SOUTHCREST FINANCIAL GROUP, INC.
AND SUBSIDIARIES

CONSOLIDATED FINANCIAL REPORT

DECEMBER 31, 2013

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
SouthCrest Financial Group, Inc.
Peachtree City, Georgia

We have audited the accompanying consolidated financial statements of **SouthCrest Financial Group, Inc. and subsidiaries**, which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive loss, stockholders' equity, and cash flows for each of the years in the three year period ended December 31, 2013, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of SouthCrest Financial Group, Inc. and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2013, in accordance with accounting principles generally accepted in the United States of America.

Mauldin & Jenkins, LLC

Atlanta, Georgia
March 31, 2014

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SOUTHCREST FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2013 AND 2012
(Dollars in thousands)

	2013	2012
Assets		
Cash and due from banks	**$ 18,717**	$ 14,509
Interest-bearing deposits in other banks	**108,327**	123,839
Federal funds sold	**-**	1,500
Securities available for sale	**119,982**	102,084
Securities held to maturity	**2,589**	-
Restricted equity securities, at cost	**1,113**	1,331
Loans held for sale	**4,642**	1,773
Loans receivable:		
Not covered by loss sharing agreement	**237,707**	241,570
Covered by loss sharing agreement	**13,426**	15,485
Less allowance for loan losses	**4,444**	5,717
Loans, net	**246,689**	251,338
Bank-owned life insurance	**19,155**	18,589
Premises and equipment, net	**18,617**	16,909
Intangible assets, net	**919**	1,190
FDIC indemnification asset	**5,997**	8,893
Other real estate owned:		
Not covered by loss sharing agreement	**3,628**	4,074
Covered by loss sharing agreement	**1,625**	5,272
Other assets	**7,364**	6,963
Total assets	**$ 559,364**	$ 558,264
Liabilities, Redeemable Common Stock, and Stockholders' Equity		
Liabilities:		
Deposits:		
Noninterest-bearing	**$ 127,477**	$ 110,710
Interest-bearing	**356,823**	384,984
Total deposits	**484,300**	495,694
Other liabilities	**11,580**	10,052
Total liabilities	**495,880**	505,746
Commitments and contingencies		
Redeemable common stock held by ESOP	**382**	295
Stockholders' equity		
Series A Preferred stock, no par value, 12,900 shares issued and outstanding	**12,820**	12,674
Series B Preferred stock, no par value, 645 shares issued and outstanding	**654**	671
Series C Preferred stock, no par value, 3,500,000 shares authorized, 966,143 and 737,448 shares issued and outstanding, respectively	**966**	737
Series D Preferred stock, no par value, 2,500,000 shares authorized, 2,096,165 shares issued and outstanding	**2,096**	-
Series AAA Preferred stock, no par value, 500,000 shares authorized, 190,649 shares issued and outstanding	**191**	191
Common stock, par value $1; 50,000,000 shares authorized, 5,127,380 and 3,758,199 issued and outstanding, respectively	**5,127**	3,758
Additional paid in capital - Series C preferred stock	**3,911**	2,833
Additional paid in capital - Series D preferred stock	**8,208**	-
Additional paid in capital - Series AAA preferred stock	**2,426**	2,426
Additional paid in capital	**52,915**	47,524
Accumulated deficit	**(25,656)**	(19,589)
Unearned compensation - ESOP	**(174)**	(198)
Accumulated other comprehensive income (loss)	**(382)**	1,196
Total stockholders' equity	**63,102**	52,223
Total liabilities, redeemable common stock, and stockholders' equity	**$ 559,364**	$ 558,264

See Notes to Consolidated Financial Statements.

SOUTHCREST FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2013, 2012, AND 2011
(Dollars in thousands, except per share data)

	2013	2012	2011
Interest income:			
Loans	**$ 15,553**	$ 16,726	$ 20,782
Securities - taxable	**2,334**	2,185	2,897
Securities - nontaxable	**225**	298	515
Federal funds sold	**3**	5	-
Interest-bearing deposits in other banks	**308**	381	450
Total interest income	**18,423**	19,595	24,644
Interest expense:			
Deposits	**1,672**	2,739	4,191
Short-term borrowed funds	**-**	80	148
Total interest expense	**1,672**	2,819	4,339
Net interest income	**16,751**	16,776	20,305
Provision for loan losses	**400**	7,450	2,610
Net interest income after provision for loan losses	**16,351**	9,326	17,695
Other income:			
Service charges on deposit accounts	**2,775**	3,121	3,421
Other service charges and fees	**2,460**	2,219	2,124
Net gain on sales of securities available for sale	**63**	845	973
Net gain on sales of loans	**1,155**	1,000	292
Income on bank-owned life insurance	**566**	606	624
Other operating income	**1,252**	2,478	794
Total other income	**8,271**	10,269	8,228
Other expenses:			
Salaries and employee benefits	**13,554**	10,927	10,852
Equipment and occupancy expenses	**3,056**	2,510	2,616
Amortization of intangibles	**342**	361	385
Loss on sales of other real estate owned	**323**	2,466	1,168
Writedowns of other real estate owned	**517**	1,313	2,043
Other operating expenses	**11,879**	9,213	8,501
Total other expenses	**29,671**	26,790	25,565
Income (loss) before income taxes	**(5,049)**	(7,195)	358
Income tax expense	**-**	-	470
Net loss	**(5,049)**	(7,195)	(112)
Preferred dividends	**931**	900	840
Net loss available to common shareholders	**$ (5,980)**	$ (8,095)	$ (952)
Basic and diluted losses per common share	**$ (1.03)**	$ (2.17)	$ (0.25)

See Notes to Consolidated Financial Statements.

SOUTHCREST FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
YEARS ENDED DECEMBER 31, 2013, 2012, AND 2011
(Dollars in thousands)

	2013	2012	2011
Net loss	**$ (5,049)**	$ (7,195)	$ (112)
Other comprehensive loss:			
Unrealized holding gains (losses) on securities available for sale arising during period, net of taxes (benefits) of $(943), $256, and $331.	**(1,539)**	419	546
Reclassification adjustment for gains included in net loss, net of taxes of $(24), $(318), and $(368).	**(39)**	(527)	(605)
Other comprehensive loss	**(1,578)**	(108)	(59)
Comprehensive loss	**$ (6,627)**	$ (7,303)	$ (171)

See Notes to Consolidated Financial Statements.

SOUTHCREST FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2013, 2012, AND 2011
(Dollars in thousands, except share and per share data)

	Preferred Stock					Additional Paid In Capital Series C	Additional Paid In Capital Series D	Additional Paid In Capital Series AAA	Common Stock		Additional Paid In	Accumulated	Accumulated Other Comprehensive	Unearned Compensation	Total Stockholders'
	Series A	Series B	Series C	Series D	Series AAA	Preferred	Preferred	Preferred	Shares	Par Value	Capital	Deficit	Income (Loss)	(ESOP)	Equity
Balance, December 31, 2010	$ 12,384	$ 703	$ -	$ -	$ 191	$ -	$ -	$ 2,426	3,736,579	$ 3,737	$ 47,440	$ (10,538)	$ 1,363	$ (247)	$ 57,459
Net loss	-	-	-	-	-	-	-	-	-	-	-	(112)	-	-	(112)
Preferred stock dividends declared	-	-	-	-	-	-	-	-	-	-	-	(711)	-	-	(711)
Amortization of preferred stock				-			-								
premiums and discounts	145	(16)	-	-	-	-	-	-	-	-	-	(129)	-	-	-
Stock-based compensation	-	-	-	-	-	-	-	-	-	-	8	-	-	-	8
Adjustment for shares				-			-								
owned by ESOP	-	-	-	-	-	-	-	-	-	-	-	38	-	-	38
Principal reduction of ESOP debt	-	-	-	-	-	-	-	-	-	-	-	-	-	26	26
Other comprehensive loss	-	-	-	-	-	-	-	-	-	-	-	-	(59)	-	(59)
Balance, December 31, 2011	12,529	687	-	-	191	-	-	2,426	3,736,579	3,737	47,448	(11,452)	1,304	(221)	56,649
Net loss	-	-	-	-	-	-	-	-	-	-	-	(7,195)	-	-	(7,195)
Issuance of preferred stock	-	-	737	-	-	3,503	-	-	-	-	-	-	-	-	4,240
Preferred stock offering costs	-	-	-	-	-	(670)	-	-	-	-	-	-	-	-	(670)
Preferred stock dividends declared	-	-	-	-	-	-	-	-	-	-	-	(771)	-	-	(771)
Amortization of preferred stock															
premiums and discounts	145	(16)	-	-	-	-	-	-	-	-	-	(129)	-	-	-
Stock compensation awards	-	-	-	-	-	-	-	-	21,620	21	76	-	-	-	97
Adjustment for shares															
owned by ESOP	-	-	-	-	-	-	-	-	-	-	-	(42)	-	-	(42)
Principal reduction of ESOP debt	-	-	-	-	-	-	-	-	-	-	-	-	-	23	23
Other comprehensive loss	-	-	-	-	-	-	-	-	-	-	-	-	(108)	-	(108)
Balance, December 31, 2012	12,674	671	737	-	191	2,833	-	2,426	3,758,199	3,758	47,524	(19,589)	1,196	(198)	52,223
Net loss	-	-	-	-	-	-	-	-	-	-	-	(5,049)	-	-	(5,049)
Issuance of stock	-	-	229	2,096	-	1,096	8,489	-	1,369,181	1,369	5,545	-	-	-	18,824
Stock offering costs	-	-	-	-	-	(18)	(281)	-	-	-	(174)	-	-	-	(473)
Preferred stock dividends declared	-	-	-	-	-	-	-	-	-	-	-	(802)	-	-	(802)
Amortization of preferred stock				-											
premiums and discounts	146	(17)	-	-	-	-	-	-	-	-	-	(129)	-	-	-
Stock compensation awards	-	-	-	-	-	-	-	-	-	-	20	-	-	-	20
Adjustment for shares															
owned by ESOP	-	-	-	-	-	-	-	-	-	-	-	(87)	-	-	(87)
Principal reduction of ESOP debt	-	-	-	-	-	-	-	-	-	-	-	-	-	24	24
Other comprehensive loss	-	-	-	-	-	-	-	-	-	-	-	-	(1,578)	-	(1,578)
Balance, December 31, 2013	$ 12,820	$ 654	$ 966	$ 2,096	$ 191	$ 3,911	$ 8,208	$ 2,426	5,127,380	$ 5,127	$ 52,915	$ (25,656)	$ (382)	$ (174)	$ 63,102

See Notes to Consolidated Financial Statements.

SOUTHCREST FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2013, 2012, AND 2011
(Dollars in thousands)

	2013	2012	2011
OPERATING ACTIVITIES			
Net loss	**$ (5,049)**	$ (7,195)	$ (112)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation	**1,307**	1,106	1,137
Amortization of intangibles	**342**	361	384
Other amortization	**894**	855	153
Provision for loan losses	**400**	7,450	2,610
Stock-based compensation	**20**	97	8
Deferred compensation expense	**455**	482	336
Net gain on sale of securities available for sale	**(63)**	(845)	(973)
Deferred income taxes	**-**	-	470
Income on bank-owned life insurance	**(566)**	(606)	(624)
Income on bank-owned life insurance benefits received	**-**	(962)	-
Decrease in interest receivable	**105**	262	516
Increase (decrease) in income taxes payable	**(6)**	12	3,174
Decrease in interest payable	**(163)**	(306)	(618)
Net gain on sales of loans	**(1,155)**	(1,000)	(292)
Originations of mortgage loans held for sale	**(38,449)**	(24,885)	(9,408)
Proceeds from sales of mortgage loans held for sale	**36,735**	24,572	9,808
Increase in mortgage servicing assets	**(72)**	(230)	(89)
(Gain) loss on disposal of premises and equipment	**(10)**	12	-
Loss on sales of other real estate owned	**323**	2,466	1,168
Writedowns of other real estate owned	**517**	1,313	2,043
Change in indemnification asset	**2,896**	3,466	(492)
Decrease in prepaid FDIC assessment	**476**	818	933
Decrease in other assets	**875**	1,618	3,907
Decrease in other liabilities	**(438)**	(938)	(4,146)
Net cash provided by (used in) operating activities	**(626)**	7,923	9,893
INVESTING ACTIVITIES			
Net (increase) decrease in interest-bearing deposits in other banks	**15,512**	(38,747)	(15,471)
Net decrease (increase) in federal funds sold	**1,500**	1,000	(2,500)
Purchases of securities held to maturity	**(2,612)**	-	-
Purchases of securities available for sale	**(59,498)**	(52,708)	(68,484)
Proceeds from calls, maturities and paydowns of securities available for sale	**37,875**	44,404	50,103
Proceeds from sales of available for sale securities	**375**	9,847	13,314
Redemption of restricted equity securities	**218**	308	402
Net decrease in loans	**2,462**	28,842	49,636
Net proceeds from bank-owned life insurance	**-**	1,874	-
Purchase of premises and equipment	**(3,015)**	(690)	(291)
Proceeds from sales of premises and equipment	**10**	343	-
Proceeds from sales of other real estate owned	**5,026**	10,748	5,861
Net cash provided by (used in) investing activities	**(2,147)**	5,221	32,570

See Notes to Consolidated Financial Statements.

SOUTHCREST FINANCIAL GROUP, INC . AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
YEARS ENDED DECEMBER 31, 2013, 2012, AND 2011
(Dollars in thousands)

	2013	2012	2011
FINANCING ACTIVITIES			
Net decrease in deposits	**$ (11,394)**	$ (14,892)	$ (42,054)
Principal repayments on short-term borrowed funds	**-**	(1,594)	(663)
Proceeds from the issuance of stock	**18,824**	4,240	-
Stock issuance costs	**(473)**	(670)	-
Change in unearned compensation - ESOP	**24**	23	26
Net cash provided by (used in) financing activities	**6,981**	(12,893)	(42,691)
Net increase (decrease) in cash and due from banks	**4,208**	251	(228)
Cash and due from banks at beginning of year	**14,509**	14,258	14,486
Cash and due from banks at end of year	**$ 18,717**	$ 14,509	$ 14,258
SUPPLEMENTAL DISCLOSURES			
Cash paid (received) for:			
Interest	**$ 1,835**	$ 3,125	$ 4,957
Income taxes	**6**	(12)	(3,174)
NONCASH TRANSACTIONS			
Principal balances of loans transferred to other real estate owned	**$ 5,993**	$ 9,859	$ 8,571
Financed sales of other real estate owned	**4,220**	349	160
Increase (decrease) in redeemable common stock held by ESOP	**87**	42	(38)
Unrealized loss on securities available for sale, net	**(1,578)**	(108)	(59)
Accrual of cumulative preferred dividends	**931**	900	840

See Notes to Consolidated Financial Statements.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

SouthCrest Financial Group, Inc. (the "Company") is a bank holding company whose principal activity is the ownership and management of its wholly-owned subsidiary banks (the "Banks"), SouthCrest Bank ("SouthCrest"), formerly Bank of Upson, First National Bank of Polk County ("FNB Polk"), Peachtree Bank ("Peachtree"), and Bank of Chickamauga ("Chickamauga"). SouthCrest is a commercial bank located in Thomaston, Upson County, Georgia operating branches located in Thomaston, Manchester, Luthersville, Johns Creek, and Tyrone, Georgia. SouthCrest provides a full range of banking services in its primary market area of Upson, Meriwether, Fayette, Fulton and the surrounding counties. The Johns Creek branch in Fulton County was acquired through an FDIC purchase and assumption agreement in 2010. The Warm Springs branch was closed on January 31, 2013. FNB Polk is a commercial bank located in Cedartown, Polk County, Georgia with two branches in Cedartown and one in Rockmart, Georgia. FNB Polk provides a full range of banking services in its primary market area of Polk and the surrounding counties. Peachtree is a commercial bank located in Maplesville, Chilton County, Alabama and operates one branch in Maplesville and one in Clanton, Alabama. Chickamauga is a commercial bank located in Chickamauga, Walker County, Georgia where it operates two branches. The Company considers its banking services to represent a single reporting segment.

On February 28, 2014 SouthCrest merged all of its subsidiary banks into FNB Polk, which changed its name to SouthCrest Bank, N.A. and designated the Tyrone branch to be its main office.

On March 19, 2010, SouthCrest acquired certain assets and liabilities of the former Century Security Bank from the FDIC (Note 2).

Basis of Presentation and Accounting Estimates

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Significant intercompany transactions and balances have been eliminated in consolidation.

In preparing the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet, and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the determination of FDIC indemnification asset, the valuation of foreclosed assets and deferred taxes, other-than-temporary impairments of securities, and the fair value of financial instruments.

The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Basis of Presentation and Accounting Estimates (Continued)

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Company's subsidiaries to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

The Company has evaluated all transactions, events, and circumstances for consideration or disclosure through March 31, 2014, the date these financial statements were available to be issued and has reflected or disclosed those items within the consolidated financial statements and related footnotes as deemed appropriate.

Cash, Due from Banks and Cash Flows

For purposes of reporting cash flows, cash and due from banks include cash on hand, cash items in process of collection, and amounts due from banks. Cash flows from loans, interest-bearing deposits in other banks, federal funds sold, and deposits are reported net.

The Company's subsidiaries are required to maintain reserve balances in cash or on deposit with the Federal Reserve Bank. The total of those reserve balances was approximately $4,699,000 and $4,887,000 at December 31, 2013 and 2012, respectively.

Securities

Certain debt securities that management has the positive intent and ability to hold to maturity are classified as "held to maturity" and recorded at amortized cost. Securities not classified as held to maturity are classified as "available for sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income (loss). Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

The Company evaluates investment securities for other-than-temporary impairment using relevant accounting guidance specifying that (a) if the Company does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss that has occurred in the security. If management does not intend to sell the security and it is more likely than not that they will not have to sell the security before recovery of the cost basis, management will recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income (loss).

Restricted Equity Securities

The Company is required to maintain an investment in capital stock of various entities. Based on redemption provisions of these entities, the stock has no quoted market value and is carried at cost. At their discretion, these entities may declare dividends on the stock. Management reviews for impairment based on the ultimate recoverability of the cost basis in these stocks.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans Held For Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or market value (LOCOM). For loans carried at LOCOM, gains and losses on loan sales (sales proceeds minus carrying value) are recorded in noninterest income, and direct loan origination costs and fees are deferred at origination of the loan and are recognized in noninterest income upon sale of the loan. The estimated fair value of loans held for sale is based on independent third party quoted prices.

Loans

Loans, excluding loans covered by FDIC loss share agreements, that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal balances less deferred fees and costs on originated loans and the allowance for loan losses. Interest income is accrued on the outstanding principal balance. Loan origination fees, net of certain direct origination costs of consumer and installment loans are recognized at the time the loan is placed on the books. Loan origination fees for all other loans are deferred and recognized as an adjustment of the yield over the life of the loan using the straight-line method.

Accrual of interest on loans is discontinued when management believes, after considering current economic conditions and collection efforts, that the borrower's financial condition is such that collection of interest is doubtful. All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income or charged to the allowance, unless management believes that the accrual of interest is recoverable through the liquidation of collateral. Interest income on nonaccrual loans is recognized on the cash basis or cost recovery method, until the loans are returned to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

A loan is considered impaired when it is probable, based on current information and events, the Company will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest when due. Impaired loans are measured by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Interest on accruing impaired loans is recognized as long as such loans do not meet the criteria for nonaccrual status.

SouthCrest services mortgage loans that it originates and sells to the Federal Home Loan Mortgage Corporation ("Freddie Mac"). SouthCrest's servicing obligations include receiving payments, maintaining escrow accounts and paying hazard insurance, mortgage insurance, and taxes from such accounts, collecting past due fees, resolving payment problems and disputes, generating coupon payment books, and reporting loan balances to Freddie Mac each month. SouthCrest normally receives servicing fees of one quarter of one percent (.0025) of the outstanding loan balance of the loan servicing portfolio from Freddie Mac. SouthCrest accounts for loan servicing revenues by booking such revenues as they are received. The Company amortizes mortgage servicing rights over the estimated life of the loans.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans Covered by Loss Share Agreements

The loan portfolio is divided into covered loans and non-covered loans. Covered loans are those that were acquired in the Century Security Bank acquisition on March 19, 2010. The Company's losses on covered loans are limited under a loss share agreement with the FDIC to 20% of the first $26 million and 5% for losses in excess of $26 million. Management reviews delinquencies and accrual status of covered loans in the same manner as non-covered loans and grades loans using the same criteria. Covered losses are reimbursed quarterly, including eligible costs.

Loans covered under loss share agreements with the FDIC (referred to as covered loans) are reported in loans excluding the expectant reimbursement from the FDIC. The fair values of loans with evidence of credit deterioration are recorded net of a nonaccretable discount and accretable discount. Any excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable discount and is recognized in interest income over the remaining life of the loan when there is reasonable expectation about the amount and timing of such cash flows. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is the nonaccretable discount, which is included in the carrying amount of acquired loans. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in cash flows result in a reversal of the provision for loan losses to the extent of prior changes or a reclassification of the difference from nonaccretable to accretable with a positive impact on the accretable discount. Covered loans are initially recorded at fair value at acquisition date. Accretable discounts related to certain fair value adjustments are accreted into income over the estimated lives of the loans.

The Company accounts for performing loans acquired in the acquisition using the expected cash flows method of recognizing discount accretion based on the acquired loans' expected cash flows. Purchased performing loans are recorded at fair value, including a credit discount. Credit losses on acquired performing loans are estimated based on analysis of the performing portfolio. Such estimated credit losses are recorded as nonaccretable discounts in a manner similar to purchased impaired loans. The fair value discount other than for credit loss is accreted as an adjustment to yield over the estimated lives of the loans. A provision for loan losses is recorded for any deterioration in these loans subsequent to the acquisition.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to expense. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

The allowance for loan losses is an amount that management believes will be adequate to absorb estimated losses relating to specifically identified loans, as well as probable credit losses inherent in the balance of the loan portfolio. The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the uncollectibility of loans in light of historical experience, the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, current economic conditions that may affect the borrower's ability to pay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. This evaluation does not include the effects of expected losses on specific loans or groups of loans that are related to future events or expected changes in economic conditions. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses, and may require the Company to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For impaired loans, an allowance is established when the discounted cash flows, collateral value, or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical loss experience adjusted for other qualitative factors. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data. An unallocated component may be maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Troubled Debt Restructurings

The Company designates loan modifications as troubled debt restructurings ("TDRs") when for economic and legal reasons related to the borrower's financial difficulties, it grants a concession to the borrower that it would not otherwise consider. TDRs can involve loans remaining on nonaccrual, moving to nonaccrual, or continuing on accrual status, depending on the individual facts and circumstances of the borrower. In circumstances where the TDR involves charging off a portion of the loan balance, the Company typically classifies these restructurings as nonaccrual.

In connection with restructurings, the decision to maintain a loan that has been restructured on accrual status is based on a current, well documented credit evaluation of the borrower's financial condition and prospects for repayment under the modified terms. This evaluation includes consideration of the borrower's current capacity to pay, which among other things may include a review of the borrower's current financial statements, an analysis of global cash flow sufficient to pay all debt obligations, a debt to income analysis, and an evaluation of secondary sources of payment from the borrower and any guarantors. This evaluation also includes an evaluation of the borrower's current willingness to pay, which may include a review of past payment history, an evaluation of the borrower's willingness to provide information on a timely basis, and consideration of offers from the borrower to provide additional collateral or guarantor support. The credit evaluation also reflects consideration of the borrower's future capacity and willingness to pay, which may include evaluation of cash flow projections, consideration of the adequacy of collateral to cover all principal and interest, and trends indicating improving profitability and collectability of receivables.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Troubled Debt Restructurings (Continued)

Restructured nonaccrual loans may be returned to accrual status based on a current, well-documented credit evaluation of the borrower's financial condition and prospects for repayment under the modified terms. This evaluation must include consideration of the borrower's sustained historical repayment for a reasonable period, generally a minimum of six months, prior to the date on which the loan is returned to accrual status.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed principally by the straight-line method over the estimated useful lives of the assets. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any gain or loss is included in current operations. Maintenance and repairs are expensed as incurred while major additions and improvements are capitalized. The range of estimated useful lives for premises and equipment are generally as follows:

Building and improvements	20–40 Years
Leasehold improvements	5–10 Years
Furniture and equipment	5–10 Years
Computer and software	3–5 Years

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company - put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Other Real Estate Owned

Other real estate acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less selling costs. Any write-down to fair value at the time of transfer to foreclosed assets is charged to the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less costs to sell. Costs of improvements are capitalized, whereas costs relating to holding foreclosed assets and subsequent adjustments to the value are expensed.

Other Real Estate Owned Covered by Loss Share Agreements

Other real estate covered under loss sharing agreements with the FDIC is reported exclusive of expected reimbursement cash flows from the FDIC. Subsequent adjustments to the estimated recoverable value of covered other real estate result in a reduction of covered other real estate, and a charge to other expense for up to 20% of the expected loss on the first $26 million and 5% for losses in excess of $26 million and an increase in the FDIC receivable for the amount of expected reimbursement.

Acquired other real estate property is recorded at fair value at the date of acquisition. Subsequent declines to fair value are taken in current period earnings. Costs associated with holding covered other real estate are charged to operations, net of expected reimbursements from the FDIC.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

FDIC Indemnification Asset

The indemnification asset from the FDIC for loss sharing agreements is measured separately from the related covered assets and it is not contractually embedded in the assets and is not transferable should the assets be sold. Fair value at acquisition was estimated using projected cash flows related to loss sharing agreements based on the expected reimbursements for losses using the applicable loss share percentages and the estimated true-up payment at the expiration of the loss sharing agreement. The FDIC indemnification asset is reviewed and updated prospectively as loss estimates related to covered loans and other real estate owned change and as reimbursements are received or are expected to be received from the FDIC.

Intangible Assets

Intangible assets consist of core deposit premiums and mortgage servicing rights. The core deposit premiums were acquired in connection with business combinations. The core deposit premium is initially recognized based on a valuation performed as of the consummation date. The core deposit premium is amortized over the average remaining life of the acquired customer deposits, normally 8 to 12 years, using an accelerated or straight-line method, depending on the results of the initial valuation of the specific intangibles. Mortgage servicing rights are recognized initially at fair value as loans are sold into the secondary market with servicing rights retained and are amortized over the estimated life of the underlying loans. All intangible assets are tested annually for potential impairment.

Income Taxes

The Company accounts for income taxes in accordance with income tax accounting guidance. The accounting guidance related to accounting for uncertainty in income taxes sets out a consistent framework to determine the appropriate level of tax reserves to maintain for uncertain tax positions.

The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets may be reduced by deferred tax liabilities and a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Stock-Based Compensation

Stock compensation accounting guidance requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the grant date fair value of the equity or liability instruments issued. The stock compensation accounting guidance covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans.

The stock compensation accounting guidance requires that compensation cost for all stock awards be calculated and recognized over the employees' service period, generally defined as the vesting period. For awards with graded-vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. A Black-Scholes model is used to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards and stock grants. The Company recognized stock-based compensation of $20,000, $97,000, and $8,000 for the years ended December 31, 2013, 2012, and 2011, respectively.

Profit-Sharing Plan

Profit-sharing plan costs are based on a percentage of individual employee's salary, not to exceed the amount that can be deducted for federal income tax purposes.

Losses Per Common Share

Basic losses per common share are computed by dividing net loss available to common shareholders by the weighted-average number of shares of common stock outstanding. In calculating the weighted-average shares outstanding, shares secured by the Company's loan to its Employee Stock Ownership Plan (the "ESOP") are subtracted from shares outstanding. Dilutive potential common shares are calculated in accordance with the treasury stock method, which assumes that proceeds from the exercise of all warrants and options are used to repurchase common stock at market value. The amount of shares remaining after the proceeds are exhausted represents the potentially dilutive effect of the securities. If the price at which the option may be exercised is greater than the average market price of the stock, then the option is assumed to be nondilutive and therefore is not included in the computation of diluted losses per common share. In 2005, the Company issued 183,500 options under the SouthCrest Financial Group, Inc. 2005 Stock Incentive Plan (the "Stock Incentive Plan"), and in 2006 issued an additional 7,900 options. In 2013, the Company issued 327,000 options. The options granted were nondilutive for 2011, 2012, and 2013 due to net losses. The Stock Incentive Plan is explained more fully in Note 10. The weighted average number of common equivalent shares outstanding for the years ended December 31, 2013, 2012, and 2011 was 5,813,123, 3,737,701, and 3,736,579, respectively.

Derivative Instruments and Hedging Activities

The Company has entered into interest rate swap contracts in connection with its hedging of specific loans made to customers. During 2012, the Bank entered into interest rate swaps with original notional amounts totaling $3,680,000 using receive-variable swaps to mitigate the exposure to changes in the fair value attributable to the benchmark interest rate and the hedged items (loans receivable) from the effective date of the hedged instruments. As structured, the derivatives are evaluated as fair value hedges and are considered highly effective. As highly effective fair value designated hedges, the underlying hedged instruments are recorded on the balance sheet at fair value with the periodic changes of the fair value reported in the consolidated statements of operations.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Derivative Instruments and Hedging Activities (Continued)

The fair value of the swaps at December 31, 2013 was recorded on the consolidated balance sheets as a liability in the amount of $7,000 while the fair value of the related collars was recorded in other assets in the amount of $7,000. The loans being hedged with these interest rate products are structured to include a prepayment make-whole clause. The prepayment make-whole fee represents a reasonable estimate of the economic loss (if any) from the early prepayment, in part or in whole, of the loan.

Comprehensive Loss

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net loss. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net loss, are components of comprehensive loss.

Preferred Stock

The Company is authorized to issue a total of 10,000,00 shares of preferred stock. As of December 31, 2013, 3,486,455 shares remain unallocated to any issue.

In 2012, the Company issued and sold 737,448 shares of Series C 6.5% non-cumulative convertible perpetual preferred stock for $4,240,000. The Series C preferred stock ranks senior to voting and non-voting common stock and Series AAA preferred stock but ranks junior to the Series A and Series B preferred stock with respect to dividend and liquidation rights. The Series C preferred stock does not have the voting rights of common stock, except under very limited circumstances. The Series C preferred stock may be converted at any time after the one year anniversary date of issuance by the Series C preferred shareholders to common stock at a rate of one share of common stock for each share of preferred stock. The Company has no right to redeem the preferred stock without the consent of the shareholder. On the thirty month anniversary of the issuance date, the preferred stock will automatically convert to common stock at the same conversion rate.

Subsequent to December 31, 2012, the Company sold an additional 228,695 shares for $1,315,000, bringing the total to 966,143 shares issued for total proceeds of $5,555,000. The sale of the Series C preferred stock was closed on January 31, 2013.

On March 1, 2013, the United States Department of the Treasury announced that the Company's Series A and B preferred stock, which it sold to the Treasury in 2010, had been auctioned to private investors. This transaction closed on March 11, 2013.

On September 27, 2013 the Company sold 2,096,165 shares of Series D convertible perpetual preferred stock for $10,585,000 and 1,369,181 shares of common stock for $6,914,000 for total combined proceeds of $17,499,000. The Series D preferred stock ranks equal with common stock but is subordinate to the various preferred stock issued by the Company. The Series D preferred stock does not have the voting rights of common stock, except under very limited circumstances, but it has equal dividend rights with common. The Company has no right to redeem the preferred stock without the consent of the shareholder. Shares may be converted to common at the request of either the shareholder or the Company provided that no holder will own more than 9.9% of the common stock.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Stock Reclassification

On December 10, 2009, the stockholders approved the reclassification of certain shares of common stock to a new class of Series AAA preferred stock. All stockholders owning fewer than 2,000 shares of common stock received one share of Series AAA preferred stock for each share of common stock owned. Series AAA preferred stock has limited voting rights such as in the event of a merger, sale, or other change of control of the Company. Series AAA preferred stock will receive cash dividends in an amount 10% greater than any cash dividends paid on common stock and on any stock dividends at least equal to stock dividends paid on common stock.

Shareholders owning a total of 28,856 shares dissented from the reclassification process. During 2010, the Company purchased 26,356 shares of these for $191,000 and 2,500 shares were reclassified to common shares. Of the shares purchased, the Company reissued 22,056 common shares for total consideration of $134,000.

Nonvoting Common Stock

The Company is authorized to issue 50,000,000 shares of nonvoting common stock. As of December 31, 2013, the Company has not issued any such shares.

Fair Value of Financial Instruments

Fair values of financial instruments are estimates using relevant market information and other assumptions, as more fully disclosed in Note 15. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

Reclassification

Certain items on the balance sheets and statements of operations for the years ended December 31, 2012 and 2011 have been reclassified, with no impact on total assets or net loss, to be consistent with the classifications adopted for the year ended December 31, 2013.

NOTE 2. BUSINESS ACQUISITION AND COVERED ASSETS

On March 19, 2010, SouthCrest acquired from the FDIC certain assets and assumed certain liabilities of Century Security Bank, Johns Creek, Georgia, a failed institution. The Bank received approximately $94,348,000 in assets and liabilities as of March 19, 2010. The loans and other real estate received are guaranteed by the FDIC at 80% up to the stated threshold of $26,000,000, after which the FDIC guarantee increases to 95%. Through December 31, 2013, the cumulative losses recognized on these assets totaled $28,891,000. Since the stated threshold has been exceeded, the Bank's share of future losses will be 5%. The Bank is required to administer and manage any asset subject to loss share by the FDIC in accordance with usual and prudent banking standards and business practices until such time as such assets are purchased by the FDIC.

At December 31, 2013, assets covered by loss sharing agreements with the FDIC consisted of loans totaling $13,426,000 and other real estate owned totaling $1,625,000.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3. SECURITIES

The amortized cost and fair value of securities available for sale with gross unrealized gains and losses are summarized as follows:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale				
December 31, 2013:				
U.S. Government-sponsored enterprises (GSEs)	**$ 32,063**	**$ 8**	**$ (933)**	**$ 31,138**
State and municipal securities	**12,148**	**148**	**(130)**	**12,166**
Mortgage-backed GSE residential	**57,235**	**695**	**(335)**	**57,595**
Corporate bonds	**7,520**	**55**	**(13)**	**7,562**
Equity securities	**11,631**	**104**	**(214)**	**11,521**
Total securities available for sale	**$ 120,597**	**$ 1,010**	**$ (1,625)**	**$ 119,982**
December 31, 2012:				
U.S. Government-sponsored enterprises (GSEs)	$ 25,174	$ 209	$ (48)	$ 25,335
State and municipal securities	12,137	400	(8)	12,529
Mortgage-backed GSE residential	59,276	1,464	(25)	60,715
Corporate bonds	2,946	15	(48)	2,913
Equity securities	623	1	(32)	592
Total securities available for sale	$ 100,156	$ 2,089	$ (161)	$ 102,084

The amortized cost and fair value of securities held to maturity with gross unrealized gains and losses are summarized as follows:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Held to Maturity				
December 31, 2013:				
U.S. Government-sponsored enterprises (GSEs)	**$ 2,589**	**$ -**	**$ (26)**	**$ 2,563**

NOTE 3. SECURITIES (Continued)

The amortized cost and fair value of securities available for sale as of December 31, 2013 by contractual maturity are shown below. Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)	Securities Available for Sale Amortized Cost	Securities Available for Sale Fair Value	Securities Held to Maturity Amortized Cost	Securities Held to Maturity Fair Value
Due within one year	$ 913	$ 922	$ -	$ -
Due from one to five years	15,420	15,441	-	-
Due from five to ten years	32,498	31,614	2,589	2,563
Due after ten years	2,900	2,889	-	-
Mortgage-backed	57,235	57,595	-	-
Equity securities	11,631	11,521	-	-
	$ 120,597	$ 119,982	$ 2,589	$ 2,563

Securities with a carrying value of $75,458,000 and $65,877,000 at December 31, 2013 and 2012, respectively, were pledged to secure public deposits and for other purposes required or permitted by law.

Gains and losses on sales of securities available for sale consist of the following:

	Years Ended December 31, 2013	2012	2011
Gross gains	**$ 63**	$ 845	$ 1,028
Gross losses	**-**	-	(55)
Net realized gains	**$ 63**	$ 845	$ 973

Restricted equity securities consist of the following:

(Dollars in thousands)	December 31, 2013	2012
Federal Reserve Bank stock	**$ 444**	$ 463
Federal Home Loan Bank stock	**669**	868
	$ 1,113	$ 1,331

NOTE 3. SECURITIES (Continued)

Temporarily Impaired Securities

The following tables show the gross unrealized losses and fair value of the entity's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2013 and 2012, respectively.

	Less Than Twelve Months		Over Twelve Months		
Securities Available for Sale (Dollars in thousands)	**Gross Unrealized Losses**	**Fair Value**	**Gross Unrealized Losses**	**Fair Value**	**Total Unrealized Losses**
December 31, 2013:					
GSEs	**$ (802)**	**$ 24,612**	**$ (131)**	**$ 2,506**	**$ (933)**
State and municipal securities	**(125)**	**5,640**	**(5)**	**470**	**(130)**
Mortgage-backed securities					
GSE residential	**(335)**	**23,570**	**-**	**-**	**(335)**
Corporate bonds	**(13)**	**3,985**	**-**	**-**	**(13)**
Equity securities	**(183)**	**278**	**(31)**	**169**	**(214)**
Total	**$ (1,458)**	**$ 58,085**	**$ (167)**	**$ 3,145**	**$ (1,625)**
Securities Available for Sale December 31, 2012:					
GSEs	$ (48)	$ 7,688	$ -	$ -	$ (48)
State and municipal securities	(8)	1,426	-	-	(8)
Mortgage-backed securities					
GSE residential	(7)	2,158	(18)	998	(25)
Corporate bonds	(3)	973	(45)	955	(48)
Equity securities	-	-	(32)	168	(32)
Total	$ (66)	$ 12,245	$ (95)	$ 2,121	$ (161)

	Less Than Twelve Months		Over Twelve Months		
Held to Maturity (Dollars in thousands)	**Gross Unrealized Losses**	**Fair Value**	**Gross Unrealized Losses**	**Fair Value**	**Total Unrealized Losses**
December 31, 2013:					
GSEs	**$ (26)**	**$ 2,563**	**$ -**	**$ -**	**$ (26)**

GSE debt securities. The unrealized losses on the thirty-four investments in GSEs were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2013.

NOTE 3. SECURITIES (Continued)

Temporarily Impaired Securities (Continued)

State and municipal securities. The unrealized losses on the fifteen investments in state and municipal securities were caused by interest rate increases. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell these investments and it is more likely than not that the Company will not be required to sell these investments before recovery of its amortized cost bases, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2013.

GSE residential mortgage-backed securities. The unrealized losses on the Company's investment in twenty-seven GSE mortgage-backed securities were caused by interest rate increases. While the Company purchased those investments at a premium relative to their face amount, such premiums are amortized over the anticipated average life of the securities. Furthermore contractual cash flows of those investments are guaranteed by an agency of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost bases of the Company's investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2013.

Corporate bonds. The Company's unrealized losses on investments in six corporate bonds relates to investments in companies within the financial services sector. The unrealized losses are primarily caused by decreases in profitability and profit forecasts by industry analysts resulting from the sub-prime mortgage market and a sector downgrade by several industry analysts. The contractual terms of those investments do not permit the Company to settle the security at a price less than the par value of the investments. The Company currently does not believe it is probable that it will be unable to collect all amounts due according to the contractual terms of the investments. Because the Company does not intend to sell the investment and it is not more likely than not that the Company will be required to sell the investments before recovery of its par value, which may be maturity, it does not consider these investments to be other-than-temporarily impaired at December 31, 2013.

Equity securities. The Company's investment in two marketable equity securities consists of an investment in common stock and trust preferred stock of entities in the financial services industry. The Company evaluated the prospects of the issuer in relation to the severity and duration of the impairment. Based on that evaluation and the Company's ability and intent to hold this investment for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2013.

Other-Than-Temporary Impairment

The Company routinely conducts periodic reviews to identify and evaluate each investment security to determine whether an other-than-temporary impairment has occurred. While all securities are considered, the securities primarily impacted by other-than-temporary impairment have been certain securities included in restricted equity securities. For each security in the investment portfolio, a regular review is conducted to determine if an other-than-temporary impairment has occurred. However, the most significant factors are default rates and the creditworthiness of the issuer. Other factors may include geographic concentrations, credit ratings, and other performance indicators of the underlying asset. There were no other-than-temporary impairment charges recorded during the years ended December 31, 2013, 2012, and 2011.

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES

The composition of loans, excluding loans held for sale and loans covered under the loss sharing agreement with the FDIC, is summarized as follows:

(Dollars in thousands)	December 31, 2013	2012
Real estate mortgages:		
Real estate - commercial	**$ 78,287**	$ 72,327
Real estate – construction and land development	**15,386**	15,336
Real estate – 1-4 family first mortgage	**92,098**	92,315
Real estate – other	**18,516**	20,263
Commercial, financial, and agricultural	**10,091**	10,727
Consumer and other	**23,336**	30,640
	237,714	241,608
Deferred loan fees	**(7)**	(38)
Allowance for loan losses	**(3,689)**	(4,729)
Loans, net	**$ 234,018**	$ 236,841

The composition of covered loans is summarized as follows:

(Dollars in thousands)	December 31, 2013	2012
Real estate mortgages:		
Real estate - commercial	**$ 16,496**	$ 19,935
Real estate – construction and land development	**484**	548
Real estate – 1-4 family first mortgage	**1,465**	1,689
Real estate – other	**710**	838
Commercial, financial, and agricultural	**49**	329
	19,204	23,339
Allowance for loan losses	**(755)**	(988)
Non-accretable discount	**(3,228)**	(5,331)
Accretable discount	**(2,550)**	(2,523)
Loans, net	**$ 12,671**	$ 14,497

The following is a summary of the changes in accretable discount for the years ended December 31, 2013 and 2012:

(Dollars in thousands)	2013	2012
Balance at beginning of year	**$ 2,523**	$ 623
Reclassification from non-accretable discount	**1,769**	2,435
Accretion	**(1,742)**	(535)
Balance at end of year	**$ 2,550**	$ 2,523

Loans serviced for others totaled $84,296,000, $92,196,000, and $94,547,000 at December 31, 2013, 2012, and 2011, respectively.

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

The Company has pledged certain loans secured by 1-4 family residential mortgages under a blanket collateral agreement to secure possible future borrowings from the FHLB. The amount of such pledged loans totaled $130,123 and $140,849 at December 31, 2013 and December 31, 2012, respectively.

For purposes of the disclosures required pursuant to ASC 310, the loan portfolio was disaggregated into segments and then further disaggregated into classes for certain disclosures. A portfolio segment is defined as the level at which an entity develops and documents a systematic method for determining its allowance for credit losses. There are three loan portfolio segments that include real estate, commercial, and consumer. A class is generally determined based on the initial measurement attribute, risk characteristic of the loan, and an entity's method for monitoring and assessing credit risk. Commercial, financial, and agricultural is a separate commercial loan class. Classes within the real estate portfolio segment include construction and land development, 1-4 family first mortgages, commercial, and other. Consumer loans are a class in itself.

The following describe risk characteristics relevant to each of the portfolio segments:

Real Estate - As discussed below, the Company offers various types of real estate loan products. All loans within this portfolio segment are particularly sensitive to the valuation of real estate:

- Loans for real estate construction and land development are repaid through cash flow related to the operations, sale or refinance of the underlying property. This portfolio segment includes extensions of credit to real estate developers or investors where repayment is dependent on the sale of the real estate or income generated from the real estate collateral.

- 1-4 family first mortgage loans are repaid by various means such as a borrower's income, sale of the property, or rental income derived from the property.

- Commercial real estate mortgage loans include owner-occupied commercial real estate loans, owner-occupied construction loans for commercial businesses, and loans secured by income producing properties. Owner-occupied commercial real estate loans to operating businesses are long-term financing of land and buildings. Owner-occupied construction loans for a commercial business are for the development of land or construction of a building. Both of these loans are repaid by cash flow generated from the business operation. Real estate loans for income-producing properties such as apartment buildings, office and industrial buildings, and retail shopping centers are repaid from rent income derived from the properties.

- Other real estate mortgage loans include real estate loans secured by farmland, second liens, or open end real estate loans, such as home equity lines. These are repaid by various means such as a borrower's income, sale of the property, or rental income derived from the property.

Commercial - The commercial loan portfolio segment includes commercial, financial, and agricultural loans. These loans include loans to commercial customers for use in normal business operations to finance working capital needs, equipment purchases, or expansion projects. Loans are repaid by business cash flows. Collection risk in this portfolio is driven by the creditworthiness of the underlying borrower, particularly cash flows from the customers' business operations.

Consumer and other - The consumer and other loan portfolio segment includes direct consumer installment loans, overdrafts and other revolving credit loans, educational loans, and municipal loans. Loans in this portfolio are sensitive to unemployment and other key consumer economic measures.

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

Credit administration and special assets management are both involved in the credit risk management process and assess the accuracy of risk ratings, the quality of the portfolio and the estimation of inherent credit losses in the loan portfolio. This comprehensive process also assists in the prompt identification of problem credits. The Company has taken a number of measures to manage the portfolios and reduce risk, particularly in the more problematic portfolios.

The Company employs a credit risk management process with defined policies, accountability and routine reporting to manage credit risk in the loan portfolio segments. Credit risk management is guided by credit policies that provide for a consistent and prudent approach to underwriting and approvals of credits. Within the Credit Policy, procedures exist that elevate the approval requirements as credits become larger and more complex. All loans are individually underwritten, risk-rated, approved, and monitored.

Responsibility and accountability for adherence to underwriting policies and accurate risk ratings lies in each portfolio segment. For the consumer portfolio segment, the risk management process focuses on managing customers who become delinquent in their payments. For the commercial and real estate portfolio segments, the risk management process focuses on underwriting new business and, on an ongoing basis, monitoring the credit of the portfolios. To insure problem credits are identified on a timely basis, several specific portfolio reviews occur each quarter to assess the larger adversely rated credits for proper risk rating and accrual status and, if necessary, to ensure such individual credits are transferred to the Special Assets Division.

Credit quality and trends in the loan portfolio segments are measured and monitored regularly. This review includes detailed reports, by product, collateral, and accrual status.

The allowance for loan losses is a valuation reserve established through provisions for loan losses charged against income. The allowance for loan losses, which is evaluated quarterly, is maintained at a level that management deems sufficient to absorb probable losses inherent in the loan portfolio. Loans deemed to be uncollectible are charged against the allowance for loan losses, while recoveries of previously charged-off amounts are credited to the allowance for loan losses. The allowance for loan losses is comprised of specific valuation allowances for loans evaluated individually for impairment, general allocations for pools of homogeneous loans with similar risk characteristics and trends, and an unallocated component that reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

The allowance for loan losses related to specific loans is based on management's estimate of potential losses on impaired loans as determined by (1) the present value of expected future cash flows; (2) the fair value of collateral if the loan is determined to be collateral dependent or (3) the loan's observable market price. The Company's homogeneous loan pools include commercial real estate loans, real estate construction and land development loans, residential real estate loans, real estate other loans, commercial/financial/agricultural, industrial loans, and consumer loans. The general allocations to these loan pools are based on the historical loss rates for specific loan types and the internal risk grade, if applicable, adjusted for both internal and external qualitative risk factors. The qualitative factors considered by management include, among other factors, (1) changes in local and national economic conditions; (2) changes in asset quality; (3) changes in loan portfolio volume; (4) the composition and concentrations of credit; and (5) effectiveness of the Company's loan policies, procedures and internal controls. The total allowance established for each homogeneous loan pool represents the product of the historical loss ratio (as adjusted for qualitative factors) and the total dollar amount of the loans in the pool.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

The following tables detail activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2013 and 2012. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

(Dollars in thousands)	Real Estate	Commercial	Consumer	Unallocated	Total
December 31, 2013:					
Allowance for loan losses:					
Beginning balance	$ 4,390	$ 156	$ 284	$ 887	$ 5,717
Charge-offs	(1,889)	(101)	(240)	-	(2,230)
Recoveries	115	190	252	-	557
Provision (Re-allocation)	1,160	(208)	(187)	(365)	400
Ending balance	$ 3,776	$ 37	$ 109	$ 522	$ 4,444
Ending balance – individually evaluated for impairment	$ 746	$ -	$ -	$ -	$ 746
Ending balance – collectively evaluated for impairment	$ 2,275	$ 37	$ 109	$ 522	$ 2,943
Ending balance – loans acquired with deteriorated credit quality	$ 755	$ -	$ -	$ -	$ 755
Loans:					
Ending balance	$ 223,442	$ 10,140	$ 23,336		$ 256,918
Ending balance - individually evaluated for impairment	$ 4,437	$ -	$ -		$ 4,437
Ending balance – collectively evaluated for impairment	$ 199,850	$ 10,091	$ 23,336		$ 233,277
Ending balance – loans acquired with deteriorated credit quality	$ 19,155	$ 49	$ -		$ 19,204

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

(Dollars in thousands)	Real Estate	Commercial	Consumer	Unallocated	Total
December 31, 2012:					
Allowance for loan losses:					
Beginning balance	$ 7,126	$ 174	$ 193	$ 535	$ 8,028
Charge-offs	(10,316)	(35)	(338)	-	(10,689)
Recoveries	575	49	304	-	928
Provision (Re-allocation)	7,005	(32)	125	352	7,450
Ending balance	$ 4,390	$ 156	$ 284	$ 887	$ 5,717
Ending balance – individually evaluated for impairment	$ 736	$ -	$ -	$ -	$ 736
Ending balance – collectively evaluated for impairment	$ 2,666	$ 156	$ 284	$ 887	$ 3,993
Ending balance – loans acquired with deteriorated credit quality	$ 988	$ -	$ -	$ -	$ 988
Loans:					
Ending balance	$ 223,251	$ 11,056	$ 30,640		$ 264,947
Ending balance - individually evaluated for impairment	$ 7,057	$ 11	$ 11		$ 7,079
Ending balance – collectively evaluated for impairment	$ 193,184	$ 10,716	$ 30,629		$ 234,529
Ending balance – loans acquired with deteriorated credit quality	$ 23,010	$ 329	$ -		$ 23,339

A description of the general characteristics of the risk grades used by the Company is as follows:

Pass: Loans in this risk category involve borrowers of acceptable-to-strong credit quality and risk who have the apparent ability to satisfy their loan obligations. Loans in this risk grade would possess sufficient mitigating factors, such as adequate collateral or strong guarantors possessing the capacity to repay the debt if required, for any weakness that may exist.

Watch: Loans in this risk grade are the equivalent of the regulatory definition of “Other Assets Especially Mentioned” classification. Loans in this category possess some credit deficiency or potential weakness, which requires a high level of management attention. Potential weaknesses include declining trends in operating earnings and cash flows and /or reliance on the secondary source of repayment. If left uncorrected, these potential weaknesses may result in noticeable deterioration of the repayment prospects for the asset or in the Company’s credit position.

Substandard: Loans in this risk grade are inadequately protected by the borrower’s current financial condition and payment capability or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the orderly repayment of debt. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.

Doubtful: Loans in this risk grade have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or orderly repayment in full, on the basis of current existing facts, conditions and values, highly questionable and improbable. Possibility of loss is extremely high, but because of certain important and reasonably specific factors that may work to the advantage and strengthening of the exposure, its classification as an estimated loss is deferred until its more exact status may be determined.

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

Loss: Loans in this risk grade are considered to be non-collectible and of such little value that their continuance as bankable assets is not warranted. This does not mean the loan has absolutely no recovery value, but rather it is neither practical nor desirable to defer writing off the loan, even though partial recovery may be obtained in the future. Charge-offs against the allowance for loan losses are taken in the period in which the loan becomes uncollectible. Consequently, the Company typically does not maintain a recorded investment in loans within this category.

The following tables summarize the risk category of the Company' loan portfolio not covered by loss share based on the most recent analysis performed as of December 31, 2013 and 2012:

(Dollars in thousands)	**Pass**	**Watch**	**Substandard**	**Doubtful**	**Total**
December 31, 2013:					
Real estate mortgages:					
Commercial	$ 71,630	$ 5,548	$ 1,109	$ -	$ 78,287
Construction and land development	13,142	44	2,200	-	15,386
1-4 family first mortgage	81,505	904	9,689	-	92,098
Other	17,768	10	738	-	18,516
Commercial, financial, and agricultural	10,029	41	21	-	10,091
Consumer and other	22,085	676	575	-	23,336
Total	$ 216,159	$ 7,223	$ 14,332	$ -	$ 237,714

(Dollars in thousands)	Pass	Watch	Substandard	Doubtful	Total
December 31, 2012:					
Real estate mortgages:					
Commercial	$ 63,441	$ 6,638	$ 2,248	$ -	$ 72,327
Construction and land development	12,067	-	3,269	-	15,336
1-4 family first mortgage	81,498	897	9,915	5	92,315
Other	19,134	68	1,061	-	20,263
Commercial, financial, and agricultural	10,490	56	178	3	10,727
Consumer and other	29,741	41	858	-	30,640
Total	$ 216,371	$ 7,700	$ 17,529	$ 8	$ 241,608

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

The following tables summarize the risk category of the Company's loan portfolio covered by loss share as of December 31, 2013 and 2012:

(Dollars in thousands)	**Pass**	**Watch**	**Substandard**	**Doubtful**	**Total**
December 31, 2013:					
Real estate mortgages:					
Commercial	$ 7,350	$ 4,814	$ 4,332	$ -	$ 16,496
Construction and land development	468	-	16	-	484
1-4 family first mortgage	325	841	299	-	1,465
Other	389	-	321	-	710
Commercial, financial, and agricultural	-	49	-	-	49
Total	$ 8,532	$ 5,704	$ 4,968	$ -	$ 19,204

(Dollars in thousands)	Pass	Watch	Substandard	Doubtful	Total
December 31, 2012:					
Real estate mortgages:					
Commercial	$ 7,077	$ 7,540	$ 4,173	$ 1,145	$ 19,935
Construction and land development	516	-	32	-	548
1-4 family first mortgage	1,308	139	242	-	1,689
Other	313	200	200	125	838
Commercial, financial, and agricultural	65	224	40	-	329
Total	$ 9,279	$ 8,103	$ 4,687	$ 1,270	$ 23,339

A loan is considered past due if any required principal and interest payments have not been received as of the date such payments were required to be made under the terms of the loan agreement. Generally, management places loans on non-accrual when there is a clear indication that the borrower's cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. The following tables present the aging of the recorded investment in loans and leases not covered by loss share as of December 31, 2013 and 2012:

	Past Due Status (Accruing Loans)					
(Dollars in thousands)	**Current**	**30-89 Days**	**90+ Days**	**Total Past Due**	**Non-accrual**	**Total**
December 31, 2013:						
Real estate mortgages:						
Commercial	$ 77,296	$ 158	$ -	$ 158	$ 833	$ 78,287
Construction and land development	14,226	7	-	7	1,153	15,386
1-4 family first mortgage	86,404	2,830	-	2,830	2,864	92,098
Other	17,952	369	-	369	195	18,516
Commercial, financial, and agricultural	10,036	35	-	35	20	10,091
Consumer and other	22,944	288	3	291	101	23,336
Total	$ 228,858	$ 3,687	$ 3	$ 3,690	$ 5,166	$ 237,714

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

(Dollars in thousands)	Past Due Status (Accruing Loans) Current	30-89 Days	90+ Days	Total Past Due	Non-accrual	Total
December 31, 2012:						
Real estate mortgages:						
Commercial	$ 64,967	$ 6,901	$ -	$ 6,901	$ 459	$ 72,327
Construction and land development	12,948	204	-	204	2,184	15,336
1-4 family first mortgage	86,916	2,552	423	2,975	2,424	92,315
Other	19,871	238	-	238	154	20,263
Commercial, financial, and agricultural	10,481	174	8	182	64	10,727
Consumer and other	30,037	478	16	494	109	30,640
Total	$ 225,220	$ 10,547	$ 447	$ 10,994	$ 5,394	$ 241,608

The following tables present the aging of the recorded investment in loans and leases covered by loss share as of December 31, 2013 and 2012:

(Dollars in thousands)	**Past Due Status (Accruing Loans) Current**	**30-89 Days**	**90+ Days**	**Total Past Due**	**Non-accrual**	**Total**
December 31, 2013:						
Real estate mortgages:						
Commercial	$ 14,183	$ 1,187	$ -	$ 1,187	$ 1,126	$ 16,496
Construction and land development	484	-	-	-	-	484
1-4 family first mortgage	1,465	-	-	-	-	1,465
Other	589	-	-	-	121	710
Commercial, financial, and agricultural	-	49	-	49	-	49
Total	$ 16,721	$ 1,236	$ -	$ 1,236	$ 1,247	$ 19,204

(Dollars in thousands)	Past Due Status (Accruing Loans) Current	30-89 Days	90+ Days	Total Past Due	Non-accrual	Total
December 31, 2012:						
Real estate mortgages:						
Commercial	$ 16,734	$ 1,155	$ 746	$ 1,901	$ 1,300	$ 19,935
Construction and land development	516	32	-	32	-	548
1-4 family first mortgage	1,689	-	-	-	-	1,689
Other	713	-	-	-	125	838
Commercial, financial, and agricultural	306	-	-	-	23	329
Total	$ 19,958	$ 1,187	$ 746	$ 1,933	$ 1,448	$ 23,339

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

A loan held for investment is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due (both principal and interest) according to the terms of the loan agreement. The following tables detail our impaired loans, by portfolio class as of December 31, 2013 and 2012:

(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2013:					
With no related allowance recorded:					
Commercial real estate	$ 1,119	$ 2,932	$ -	$ 1,204	$ 1
Construction and land development	1,450	2,207	-	1,494	16
Real estate – 1-4 family first mortgage	416	587	-	446	1
Other real estate	127	127	-	111	2
Commercial, financial, and agriculture	-	-	-	-	-
Consumer	-	-	-	-	-
Total with no related allowance recorded	3,112	5,853	-	3,255	20
With an allowance recorded:					
Commercial real estate	-	-	-	-	-
Construction & land development	-	-	-	-	-
Real estate – 1-4 family first mortgage	1,202	1,672	623	1,224	49
Other real estate	123	123	123	127	7
Commercial, financial, and agriculture	-	-	-	-	-
Consumer	-	-	-	-	-
Total with an allowance recorded	1,325	1,795	746	1,351	56
Total impaired loans	$ 4,437	$ 7,648	$ 746	$ 4,606	$ 76

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2012:					
With no related allowance recorded:					
Commercial real estate	$ 1,218	$ 3,566	$ -	$ 5,769	$ 119
Construction and land development	694	987	-	867	20
Real estate – 1-4 family first mortgage	610	767	-	843	65
Other real estate	324	336	-	469	28
Commercial, financial, and agriculture	11	11	-	13	2
Consumer	11	11	-	11	1
Total with no related allowance recorded	2,868	5,678	-	7,972	235
With an allowance recorded:					
Commercial real estate	920	920	60	919	35
Construction & land development	1,824	1,848	386	1,474	102
Real estate – 1-4 family first mortgage	1,467	1,467	290	1,505	77
Other real estate	-	-	-	-	-
Commercial, financial, and agriculture	-	-	-	-	-
Consumer	-	-	-	-	-
Total with an allowance recorded	4,211	4,235	736	3,898	214
Total impaired loans	$ 7,079	$ 9,913	$ 736	$ 11,870	$ 449

At December 31, 2013 and 2012, impaired loans included loans that were classified as Troubled Debt Restructurings “TDRs”. The restructuring of a loan is considered a TDR if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession.

In assessing whether or not a borrower is experiencing financial difficulties, the Company considers information currently available regarding the financial condition of the borrower. This information includes, but is not limited to, whether (i) the debtor is currently in payment default on any of its debt; (ii) a payment default is probable in the foreseeable future without the modification; (iii) the debtor has declared or is in the process of declaring bankruptcy and (iv) the debtor's projected cash flow is sufficient to satisfy contractual payments due under the original terms of the loan without a modification.

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

The Company considers all aspects of the modification to loan terms to determine whether or not a concession has been granted to the borrower. Key factors considered by the Company include the debtor's ability to access funds at a market rate for debt with similar risk characteristics, the significance of the modification relative to unpaid principal balance or collateral value of the debt, and the significance of a delay in the timing of payments relative to the original contractual terms of the loan. The most common concessions granted by the Company generally include one or more modifications to the terms of the debt, such as (i) a reduction in the interest rate for the remaining life of the debt, (ii) an extension of the maturity date at an interest rate lower than the current market rate for new debt with similar risk, (iii) a temporary period of interest-only payments, and (iv) a reduction in the contractual payment amount for either a short period or remaining term of the loan. As of December 31, 2013 and 2012, we had $361,000 and $655,000, respectively, in loans considered restructured that are not on nonaccrual. Of the nonaccrual loans at December 31, 2013 and 2012, $2,088,000 and $2,091,000, respectively, met the criteria for restructured. A loan is placed back on accrual status when both principal and interest are current and it is probable that we will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement.

The following tables summarize the loans that were modified as a TDR during the year-ended December 31, 2013 and 2012:

	Troubled-Debt Restructurings			
(Dollars in thousands)	**Number of Loans**	**Recorded Investment Prior to Modification**	**Recorded Investment After Modification**	**Impact on the Allowance for Loan Losses**
December 31, 2013:				
Real estate mortgages:				
Commercial	-	$ -	$ -	$ -
Construction and land development	1	1,000	1,000	-
1-4 family first mortgages	1	176	176	-
Other	-	-	-	-
Commercial, financial, and agricultural	-	-	-	-
Consumer and other	-	-	-	-
Total	2	$ 1,176	$ 1,176	$ -

	Troubled-Debt Restructurings			
(Dollars in thousands)	Number of Loans	Recorded Investment Prior to Modification	Recorded Investment After Modification	Impact on the Allowance for Loan Losses
December 31, 2012:				
Real estate mortgages:				
Commercial	-	$ -	$ -	$ -
Construction and land development	-	-	-	-
1-4 family first mortgages	2	360	360	-
Other	-	-	-	-
Commercial, financial, and agricultural	-	-	-	-
Consumer and other	-	-	-	-
Total	2	$ 360	$ 360	$ -

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

The following table presents those loans modified in a TDR over the last twelve months that subsequently defaulted (i.e., 90 days or more past due following a modification) during the year ended December 31, 2011. There were no loans modified in a TDR over the last twelve months that subsequently defaulted during the years ended December 31, 2013 and 2012.

(Dollars in thousands)	Troubled-Debt Restructurings That Have Subsequently Defaulted		Impact on the Allowance for Loan Losses
December 31, 2011:	Number of Loans	Recorded Investment	
Real estate mortgages:			
Commercial	-	$ -	$ -
Construction and land development	-	-	-
1-4 family first mortgages	-	-	-
Other	1	112	-
Commercial, financial, and agricultural	-	-	-
Consumer and other	-	-	-
Total	1	$ 112	$ -

The Company has no additional commitments to lend additional funds to any of the related debtors whose terms have been modified in a TDR.

In the ordinary course of business, the Company has granted loans to certain related parties, including directors, executive officers, and their affiliates. The interest rates on these loans were substantially the same as rates prevailing at the time of the transaction and repayment terms are customary for the type of loan. Changes in related party loans for the years ended December 31, 2013 and 2012 are as follows:

(Dollars in thousands)	December 31, 2013	December 31, 2012
Balance, beginning of year	**$ 1,014**	$ 982
Advances	**181**	382
Repayments	**(193)**	(281)
Change in related parties	**-**	(69)
Balance, end of year	**$ 1,002**	$ 1,014

NOTE 5. PREMISES AND EQUIPMENT

Premises and equipment are summarized as follows:

(Dollars in thousands)	December 31, 2013	December 31, 2012
Land	**$ 3,878**	$ 3,018
Buildings	**16,725**	15,787
Leasehold improvements	**624**	541
Equipment	**8,811**	7,123
	30,038	26,469
Accumulated depreciation	**(11,421)**	(9,560)
	$ 18,617	$ 16,909

NOTE 5. PREMISES AND EQUIPMENT (Continued)

Leases:

Effective October 1, 2012, the Company signed a lease amendment for a facility in Johns Creek. The lease has a term of three years and can be renewed for an additional five years.

Effective November 1, 2010, the Company moved its Fayetteville office to Peachtree City in a facility subject to a lease having a term of five and a half years.

Rental expense under all operating leases amounted to $553,000, $333,000, and $282,000 for the years ended December 31, 2013, 2012, and 2011, respectively.

Future minimum lease commitments on noncancelable operating leases, excluding any renewal options, are summarized as follows:

(Dollars in thousands)

2014	$	605
2015		533
2016		162
2017		44
2018		-
	$	1,344

NOTE 6. INTANGIBLE ASSETS

Following is a summary of information related to intangible assets:

(Dollars in thousands)	**As of December 31, 2013**				As of December 31, 2012			
		Gross Carrying Amount		**Accumulated Amortization**		Gross Carrying Amount		Accumulated Amortization
Core deposit intangible	**$**	**9,655**	**$**	**(9,355)**	$	9,655	$	(9,123)
Mortgage servicing rights		**1,868**		**(1,249)**		1,797		(1,139)
Total other intangible assets	**$**	**11,523**	**$**	**(10,604)**	$	11,452	$	(10,262)

Amortization expense for the core deposit intangibles was $232,000, $234,000, and $238,000 for the years ended December 31, 2013, 2012, and 2011, respectively. Amortization expense for the mortgage servicing rights was $110,000, $127,000, and $138,000 for the years ended December 31, 2013, 2012, and 2011, respectively. The estimated amortization expense of all intangible assets in future years is as follows:

(Dollars in thousands)

2014	$	335
2015		168
2016		149
2017		132
2018		114
Thereafter		21
	$	919

NOTE 6. INTANGIBLE ASSETS (Continued)

The following reflects the activity in our mortgage servicing assets, net:

(Dollars in thousands)	2013	2012	2011
Beginning balance, net	$ 658	$ 536	$ 585
Amounts recognized upon sales	71	249	89
Amortization	(110)	(127)	(138)
Ending balance, net	$ 619	$ 658	$ 536

NOTE 7. DEPOSITS

The composition of deposits is summarized as follows:

	December 31,	
(Dollars in thousands)	2013	2012
Noninterest bearing deposits	$ 127.477	$ 110,710
Interest checking	81,546	81,646
Money market	54,704	59,300
Savings	61,960	60,175
Certificates of deposit	158,613	183,863
	$ 484,300	$ 495,694

The aggregate amount of time deposits in denominations of $100,000 or more at December 31, 2013 and 2012 was $50,623,000 and $59,277,000, respectively. The scheduled maturities of time deposits at December 31, 2013 are as follows:

(Dollars in thousands)	
2014	$ 116,906
2015	19,426
2016	9,143
2017	6,214
2018	6,908
Thereafter	15
	$ 158,612

Overdraft demand and savings deposits reclassified to loans totaled $222,000 and $370,000 at December 31, 2013 and 2012, respectively. At December 31, 2013, the Company had deposits to two different public depositors totaling $5,138,000 and $3,863,000, respectively. At December 31, 2012, the Company had deposits to two different public depositors totaling $8,167,000 and $3,078,000, respectively.

NOTE 8. UNUSED LINES OF CREDIT

The Company had unused lines of credit totaling approximately $79,553,000 at December 31, 2013. These lines represent credit for overnight borrowings from correspondent institutions and availability under FHLB and FRB lines of credit.

NOTE 9. EMPLOYEE BENEFIT PLANS

The Company maintains two defined contribution retirement plans (the "Plans") for its officers and employees: the SouthCrest Financial Group, Inc. 401(k) and Profit-Sharing Plan (the "401(k) Plan") and the SouthCrest Financial Group, Inc. Employee Stock Ownership Plan (the "ESOP"). Prior to 2009, the Company made an annual contribution to the funds of approximately 8% of compensation less amounts paid as incentives and bonuses. Once the Company determined the total funds to be contributed to the Plans, funds were first contributed to the 401(k) plan with the remainder contributed to the ESOP. The Company reduced its contributions to both plans, ceasing its 401(k) contribution in the third quarter of 2009 and reducing its ESOP contribution to the minimum amount needed to fund its annual loan payment to the Company.

401(k) and Profit Sharing Plan

The 401(k) Plan is available to all eligible employees, subject to certain minimum age and service requirements. There were no contributions charged to expense for the years ended December 31, 2013, 2012, and 2011, respectively.

Employee Stock Ownership Plan

The ESOP is available to all eligible employees, subject to certain age and service requirements. For the years ended December 31, 2013, 2012, and 2011, the Company contributed $34,000, $35,000, and $37,000, respectively, to the ESOP. These expenses are included in salaries and employee benefits expense in the accompanying statements of operations.

At December 31, 2013 and 2012, the ESOP held 68,110 and 68,110 shares, respectively, of the Company stock. Shares held by the ESOP considered outstanding for purposes of calculating the Company's earnings per share were 60,184 and 59,126 shares as of December 31, 2013 and 2012, respectively. In November 2007, the ESOP purchased 15,880 shares funded by a $349,000 direct loan from the Company. At December 31, 2013 and 2012, the balance of the loan was $174,000 and $198,000, respectively, and is reported on the balance sheet as "Unearned Compensation - ESOP" as a reduction of stockholders' equity. In December 2009, the loan agreement was amended to provide for a fixed interest rate of 5.50%. The loan previously carried an interest rate of Prime minus 0.50%. The loan is to be repaid over a term of fifteen years. Under applicable regulations, the ESOP must receive, either through dividend income or employer contributions, sufficient funds with which to make its required annual payment under the loan. As principal reductions are made to the loan, shares are released from the loan as collateral and allocated to participant accounts. The number of shares originally secured by the loan and allocated to participant accounts totaled 7,954 and 6,896 at December 31, 2013 and 2012, respectively. Shares still secured by the loan are not allocated to participant accounts and therefore are not considered outstanding for purposes of computing basic earnings per common share.

NOTE 9. EMPLOYEE BENEFIT PLANS (Continued)

Employee Stock Ownership Plan (Continued)

In accordance with the ESOP, the Company is expected to honor the rights of certain participants to diversify their account balances or to liquidate their ownership of the common stock in the event of termination. The purchase price of the common stock would be based on the fair market value of the Company's common stock as of the annual valuation date, which precedes the date the put option is exercised. No participant has exercised their right to diversify their account balances since the inception of the ESOP, and no significant cash outlay is expected during 2014. However, since the redemption of common stock is outside the control of the Company, the Company's maximum cash obligation based on the approximate market prices of common stock as of the reporting date has been presented outside stockholders' equity. The amount presented as redeemable common stock held by the ESOP in the consolidated balance sheet represents the Company's maximum cash obligation and has been reflected as a reduction of retained earnings.

Deferred Compensation Plan

The Company has a deferred compensation plan for death and retirement benefits for certain key officers. The estimated amounts to be paid under the compensation plan have been funded through the purchase of life insurance policies on the officers. The balance of the policy cash surrender values at December 31, 2013 and 2012 is $19,155,000 and $18,589,000, respectively. Income recognized on the policies amounted to $566,000, $606,000, and $624,000 for the years ended December 31, 2013, 2012, and 2011, respectively. The balance of deferred compensation included in other liabilities at December 31, 2013 and 2012 is $6,296,000 and $6,282,000, respectively. Expense recognized for deferred compensation amounted to $405,000, $439,000, and $236,000 for the years ended December 31, 2013, 2012, and 2011, respectively.

NOTE 10. STOCK COMPENSATION PLAN

The Company maintains the SouthCrest Financial Group, Inc. 2005 Stock Incentive Plan (the "Stock Incentive Plan"), which provides for up to 549,000 shares of the Company's stock to be awarded in the form of stock options. Both incentive stock options and non-qualified options may be granted under the Plan. The exercise price of each option equals the market price of the Company's stock on the date of grant. The incentive stock options generally vest at the rate of 20% per year over five years, and expire after ten years from the date of grant. The Company immediately vested a grant of 104,000 stock options in 2005. At December 31, 2013, 173,380 shares remained available for future grant. Compensation cost related to stock options that has been charged against income was approximately $20,000, $0, and $8,000 for the years ended December 31, 2013, 2012, and 2011, respectively. Because all options that are subject to expensing under FASB ASC 718 (Compensation - Stock Compensation) are tax qualifying granted prior to 2012, it is not expected that recognized compensation expense relating to these stock options will result in future tax benefits. Options granted in 2013 were non-qualifying and therefore will result in future tax benefits.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. No options were granted for the years ended December 31, 2013, 2012, and 2011.

During 2011, the Company entered into an agreement with certain executive officers to grant up to a maximum of 70,000 restricted stock awards under the plan. The restricted stock awards were cancelled during 2012.

During 2012, the Company granted 21,620 shares of fully-vested common stock to certain executive officers as stock compensation awards under the Stock Incentive Plan.

NOTE 10. STOCK COMPENSATION PLAN (Continued)

On October 18, 2013, the Company granted 327,000 non-qualifying options with a fair value of $1.95 per each option. The options vest at the rate of 25% per year, but are not exercisable for a period of three years from the date of grant. A Black-Sholes model was used to determine the fair value of the options granted in 2013. The assumptions are as follows:

Expected volatility	31%
Expected dividends	0%
Expected term (in years)	7
Risk-free rate	2.81%
Expected forfeiture rate	0%

A summary of activity in the Stock Incentive Plan is presented below:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2010	185,400	$ 23.44		
Granted	-			
Exercised	-			
Forfeited	-			
Outstanding at December 31, 2011	185,400	$ 23.44		
Granted	-			
Exercised	-			
Forfeited	(3,000)	23.39		
Outstanding at December 31, 2012	182,400	$ 23.44		
Granted	327,000	5.05		
Exercised	-			
Forfeited	(155,400)	23.45		
Outstanding at December 31, 2013	354,000	6.57		
Options exercisable at December 31, 2013	27,000	$ 23.39	2 Years	$ -

Since the inception of the Stock Incentive Plan, no options have been exercised. Because the end of period stock price was less than or equal to the exercise prices of exercisable options outstanding, the options outstanding and exercisable at December 31, 2013 had no intrinsic value. As of December 31, 2013, $618,000 in compensation cost related to share-based compensation arrangements had not been recognized and is expected to be recognized over four years.

Information pertaining to options outstanding at December 31, 2013 is as follows:

	Options Outstanding			Options Exercisable		
Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
$ 5.05	327,000	9.8 Years	$ 5.05	-	9.8 Years	$ 5.05
$23.10	4,500	3 Years	23.10	4,500	3 Years	23.10
$23.45	22,500	2 Years	23.45	22,500	2 Years	23.45
	354,000			27,000		

NOTE 11. INCOME TAXES

The components of income tax expense are as follows:

(Dollars in thousands)	Years Ended December 31, 2013	2012	2011
Current			
Federal	**$ -**	$ -	$ -
State	**-**	-	-
Total current	**-**	-	-
Deferred			
Federal	**(1,922)**	(2,871)	(354)
State	**(340)**	(509)	(62)
Total deferred	**(2,262)**	(3,380)	(416)
Valuation allowance	**2,262**	3,380	886
	$ -	$ -	$ 470

The Company's income tax expense differs from the amounts computed by applying the Federal income tax statutory rates to loss before income taxes. A reconciliation of the differences is as follows:

(Dollars in thousands)	Years Ended December 31, 2013	2012	2011
Tax provision at statutory rate	**$ (1,716)**	$ (2,446)	$ 119
State income taxes, net of federal benefit	**(225)**	(336)	(41)
Tax-exempt income	**(330)**	(326)	(538)
Stock-based compensation	**-**	33	3
Change in valuation allowance	**2,262**	3,380	886
Life insurance death benefits	**-**	(327)	-
Other	**9**	22	41
Income tax expense	**$ -**	$ -	$ 470

NOTE 11. INCOME TAXES (Continued)

The components of deferred income taxes are as follows:

(Dollars in thousands)	Years Ended December 31, 2013	2012
Deferred tax assets:		
Loan loss reserves	**$ 1,676**	$ 2,159
Deferred compensation	**2,032**	2,026
Security impairment	**136**	136
Intangibles	**157**	206
Purchase accounting	**92**	90
State tax credit carryforward	**326**	326
Charitable contributions	**42**	40
Other real estate	**347**	207
Alternative minimum tax credit	**116**	116
Securities available for sale	**233**	-
Net operating loss carryforward	**10,985**	8,599
	16,142	13,905
Deferred tax liabilities:		
Securities available for sale	**-**	704
Depreciation	**624**	574
Deferred gain on bargain purchase	**689**	1,034
Valuation allowance	**10,577**	8,280
	11,890	10,592
Net deferred tax asset	**$ 4,252**	$ 3,313

The years 2010 through 2012 are still subject to audit for the Company's Federal, Georgia, and Alabama income tax returns. No material tax uncertainties exist as of December 31, 2013 or 2012. The Company has approximately $29,098,000 of net operating loss carryforwards which will begin expiring in 2030.

NOTE 12. COMMITMENTS AND CONTINGENCIES

Loan Commitments

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such commitments involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amount recognized in the balance sheets. The majority of all commitments to extend credit and standby letters of credit are variable rate instruments.

The Company's exposure to credit loss is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments as it does for on-balance sheet instruments. A summary of the Company's commitments is as follows:

(Dollars in thousands)	December 31, 2013	2012
Commitments to extend credit	**$ 21,416**	$ 15,823
Credit card commitments	**5,339**	5,226
Financial standby letters of credit	**699**	140
Commercial letters of credit	**43**	605
	$ 27,497	$ 21,794

NOTE 12. COMMITMENTS AND CONTINGENCIES (Continued)

Loan Commitments (Continued)

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies, but may include accounts receivable, inventory, property and equipment, residential real estate, and income-producing commercial properties.

Credit card commitments are unsecured.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. Collateral held varies and is required in instances which the Company deems necessary.

At December 31, 2013 and 2012, the carrying amount of liabilities related to the Company's obligation to perform under standby letters of credit was insignificant. The Company has not been required to perform on any standby letters of credit, and the Company has not incurred any losses on financial standby letters of credit for the years ended December 31, 2013 and 2012.

Interest Rate Derivatives

The Company maintains an overall interest rate risk-management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. The goal is to manage interest rate sensitivity by modifying the repricing characteristics of certain assets and liabilities so that certain movements in interest rates do not, on a material basis, adversely affect the net interest margin. The Company views this strategy as prudent management of interest rate sensitivity, such that earnings are not exposed to undue risk presented by changes in interest rates. As a matter of policy, the Company does not use speculative derivative instruments for interest rate risk management.

By using derivative instruments, the Company is potentially exposed to credit and market risk. If the counter-party fails to perform, credit risk is equal to the extent of the fair value gain in a derivative. When the fair value of a derivative contract is positive, this generally indicates that the counterparty owes the Company, and, therefore, creates a repayment risk for the Company. When the fair value of a derivative contract is negative, the Company owes the counterparty and, therefore, has no repayment risk. The Company minimizes the credit (or repayment) risk in derivative instruments by entering into transactions with high-quality counterparties that are reviewed periodically.

The Company's derivative activities are monitored by its asset/liability management committee as part of that committee's oversight of the Company's asset/liability management and treasury functions. The Company's asset/liability management committee is responsible for implementing various hedging strategies that are developed through its analysis of data from financial simulation models and other internal and industry sources. The resulting hedging strategies are then incorporated into the overall interest-rate risk management.

NOTE 12. COMMITMENTS AND CONTINGENCIES (Continued)

Contingencies

In the normal course of business, the Company is involved in various legal proceedings. In the opinion of management, any liability resulting from such proceedings could range between $50,000 and $100,000 and would not have a material effect on the Company's financial statements.

NOTE 13. CONCENTRATIONS OF CREDIT RISK

The Company originates primarily commercial, residential, and consumer loans to customers in its respective markets. The ability of the majority of the Company's customers to honor their contractual loan obligations is dependent on the economy in the Company's primary market area.

Eighty-four percent of the Company's loan portfolio is concentrated in loans secured by real estate, of which a substantial portion is secured by real estate in the Company's primary market area. Additionally, six percent of the Company's loan portfolio is concentrated in real estate construction loans. Accordingly, the ultimate collectability of the loan portfolio and recovery of the carrying amount of foreclosed assets is susceptible to changes in real estate conditions in the Company's primary market area. The other concentrations of credit by type of loan are set forth in Note 4.

The Company, as a matter of policy, does not extend credit to any single borrower or group of related borrowers in excess of regulatory limits, or approximately $5,796,000 for SouthCrest, $2,255,000 for FNB Polk, $1,122,000 for Peachtree, and $1,216,000 for Chickamauga.

NOTE 14. REGULATORY MATTERS

The Company's bank subsidiaries are subject to certain restrictions on the amount of dividends that may be declared without prior regulatory approval. At December 31, 2013, no dividends could be declared without regulatory approval.

The Company (on a consolidated basis) and the Banks are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and Banks must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets, as defined, and of Tier 1 capital to average assets, as defined. Management believes, as of December 31, 2013 and 2012, that the Company and the Banks met all capital adequacy requirements to which they are subject. If, in the opinion of the regulators, the Company or a subsidiary bank engaged in unsafe or unsound practices, the regulators could subject the Company or the subsidiary bank to a variety of enforcement remedies, including issuance of a capital directive, a prohibition on accepting brokered deposits, and other restrictions.

NOTE 14. REGULATORY MATTERS (Continued)

As of December 31, 2013, the most recent notification from the Federal Deposit Insurance Corporation categorized the Banks, as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Banks must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following tables, and not be operating under a formal order from a regulatory agency. Prompt corrective action provisions are not applicable to bank holding companies.

On July 8, 2013, the Office of the Comptroller of the Currency (the "OCC") terminated a consent order previously accepted by FNB Polk on March 8, 2011. Contained in the consent were various reporting requirements by management and the Board of Directors. In addition, the consent required that FNB Polk achieve and maintain the following minimum capital levels:

(i) Tier I capital at least equal to 9% of total average assets;

(ii) Total risk-based capital at least equal to 12% of total risk-weighted assets.

Additional requirements included, but were not limited to, reducing the levels of classified assets, limiting the use of brokered deposits without prior approval, reducing concentrations of credit, prohibition of paying dividends, and maintaining an adequate allowance for loans losses. As a result of this agreement, FNB Polk was considered adequately capitalized, not well-capitalized, for regulatory capital purposes.

On February 28, 2014 SouthCrest merged all of its subsidiary banks into FNB Polk, and changed its name to SouthCrest Bank, N.A.

The Company and the Banks' actual capital amounts and ratios are presented in the following table.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2013:			(Dollars in Thousands)			
Total Capital to Risk Weighted Assets						
Consolidated	$ 65,473	20.95%	$ 25,007	8.00%	$ 31,259	N/A
SouthCrest Bank	24,352	13.37%	14,575	8.00%	18,219	10.00%
FNB Polk County	14,793	19.61%	6,033	8.00%	7,542	10.00%
Peachtree Bank	5,368	20.81%	2,064	8.00%	2,579	10.00%
Bank of Chickamauga	4,875	20.49%	1,903	8.00%	2,379	10.00%
Tier I Capital to Risk Weighted Assets						
Consolidated	$ 61,522	19.68%	$ 12,503	4.00%	$ 18,755	N/A
SouthCrest Bank	22,066	12.11%	7,288	4.00%	10,931	6.00%
FNB Polk County	13,811	18.31%	3,017	4.00%	4,525	6.00%
Peachtree Bank	5,199	20.16%	1,032	4.00%	1,548	6.00%
Bank of Chickamauga	4,637	19.49%	952	4.00%	1,427	6.00%
Tier I Capital to Average Assets						
Consolidated	$ 61,522	10.98%	$ 22,422	4.00%	$ 28,028	N/A
SouthCrest Bank	22,066	7.64%	11,546	4.00%	14,432	5.00%
FNB Polk County	13,811	9.07%	6,091	4.00%	7,614	5.00%
Peachtree Bank	5,199	9.77%	2,128	4.00%	2,660	5.00%
Bank of Chickamauga	4,637	9.55%	1,943	4.00%	2,429	5.00%

NOTE 14. REGULATORY MATTERS (Continued)

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2012:			(Dollars in Thousands)			
Total Capital to Risk Weighted Assets						
Consolidated	$ 53,224	17.46%	$ 24,384	8.00%	$ 30,480	N/A
SouthCrest Bank	27,333	16.10%	13,578	8.00%	16,972	10.00%
FNB Polk County	14,742	18.68%	6,315	8.00%	7,894	10.00%
Peachtree Bank	5,594	19.61%	2,283	8.00%	2,853	10.00%
Bank of Chickamauga	5,242	19.39%	2,163	8.00%	2,704	10.00%
Tier I Capital to Risk Weighted Assets						
Consolidated	$ 49,391	16.20%	$ 12,192	4.00%	$ 18,288	N/A
SouthCrest Bank	25,193	14.84%	6,789	4.00%	10,184	6.00%
FNB Polk County	13,748	17.42%	3,158	4.00%	4,737	6.00%
Peachtree Bank	5,386	18.88%	1,142	4.00%	1,712	6.00%
Bank of Chickamauga	4,978	18.41%	1,082	4.00%	1,623	6.00%
Tier I Capital to Average Assets						
Consolidated	$ 49,391	8.83%	$ 22,374	4.00%	$ 27,967	N/A
SouthCrest Bank	25,193	8.25%	12,211	4.00%	15,263	5.00%
FNB Polk County	13,748	9.12%	6,030	4.00%	7,537	5.00%
Peachtree Bank	5,386	10.21%	2,110	4.00%	2,637	5.00%
Bank of Chickamauga	4,978	9.88%	2,016	4.00%	2,520	5.00%

On July 17, 2009, the Company entered into an agreement with the United States Department of the Treasury (the “Treasury”), pursuant to which the Company issued and sold to the Treasury for an aggregate purchase price of $12,900,000 in cash (i) 12,900 shares of the Company’s 5% Fixed Rate Cumulative Perpetual Preferred Stock, Series A, no par value, having a liquidation preference of $1,000 per share (the “Series A Preferred Stock”), and (ii) a ten-year warrant to purchase 645 shares of the Company’s 9% Fixed Rate Cumulative Perpetual Preferred Stock, Series B, no par value (“Series B Preferred Stock”), at an initial exercise price of $0.01 per share (the “Warrant”). The Warrant was exercised in full by the Treasury at closing.

Dividends of the Series A Preferred Stock are to be paid on the liquidation preferences at a rate of 5% per annum for the first five years, and at a rate of 9% per annum thereafter. The Series A Preferred Stock has no maturity date and ranks senior to the Company’s Common Stock with respect to the payment of dividends and distributions and amount payable upon liquidations, dissolution and winding up the Company. The Series A Preferred Stock is generally non-voting. The Series B Preferred Stock has the same rights, preferences, privileges, voting rights, and other terms as the Series A Preferred Stock, except that the Series B Preferred Stock (1) will pay dividends at a rate of 9% per annum from the date of issuance, and (2) may not be redeemed until all the Series A Preferred Stock has been redeemed.

The Company may redeem the Series A and Series B Preferred Stock in whole or in part at $1,000 per share, provided, however, that no Series B Preferred Stock may be redeemed until all of the Series A Preferred Stock has been redeemed.

On March 1, 2013, the United States Department of the Treasury announced that the Company’s Series A and B preferred stock, which it sold to the Treasury in 2010, had been auctioned to private investors. This transaction closed on March 11, 2013.

NOTE 14. REGULATORY MATTERS (Continued)

In January 2011, the Company received a letter proposed by the Federal Reserve Bank of Atlanta pursuant to which the Company agreed not to incur additional indebtedness, pay cash dividends, make payments on subordinated debt, or repurchase stock without regulatory approval. As a result of this agreement, the Company may not currently pay dividends on any outstanding common or preferred stock.

NOTE 15. FAIR VALUE OF FINANCIAL INSTRUMENTS

Determination of Fair Value

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the Fair Value Measurements and Disclosures topic (FASB ASC 820), the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

NOTE 15. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Fair Value Hierarchy

In accordance with this guidance, the Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 - Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 - Valuation is based on inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

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

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

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

Cash, Due From Banks, Interest-Bearing Deposits in Banks, and Federal Funds Sold: The carrying amounts of cash, due from banks, interest-bearing deposits in banks, and federal funds sold approximate fair values.

Securities: Where quoted prices are available in an active market, we classify the securities within level 1 of the valuation hierarchy. Level 1 securities include highly liquid government bonds and exchange-traded equities.

If quoted market prices are not available, we estimate fair values using pricing models and discounted cash flows that consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes, and credit spreads. Examples of such instruments, which would generally be classified within level 2 of the valuation hierarchy, include GSE obligations and other securities. Mortgage-backed securities are included in level 2 if observable inputs are available. In certain cases where there is limited activity or less transparency around inputs to the valuation, management classifies those securities in level 3.

The carrying amount of restricted equity securities with no readily determinable fair value approximates fair value.

NOTE 15. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Loans: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair value for other loans are estimated using discounted cash flow analyses, using market interest rates for comparable loans. Fair values for impaired loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Derivative Assets and Liabilities: The Company uses derivatives to manage interest rate risk. Fair values are determined based on dealer quotes and pricing models.

Deposits: The fair values disclosed for demand deposits (for example, interest and noninterest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates on comparable instruments to a schedule of aggregated expected monthly maturities on time deposits.

Short-Term and Loan-Term Borrowed Funds: The carrying amounts of variable-rate notes payable and short-term Federal Home Loan Bank advances approximates fair values. The fair value of fixed rate Federal Home Loan Bank advances are estimated based on discounted contractual cash flows using the current incremental borrowing rates for similar types of borrowing arrangements.

Accrued Interest: The carrying amounts of accrued interest approximate fair value.

Off-balance Sheet Credit-Related Instruments: Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

Assets and Liabilities Measured at Fair Value on a Recurring Basis: Assets and liabilities measured at fair value on a recurring basis are summarized below:

(Dollars in thousands)	Fair Value Measurements at December 31, 2013 Using			
	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Carrying Value
Assets:				
Securities available for sale	$ 2,732	$ 106,901	$ 10,349	$ 119,982
Interest rate derivatives	-	7	-	7
Total assets at fair value	$ 2,732	$ 106,908	$ 10,349	$ 119,989
Liabilities:				
Interest rate derivatives	$ -	$ 7	$ -	$ 7
Total liabilities at fair value	$ -	$ 7	$ -	$ 7

NOTE 15. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

(Dollars in thousands)	Fair Value Measurements at December 31, 2012 Using			
	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Carrying Value
Assets:				
Securities available for sale	$ 2,515	$ 99,001	$ 568	$ 102,084
Interest rate derivatives	-	73	-	73
Total assets at fair value	$ 2,515	$ 99,074	$ 568	$ 102,157
Liabilities:				
Interest rate derivatives	$ -	$ 73	$ -	$ 73
Total liabilities at fair value	$ -	$ 73	$ -	$ 73

The securities measured as Level 3 include investment in common stock of a bank holding company that is not listed on an exchange. Its fair value is measured as a factor of book value.

For those securities available for sale with fair values that are determined by reliance on significant unobservable inputs, the following table identifies the factors causing the change in fair value for the year ended December 31, 2013 and 2012:

	Investment Securities Available For Sale	
(Dollars in thousands)	**2013**	2012
Beginning balance	**$ 568**	$ 450
Total gains (losses) realized or unrealized		
Included in earnings	**(11)**	-
Included in other comprehensive income	**(162)**	118
Net purchases	**9,954**	-
Ending balance	**$ 10,349**	$ 568

Assets Measured at Fair Value on a Nonrecurring Basis: Under certain circumstances management makes adjustments to fair value for assets although they are not measured at fair value on an ongoing basis. The following tables present the financial instruments carried on the consolidated balance sheet by caption and by level in the fair value hierarchy for which a nonrecurring change in fair value has been recorded:

	Fair Value Measurements at December 31, 2013 Using			
(Dollars in thousands)	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total Losses**
Impaired loans	**$ -**	**$ -**	**$ 1,383**	**$ (482)**
Other real estate owned	**-**	**-**	**1,206**	**(489)**
Total	**$ -**	**$ -**	**$ 2,589**	**$ (971)**

NOTE 15. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

(Dollars in thousands)	Fair Value Measurements at December 31, 2012 Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses
Impaired loans	$ -	$ -	$ 4,981	$ (327)
Other real estate owned	-	-	1,787	(215)
Total	$ -	$ -	$ 6,768	$ (542)

In accordance with the provisions of the loan impairment guidance (FASB ASC 310-10-35), individual loans with a carrying amount before impairment recognition of $1,865,000, were written down to their fair value of $1,383,000 as of December 31, 2013. Write downs of impaired loans are estimated using the present value of expected cash flows or the appraised value of the underlying collateral. Appraised values are discounted as necessary by management to reflect changes in economic conditions.

Other real estate owned is adjusted to fair value upon transfer of the loans to other real estate owned. Subsequently, other real estate owned is carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed assets as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset as nonrecurring Level 3. Foreclosed assets with a carrying amount before impairment recognition of $1,695,000 were written down to their fair value of $1,206,000 as of December 31, 2013.

The estimated fair values and related carrying amounts of the Company's financial instruments were as follows:

	December 31,			
	2013		2012	
(Dollars in thousands)	**Carrying Amount**	**Fair Value**	Carrying Amount	Fair Value
Financial assets:				
Cash, due from banks, interest-bearing deposits in other banks, and federal funds sold	**$ 127,044**	**$ 127,044**	$ 139,848	$ 139,848
Securities available for sale	**119,982**	**119,982**	102,084	102,084
Securities held to maturity	**2,589**	**2,563**	-	-
Restricted equity securities	**1,113**	**1,113**	1,331	1,331
Loans and loans held for sale, net	**251,331**	**246,666**	253,111	252,881
Bank-owned life insurance	**19,155**	**19,155**	18,589	18,589
Interest rate derivative	**7**	**7**	73	73
Accrued interest receivable	**1,290**	**1,290**	1,394	1,394
Financial liabilities:				
Deposits	**484,300**	**468,117**	495,694	488,026
Short-term borrowed funds	**-**	**-**	-	-
Interest rate derivative	**7**	**7**	73	73
Accrued interest payable	**401**	**401**	564	564

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 16. PARENT COMPANY FINANCIAL INFORMATION

The following information presents the condensed balance sheets of SouthCrest Financial Group, Inc. as of December 31, 2013 and 2012 and the condensed statements of operations and cash flows for each of the three years ended December 31, 2013:

CONDENSED BALANCE SHEETS

(Dollars in thousands)	December 31, 2013	December 31, 2012
Assets		
Cash	**$ 17,833**	$ 1,698
Investment in subsidiaries	**47,684**	51,907
Securities available for sale	**212**	192
Loans, net of allowance for loan losses	**662**	686
Other assets	**15**	(3)
Total assets	**$ 66,406**	$ 54,480
Liabilities, redeemable common stock and stockholders' equity		
Other liabilities	**$ 2,922**	$ 1,962
Redeemable common stock and stockholders' equity		
Redeemable common stock held by ESOP	**382**	295
Stockholders' equity	**63,102**	52,223
Total liabilities, redeemable common stock, and stockholders' equity	**$ 66,406**	$ 54,480

NOTE 16. PARENT COMPANY FINANCIAL INFORMATION (Continued)

CONDENSED STATEMENTS OF OPERATIONS

(Dollars in thousands)	Years Ended December 31, 2013	2012	2011
Income:			
Interest	**$ 16**	$ 12	$ 42
Other income	**1,197**	2,183	2,134
Total income	**1,213**	2,195	2,176
Expenses:			
Interest expense	**-**	80	148
Provision for loan losses	**-**	-	25
Other real estate owned writedowns	**-**	-	285
Other expense	**2,474**	3,456	3,005
Total expenses	**2,474**	3,536	3,463
Loss before income tax and equity in undistributed income (loss) of subsidiaries	**(1,261)**	(1,341)	(1,287)
Income tax	**-**	-	-
Loss before equity in undistributed income (loss) of subsidiaries	**(1,261)**	(1,341)	(1,287)
Equity in undistributed income (loss) of subsidiaries	**(3,788)**	(5,854)	1,175
Net loss	**$ (5,049)**	$ (7,195)	$ (112)

NOTE 16. PARENT COMPANY FINANCIAL INFORMATION (Continued)

CONDENSED STATEMENTS OF CASH FLOWS

(Dollars in thousands)	Years Ended December 31, 2013	2012	2011
OPERATING ACTIVITIES			
Net loss	**$ (5,049)**	$ (7,195)	$ (112)
Adjustments to reconcile net loss to net cash used in operating activities:			
Equity in undistributed (income) loss of subsidiaries	**3,788**	5,854	(1,175)
Stock-based compensation	**20**	97	8
Provision for loan losses	**-**	-	25
Net loss on sales of other real estate owned	**-**	51	292
Writedowns of other real estate owned	**-**	-	285
Change in other assets	**(26)**	380	(356)
Change in other liabilities	**158**	(98)	(573)
Net cash used in operating activities	**(1,109)**	(911)	(1,606)
INVESTING ACTIVITIES			
Investment in subsidiaries	**(1,155)**	(506)	-
(Increase) decrease in loans	**24**	(541)	753
Proceeds from sales of other real estate owned	**-**	60	535
Net cash provided by (used in) investing activities	**(1,131)**	(987)	1,288
FINANCING ACTIVITIES			
Repayment of short-term borrowed funds	**-**	(1,594)	(663)
Change in unearned compensation-ESOP	**24**	23	26
Proceeds from issuance of stock	**18,824**	4,240	-
Stock issuance costs	**(473)**	(670)	-
Net cash provided by (used in) financing activities	**18,375**	1,999	(637)
Net increase (decrease) in cash	**16,135**	101	(955)
Cash at beginning of year	**1,698**	1,597	2,552
Cash at end of year	**$ 17,833**	$ 1,698	$ 1,597
Noncash transactions:			
Unrealized gain on securities available for sale	**$ 20**	$ 67	$ 14
Accrual of cumulative preferred dividends	**802**	771	711
Loans transferred to other real estate owned	**-**	-	143
Financed sales of other real estate owned	**-**	-	46
Increase (decrease) in redeemable common stock held by ESOP	**87**	42	(38)