PEOPLES BANCORP OF NORTH CAROLINA INC
Form 10-Q
May 08, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: March 31, 2015

OR

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

For the transition period from __________ to __________

PEOPLES BANCORP OF NORTH CAROLINA, INC.
(Exact name of registrant as specified in its charter)

North Carolina
(State or other jurisdiction of incorporation or organization)

000-27205 (Commission File No.)	56-2132396 (IRS Employer Identification No.)
518 West C Street, Newton, North Carolina (Address of principal executive offices)	28658 (Zip Code)

(828) 464-5620
(Registrant's telephone number, including area code)

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

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

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

Large Accelerate Filer	Accelerated Filer	Non-Accelerated Filer

Smaller Reporting Company	X

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2 of the Exchange Act).

Yes No X

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.
5,612,588 shares of common stock, outstanding at April 30, 2015.

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Statements made in this Form 10-Q, other than those concerning historical information, should be considered forward-looking statements pursuant to the safe harbor provisions of the Securities Exchange Act of 1934 and the Private Securities Litigation Act of 1995. These forward-looking statements involve risks and uncertainties and are based on the beliefs and assumptions of management and on the information available to management at the time that this Form 10-Q was prepared. These statements can be identified by the use of words like "expect," "anticipate," "estimate," and "believe," variations of these words and other similar expressions. Readers should not place undue reliance on forward-looking statements as a number of important factors could cause actual results to differ materially from those in the forward-looking statements. Factors that could cause actual results to differ include, but are not limited to, (1) competition in the markets served by Peoples Bank, (2) changes in the interest rate environment, (3) general national, regional or local economic conditions may be less favorable than expected, resulting in, among other things, a deterioration in credit quality and the possible impairment of collectibility of loans, (4) legislative or regulatory changes, including changes in accounting standards, (5) significant changes in the federal and state legal and regulatory environments and tax laws, (6) the impact of changes in monetary and fiscal policies, laws, rules and regulations and (7) other risks and factors identified in other filings with the Securities and Exchange Commission, including but not limited to, those described in Peoples Bancorp of North Carolina, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2014.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

PEOPLES BANCORP OF NORTH CAROLINA, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

March 31, 2015 and December 31, 2014

(Dollars in thousands)

Assets		March 31, 2015 (Unaudited)	December 31, 2014 (Audited)
Cash and due from banks, including reserve requirements	$	47,730	51,213
of $11,391 and $12,569			
Interest-bearing deposits		19,783	17,885
Cash and cash equivalents		67,513	69,098
Investment securities available for sale		282,575	281,099
Other investments		3,912	4,031
Total securities		286,487	285,130
Mortgage loans held for sale		806	1,375
Loans		660,477	651,891
Less allowance for loan losses		(10,843)	(11,082)
Net loans		649,634	640,809
Premises and equipment, net		16,745	17,000
Cash surrender value of life insurance		14,229	14,125
Other real estate		3,424	2,016
Accrued interest receivable and other assets		10,617	10,941
Total assets	$	1,049,455	1,040,494
Liabilities and Shareholders' Equity			
Deposits:			
Noninterest-bearing demand	$	217,603	210,758
NOW, MMDA & savings		432,541	407,504
Time, $250,000 or more		36,237	47,872
Other time		143,579	148,566
Total deposits		829,960	814,700

Securities sold under agreements to repurchase		38,702	48,430
FHLB borrowings		50,000	50,000
Junior subordinated debentures		20,619	20,619
Accrued interest payable and other liabilities		8,660	8,080
Total liabilities		947,941	941,829
Commitments			
Shareholders' equity:			
Series A preferred stock, $1,000 stated value; authorized			
5,000,000 shares; no shares issued and outstanding		-	-
Common stock, no par value; authorized			
20,000,000 shares; issued and outstanding 5,612,588			
shares at March 31, 2015 and December 31, 2014		48,088	48,088
Retained earnings		47,110	45,124
Accumulated other comprehensive income		6,316	5,453
Total shareholders' equity		101,514	98,665
Total liabilities and shareholders' equity	$	1,049,455	1,040,494

See accompanying Notes to Consolidated Financial Statements.

PEOPLES BANCORP OF NORTH CAROLINA, INC. AND SUBSIDIARIES

Consolidated Statements of Earnings

Three Months Ended March 31, 2015 and 2014

(Dollars in thousands, except per share amounts)

		2015 (Unaudited)	2014 (Unaudited)	
Interest income:				
Interest and fees on loans	$	7,593	7,401	
Interest on due from banks		10	12	
Interest on investment securities:				
U.S. Government sponsored enterprises		713	847	
State and political subdivisions		1,163	1,177	
Other		88	108	
Total interest income		9,567	9,545	
Interest expense:				
NOW, MMDA & savings deposits		111	126	
Time deposits		247	334	
FHLB borrowings		418	545	
Junior subordinated debentures		97	96	
Other		11	10	
Total interest expense		884	1,111	
Net interest income		8,683	8,434	
Provision for (reduction of provision for) loan losses		173	(349	)
Net interest income after provision for loan losses		8,510	8,783	
Non-interest income:				
Service charges		1,134	1,129	
Other service charges and fees		355	419	
Gain on sale of securities		-	26	
Mortgage banking income		239	104	
Insurance and brokerage commissions		161	198	
Gain/(loss) on sale and write-down of				
other real estate		87	(162	)
Miscellaneous		1,269	1,127	
Total non-interest income		3,245	2,841	
Non-interest expense:				
Salaries and employee benefits		4,801	4,276	
Occupancy		1,483	1,521	

Other		2,464	2,326
Total non-interest expense		8,748	8,123
Earnings before income taxes		3,007	3,501
Income tax expense		679	923
Net earnings		2,328	2,578
Basic and diluted net earnings per share	$	0.41	0.46
Cash dividends declared per share	$	0.06	0.04

See accompanying Notes to Consolidated Financial Statements.

PEOPLES BANCORP OF NORTH CAROLINA, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

Three Months Ended March 31, 2015 and 2014

(Dollars in thousands)

		2015 (Unaudited)	2014 (Unaudited)
Net earnings	$	2,328	2,578
Other comprehensive income:			
Unrealized holding gains on securities available for sale		1,413	3,860
Reclassification adjustment for gains on securities available for sale included in net earnings		-	(26)
Total other comprehensive income, before income taxes		1,413	3,834
Income tax expense related to other comprehensive income:			
Unrealized holding gains on securities available for sale		550	1,503
Reclassification adjustment for gains on sales of securities available for sale included in net earnings		-	(10)
Total income tax expense related to other comprehensive income		550	1,493
Total other comprehensive income, net of tax		863	2,341
Total comprehensive income	$	3,191	4,919

See accompanying Notes to Consolidated Financial Statements.

PEOPLES BANCORP OF NORTH CAROLINA, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Three Months Ended March 31, 2015 and 2014

(Dollars in thousands)

	2015 (Unaudited)	2014 (Unaudited)
Cash flows from operating activities:		
Net earnings	$ 2,328	2,578
Adjustments to reconcile net earnings to net cash provided (used) by operating activities:		
Depreciation, amortization and accretion	1,471	1,712
Provision for (reduction of provision for) loan losses	173	(349)
Gain on sale of investment securities	-	(26)
(Gain)/loss on sale of other real estate	(87)	10
Write-down of other real estate	-	152
Restricted stock expense	117	82
Change in:		
Mortgage loans held for sale	569	(138)
Cash surrender value of life insurance	(104)	(103)
Other assets	(344)	(1,428)
Other liabilities	580	(9,709)
Net cash provided (used) by operating activities	4,703	(7,219)
Cash flows from investing activities:		
Purchases of investment securities available for sale	(7,359)	(10,566)
Proceeds from calls, maturities and paydowns of investment securities available for sale	6,377	9,738
Proceeds from sales of investment securities available for sale	-	677
Purchases of FHLB stock	(6)	-
FHLB stock redemption	125	284
Net change in loans	(11,601)	500
Purchases of premises and equipment	(297)	(627)
Proceeds from sales of other real estate and repossessions	1,283	482
Net cash (used) provided by investing activities	(11,478)	488
Cash flows from financing activities:		
Net change in deposits	15,260	11,174
Net change in securities sold under agreements to repurchase	(9,728)	(2,077)

Cash dividends paid on common stock		(342)	(227)
Net cash provided by financing activities		5,190	8,870
Net change in cash and cash equivalents		(1,585)	2,139
Cash and cash equivalents at beginning of period		69,098	76,773
Cash and cash equivalents at end of period	$	67,513	78,912

PEOPLES BANCORP OF NORTH CAROLINA, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows, continued

Three Months Ended March 31, 2015 and 2014

(Dollars in thousands)

		2015 (Unaudited)	2014 (Unaudited)
Supplemental disclosures of cash flow information:			
Cash paid during the period for:			
Interest	$	904	1,267
Income taxes	$	-	-
Noncash investing and financing activities:			
Change in unrealized gain on investment securities			
available for sale, net	$	863	2,341
Transfers of loans to other real estate and repossessions	$	2,603	2,246

See accompanying Notes to Consolidated Financial Statements.

PEOPLES BANCORP OF NORTH CAROLINA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

(1) Summary of Significant Accounting Policies

The consolidated financial statements include the financial statements of Peoples Bancorp of North Carolina, Inc. and its wholly owned subsidiaries, Peoples Bank (the "Bank") and Community Bank Real Estate Solutions, LLC, along with the Bank's wholly owned subsidiaries, Peoples Investment Services, Inc. and Real Estate Advisory Services, Inc. ("REAS") (collectively called the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation.

The consolidated financial statements in this report (other than the Consolidated Balance Sheet at December 31, 2014) are unaudited. In the opinion of management, all adjustments (none of which were other than normal accruals) necessary for a fair presentation of the financial position and results of operations for the periods presented have been included. Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these consolidated financial statements in conformity with generally accepted accounting principles in the United States ("GAAP"). Actual results could differ from those estimates.

The Company's accounting policies are fundamental to understanding management's discussion and analysis of results of operations and financial condition. Many of the Company's accounting policies require significant judgment regarding valuation of assets and liabilities and/or significant interpretation of the specific accounting guidance. A description of the Company's significant accounting policies can be found in Note 1 of the Notes to Consolidated Financial Statements in the Company's 2014 Annual Report to Shareholders which is Appendix A to the Proxy Statement for the May 7, 2015 Annual Meeting of Shareholders.

Recently Issued Accounting Pronouncements
In January 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-01, (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items. ASU No. 2015-01 eliminates the concept of extraordinary items from GAAP. ASU No. 2015-01 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. The adoption of this guidance is not expected to have a material impact on the Company's results of operations, financial position or disclosures.

In February 2015, FASB issued ASU No. 2015-02, (Topic 810): Amendments to the Consolidation Analysis. ASU No. 2015-02 provides amendments to respond to stakeholders' concerns about the current accounting for consolidation of certain legal entities. Stakeholders expressed concerns that GAAP might require a reporting entity to consolidate another legal entity in situations in which the reporting entity's contractual rights do not give it the ability to act primarily on its own behalf, the reporting entity does not hold a majority of the legal entity's voting rights, or the reporting entity is not exposed to a majority of the legal entity's economic benefits or obligations. ASU No. 2015-02 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. The adoption of this guidance is not expected to have a material impact on the Company's results of operations, financial position or disclosures.

In April 2015, FASB issued ASU No. 2015-03, (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. ASU No. 2015-03 provides guidance that will require debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. ASU No. 2015-03 affects disclosures related to debt issuance costs but does not affect existing recognition and measurement guidance for these items. ASU No. 2015-03 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. The adoption of this guidance is not expected to have a material impact on the Company's results of operations, financial position or disclosures.

In April 2015, FASB issued ASU No. 2015-04, (Topic 715): Practical Expedient for the Measurement Date of an Employer's Defined Benefit Obligation and Plan Assets. ASU No. 2015-04 simplifies the fair value measurement of defined benefit pension plans and other retirement plans for entities with a fiscal year-end that does not coincide with a month-end. ASU No. 2015-04 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. The adoption of this guidance is not expected to have a material impact on the Company's results of operations, financial position or disclosures.

In April 2015, FASB issued ASU No. 2015-05, (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangements. ASU No. 2015-05 provides guidance on a customer's accounting for fees paid in a cloud computing arrangement, which includes software as a service, platform as a service, infrastructure as a service, and other similar hosting arrangements. ASU No. 2015-05 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. The adoption of this guidance is not expected to have a material impact on the Company's results of operations, financial position or disclosures.

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

(2) Investment Securities

Investment securities available for sale at March 31, 2015 and December 31, 2014 are as follows:

(Dollars in thousands)

	March 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Mortgage-backed securities	$ 86,230	2,331	8	88,553
U.S. Government sponsored enterprises	36,977	526	141	37,362
State and political subdivisions	145,568	7,044	138	152,474
Corporate bonds	1,957	11	5	1,963
Trust preferred securities	750	-	-	750
Equity securities	748	725	-	1,473
Total	$ 272,230	10,637	292	282,575

(Dollars in thousands)

	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Mortgage-backed securities	$ 88,496	1,766	52	90,210
U.S. Government sponsored enterprises	33,766	418	136	34,048
State and political subdivisions	145,938	6,534	226	152,246
Corporate bonds	2,469	16	18	2,467
Trust preferred securities	750	-	-	750
Equity securities	748	630	-	1,378
Total	$ 272,167	9,364	432	281,099

The current fair value and associated unrealized losses on investments in securities with unrealized losses at March 31, 2015 and December 31, 2014 are summarized in the tables below, with the length of time the individual securities have been in a continuous loss position.

(Dollars in thousands)

	March 31, 2015		
	Less than 12 Months	12 Months or More	Total

		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities	$	127	-	2,954	8	3,081	8
U.S. Government sponsored enterprises		2,549	21	9,639	120	12,188	141
State and political subdivisions		6,328	30	6,784	108	13,112	138
Corporate bonds		-	-	533	5	533	5
Total	$	9,004	51	19,910	241	28,914	292

(Dollars in thousands)

	December 31, 2014						
	Less than 12 Months		12 Months or More		Total		
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities	$	436	1	2,963	51	3,399	52
U.S. Government sponsored enterprises		2,996	4	9,850	132	12,846	136
State and political subdivisions		567	1	14,998	225	15,565	226
Corporate bonds		-	-	525	18	525	18
Total	$	3,999	6	28,336	426	32,335	432

At March 31, 2015, unrealized losses in the investment securities portfolio relating to debt securities totaled $292,000. The unrealized losses on these debt securities arose due to changing interest rates and are considered to be temporary. From the March 31, 2015 tables above, 14 out of 173 securities issued by state and political subdivisions contained unrealized losses, seven out of 82 securities issued by U.S. Government sponsored enterprises, including mortgage-backed securities, contained unrealized losses, and one out of three securities issued by corporations contained unrealized losses. These unrealized losses are considered temporary because of acceptable financial condition and results of operations of entities that issued each security and the repayment sources of principal and interest on U.S. Government sponsored enterprises, including mortgage-backed securities, are government backed.

The amortized cost and estimated fair value of investment securities available for sale at March 31, 2015, by contractual maturity, are shown below. Expected maturities of mortgage-backed securities will differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

March 31, 2015
(Dollars in thousands)

		Amortized Cost	Estimated Fair Value
Due within one year	$	4,399	4,412
Due from one to five years		50,121	52,794
Due from five to ten years		111,462	115,413
Due after ten years		19,270	19,930
Mortgage-backed securities		86,230	88,553
Equity securities		748	1,473
Total	$	272,230	282,575

No securities available for sale were sold during the three months ended March 31, 2015. Proceeds from sales of securities available for sale during the three months ended March 31, 2014 were $677,000 and resulted in gross gains of $26,000.

Securities with a fair value of approximately $85.9 million and $89.9 million at March 31, 2015 and December 31, 2014, respectively, were pledged to secure public deposits and for other purposes as required by law.

(3) Loans

Major classifications of loans at March 31, 2015 and December 31, 2014 are summarized as follows:

(Dollars in thousands)

		March 31, 2015	December 31, 2014
Real estate loans:			
Construction and land development	$	57,247	57,617
Single-family residential		207,113	206,417
Single-family residential -			
Banco de la Gente stated income		46,272	47,015
Commercial		227,471	228,558
Multifamily and farmland		12,331	12,400
Total real estate loans		550,434	552,007
Loans not secured by real estate:			
Commercial loans		87,055	76,262
Farm loans		5	7
Consumer loans		9,857	10,060
All other loans		13,126	13,555
Total loans		660,477	651,891
Less allowance for loan losses		10,843	11,082
Total net loans	$	649,634	640,809

The Bank grants loans and extensions of credit primarily within the Catawba Valley region of North Carolina, which encompasses Catawba, Alexander, Iredell and Lincoln counties, and also in Mecklenburg, Union, Wake and Durham counties of North Carolina. Although the Bank has a diversified loan portfolio, a substantial portion of the loan portfolio is collateralized by improved and unimproved real estate, the value of which is dependent upon the real estate market. Risk characteristics of the major components of the Bank's loan portfolio are discussed below:

- Construction and land development loans – The risk of loss is largely dependent on the initial estimate of whether the property's value at completion equals or exceeds the cost of property construction and the availability of take-out financing. During the construction phase, a number of factors can result in delays or cost overruns. If the estimate is inaccurate or if actual construction costs exceed estimates, the value of the property securing the loan may be insufficient to ensure full repayment when completed through a permanent loan, sale of the property, or by seizure of collateral. As of March 31, 2015, construction and land development loans comprised approximately 9% of the Bank's total loan portfolio.

- Single-family residential loans – Declining home sales volumes, decreased real estate values and higher than normal levels of unemployment could contribute to losses on these loans. As of March 31, 2015, single-family residential loans comprised approximately 38% of the Bank's total loan portfolio, and include Banco de la Gente single-family residential stated income loans, which were approximately 7% of the Bank's total loan portfolio.

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Commercial real estate loans – Repayment is dependent on income being generated in amounts sufficient to cover operating expenses and debt service. These loans also involve greater risk because they are generally not fully amortizing over a loan period, but rather have a balloon payment due at maturity. A borrower's ability to make a balloon payment typically will depend on being able to either refinance the loan or timely sell the underlying property. As of March 31, 2015, commercial real estate loans comprised approximately 34% of the Bank's total loan portfolio.

- Commercial loans – Repayment is generally dependent upon the successful operation of the borrower's business. In addition, the collateral securing the loans may depreciate over time, be difficult to appraise, be illiquid or fluctuate in value based on the success of the business. As of March 31, 2015, commercial loans comprised approximately 13% of the Bank's total loan portfolio.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The following tables present an age analysis of past due loans, by loan type, as of March 31, 2015 and December 31, 2014:

March 31, 2015
(Dollars in thousands)

		Loans 30-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Total Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Real estate loans:							
Construction and land development	$	62	257	319	56,928	57,247	-
Single-family residential		4,313	1,286	5,599	201,514	207,113	-
Single-family residential -							
Banco de la Gente stated income		5,727	442	6,169	40,103	46,272	-
Commercial		1,875	381	2,256	225,215	227,471	-
Multifamily and farmland		-	-	-	12,331	12,331	-
Total real estate loans		11,977	2,366	14,343	536,091	550,434	-
Loans not secured by real estate:							
Commercial loans		162	-	162	86,893	87,055	-
Farm loans		-	-	-	5	5	-
Consumer loans		97	9	106	9,751	9,857	-
All other loans		-	-	-	13,126	13,126	-
Total loans	$	12,236	2,375	14,611	645,866	660,477	-

December 31, 2014
(Dollars in thousands)

		Loans 30-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Total Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Real estate loans:							
Construction and land development	$	294	3,540	3,834	53,783	57,617	-
Single-family residential		5,988	268	6,256	200,161	206,417	-
Single-family residential -							
Banco de la Gente stated income		8,998	610	9,608	37,407	47,015	-

Commercial		3,205	366	3,571	224,987	228,558	-
Multifamily and farmland		85	-	85	12,315	12,400	-
Total real estate loans		18,570	4,784	23,354	528,653	552,007	-
Loans not secured by real estate:							
Commercial loans		241	49	290	75,972	76,262	-
Farm loans		-	-	-	7	7	-
Consumer loans		184	-	184	9,876	10,060	-
All other loans		-	-	-	13,555	13,555	-
Total loans	$	18,995	4,833	23,828	628,063	651,891	-

The following table presents the Company's non-accrual loans as of March 31, 2015 and December 31, 2014:

(Dollars in thousands)

	March 31, 2015	December 31, 2014
Real estate loans:		
Construction and land development	$ 565	3,854
Single-family residential	3,891	2,370
Single-family residential -		
Banco de la Gente stated income	1,432	1,545
Commercial	2,755	2,598
Multifamily and farmland	99	110
Total real estate loans	8,742	10,477
Loans not secured by real estate:		
Commercial loans	111	176
Consumer loans	81	75
Total	$ 8,934	10,728

At each reporting period, the Bank determines which loans are impaired. Accordingly, the Bank's impaired loans are reported at their estimated fair value on a non-recurring basis. An allowance for each impaired loan that is collateral-dependent is calculated based on the fair value of its collateral. The fair value of the collateral is based on appraisals performed by REAS, a subsidiary of the Bank. REAS is staffed by certified appraisers that also perform appraisals for other companies. Factors, including the assumptions and techniques utilized by the appraiser, are considered by management. If the recorded investment in the impaired loan exceeds the measure of fair value of the collateral, a valuation allowance is recorded as a component of the allowance for loan losses. An allowance for each impaired loan that is not collateral dependent is calculated based on the present value of projected cash flows. If the recorded investment in the impaired loan exceeds the present value of projected cash flows, a valuation allowance is recorded as a component of the allowance for loan losses. Impaired loans under $250,000 are not individually evaluated for impairment with the exception of the Bank's troubled debt restructured ("TDR") loans in the residential mortgage loan portfolio, which are individually evaluated for impairment. Accruing impaired loans were $25.9 million, $25.6 million and $28.8 million at March 31, 2015, December 31, 2014 and March 31, 2014, respectively. Interest income recognized on accruing impaired loans was $335,000, $356,000 and $1.3 million for the three months ended March 31, 2015, the three months ended March 31, 2014 and the year ended December 31, 2014, respectively. No interest income is recognized on non-accrual impaired loans subsequent to their classification as non-accrual.

The following tables present the Company's impaired loans as of March 31, 2015 and December 31, 2014:

March 31, 2015
(Dollars in thousands)

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Recorded Investment in Impaired Loans	Related Allowance	Average Outstanding Impaired Loans
Real estate loans:						
	$ 1,174	266	647	913	35	2,554

Construction and land development							
Single-family residential		9,169	2,092	6,496	8,588	170	8,246
Single-family residential - Banco de la Gente stated income		20,886	-	20,310	20,310	1,179	19,764
Commercial		4,824	1,794	2,701	4,495	256	4,423
Multifamily and farmland		102	-	100	100	1	105
Total impaired real estate loans		36,155	4,152	30,254	34,406	1,641	35,092
Loans not secured by real estate:							
Commercial loans		152	-	136	136	3	168
Consumer loans		317	-	310	310	4	312
Total impaired loans	$	36,624	4,152	30,700	34,852	1,648	35,572

December 31, 2014
(Dollars in thousands)

		Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Recorded Investment in Impaired Loans	Related Allowance	Average Outstanding Impaired Loans
Real estate loans:							
Construction and land development	$	5,481	3,639	555	4,194	31	5,248
Single-family residential		6,717	933	5,540	6,473	154	7,430
Single-family residential - Banco de la Gente stated income		21,243	-	20,649	20,649	1,191	19,964
Commercial		4,752	1,485	2,866	4,351	272	4,399
Multifamily and farmland		111	-	110	110	1	154
Total impaired real estate loans		38,304	6,057	29,720	35,777	1,649	37,195
Loans not secured by real estate:							
Commercial loans		218	-	201	201	4	641
Farm loans (non RE)				-			
Consumer loans		318	-	313	313	5	309
All other loans (not secured by real estate)		-	-	-	-	-	-
Total impaired loans	$	38,840	6,057	30,234	36,291	1,658	38,145

Changes in the allowance for loan losses for the three months ended March 31, 2015 and 2014 were as follows:

(Dollars in thousands)		Real Estate Loans								
	Construction and Land Development	Single-Family Residential	Single-Family Residential - Banco de la Gente Stated Income	Commercial	Multifamily and Farmland	Commercial	Farm	Consumer and All Other	Unallocated	Total
Three months ended March 31, 2015										
Allowance for loan losses:										
	$2,785	2,566	1,610	1,902	7	1,098	-	233	881	11,082

Beginning balance										
Charge-offs	(88)	(291)	(42)	(2)	-	-	-	(107)	-	(530
Recoveries	5	6	22	5	-	36	-	44	-	118
Provision	56	318	(4)	(119)	(1)	47	-	38	(162)	173
Ending balance	$2,758	2,599	1,586	1,786	6	1,181	-	208	719	10,843
Allowance for loan losses March 31, 2015:										
Ending balance: individually evaluated for impairment	$-	82	1,145	245	-	-	-	-	-	1,472
Ending balance: collectively evaluated for impairment	2,758	2,517	441	1,541	6	1,181	-	208	719	9,371
Ending balance	$2,758	2,599	1,586	1,786	6	1,181	-	208	719	10,843
Loans March 31, 2015:										
Ending balance	$57,247	207,113	46,272	227,471	12,331	87,055	5	22,983	-	660,477
Ending balance: individually evaluated for impairment	$266	3,448	18,655	3,633	-	-	-	-	-	26,002
Ending balance: collectively evaluated for impairment	$56,981	203,665	27,617	223,838	12,331	87,055	5	22,983	-	634,475

(Dollars in thousands)

	Real Estate Loans									
	Construction and Land Development	Single-Family Residential	Single-Family Residential - Banco de la Gente Stated Income	Commercial	Multifamily and Farmland	Commercial	Farm	Consumer and All Other	Unallocated	Total
Three months ended March 31, 2014										
Allowance for loan losses:										
Beginning balance	$3,218	3,123	1,863	2,219	37	1,069	-	245	1,727	13,501
Charge-offs	(260)	(22)	(32)	(111)	-	(12)	-	(138)	-	(575
Recoveries	279	9	12	60	-	5	-	36	-	401
Provision	(104)	22	(76)	28	(1)	(117)	-	87	(188)	(349
Ending balance	$3,133	3,132	1,767	2,196	36	945	-	230	1,539	12,978
Allowance for loan losses March 31, 2014:										
Ending balance: individually evaluated for impairment	$-	68	1,187	174	-	-	-	-	-	1,429
Ending balance: collectively evaluated for impairment	3,133	3,064	580	2,022	36	945	-	230	1,539	11,549
Ending balance	$3,133	3,132	1,767	2,196	36	945	-	230	1,539	12,978
Loans March 31, 2014:										
Ending balance	$61,162	196,447	48,926	211,882	11,566	65,456	16	22,585	-	618,040

Ending balance: individually evaluated for impairment	$5,464	3,220	19,625	3,577	-	253	-	257	-	32,396
Ending balance: collectively evaluated for impairment	$55,698	193,227	29,301	208,305	11,566	65,203	16	22,328	-	585,644

The provision for loan losses for the three months ended March 31, 2015 was an expense of $173,000, as compared to a credit of $349,000 for the three months ended March 31, 2014. The increase in the provision for loan losses is primarily attributable to a $42.5 million increase in loans from March 31, 2014 to March 31, 2015 and a $238,000 increase in net charge-offs during the three months ended March 31, 2015, as compared to the same period one year ago.

The Company utilizes an internal risk grading matrix to assign a risk grade to each of its loans. Loans are graded on a scale of 1 to 8. These risk grades are evaluated on an ongoing basis. A description of the general characteristics of the eight risk grades is as follows:

- Risk Grade 1 – Excellent Quality: Loans are well above average quality and a minimal amount of credit risk exists. CD or cash secured loans or properly margined actively traded stock or bond secured loans would fall in this grade.
- Risk Grade 2 – High Quality: Loans are of good quality with risk levels well within the Company's range of acceptability. The organization or individual is established with a history of successful performance though somewhat susceptible to economic changes.
- Risk Grade 3 – Good Quality: Loans of average quality with risk levels within the Company's range of acceptability but higher than normal. This may be a new organization or an existing organization in a transitional phase (e.g. expansion, acquisition, market change).
- Risk Grade 4 – Management Attention: These loans have higher risk and servicing needs but still are acceptable. Evidence of marginal performance or deteriorating trends is observed. These are not problem credits presently, but may be in the future if the borrower is unable to change its present course.
- Risk Grade 5 – Watch: These loans are currently performing satisfactorily, but there has been some recent past due history on repayment and there are potential weaknesses that may, if not corrected, weaken the asset or inadequately protect the Company's position at some future date.
- Risk Grade 6 – Substandard: A Substandard loan is inadequately protected by the current sound net worth and paying capacity of the obligor or the collateral pledged (if there is any). There is a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. There is a distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.
- Risk Grade 7 – Doubtful: Loans classified as Doubtful have all the weaknesses inherent in loans classified as Substandard, plus the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values highly questionable and improbable. Doubtful is a temporary grade where a loss is expected but is presently not quantified with any degree of accuracy. Once the loss position is determined, the amount is charged off.
- Risk Grade 8 – Loss: Loans classified as Loss are considered uncollectable and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this worthless loan even

though partial recovery may be realized in the future. Loss is a temporary grade until the appropriate authority is obtained to charge the loan off.

The following tables present the credit risk profile of each loan type based on internally assigned risk grades as of March 31, 2015 and December 31, 2014:

March 31, 2015
(Dollars in thousands)

	Real Estate Loans									
	Construction and Land Development	Single-Family Residential	Single-Family Residential - Banco de la Gente Stated Income	Commercial	Multifamily and Farmland	Commercial	Farm	Consumer	All Other	Total
1- Excellent Quality	$-	13,705	-	-	-	1,026	-	1,245	-	15,976
2- High Quality	7,768	76,955	-	38,374	231	26,199	-	3,465	1,798	154,790
3- Good Quality	26,737	74,746	20,561	140,510	8,978	47,317	5	4,494	10,392	333,740
4- Management Attention	12,918	29,884	12,714	38,734	369	11,995	-	514	936	108,064
5- Watch	9,176	4,619	5,677	5,706	2,653	379	-	47	-	28,257
6- Substandard	648	7,204	7,320	4,147	100	139	-	92	-	19,650
7- Doubtful	-	-	-	-	-	-	-	-	-	-
8- Loss	-	-	-	-	-	-	-	-	-	-
Total	$57,247	207,113	46,272	227,471	12,331	87,055	5	9,857	13,126	660,477

December 31, 2014
(Dollars in thousands)

	Real Estate Loans									
	Construction and Land Development	Single-Family Residential	Single-Family Residential - Banco de la Gente Stated	Commercial	Multifamily and Farmland	Commercial	Farm	Consumer	All Other	Total

Income

1- Excellent Quality	$-	15,099	-	-	-	924	-	1,232	-	17,255
2- High Quality	6,741	74,367	-	39,888	241	18,730	-	3,576	1,860	145,403
3- Good Quality	24,641	74,453	21,022	142,141	8,376	44,649	7	4,549	8,055	327,893
4- Management Attention	13,013	30,954	12,721	36,433	1,001	11,312	-	566	3,640	109,640
5- Watch	9,294	5,749	5,799	6,153	2,672	383	-	46	-	30,096
6- Substandard	3,928	5,795	7,473	3,943	110	264	-	87	-	21,600
7- Doubtful	-	-	-	-	-	-	-	-	-	-
8- Loss	-	-	-	-	-	-	-	4	-	4
Total	$57,617	206,417	47,015	228,558	12,400	76,262	7	10,060	13,555	651,891

Total TDR loans amounted to $5.5 million and $15.0 million at March 31, 2015 and December 31, 2014, respectively. The terms of these loans have been renegotiated to provide a concession to original terms, including a reduction in principal or interest as a result of the deteriorating financial position of the borrower. There were $146,000 and $1.4 million in performing loans classified as TDR loans at March 31, 2015 and December 31, 2014, respectively.

The following tables present an analysis of loan modifications during the three months ended March 31, 2015 and 2014:

Three months ended March 31, 2015
(Dollars in thousands)

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Real estate loans			
Single-family residential	1	$ 146	146
Total real estate TDR loans	1	146	146
Total TDR loans	1	$ 146	146

Three months ended March 31, 2014
(Dollars in thousands)

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Real estate loans			
Construction and land development	1	$ 316	316
Single family residential	1	737	737
Single-family residential -			
Banco de la Gente stated income	6	497	497
Total real estate TDR loans	8	1,550	1,550
Total TDR loans	8	$ 1,550	1,550

(4) Net Earnings Per Share

Net earnings per share is based on the weighted average number of shares outstanding during the period while the effects of potential shares outstanding during the period are included in diluted earnings per share. The average market price during the year is used to compute equivalent shares.

The reconciliation of the amounts used in the computation of both "basic earnings per share" and "diluted earnings per share" for the three months ended March 31, 2015 and 2014 is as follows:

For the three months ended March 31, 2015

	Net Earnings (Dollars in thousands)	Shares	Per Share Amount
Basic earnings per share	$ 2,328	5,612,588	$ 0.41
Effect of dilutive securities:			
Stock options	-	38,470	
Diluted earnings per share	$ 2,328	5,651,058	$ 0.41

For the three months ended March 31, 2014

	Net Earnings (Dollars in thousands)	Shares	Per Share Amount
Basic earnings per share	$ 2,578	5,613,495	$ 0.46
Effect of dilutive securities:			
Stock options	-	19,359	
Diluted earnings per share	$ 2,578	5,632,854	$ 0.46

(5) Stock-Based Compensation

The Company has an Omnibus Stock Ownership and Long Term Incentive Plan (the "1999 Plan") whereby certain stock-based rights, such as stock options and restricted stock units, were granted to eligible directors and employees. The 1999 Plan expired on May 13, 2009 but still governs the rights and obligations of the parties for grants made thereunder. As of March 31, 2015, there were no outstanding options under the 1999 Plan.

Under the 1999 Plan, the Company granted 3,000 restricted stock units in 2007 at a grant date fair value of $17.40 per share. The Company granted 1,750 restricted stock units at a grant date fair value of $12.80 per share during the third quarter of 2008 and 2,000 restricted stock units at a grant date fair value of $11.37 per share during the fourth quarter of 2008. The Company recognized compensation expense on the restricted stock units over the period of time the restrictions were in place (three years from the grant date for the grants of restricted stock units under the 1999 Plan). The amount of expense recorded in each period reflected the changes in the Company's stock price during such period. As of March 31, 2015, there was no unrecognized compensation expense related to the 2007 and 2008 restricted stock unit grants granted under the 1999 Plan.

The Company also has an Omnibus Stock Ownership and Long Term Incentive Plan that was approved by shareholders on May 7, 2009 (the "2009 Plan") whereby certain stock-based rights, such as stock options, restricted stock, restricted stock units, performance units, stock appreciation rights or book value shares, may be granted to eligible directors and employees. A total of 267,560 shares are currently reserved for possible issuance under the 2009 Plan. All stock-based rights under the 2009 Plan must be granted or awarded by May 7, 2019 (or ten years from the 2009 Plan effective date).

The Company granted 29,514 restricted stock units under the 2009 Plan at a grant date fair value of $7.90 per share during the first quarter of 2012, of which 5,355 restricted stock units were forfeited by the executive officers of the Company as required by the agreement with the U.S. Department of the Treasury ("UST") in conjunction with the Company's participation in the Capital Purchase Program ("CPP") under the Troubled Asset Relief Program ("TARP"). In July 2012, the Company granted 5,355 restricted stock units at a grant date fair value of $8.25 per share. The Company granted 26,795 restricted stock units under the 2009 Plan at a grant date fair value of $11.90 per share during the second quarter of 2013. The Company granted 21,056 restricted stock units under the 2009 Plan at a grant date fair value of $15.70 per share during the first quarter of 2014. The Company granted 15,075 restricted stock units under the 2009 Plan at a grant date fair value of $17.97 per share during the first quarter of 2015. The Company recognizes compensation expense on the restricted stock units over the period of time the restrictions are in place (five years from the grant date for the 2012 grants, four years from the grant date for the 2013 and 2015 grants and three years from the grant date for the 2014 grants). The amount of expense recorded each period reflects the changes in the Company's stock price during such period. As of March 31, 2015, the total unrecognized compensation expense related to the restricted stock unit grants under the 2009 Plan was $968,000.

The Company recognized compensation expense for restricted stock unit awards granted under the 2009 Plan of $117,000 and $82,000 for the three months ended March 31, 2015 and 2014, respectively.

(6) Fair Value

The Company is required to disclose fair value information about financial instruments, whether or not recognized on the face of the balance sheet, for which it is practicable to estimate that value. The assumptions used in the estimation of the fair value of the Company's financial instruments are detailed below. Where quoted prices are not available, fair values are based on estimates using discounted cash flows and other valuation techniques. The use of discounted cash flows can be significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The following disclosures should not be considered a surrogate of the liquidation value of the Company, but rather a good faith estimate of the increase or decrease in the value of financial instruments held by the Company since purchase, origination or issuance.

The Company groups assets and liabilities 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. These levels are:

- Level 1 – Valuation is based upon quoted prices for identical instruments traded in active markets.
- Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 – Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

Cash and Cash Equivalents

For cash, due from banks and interest-bearing deposits, the carrying amount is a reasonable estimate of fair value. Cash and cash equivalents are reported in the Level 1 fair value category.

Investment Securities Available for Sale

Fair values of investment securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges when available. If quoted prices are not available, fair value is determined using matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities. Fair values for investment securities with quoted market prices are reported in the Level 1 fair value category. Fair value measurements obtained from independent pricing services are reported in the Level 2 fair value category. All other fair value measurements are reported in the Level 3 fair value category.

Other Investments
For other investments, the carrying value is a reasonable estimate of fair value. Other investments are reported in the Level 3 fair value category.

Mortgage Loans Held for Sale
Mortgage loans held for sale are carried at the lower of aggregate cost or market value. The cost of mortgage loans held for sale approximates the market value. Mortgage loans held for sale are reported in the Level 3 fair value category.

Loans
The fair value of fixed rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings. For variable rate loans, the carrying amount is a reasonable estimate of fair value. Loans are reported in the Level 3 fair value category, as the pricing of loans is more subjective than the pricing of other financial instruments.

Cash Surrender Value of Life Insurance
For cash surrender value of life insurance, the carrying value is a reasonable estimate of fair value. Cash surrender value of life insurance is reported in the Level 2 fair value category.

Other Real Estate
The fair value of other real estate is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. Other real estate is reported in the Level 3 fair value category.

Deposits
The fair value of demand deposits, interest-bearing demand deposits and savings is the amount payable on demand at the reporting date. The fair value of certificates of deposit is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities. Deposits are reported in the Level 2 fair value category.

Securities Sold Under Agreements to Repurchase
For securities sold under agreements to repurchase, the carrying value is a reasonable estimate of fair value. Securities sold under agreements to repurchase are reported in the Level 2 fair value category.

Federal Home Loan Bank ("FHLB") Borrowings
The fair value of FHLB borrowings is estimated based upon discounted future cash flows using a discount rate comparable to the current market rate for such borrowings. FHLB borrowings are reported in the Level 2 fair value category.

Junior Subordinated Debentures
Because the Company's junior subordinated debentures were issued at a floating rate, the carrying amount is a reasonable estimate of fair value. Junior subordinated debentures are reported in the Level 2 fair value category.

Commitments to Extend Credit and Standby Letters of Credit
Commitments to extend credit and standby letters of credit are generally short-term and at variable interest rates. Therefore, both the carrying value and estimated fair value associated with these instruments are immaterial.

Limitations
Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for

sale at one time the Company’s entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company’s financial instruments, fair value estimates are based on many judgments. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets and liabilities that are not considered financial instruments include deferred income taxes and premises and equipment. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

The table below presents the balance of securities available for sale, which are measured at fair value on a recurring basis by level within the fair value hierarchy, as of March 31, 2015 and December 31, 2014.

(Dollars in thousands)

	March 31, 2015			
	Fair Value Measurements	Level 1 Valuation	Level 2 Valuation	Level 3 Valuation
Mortgage-backed securities	$ 88,553	-	88,553	-
U.S. Government sponsored enterprises	$ 37,362	-	37,362	-
State and political subdivisions	$ 152,474	-	152,474	-
Corporate bonds	$ 1,963	-	1,963	-
Trust preferred securities	$ 750	-	-	750
Equity securities	$ 1,473	1,473	-	-

(Dollars in thousands)

	December 31, 2014			
	Fair Value Measurements	Level 1 Valuation	Level 2 Valuation	Level 3 Valuation
Mortgage-backed securities	$ 90,210	-	90,210	-
U.S. Government sponsored enterprises	$ 34,048	-	34,048	-
State and political subdivisions	$ 152,246	-	152,246	-
Corporate bonds	$ 2,467	-	2,467	-
Trust preferred securities	$ 750	-	-	750
Equity securities	$ 1,378	1,378	-	-

The following is an analysis of fair value measurements of investment securities available for sale using Level 3, significant unobservable inputs, for the three months ended March 31, 2015.

(Dollars in thousands)

	Investment Securities Available for Sale Level 3 Valuation
Balance, beginning of period	$ 750
Change in book value	-
Change in gain/(loss) realized and unrealized	-
Purchases/(sales and calls)	-
Transfers in and/or (out) of Level 3	-
Balance, end of period	$ 750

Change in unrealized gain/(loss) for assets still held in Level 3	$ -

The fair value measurements for impaired loans and other real estate on a non-recurring basis at March 31, 2015 and December 31, 2014 are presented below. The fair value measurement process uses certified appraisals and other market-based information; however, in many cases, it also requires significant input based on management's knowledge of, and judgment about, current market conditions, specific issues relating to the collateral and other matters. As a result, all fair value measurements for impaired loans and other real estate are considered Level 3.

(Dollars in thousands)

		Fair Value Measurements March 31, 2015	Level 1 Valuation	Level 2 Valuation	Level 3 Valuation	Total Gains/(Losses) for the Three Months Ended March 31, 2015
Impaired loans	$	33,204	-	-	33,204	(412)
Other real estate	$	3,424	-	-	3,424	87

(Dollars in thousands)

		Fair Value Measurements December 31, 2014	Level 1 Valuation	Level 2 Valuation	Level 3 Valuation	Total Gains/(Losses) for the Year Ended December 31, 2014
Impaired loans	$	34,633	-	-	34,633	(1,444)
Other real estate	$	2,016	-	-	2,016	(622)

The carrying amount and estimated fair value of financial instruments at March 31, 2015 and December 31, 2014 are as follows:

(Dollars in thousands)

			Fair Value Measurements at March 31, 2015			
		Carrying Amount	Level 1	Level 2	Level 3	Total
Assets:						
Cash and cash equivalents	$	67,513	67,513	-	-	67,513
Investment securities available for sale	$	282,575	1,473	280,352	750	282,575
Other investments	$	3,912	-	-	3,912	3,912
Mortgage loans held for sale	$	806	-	-	806	806
Loans, net	$	649,634	-	-	653,303	653,303
Cash surrender value of life insurance	$	14,229	-	14,229	-	14,229
Liabilities:						
Deposits	$	829,960	-	-	828,245	828,245
Securities sold under agreements to repurchase	$	38,702	-	38,702	-	38,702
FHLB borrowings	$	50,000	-	49,593	-	49,593
Junior subordinated debentures	$	20,619	-	20,619	-	20,619

(Dollars in thousands)

	Carrying Amount	Fair Value Measurements at December 31, 2014 Level 1	Level 2	Level 3	Total
Assets:					
Cash and cash equivalents	$ 69,098	69,098	-	-	69,098
Investment securities available for sale	$ 281,099	1,378	278,971	750	281,099
Other investments	$ 4,031	-	-	4,031	4,031
Mortgage loans held for sale	$ 1,375	-	-	1,375	1,375
Loans, net	$ 640,809	-	-	644,708	644,708
Cash surrender value of life insurance	$ 14,125	-	14,125	-	14,125
Liabilities:					
Deposits	$ 814,700	-	-	813,288	813,288
Securities sold under agreements to repurchase	$ 48,430	-	48,430	-	48,430
FHLB borrowings	$ 50,000	-	49,598	-	49,598
Junior subordinated debentures	$ 20,619	-	20,619	-	20,619

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(7) Subsequent Events

The Company has reviewed and evaluated subsequent events and transactions for material subsequent events through the date the financial statements are issued. Management has concluded that there were no material subsequent events.

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

The following is a discussion of our financial position and results of operations and should be read in conjunction with the information set forth under Item 1A Risk Factors and the Company's Consolidated Financial Statements and Notes thereto on pages A-26 through A-62 of the Company's 2014 Annual Report to Shareholders which is Appendix A to the Proxy Statement for the May 7, 2015 Annual Meeting of Shareholders.

Introduction

Management's discussion and analysis of earnings and related data are presented to assist in understanding the consolidated financial condition and results of operations of the Company. The Company is the parent company of the Bank and a registered bank holding company operating under the supervision of the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The Bank is a North Carolina-chartered bank, with offices in Catawba, Lincoln, Alexander, Mecklenburg, Iredell, Union, Wake and Durham counties, operating under the banking laws of North Carolina and the rules and regulations of the Federal Deposit Insurance Corporation (the "FDIC").

Overview

Our business consists principally of attracting deposits from the general public and investing these funds in commercial loans, real estate mortgage loans, real estate construction loans and consumer loans. Our profitability depends primarily on our net interest income, which is the difference between the income we receive on our loan and investment securities portfolios and our cost of funds, which consists of interest paid on deposits and borrowed funds. Net interest income also is affected by the relative amounts of our interest-earning assets and interest-bearing liabilities. When interest-earning assets approximate or exceed interest-bearing liabilities, a positive interest rate spread will generate net interest income. Our profitability is also affected by the level of other income and operating expenses. Other income consists primarily of miscellaneous fees related to our loans and deposits, mortgage banking income and commissions from sales of annuities and mutual funds. Operating expenses consist of compensation and benefits, occupancy related expenses, federal deposit and other insurance premiums, data processing, advertising and other expenses.

Our operations are influenced significantly by local economic conditions and by policies of financial institution regulatory authorities. The earnings on our assets are influenced by the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Federal Reserve, inflation, interest rates, market and monetary fluctuations. Lending activities are affected by the demand for commercial and other types of loans, which in turn is affected by the interest rates at which such financing may be offered. Our cost of funds is influenced by interest rates on competing investments and by rates offered on similar investments by competing financial institutions in our market area, as well as general market interest rates. These factors can cause fluctuations in our net interest income and other income. In addition, local economic conditions can impact the credit risk of our loan portfolio, in that (1) local employers may be required to eliminate employment positions of individual borrowers, and (2) small businesses and commercial borrowers may experience a downturn in their operating performance and become unable to make timely payments on their loans. Management evaluates these factors in estimating its allowance for loan losses and changes in these economic factors could result in increases or decreases to the provision for loan losses.

Economic conditions in 2015 continue to demonstrate signs of improvement. However, with the unemployment rate continuing to be higher than historical norms and home prices still well below pre-crisis levels, the primary indicators of economic activity for our markets continue to point to uncertain business conditions.

Although we are unable to control the external factors that influence our business, by maintaining high levels of balance sheet liquidity, managing our interest rate exposures and by actively monitoring asset quality, we seek to minimize the potentially adverse risks of unforeseen and unfavorable economic trends.

Our business emphasis has been and continues to be to operate as a well-capitalized, profitable and independent community-oriented financial institution dedicated to providing quality customer service. We are committed to meeting the financial needs of the communities in which we operate. The Company expects growth to be achieved in its local markets and through expansion opportunities in contiguous or nearby markets. While the Company would be willing to consider growth by acquisition in certain circumstances, it does not consider the acquisition of another company to be necessary for its continued ability to provide a reasonable return to its shareholders. We believe that we can be more effective in serving our customers than many of our non-local competitors because of our ability to quickly and effectively provide senior management responses to customer needs and inquiries. Our ability to provide these services is enhanced by the stability and experience of our Bank officers and managers.

The Federal Reserve has maintained the Federal Funds Rate at 0.25% since December 2008. This historically low rate has had a negative impact on earnings and will continue to have a negative impact on our net interest income in future periods. The negative impact of low interest rates has been partially offset by earnings realized on interest rate contracts utilized by the Bank. Additional information regarding the Bank's interest rate contacts is provided below in the section entitled "Asset Liability and Interest Rate Risk Management."

Summary of Significant Accounting Policies

The Company's accounting policies are fundamental to understanding management's discussion and analysis of results of operations and financial condition. Many of the Company's accounting policies require significant judgment regarding valuation of assets and liabilities and/or significant interpretation of specific accounting guidance. A more complete description of the Company's significant accounting policies can be found in Note 1 of the Notes to Consolidated Financial Statements in the Company's 2014 Annual Report to Shareholders which is Appendix A to the Proxy Statement for the May 7, 2015 Annual Meeting of Shareholders.

Many of the Company's assets and liabilities are recorded using various techniques that require significant judgment as to recoverability. The collectibility of loans is reflected through the Company's estimate of the allowance for loan losses. The Company performs periodic and systematic detailed reviews of its lending portfolio to assess overall collectibility. In addition, certain assets and liabilities are reflected at their estimated fair value in the consolidated financial statements. Such amounts are based on either quoted market prices or estimated values derived from dealer quotes used by the Company, market comparisons or internally generated modeling techniques. The Company's internal models generally involve present value of cash flow techniques. The various techniques are discussed in greater detail elsewhere in this management's discussion and analysis and the Notes to the Consolidated Financial Statements. Fair value of the Company's financial instruments is discussed in Note (6) of the Notes to Consolidated Financial Statements (Unaudited) included in this Quarterly Report.

Results of Operations

Summary. Net earnings were $2.3 million or $0.41 basic and diluted net earnings per share for the three months ended March 31, 2015, as compared to $2.6 million or $0.46 basic and diluted net earnings per share for the same period one year ago. The decrease in first quarter earnings is attributable to an increase in the provision for loan losses and an increase in non-interest expense, which were partially offset by an increase in non-interest income and an increase in net interest income, as discussed below.

The annualized return on average assets was 0.91% for the three months ended March 31, 2015, compared to 1.03% for the same period one year ago, and annualized return on average shareholders' equity was 9.32% for the three months ended March 31, 2015, compared to 11.92% for the same period one year ago.

Net Interest Income. Net interest income, the major component of the Company's net earnings, was $8.7 million for the three months ended March 31, 2015, compared to $8.4 million for the same period one year ago. The increase in net interest income was primarily due to an increase in interest income resulting from an increase in the average outstanding principal balance of loans and was augmented by a decrease in interest expense resulting from a reduction in the cost of funds and a decrease in the average outstanding balance of interest bearing liabilities

Interest income increased $22,000 for the three months ended March 31, 2015, compared to the same period one year ago. The increase in interest income was primarily due to an increase in the average outstanding principal balance of loans, which was partially offset by a decrease in the average outstanding principal balance of available for sale securities. During the quarter ended March 31, 2015, average loans increased $37.2 million to $654.7 million from $617.5 million for the quarter ended March 31, 2014. During the quarter ended March 31, 2015, average investment securities available for sale decreased $26.9 million to $272.1 million from $299.0 million for the quarter ended March 31, 2014. The average yield on loans for the quarters ended March 31, 2015 and 2014 was 4.70% and 4.86%, respectively. The average yield on investment securities available for sale for the quarters ended March 31, 2015 and 2014 was 3.68% and 3.58%, respectively. The average yield on earning assets for the quarters ended March 31, 2015 and 2014 was 4.34% and 4.36%, respectively.

Interest expense decreased $227,000 or 20% for the three months ended March 31, 2015, compared to the same period one year ago. The decrease in interest expense was the result of lower cost of funds and a reduction in certificates of deposit. The average rate paid on interest-bearing checking and savings accounts was 0.11% for the quarter ended March 31, 2015, as compared to 0.13% for the same period one year ago. The average rate paid on certificates of deposit was 0.54% for the quarter ended March 31, 2015, as compared to 0.62% for the same period one year ago. The average rate paid on interest-bearing liabilities was 0.50% for the quarter ended March 31, 2015, as compared to 0.61% for the same period one year ago. During the quarter ended March 31, 2015, average certificates of deposit decreased $33.1 million to $186.3 million from $219.4 million for the quarter ended March 31, 2014.

The following table sets forth for each category of interest-earning assets and interest-bearing liabilities, the average amounts outstanding, the interest incurred on such amounts and the average rate earned or incurred for the three months ended March 31, 2015 and 2014. The table also sets forth the average rate earned on total interest-earning assets, the average rate paid on total interest-bearing liabilities, and the net yield on total average interest-earning assets for the same periods. Yield information does not give effect to changes in fair value that are reflected as a component of shareholders' equity. Yields and interest income on tax-exempt investments have been adjusted to a tax equivalent basis using an effective tax rate of 37.30% for securities that are both federal and state tax exempt and an effective tax rate of 32.30% for federal tax exempt securities. Non-accrual loans and the interest income that was recorded on non-accrual loans, if any, are included in the yield calculations for loans in all periods reported.

	Three months ended March 31, 2015			Three months ended March 31, 2014		
(Dollars in thousands)	Average Balance	Interest	Yield / Rate	Average Balance	Interest	Yield / Rate
Interest-earning assets:						
Loans receivable	$ 654,728	7,593	4.70%	$ 617,461	7,401	4.86%
Investments - taxable	97,143	621	2.59%	130,593	810	2.52%
Investments - nontaxable*	179,606	1,932	4.36%	173,999	1,913	4.46%
Other	16,802	10	0.24%	20,670	12	0.24%
Total interest-earning assets	948,279	10,156	4.34%	942,723	10,136	4.36%
Cash and due from banks	44,311			43,386		
Other assets	54,809			46,766		
Allowance for loan losses	(11,100)			(13,600)		
Total assets	$ 1,036,299			$ 1,019,275		
Interest-bearing liabilities:						
NOW, MMDA & savings deposits	$ 419,633	111	0.11%	$ 386,278	126	0.13%
Time deposits	186,266	247	0.54%	219,449	334	0.62%
FHLB borrowings	50,000	418	3.39%	65,000	545	3.40%
Trust preferred securities	20,619	97	1.91%	20,619	96	1.89%
Other	41,637	11	0.11%	43,555	10	0.09%
Total interest-bearing liabilities	718,155	884	0.50%	734,901	1,111	0.61%
Demand deposits	213,755			192,570		
Other liabilities	4,197			5,589		
Shareholders' equity	101,328			87,712		
Total liabilities and shareholder's equity	$ 1,037,435			$ 1,020,772		
Net interest spread		$ 9,272	3.84%		$ 9,025	3.75%

Net yield on interest-earning assets	3.97%	3.88%
Taxable equivalent adjustment		
Investment securities	$ 589	$ 591
Net interest income	$ 8,683	$ 8,434

*Includes U.S. Government agency securities that are non-taxable for state income tax purposes of $33.8 million in 2015 and $22.9 million in 2014. Tax rates of 5.00% and 6.00% were used to calculate the tax equivalent yield on these securities in 2015 and 2014, respectively.

Changes in interest income and interest expense can result from variances in both volume and rates. The following table presents the impact on the Company's tax equivalent net interest income resulting from changes in average balances and average rates for the periods indicated. The changes in interest due to both volume and rate have been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the changes in each.

(Dollars in thousands)	Three months ended March 31, 2015 compared to three months ended March 31, 2014 Changes in average volume	Changes in average rates	Total Increase (Decrease)	Three months ended March 31, 2014 compared to three months ended March 31, 2013 Changes in average volume	Changes in average rates	Total Increase (Decrease)
Interest income:						
Loans: Net of unearned income	$ 440	(248)	192	$ (44)	(195)	(239)
Investments - taxable	(231)	42	(189)	(77)	527	450
Investments - nontaxable	100	(81)	19	337	(1)	336
Other	(2)	-	(2)	(1)	1	-
Total interest income	307	(287)	20	215	332	547
Interest expense:						
NOW, MMDA & savings deposits	10	(25)	(15)	8	(100)	(92)
Time deposits	(47)	(40)	(87)	(40)	(93)	(133)
FHLB borrowings	(126)	(1)	(127)	(45)	(71)	(116)
Trust preferred securities	-	1	1	-	(4)	(4)
Other	-	1	1	2	(9)	(7)
Total interest expense	(163)	(64)	(227)	(75)	(277)	(352)
Net interest income	$ 470	(223)	247	$ 290	609	899

Provision for Loan Losses. The provision for loan losses for the three months ended March 31, 2015 was an expense of $173,000, as compared to a credit of $349,000 for the three months ended March 31, 2014. The increase in the provision for loan losses is primarily attributable to a $42.5 million increase in loans from March 31, 2014 to March 31, 2015 and a $238,000 increase in net charge-offs during the three months ended March 31, 2015, as compared to the same period one year ago.

Non-Interest Income. Total non-interest income was $3.2 million for the three months ended March 31, 2015, compared to $2.8 million for the three months ended March 31, 2014. The increase in non-interest income is primarily attributable to a $391,000 increase in miscellaneous non-interest income and a $135,000 increase in mortgage banking income. The increase in miscellaneous non-interest income is primarily due to $87,000 in net gains on other real estate owned properties for the three months ended March 31, 2015, as compared to $162,000 in net losses and write-downs on other real estate owned properties for the three months ended March 31, 2014.

Non-Interest Expense. Total non-interest expense was $8.7 million for the three months ended March 31, 2015, compared to $8.1 million for the three months ended March 31, 2014. The increase in non-interest expense was primarily due to a $525,000 increase in salaries and benefits expense resulting primarily from an increase in the number of full-time equivalent employees and annual salary increases combined with a $138,000 increase in other non-interest expenses primarily due to a $49,000 increase in foreclosed property expense and a $25,000 increase in legal fees, which were partially offset by a $38,000 decrease in occupancy expense during the three months ended March 31, 2015, as compared to the three months ended March 31, 2014.

Income Taxes. The Company reported income tax expense of $679,000 and $923,000 for the three months ended March 31, 2015 and 2014, respectively. This represented an effective tax rate of 23% and 26% for the respective periods.

Analysis of Financial Condition

Investment Securities. Available for sale securities were $282.6 million at March 31, 2015, compared to $281.1 million at December 31, 2014. Average investment securities available for sale for the three months ended March 31, 2015 were $272.1 million, compared to $287.4 million for the year ended December 31, 2014.

Loans. At March 31, 2015, loans were $660.5 million, compared to $651.9 million at December 31, 2014. The increase in loans is primarily attributable to a $10.8 million increase in commercial loans not secured by real estate. Loans originated or renewed during the three months ended March 31, 2015, of approximately $42.8 million, were offset by paydowns and payoffs of existing loans. Average loans represented 69% and 66% of average earning assets for the three months ended March 31, 2015 and the year ended December 31, 2014, respectively. The Company had $806,000 and $1.4 million in mortgage loans held for sale as of March 31, 2015 and December 31, 2014, respectively.

Although the Company has a diversified loan portfolio, a substantial portion of the loan portfolio is collateralized by real estate, which is dependent upon the real estate market. Real estate mortgage loans include both commercial and residential mortgage loans. At March 31, 2015, the Company had $105.7 million in residential mortgage loans, $89.7 million in home equity loans and $296.4 million in commercial mortgage loans, which include $238.2 million secured by commercial property and $58.2 million secured by residential property. Residential mortgage loans include $59.4 million made to customers in the Company's traditional banking offices and $46.3 million in mortgage loans originated in the Company's Latino banking offices. All residential mortgage loans are originated as fully amortizing loans, with no negative amortization.

At March 31, 2015, the Company had $57.0 million in construction and land development loans. The following table presents a breakout of these loans.

(Dollars in thousands)

	Number of Loans	Balance Outstanding	Non-accrual Balance
Land acquisition and development - commercial purposes	63	$ 11,827	$ 34
Land acquisition and development - residential purposes	262	29,531	531
1 to 4 family residential construction	54	11,430	-
Commercial construction	7	4,459	-
Total construction and land development	386	$ 57,247	$ 565

Total TDR loans amounted to $5.5 million and $15.0 million at March 31, 2015 and December 31, 2014, respectively. The terms of these loans have been renegotiated to provide a concession to original terms, including a reduction in principal or interest as a result of the deteriorating financial position of the borrower. There were $146,000 and $1.4 million in performing loans classified as TDR loans at March 31, 2015 and December 31, 2014, respectively.

Allowance for Loan Losses. The allowance for loan losses reflects management's assessment and estimate of the risks associated with extending credit and its evaluation of the quality of the loan portfolio. The Bank periodically analyzes the loan portfolio in an effort to review asset quality and to establish an allowance for loan losses that management believes will be adequate in light of anticipated risks and loan losses. In assessing the adequacy of the allowance, size, quality and risk of loans in the portfolio are reviewed. Other factors considered are:

- the Bank's loan loss experience;
- the amount of past due and non-performing loans;
- specific known risks;
- the status and amount of other past due and non-performing assets;
- underlying estimated values of collateral securing loans;
- current and anticipated economic conditions; and
- other factors which management believes affect the allowance for potential credit losses.

Management uses several measures to assess and monitor the credit risks in the loan portfolio, including a loan grading system that begins upon loan origination and continues until the loan is collected or collectability becomes doubtful. Upon loan origination, the Bank's originating loan officer evaluates the quality of the loan and assigns one of eight risk grades. The loan officer monitors the loan's performance and credit quality and makes changes to the credit grade as conditions warrant. When originated or renewed, all loans over a certain dollar amount receive in-depth reviews and risk assessments by the Bank's Credit Administration. Before making any changes in these risk grades, management considers assessments as determined by the third party credit review firm (as described below), regulatory examiners and the Bank's Credit Administration. Any issues regarding the risk assessments are addressed by the Bank's senior credit administrators and factored into management's decision to originate or renew the loan. The Bank's Board of Directors reviews, on a monthly basis, an analysis of the Bank's reserves relative to the range of reserves estimated by the Bank's Credit Administration.

As an additional measure, the Bank engages an independent third party to review the underwriting, documentation and risk grading analyses. This independent third party reviews and evaluates loan relationships greater than $1.0 million, excluding loans in default, and loans in process of litigation or liquidation. The third party's evaluation and report is shared with management and the Bank's Board of Directors.

Management considers certain commercial loans with weak credit risk grades to be individually impaired and measures such impairment based upon available cash flows and the value of the collateral. Allowance or reserve levels are estimated for all other graded loans in the portfolio based on their assigned credit risk grade, type of loan and other matters related to credit risk.

Management uses the information developed from the procedures described above in evaluating and grading the loan portfolio. This continual grading process is used to monitor the credit quality of the loan portfolio and to assist management in estimating the allowance for loan losses. The provision for loan losses charged or credited to earnings is based upon management's judgment of the amount necessary to maintain the allowance at a level appropriate to absorb probable incurred losses in the loan portfolio at the balance sheet date. The amount each quarter is dependent upon many factors, including growth and changes in the composition of the loan portfolio, net charge-offs, delinquencies, management's assessment of loan portfolio quality, the value of collateral, and other macro-economic factors and trends. The evaluation of these factors is performed quarterly by management through an analysis of the appropriateness of the allowance for loan losses.

The allowance for loan losses is comprised of three components: specific reserves, general reserves and unallocated reserves. After a loan has been identified as impaired, management measures impairment. When the measure of the impaired loan is less than the recorded investment in the loan, the amount of the impairment is recorded as a specific reserve. These specific reserves are determined on an individual loan basis based on management's current evaluation of the Bank's loss exposure for each credit, given the appraised value of any underlying collateral. Loans for which specific reserves are provided are excluded from the general allowance calculations as described below.

The general allowance reflects reserves established under GAAP for collective loan impairment. These reserves are based upon historical net charge-offs using the greater of the last two, three, four or five years' loss experience. This charge-off experience may be adjusted to reflect the effects of current conditions. The Bank considers information derived from its loan risk ratings and external data related to industry and general economic trends in establishing reserves.

The unallocated allowance is determined through management's assessment of probable losses that are in the portfolio but are not adequately captured by the other two components of the allowance, including consideration of current economic and business conditions and regulatory requirements. The unallocated allowance also reflects management's acknowledgement of the imprecision and subjectivity that underlie the modeling of credit risk. Due to the subjectivity involved in determining the overall allowance, including the unallocated portion, the unallocated portion may fluctuate from period to period based on management's evaluation of the factors affecting the assumptions used in calculating the allowance.

Effective December 31, 2012, stated income mortgage loans from the Banco de la Gente division of the Bank were analyzed separately from other single family residential loans in the Bank's loan portfolio. These loans are first mortgage loans made to the Latino market, primarily in Mecklenburg and surrounding counties. These loans are non-traditional mortgages in that the customer normally did not have a credit history, so all credit information was accumulated by the loan officers. These loans were made as stated income loans rather than full documentation loans because the customer may not have had complete documentation on the income supporting the loan.

Various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require adjustments to the allowance based on their judgments of information available to them at the time of their examinations. Management believes it has established the allowance for credit losses pursuant to GAAP, and has taken into account the views of its regulators and the current economic environment. Management considers the allowance for loan losses adequate to cover the estimated losses inherent in the Bank's loan portfolio as of the date of the financial statements. Although management uses the best information available to make evaluations, significant future additions to the allowance may be necessary based on changes in economic and other conditions, thus adversely affecting the operating results of the Company.

There were no significant changes in the estimation methods or fundamental assumptions used in the evaluation of the allowance for loan losses for the three months ended March 31, 2015 as compared to the three months ended March

31, 2014. Revisions, estimates and assumptions may be made in any period in which the supporting factors indicate that loss levels may vary from the previous estimates.

The allowance for loan losses at March 31, 2015 was $10.8 million or 1.64% of total loans, compared to $11.1 million or 1.70% of total loans at December 31, 2014.

The following table presents the percentage of loans assigned to each risk grade at March 31, 2015 and December 31, 2014.

Risk Grade	Percentage of Loans By Risk Grade 3/31/2015	12/31/2014
Risk Grade 1 (Excellent Quality)	2.03%	2.18%
Risk Grade 2 (High Quality)	23.44%	22.30%
Risk Grade 3 (Good Quality)	50.69%	50.76%
Risk Grade 4 (Management Attention)	16.36%	16.54%
Risk Grade 5 (Watch)	4.28%	4.62%
Risk Grade 6 (Substandard)	2.96%	3.30%
Risk Grade 7 (Doubtful)	0.00%	0.00%
Risk Grade 8 (Loss)	0.00%	0.00%

At March 31, 2015, including non-accrual loans, there were six relationships exceeding $1.0 million in the Watch risk grade (which totaled $14.2 million) and one relationship exceeding $1.0 million in the Substandard risk grade (which totaled $1.3 million). There was one relationship with loans in both the Watch and Substandard risk grades, which totaled $1.3 million for loans in both risk grades combined.

Non-performing Assets. Non-performing assets totaled $12.4 million at March 31, 2015 or 1.18% of total assets, compared to $12.7 million or 1.22% of total assets at December 31, 2014. Non-accrual loans were $8.9 million at March 31, 2015 and $10.7 million at December 31, 2014. As a percentage of total loans outstanding, non-accrual loans were 1.35% at March 31, 2015, compared to 1.65% at December 31, 2014. Non-accrual loans include $8.1 million in commercial and residential mortgage loans, $565,000 in construction and land development loans and $192,000 in other loans at March 31, 2015, compared to $6.6 million in commercial and residential mortgage loans, $3.9 million in construction and land development loans and $251,000 in other loans at December 31, 2014. The Bank did not have any loans 90 days past due and still accruing at March 31, 2015 and December 31, 2014. Other real estate totaled $3.4 million at March 31, 2015, compared to $2.0 million at December 31, 2014.

Deposits. Total deposits at March 31, 2015 were $830.0 million compared to $814.7 million at December 31, 2014. Core deposits, which include non-interest bearing demand deposits, NOW, MMDA, savings and non-brokered certificates of deposit of denominations less than $250,000, were $786.2 million at March 31, 2015 as compared to $755.8 million at December 31, 2014. Certificates of deposit in amounts of $250,000 or more totaled $36.2 million at March 31, 2015, as compared to $47.9 million at December 31, 2014. At March 31, 2015, brokered deposits were $7.5 million as compared to $11.1 million at December 31, 2014. Brokered deposits outstanding as of March 31, 2015 had a weighted average rate of 0.09% with a weighted average original term of 12 months as compared to brokered deposits outstanding at December 31, 2014, which had a weighted average rate of 0.13% with a weighted average original term of 11 months.

Borrowed Funds. Borrowings from the FHLB totaled $50.0 million at March 31, 2015 and December 31, 2014. The average balance of FHLB borrowings for the three months ended March 31, 2015 was $50.0 million, compared to $63.7 million for the year ended December 31, 2014. The FHLB borrowings outstanding at March 31, 2015 had interest rates ranging from 1.82% to 3.67% and maturity dates in 2018.

Securities sold under agreements to repurchase were $38.7 million at March 31, 2015 compared to $48.4 million at December 31, 2014.

Junior Subordinated Debentures (related to Trust Preferred Securities). In June 2006, the Company formed a wholly owned Delaware statutory trust, PEBK Capital Trust II ("PEBK Trust II"), which issued $20.0 million of guaranteed preferred beneficial interests in the Company's junior subordinated deferrable interest debentures. All of the common securities of PEBK Trust II are owned by the Company. The proceeds from the issuance of the common securities and the trust preferred securities were used by PEBK Trust II to purchase $20.6 million of junior subordinated debentures of the Company, which pay a floating rate equal to three-month LIBOR plus 163 basis points. The proceeds received by the Company from the sale of the junior subordinated debentures were used to repay in December 2006 the trust preferred securities issued in December 2001 by PEBK Capital Trust, a wholly owned Delaware statutory trust of the Company, and for general purposes. The debentures represent the sole asset of PEBK Trust II. PEBK Trust II is not included in the Consolidated Financial Statements.

The trust preferred securities issued by PEBK Trust II accrue and pay quarterly at a floating rate of three-month LIBOR plus 163 basis points. The Company has guaranteed distributions and other payments due on the trust preferred securities to the extent PEBK Trust II does not have funds with which to make the distributions and other payments. The net combined effect of the trust preferred securities transaction is that the Company is obligated to make the distributions and other payments required on the trust preferred securities.

These trust preferred securities are mandatorily redeemable upon maturity of the debentures on June 28, 2036, or upon earlier redemption as provided in the indenture. The Company has the right to redeem the debentures purchased by PEBK Trust II, in whole or in part, which right became effective on June 28, 2011. As specified in the indenture, if the debentures are redeemed prior to maturity, the redemption price will be the principal amount plus any accrued but unpaid interest.

Asset Liability and Interest Rate Risk Management. The objective of the Company's Asset Liability and Interest Rate Risk strategies is to identify and manage the sensitivity of net interest income to changing interest rates and to minimize the interest rate risk between interest-earning assets and interest-bearing liabilities at various maturities. This is to be done in conjunction with the need to maintain adequate liquidity and the overall goal of maximizing net interest income.

The Company manages its exposure to fluctuations in interest rates through policies established by our Asset/Liability Committee ("ALCO"). ALCO meets monthly and has the responsibility for approving asset/liability management policies, formulating and implementing strategies to improve balance sheet positioning and/or earnings and reviewing the interest rate sensitivity of the Company. ALCO tries to minimize interest rate risk between interest-earning assets and interest-bearing liabilities by attempting to minimize wide fluctuations in net interest income due to interest rate movements. The ability to control these fluctuations has a direct impact on the profitability of the Company. Management monitors this activity on a regular basis through analysis of its portfolios to determine the difference between rate sensitive assets and rate sensitive liabilities.

The Company's rate sensitive assets are those earning interest at variable rates and those with contractual maturities within one year. Rate sensitive assets therefore include both loans and available for sale securities. Rate sensitive liabilities include interest-bearing checking accounts, money market deposit accounts, savings accounts, time deposits and borrowed funds. Average rate sensitive assets for the three months ended March 31, 2015 totaled $948.3 million, exceeding average rate sensitive liabilities of $718.2 million by $230.1 million.

The Company has 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. By using derivative instruments, the Company is exposed to credit and market risk. If the counterparty fails to perform, credit risk is equal to the extent of the fair-value gain in the derivative. The Company minimizes the credit risk in derivative instruments by entering into transactions with high-quality counterparties that are reviewed periodically by the Company. The Company did not have any interest rate derivatives outstanding as of March 31, 2015.

Included in the rate sensitive assets are $292.5 million in variable rate loans indexed to prime rate subject to immediate repricing upon changes by the Federal Open Market Committee ("FOMC"). The Company utilizes interest rate floors on certain variable rate loans to protect against further downward movements in the prime rate. At March 31, 2015, the Company had $192.6 million in loans with interest rate floors. The floors were in effect on $190.2 million of these loans pursuant to the terms of the promissory notes on these loans. The weighted average rate on these loans is 0.91% higher than the indexed rate on the promissory notes without interest rate floors.

Liquidity. The objectives of the Company's liquidity policy are to provide for the availability of adequate funds to meet the needs of loan demand, deposit withdrawals, maturing liabilities and to satisfy regulatory requirements. Both deposit and loan customer cash needs can fluctuate significantly depending upon business cycles, economic conditions and yields and returns available from alternative investment opportunities. In addition, the Company's liquidity is affected by off-balance sheet commitments to lend in the form of unfunded commitments to extend credit and standby letters of credit. As of March 31, 2015, such unfunded commitments to extend credit were $170.9 million, while commitments in the form of standby letters of credit totaled $4.1 million.

The Company uses several sources to meet its liquidity requirements. The primary source is core deposits, which includes demand deposits, savings accounts and non-brokered certificates of deposit of denominations less than $250,000. The Company considers these to be a stable portion of the Company's liability mix and the result of on-going consumer and commercial banking relationships. As of March 31, 2015, the Company's core deposits totaled $786.2 million, or 95% of total deposits.

The other sources of funding for the Company are through large denomination certificates of deposit, including brokered deposits, federal funds purchased, securities under agreements to repurchase and FHLB borrowings. The Bank is also able to borrow from the Federal Reserve Bank ("FRB") on a short-term basis. The Company's policies include the ability to access wholesale funding of up to 40% of total assets. The Company's wholesale funding includes FHLB borrowings, FRB borrowings, brokered deposits, internet certificates of deposit and certificates of deposit issued to the State of North Carolina. The Company's ratio of wholesale funding to total assets was 5.52% as of March 31, 2015.

The Bank has a line of credit with the FHLB equal to 20% of the Bank's total assets, with an outstanding balance of $50.0 million at March 31, 2015 and December 31, 2014. At March 31, 2015, the carrying value of loans pledged as collateral to the FHLB totaled $122.4 million compared to $126.0 million at December 31, 2014. The remaining availability under the line of credit with the FHLB was $25.1 million at March 31, 2015 compared to $27.7 million at December 31, 2014. The Bank had no borrowings from the FRB at March 31, 2015 or December 31, 2014. FRB borrowings are collateralized by a blanket assignment on all qualifying loans that the Bank owns which are not pledged to the FHLB. At March 31, 2015, the carrying value of loans pledged as collateral to the FRB totaled $354.6 million compared to $340.5 million at December 31, 2014.

The Bank also had the ability to borrow up to $54.5 million for the purchase of overnight federal funds from five correspondent financial institutions as of March 31, 2015.

The liquidity ratio for the Bank, which is defined as net cash, interest-bearing deposits, federal funds sold and certain investment securities, as a percentage of net deposits and short-term liabilities was 32.05% at March 31, 2015 and 31.76% at December 31, 2014. The minimum required liquidity ratio as defined in the Bank's Asset/Liability and Interest Rate Risk Management Policy was 10% at March 31, 2015 and December 31, 2014.

Contractual Obligations and Off-Balance Sheet Arrangements. The Company's contractual obligations and other commitments as of March 31, 2015 and December 31, 2014 are summarized in the table below. The Company's contractual obligations include the repayment of principal and interest related to FHLB advances and junior subordinated debentures, as well as certain payments under current lease agreements. Other commitments include commitments to extend credit. Because not all of these commitments to extend credit will be drawn upon, the actual cash requirements are likely to be significantly less than the amounts reported for other commitments below.

(Dollars in thousands)

		March 31, 2015	December 31, 2014
Contractual Cash Obligations			
Long-term borrowings	$	50,000	50,000
Junior subordinated debentures		20,619	20,619
Operating lease obligations		4,436	4,585
Total	$	75,055	75,204
Other Commitments			
Commitments to extend credit	$	170,894	168,733
Standby letters of credit and financial guarantees written		4,064	3,911
Total	$	174,958	172,644

The Company enters into derivative contracts to manage various financial risks. A derivative is a financial instrument that derives its cash flows, and therefore its value, by reference to an underlying instrument, index or referenced interest rate. Derivative contracts are carried at fair value on the consolidated balance sheet with the fair value representing the net present value of expected future cash receipts or payments based on market interest rates as of the balance sheet date. Derivative contracts are written in amounts referred to as notional amounts, which only provide the basis for calculating payments between counterparties and are not a measure of financial risk. Further discussions of derivative instruments are included above in the section entitled "Asset Liability and Interest Rate Risk Management".

Capital Resources. Shareholders' equity was $101.5 million, or 9.7% of total assets, as of March 31, 2015, compared to $88.4 million, or 8.5% of total assets, as of March 31, 2014. This increase is primarily due to an increase in retained earnings and an increase in accumulated other comprehensive income resulting from an increase in the unrealized gain on investment securities.

Annualized return on average equity for the three months ended March 31, 2015 was 9.32% compared to 11.92% for the three months ended March 31, 2014. Total cash dividends paid on common stock were $341,000 and $227,000 for the three months ended March 31, 2015 and 2014, respectively.

The Board of Directors, at its discretion, can issue shares of preferred stock up to a maximum of 5,000,000 shares. The Board is authorized to determine the number of shares, voting powers, designations, preferences, limitations and relative rights. The Board of Directors does not currently anticipate issuing any additional series of preferred stock.

In 2014, the Company's Board of Directors authorized a stock repurchase program, pursuant to which up to $2 million will be allocated to repurchase the Company's common stock. Any purchases under the Company's stock repurchase program may be made periodically as permitted by securities laws and other legal requirements in the open market or in privately negotiated transactions. The timing and amount of any repurchase of shares will be determined by the Company's management, based on its evaluation of market conditions and other factors. The repurchase program may be suspended at any time or from time-to-time without prior notice. The Company has repurchased $82,000, or 4,537 shares, of its common stock under this program as of March 31, 2015.

In 2013, the Federal Reserve Board approved its final rule on the Basel III capital standards, which implement changes to the regulatory capital framework for banking organizations. The Basel III capital standards, which became effective January 1, 2015, include new risk-based capital and leverage ratios, which will be phased in from 2015 to 2019. The new minimum capital level requirements applicable to the Company and the Bank under the final rules are as follows: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6% (increased from 4%); (iii) a total risk based capital ratio of 8% (unchanged from previous rules); and (iv) a Tier 1 leverage ratio of 4% (unchanged from previous rules). An additional capital conservation buffer will be added to the minimum requirements for capital adequacy purposes beginning on January 1, 2016 at 0.625% and will be phased in through 2019 (increasing by 0.625% on each subsequent January 1, until it reaches 2.5% on January 1, 2019). This will result in the following minimum ratios beginning in 2019: (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. Under the final rules, institutions would be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained earnings that could be utilized for such actions.

Under the regulatory capital guidelines, financial institutions are currently required to maintain a total risk-based capital ratio of 8.0% or greater, with a Tier 1 risk-based capital ratio of 6.0% or greater and a common equity Tier 1 capital ratio of 4.5% or greater, as required by Basel III capital standards referenced above. Tier 1 capital is generally defined as shareholders’ equity and trust preferred securities less all intangible assets and goodwill. Tier 1 capital at March 31, 2015 and December 31, 2014 includes $20.0 million in trust preferred securities. The Company’s Tier 1 capital ratio was 15.07% and 15.33% at March 31, 2015 and December 31, 2014, respectively. Total risk-based capital is defined as Tier 1 capital plus supplementary capital. Supplementary capital, or Tier 2 capital, consists of the Company’s allowance for loan losses, not exceeding 1.25% of the Company’s risk-weighted assets. Total risk-based capital ratio is therefore defined as the ratio of total capital (Tier 1 capital and Tier 2 capital) to risk-weighted assets. The Company’s total risk-based capital ratio was 16.36% and 16.62% at March 31, 2015 and December 31, 2014, respectively. The Company's common equity Tier 1 capital consists of common stock and retained earnings. The Company's common equity Tier 1 capital ration was 12.45% and 12.62% at March 31, 2015 and December 31, 2014, respectively. Financial institutions are also required to maintain a leverage ratio of Tier 1 capital to total average assets of 4.0% or greater. The Company’s Tier 1 leverage capital ratio was 11.12% and 10.74% at March 31, 2015 and December 31, 2014, respectively.

The Bank’s Tier 1 risk-based capital ratio was 14.60% and 14.78% at March 31, 2015 and December 31, 2014, respectively. The total risk-based capital ratio for the Bank was 15.88% and 16.06% at March 31, 2015 and December 31, 2014, respectively. The Bank's common equity Tier 1 capital ratio was 14.60% and 14.78% at March 31, 2015 and December 31, 2014, respectively. The Bank’s Tier 1 leverage capital ratio was 10.75% and 10.33% at March 31, 2015 and December 31, 2014, respectively.

A bank is considered to be “well capitalized” if it has a total risk-based capital ratio of 10.0 % or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, a common equity Tier 1 capital ratio of 6.5% or greater and a leverage ratio of 5.0% or greater. Based upon these guidelines, the Bank was considered to be “well capitalized” at March 31, 2015.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not required for smaller reporting companies.

Item 4T. Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act.

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On April 2, 2013, the Bank received notice that a lawsuit was filed against it in the General Court of Justice, Superior Court Division, Lincoln County, North Carolina. The complaint alleges (i) breach of contract and the covenants of good faith and fair dealing by the Bank, (ii) conversion, (iii) unjust enrichment and (iv) violations of the North Carolina Unfair and Deceptive Trade Practices Act in its assessment and collection of overdraft fees. It seeks the refund of overdraft fees, treble damages, attorneys' fees and injunctive relief. The Plaintiff seeks to have the lawsuit certified as a class action. The Court has not acted on that request. The Bank has filed, briefed and argued to the Court a motion for summary judgment. The Court has not ruled on that motion. The Bank continues to believe that the allegations in the complaint are without merit and intends to vigorously defend the lawsuit, including the request that the lawsuit be certified as a class action.

Item 1A. Risk Factors

Not required for smaller reporting companies.

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

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs (2)
January 1 - 31, 2015	527	$ 18.97	-	$ 1,917,648
February 1 - 28, 2015	715	18.97	-	$ 1,917,648
March 1 - 31, 2015	-	-	-	$ 1,917,648

Total	1,242	(1)	$ 18.91	-

(1) The Company purchased 1,242 shares on the open market in the three months ended March 31, 2015 for its deferred compensation plan. All purchases were funded by participant contributions to the plan.

(2) Reflects dollar value of shares that may yet be purchased under the Stock Repurchase Plan authorized by the Company's Board of Directors in 2014.

Item 3. Defaults Upon Senior Securities

Not applicable

Item 5. Other Information

Not applicable

Item 6. Exhibits

Exhibit (3)(i)(a) Articles of Incorporation of the Registrant, incorporated by reference to Exhibit (3)(i) to the Form 8-A filed with the Securities and Exchange Commission on September 2, 1999

Exhibit (3)(i)(b) Articles of Amendment dated December 19, 2008, regarding the Series A Preferred Stock, incorporated by reference to Exhibit (3)(1) to the Form 8-K filed with the Securities and Exchange Commission on December 29, 2008

Exhibit (3)(i)(c) Articles of Amendment dated February 26, 2010, incorporated by reference to Exhibit (3)(2) to the Form 10-K filed with the Securities and Exchange Commission on March 25, 2010

Exhibit (3)(ii) Amended and Restated Bylaws of the Registrant, incorporated by reference to Exhibit (3)(ii) to the Form 10-K filed with the Securities and Exchange Commission on March 25, 2010

Exhibit (4) Specimen Stock Certificate, incorporated by reference to Exhibit (4) to the Form 8-A filed with the Securities and Exchange Commission on September 2, 1999

Exhibit (10)(i) Amended and Restated Executive Salary Continuation Agreement between Peoples Bank and Tony W. Wolfe dated December 18, 2008, incorporated by reference to Exhibit (10)(a)(iii) to the Form 8-K filed with the Securities and Exchange Commission on December 29, 2008

Exhibit (10)(ii) Employment Letter Agreement dated December 23, 2008 between the Registrant and Joseph F. Beaman, Jr., incorporated by reference to Exhibit (10(b)(i) to the Form 8-K filed with the Securities and Exchange Commission on December 29, 2008

Exhibit (10)(iii) Amendment to Employment Agreement between Peoples Bank and Joseph F. Beaman, Jr. dated December 18, 2008, incorporated by reference to Exhibit (10)(b)(ii) to the Form 8-K filed with the Securities and Exchange Commission on December 29, 2008

Exhibit (10)(iv) Amended and Restated Executive Salary Continuation Agreement between Peoples Bank and Joseph F. Beaman, Jr. dated December 18, 2008, incorporated by reference to Exhibit (10)(b)(iii) to the Form 8-K filed with the Securities and Exchange Commission on December 29, 2008

Exhibit (10)(v)	Amended and Restated Executive Salary Continuation Agreement between Peoples Bank and William D. Cable, Sr. dated December 18, 2008, incorporated by reference to Exhibit (10)(c)(iii) to the Form 8-K filed with the Securities and Exchange Commission on December 29, 2008
Exhibit (10)(vi)	Employment agreement dated January 22, 2015 between the Registrant and William D. Cable, Sr., incorporated by reference to Exhibit (10)(c) to the Form 8-K filed with the Securities and Exchange Commission on February 9, 2015
Exhibit (10)(vii)	Amended and Restated Executive Salary Continuation Agreement between Peoples Bank and Lance A. Sellers dated December 18, 2008, incorporated by reference to Exhibit (10)(d)(iii) to the Form 8-K filed with the Securities and Exchange Commission on December 29, 2008
Exhibit (10)(viii)	Employment agreement dated January 22, 2015 between the Registrant and Lance A. Sellers, incorporated by reference to Exhibit (10)(a) to the Form 8-K filed with the Securities and Exchange Commission on February 9, 2015
Exhibit (10)(ix)	Peoples Bancorp of North Carolina, Inc. Omnibus Stock Ownership and Long Term Incentive Plan incorporated by reference to Exhibit (10)(f) to the Form 10-K filed with the Securities and Exchange Commission on March 30, 2000

Exhibit (10)(x)	Amendment No. 1 to the Peoples Bancorp of North Carolina, Inc. Omnibus Stock Ownership and Long Term Incentive Plan incorporated by reference to Exhibit (10)(e)(i) to the Form 10-K filed with the Securities and Exchange Commission on March 15, 2007
Exhibit (10)(xi)	Amended and Restated Executive Salary Continuation Agreement between Peoples Bank and A. Joseph Lampron, Jr. dated December 18, 2008, incorporated by reference to Exhibit (10)(f)(iii) to the Form 8-K filed with the Securities and Exchange Commission on December 29, 2008
Exhibit (10)(xii)	Employment agreement dated January 22, 2015 between the Registrant and A. Joseph Lampron, Jr., incorporated by reference to Exhibit (10)(b) to the Form 8-K filed with the Securities and Exchange Commission on February 9, 2015
Exhibit (10)(xiii)	Peoples Bank Directors' and Officers' Deferral Plan, incorporated by reference to Exhibit (10)(h) to the Form 10-K filed with the Securities and Exchange Commission on March 28, 2002
Exhibit (10)(xiv)	Rabbi Trust for the Peoples Bank Directors' and Officers' Deferral Plan, incorporated by reference to Exhibit (10)(i) to the Form 10-K filed with the Securities and Exchange Commission on March 28, 2002
Exhibit (10)(xv)	Description of Service Recognition Program maintained by Peoples Bank, incorporated by reference to Exhibit (10)(i) to the Form 10-K filed with the Securities and Exchange Commission on March 27, 2003
Exhibit (10)(xvi)	Capital Securities Purchase Agreement dated as of June 26, 2006, by and among the Registrant, PEBK Capital Trust II and Bear, Sterns Securities Corp., incorporated by reference to Exhibit (10)(j) to the Form 10-Q filed with the Securities and Exchange Commission on November 13, 2006
Exhibit (10)(xvii)	Amended and Restated Trust Agreement of PEBK Capital Trust II, dated as of June 28, 2006, incorporated by reference to Exhibit (10)(k) to the Form 10-Q filed with the Securities and Exchange Commission on November 13, 2006
Exhibit (10)(xviii)	Guarantee Agreement of the Registrant dated as of June 28, 2006, incorporated by reference to Exhibit (10)(l) to the Form 10-Q filed with the Securities and Exchange Commission on November 13, 2006

Exhibit (10)(xix)	Indenture, dated as of June 28, 2006, by and between the Registrant and LaSalle Bank National Association, as Trustee, relating to Junior Subordinated Debt Securities Due September 15, 2036, incorporated by reference to Exhibit (10)(m) to the Form 10-Q filed with the Securities and Exchange Commission on November 13, 2006
Exhibit (10)(xx)	Form of Amended and Restated Director Supplemental Retirement Agreement between Peoples Bank and Directors Robert C. Abernethy, James S. Abernethy, Douglas S. Howard, John W. Lineberger, Jr., Gary E. Matthews, Dr. Billy L. Price, Jr., Larry E. Robinson, W. Gregory Terry, Dan Ray Timmerman, Sr. and Benjamin I. Zachary, incorporated by reference to Exhibit (10)(n) to the Form 8-K filed with the Securities and Exchange Commission on December 29, 2008
Exhibit (10)(xxi)	2009 Omnibus Stock Ownership and Long Term Incentive Plan incorporated by reference to Exhibit (10)(o) to the Form 10-K filed with the Securities and Exchange Commission on March 20, 2009
Exhibit (14)	Code of Business Conduct and Ethics of Peoples Bancorp of North Carolina, Inc., incorporated by reference to Exhibit (14) to the Form 10-K filed with the Securities and Exchange Commission on March 25, 2005

Exhibit (31)(a)	Certification of principal executive officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002
Exhibit (31)(b)	Certification of principal financial officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002
Exhibit (32)	Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit (101)	The following materials from the Company's 10-Q Report for the quarterly period ended March 31, 2015, formatted in XBRL: (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Income, (iii) the Condensed Consolidated Statements of Changes in Shareholders' Equity, (iv) the Condensed Consolidated Statements of Cash Flows, and (v) the Notes to the Condensed Consolidated Financial Statements, tagged as blocks of text.*

*Furnished, not filed.

SIGNATURES

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

	Peoples Bancorp of North Carolina, Inc.
May 8, 2015 Date	/s/ Lance A. Sellers Lance A. Sellers President and Chief Executive Officer (Principal Executive Officer)
May 8, 2015 Date	/s/ A. Joseph Lampron, Jr. A. Joseph Lampron, Jr. Executive Vice President and Chief Financial Officer (Principal Financial and Principal Accounting Officer)

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Our ability to assess the creditworthiness of our customers may be impaired if the models and approaches we use to select, manage, and underwrite our customers become less predictive of future charge-offs.

· Collateral for loans made by the Bank, especially real estate, may continue to decline in value, in turn reducing a client's borrowing power, and reducing the value of assets and collateral associated with our loans held for investment.

· Consumer confidence levels may decline and cause adverse changes in payment patterns, resulting in increased delinquencies and default rates on loans and other credit facilities and decreased demand for our products and services.

· Performance of the underlying loans in the private label mortgage backed securities may continue to deteriorate as the recession continues potentially causing further other-than-temporary impairment markdowns to our investment portfolio.

We may suffer losses in our loan portfolio in excess of our allowance for loan losses.

We have experienced increases in the levels of our nonperforming assets and loan charge-offs in recent periods. Our total nonperforming assets amounted to $13.4 million, or 1.6% of our total assets, at September 30, 2009, up from $5.2 million or 0.7% of our total assets, at December 31, 2008. We had $3.3 million of net loan charge-offs for the first nine months of 2009, compared to $966,000 in net loan charge-offs for the entire year ended December 31, 2008. Our provision for loan losses was $5.5 million for the year-to-date period ended September 30, 2009, compared to $2.2 million for the entire year ended December 31, 2008. At September 30, 2009, the ratio of our allowance for loan losses to nonperforming loans was 83.1% and the ratio of our allowance for loan losses to total loans was 1.4%. Additional increases in our nonperforming assets or loan charge-offs may have an adverse effect upon our future results of operations.

We seek to mitigate the risks inherent in our loan portfolio by adhering to specific underwriting practices. These practices include analysis of a borrower's prior credit history, financial statements, tax returns and cash flow projections, valuation of collateral based on reports of independent appraisers and verification of liquid assets. Although we believe that our underwriting criteria are appropriate for the various kinds of loans we make, we may incur losses on loans that meet our underwriting criteria, and these losses may exceed the amounts set aside as reserves in our allowance for loan losses. We create an allowance for estimated loan losses in our accounting records, based on estimates of the following:

· Industry historical losses as reported by the FDIC;

· Historical experience with our loans;

· Evaluation of economic conditions;

· Regular reviews of the quality, mix and size of the overall loan portfolio;

· Regular reviews of delinquencies; and

· The quality of the collateral underlying our loans.

Although we maintain an allowance for loan losses at a level that we believe is adequate to absorb losses inherent in our loan portfolio, changes in economic, operating and other conditions, including the sharp decline in real estate values and changes in interest rates, which are beyond our control, may cause our actual loan losses to exceed our current allowance estimates. If the actual loan losses exceed the amount reserved, it will adversely affect our financial condition and results of operations.

In addition, the Federal Reserve Board and the DFI as part of their supervisory function, periodically review our allowance for loan losses. Either agency may require us to increase our provision for loan losses or to recognize further loan losses, based on their judgments, which may be different from those of our management. Any increase in the allowance required by them could also adversely affect our financial condition and results of operations.

Deteriorating economic conditions in California may cause us to suffer higher default rates on our loans and reduce the value of the assets we hold as collateral.

Our business activities and credit exposure are concentrated in Southern California. As a result, the continued deterioration in economic conditions in Southern California may cause us to incur losses associated with higher default rates and decreased collateral values in our loan portfolio. In addition, demand for our products and services may decline. The significant decline in the Southern California real estate market could hurt our business because the vast majority of our loans are secured by real estate located within Southern California. As of September 30, 2009, approximately 92% of our loan portfolio consisted of loans secured by real estate located in Southern California. As real estate values continue to decline, especially in Southern California, the collateral for our loans provide less security. As a result, our ability to recover on defaulted loans by selling the underlying real estate would be diminished, and we would be more likely to suffer losses on defaulted loans.

Our level of credit risk is increasing due to our focus on commercial lending and the concentration on small businesses customers with heightened vulnerability to economic conditions.

As of September 30, 2009, our largest outstanding commercial business loan was $3.0 million, which is fully committed as of such date and our largest outstanding commercial real estate loan was $11.6 million. At such date, our commercial real estate loans amounted to $437.5 million, or 74.8% of our total loan portfolio, and our commercial business loans amounted to $28.8 million, or 4.9% of our total loan portfolio. Commercial real estate and commercial business loans generally are considered riskier than single-family residential loans because they have larger balances to a single borrower or group of related borrowers. Commercial real estate and commercial business loans involve risks because the borrowers' ability to repay the loans typically depends primarily on the successful operation of the businesses or the properties securing the loans. Most of the Bank's commercial business loans are made to small business or middle market customers who may have a heightened vulnerability to economic conditions. Moreover, a portion of these loans have been made or acquired by us in recent years and the borrowers may not have experienced a complete business or economic cycle. Furthermore, the deterioration of our borrowers' businesses may hinder their ability to repay their loans with us, which could adversely affect our results of operations.

Nonperforming assets take significant time to resolve and adversely affect our results of operations and financial condition.

Nonperforming assets adversely affect our net income in various ways. Until economic and market conditions improve, we may expect to continue to incur losses relating to an increase in nonperforming assets. We generally do not record interest income on nonperforming loans or other real estate owned, thereby adversely affecting our income, and increasing our loan administration costs. When we take collateral in foreclosures and similar proceedings, we are required to mark the related asset to the then fair market value of the collateral, which may ultimately result in a loss. An increase in the level of nonperforming assets increases our risk profile and may impact the capital levels our regulators believe are appropriate in light of the ensuing risk profile. While we reduce problem assets through loan sales, workouts, restructurings and otherwise, decreases in the value of the underlying collateral, or in these borrowers' performance or financial condition, whether or not due to economic and market conditions beyond our control, could adversely affect our business, results of operations and financial condition. In addition, the resolution of nonperforming assets requires significant commitments of time from management and our directors, which can be detrimental to the performance of their other responsibilities. There can be no assurance that we will not experience future increases in nonperforming assets.

We may be unable to successfully compete in our industry.

We face direct competition from a significant number of financial institutions, many with a state-wide or regional presence, and in some cases, a national presence, in both originating loans and attracting deposits. Competition in originating loans comes primarily from other banks and mortgage companies that make loans in our primary market areas. We also face substantial competition in attracting deposits from other banking institutions, money market and mutual funds, credit unions and other investment vehicles. In addition banks with larger capitalizations and non-bank financial institutions that are not governed by bank regulatory restrictions have larger lending limits and are better able to serve the needs of larger customers. Many of these financial institutions are also significantly larger and have greater financial resources than we have, and have established customer bases and name recognition. We compete for loans principally on the basis of interest rates and loan fees, the types of loans that we originate and the quality of service that we provide to our borrowers. Our ability to attract and retain deposits requires that we provide customers with competitive investment opportunities with respect to rate of return, liquidity, risk and other factors. To effectively compete, we may have to pay higher rates of interest to attract deposits, resulting in reduced profitability. In addition, we rely upon local promotional activities, personal relationships established by our officers, directors and employees and specialized services tailored to meet the individual needs of our customers in order to compete. If we are not able to effectively compete in our market area, our profitability may be negatively affected.

Interest rate fluctuations, which are out of our control, could harm profitability.

Our profitability depends to a large extent upon net interest income, which is the difference between interest income on interest-earning assets, such as loans and investments, and interest expense on interest-bearing liabilities, such as deposits and borrowings. Any change in general market interest rates, whether as a result of changes in the monetary policy of the Federal Reserve Board or otherwise, may have a significant effect on net interest income. The assets and liabilities may react differently to changes in overall interest rates or conditions. In general, higher interest rates are associated with a lower volume of loan originations while lower interest rates are usually associated with higher loan originations. Further, if interest rates decline, our loans may be refinanced at lower rates or paid off and our investments may be prepaid earlier than expected. If that occurs, we may have to redeploy the loan or investment proceeds into lower yielding assets, which might also decrease our income. Also, as many of our loans currently have interest rate floors, a rise in rates may increase the cost of our deposits while the rates on the loans remain at the floor, which could decrease our margin. Accordingly, changes in levels of market interest rates could materially and adversely affect our net interest margin, asset quality and loan origination volume.

Adverse outcomes of litigation against us could harm our business and results of operations.

We are currently involved in litigation relating to the origination of certain subprime mortgages that prior management purchased on the secondary market (and later sold), as well as other actions arising in the ordinary course of business. A significant judgment against us in connection with any pending or future litigation could harm our business and results of operations.

Changes in the fair value of our securities may reduce our stockholders’ equity and net income.

At September 30, 2009, $101.7 million of our securities were classified as available for sale and had an aggregate net unrealized loss of $3.2 million. We increase or decrease stockholders’ equity by the amount of change from the unrealized gain or loss (the difference between the estimated fair value and the amortized cost) of our available-for-sale securities portfolio, net of the related tax, under the category of accumulated other comprehensive income/loss. Therefore, a decline in the estimated fair value of this portfolio will result in a decline in reported stockholders' equity, as well as book value per common share and tangible book value per common share. This decrease will occur even though the securities are not sold. In the case of debt securities, if these securities are never sold and there are no credit impairments, the decrease will be recovered over the life of the securities. In the case of equity securities which have no stated maturity, the declines in fair value may or may not be recovered over time.

For the year ended December 31, 2008, we reported a non-cash other-than-temporary impairment charge of $1.3 million on our securities portfolio. We continue to monitor the fair value of our entire securities portfolio as part of our ongoing other-than-temporary impairment evaluation process. No assurance can be given that we will not need to recognize additional other-than-temporary impairment charges related to securities in the future. In addition, as a condition to membership in the FHLB of San Francisco, we are required to purchase and hold a certain amount of FHLB stock. Our stock purchase requirement is based, in part, upon the outstanding principal balance of advances from the FHLB. At September 30, 2009, we had stock in the FHLB of San Francisco totaling $12.7 million. The FHLB stock held by us is carried at cost and is subject to recoverability testing under applicable accounting standards. The FHLB has discontinued the repurchase of their stock and discontinued the distribution of dividends. For the nine months ended September 30, 2009, we did not recognize an impairment charge related to our FHLB stock holdings. There can be no assurance, however, that future negative changes to the financial condition of the FHLB may not require us to recognize an impairment charge with respect to such holdings.

Conditions in the financial markets may limit our access to additional funding to meet our liquidity needs.

Liquidity is essential to our business, as we must maintain sufficient funds to respond to the needs of depositors and borrowers. An inability to raise funds through deposits, repurchase agreements, federal funds purchased, FHLB advances, the sale or pledging as collateral of loans and other assets could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could negatively affect our access to liquidity sources include negative operating results, a decrease in the level of our business activity due to a market downturn or negative regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as severe disruption of the financial markets or negative news and expectations about the prospects for the financial services industry as a whole, as evidenced by recent turmoil in the domestic and worldwide credit markets.

The soundness of other financial institutions could negatively affect us.

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

Changes in laws, government regulation and monetary policy may have a material effect on our results of operations.

Financial institutions have been the subject of substantial legislative and regulatory changes and may be the subject of further legislation or regulation in the future, none of which is within our control. Significant new laws or regulations or changes in, or repeals of, existing laws or regulations may cause our results of operations to differ materially. In addition, the cost and burden of compliance with applicable laws and regulations have significantly increased and could adversely affect our ability to operate profitably. Further, federal monetary policy significantly affects credit conditions for us, as well as for our borrowers, particularly as implemented by the Federal Reserve Board, primarily through open market operations in U.S. government securities, the discount rate for bank borrowings and reserve requirements. A material change in any of these conditions could have a material impact on us or our borrowers, and therefore on our results of operations.

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 ("EESA") was signed into law. Pursuant to the EESA, the U.S. Department of the Treasury ("the Treasury") was granted the authority to take a range of actions for the purpose of stabilizing and providing liquidity to the U.S. financial markets and has proposed several programs, including the purchase by the Treasury of certain troubled assets from financial institutions and the direct purchase by the Treasury of equity of financial institutions. There can be no assurance, however, as to the actual impact that the foregoing or any other governmental program will have on the financial markets. The failure of the financial markets to stabilize and a continuation or worsening of current financial market conditions could materially and adversely affect our business, financial condition, results of operations, access to credit or the trading price of our common stock. In addition, current initiatives of President Obama's Administration and the possible enactment of recently proposed bankruptcy legislation may adversely affect our financial condition and results of operations. There can be no assurance, however, as to the actual impact that the foregoing or any other governmental program will have on the financial markets. The failure of the financial markets to stabilize and a continuation or worsening of current financial market conditions could materially and adversely affect our business, financial condition, results of operations, access to credit or the trading price of our common stock.

We expect to face increased regulation and supervision of our industry as a result of the existing financial crisis, and there will be additional requirements and conditions imposed on us to the extent that we participate in any of the programs established or to be established by the Treasury or by the federal bank regulatory agencies. Such additional regulation and supervision may increase our costs and limit our ability to pursue business opportunities. The affects of such recently enacted, and proposed, legislation and regulatory programs on us cannot reliably be determined at this time.

Confidential customer information transmitted through the Bank's online banking service is vulnerable to security breaches and computer viruses, which could expose the Bank to litigation and adversely affect its reputation and ability to generate deposits.

The Bank provides its customers the ability to bank online. The secure transmission of confidential information over the Internet is a critical element of online banking. The Bank's network could be vulnerable to unauthorized access, computer viruses, phishing schemes and other security problems. The Bank may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses. To the extent that the Bank's activities or the activities of its customers involve the storage and transmission of confidential information, security breaches and viruses could expose the Bank to claims, litigation and other possible liabilities. Any inability to prevent security breaches or computer viruses could also cause existing customers to lose confidence in the Bank's systems and could adversely affect its reputation and our ability to generate deposits.

We are dependent on our key personnel.

Our future operating results depend in large part on the continued services of our key personnel, including Steven R. Gardner, our President and Chief Executive Officer, who developed and implemented our new business strategy in late 2000. The loss of Mr. Gardner could have a negative impact on the success of our business strategy. In addition, we rely upon the services of Eddie Wilcox, our Executive Vice President and Chief Banking Officer, and our ability to attract and retain highly skilled personnel. We do not maintain key-man life insurance on any employee other than Mr. Gardner. We cannot assure you that we will be able to continue to attract and retain the qualified personnel necessary for the development of our business.

Potential acquisitions may disrupt our business and dilute stockholder value.

We have evaluated merger and acquisition opportunities and conduct due diligence activities related to possible transactions with other financial institutions. As a result, merger or acquisition discussions and, in some cases, negotiations may take place and future mergers or acquisitions involving cash, debt or equity securities may occur at any time. Acquisitions typically involve the payment of a premium over book and market values, and, therefore, some dilution of our stock's tangible book value and net income per common share may occur in connection with any future transaction. Furthermore, failure to realize the expected revenue increases, cost savings, increases in geographic or product presence, and/or other projected benefits from an acquisition could have a material adverse effect on our financial condition and results of operations.

We may seek merger or acquisition partners that are culturally similar and have experienced management and possess either significant market presence or have potential for improved profitability through financial management, economies of scale or expanded services. We do not currently have any specific plans, arrangements or understandings regarding such expansion. We cannot say with any certainty that we will be able to consummate, or if consummated, successfully integrate future acquisitions or that we will not incur disruptions or unexpected expenses in integrating such acquisitions. In attempting to make such acquisitions, we anticipate competing with other financial institutions, many of which have greater financial and operational resources. Acquiring other banks, businesses, or branches involves various risks commonly associated with acquisitions, including, among other things:

- Potential exposure to unknown or contingent liabilities of the target company;
- Exposure to potential asset quality issues of the target company;
- Difficulty and expense of integrating the operations and personnel of the target company;
- Potential disruption to our business;
- Potential diversion of management's time and attention;
- The possible loss of key employees and customers of the target company;
- Difficulty in estimating the value of the target company; and
- Potential changes in banking or tax laws or regulations that may affect the target company.

We are subject to extensive regulation which could adversely affect our business.

Our operations are subject to extensive regulation by federal, state and local governmental authorities and are subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of our operations. Given the current disruption in the financial markets and potential new regulatory initiatives, including the Obama Administration's recent financial regulatory reform proposal, new regulations and laws that may affect us are increasingly likely. Because our business is highly regulated, the laws, rules and regulations applicable to us are subject to regular modification and change. There are currently proposed laws, rules and regulations that, if adopted, would impact our operations. These proposed laws, rules and regulations, or any other laws, rules or regulations, may be adopted in the future, which could (1) make compliance much more difficult or expensive, (2) restrict our ability to originate, broker or sell loans or accept certain deposits, (3) further limit or restrict the amount of commissions, interest or other charges earned on loans originated or sold by us, or (4) otherwise adversely affect our business or prospects for business.

Moreover, banking regulators have significant discretion and authority to prevent or remedy unsafe or unsound practices or violations of laws or regulations by financial institutions and holding companies in the performance of their supervisory and enforcement duties. The exercise of regulatory authority may have a negative impact on our financial condition and results of operations.

Additionally, in order to conduct certain activities, including acquisitions, we are required to obtain regulatory approval. There can be no assurance that any required approvals can be obtained, or obtained without conditions or on a timeframe acceptable to us.

Higher FDIC deposit insurance premiums and assessments could adversely affect our financial condition.

FDIC insurance premiums have increased substantially in 2009, and we expect to pay significantly higher FDIC premiums in the future. As the large number of recent bank failures continues to deplete the Deposit Insurance Fund, the FDIC adopted a revised risk-based deposit insurance assessment schedule in February 2009, which raised deposit insurance premiums. The FDIC also implemented a five basis point special assessment of each insured depository institution's assets minus Tier 1 capital as of June 30, 2009, which special assessment amount was capped at 10 basis points times the institution's assessment base for the second quarter of 2009. The amount of our special assessment was $360,000. In addition, the FDIC recently announced a proposed rule that will require financial institutions, such as the Bank, to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010 through and including 2012 in order to re-capitalize the Deposit Insurance Fund. The proposed rule also provides for increasing the FDIC assessment rates by three basis points effective January 1, 2011.

A natural disaster or recurring energy shortage, especially in California, could harm our business.

We are based in Costa Mesa, California, and approximately 92% of our total loan portfolio was secured by real estate located in California at September 30, 2009. In addition, the computer systems that operate our Internet websites and some of their back-up systems are located in Costa Mesa, California. Historically, California has been vulnerable to natural disasters. Therefore, we are susceptible to the risks of natural disasters, such as earthquakes, wildfires, floods and mudslides. Natural disasters could harm our operations directly through interference with communications, including the interruption or loss of our websites, which would prevent us from gathering deposits, originating loans and processing and controlling our flow of business, as well as through the destruction of facilities and our operational, financial and management information systems. A natural disaster or recurring power outages may also impair the value of our largest class of assets, our loan portfolio, which is comprised substantially of real estate loans. Uninsured or underinsured disasters may reduce borrowers' ability to repay mortgage loans. Disasters may also reduce the value of the real estate securing our loans, impairing our ability to recover on defaulted loans through foreclosure and making it more likely that we would suffer losses on defaulted loans. California has also experienced energy shortages, which, if they recur, could impair the value of the real estate in those areas affected. Although we have implemented several back-up systems and protections (and maintain business interruption insurance), these measures may not protect us fully from the effects of a natural disaster. The occurrence of natural disasters or energy shortages in California could have a material adverse effect on our business, prospects, financial condition and results of operations.

Risks Related to Ownership of Our Common Stock

The price of our common stock may fluctuate significantly, and this may make it difficult for you to resell shares of common stock owned by you at times or at prices you find attractive.

Stock price volatility may make it difficult for you to resell your common stock when you want and at prices you find attractive. Our stock price can fluctuate significantly in response to a variety of factors including, among other things:

- Actual or anticipated variations in quarterly results of operations;
- Recommendations by securities analysts;

- Operating and stock price performance of other companies that investors deem comparable to us;
- News reports relating to trends, concerns and other issues in the financial services industry, including the failures of other financial institutions in the current economic downturn;
- Perceptions in the marketplace regarding us and/or our competitors;
- New technology used, or services offered, by competitors;
- Significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving us or our competitors;
- Failure to integrate acquisitions or realize anticipated benefits from acquisitions;
- Changes in government regulations; and
- Geopolitical conditions such as acts or threats of terrorism or military conflicts.

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause our stock price to decrease regardless of operating results as evidenced by the current volatility and disruption of capital and credit markets.

Only a limited trading market exists for our common stock, which could lead to significant price volatility.

Our common stock is traded on the NASDAQ Global Market under the trading symbol "PPBI," but there is low trading volumes in our common stock. The limited trading market for our common stock may cause fluctuations in the market value of our common stock to be exaggerated, leading to price volatility in excess of that which would occur in a more active trading market of our common stock. Future sales of substantial amounts of common stock in the public market, or the perception that such sales may occur, could adversely affect the prevailing market price of the common stock. In addition, even if a more active market in our common stock develops, we cannot assure you that such a market will continue.

We do not expect to pay cash dividends in the foreseeable future.

We do not intend to pay cash dividends on our common stock in the foreseeable future. Instead, we intend to reinvest our earnings in our business. In addition, in order to pay cash dividends to our stockholders, we would most likely need to obtain funds from the Bank. The Bank's ability to pay dividends to us is subject to restrictions set forth in the California Financial Code. The California Financial Code provides that a bank may not make a cash distribution to its stockholders in excess of the lesser of (1) a bank's retained earnings; or (2) a bank's net income for its last three fiscal years, less the amount of any distributions made by the bank or by any majority-owned subsidiary of the bank to the stockholders of the bank during such period. However, a bank may, with the approval of the DFI, make a distribution to its stockholders in an amount not exceeding the greatest of (a) its retained earnings; (b) its net income for its last fiscal year; or (c) its net income for its current fiscal year. In the event that bank regulators determine that the stockholders' equity of a bank is inadequate or that the making of a distribution by the bank would be unsafe or unsound, the regulators may order the bank to refrain from making a proposed distribution. The payment of dividends could, depending on the financial condition of the Bank, be deemed to constitute an unsafe or unsound practice. Under these provisions, the amount available for distribution from the Bank to us was approximately $9.4 million at September 30, 2009.

Approval of the Federal Reserve Board is required for payment of any dividend by a state chartered bank that is a member of the Federal Reserve Board System, such as the Bank, if the total of all dividends declared by the bank in any calendar year would exceed the total of its retained net income for that year combined with its retained net income for the preceding two years. In addition, a state member bank may not pay a dividend in an amount greater than its undivided profits without regulatory and stockholder approval. The Bank is also prohibited under federal law from paying any dividend that would cause it to become undercapitalized.

Upon exercise by certain stockholders of warrants for our common stock, existing stockholders will experience significant dilution in their shares of common stock.

We have issued warrants to certain stockholders representing the right to purchase 966,400 shares of our common stock at an exercise price of $0.75 per share outstanding as of September 30, 2009. The aggregate number of shares of our common stock subject to these warrants represents approximately 16% of our issued and outstanding shares as of September 30, 2009, reduced to 10% after the completion of our previously announced public offering on November 9, 2009. For further information on the public offering, see "Note 8 – Subsequent Event" in our Notes to Consolidated Financial Statements contained herein. The trading price of our common stock has been significantly higher than the exercise price of the warrants for the last three consecutive fiscal years. Upon exercise of the warrants, existing stockholders will experience significant dilution of the shares of our common stock that they hold.

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

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

There may be future sales or other dilutions of our equity which may adversely affect the market price of our common stock.

We generally are not restricted from issuing additional shares of common stock, including securities that are convertible into or exchangeable for, or that represent the right to receive our common stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of any future offerings. Thus, our stockholders bear the risk of any future stock issuances reducing the market price of our common stock and diluting their stock holdings in us. The exercise of any options granted to our directors and employees, the exercise of the outstanding warrants for our common stock as referenced herein, the issuance of shares of common stock in acquisitions and other issuances of our common stock could have an adverse effect on the market price of the shares of our common stock. In addition, the existence of options and warrants to acquire shares of our common stock may materially adversely affect the terms upon which we may be able to obtain additional capital in the future through the sale of equity securities. Any future issuances of shares of our common stock will be dilutive to existing stockholders.

Anti-takeover defenses may delay or prevent future transactions.

Our certificate of incorporation and bylaws, among other things:

- Divide the board of directors into three classes with directors of each class serving for a staggered three year period;
- Provides that our directors must fill vacancies on the board of directors;
- Permit the issuance, without stockholder approval, of shares of preferred stock having rights and preferences determined by the board of directors;

· Provide that stockholders holding 80% of our issued and outstanding shares must vote to approve certain business combinations and other transactions involving holders of more than 10% of our common stock or our affiliates;

· Provide that stockholders holding 80% of our issued and outstanding shares must vote to remove directors for cause; and

· Provide that record holders of our common stock who beneficially own in excess of 10% of our common stock are not entitled to vote shares held by them in excess of 10% of our common stock..

These provisions in our certificate of incorporation and bylaws could make the removal of incumbent directors more difficult and time-consuming and may have the effect of discouraging a tender offer or other takeover attempts not previously approved by our board of directors.

Future offerings of debt, which would be senior to our common stock upon liquidation, and/or preferred equity securities, which may be senior to our common stock for purposes of dividend distributions or upon liquidation, may adversely affect the market price of our common stock.

In the future, we may attempt to increase our capital resources or, if the Bank's capital ratios fall below the required minimums, we could be forced to raise additional capital by making additional offerings of debt or preferred equity securities, including medium-term notes, trust preferred securities, senior or subordinated notes or preferred stock, including preferred stock issued under the U.S. Treasury's TARP Capital Purchase Program. Upon liquidation, holders of our debt securities and shares of preferred stock and lenders with respect to other borrowings will receive distributions of our available assets prior to the holders of our common stock. Holders of our common stock are not entitled to preemptive rights or other protections against dilution.

A holder with as little as a 5% interest in us could, under certain circumstances, be subject to regulation as a "bank holding company."

Any entity (including a "group" composed of natural persons) owning 25% or more of our outstanding common stock, or 5% or more if such holder otherwise exercises a "controlling influence" over us, may be subject to regulation as a "bank holding company" in accordance with the Bank Holding Company Act of 1956, as amended, or the BHCA. In addition, (1) any bank holding company or foreign bank with a U.S. presence may be required to obtain the approval of the Federal Reserve Board under the BHCA to acquire or retain 5% or more of our outstanding common stock and (2) any person other than a bank holding company may be required to obtain the approval of the Federal Reserve Board under the Change in Bank Control Act of 1978, as amended, to acquire or retain 10% or more of our outstanding common stock. Becoming a bank holding company imposes certain statutory and regulatory restrictions and burdens, and might require the holder to divest all or a portion of the holder's investment in us. In addition, because a bank holding company is required to provide managerial and financial strength for its bank subsidiary, such a holder may be required to divest investments that may be deemed incompatible with bank holding company status, such as a material investment in a company unrelated to banking.

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

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None

Item 6. Exhibits

Exhibit 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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

PACIFIC PREMIER BANCORP, INC.,

November 16, 2009 By: /s/ Steven R. Gardner
Date Steven R. Gardner
President and Chief Executive Officer
(principal executive officer)

November 16, 2009 /s/ Kent J. Smith
Date Kent J. Smith
Senior Vice President and Chief Financial Officer
(principal financial and accounting officer)

Index to Exhibits

Exhibit No.	Description of Exhibit
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act.