaluated loans determined to be impaired as well as estimated credit losses inherent in the remainder of the loan and lease portfolio. The Bank’s estimate of credit losses reflects consideration of all significant factors that affect the collectability of the portfolio as of the evaluation date.

Commercial Real Estate Lending. Our lending operations may be subject to enhanced scrutiny by federal banking regulators based on its concentration of commercial real estate loans. On December 6, 2006, the federal banking regulators issued final guidance to remind financial institutions of the risk posed by commercial real estate ("CRE") lending concentrations. CRE loans generally include land development, construction loans and loans secured by multifamily property, and nonfarm, nonresidential real property where the primary source of repayment is derived from rental income associated with the property. The guidance prescribes the following guidelines for its examiners to help identify institutions that are potentially exposed to significant CRE risk and may warrant greater supervisory scrutiny:

total reported loans for construction, land development and other land represent 100% or more of the institutions total capital, or
total commercial real estate loans represent 300% or more of the institution's total capital, and the outstanding balance of the institution's commercial real estate loan portfolio has increased by 50% or more.

Other Regulations. Interest and other charges collected or contracted for by the Bank are subject to state usury laws and federal laws concerning interest rates. Our loan operations will be subject to federal laws applicable to credit transactions, such as the:

- Federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- Fair Credit Reporting Act of 1978, as amended by the Fair and Accurate Credit Transactions Act, governing the use and provision of information to credit reporting agencies, certain identity theft protections, and certain credit and other disclosures;
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies;
- Soldiers' and Sailors' Civil Relief Act of 1940, as amended by the Servicemembers' Civil Relief Act, governing the repayment terms of, and property rights underlying, secured obligations of persons currently on active duty with the United States military;
- Talent Amendment in the 2007 Defense Authorization Act, establishing a 36% annual percentage rate ceiling, which includes a variety of charges including late fees, for consumer loans to military service members and their dependents; and
- rules and regulations of the various federal banking regulators charged with the responsibility of implementing these federal laws.

The Bank's deposit operations are subject to federal laws applicable to depository accounts, such as:

- Truth-In-Savings Act, requiring certain disclosures of consumer deposit accounts:
- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve to implement that act, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services; and
- rules and regulations of the various federal banking regulators charged with the responsibility of implementing these federal laws.

Capital Adequacy

We are required to comply with the capital adequacy standards established by the Federal Reserve. The Federal Reserve has established a risk-based and a leverage measure of capital adequacy for member banks and bank holding companies.

The risk-based capital standards are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance-sheet exposure, and to minimize disincentives for holding liquid assets. Assets and off-balance-sheet items, such as letters of credit and unfunded loan

commitments, are assigned to broad risk categories, each with appropriate risk weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance-sheet items.

The minimum guideline for the ratio of total capital to risk-weighted assets, and classification as adequately capitalized, is 8%. A bank that fails to meet the required minimum guidelines is classified as undercapitalized and subject to operating and managerial restrictions. A bank, however, that significantly exceeds its capital requirements and maintains a ratio of total capital to risk-weighted assets of 10% is classified as well capitalized unless it is subject to a regulatory order requiring it to maintain specified capital levels, in which case it is considered adequately capitalized.

Total capital consists of two components: Tier 1 Capital and Tier 2 Capital. Tier 1 Capital generally consists of common stockholders' equity, minority interests in the equity accounts of consolidated subsidiaries, qualifying noncumulative perpetual preferred stock and a limited amount of qualifying cumulative perpetual preferred stock, less goodwill and other specified intangible assets. Tier 1 Capital must equal at least 4% of risk-weighted assets. Tier 2 Capital generally consists of subordinated debt, other preferred stock and hybrid capital, and a limited amount of loan loss reserves. The total amount of Tier 2 Capital is limited to 100% of Tier 1 Capital. Our ratio of total capital to risk-weighted assets and ratio of Tier 1 Capital to risk-weighted assets were 12.78% and 11.52% at December 31, 2009, respectively, compared 13.96% and 12.71%, as of December 31, 2008.

In addition, the Federal Reserve has established minimum leverage ratio guidelines for bank holding companies. These guidelines provide for a minimum ratio of Tier 1 Capital to average assets, less goodwill and other specified intangible assets, of 3% for bank holding companies that meet specified criteria, including having the highest regulatory rating and implementing the Federal Reserve risk-based capital measure for market risk. All other bank holding companies generally are required to maintain a leverage ratio of at least 4%. At December 31, 2009, our leverage ratio was 8.25%, as compared to 8.81% on December 31, 2008. The guidelines also provide that bank holding companies experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without reliance on intangible assets. The Federal Reserve considers the leverage ratio and other indicators of capital strength in evaluating proposals for expansion or new activities.

Failure to meet capital guidelines could subject a bank and a bank holding company to a variety of enforcement remedies, including issuance of a capital directive, the termination of deposit insurance by the FDIC, a prohibition on accepting brokered deposits and certain other restrictions on its business. As described above, significant additional restrictions can be imposed on FDIC-insured depository institutions that fail to meet applicable capital requirements.

Payment of Dividends

The Company is a legal entity separate and distinct from the Bank. The principal sources of our cash flow, including cash flow to pay dividends to shareholders, are dividends that we receive from the Bank. Statutory and regulatory limitations apply to the payment of dividends by a subsidiary bank to its bank holding company.

Under South Carolina law, the Bank is authorized to upstream to the Company, by way of a cash dividend, up to 100% of the Bank's net income in any calendar year without obtaining the prior approval of the SC State Board, provided that the Bank received a composite rating of one or two at the last examination conducted by a state or federal regulatory authority. All other cash dividends require prior approval by the SC State Board. South Carolina law requires each state nonmember bank to maintain the same reserves against deposits as are required for a state member bank under the Federal Reserve Act. This requirement is not expected to limit the ability of the Bank to pay dividends on its common stock.

The payment of dividends by the Company and the Bank may also be affected by other factors, such as the requirement to maintain adequate capital above regulatory guidelines. If, in the opinion of the FDIC, the Bank were engaged in or about to engage in an unsafe or unsound practice, the FDIC could require, after notice and a hearing,

that the Bank stop or refrain engaging in the practice. The federal banking agencies have indicated that paying dividends that deplete a depository institution's capital base to an inadequate level would be an unsafe and unsound banking practice. Under the Federal Deposit Insurance Corporation Improvement Act of 1991, a depository institution may not pay any dividend if payment would cause it to become undercapitalized or if it already is undercapitalized. Moreover, the federal agencies have issued policy statements that provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings.

The Company received a capital investment from the U.S. Treasury under the capital purchase component of TARP on March 6, 2009. Concurrent with the closing of that transaction, the Company became subject to additional limitations on the payment of dividends. These limitations require, among other things, that (i) all dividends for the securities purchased under TARP be paid before other dividends can be paid (including dividends on Shares of Series C preferred stock sold in this offering) and (ii) the U.S. Treasury must approve any payment of dividends on our common stock for three years following the U.S. Treasury's investment.

Any future determination relating to dividend policy will be made at the discretion of our Board of Directors and will depend on many of the statutory and regulatory factors mentioned above.

Restrictions on Transactions with Affiliates

The Company and the Bank are subject to the provisions of Section 23A of the Federal Reserve Act. Section 23A places limits on the amount of:

- a bank's loans or extensions of credit to affiliates;
- a bank's investment in affiliates;
- assets a bank may purchase from affiliates, except for real and personal property exempted by the Federal Reserve;
- loans or extensions of credit to third parties collateralized by the securities or obligations of affiliates; and
- a bank's guarantee, acceptance or letter of credit issued on behalf of an affiliate.

The total amount of the above transactions is limited in amount, as to any one affiliate, to 10% of a bank's capital and surplus and, as to all affiliates combined, to 20% of a bank's capital and surplus. In addition to the limitation on the amount of these transactions, each of the above transactions must also meet specified collateral requirements. We must also comply with other provisions designed to avoid the taking of low-quality assets.

We are subject to the provisions of Section 23B of the Federal Reserve Act which, among other things, prohibit an institution from engaging in the above transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to the institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies.

We are subject to restrictions on extensions of credit to our executive officers, directors, principal shareholders and their related interests. These extensions of credit (1) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties and (2) must not involve more than the normal risk of repayment or present other unfavorable features.

Limitations on Senior Executive Compensation

Because the Company received an investment from the U.S. Treasury under the capital purchase component of TARP, the Company and certain executive officers and employees agreed to certain compensation limitations. These limitations include:

- ensuring that executive incentive compensation packages do not encourage excessive risk;

- subjecting certain executive officers' and employees' bonus compensation to "clawback" if the compensation was based on inaccurate financial information or performance metrics; and

- prohibiting any golden parachute payments to certain executive officers and employees

In addition, the Company agreed not to deduct for tax purposes more than $500,000 for certain executive officers and employees. These limitations may have a material impact upon certain compensation arrangements we have with our senior executive officers.

Proposed Legislation and Regulatory Action

New regulations and statutes are regularly proposed that contain wide-ranging proposals for altering the structures, regulations and competitive relationships of financial institutions operating and doing business in the United States. We cannot predict whether or in what form any proposed regulation or statute will be adopted or the extent to which our business may be affected by any new regulation or statute.

Effect of Governmental Monetary Policies

The Bank's earnings are affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The Federal Reserve's monetary policies have had, and are likely to continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The monetary policies of the Federal Reserve affect the levels of bank loans, investments and deposits through its control over the issuance of United States government securities, its regulation of the discount rate applicable to member banks, and its influence over reserve requirements to which member banks are subject. The Bank cannot predict the nature or impact of future changes in monetary and fiscal policies.

Selected Statistical Information

The selected statistical information required by Item 1 is included in the Company's 2008 Annual Report to Shareholders, which is Exhibit 13.1 to this Report, under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" and is incorporated herein by reference.

ITEM 1A. RISK FACTORS

An investment in our common stock involves risks. If any of the following risks or other risks, which have not been identified or which we may believe are immaterial or unlikely, actually occur, our business, financial condition and results of operations could be harmed. In such a case, the trading price of our common stock could decline, and you may lose all or part of your investment. The risks discussed below also include forward-looking statements, and our actual results may differ substantially from those discussed in these forward-looking statements.

We may continue to suffer loan losses from a decline in credit quality.

We have sustained and could continue to sustain losses if borrowers, guarantors, and related parties fail to perform in accordance with the terms of their loans. We have adopted underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for credit losses, which we believe are appropriate to minimize this risk by assessing the likelihood of nonperformance, tracking loan performance, and diversifying our credit portfolio. These policies and procedures, however, may not prevent unexpected losses that could materially adversely affect our results of operations.

We are subject to the local economies in Charleston, Florence, and Lexington Counties, South Carolina.

Our success depends upon the growth in population, income levels, deposits, and housing starts in our primary market areas. If the communities in which the Bank operates do not grow, or if prevailing economic conditions locally or nationally continue to be unfavorable, our business may not succeed. Unpredictable economic conditions may have an adverse effect on the quality of our loan portfolio and our financial performance. Economic recession over a prolonged period or other economic problems in our market areas could have a material adverse impact on the quality of the loan portfolio and the demand for our products and services. Future adverse changes in the economies in our market areas may have a material adverse effect on our financial condition, results of operations or cash flows. Further, the banking industry in South Carolina is affected by general economic conditions such as inflation, recession, unemployment and other factors beyond our control. As a community bank, we are less able to spread the risk of unfavorable local economic conditions than larger or more regional banks. Moreover, we cannot give any assurance that we will benefit from any market growth or favorable economic conditions in our primary market areas if market growth and favorable economic conditions do occur.

In addition to considering the financial strength and cash flow characteristics of borrowers, we often secure loans with real estate collateral. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. The market value of the real estate securing our loans as collateral has been adversely affected by the slowing economy and unfavorable changes in economic conditions in our market areas and could be further adversely affected in the future.

As of December 31, 2009, approximately 89.8% of our loans receivable were secured by real estate. Any sustained period of increased payment delinquencies, foreclosures, or losses caused by the adverse market and economic conditions, including the downturn in the real estate market, in our markets will adversely affect the value of our assets, revenues, results of operations and financial condition. Currently, we are experiencing such an economic downturn, and if it continues, our operations could be further adversely affected.

We are subject to increased FDIC deposit insurance assessments that could have an adverse effect on our earnings.

As an insured depository institution, we are required to pay quarterly deposit insurance premium assessments to the FDIC. These assessments are required to ensure that FDIC deposit insurance reserve ratio is at least 1.15% of insured deposits. Under the Federal Deposit Insurance Act, the FDIC, absent extraordinary circumstances, must establish and implement a plan to restore the deposit insurance reserve ratio to 1.15% of insured deposits, over a five-year period, when the reserve ratio falls below 1.15%. The recent failures of numerous financial institutions have significantly increased the Deposit Insurance Fund's loss provisions, resulting in a decline in the reserve ratio. The FDIC expects a higher rate of insured institution failures in the next few years, which may result in a continued decline in the reserve ratio.

Market developments have significantly depleted the insurance fund of the FDIC and reduced the ratio of reserves to insured deposits. As a result, beginning on January 1, 2009, there was a uniform seven basis points (annualized) increase to the assessments that banks pay for deposit insurance. The increased assessment rates range from 12 to 50 basis points (annualized) for the first quarter 2009 assessment, which was payable on June 30, 2009. On April 1, 2009, the FDIC modified the risk-based assessments to account for each institution's unsecured debt, secured liabilities and use of brokered deposits. Assessment rates will range from 7 to 77.5 basis points (annualized) starting with the second quarter 2009 assessments, which was payable on November 15, 2009. In addition, on May 22, 2009, the FDIC adopted a final rule imposing an emergency special assessment of 5 basis points of a bank's total assets less tier 1 capital as of June 30, 2009, up to a maximum of 10 basis points times the bank's deposits. This special assessment was payable on November 15, 2009.

Further, on November 12, 2009, the FDIC announced that it would require banks to prepay their insurance premiums for 2010-2012 on December 30, 2009. This did not affect the Bank's reporting of net income, but has a negative effect on the Bank's cash flow.

It is also possible that the FDIC may impose additional special assessments in the future as part of its restoration plan. If the FDIC does impose additional special assessments, or otherwise further increases assessment rates, our earnings could be further adversely impacted.

Current and anticipated deterioration in the housing market and the homebuilding industry may lead to increased losses and further worsening of delinquencies and non-performing assets in our loan portfolios. Consequently, our results of operations may be adversely impacted.

There has been substantial industry concern and publicity over decreasing asset quality among financial institutions due in large part to issues related to subprime mortgage lending, declining real estate values and general economic concerns. As of December 31, 2009, our non-performing assets had increased significantly to $34.4 million, or 8.46%, of our loan portfolio plus other real estate owned, compared to $22.1 million, or 4.70%, as of December 31, 2008. Furthermore, the housing and the residential mortgage markets recently have experienced a variety of difficulties and changed economic conditions. If market conditions continue to deteriorate, they may lead to additional valuation adjustments on our loan portfolios and real estate owned as we continue to reassess the market value of our loan portfolio, the losses associated with the loans in default and the net realizable value of real estate owned.

The homebuilding industry has experienced a significant and sustained decline in demand for new homes and an oversupply of new and existing homes available for sale in various markets, including some of the markets in which we lend. Our customers who are builders and developers face greater difficulty in selling their homes in markets where these trends are more pronounced. Consequently, we are facing increased delinquencies and non-performing assets as these builders and developers are forced to default on their loans with us. We do not know when the housing

market will improve, and accordingly, additional downgrades, provisions for loan losses and charge-offs related to our loan portfolio may occur.

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings could decrease.

Our success depends to a significant extent upon the quality of our assets, particularly loans. In originating loans, there is a substantial likelihood that we will experience credit losses. The risk of loss will vary with, among other things, general economic conditions, the type of loan, the creditworthiness of the borrower over the term of the loan and, in the case of a collateralized loan, the quality of the collateral for the loan.

Our loan customers may not repay their loans according to the terms of these loans, and the collateral securing the payment of these loans may be insufficient to assure repayment. As a result, we may experience significant loan losses, which could have a material adverse effect on our operating results. Management makes various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. We maintain an allowance for loan losses in an attempt to cover any loan losses that may occur. In determining the size of the allowance, we rely on an analysis of our loan portfolio based on historical loss experience, volume and types of loans, trends in classification, volume and trends in delinquencies and non-accruals, national and local economic conditions, and other pertinent information.

If our assumptions are wrong, our current allowance may not be sufficient to cover future loan losses, and we may need to make adjustments to allow for different economic conditions or adverse developments in our loan portfolio. Material additions to our allowance would materially decrease our net income. As a result of a difficult real estate market, we increased our allowance from $8.2 million as of December 31, 2008 to $9.8 million as of December 31, 2009. We expect our allowance to continue to fluctuate throughout 2010 and into 2011; however, given current and future market conditions, we can make no assurance that our allowance will be adequate to cover future loan losses.

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

Our business strategy includes the continuation of growth plans, and our financial condition and results of operations could be negatively affected if we fail to grow or fail to manage our growth effectively.

We intend to continue pursuing a growth strategy for our business. Our prospects must be considered in light of the risks, expenses, and difficulties frequently encountered by companies in significant growth stages of development. We cannot assure you we will be able to expand our market presence in our existing markets or successfully enter new markets or that any such expansion will not adversely affect our results of operations. Failure to manage our growth effectively could have a material adverse effect on our business, future prospects, financial condition or results of operations, and could adversely affect our ability to successfully implement our business strategy. Also, if our growth occurs more slowly than anticipated or declines, our operating results could be materially adversely affected.

Our ability to successfully grow will depend on a variety of factors including the continued availability of desirable business opportunities, the competitive responses from other financial institutions in our market areas and our ability to manage our growth. While we believe we have the management resources and internal systems in place to successfully manage our future growth, there can be no assurance growth opportunities will be available or growth will be successfully managed.

Our pace of growth and results of operations may require us to raise additional capital in the future, but that capital may not be available when it is needed.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. We anticipate our capital resources following these offerings will satisfy our capital requirements for the foreseeable future. We may at some point need to raise additional capital to support our operations and any future growth, as well as to protect against any further deterioration in our loan portfolio.

Recently, the volatility and disruption in the capital and credit markets have reached unprecedented levels. In some cases, the markets have produced downward pressure on stock prices and credit availability for certain issuers without regard to those issuers' underlying financial strength. If current levels of market disruption and volatility continue or worsen, our ability to raise additional capital may be disrupted. If we cannot raise additional capital when needed, our ability to further expand our operations through internal growth and acquisitions could be materially impaired, and our results of operations and financial condition may be adversely affected.

Changes in the interest rate environment could reduce our profitability.

As a financial institution, our earnings are significantly dependent upon our net interest income, which is the difference between the interest income that we earn on interest-earning assets, such as investment securities and loans, and the interest expense that we pay on interest-bearing liabilities, such as deposits and borrowings. Therefore, any change in general market interest rates, including changes resulting from changes in the Federal Reserve's fiscal and monetary policies, affects us more than nonfinancial institutions and can have a significant effect on our net interest income and total income. Our assets and liabilities may react differently to changes in overall market rates or conditions because there may be mismatches between the repricing or maturity characteristics of the assets and liabilities. As a result, an increase or decrease in market interest rates could have material adverse effects on our net interest margin and results of operations.

Since January 2008, in response to the dramatic deterioration of the subprime, mortgage, credit, and liquidity markets, the Federal Reserve has taken action on seven occasions to reduce interest rates by a total of 400 to 425 basis points, which has reduced our net interest income and will likely continue to reduce this income for the foreseeable future. Any reduction in our net interest income will negatively affect our business, financial condition, liquidity, operating results, cash flows and, potentially, the price of our securities. Additionally, throughout 2010, we expect to have continued margin pressure given these historically low interest rates, along with elevated levels of non-performing assets.

Recent negative developments in the financial industry, and the domestic and international credit markets may adversely affect our operations and results.

Negative developments during 2008 and 2009 in the global credit and derivative markets have resulted in uncertainty in the financial markets in general with the expectation of the general economic downturn continuing through 2010. As a result of this "credit crunch," commercial as well as consumer loan portfolio performances have deteriorated at many institutions and the competition for deposits and quality loans has increased significantly. In addition, the values of real estate collateral supporting many commercial loans and home mortgages have declined and may continue to decline. Global securities markets, and bank holding company stock prices in particular, have been negatively affected, as has the ability of banks and bank holding companies to raise capital or borrow in the debt markets. If these negative trends continue, our business operations and financial results may be negatively affected.

We face strong competition from larger, more established competitors.

The banking business is highly competitive, and we experience strong competition from many other financial institutions. We compete with commercial banks, credit unions, savings and loan associations, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market funds and other financial institutions that operate in our primary market areas and elsewhere.

We compete with these institutions both in attracting deposits and in making loans. In addition, we have to attract our customer base from other existing financial institutions and from new residents. Many of our competitors are well-established and much larger financial institutions. While we believe we can and do successfully compete with these other financial institutions in our markets, we may face a competitive disadvantage as a result of our smaller size and lack of geographic diversification.

Although we compete by concentrating our marketing efforts in our primary market area with local advertisements, personal contacts and greater flexibility in working with local customers, we can give no assurance that this strategy will be successful.

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

We continually seek to acquire other financial institutions or parts of those institutions and may continue to engage in de novo branch expansion in the future. Acquisitions and mergers involve a number of risks, including:

- the time and costs associated with identifying and evaluating potential acquisitions and merger partners may negatively affect our business;
- the estimates and judgments used to evaluate credit, operations, management, and market risks with respect to the target institution may not be accurate;
- the time and costs of evaluating new markets, hiring experienced local management, and opening new offices and the time lags between these activities and the generation of sufficient assets and deposits to support the costs of the expansion may negatively affect our business;

- we may not be able to finance an acquisition without diluting our existing shareholders;
- the diversion of our management's attention to the negotiation of a transaction may detract from their business productivity;
- we may enter into new markets where we lack experience;
- we may introduce new products and services into our business with which we have no prior experience; and
- we may incur an impairment of goodwill associated with an acquisition and experience adverse short-term effects on our results of operations.

In addition, no assurance can be given that we will be able to integrate our operations after an acquisition without encountering difficulties including, without limitation, the loss of key employees and customers, the disruption of our respective ongoing businesses or possible inconsistencies in standards, controls, procedures and policies. Successful integration of our operations with another entity's will depend primarily on our ability to consolidate operations, systems, and procedures and to eliminate redundancies and costs. If we have difficulties with the integration, we might not achieve the economic benefits we expect to result from any particular acquisition or merger. In addition, we may experience greater than expected costs or difficulties relating to such integration.

Hurricanes or other adverse weather events could negatively affect our local economies or disrupt our operations, which could have an adverse effect on our business or results of operations.

The economy of South Carolina's coastal region is affected, from time to time, by adverse weather events, particularly hurricanes. Our Charleston County market area consists primarily of coastal communities, and we cannot predict whether, or to what extent, damage caused by future hurricanes will affect our operations, our customers, or the economies in our banking markets. However, weather events could cause a decline in loan originations, destruction or decline in the value of properties securing our loans, or an increase in the risks of delinquencies, foreclosures, and loan losses. Even if a hurricane does not cause any physical damage in our market area, a turbulent hurricane season could significantly affect the market value of all coastal property.

Our recent results may not be indicative of our future results.

We may not be able to sustain our historical rate of growth or may not even be able to grow our business at all. In addition, our growth over the past few years may distort some of our historical financial ratios and statistics. In the future, we may not have the benefit of several recently favorable factors, such as a generally predictable interest rate environment, a strong residential mortgage market or the ability to find suitable expansion opportunities. Various factors, such as economic conditions, regulatory and legislative considerations and competition, may also impede or prohibit our ability to expand our market presence. If we experience a significant decrease in our historical rate of growth, our results of operations and financial condition may be adversely affected due to a high percentage of our operating costs being fixed expenses.

Our corporate culture has contributed to our success, and if we cannot maintain this culture as we grow, we could lose the teamwork and increased productivity fostered by our culture, which could harm our business.

We believe that a critical contributor to our success has been our corporate culture, which we believe fosters teamwork and increased productivity. As our organization grows and we are required to implement more complex organization management structures, we may find it increasingly difficult to maintain the beneficial aspects of our corporate culture. This could negatively impact our future success.

As a community bank, we have different lending risks than larger banks.

We provide services to our local communities. Our ability to diversify our economic risks is limited by our own local markets and economies. We lend primarily to individuals and to small to medium-sized businesses, which may expose us to greater lending risks than those of banks lending to larger, better-capitalized businesses with longer operating histories.

We manage our credit exposure through careful monitoring of loan applicants and loan concentrations in particular industries, and through loan approval and review procedures. We have established an evaluation process designed to determine the adequacy of our allowance for loan losses. While this evaluation process uses historical and other objective information, the classification of loans and the establishment of loan losses is an estimate based on experience, judgment and expectations regarding our borrowers, the economies in which we and our borrowers operate, as well as the judgment of our regulators. We cannot assure you that our loan loss reserves will be sufficient to absorb future loan losses or prevent a material adverse effect on our business, profitability or financial condition.

We are subject to extensive regulation that could limit or restrict our activities and impose financial requirements or limitations on the conduct of our business.

As a bank holding company, we are primarily regulated by the Federal Reserve. Our bank subsidiary is primarily regulated by the South Carolina State Board of Financial Institutions (the "SC State Board") and the FDIC. Our compliance with Federal Reserve, SC State Board, and FDIC regulations is costly and may limit our growth and restrict certain of our activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates charged, interest rates paid on deposits and locations of offices. We are also subject to capital requirements of our regulators.

The laws and regulations applicable to the banking industry could change at any time, especially in light of political, legal, and regulatory reactions to the recent economic downturn, and we cannot predict the effects of these changes on our business and profitability. Because government regulation greatly affects the business and financial results of all commercial banks and bank holding companies, our cost of compliance could adversely affect our ability to operate profitably.

The Sarbanes-Oxley Act of 2002 and the related rules and regulations promulgated by the SEC, have increased the scope, complexity and cost of corporate governance, reporting and disclosure practices. As a result, we may experience greater compliance costs.

Weakness in the economy and in the real estate market, including specific weakness within our geographic footprint, has adversely affected us and may continue to adversely affect us.

Declines in the United States economy and our local real estate markets contributed to our increasing provisions for loan losses during 2009, and may result in additional loan losses and loss provisions in 2010 and 2011. These factors could result in further increases in loan loss provisions, delinquencies, and/or charge-offs in future periods, which may adversely affect our financial condition and results of operations. If the strength of the United States economy in general and the strength of the local economies in which we conduct operations continue to decline, this could result in, among other things, further deterioration in credit quality or a reduced demand for credit, including a resultant adverse effect on our loan portfolio and allowance for loan and lease losses.

In addition, deterioration of the United States economy may adversely impact our banking business more generally. Economic declines may be accompanied by a decrease in demand for consumer or commercial credit and declining real estate and other asset values. Declining real estate and other asset values may reduce the ability of borrowers to use such equity to support borrowings. Delinquencies, foreclosures, and losses generally increase during economic slowdowns or recessions. Additionally, our servicing costs, collection costs and credit losses may also increase in periods of economic slowdown or recessions. Effects of the current real estate slowdown have not been limited to those directly involved in the real estate construction industry (such as builders and developers). Rather, it has impacted a number of related businesses such as building materials suppliers, equipment leasing firms, and real estate attorneys, among others. All of these affected businesses have banking relationships, and when their businesses suffer from recession, the banking relationship suffers as well.

We are subject to liquidity risk in our operations.

Liquidity risk is the possibility of being unable to satisfy obligations as they come due, capitalize on growth opportunities as they arise, or pay regular dividends because of an inability to liquidate assets or obtain adequate funding on a timely basis, at a reasonable cost and within acceptable risk tolerances. Liquidity is required to fund various obligations, including credit obligations to borrowers, mortgage originations, withdrawals by depositors, repayment of debt, dividends to shareholders, operating expenses and capital expenditures. Liquidity is derived primarily from retail deposit growth and retention, principal and interest payments on loans and investment securities, net cash provided from operations and access to other funding sources. Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could detrimentally affect our access to liquidity sources include a decrease in the level of our business activity due to a market downturn or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as a severe disruption in the financial markets or negative views and expectations about the prospects for the financial services industry as a whole, given the recent turmoil faced by banking organizations in the domestic and worldwide credit markets.

The impact of the current economic downturn on the performance of other financial institutions in our geographic area, actions taken by our competitors to address the current economic downturn, and the public perception of and confidence in the economy generally, and the banking industry specifically, could negatively impact our performance and operations.

All financial institutions are subject to the same risks resulting from a weakening economy such as increased charge-offs and levels of past due loans and nonperforming assets. As troubled institutions in our market area continue to dispose of problem assets, the already excess inventory of residential homes and lots will continue to negatively affect home values and increase the time it takes us or our borrowers to sell existing inventory. The perception that troubled banking institutions (and smaller banking institutions that are not "in trouble") are risky institutions for purposes of regulatory compliance or safeguarding deposits may cause depositors nonetheless to move their funds to larger institutions. If our depositors should move their funds based on events happening at other financial institutions, our operating results would suffer.

Our agreement with the U.S. Treasury under the capital purchase component of the Troubled Asset Relief Program is subject to unilateral change by the U.S. Treasury, which could adversely affect our business, financial condition, and results of operations.

Under the capital purchase component of the Troubled Asset Relief Program ("TARP"), the U.S. Treasury may unilaterally amend the terms of its agreement with us in order to comply with any changes in federal law. We cannot predict the effects of any of these changes and of the associated amendments.

The Emergency Economic Stabilization Act of 2008 ("EESA") or other governmental actions may not stabilize the financial services industry.

The EESA, which was signed into law on October 3, 2008, is intended to alleviate the financial crisis affecting the United States banking system. A number of programs have been, and are being, developed and implemented under EESA. The EESA may not have the intended effect, however, and as a result, the condition of the financial services industry could decline instead of improve. The failure of the EESA to improve the condition of the United States banking system could significantly adversely affect our access to funding or capital, the trading price of our stock, and other elements of our business, financial condition, and results of operations.

In addition to EESA, a variety of legislative, regulatory, and other proposals have been discussed or may be introduced in an effort to address the financial crisis. Depending on the scope of such proposals, if they are adopted and applied to the Company, our financial condition, results of operations or liquidity could, directly or indirectly, benefit or be adversely affected in a manner that could be material to our business.

The short term and long term impact of a likely new capital framework, whether through the current proposal for non-Basel II United States banking institutions or through another set of capital standards, is uncertain.

For United States banking institutions with assets of less than $250 billion and foreign exposures of less than $10 billion, including the Company and the Bank, a proposal is currently pending that would apply to them the "standardized approach" of the new risk-based capital standards developed by the Basel Committee on Banking Supervision (Basel II). As a result of the recent deterioration in the global credit markets and increases in credit, liquidity, interest rate, and other risks, the United States banking regulators have for the last several months discussed possible increases in capital requirements for all financial institutions, separate from the current proposal for the standardized approach of Basel II. In August 2009, the Treasury issued principles for international regulatory reform, which included recommendations for higher capital standards for all banking organizations. Any new capital framework is likely to affect the cost and availability of different types of credit. United States banking organizations

are likely to be required to hold higher levels of capital and could incur increased compliance costs. Any of these developments, including increased capital requirements, could have a material negative effect on our business, results of operations and financial condition.

We may lose members of our management team due to compensation restrictions.

Our ability to retain key officers and employees may be negatively impacted by recent legislation and regulation affecting the financial services industry. On February 17, 2009, the American Recovery and Reinvestment Act of 2009 ("ARRA") was signed into law. While the Treasury must promulgate regulations to implement the restrictions and standards set forth in the new law, the ARRA, among other things, significantly expands the executive compensation restrictions previously imposed by the EESA. Such restrictions apply to any entity that has received or will receive financial assistance under the TARP, and will generally continue to apply for as long as any obligation arising from financial assistance provided under the TARP, including preferred stock issued under the TARP capital purchase program, remains outstanding. As a result of our participation in the TARP capital purchase program, the restrictions and standards set forth in the ARRA are applicable to us. Such restrictions and standards may impact management's ability to retain key officers and employees as well as our ability to compete with financial institutions that are not subject to the same limitations as we are under the ARRA.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not Applicable.

ITEM 2. PROPERTIES

The executive and main offices of the Company and the Bank are located at 2170 W. Palmetto Street in Florence, South Carolina. The facility at that location is owned by the Bank. The Bank also owns an adjacent lot that is used as a parking lot. The headquarters building is a two-story building having approximately 12,000 square feet. The building has six inside teller stations, two teller stations servicing four drive-through lanes and a night depository and automated teller machine drive-through lane that is accessible after the Bank's normal business hours.

On April 26, 2000, the Bank opened a branch at 411 Second Loop Road in Florence, South Carolina. The Second Loop branch facility, which is owned by the Bank, is located on approximately one acre of land and contains approximately 3,000 square feet.

On May 15, 2002, the Bank purchased an additional facility located at 2145 Fernleaf Drive in Florence, South Carolina. The Fernleaf Drive site contains approximately 0.5 acres of land and includes a 7,500 square feet building. The facility will serve as additional space for the operational and information technology activities of the Bank, including data processing and auditing. No customer services will be conducted in this facility.

On June 17, 2004, the Bank opened a temporary branch at 709 North Lake Drive in Lexington, South Carolina. On July 1, 2008, the bank subsequently moved into its permanent branch facility at 801 North Lake Drive in Lexington, South Carolina. The Lexington branch facility, which is owned by the Bank, is located on approximately two acres of land and contains approximately 13,000 square feet.

On March 15, 2005, the Bank opened a branch at 51 State Street, Charleston, South Carolina. This property is leased. On August 8, 2005, the bank changed the street address of this location to 25 Cumberland Street, Charleston, South Carolina because of a change in the primary entrance to the branch.

On March 24, 2005, the Bank leased approximately five acres at 2211 West Palmetto Street in Florence, South Carolina for possible development of a future headquarters location. This property and an adjacent parcel were purchased by the Company on November 24, 2008 and are leased by the Bank.

On October 3, 2005, the Bank opened a branch office at 800 South Shelmore Blvd., Mount Pleasant, South Carolina. The Mount Pleasant branch facility is located on approximately one acre of land and contains approximately 6,500 square feet.

On February 9, 2006, the Bank purchased approximately 0.75 acres at 2148 West Palmetto Street, Florence, South Carolina for a future training facility. On April 1, 2007, the Bank opened its Learning Center which contains approximately 6,000 square feet.

The Bank owns property at 44th Business Park, Lots 1, 2 & 3, North Myrtle Beach, South Carolina, which is an abandoned branch site listed for sale.

In March 2008, the Bank purchased 1.37 acres at 8551 Rivers Avenue, North Charleston, South Carolina and one acre at 950 Lake Murray Boulevard, Columbia, South Carolina, which are expected to be future branch office locations.

On July 24, 2009, the Bank opened a branch office at 2005A Sunset Boulevard, West Columbia, South Carolina in a facility leased by the Bank.

Other than the Bank facilities described in the preceding paragraphs and the real estate-related loans funded by the Bank previously described in “Item 1. Business—First Reliance Bank,” the Company does not invest in real estate, interests in real estate, real estate mortgages, or securities of or interests in persons primarily engaged in real estate activities.

ITEM 3. LEGAL PROCEEDINGS

None.

PART II

ITEM 4. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

(a) The response to this Item 5(a) is included in the Company’s 2009 Annual Report to Shareholders under the heading, “Market for First Reliance Bancshares, Inc.’s Common Stock; Payment of Dividends,” and is incorporated herein by reference.

(b) Not Applicable

(c) Not Applicable

ITEM 5. SELECTED FINANCIAL DATA

The following selected financial data is derived from the consolidated financial statements and other data of First Reliance Bancshares, Inc. and Subsidiary (the "Company"). The selected financial data should be read in conjunction with the consolidated financial statements, including the accompanying notes, included elsewhere herein.

(Dollars in thousands, except per share data)	2009	2008	2007	2006	2005
Income Statement Data:					
Interest income	$ 32,025	$ 36,243	$ 37,540	$ 31,717	$ 23,131
Interest expense	15,341	17,298	18,433	14,214	8,979
Net interest income	16,684	18,945	19,107	17,503	14,152
Provision for loan losses	14,401	4,935	1,643	1,393	1,811
Net interest income after provision for loan losses	2,283	14,010	17,464	16,110	12,341
Noninterest income	7,545	5,009	5,302	4,591	2,871
Noninterest expense	19,853	18,852	18,961	16,272	12,475
Income (loss) before income taxes	(10,025)	167	3,805	4,429	2,737
Income tax expense (benefit)	(4,181)	(459)	1,245	1,183	789
Net income (loss)	(5,844)	626	2,560	3,246	1,948
Preferred stock dividends	837	-	-	-	-
Net income (loss) available to common shareholders	$ (6,681)	$ 626	$ 2,560	$ 3,246	$ 1,948
Balance Sheet Data:					
Assets	$ 645,508	$ 603,434	$ 591,704	$ 456,211	$ 403,038
Earning assets	589,657	560,032	550,559	412,687	381,158
Securities available for sale(1)	121,949	76,311	58,580	35,931	37,121
Loans (2)	411,728	478,579	487,739	360,123	319,539
Allowance for loan losses	9,801	8,224	5,271	4,002	3,419
Deposits	552,763	461,135	449,498	372,938	334,437
Shareholders' equity	45,224	37,426	37,028	34,093	29,651
Per Common Share Data:					
Basic earnings (loss)	$ (1.87)	$ 0.18	$ 0.74	$ 0.96	$ 0.60
Diluted earnings (loss)	(1.87)	0.18	0.72	0.91	0.57
Common book value	8.37	10.65	10.63	9.95	8.97
Performance Ratios:					
Return on average assets	(0.88)%	0.11%	0.52%	0.75%	0.54%
Return on average equity	(12.14)	1.65	7.16	10.19	6.82
Net interest margin (3)	2.81	3.53	4.20	4.42	4.20
Efficiency (4)	81.94	78.80	77.69	73.65	73.28
Capital and Liquidity Ratios:					
Average equity to average assets	7.28%	6.42%	7.15%	7.39%	7.96%
Leverage (4.00% required minimum)	8.25	9.28	9.46	9.90	10.02
Risk-based capital					

Tier 1	11.52	10.73	9.26	11.42	12.02
Total	12.78	11.97	10.29	12.45	13.05
Average loans to average deposits	86.07	106.63	99.37	96.86	102.07

(1) Securities available-for-sale are stated at fair value.
(2) Loans are stated at gross amounts before allowance for loan losses and include loans held for sale.
(3) Tax equivalent net interest income divided by average earning assets.
Noninterest expense divided by the sum of net interest income and noninterest income, excluding gains and losses on sales of assets.

ITEM 6.MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Basis of Presentation

The following discussion should be read in conjunction with the preceding "Selected Financial Data" and the Company's Consolidated Financial Statements and the Notes thereto and the other financial data included elsewhere herein. The financial information provided below has been rounded in order to simplify its presentation. However, the ratios and percentages provided below are calculated using the detailed financial information contained in the Consolidated Financial Statements, the Notes thereto and the other financial data included elsewhere herein.

General

First Reliance Bank (the "Bank") is a state-chartered bank headquartered in Florence, South Carolina. The Bank opened for business on August 16, 1999. The principal business activity of the Bank is to provide banking services to domestic markets, principally in Florence County, Lexington County, and Charleston County, South Carolina. The deposits of the Bank are insured by the Federal Deposit Insurance Corporation (the "FDIC").

On June 7, 2001, the shareholders of the Bank approved a plan of corporate reorganization (the "Reorganization") under which the Bank would become a wholly owned subsidiary of First Reliance Bancshares, Inc. (the "Company"), a South Carolina corporation. The Reorganization was accomplished through a statutory share exchange between the Bank and the Company, whereby each outstanding share of common stock of the Bank was exchanged for one share of common stock of the Company. The Reorganization was completed on April 1, 2002, and the Bank became a wholly-owned subsidiary of the Company.

Organizing activities for the Bank began on November 23, 1998. Upon the completion of the application process with the South Carolina State Board of Financial Institutions for a state charter and with the FDIC for deposit insurance, the Bank issued 723,518 shares of common stock at a price of $10.00 per share, resulting in capital totaling $7,173,293, net of selling expenses of $61,887.

The Bank began operations on August 16, 1999 at its temporary facility on West Palmetto Street in Florence, South Carolina. In June of 2000, the Bank moved into its headquarters at 2170 West Palmetto Street in Florence, South Carolina. The Bank also opened a banking office on Second Loop Road in Florence, South Carolina in April of 2001. On May 15, 2002, the Bank purchased an additional facility located at 2145 Fernleaf Drive in Florence, South Carolina. The Fernleaf Drive site contains approximately 0.5 acres of land and includes a 7,500 square feet building. The facility serves as additional space for operational activities of the Bank, including data processing and auditing. No customer services are being conducted in this facility.

On November 12, 2002, the Company commenced a stock offering whereby a minimum of 125,000 shares and a maximum of 1,250,000 shares of common stock were offered to fund continued expansion. The offering price was $8.00 per share. This was a best efforts offering and was conducted without an underwriter. The Company had sold 1,007,430 shares resulting in additional capital of $8,059,439 net of selling expenses of $162,965, at the close of the offering in May 2003. Also 10,400 stock options were exercised in 2003 for a total amount of $52,000.

During the second quarter of 2004, the Bank opened its third branch in Lexington, South Carolina. On March 15, 2005, the Bank opened its fourth branch in Charleston, South Carolina located at 51 State Street. The Bank also opened its fifth branch in Mount Pleasant, South Carolina located at 800 South Shelmore Blvd on October 3, 2005.

On June 30, 2005, First Reliance Capital Trust I (a non-consolidated affiliate) issued $10,000,000 in trust preferred securities with a maturity of November 23, 2035 and may be redeemed by the Company after five years, and sooner in certain specific events. The rate is fixed at 5.93% until August 23, 2010, at which point the rate adjusts quarterly to the three-month LIBOR plus 1.83%, and can be called without penalty beginning on June 15, 2011. The trust has not been consolidated in these financial statements. The Company received from the trust the $10,000,000 proceeds from the issuance of the securities and the $310,000 initial proceeds from the capital investment in the trust, and accordingly has shown the funds due to the trust as $10,310,000 junior subordinated debentures. Current regulations allow the entire amount of junior subordinated debentures to be included in the calculation of regulatory capital.

On December 28, 2008, the Company injected $3,000,000 into the Bank as permanent capital.

On March 6, 2009, the Company completed a transaction with the United States Treasury (“Treasury”) under the Troubled Asset Relief Program Capital Purchase Program (“TARP CPP”). Under the TARP CPP, the Company received $15,225,312, net of expenses of $123,688, in exchange for 15,349 and 767 shares of its Series A and Series B Cumulative Perpetual Preferred Stock, respectively. The preferred shares issued to the Treasury qualify as tier 1 capital for regulatory purposes.

Like most financial institutions, the Company’s profitability depends largely upon net interest income, which is the difference between the interest received on earning assets, such as loans and investment securities, and the interest paid on interest-bearing liabilities, principally deposits and borrowings. The Company’s results of operations are also affected by the provision for loan losses; non-interest expenses, such as salaries, employee benefits, and occupancy expenses; and non-interest income, such as mortgage loan fees and service charges on deposit accounts.

Economic conditions, competition and federal monetary and fiscal policies also affect financial institutions. Lending activities are also influenced by regional and local economic factors, such as housing supply and demand, competition among lenders, customer preferences and levels of personal income and savings in our primary market area.

Results of Operations

We realized a net loss available to common shareholders for the year ended December 31, 2009, of $6,680,787, or a loss of $1.87 per diluted share, compared to a net income of $625,632, or earnings of $0.18 per diluted share, for the year ended December 31, 2008.

Our operating results for 2009 were negatively impacted by the credit crisis that began in 2008, continuing into 2009, which resulted in rising unemployment, substantial decrease in consumer confidence and spending, and declining real estate values throughout our market area. During 2009, the existing weak economic environment and the depressed real estate valuations in our market had an adverse impact on our borrowers, which has resulted in a negative impact on our asset quality. Defaults by borrowers, especially in the residential and commercial real estate sectors, increased substantially in 2009, resulting in the recording of higher provisions for credit losses and higher net charge-offs. For the year ended December 31, 2009, we recorded a provision for loan losses of $14,400,652 compared to $4,934,912 for the year ended 2008. Our net charge offs for the comparable periods were $12,823,805 and $1,981,620, respectively. In addition, these factors contributed materially to the $2,260,204 decrease in our net interest income for the year ended 2009 compared to 2008.

Our 2009 operating results were also negatively impacted by an increase in our deposit insurance premiums. Like all federally insured financial institutions, we have been subjected to substantial increases in deposit insurance premiums, as well as a special assessment levied by the FDIC in the second quarter of 2009. For the year ended December 31, 2009, our deposit insurance premiums, including the special assessment, were $1,348,914 and $378,904 for the year ended December 31, 2009 and 2008, respectively.

In spite of the difficult challenges we faced during 2009, we were able to increase our total assets and core deposits by $41,303,424 and $33,726,271, respectively; to improve our liquidity; and to maintain our regulatory capital ratios in excess of those required for being a well capitalized financial institution.

Net Interest Income

The largest component of our net income is its net interest income, which is the difference between the income earned on assets and interest paid on deposits and on the borrowings used to support such assets. Net interest income is

determined by the yields earned on our interest-earning assets and the rates paid on interest-bearing liabilities, the relative amounts of interest-earning assets and interest-bearing liabilities, and the degree of mismatch and the maturity and repricing characteristics of its interest-earning assets and interest-bearing liabilities. Total interest-earning assets yield less total interest-bearing liabilities rate represents our net interest rate spread.

Net interest income for 2009 was $16,684,142 compared to $18,944,346 for 2008, a decrease of $2,260,204, or 11.93%. This decrease was the product of the substantial increase of $10,842,185 in our net loans charged off and the substantial increase in the average balance of our nonperforming loans for 2009 compared to 2008. Interest lost on our nonaccruing loans was $2,450,489 and $1,403,619 for 2009 and 2008, respectively. This negatively affected our 2009 net interest income by $1,046,870. Further impacting our 2009 net interest income is the fact that our annualized yield on average earning assets decreased 138 basis points for 2009 compared to 2008, while our annualized average cost of our interest-bearing liabilities decreased only 71 basis points for 2009 compared to 2008. See “Rate/Volume Analysis” below for a more detailed discussion.

For 2009, average-earning assets totaled $617,075,948 with an annualized average yield of 5.29% compared to $549,691,569 and 6.67%, respectively, for 2008. Average interest-bearing liabilities totaled $566,202,286 with an annualized average cost of 2.71% for 2009 compared to $506,359,427 and 3.42%, respectively, for 2008.

Our net interest margin and net interest spread was 2.81% and 2.58%, respectively, for 2009 compared to 3.53% and 3.25%, respectively, for 2008.

Because loans often provide a higher yield than other types of earning assets, one of our goals is to maintain our loan portfolio as the largest component of total earning assets. Loans comprised 74.93% and 87.61% of average earning assets for December 31, 2009 and 2008, respectively. Loan interest income for the years ended December 31, 2009 and 2008 was $27,758,195 and $33,150,366, respectively. The annualized average yield on loans was 6.00% and 6.88% for 2009 and 2008, respectively. Average balances of loans decreased to $462,400,290 during 2009, a decrease of $19,171,818 from the average of $481,572,108 during 2008. Our loan income for 2009 was significantly impacted by the depressed real estate market and the significant increase in charged off loans and the average volume of nonperforming loans. The combined decreases in loan and yield volume had a significant impact on our net interest income. Because of the economic downturn in our markets that caused the volume of new loan customers to decrease, we shifted our asset mix toward securities in 2009.

Available-for-sale investment securities averaged $94,506,986, or 15.32% of average earning assets, for December 31, 2009 compared to approximately $60,187,152, or 10.95% of average earning assets for 2008. Interest earned on investment securities amounted to $4,103,831 for the year ended December 31, 2009, compared to $2,818,078 for the same period last year. Our fully tax-equivalent yield was 5.03% and 5.42% for the period ended December 31, 2009 and 2008, respectively.

Our total average interest-bearing deposits were $492,325,051 and $407,813,354 for 2009 and 2008, respectively, which represented an increase of $84,511,697, or 20.72%. The increase in deposits resulted from successful pricing and marketing promotions, a key strategic initiative for our Company. Total interest paid on deposits for the years ended December 31, 2009 and 2008 was $12,560,062 and $13,620,344, respectively. The annualized average cost of deposits was 2.55% and 3.34% for the year ended December 31, 2009 and 2008, respectively. The decline in average rate paid for deposits during 2009 is mainly due to the decline in market interest rates.

The average balance of other interest-bearing liabilities was $73,877,235 and $98,546,073 for 2009 and 2008, respectively.
This represented a decrease of $24,668,838, or 25.03%. The decrease is partially attributable to the decrease of $12,844,098 in our average borrowings from the Federal Home Loan Bank. With the availability of interest-bearing deposits at lower cost during 2009, we became less reliant on using borrowings from the Federal Home Loan Bank to fund loan demands. The extremely low market interest rates that existed during 2009 for federal funds purchased and securities sold under agreements to repurchase resulted in an average decrease of $9,921,420 in the use of these types of financial instruments.

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

Year ended December 31,	2009			2008			2007		
(Dollars in thousands)	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield / Rate
Assets									
Earning assets:									
Loans (2)	$ 462,400	$ 27,758	6.00%	$ 481,572	$ 33,150	6.88%	$ 414,907	$ 35,325	8.51%
Securities, taxable	51,837	2,199	4.24	30,075	1,519	5.05	17,967	892	4.96
Securities, nontaxable (1)	42,670	2,552	5.98	30,112	1,741	5.75	18,204	1,045	5.74
Federal funds sold	512	1	0.26	2,838	56	1.97	7,479	391	5.23
Other earning assets	59,656	163	.27	5,095	218	4.28	2,529	152	6.01
Total earning assets	617,075	32,673	5.29	549,692	36,684	6.67	461,086	37,805	8.20
Cash due from banks	2,421			5,524			8,586		
Premises and equipment	26,863			23,983			18,049		
Other assets	23,871			17,490			16,758		
Allowance for loan losses	(8,427)			(5,819)			(4,433)		
Total assets	$ 661,803			$ 590,870			$ 500,046		
Liabilities and Shareholders' Equity									
Interest-bearing deposits:									
Transaction accounts	$ 37,516	$ 214	0.57%	$ 28,761	$ 184	.64%	$ 36,625	$ 710	1.94%
Savings and money market accounts	104,429	1,743	1.67	98,210	2,123	2.16	80,943	3,184	3.93
Time deposits	350,380	10,603	3.03	280,842	11,313	4.03	254,934	12,874	5.05
Total interest-bearing deposits	492,325	12,560	2.55	407,813	13,620	3.34	372,502	16,768	4.50
Other interest-bearing liabilities:									
Securities sold under agreement to repurchase	2,261	1	0.05	7,845	121	1.54	9,128	400	4.38
Federal funds purchased	21		0.82	4,359	130	2.99	1,809	92	5.09
Federal Home Loan Bank borrowing	59,800	2,137	3.57	72,644	2,675	3.68	22,986	553	2.41
	10,310	613	5.95	10,310	616	5.98	10,310	620	6.01

Junior subordinated debentures									
Note payable	1,485	30	2.01	3,388	136	4.00	8	-	0.00
Total other interest-bearing liabilities	73,877	2,781	3.76	98,546	3,678	3.73	44,241	1,665	3.76
Total interest-bearing liabilities	566,202	15,341	2.71	506,359	17,298	3.42	416,743	18,433	4.42
Noninterest-bearing deposits	44,900			43,812			45,038		
Other liabilities	2,552			2,732			2,513		
Shareholders' equity	48,149			37,967			35,752		
Total liabilities and equity	$ 661,803			$ 590,870			$ 500,046		
Net interest income/interest spread		$ 17,332	2.58%		$ 19,386	3.25%		$ 19,372	3.78%
Net yield on earning assets			2.81%			3.53%			4.20%

(1) Fully tax-equivalent basis at 34% tax rate for nontaxable securities

(2) Includes mortgage loans held for sale and nonaccruing loans

Rate/Volume Analysis

Analysis of Changes in Net Interest Income - Net interest income can also be analyzed in terms of the impact of changing rates and changing volume. The following table describes the extent to which changes in interest rates and changes in the volume of earning assets and interest-bearing liabilities have affected the Company's interest income and interest expense during the periods indicated. Information on changes in each category attributable to (i) changes due to volume (change in volume multiplied by prior period rate), (ii) changes due to rates (changes in rates multiplied by prior period volume) and (iii) changes in rate/volume (change in rate multiplied by the change in volume) is provided in the table below. Changes to both rate and volume (in iii above), which cannot be segregated have been allocated proportionately.

	2009 Compared to 2008 Due to increase (decrease) in			2008 Compared to2007 Due to increase (decrease) in		
(Dollars in thousands)	Volume	Rate	Total	Volume	Rate	Total
Interest income:						
Loans	$ (1,280)	$ (4,112)	$ (5,392)	$ 5,178	$ (7,353)	$ (2,175)
Securities, taxable	955	(275)	680	611	16	627
Securities, tax exempt	741	71	812	689	7	696
Federal funds sold	(27)	(28)	(55)	(167)	(168)	(335)
Other earning assets	324	(380)	(56)	120	(54)	66
Total interest income	713	(4,724)	(4,011)	6,431	(7,552)	(1,121)
Interest expense:						
Interest-bearing deposits						
Interest-bearing transaction accounts	52	(21)	31	(128)	(398)	(526)
Savings and money market accounts	127	(507)	(380)	580	(1,641)	(1,061)
Time deposits	2,450	(3,161)	(711)	1,218	(2,779)	(1,561)
Total interest-bearing deposits	2,629	(3,689)	(1,060)	1,670	(4,818)	(3,148)
Other interest-bearing liabilities						
Securities sold under agreement to repurchase	(51)	(69)	(120)	(50)	(229)	(279)
Federal funds purchased	(75)	(55)	(130)	89	(51)	38
Federal Home Loan Bank borrowings	(460)	(78)	(538)	1,702	420	2,122
Junior subordinated debentures	-	(3)	(3)	-	(4)	(4)
Note payable	(56)	(50)	(106)	136	-	136
Total other interest-bearing liabilities	(642)	(255)	(897)	1,877	136	2,013
Total interest expense	1,988	(3,944)	(1,957)	3,547	(4,682)	(1,135)
Net interest income	$ (1,274)	$ (780)	$ (2,054)	$ 2,884	$ (2,870)	$ 14

Net Interest Income

Interest Sensitivity - The Company monitors and manages the pricing and maturity of its assets and liabilities in order to diminish the potential adverse impact that changes in interest rates could have on its net interest income. The principal monitoring technique employed by the Company is the measurement of the Company's interest sensitivity "gap," which is the positive or negative dollar difference between assets and liabilities that are subject to interest rate repricing within a given period of time. Interest rate sensitivity can be managed by repricing assets or liabilities, selling securities available-for-sale, replacing an asset or liability at maturity, or adjusting the interest rate during the life of an asset or liability. Managing the amount of assets and liabilities repricing in this same time interval helps to hedge interest sensitivity and minimize the impact on net interest income of rising or falling interest rates.

The following table sets forth the Company's interest rate sensitivity at December 31, 2009.

December 31, 2009 (Dollars in thousands)	Within One Month	After One Through Three Months	After Three Through Twelve Months	Within One Year	Greater Than One Year or Non-Sensitive	Total
Assets						
Interest-earning assets						
Interest-bearing deposits in other banks	$ 50,356	$ -	$ -	$ 50,356	$ -	$ 50,356
Loans, including held for sale	51,169	22,847	83,985	158,001	253,727	411,728
Securities, taxable	68	-	-	68	61,144	61,212
Securities, nontaxable	-	-	-	-	60,737	60,737
Nonmarketable securities	4,812	-	-	4,812		4,812
Time deposits in other banks			502	502		502
Investment in trust	-	-	-	-	310	310
Total earning assets	106,405	22,847	84,487	213,739	375,918	589,657
Liabilities						
Interest-bearing liabilities:						
Interest-bearing deposits:						
Transaction accounts	47,733	-	-	47,733	-	47,733
Savings deposits	103,605	-	-	103,605	-	103,605
Time deposits	19,078	33,260	143,998	196,336	160,790	357,126
Total interest-bearing deposits	170,416	33,260	143,998	347,674	160,790	508,464
Advances from Federal Home Loan Bank	7,000	-	14,000	21,000	13,000	34,000
Junior subordinated debentures	-	-	-	-	10,310	10,310
Repurchase agreements	598	-	-	598	-	598
Total interest-bearing liabilities	178,014	33,260	157,998	369,272	184,100	553,372
Period gap	$ (71,609)	$ (10,413)	$ (73,511)	$ (155,533)	$ 191,818	
Cumulative gap	$ (71,609)	$ (82,022)	$ (155,533)	$ (155,533)	$ 36,285	

Ratio of cumulative gap to total earning assets	(12.14)%	(13.91)%	(26.38)%	(26.38)%	6.15%

The above table reflects the balances of earning assets and interest-bearing liabilities at the earlier of their repricing or maturity dates. Federal funds sold are reflected at the earliest pricing interval due to the immediately available nature of the instruments. Securities are reflected at each instrument's ultimate maturity date. Scheduled payment amounts of fixed rate amortizing loans are reflected at each scheduled payment date. Scheduled payment amounts of variable rate amortizing loans are reflected at each scheduled payment date until the loan may be repriced contractually; the unamortized balance is reflected at that point. Interest-bearing liabilities with no contractual maturity, such as demand deposits and savings deposits, are reflected in the earliest repricing period due to contractual arrangements, which give us the opportunity to vary the rates paid on those deposits within one month or shorter period. However, we are not obligated to vary the rates paid on these deposits within any given period. Fixed rate time deposits, principally certificates of deposit, are reflected at their contractual maturity dates. Repurchase agreements mature on a daily basis and are reflected in the earliest pricing period. Advances from the Federal Home Loan Bank and junior subordinated debentures are reflected at their contractual maturity date.

We are in a liability sensitive position (or a negative gap) of $155.5 million over the 12 month time frame. The gap is negative when interest-bearing liabilities exceed interest sensitive earning assets, as was the case at the end of 2009 with respect to the one-year time horizon. When interest sensitive earning assets exceed interest-bearing liabilities for a specific repricing "horizon," a positive interest sensitivity gap is the result.

A positive gap generally has a favorable effect on net interest income during periods of rising rates. A positive one year gap position occurs when the dollar amount of earning assets maturing or repricing within one year exceeds the dollar amount of interest-bearing liabilities maturing or repricing during that same period. As a result, during periods of rising interest rates, the interest received on earning assets will increase faster than interest paid on interest-bearing liabilities, thus increasing interest income. The reverse is true in periods of declining interest rates resulting generally in a decrease in net interest income.

Our Board of Directors and management review the asset liability management with information produced by a quantitative model that measures our interest rate sensitivity. Our asset and liability policies are focused upon maximizing long term profitability while managing acceptable interest rate risk.

However, our gap analysis is not a precise indicator of our interest rate sensitivity position. The analysis presents only a static view of the timing of maturities and repricing opportunities, without taking into consideration that changes in interest rates do not affect all assets and liabilities equally. For example, rates paid on a substantial portion of core deposits may change contractually within a relatively short time frame, but those rates are viewed by management as significantly less interest-sensitive than market-based rates such as those paid on non-core deposits. Net interest income may be impacted by other significant factors in a given interest rate environment, including changes in the volume and mix of earning assets and interest-bearing liabilities. We believe we have positioned ourselves to where there is minimal impact on interest income in a rising or falling rate environment.

Provision and Allowance for Loan Losses

We have developed policies and procedures for evaluating the overall quality of our credit portfolio and the timely identification of potential problem credits. On a quarterly basis, our Board of Directors reviews and approves the appropriate level for the allowance for loan losses based upon management's recommendations, the results of the internal monitoring and reporting system, and an analysis of economic conditions in our market. The objective of management has been to fund the allowance for loan losses at a level greater than or equal to our internal risk measurement system for loan risk.

Additions to the allowance for loan losses, which are expensed as the provision for loan losses on our income statement, are made periodically to maintain the allowance at an appropriate level based on management's analysis of the potential risk in the loan portfolio. Loan losses and recoveries are charged or credited directly to the allowance. The amount of the provision is a function of the level of loans outstanding, the level of nonperforming loans, historical loan loss experience, the amount of loan losses actually charged against the reserve during a given period, and current and anticipated economic conditions.

The allowance represents an amount which management believes will be adequate to absorb inherent losses on existing loans that may become uncollectible. Our judgment as to the adequacy of the allowance for loan losses is based on a number of assumptions about future events, which we believe to be reasonable, but which may or may not prove to be accurate. Our determination of the allowance for loan losses is based on evaluations of the collectability of loans, including consideration of factors such as the balance of impaired loans, the quality, mix, and size of our overall loan portfolio, economic conditions that may affect the borrower's ability to repay, the amount and quality of collateral securing the loans, our historical loan loss experience, and a review of specific problem loans. We also consider subjective issues such as changes in the lending policies and procedures, changes in the local and national economy, changes in volume or type of credits, changes in the volume or severity of problem loans, quality of loan review and board of director oversight, concentrations of credit, and peer group comparisons.

More specifically, in determining our allowance for loan loss, we review loans for specific and impaired reserves based on current appraisals less estimated closing costs. General and unallocated reserves are determined using historical loss trends applied to risk rated loans grouped by loan type. The general and unallocated reserves are calculated by applying the appropriate historical loss ratio to the loan categories. Impaired loans are excluded from this analysis. The sum of all such amounts determines our general and unallocated reserves.

We also track our portfolio and analyze loans grouped by loan type categories. The first step in this process is to risk grade each and every loan in the portfolio based on one common set of parameters. These parameters include items like debt-to-worth ratio, liquidity of the borrower, net worth, experience in a particular field and other factors such as underwriting exceptions. Weight is also given to the relative strength of any guarantors on the loan. Due to our short operating history and only recent experience with problem assets, the results of our migration analysis have yet to provide significant relevant information with respect to determining the general allowance related to nonimpaired loans. We anticipate, however, that this analysis will eventually provide us with historical behavioral indications by credit grading as we develop sufficient history to analyze the general allowance related to non-impaired loans.

After risk grading each loan, we then use 15 qualitative factors to analyze the trends in the portfolio. These 15 factors include both internal and external factors. The internal factors are the concentration of credit across the portfolio, current delinquency ratios and trends, the experience level of management and staff, our adherence to lending policies and procedures, current loss and recovery trends, the nature and volume of the portfolio's categories, current non-accrual and problem loan trends, the quality of our loan review system, and other factors which include collateral, loan to value ratio, and policy exceptions. The external factors are the current economic and business environment, which includes indicators such as national GDP, pricing indicators, employment statistics, housing statistics, market

indicators, financial regulatory economic analysis, and economic forecasts from reputable sources. A quantitative value is assigned to each of the 15 internal and external factors, which, when added together, creates a net qualitative weight. The net qualitative weight is then added to the minimum loss ratio. Negative trends in the loan portfolio increase the quantitative values assigned to each of the qualitative factors and, therefore, increase the loss ratio. As a result, an increased loss ratio will result in a higher allowance for loan loss. For example, as general economic and business conditions decline, this qualitative factor's quantitative value will increase, which will increase the net qualitative weight and the loss ratio (assuming all other qualitative factors remain constant). Similarly, positive trends in the loan portfolio, such as an improvement in general economic and business conditions, will decrease the quantitative value assigned to this qualitative factor, thereby decreasing the net qualitative weight (assuming all other qualitative factors remain constant). These factors are reviewed and updated by our risk management committee on a quarterly basis to arrive at a consensus for our qualitative adjustments.

We then create a loss range by applying average historical industry loss rates for the last 10 years to determine the level of the allowance for loan and lease losses on the non-impaired loans in the portfolio. We utilize a 10 year time frame, as we believe it includes numerous complete economic cycles. As such, we consider the time frame long enough to include both favorable and problematic industry trends relevant in determining historical loss rates. The resulting unadjusted historical loss factor is used as a beginning point upon which we add our quantitative adjustments based on the qualitative factors discussed above. Once the qualitative adjustments are made, we refer to the final amount as the historical loss factor. The historical loss factor is then multiplied by the loans outstanding for the period ended, except for any loans classified as non-performing, which are addressed specifically as discussed below.

Separately, we review all impaired loans individually to determine a specific allocation for each. In our assessment of impaired loans, we consider the primary source of repayment when determining whether loans are collateral dependent or not.

Periodically, we adjust the amount of the allowance based on changing circumstances. We recognize loan losses to the allowance and add subsequent recoveries back to the allowance for loan losses. In addition, on a quarterly basis we informally compare our allowance for loan losses to various peer institutions; however, we recognize that allowances will vary as financial institutions are unique in the make-up of their loan portfolios and customers, which necessarily creates different risk profiles for the institutions. We would only consider further adjustments to our allowance for loan losses based on this peer review if our allowance was significantly different from our peer group. To date, we have not made any such adjustment. There can be no assurance that charge-offs of loans in future periods will not exceed the allowance for loan losses as estimated at any point in time or that provisions for loan losses will not be significant to a particular accounting period, especially considering the overall weakness in the commercial real estate market in our market areas.

Our various regulatory agencies review our allowance for loan losses through their periodic examinations, and they may require additions to the allowance for loan losses based on their judgment about information available to them at the time of their examinations. Our losses will undoubtedly vary from our estimates, and it is possible that charge-offs in future periods will exceed the allowance for loan losses as estimated at any point in time.

As of December 31, 2009 and 2008, the allowance for loan losses was $9,800,746 and $8,223,899, respectively, an increase of $1,576,847, or 19.17%, over the 2008 allowance. As a percentage of total loans, the allowance for loan losses was 2.41% and 1.75% at December 31, 2009 and 2008, respectively. The increase in the allowance for loan losses was driven by the significant increase in net loans charged off during 2009 and continuing adverse economic trends in our markets. During 2009, net loans charged off totaled $12,823,805 compared to $1,981,620 for the year ended December 31, 2008, an increase of $10,842,185. See "Nonperforming Assets" below for additional information regarding our asset quality and loan portfolio.

For the years 2009 and 2008, the provision for loan losses was $14,400,652 and $4,934,912, respectively. This represents an increase of $9,465,740, which is primarily attributable to the significant increase in our net loans charged off.

We believe the allowance for loan losses at December 31, 2009, is adequate to meet potential loan losses inherent in the loan portfolio.

The following table sets forth certain information with respect to the Company's allowance for loan losses and the composition of charge-offs and recoveries for the five years ended December 31, 2009.

Allowance for Loan Losses

(Dollars in thousands)	2009	2008	2007	2006	2005
Total loans outstanding at end of year	$ 406,627	$ 468,990	$ 468,138	$ 353,491	$ 311,544
Average loans outstanding	$ 462,400	$ 481,572	$ 414,907	$ 348,709	$ 294,740
Balance of allowance for loan losses at beginning of year	$ 8,224	$ 5,271	$ 4,002	$ 3,419	$ 2,758
Loans charged off:					
Real estate – construction	7,114	-	-	17	142
Real estate – mortgage	4,197	1,136	205	718	472
Commercial and industrial	2,530	997	58	170	317
Consumer and other	446	235	193	151	300
Total loan losses	14,287	2,368	456	1,056	1,231
Recoveries of previous loan losses:					
Real estate – construction	985	-	-	-	-
Real estate – mortgage	390	322	36	105	38
Commercial and industrial	68	10	24	111	12
Consumer and other	20	54	22	31	31
Total recoveries	1,463	386	82	247	81
Net charge-offs	12,824	1,982	374	809	1,150
Provision for loan losses	14,401	4,935	1,643	1,392	1,811
Balance of allowance for loan losses at end of year	$ 9,801	$ 8,224	$ 5,271	$ 4,002	$ 3,419
Ratios:					
Net charge-offs to average loans outstanding	2.77%	0.41%	0.09%	0.23%	0.39%
Net charge-offs to loans at end of year	3.15	0.42	0.08	0.23	0.37
Allowance for loan losses to average loans	2.12	1.71	1.27	1.15	1.16
Allowance for loan losses to loans at end of year	2.41	1.75	1.13	1.13	1.10
Net charge-offs to allowance for loan losses	130.84	24.10	7.10	20.21	33.64
Net charge-offs to provisions for loan losses	89.05	40.16	22.76	58.11	63.50

Nonperforming Assets - At December 31, 2009 and 2008, loans totaling $25,406,383 and $19,591,982, respectively, were in nonaccrual status, total loans of $40,197 and $2,097,426, respectively, were ninety days or more overdue and still accruing interest, and restructured loans were $420,033 and $566,161, respectively.

The following table shows the nonperforming assets, percentages of net charge-offs, and the related percentage of allowance for loan losses for the five years ended December 31, 2009.

(Dollars in thousands)	2009	2008	2007	2006	2005
Loans over 90 days past due and still accruing	$ 40	$ 2,097	$ 1,781	$ 464	$ 705
Loans on nonaccrual:					
Real Estate Construction	16,380	6,250	-	-	-
Real Estate Mortgage	8,840	12,573	1,465	637	1,619
Commercial	154	563	114	-	95
Consumer	32	206	79	34	78
Total nonaccrual loans	25,406	19,592	1,658	671	1,792
Total of nonperforming loans	25,446	21,689	3,439	1,135	2,497
Other nonperforming assets	8,954	380	197	1,386	346
Total nonperforming assets	$ 34,400	$ 22,069	$ 3,636	$ 2,521	$ 2,843
Percentage of nonperforming assets to total assets	5.33%	3.66%	0.61%	0.55%	0.71%
Percentage of nonperforming loans to total loans	8.46%	4.71%	0.73%	0.32%	0.80%
Allowance for loan losses as a percentage of non-performing loans	38.52%	37.92%	153.27%	352.60%	136.92%

Generally, loans are placed on nonaccrual status if principal or interest payments become 90 days past due and/or we deem the collectibility of the principal and/or interest to be doubtful. Once a loan is placed in nonaccrual status, all previously accrued and uncollected interest is reversed against interest income. Interest income on nonaccrual loans is recognized on a cash basis when the ultimate collectability is no longer considered doubtful. Loans are returned to accrual status when the principal and interest amounts contractually due are brought current and future payments are reasonably assured. If interest on our loans classified as nonaccrual at December 31, 2009 and 2008 had been recognized on a fully accruing basis, we would have recorded an additional $2,450,489 and $1,403,619 of interest income for the years ended December 31, 2009 and 2008, respectively. All nonaccruing loans at December 31, 2009 and 2008 were included in our classification of impaired loans at those dates.

We implanted a number of initiatives in 2009 to strengthen credit administration to better control, account and prepare for the increase in nonperforming assets created by economic duress in our markets. These initiatives include:

- closing of newer offices with little core deposit base;
- establishment of a distinct loss mitigation team;

- formalized and updated our policies and procedures for loss mitigation and nonperforming asset management;
- enhanced internal reporting for problem loans, monitoring, and grading;
- improved monitoring for potential nonperforming loans;
- purchase of software to be installed in the second quarter of 2010 to improve our modeling for allowance for loan losses; and
- enhanced monitoring and controls of other real estate owned to pursue the highest and quickest recovery possible.

Impaired loans - At December 31, 2009, we had impaired loans totaling $48,692,632, as compared to $26,183,601 at December 31, 2008. Included in the impaired loans at December 31, 2009, were 40 borrowers that accounted for approximately 83.32% of the total amount of the impaired loans at that date. These loans were primarily commercial real estate loans isolated to the coastal regions of South Carolina. Impaired loans, as a percentage of total loans, were 11.97% at December 31, 2009 as compared to 5.58% at December 31, 2008.

During the year ended December 31, 2009, the average investment in impaired loans was $43,537,156 as compared to $8,509,024 during the year ended December 31, 2008. Impaired loans with a specific allocation of the allowance for loan losses totaled $17,526,321 and $20,235,727 at December 31, 2009 and 2008, respectively. The amount of the specific allocation at December 31, 2009 and 2008 was $3,755,475 and $3,658,653, respectively.

The recent downturn in the real estate market has resulted in an increase in loan delinquencies, defaults and foreclosures; however, we believe these trends are slowing. In some cases, this downturn has resulted in a significant impairment to the value of our collateral and ability to sell the collateral upon foreclosure at its appraised value. However, there is a risk that these trends could continue at a higher pace. If real estate values continue to decline, it is also more likely that we would be required to increase our allowance for loan losses.

On a monthly basis, we analyze each loan that is classified as impaired to determine the potential for possible loan losses. This analysis is focused upon determining the then current estimated value of the collateral, local market condition, and estimated costs to foreclose, repair and resell the property. The net realizable value of the property is then computed and compared to the loan balance to determine the appropriate amount of specific reserve for each loan.

Noninterest Income and Expense

Noninterest Income - The following table sets forth the principal components of noninterest income for the years ended December 31, 2009 and 2008.

(Dollars in thousands)		2009		2008
Service fees on deposit accounts	$	1,969	$	2,019
Other service charges, commissions and fees		559		477
Gain on sale of mortgage loans		2,464		1,700
Gain on sale of securities available-for-sale		1,877		-
Income from bank owned life insurance		423		446
Other income		253		367
Total noninterest income	$	7,545	$	5,009

Noninterest income for 2009 was $2,535,716 higher than for 2008. The increase is largely attributable to the $1,876,560 gain on sale of securities available-for-sale and to the increase in gain on sale of mortgage loans. The underlying available-for-sale securities were sold in accordance with our strategy to reposition the investment portfolio in order to maximize the yield on our investment securities. Gain on sale of mortgage loans was $763,466 higher for 2009 compared to 2008 as a result of the increase in volume of residential mortgages being refinanced due to the low interest rate environment.

Noninterest Expense - Total noninterest expense increased by $1,001,038, or 5.31%, to $19,852,684 in 2009 from $18,851,646 in 2008. The increase was largely attributable to our FDIC insurance premiums, which were $970,010 higher than the premiums for 2008 and to the increase of approximately $497,000 in expenses relating to other real estate owned. Before the expense of the FDIC insurance premiums, an expense that we feel that we have no control over, our noninterest expense for 2009 was only $31,028, or 0.16%, higher than for 2008. This minimal increase is

the result of our continuing emphasis on expense management.

For the year 2009, our salary and employee expense was $148,758, or 1.46%, higher than for the year 2008. Occupancy expense was $1,529,844 and $1,926,547 for the years ended December 31, 2009 and 2008, respectively. The decrease of $396,703 in occupancy expense is partially attributable to the reduction in rental expenses relating to a facility that we acquired in December of 2008 that we were formerly leasing. Other noninterest expense for the year 2009 was $6,856,438 compared to $5,676,096 for the year 2008. This represented an increase of $1,180,342, which was mainly due to the increase in our FDIC insurance premiums and to the increase in other real estate owned expenses.

The following table sets forth the primary components of noninterest expense for the years ended December 31, 2009 and 2008.

(Dollars in thousands)	2009	2008
Salaries and employee benefits	$ 10,330	$ 10,181
Net occupancy	1,530	1,927
Furniture and equipment	1,136	1,068
Advertising	264	345
Office supplies and printing	238	237
Computer supplies and software amortization	257	483
Telephone	262	262
Professional fees and services	812	820
Meetings and travel expenses	220	372
Supervisory fees and assessment	1,349	379
Debit and credit card expenses	357	353
Other real estate owned expenses	545	48
Mortgage loan expenses	665	289
Other	1,888	2,088
Total noninterest expense	$ 19,853	$ 18,852
Efficiency ratio	81.94%	78.80%

The change from the income tax benefit of $459,040 for the year ended December 31, 2008, to the income tax benefit of $4,180,521 for the year ended December 31, 2009 is attributable to the net operating loss incurred before our income tax provision and to the increase in nontaxable investment income.

Earning Assets

Loans - Loans, including loans held for sale, are the largest category of earning assets and typically provide higher yields than the other types of earning assets. Associated with the higher loan yields are the inherent credit and liquidity risks which management attempts to control and counterbalance. Loans averaged $462,400,290 in 2009 compared to $481,572,108 in 2008, a decrease of $19,171,818, or 3.98%. At December 31, 2009, total loans were $411,728,010 compared to $478,579,283 at December 31, 2008, a decrease of $66,851,273, or 13.97%. Excluding loans held for sale, loans were $406,627,401 at December 31, 2009 compared to $468,990,202 at December 31, 2008, which equated to a decrease of $62,362,801, or 13.30%. This decrease is the result of the economic downturn in our markets that caused the volume of new loan customers to decrease and to the $14,287,439 of loans that were charged off during the year.

The following table sets forth the composition of the loan portfolio, excluding loans held for sale, by category at the dates indicated and highlights the Company's general emphasis on all types of lending.

Composition of Loan Portfolio

December 31, (Dollars in thousands)	2009 Amount	2009 Percent of total	2008 Amount	2008 Percent of Total	2007 Amount	2007 Percent of Total
Commercial and industrial	$ 45,887	11.28%	$ 70,878	15.11%	$ 67,772	14.48%
Real estate						
Construction	77,567	19.08	60,744	12.95	65,432	13.98
Mortgage-residential	103,845	25.54	122,133	26.04	120,198	25.67
Mortgage-nonresidential	169,934	41.79	201,318	42.94	195,992	41.87
Consumer	7,943	1.95	8,974	1.91	11,342	2.42
Other	1,452	.36	4,943	1.05	7,402	1.58
Total loans	406,628	100.00%	468,990	100.00%	468,138	100.00%
Allowance for loan losses	(9,801)		(8,224)		(5,271)	
Net loans	$ 396,827		$ 460,766		$ 462,867	

December 31 (Dollars in thousands)	2006 Amount	2006 Percent of Total	2005 Amount	2005 Percent of Total
Commercial and industrial	$ 51,710	14.63%	$ 50,320	16.15%
Real estate				
Construction	64,118	18.14	52,268	16.78
Mortgage-residential	91,039	25.75	86,716	27.83
Mortgage-nonresidential	127,214	35.99	106,125	34.06
Consumer	12,729	3.60	13,953	4.48
Other	6,681	1.89	2,162	0.70
Total loans	353,491	100.00%	311,544	100.00%
Allowance for loan losses	(4,002)		(3,419)	
Net loans	$ 349,489		$ 308,125	

In the context of this discussion, a "real estate mortgage loan" is defined as any loan, other than a loan for construction purposes, secured by real estate, regardless of the purpose of the loan. It is common practice for financial institutions in our market area to obtain a mortgage on real estate whenever possible, in addition to any other available collateral. This collateral is taken to reinforce the likelihood of the ultimate repayment of the loan and tends to increase management's willingness to make real estate loans and, to that extent, also tends to increase the magnitude of the real estate loan portfolio component.

The largest component of our loan portfolio is real estate mortgage loans. At December 31, 2009, real estate mortgage loans totaled $273,778,501 and represented 67.33% of the total loan portfolio, compared to $323,450,913, or 68.97%, at December 31, 2008.

Residential mortgage loans totaled $103,845,154 at December 31, 2009, and represented 25.54% of the total loan portfolio, compared to $122,132,568 and 26.04%, respectively, at December 31, 2008. Residential real estate loans consist of first and second mortgages on single or multi-family residential dwellings. Nonresidential mortgage loans, which include commercial loans and other loans secured by multi-family properties and farmland, totaled $169,933,348 at December 31, 2009, compared to $201,318,345 at December 31, 2008. This represents a decrease of $31,384,997, or 15.59%, from the December 31, 2008 balance. Real estate construction loans were $77,566,504 and $60,744,432 at December 31, 2009 and 2008, respectively, and represented 19.08% and 12.95% of the total loan portfolio, respectively. The increase in our real estate construction loans is primarily attributable to the reclassification of loans that were previously classified as commercial and industrial loans. Currently, the demand for all types of real estate mortgage loans in our market area is very weak.

Commercial and industrial loans decreased $24,990,653, or 35.26%, to $45,887,237 at December 31, 2009, from $70,877,890 at December 31, 2008. The decrease is mainly due to the economic downturn in our markets that caused the demand for these types of loans to decrease and to the reclassification of certain loans to real estate construction loans.

Our loan portfolio is also comprised of consumer loans. Consumer loans decreased $1,031,780, or 11.50%, to $7,942,668 at December 31, 2009, from $8,974,448 at December 31, 2008.

Our loan portfolio reflects the diversity of its markets. The economies of our markets contain elements of medium and light manufacturing, higher education, regional health care, and distribution facilities. We expect the area to remain stable; however due to the current depressed economies of our markets, we do not expect any material growth in the near future. The diversity of the economy creates opportunities for all types of lending. We do not engage in foreign lending.

The repayment of loans in the loan portfolio as they mature is also a source of liquidity for the Company. The following table sets forth the Company's loans maturing within specified intervals at December 31, 2009.

Loan Maturity Schedule and Sensitivity to Changes in Interest Rates

December 31, 2009 (Dollars in thousands)	One Year or Less	Over One Year Through Five Years	Over Five Years	Total
Commercial and industrial	$ 2,684	$ 40,602	$ 2,601	$ 45,887
Real estate	32,188	254,228	64,929	351,345
Consumer and other	1,047	7,115	1,233	9,395
	$ 35,919	$ 301,945	$ 68,763	$ 406,627
Loans maturing after one year with:				
Fixed interest rates				$ 187,446
Floating interest rates				183,262
				$ 370,708

The information presented in the above table is based on the contractual maturities of the individual loans, including loans which may be subject to renewal at their contractual maturity. Renewal of such loans is subject to review and credit approval as well as modification of terms upon maturity. Consequently, we believe this treatment presents fairly the maturity and repricing structure of the loan portfolio shown in the above table.

Investment Securities - The investment securities portfolio is also a component of our total earning assets. Investment securities consist of securities available-for-sale and nonmarketable equity securities. Total securities available-for-sale averaged $94,506,986 in 2009, compared to $60,187,152 in 2008. Available-for-sale securities increased $45,637,928, or 59.81%, to $121,948,744 at December 31, 2009, from $76,310,816 at December 31, 2008. As the volume of our loans declined during 2009, we shifted our investable funds toward investment securities.

At December 31, 2009 and 2008, nonmarketable equity securities consist of Federal Home Loan Bank stock, which is recorded at its original cost of $4,812,100 and $4,574,700 at December 31, 2009 and 2008, respectively.

The following table sets forth the fair market value of the securities available-for-sale held by the Company at December 31, 2009 and 2008.

Fair Value of Securities available-for-sale

December 31, (Dollars in thousands)	2009	2008
U.S. government agencies and corporations	$ 3,011	$ 88
Mortgage-backed securities	58,133	47,574
Municipals	60,737	28,525
Other Securities	68	124
Total securities available-for-sale	$ 121,949	$ 76,311

The following table sets forth the scheduled maturities and average yields of securities held at December 31, 2009.

Investment Securities Maturity Distribution and Yields

December 31, 2009	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years		Total	
(Dollars in thousands)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
U.S. government agencies and corporations	$ -	-	$ 16	6.32%	$ -	-%	$ 2,996	4.17%	$ 3,012	4.19%
Municipals(2)	-	-	-	-	1,234	4.35	59,503	6.36	60,737	6.32
Total securities(1)	$ -	-	$ 16	6.32%	$ 1,234	4.35%	$ 62,499	6.26%	$ 63,749	6.22%

(1) Excludes mortgage-backed securities totaling $58,132,671 with a yield of 3.96 % and other securities totaling $67,515.
(2) Yields are based on a tax equivalent basis of 34%.

Other attributes of the securities portfolio, including yields and maturities, are discussed above in “Net Interest Income-Interest Sensitivity Analysis.”

Interest-Bearing Deposits with Other Banks – At December 31, 2009 and 2008, interest-bearing deposits with other banks totaled $50,356,191 and $0, respectively. For the years 2009 and 2008, the average balance of these deposits was $53,492,638 and $0, respectively.

Federal Funds Sold - Federal funds sold averaged $512,079 in 2009 compared to $2,837,541 in 2008. At December 31, 2009 and 2008, federal funds sold totaled $0 and $257,000, respectively.

Deposits and Other Interest-Bearing Liabilities

Average interest-bearing liabilities increased $59,842,859, or 11.82%, to $566,202,286 in 2009, from $506,359,427 in 2008. The increase is primarily a result of the increase in our total deposits.

Deposits - Average total deposits increased $85,600,182, or 18.95%, to $537,225,053 in 2009, from $451,624,870 in 2008. At December 31, 2009, total deposits were $552,762,979 compared to $461,135,384 a year earlier, an increase of $91,627,595, or 19.87%.

Average interest-bearing deposits increased $84,511,697, or 20.72%, to $492,325,051 in 2009, from $407,813,354 in 2008. The average balance of non-interest bearing deposits increased $1,088,485, or 2.48%, to $44,900,002 in 2009, from $43,811,517 in 2008. The following table sets forth the average balance amounts and the average rates paid on deposits of the Company by category at December 31, 2009 and 2008.

Deposits

	2009		2008	
(Dollars in thousands)	Average Amount	Average Rate Paid	Average Amount	Average Rate Paid
Demand deposit accounts	$ 44,900	-%	$ 43,812	-%
NOW accounts	37,516	0.57	28,760	0.64
Savings accounts	104,429	1.67	98,210	2.16
Time deposits $100,000 and over	188,744	2.95	164,409	4.08
Other time deposits	161,636	3.11	116,434	3.95
Total deposits	$ 537,225	2.34%	$ 451,625	3.02%

Core deposits, which exclude time deposits of $100,000 or more, provide a relatively stable funding source for our loan portfolio and other earning assets. Our core deposits were $357,416,788 and $323,690,517 at December 31, 2009 and 2008, respectively. This equates to an increase in core deposits of $33,726,271, or 10.42%. The increase in core deposits resulted from successful pricing and marketing promotions.

Included in time deposits $100,000 and over, at December 31, 2009 and 2008 are brokered time deposits of $124,468,000 and $96,652,000, respectively. We anticipate being able to either renew or replace brokered deposits when they mature, although we may not be able to replace them with deposits with the same terms or rates.

Deposits, and particularly core deposits, have been our primary source of funding and have enabled us to meet successfully both our short-term and long-term liquidity needs. We anticipate that such deposits will continue to be our primary source of funding in the future. However, advances from the Federal Home Loan Bank are being used as an alternative source of funds. Our loan-to-deposit ratio was 73.56% at December 31, 2009, and 101.70% at December 31, 2008. The maturity distribution of our time deposits over $100,000 and over at December 31, 2009, is set forth in the following table:

Maturities of Time Deposits of $100,000 or over

(Dollars in thousands)	Within Three Months	After Three Through Six Months	After Six Through Twelve Months	After Twelve Months	Total
Certificates of deposit of $100,000 or over	$ 13,264	$ 9,364	$ 41,774	$ 130,944	$ 195,346

Maturities of Time Deposits of $100,000 or over

Approximately 32.96% of our time deposits of $100,000 or more had scheduled maturities within one year. Large certificate of deposit customers tend to be extremely sensitive to interest rate levels, making these deposits less reliable sources of funding for liquidity planning purposes than core deposits. We expect most certificates of deposits with maturities less than one year to be renewed upon maturity. However, there is the possibility that some certificates may not be renewed. We believe that, should that occur, the impact would be minimal on our operations and liquidity due to the availability of other funding sources. We have available line to borrow funds from the Federal Home Loan Bank up to 30% of the our total assets which provided additional available funds of approximately $178,210,000 at December 31, 2009 and available lines to purchase federal funds with various financial institutions up to $69,000,000 at December 31, 2009. We believe that these funds would be sufficient to meet future liquidity needs.

Other Borrowings - The following table summarizes the Company's borrowings for the years ended December 31, 2009 and 2008. These borrowings consist of securities sold under agreements to repurchase, advances from the Federal Home Loan Bank, federal funds purchased, a note payable and junior subordinated debentures. Securities sold under agreements to repurchase mature on a one to seven day basis. These agreements are secured by U.S. government agencies. Advances from Federal Home Loan Bank mature at different periods as discussed in the footnotes to the financial statements and are secured by the Company's one to four family residential mortgage loans and the Company's investment in Federal Home Loan Bank stock. Federal funds purchased are short-term borrowings from other financial institutions that mature daily.

Maximum