FIRST CHARTER CORP /NC/
Form 10-Q
November 07, 2003

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 September 30, 2003

OR

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

Commission File Number 0-15829

FIRST CHARTER CORPORATION

(Exact name of registrant as specified in its charter)

North Carolina	**56-1355866**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification Number)*
10200 David Taylor Drive, Charlotte, NC	**28262-2373**
(Address of Principal Executive Offices)	(Zip Code)

Registrant s telephone number, including area code **(704) 688-4300**

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 o

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

As of November 6, 2003 the Registrant had outstanding 29,653,239 shares of Common Stock, no par value.

First Charter Corporation

Form 10-Q for the Quarterly Period Ended September 30, 2003

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PART 1. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

First Charter Corporation and Subsidiaries

Consolidated Balance Sheets

(Dollars in thousands, except share data)	**September 30 2003** **(Unaudited)**	**December 31 2002**
Assets:		
Cash and due from banks	**$ 84,468**	$ 162,087
Federal funds sold	**2,004**	1,154
Interest bearing bank deposits	**42,560**	6,609
Cash and cash equivalents	**129,032**	169,850
Securities available for sale (cost of **$1,597,220** and $1,103,107; carrying amount of pledged collateral **$1,175,940** and $735,208)	**1,603,262**	1,129,212
Loans held for sale	**14,784**	158,404
Loans	**2,109,481**	2,072,717
Less: Unearned income	**(190)**	(247)
Allowance for loan losses	**(23,953)**	(27,204)
Loans, net	**2,085,338**	2,045,266
Premises and equipment, net	**96,097**	94,647
Other assets	**159,454**	148,570
Total assets	**$4,087,967**	$3,745,949
Liabilities:		
Deposits, domestic:		
Noninterest bearing demand	**$ 337,409**	$ 305,924
Interest bearing	**2,144,173**	2,016,723
Total deposits	**2,481,582**	2,322,647
Other borrowings	**1,261,412**	1,042,440
Other liabilities	**42,710**	56,176
Total liabilities	**3,785,704**	3,421,263
Shareholders equity:		
Preferred stock no par value; authorized 2,000,000 shares; no shares issued and outstanding		
Common stock no par value; authorized 100,000,000 shares; issued and outstanding **29,643,114** and 30,069,147 shares	**114,578**	122,870
Common stock held in Rabbi Trust for deferred compensation	**(622)**	(476)
Deferred compensation payable in common stock	**622**	476
Retained earnings	**183,999**	185,900
Accumulated other comprehensive income:		
Unrealized gain on securities available for sale, net	**3,686**	15,916

Total shareholders equity	**302,263**	324,686
Total liabilities and shareholders equity	**$4,087,967**	$3,745,949

See accompanying notes to consolidated financial statements.

First Charter Corporation and Subsidiaries

Consolidated Statements of Income
(Unaudited)

(Dollars in thousands, except share and per share data)	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2003	**2002**	**2003**	**2002**
Interest income:				
Loans	**$ 28,936**	$ 34,716	**$ 89,731**	$ 101,028
Federal funds sold	**6**	5	**17**	14
Interest bearing bank deposits	**91**	45	**430**	106
Securities	**14,200**	15,016	**43,564**	47,107
Total interest income	**43,233**	49,782	**133,742**	148,255
Interest expense:				
Deposits	**9,963**	12,498	**33,095**	38,941
Federal funds purchased and securities sold under agreements to repurchase	**590**	586	**1,633**	1,777
Federal Home Loan Bank and other borrowings	**6,480**	7,733	**20,192**	22,414
Total interest expense	**17,033**	20,817	**54,920**	63,132
Net interest income	**26,200**	28,965	**78,822**	85,123
Provision for loan losses	**2,400**	1,750	**23,943**	6,095
Net interest income after provision for loan losses	**23,800**	27,215	**54,879**	79,028
Noninterest income:				
Service charges on deposit accounts	**5,674**	4,689	**16,375**	14,135
Financial management income	**1,400**	566	**2,466**	1,913
Gain on sale of securities	**270**	1,416	**9,782**	6,168
Gain on sale of credit card loan portfolio	**49**		**2,262**	
Income (loss) from equity method investments	**78**	(2,525)	**(298)**	(5,461)
Mortgage services income	**1,329**	504	**2,613**	1,320
Brokerage services income	**861**	640	**2,159**	1,697
Insurance services income	**2,327**	2,313	**6,993**	6,658
Trading gains	**158**	298	**1,754**	1,040
Bank owned life insurance	**992**		**2,905**	
Gain on sale of properties	**382**		**382**	1,013
Other	**1,324**	829	**3,270**	2,869
Total noninterest income	**14,844**	8,730	**50,663**	31,352
Noninterest expense:				
Salaries and employee benefits	**13,277**	11,988	**39,588**	38,093
Occupancy and equipment	**4,079**	3,839	**12,158**	12,264
Data processing	**712**	758	**2,024**	2,208
Marketing	**1,173**	630	**3,487**	1,904
Postage and supplies	**982**	967	**3,270**	3,234
Professional services	**3,158**	1,393	**8,160**	4,774
Telephone	**584**	461	**1,700**	1,575
Amortization of intangibles	**127**	88	**289**	278
Prepayment costs on borrowings			**7,366**	
Other	**2,451**	1,616	**7,587**	5,811

Total noninterest expense	**26,543**	21,740	**85,629**	70,141
Income before income taxes	**12,101**	14,205	**19,913**	40,239
Income tax expense	3,207	3,878	5,277	10,985
Net income	**$ 8,894**	$ 10,327	**$ 14,636**	$ 29,254
Net income per share:				
Basic	**$ 0.30**	$ 0.34	**$ 0.49**	$ 0.95
Diluted	**$ 0.30**	$ 0.34	**$ 0.49**	$ 0.95
Weighted average shares:				
Basic	**29,672,137**	30,379,838	**29,825,313**	30,667,773
Diluted	**29,904,440**	30,506,426	**30,020,709**	30,864,476

See accompanying notes to consolidated financial statements.

First Charter Corporation and Subsidiaries

Consolidated Statements of Shareholders Equity
(Unaudited)

(Dollars in thousands, except share data)	Common Stock Shares	Common Stock Amount	Common Stock held in Rabbi Trust for Deferred Compensation	Deferred Compensation Payable in Common Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance, December 31, 2001	30,742,532	$135,167	$ (388)	$ 388	$168,334	$ 5,840	$309,341
Comprehensive income:							
Net income					29,254		29,254
Unrealized gain on securities available for sale, net						13,798	13,798
Total comprehensive income							43,052
Common stock purchased by Rabbi Trust for deferred compensation			(59)				(59)
Deferred compensation payable in common stock				59			59
Cash dividends					(16,676)		(16,676)
Stock options exercised	95,662	1,033					1,033
Purchase and retirement of common stock	(698,600)	(11,995)					(11,995)
Balance, September 30, 2002	30,139,594	$124,205	$ (447)	$ 447	$180,912	$ 19,638	$324,755
Balance, December 31, 2002	30,069,147	$122,870	$ (476)	$ 476	$185,900	$ 15,916	$324,686
Comprehensive income:							
Net income					14,636		14,636
Unrealized loss on securities available for sale, net						(12,230)	(12,230)
Total comprehensive income							2,406
Common stock purchased by Rabbi Trust for deferred compensation			(146)				(146)
Deferred compensation payable in common stock				146			146
Cash dividends					(16,537)		(16,537)
Stock options exercised	60,526	893					893
Shares issued in connection with business acquisition	78,441	1,323					1,323
Purchase and retirement of common stock	(565,000)	(10,508)					(10,508)
Balance, September 30, 2003	29,643,114	$114,578	$ (622)	$ 622	$183,999	$ 3,686	$302,263

See accompanying notes to consolidated financial statements.

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First Charter Corporation and Subsidiaries

Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended September 30	
(Dollars in thousands)	**2003**	**2002**
Cash flows from operating activities:		
Net income	**$ 14,636**	$ 29,254
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Provision for loan losses	**23,943**	6,095
Depreciation	**6,687**	7,039
Amortization of intangibles	**289**	278
Premium amortization and discount accretion, net	**5,620**	519
Net gain on securities available for sale transactions	**(9,782)**	(6,168)
Net (gain) loss on sale of foreclosed assets	**(2)**	53
Net gain on sale of premises and equipment	**(377)**	(1,013)
Gain on sale of credit card loan portfolio	**(2,262)**	
Loss from equity method investments	**298**	5,461
Origination of mortgage loans held for sale	**(385,222)**	(67,142)
Proceeds from sale of mortgage loans held for sale	**241,920**	59,943
(Increase) in cash surrender value of bank owned life insurance	**(2,905)**	
(Increase) in other assets	**(2,150)**	(2,880)
(Decrease) increase in other liabilities	**(14,086)**	5,416
Net cash (used in) provided by operating activities	**(123,393)**	36,855
Cash flows from investing activities:		
Proceeds from sales of securities available for sale	**916,697**	463,713
Proceeds from maturities of securities available for sale	**484,641**	188,053
Purchase of securities available for sale	**(1,604,367)**	(759,907)
Net increase in loans	**(119,936)**	(288,250)
Proceeds from sale of loans	**40,220**	
Proceeds from sales of other real estate	**8,207**	2,467
Net purchases of premises and equipment	**(7,604)**	(4,695)
Proceeds from sale of credit card portfolio	**13,242**	
Acquisition of businesses, net of cash paid	**(280)**	
Net cash used in investing activities	**(269,180)**	(398,619)
Cash flows from financing activities:		
Net increase in demand, money market and savings accounts	**269,318**	67,365
Net (decrease) increase in certificates of deposit	**(110,382)**	83,478
Net increase in securities sold under repurchase agreements and other borrowings	**218,971**	196,324
Purchase and retirement of common stock	**(10,508)**	(11,995)
Proceeds from issuance of common stock	**893**	1,033
Dividends paid	**(16,537)**	(16,676)
Net cash provided by financing activities	**351,755**	319,529
Net decrease in cash and cash equivalents	**(40,818)**	(42,235)
Cash and cash equivalents at beginning of period	**169,850**	141,465
Cash and cash equivalents at end of period	**$ 129,032**	$ 99,230

Supplemental disclosures of cash flow information:		
Cash paid for interest	**$ 57,066**	$ 64,426
Cash paid for income taxes	**12,543**	8,613
Supplemental disclosure of non-cash transactions:		
Transfer of loans and premises and equipment to other real estate	**4,633**	4,146
Unrealized (loss) gain on securities available for sale (net of tax effect of $(7,833) and $8,828, respectively)	**(12,230)**	13,798
Issuance of common stock for business acquisition	**1,323**	
Loans held for sale securitized and transferred to the securities available for sale portfolio	**286,922**	
Allowance related to loans sold	**20,783**	322

See accompanying notes to consolidated financial statements.

FIRST CHARTER CORPORATION AND SUBSIDIARIES

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

First Charter Corporation (the Corporation) is a regional financial services company with assets of approximately $4.1 billion and is the holding company for First Charter Bank (FCB or the Bank). FCB is a full-service bank and trust company with 53 financial centers and five insurance offices located in 17 counties throughout the piedmont and western half of North Carolina. FCB also maintains one mortgage origination office in Virginia. FCB provides businesses and individuals with a broad range of financial services, including banking, comprehensive financial planning, funds management, investments, insurance, mortgages and a full array of employee benefit programs.

Note One Accounting Policies

The consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiary, FCB. In consolidation, all intercompany accounts and transactions have been eliminated.

The information contained in the consolidated financial statements, excluding December 31, 2002 information, is unaudited. The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements, as well as the amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

The information furnished in this report reflects all adjustments which are, in the opinion of management, necessary to present a fair statement of the financial condition and the results of operations for interim periods. All such adjustments were of a normal and recurring nature. Certain amounts reported in prior periods have been reclassified to conform to the current period presentation. Such reclassifications have no effect on net income or shareholders equity as previously reported.

Accounting policies followed by the Corporation are presented on pages 51 to 59 of the Corporation s Annual Report on Form 10-K for the year ended December 31, 2002.

In August 2001, the FASB issued Statement of Financial Accounting Standards No. 143 (SFAS No. 143), Accounting for Asset Retirement Obligations , which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement cost. This standard requires the Corporation to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development and/or normal use of the assets. The Corporation also is to record a corresponding increase to the carrying amount of the related long-lived asset and to depreciate that cost over the life of the asset. The liability is changed at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the initial fair value measurement. This statement is effective for fiscal years beginning after June 15, 2002. Accordingly, the Corporation adopted SFAS No. 143 on January 1, 2003, with no material impact on its consolidated financial statements.

In August 2002, the FASB issued Statement of Financial Accounting Standards No. 146 (SFAS No. 146), Accounting for Costs Associated with Exit or Disposal Activities , which addresses financial accounting and reporting costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). Under EITF Issue No. 94-3, an entity recognized a liability for an exit cost on the date that the entity committed itself to an exit plan. In SFAS No. 146, the FASB acknowledges that an entity s commitment to a plan does not, by itself, create a present obligation to other parties that meets the definition of a liability. An obligation becomes a present obligation when a transaction or event occurs that leaves an entity little or no discretion to avoid the future transfer or use of assets to settle the liability. SFAS No. 146 also establishes that fair value is the objective for the initial measurement of the liability. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002. There was no impact to the Corporation upon adoption.

In October 2002, the FASB issued Statement of Financial Accounting Standards No. 147 (SFAS No. 147), Acquisitions of Certain Financial Institutions , which addresses the financial accounting and reporting for the acquisition of all or part of a financial institution. This standard removes certain acquisitions of financial institutions from the scope of Statement of Financial Accounting Standards No. 72 (SFAS No. 72). This statement requires financial institutions to reclassify goodwill, which was created from a qualified business acquisition, from SFAS No. 72 goodwill to goodwill subject to the provisions of SFAS No. 142. The reclassified goodwill will no longer be amortized but will be subject to an annual impairment test, pursuant to SFAS No. 142. SFAS No. 147 required the Corporation to retroactively restate its previously issued 2002 interim financial statements, to reverse SFAS No. 72 goodwill amortization expense recorded in the first three quarters of the 2002 fiscal year, the year in which the Corporation adopted SFAS No. 142. The Corporation adopted SFAS No. 147 on October 1, 2002. The Corporation had $12.1 million of SFAS No. 72 goodwill which was reclassified and will no longer be amortized. This resulted in the reversal of $716,000 ($520,000 or $0.02 diluted earnings per share, after-tax) of amortization expense for the nine months ended September 30, 2002. In accordance with SFAS No. 147, the Corporation performed a transitional impairment test of this goodwill in the fourth quarter of 2002. As a result of this testing, no impairment charges were recorded. The Corporation performed an annual impairment test of the goodwill in 2003, with no impairment charges recorded. The Corporation will continue to test annually.

In October 2002, the FASB issued Financial Accounting Standards Board Interpretation No. 45, (FASB Interpretation No. 45), Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, which establishes disclosure standards for a guarantor about its obligations under certain guarantees that it has issued. Under FASB Interpretation No. 45 a guarantor is required to disclose the nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose, and the events or circumstances that would require the guarantor to perform under the guarantee. The guarantor is also required to disclose the maximum potential amount of future payments under the guarantee, the carrying amount of the liability, if any, for the guarantor s obligations under the guarantee, and the nature and extent of any recourse provisions or available collateral that would enable the guarantor to recover the amounts paid under the guarantee. The initial recognition and measurement of FASB Interpretation No. 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. Accordingly, the Corporation adopted these provisions of FASB Interpretation No. 45 on January 1, 2003. The impact to the Corporation upon adoption was immaterial. The disclosure requirements in FASB Interpretation No. 45 are effective for financial statements of interim or annual periods ending after December 15, 2002. Accordingly, the Corporation adopted the disclosure provisions in 2002 and has made the relevant disclosures in ***Note Twelve*** of the accompanying consolidated financial statements.

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148 (SFAS No. 148), Accounting for Stock-Based Compensation Transition and Disclosure, an amendment of FASB Statement No. 123 . This Statement amends SFAS No. 123, to provide alternative methods of transition for an entity that voluntarily changes to the fair value method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that Statement to require prominent disclosure about the effects on reported net income of an entity s accounting policy with respect to stock-based employee compensation. Finally, this Statement amends APB Opinion No. 28 (APB No. 28), Interim Financial Reporting , to require disclosure about those effects in interim financial information. The Corporation currently has no plans to change its accounting for stock-based employee compensation. The disclosure provisions of this statement, except for the amendment of APB No. 28, are effective for financial statements for fiscal years ending after December 15, 2002. Accordingly, the Corporation adopted the disclosure provisions pursuant to this portion of the interpretation on December 31, 2002 and these disclosures are presented in the notes to the consolidated financial statements. The provisions of this statement related to the amendment of APB Opinion No. 28 are effective for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002. Accordingly, the Corporation adopted the disclosure provisions pursuant to this portion of the interpretation on January 1, 2003, and these disclosures are presented in the notes to the consolidated financial statements.

In January 2003, the FASB issued Financial Accounting Standards Board Interpretation No. 46, (FASB Interpretation No. 46), Consolidation of Variable Interest Entities, which addresses consolidation of variable interest entities by business enterprises. Variable interest entities are equity interests that do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. An enterprise shall consolidate a variable interest entity if that enterprise has a variable interest (or combination of variable interests) that will absorb a majority of expected losses if they occur, receive a majority of the entity s residual returns if they occur, or both.

The enterprise that consolidates the variable interest entity is called the primary beneficiary of that entity. Under FASB Interpretation No. 46 an enterprise that holds significant variable interests in a variable interest entity but is not the primary beneficiary is required to disclose the nature, purpose, size, and activities of the variable interest entity, its exposure to loss as a result of the variable interest holder s involvement with the entity, and the nature of its involvement with the entity and date when the involvement began. The primary beneficiary of a variable interest entity is required to disclose the nature, purpose, size, and activities of the variable interest entity, the carrying amount and classification of consolidated assets that are collateral for the variable interest entity s obligations, and any lack of recourse by creditors (or beneficial interest holders) of a consolidated variable interest entity to the general credit of the primary beneficiary. FASB Interpretation No. 46 will be effective for the Corporation beginning December 31, 2003. The Corporation is in the process of evaluating the impact of this Interpretation and does not expect a material effect on its consolidated financial statements.

In April 2003, the FASB issued Statement of Financial Accounting Standards No. 149 (SFAS No. 149), Amendment of Statement 133 on Derivative Instruments and Hedging Activities, which amends and clarifies financial accounting and reporting for derivative instruments and for hedging activities under Statement of Financial Accounting Standards No. 133 (SFAS No. 133). This statement clarifies when a contract with an initial net investment meets the characteristic of a derivative, clarifies when a derivative instrument contains a financing component, amends the definition of an underlying to conform it to language used in Financial Accounting Standards Board Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others , and amends certain other existing pronouncements. This Statement requires that contracts with comparable characteristics be accounted for similarly. This Statement is effective for most contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. For contracts with forward purchases or sales of when-issued securities or other securities that do not yet exist, this Statement is effective for both existing contracts and new contracts entered into after June 30, 2003. All provisions of this Statement should be applied prospectively. The Corporation adopted SFAS No. 149 on July 1, 2003 with no material effect on its consolidated financial statements.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150 (SFAS No. 150), Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity , which establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). This Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. It is to be implemented by reporting the cumulative effect of a change in accounting principle for financial instruments created before the issuance date of the Statement and still existing at the beginning of the interim period of adoption. Accordingly, the Corporation adopted SFAS No. 150 on July 1, 2003, with no effect on its consolidated financial statements. There were no financial instruments issued between June 1, 2003 and June 30, 2003 to which SFAS No. 150 applied.

From time to time, the FASB issues exposure drafts for proposed statements of financial accounting standards. Such exposure drafts are subject to comment from the public, to revisions by the FASB and to final issuance by the FASB as statements of financial accounting standards. Management considers the effect of the proposed statements on the consolidated financial statements of the Corporation and monitors the status of changes to and proposed effective dates of exposure drafts.

Note Two Acquisitions

On July 7, 2003, the Corporation, through a subsidiary of FCB, purchased a third party benefits administrator in a stock transaction. The purchase price delivered at closing consisted of First Charter common stock valued at $1.32 million, and the agreement contemplates additional common stock payments based on the post closing performance of the business. The value of such additional payments, if earned, is expected to total approximately $880,000. This acquisition was accounted for as a purchase. Accordingly, the results of operations of this entity will be included in the consolidated results of operations of the Corporation from the date of the acquisition. Pro forma financial information reflecting the effect of this acquisition on periods prior to the combination is not considered material. Intangibles amounted to $1.1 million of the purchase price. See ***Note Four***.

On July 31, 2003, the Corporation completed the acquisition of Piedmont Insurance Agency, Inc., a North Carolina based insurance company, which was merged into First Charter Insurance Services. The acquisition was accounted for as a purchase. Pro forma financial information reflecting the effect of this acquisition on periods prior to the combination is not considered material.

Note Three Net income Per Share

Basic net income per share is computed by dividing net income by the weighted average number of shares of common stock outstanding for the year. Diluted net income per share reflects the potential dilution that could occur if the Corporation s potential common stock and contingently issuable shares, which consist of dilutive stock options and restricted stock, were issued. The numerators of the basic net income per share computations are the same as the numerators of the diluted net income per share computations for all periods presented.

A reconciliation of the basic average common shares outstanding to the diluted average common shares outstanding is as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2003	**2002**	**2003**	**2002**
Basic weighted average number of common shares outstanding	**29,672,137**	30,379,838	**29,825,313**	30,667,773
Dilutive effect arising from potential common stock issuances	**232,303**	126,588	**195,396**	196,703
Diluted weighted average number of common shares outstanding	**29,904,440**	30,506,426	**30,020,709**	30,864,476

The effects of stock options are excluded from the computation of diluted earnings per common share in periods in which the effect would be antidilutive. In both the three and nine months ended September 30, 2003, options to purchase 1.1 million shares, compared to 1.8 million shares and 1.2 million shares for the comparable 2002 periods, were outstanding but not included in the computation of earnings per share because they were antidilutive.

The Corporation paid cash dividends of $0.185 per share for both the three months ended September 30, 2003 and 2002, respectively, and paid cash dividends of $0.555 and $0.545 for the nine months ended September 30, 2003 and 2002, respectively.

Note Four Goodwill and Other Intangible Assets

The following is a summary of the gross carrying amount and accumulated amortization of amortized intangible assets and the carrying amount of unamortized intangible assets as of September 30, 2003 and December 31, 2002:

	September 30 2003		December 31 2002	
(Dollars in thousands)	**Gross Carrying Amount**	**Accumulated Amortization**	**Gross Carrying Amount**	**Accumulated Amortization**
Amortized intangible assets:				
Noncompete agreements(1)	**$ 946**	**$ 833**	$ 946	$ 744
Customer lists(1)	**1,221**	**166**	417	106
Mortgage servicing rights(1)	**7,084**	**4,609**	4,643	3,165
Branch acquisitions(2)	**1,110**	**1,054**	1,110	925
Other intangibles(1)(4)	**232**	**12**		
Total	**$10,593**	**$6,674**	$ 7,116	$4,940

Unamortized intangible assets:				
Goodwill(3)	**$18,887**	**$**	$18,093	$

(1) Noncompete agreements, customer lists, mortgage servicing rights and other intangibles are recorded in the Other Operating Segments as described in the 2002 Annual Report on Form 10-K.

(2) Branch acquisition intangible assets are recorded in the FCB segment as described in the 2002 Annual Report on Form 10-K.

(3) Goodwill of $6,018 million is recorded in the Other Operating Segments and $12,869 is recorded on FCB as described in the 2002 Annual Report on Form 10-K.

(4) Other intangibles include trade name and proprietary software.

The gross carrying amount of goodwill at September 30, 2003 increased $794,000 compared to December 31, 2002, due to goodwill of $409,000 associated with the acquisition of a third party benefits administrator in July 2003 and goodwill of $385,000 associated with the acquisition of Piedmont Insurance Agency in July 2003.

Amortization expense, excluding amortization of mortgage servicing rights, totaled $127,000 and $289,000 for the three months and nine months ended September 30, 2003, respectively, compared to $88,000 and $278,000 for the comparable 2002 periods.

The following table presents the estimated amortization expense for intangible assets for the years ended December 31, 2003, 2004, 2005, 2006, 2007 and 2008 and thereafter:

(Dollars in thousands)	Noncompete Agreements	Customer Lists	Mortgage Servicing Rights	Branch Acquisitions	Other Intangibles	Total
2003	$ 117	$ 91	$1,769	$ 171	$ 44	$2,192
2004	85	157	881	14	81	1,218
2005		138	460		72	670
2006		119	306		63	488
2007		100	215		54	369
2008 and after		291	287		137	715
Total	$ 202	$896	$3,918	$ 185	$451	$5,652

There was no adjusted effect of goodwill amortization on net income and on basic and diluted earnings per share for both the three months and nine months ended September 30, 2003 and 2002.

Note Five Loans and Loans Held for Sale

The Corporation s primary market area includes North Carolina, and predominately centers around the Metro region of Charlotte, North Carolina. At September 30, 2003, the majority of the total loan portfolio, as well as a substantial portion of the commercial and real estate loan portfolios, were to borrowers within this region. The diversity of the region s economic base provides a stable lending environment. No areas of significant concentrations of credit risk have been identified due to the diverse industrial base in the region.

Loans at September 30, 2003 and December 31, 2002 were:

	September 30, 2003		**December 31, 2002**	
(Dollars in thousands)	**Amount**	**Percent**	**Amount**	**Percent**
Commercial real estate	**$ 732,434**	**34.6%**	$ 798,664	38.6%
Commercial non real estate	**199,412**	**9.5**	223,178	10.8
Construction	**275,005**	**13.0**	215,859	10.4
Mortgage	**258,927**	**12.3**	237,085	11.4
Consumer	**279,512**	**13.3**	280,201	13.5
Home equity	**364,191**	**17.3**	317,730	15.3
Total	**$2,109,481**	**100.0%**	$2,072,717	100.0%

The following is a summary of the changes in the allowance for loan losses for the three and nine months ended September 30, 2003 and 2002:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands)	**2003**	**2002**	**2003**	**2002**
Balance, beginning of period	**$23,644**	$27,213	**$ 27,204**	$25,843
Provision for loan losses	**2,400**	1,750	**23,943**	6,095
Allowance related to loans sold		(322)	**(20,783)**	(322)
Charge-offs	**(2,238)**	(1,517)	**(7,152)**	(4,852)
Recoveries	**147**	287	**741**	647
Net charge-offs	**(2,091)**	(1,230)	**(6,411)**	(4,205)
Balance, September 30	**$23,953**	$27,411	**$ 23,953**	$27,411

During the second quarter of 2003, $60.9 million in nonaccruing and accruing higher risk loans were sold to investors, which reduced the allowance for loan losses $20.2 million. In addition, the Corporation s $11.7 million credit card portfolio was sold, during the first quarter of 2003, which reduced the allowance for loan losses $0.5 million.

Loans held for sale are carried at the lower of aggregate cost or market. Loans held for sale were $14.8 million and $158.4 million at September 30, 2003 and December 31, 2002, respectively. Loans held for sale was impacted by originations, sales activity and securitizations, which is reflected in the **Consolidated Statement of Cash Flows**. Loans held for sale consists primarily of 15 and 30 year mortgages which the Corporation intends to sell as whole loans. No valuation allowance to reduce these loans to lower of cost or market was required at September 30, 2003 and December 31, 2002.

The table below summarizes the Corporation s nonperforming assets and loans 90 days or more past due and still accruing interest as of the dates indicated.

(Dollars in thousands)	**September 30 2003**	**December 31 2002**
Nonaccrual loans	**$13,398**	$26,467
Other real estate owned	**6,709**	10,278
Total nonperforming assets	**20,107**	36,745
Loans 90 days or more past due and still accruing	**21**	
Total nonperforming assets and loans 90 days or more past due and still accruing	**$20,128**	$36,745

The recorded investment in individually impaired loans was $2.6 million (all of which were on nonaccrual status) and $17.9 million (all of which were on nonaccrual status) at September 30, 2003 and December 31, 2002, respectively. The related allowance for loan losses on these loans was $0.3 million and $4.8 million at September 30, 2003 and December 31, 2002, respectively. The average recorded investment in impaired loans for the nine months ended September 30, 2003 and 2002 was $12.7 million and $24.5 million, respectively.

Note Six Stock Repurchase Program

On January 23, 2002, the Corporation s Board of Directors authorized the repurchase of up to 1.5 million shares of the Corporation s common stock. During the nine months ended September 30, 2003, the Corporation repurchased 565,000 shares of its common stock at an average per-share price of $18.47, which reduced shareholders equity by $10.5 million. As of September 30, 2003, the Corporation had repurchased a total of 1.4 million shares of its common stock at an average per-share price of $17.52 under this authorization, which reduced shareholders equity by $24.1 million.

On October 24, 2003, the Corporation s Board of Directors authorized the repurchase of up to 1.5 million additional shares of the Corporation s common stock.

Note Seven Trading Activity

The Corporation engages in writing over-the-counter covered call options on specific fixed income securities in the available for sale portfolio. Under these agreements, the Corporation agrees to sell, upon election by the optionholder, a fixed income security at a fixed price. The Corporation receives a premium from the optionholder in exchange for writing the option contract. For the three and nine months ended September 30, 2003, the Corporation recognized income of $0.2 million and $1.8 million, respectively, from writing covered call options. The Corporation recognized income of $0.3 million and $1.0 million, respectively, for the three and nine months ended September 30, 2002 from writing covered call options. There were no written covered call options outstanding at September 30, 2003.

Note Eight Related Party Transactions

In the ordinary course of business, the Corporation engages in business transactions with certain of its directors. Such transactions are competitively negotiated at arms-length by the Corporation and are not considered to include terms which are unfavorable to the Corporation.

During 2001, the Corporation decided to upgrade its service offerings to include an automatic overdraft product, which allows customers the ability to overdraw their account and have their transactions honored for a fee. During the fourth quarter of 2001, the Corporation engaged Impact Financial Services (Impact) to provide this product. Impact will receive a fee from the Corporation equal to 15 percent of the incremental income from this new product for a twenty four-month period commencing the fourth full month after the Corporation began to offer the product. John Godbold, a director of the Corporation, is the president and owner of Godbold Financial Associates, Inc. (GFA), which acts as an independent sales representative for Impact for Maryland, North Carolina, South Carolina and Virginia, and as such GFA and Mr. Godbold will receive commissions from Impact based on fees earned by Impact. Management believes that the transaction was at arms-length. Pursuant to the Corporation s conflict of interest policy for directors and executive officers, the members of the Corporation s Board of Directors who did not have a direct or indirect interest in the related party transaction, reviewed this related party transaction and determined that it was fair to the Corporation and subsequently approved and ratified the transaction. As described above, no fees were required to be paid to Impact until the fourth full month following introduction of the new product, therefore, no fees were payable to Impact and no commissions were payable to GFA and Mr. Godbold until March 2002. For the three and nine months ended September 30, 2003, the Corporation received revenues of approximately $1.9 million and $5.4 million, respectively, which resulted in fees of $274,000, and $789,000, respectively, to Impact and resulted in Impact paying commissions to GFA and Mr. Godbold of $192,000 and $552,000, respectively. For the three and nine months ended September 30, 2002, the Corporation received revenues of approximately $1.2 million and $3.4 million, respectively, which resulted in fees of $181,000 and $402,000, respectively, to Impact and resulted in Impact paying commissions to GFA and Mr. Godbold of $127,000 and $281,000, respectively.

Note Nine Business Segment Information

Refer to the Corporation s Annual Report on Form 10-K for the year ended December 31, 2002 for information with respect to the Corporation s policies for defining and accounting for its segments. Financial information by segment for the nine months ended September 30, 2003 and 2002 is as follows:

	September 30, 2003			
(Dollars in thousands)	**FCB**	**Other Operating Segments (1)**	**Other (2)**	**Totals**
Total interest income	**$ 133,293**	**$ 392**	**$ 57**	**$ 133,742**
Total interest expense	**54,483**		**437**	**54,920**
Net interest income	**78,810**	**392**	**(380)**	**78,822**
Provision for loan losses	**23,943**			**23,943**
Total noninterest income	**36,300**	**14,364**	**(1)**	**50,663**
Total noninterest expense	**70,828**	**14,755**	**46**	**85,629**
Net income (loss) before income taxes	**20,339**	**1**	**(427)**	**19,913**
Income taxes expense (benefit)	**5,390**		**(113)**	**5,277**
Net income (loss)	**$ 14,949**	**$ 1**	**$ (314)**	**$ 14,636**
Total loans, net	**$2,083,828**	**$ 1,510**	**$**	**$2,085,338**
Total assets	**4,030,301**	**31,369**	**26,297**	**4,087,967**

	September 30, 2002			
(Dollars in thousands)	**FCB**	**Other Operating Segments (1)**	**Other (2)**	**Totals**
Total interest income	$ 147,948	$ 153	$ 154	$ 148,255
Total interest expense	62,636		496	63,132
Net interest income	85,312	153	(342)	85,123
Provision for loan losses	6,095			6,095
Total noninterest income	23,640	11,348	(3,636)	31,352
Total noninterest expense	57,840	12,225	76	70,141
Net income (loss) before income taxes	45,017	(724)	(4,054)	40,239
Income taxes expense (benefit)	12,290	(198)	(1,107)	10,985
Net income (loss)	$ 32,727	$ (526)	$ (2,947)	$ 29,254
Total loans, net	$2,197,228	$17,031	$	$2,214,259
Total assets	3,642,552	29,247	29,130	3,700,929

(1) Included in other operating segments are revenues, expenses and assets of insurance services, brokerage, mortgage and financial management.

(2) Included in other are revenues, expenses and assets of the parent company and eliminations.

Note Ten Equity Method Investments

The Corporation s equity method investments represent investments in venture capital limited partnerships.

The Corporation s recognition of earnings or losses from an equity method investment is determined by the Corporation s share of the investee s earnings on a quarterly basis (or, in the case of some smaller investments, on an annual basis if there has been no significant change in values). The limited partnerships generally provide their financial information during the quarter after the end of a given period, and the Corporation s policy is to record its share of earnings or losses on these equity method investments in the quarter such financial information is received.

These limited partnerships record their investments in investee companies on a fair value basis, with changes in the underlying fair values being reflected as an adjustment to their earnings in the period such changes are determined. The earnings of these limited partnerships, and therefore the amount recorded on an equity-method basis by the Corporation, are impacted significantly by changes in the underlying value of the companies in which these limited partnerships invest. All of the companies in which these limited partnerships invest are privately held, and their market values are not readily available. Estimations of these values are made by the management of the limited partnerships and are reviewed by the Corporation s management for reasonableness. The assumptions in the valuation of these investments include the viability of the business model, the ability of the company to obtain alternative financing, the ability to generate revenues in future periods and other subjective factors. Given the inherent risks associated with this type of investment, in the current economic environment, there can be no guarantee that there will not be widely varying gains or losses on these equity method investments in future periods.

At September 30, 2003 and December 31, 2002, the total book value of equity method investments was $2.5 million and $3.8 million, respectively, and is included in other assets on the consolidated balance sheet. Of the $2.5 million, $1.1 million represents investments in venture capital partnerships, which invest primarily in equity securities. The remaining $1.4 million is invested in Small Business Investment Companies (SBICs), which make debt investments that qualify for the investment test under the Community Reinvestment Act. At September 30, 2003, the Corporation s remaining commitment to fund the equity method investments was $1.7 million and represented commitments to three venture funds that are SBICs. These three venture funds primarily make debt investments in established companies that have a minimum of $5 million in annual revenue. These remaining commitments are callable in 2003.

Note Eleven Stock-Based Compensation

The Corporation accounts for stock-based compensation under the provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. The pro forma impact on net income per share as if the fair value of stock-based compensation plans had been recorded as a component of compensation expense in the consolidated financial statements as of the date of grant of awards related to such plans, pursuant to the provisions of the Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation and Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an amendment to FASB Statement No. 123 , is disclosed as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands, except per share data)	**2003**	**2002**	**2003**	**2002**
Net income, as reported	**$8,894**	$10,327	**$14,636**	$29,254
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	**591**	529	**2,059**	2,180
Pro forma net income	**$8,303**	$ 9,798	**$12,577**	$27,074
Earnings per share:				
Basic-as reported	**$ 0.30**	$ 0.34	**$ 0.49**	$ 0.95
Basic-pro forma	**$ 0.28**	$ 0.32	**$ 0.42**	$ 0.88
Diluted-as reported	**$ 0.30**	$ 0.34	**$ 0.49**	$ 0.95
Diluted-pro forma	**$ 0.28**	$ 0.32	**$ 0.42**	$ 0.88

Note Twelve Commitments, Contingencies and Off-Balance Sheet Risk

Commitments and Off-Balance Sheet Risk. The Corporation is party to various financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit, and involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated financial statements. Commitments to extend credit are agreements to lend to a customer so long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates and may require collateral from the borrower if deemed necessary by the Corporation. Standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party up to a stipulated amount and with specified terms and conditions. Standby letters of credit are recorded as a liability by the Corporation at the fair value of the obligation undertaken in issuing the guarantee. Commitments to extend credit are not recorded as an asset or liability by the Corporation until the instrument is exercised. The Corporation uses the same credit policies in making commitments and conditional obligations as it does for instruments reflected in the consolidated financial statements. The creditworthiness of each customer is evaluated on a case-by-case basis.

At September 30, 2003, the Corporation s exposure to credit risk was represented by preapproved but unused lines of credit totaling $314.7 million, loan commitments totaling $331.9 million and standby letters of credit aggregating $7.9 million. Of the $314.7 million of preapproved unused lines of credit, $32.4 million were at fixed rates and $282.3 million were at floating rates. Of the $331.9 million of loan commitments, $56.5 million were at fixed rates and $275.4 million were at floating rates. Of the $7.9 million of standby letters of credit, $6.9 million expire in less than one year and $1.0 million expire in one to three years. The fair value and carrying value at September 30, 2003 of standby letters of credit issued or modified during the three and nine months ended September 30, 2003 were less than $100,000. The maximum amount of credit loss of standby letters of credit is represented by the contract amount of the instruments. Management expects that these commitments can be funded through normal operations. The amount of collateral obtained if deemed necessary by the Corporation upon extension of credit is based on management s credit evaluation of the borrower at that time. The Corporation generally extends credit on a secured basis. Collateral obtained may include, but is not be limited to, accounts receivable, inventory and commercial and residential real estate.

The Bank primarily makes commercial and consumer loans to customers throughout its market area. The Corporation s primary market area includes the state of North Carolina, and predominately centers on the Metro region of Charlotte, North Carolina. The real estate loan portfolio can be affected by the condition of the local real estate markets.

Contingencies. The Corporation and the Bank are defendants in certain claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material adverse effect on the consolidated operations, liquidity or financial position of the Corporation or the Bank.

Note Thirteen Comprehensive Income

Comprehensive income includes net income and all non-owner changes to the Corporation s equity. The Corporation s only component of other comprehensive income is the change in unrealized gains and losses on available for sale securities.

The Corporation s total comprehensive income for the nine months ended September 30, 2003 and 2002 was $2.4 million and $43.1 million, respectively. Information concerning the Corporation s other comprehensive income for the nine months ended September 30, 2003 and 2002 is as follows:

	For the Nine Months Ended September 30,					
	2003			**2002**		
(Dollars in thousands)	**Before Tax Amount**	**Tax Effect**	**After Tax Amount**	**Before Tax Amount**	**Tax Effect**	**After Tax Amount**
Unrealized (losses) gains on securities:						
Unrealized (losses) gains arising during period	**$(10,281)**	**$(4,018)**	**$ (6,263)**	$28,794	$11,234	$ 17,560
Less: Reclassification for realized gains	**9,782**	**3,815**	**5,967**	6,168	2,406	3,762
Unrealized (losses) gains, net of reclassification	**$(20,063)**	**$(7,833)**	**$ (12,230)**	$22,626	$ 8,828	$ 13,798
Other comprehensive (loss) income	**$(20,063)**	**$(7,833)**	**$ (12,230)**	$22,626	$ 8,828	$ 13,798

Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the consolidated financial statements of First Charter Corporation (the Corporation) and the notes thereto.

The following discussion contains certain forward-looking statements about the Corporation s financial condition and results of operations, which are subject to certain risks and uncertainties that could cause actual results to differ materially from those reflected in the forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management s judgment only as of the date hereof. The Corporation undertakes no obligation to publicly revise these forward-looking statements to reflect events and circumstances that arise after the date hereof.

Factors that may cause actual results to differ materially from those contemplated by such forward looking statements include, among others, the following possibilities: (1) projected results in connection with the implementation of our business plan are lower than expected; (2) competitive pressure among financial services companies increases significantly; (3) costs or difficulties related to the integration of acquisitions or expenses in general are greater than expected; (4) general economic conditions, in the markets in which the company does business, are less favorable than expected; (5) risks inherent in making loans, including repayment risks and risks associated with collateral values, are greater than expected; (6) changes in the interest rate environment reduce interest margins and affect funding sources; (7) changes in market rates and prices may adversely affect the value of financial products; (8) legislation or regulatory requirements or changes thereto adversely affect the businesses in which the company is engaged; (9) regulatory compliance cost increases are greater than expected; and (10) decisions to change the business mix of the company.

Overview

The Corporation is a bank holding company established as a North Carolina Corporation in 1983, with one wholly-owned banking subsidiary, FCB. The Corporation s principal executive offices are located in Charlotte, North Carolina. FCB is a full service bank and trust company with 53 financial centers and five insurance offices located in 17 counties throughout the piedmont and western half of North Carolina. As of September 30, 2003, the Corporation and its subsidiaries owned 35 of those financial center locations, leased 18 of those financial center locations and leased the five insurance offices. The Corporation also leases a facility in Reston, Virginia for the origination of real estate loans, as well as a holding company for certain subsidiaries that own real estate and real estate-related assets, including first and second residential mortgage loans.

The Corporation s primary market area is located within North Carolina and predominately centers around the Metro region of Charlotte, North Carolina, including Mecklenburg County and its surrounding counties. Charlotte is the twenty-first largest city in the United States and has a diverse economic base. Primary business sectors in the Charlotte Metro region include banking and finance, insurance, manufacturing, health care, transportation, retail, telecommunications, government services and education. As of September 30, 2003 the unemployment rate for the Charlotte Metro region was 6.6 percent compared to 6.4 percent for the state of North Carolina. The Corporation believes that it is not dependent on any one or a few types of commerce due to the economic diversity in the region.

Through its financial center locations, the Bank provides a wide range of banking products, including interest bearing and non-interest bearing checking accounts; Money Market Rate accounts; certificates of deposit; individual retirement accounts; overdraft protection; commercial, consumer, agriculture, real estate, residential mortgage and home equity loans; personal and corporate trust services; safe deposit boxes; and automated banking.

In addition, through First Charter Brokerage Services, a subsidiary of FCB, the Corporation offers full service and discount brokerage services, annuity sales and financial planning services pursuant to a third party arrangement with UVEST Investment Services. The Bank also operates six other subsidiaries: First Charter Insurance Services, Inc., First Charter of Virginia Realty Investments, Inc., First Charter Realty Investments, Inc., FCB Real Estate, Inc., First Charter Real Estate Holding, LLC, and First Charter Leasing, Inc. First Charter Insurance Services, Inc. is a North Carolina corporation formed to meet the insurance needs of businesses and individuals throughout the

Charlotte metropolitan area. First Charter of Virginia Realty Investments, Inc. is a Virginia corporation engaged in the mortgage origination business and also acts as a holding company for First Charter Realty Investments, Inc., a Delaware real estate investment trust. FCB Real Estate, Inc. is a North Carolina real estate investment trust, and First Charter Real Estate Holdings, LLC is a North Carolina limited liability company. First Charter Leasing, Inc. is a North Carolina corporation, which leases commercial equipment. The Bank also has a majority ownership in Lincoln Center at Mallard Creek, LLC. Lincoln Center is a three-story office building occupied in part by a branch of FCB.

The principal offices of the Corporation are located in the 230,000 square foot First Charter Center located at 10200 David Taylor Drive in Charlotte, North Carolina, which is owned by the Bank through its subsidiaries. The First Charter Center contains the corporate offices of the Corporation as well as the operations, mortgage loan and data processing departments of FCB.

Critical Accounting Policies

The Corporation s accounting policies are fundamental to understanding management s discussion and analysis of financial condition and results of operations. The Corporation s significant accounting policies are presented on pages 51 to 59 of the Corporation s Annual Report on Form 10-K for the year ended December 31, 2002. Of these policies, the Corporation considers its policy regarding the allowance for loan losses to be one of its most critical accounting policies, because it requires management s most subjective and complex judgments. The Corporation has developed appropriate policies and procedures for assessing the adequacy of the allowance for loan losses, recognizing that this process requires a number of assumptions and estimates with respect to its loan portfolio. The Corporation s assessments may be impacted in future periods by changes in economic conditions, the impact of regulatory examinations and the discovery of information with respect to borrowers which is not known to management at the time of the issuance of the consolidated financial statements. For additional discussion concerning the Corporation s allowance for loan losses and related matters, see **Allowance for Loan Losses**.

In addition, the Corporation also considers its policy regarding equity method investments to be a critical accounting policy due to the assumptions in the valuation of these investments and other subjective factors. The Corporation s equity method investments represent investments in venture capital limited partnerships.

The Corporation s recognition of earnings or losses from an equity method investment is determined by the Corporation s share of the investee s earnings on a quarterly basis (or, in the case of some smaller investments, on an annual basis if there has been no significant change in values). The limited partnerships generally provide their financial information during the quarter after the end of a given period. The Corporation s policy is to record its share of earnings or losses on these equity method investments in the quarter such information was received.

These limited partnerships record their investments in investee companies on a fair value basis, with changes in the underlying fair values being reflected as an adjustment to their earnings in the period such changes are determined. The earnings of these limited partnerships, and therefore the amount recorded on an equity-method basis by the Corporation, are impacted significantly by changes in the underlying value of the companies in which these limited partnerships invest. All of the companies in which these limited partnerships invest are privately held, and their market values are not readily available. Estimations of these values are made by the management of the limited partnerships and are reviewed by the Corporation s management for reasonableness. The assumptions in the valuation of these investments include the viability of the business model, the ability of the company to obtain alternative financing, the ability to generate revenues in future periods and other subjective factors. Given the inherent risks associated with this type of investment in the current economic environment, there can be no guarantee that there will not be widely varying gains or losses on these equity method investments in future periods.

At September 30, 2003 and December 31, 2002 the total book value of equity method investments was $2.5 million and $3.8 million, respectively, and is included in other assets on the consolidated balance sheet. Of the $2.5 million, $1.1 million represents investments in venture capital partnerships, which invest primarily in equity securities. The remaining $1.4 million is invested in Small Business Investment Companies (SBICs), which make debt investments that qualify for the investment test under the Community Reinvestment Act. At September 30, 2003, the Corporation s remaining commitment to fund the equity method investments was $1.7 million and represented commitments to three venture funds that are SBICs. These three venture funds primarily make debt investments in established companies that have a minimum of $5 million in annual revenue. These remaining commitments are callable in 2003.

Results of Operations

Refer to ***Table One*** for quarterly selected financial data.

Earnings Summary

Net income amounted to $8.9 million, or $0.30 per diluted common share, for the three months ended September 30, 2003, compared to net income of $10.3 million, or $0.34 per diluted common share, for the three months ended September 30, 2002. The decrease in net income was primarily due to (i) a $4.8 million increase in noninterest expense resulting from (a) increased professional fees primarily related to consulting services in connection with the review and revision of our procedures to comply with the Bank Secrecy Act, consulting services to ensure compliance with Section 404 of the Sarbanes-Oxley Act and fees related to the investigation and collection of questionable residential rental property loans, (b) increased salaries and employee benefits resulting from additional personnel associated with the purchase of a third party benefits administrator in July 2003 and increased commission-based compensation in our mortgage, brokerage and insurance services areas, (c) increased other operating expense due to an increase in mortgage servicing fees, non-credit losses and other miscellaneous expenses, and (d) increased marketing expense associated with the implementation of the Checking Account Marketing Program (CHAMP); (ii) a $2.8 million decrease in net interest income resulting from a decrease in interest income due to lower interest income on earning assets partially offset by a decrease in interest expense resulting from the continued effects of a declining interest rate environment; and (iii) a $0.7 million increase in the provision for loan losses arising from increased net charge-offs. This decrease was partially offset by (i) a $6.1 million increase in noninterest income resulting from income recognized from the Corporation s investment in bank owned life insurance (BOLI), growth in services charges on deposit accounts, income from equity method investments, increases in financial management income due to the purchase of a third party benefits administrator, brokerage revenues and mortgage loan income, gains on the sale of bank property and increases in other income due to increased ATM fees, mortgage servicing income and lower write-downs of mortgage servicing rights and (ii) a $0.7 million decrease in income tax expense due to a decrease in taxable income and the effective tax rate.

Net income for the three months ended September 30, 2003 and 2002 includes certain selected items, which are set forth in ***Table Two***. These selected items are included in net income and should be considered in a year over year analysis of results of operations. For the three months ended September 30, 2003, these selected items primarily consisted of (i) a $0.4 million gain on the sale of property, (ii) a $0.3 million gain on the sale of securities, (iii) $0.2 million of income from trading gains and (iv) $0.1 million of income from equity method investments. For the three months ended September 30, 2002, selected items primarily consisted of (i) a $1.4 million gain on the sale of securities, (ii) $0.3 million of income from trading gains and (iii) a $2.5 million loss on equity method investments.

During the first nine months of 2003, the results of operations were also affected by the sale of $60.9 million in nonaccruing and accruing higher risk loans to investors in June 2003 (the June Loan Sale). The rationale for these sales was to improve the asset quality of the loan portfolio and to contain the financial risk of the aforementioned loans. The effect of the June Loan Sale is discussed in more detail throughout this section. In particular, the June Loan Sale resulted in an increased provision for loan losses and has impacted several of the Corporation s asset quality ratios.

Net income amounted to $14.6 million, or $0.49 per diluted common share, for the nine months ended September 30, 2003, compared to $29.3 million, or $0.95 per diluted common share, for the nine months ended September 30, 2002. The decrease in net income was primarily due to (i) a $17.8 million increase in the provision for loan losses arising from the June Loan Sale, from current adverse business conditions and increased net charge-offs, (ii) a $15.5 million increase in noninterest expense which was due to the following factors: prepayment cost associated with the refinancing of $50 million of fixed term advances; increased professional fees due to the June Loan Sale, consulting fees to ensure compliance with Section 404 of the Sarbanes-Oxley Act, the review and revision of our procedures for compliance with the Bank Secrecy Act, and fees related to the investigation and collection of questionable residential rental property loans; increased other operating expenses primarily due to an increase in sub-servicing fees, non-credit losses and other miscellaneous expenses, increased marketing expense associated with the implementation of CHAMP and increased salary and employee benefits due to additional personnel associated with the purchase of a third party benefits administrator in July 2003 and increased commission-based compensation in our mortgage, brokerage and insurance service areas, (iii) a $6.3 million decrease in net interest income resulting from a decrease in interest income due to lower interest income on earning assets partially offset by a decrease in interest expense resulting from the continued effects of a declining interest rate environment. This decrease was partially offset by (i) a $19.3 million increase in noninterest income resulting from gains on sale of securities, gain on the sale of the credit card portfolio, gains on sale of bank property, income recognized from the Corporation s investment in BOLI, growth in service charges on deposit accounts, higher trading gains, increases in brokerage revenues, mortgage services income, financial management income due to the purchase of a third party benefits administrator and insurance services revenues and (ii) a $5.7 million decrease in income tax expense due to a decrease in taxable income and the effective tax rate.

Net income for the nine months ended September 30, 2003 and 2002 includes certain selected items, which are set forth in ***Table Two***. These selected items are included in net income and should be considered in a year over year analysis of results of operations. For the nine months ended September 30, 2003, selected items primarily consisted of (i) a $9.8 million gain on the sale of securities, (ii) a $2.3 million gain on the sale of credit card loans, (iii) $1.8 million of income from trading gains, (iv) a $0.4 gain on the sale of property, (v) $7.4 million of prepayment costs on FHLB borrowings and (v) a $0.3 million net loss on equity method investments. For the nine months ended September 30, 2002, selected items primarily consisted of (i) a $6.2 million gain on the sale of securities, (ii) a $1.0 million gain recognized on the sale of excess bank property, (iii) $1.0 million of income from trading gains and (iv) a $5.5 million loss on equity method investments.

Table One
Selected Financial Data

(Dollars in thousands, except per share amounts)	For the Three Months Ended September 30 2003	For the Three Months Ended September 30 2002	For the Nine Months Ended September 30 2003	For the Nine Months Ended September 30 2002
Income statement				
Interest income	**$ 43,233**	$ 49,782	**$ 133,742**	$ 148,255
Interest expense	**17,033**	20,817	**54,920**	63,132
Net interest income	**26,200**	28,965	**78,822**	85,123
Provision for loan losses	**2,400**	1,750	**23,943**	6,095
Noninterest income	**14,844**	8,730	**50,663**	31,352
Noninterest expense	**26,543**	21,740	**85,629**	70,141
Income before income taxes	**12,101**	14,205	**19,913**	40,239
Income tax expense	**3,207**	3,878	**5,277**	10,985
Net income	**$ 8,894**	$ 10,327	**$ 14,636**	$ 29,254
Per common share				
Basic net income	**$ 0.30**	$ 0.34	**$ 0.49**	$ 0.95
Diluted net income	**0.30**	0.34	**0.49**	0.95
Cash dividends declared	**0.185**	0.185	**0.555**	0.545
Period-end book value	**10.20**	10.78	**10.20**	10.78
Average shares outstanding basic	**29,672,137**	30,379,838	**29,825,313**	30,667,773
Average shares outstanding diluted	**29,904,440**	30,506,426	**30,020,709**	30,864,476
Ratios				
Return on average shareholders equity[1]	**11.31%**	12.30%	**6.13%**	12.00%
Return on average assets[1]	**0.87**	1.14	**0.50**	1.12
Net interest margin[1]	**2.86**	3.57	**2.97**	3.63
Average loans to average deposits	**83.76**	95.27	**86.26**	93.16
Average equity to average assets	**7.66**	9.29	**8.07**	9.35
Efficiency ratio[2]	**64.26**	58.84	**70.52**	62.43
Dividend payout	**61.67**	54.41	**113.27**	57.37
Selected period end balances				
Securities available for sale	**$ 1,603,262**	$ 1,212,742	**$ 1,603,262**	$ 1,212,742
Loans held for sale	**14,784**	14,532	**14,784**	14,532
Loans	**2,109,481**	2,227,363	**2,109,481**	2,227,363
Allowance for loan losses	**23,953**	27,411	**23,953**	27,411
Total assets	**4,087,967**	3,700,929	**4,087,967**	3,700,929
Total deposits	**2,481,582**	2,313,788	**2,481,582**	2,313,788
Borrowings	**1,261,412**	1,004,836	**1,261,412**	1,004,836
Total liabilities	**3,785,704**	3,376,174	**3,785,704**	3,376,174
Total shareholders equity	**302,263**	324,755	**302,263**	324,755
Selected average balances				
Loans and loans held for sale	**2,130,236**	2,170,961	**2,140,652**	2,078,937
Earning assets	**3,730,688**	3,311,707	**3,618,677**	3,209,160
Total assets	**4,071,214**	3,586,969	**3,952,528**	3,486,391
Total deposits	**2,543,301**	2,278,758	**2,481,486**	2,231,470
Borrowings	**1,180,770**	923,570	**1,105,708**	879,948
Total shareholders equity	**311,962**	333,165	**319,048**	326,026

(1) *Annualized*

(2) *Noninterest expense divided by the sum of taxable equivalent net interest income plus noninterest income less gain on sale of securities.*

The following table presents a schedule of selected items included in net income for the three and nine months ended September 30, 2003 and 2002:

Table Two
Selected Items

	For the Three Months Ended September 30		For the Nine Months Ended September 30	
(Dollars in thousands)	**2003**	**2002**	**2003**	**2002**
Selected items included in earnings				
Noninterest income				
Gain on sale of securities	**$270**	$ 1,416	**$ 9,782**	$ 6,168
Gain on sale of credit card portfolio	**49**		**2,262**	
Equity investment write down				(20)
Equity method (loss) income	**78**	(2,525)	**(298)**	(5,461)
Trading gains	**158**	298	**1,754**	1,040
Gain on sale of property	**382**		**382**	1,013
Noninterest expense				
Prepayment costs on borrowings			**(7,366)**	

Business Segments

For the nine months ended September 30, 2003 and 2002 the Corporation only had one reportable segment, FCB. FCB provides businesses and individuals with commercial loans, retail loans, and deposit banking services. Other operating segments include brokerage, insurance, mortgage and financial management, which provides comprehensive financial planning, funds management and investments.

The following table for First Charter s reportable business segment compares total income for the nine months ended September 30, 2003 to the same period last year:

Table Three
Business Segment Net Income (Loss)

	For the Nine Months Ended September 30	
(Dollars in thousands)	**2003**	**2002**
FCB	**$14,949**	$32,727
Other operating segments	**1**	(526)
Other	**(314)**	(2,947)
Total consolidated	**$14,636**	$29,254

FCB s net income was $14.9 million for the nine months ended September 30, 2003 compared to $32.7 million for the corresponding period in 2002. The decrease was primarily due to (i) a $17.8 million increase in the provision for loan losses arising from the June Loan Sale, current adverse business conditions and increased net charge-offs, (ii) a $13.0 million increase in noninterest expense which was due to the following factors: prepayment cost associated with the refinancing of $50 million of fixed term advances; increased professional fees due to the June Loan Sale, consulting fees to ensure compliance with Section 404 of the Sarbanes-Oxley Act, the review and revision of our procedures for compliance with the Bank Secrecy Act, and fees related to the investigation and collection of questionable residential rental property loans; increased other operating expenses primarily due to an increase in mortgage servicing income, non-credit losses and other miscellaneous expenses and increased marketing expense associated with the implementation of CHAMP and (iii) a $6.5 million decrease in net interest income due to lower interest income on earning assets partially offset by a decrease in interest expense resulting from the continued effects of a declining interest rate environment. This decrease was partially offset by (i) a $12.7 million increase in noninterest income resulting from gains on sale of debt securities, gain on the sale of the credit card portfolio, income recognized from the Corporation s investment in BOLI, growth in services charges on deposit accounts and higher trading gains and (ii) a $6.9 million decrease in income tax expense due to a decrease in taxable income and the effective tax rate.

Other operating segments reported net income of $1,000 for the nine months ended September 30, 2003 compared to a net loss of $0.5 million for the corresponding period in 2002. The decrease in net loss was primarily due to higher noninterest income due to increases in brokerage services revenues, mortgage fee income, insurance services revenues and financial management income primarily due to the acquisition of a third party benefits administrator in July. The increases were partially offset by increased noninterest expense due to higher incentive compensation based on the increases in noninterest income.

Other reported a net loss of $0.3 million for the nine months ended September 30, 2003 compared to a net loss of $2.9 million for the same year ago period. The decrease in net loss was primarily due to a $5.5 million net loss on equity method investments during the nine months ended September 30, 2002 versus a net loss of $0.3 million for the nine months ended September 30, 2003. In addition, gains on sale of equity securities amounted to $0.2 million and $1.8 million for the nine months ended September 30, 2003 and September 30, 2002, respectively. These changes resulted in a decrease in the income tax benefit to $0.3 million at September 30, 2003 from $2.9 million at September 30, 2002.

Net Interest Income

An analysis of the Corporation s net interest income on a taxable-equivalent basis and average balance sheets for the three and nine months ended September 30, 2003 and 2002 is presented in ***Tables Four and Five***. The changes in net interest income (on a taxable-equivalent basis) for the three and nine months ended September 30, 2003 and 2002 are analyzed in ***Tables Six and Seven***.

Net interest income, the difference between total interest income and total interest expense, is the Corporation s principal source of earnings. Net interest income amounted to $26.2 million for the three months ended September 30, 2003, a decrease of $2.8 million from net interest income of $29.0 million for the same period in 2002. The decrease was primarily due to lower yields on earning assets resulting from the continued effects of a declining interest rate environment. As previously discussed, the Corporation sold $60.9 million in nonaccruing and accruing higher risk loans in June 2003. The reinvestment of these proceeds was made in lower yielding mortgage-backed securities. In addition, the Corporation sold $70 million in bonds in the fourth quarter of 2002 and reinvested the proceeds into Bank Owned Life Insurance (BOLI), to help offset the rise in employee benefit costs. This investment is classified as an other asset on the balance sheet, and the income is recognized as noninterest income rather than being recognized as interest income. For the third quarter of 2003, income earned on BOLI amounted to approximately $1.0 million, which is nontaxable. Also, the mortgage-backed securities portfolio has produced lower effective yields due to increased amortization of premiums resulting from increased prepayment speeds of underlying mortgages. During the first half of 2003, the Corporation sold approximately $371.7 million of these mortgage-backed securities in order to stabilize cash flows and to improve effective yields in this portfolio. These proceeds were reinvested in fixed term agency securities and mortgage-backed securities of a shorter average life and at a lower current coupon. In addition, using standard rate shock analysis, the Corporation expects that the extension risk in the reinvested portfolio should be less than that of the securities sold. These actions, coupled with weak loan demand, have resulted in a change in the mix of earning assets from higher yielding loans to lower yielding securities. The decrease in net interest income was partially offset by a $3.8 million decrease in interest expense due to (i) a decline in interest rates across the yield curve, (ii) a planned shift in funding sources from higher cost retail deposits to lower-cost transaction based accounts and (iii) the benefits from the refinancing of $100 million and $50 million of fixed-term advances during the fourth quarter of 2002 and second quarter of 2003, respectively.

Net interest income amounted to $78.8 million for the nine months ended September 30, 2003, a decrease of $6.3 million from net interest income of $85.1 million for the same period in 2002. Net interest income decreased primarily due to (i) lower interest income on earning assets resulting from the continued effects of a declining interest rate environment, (ii) lower effective yields from the mortgage-backed securities portfolio due to the acceleration of amortization of premiums resulting from increased prepayment speeds, (iii) lower reinvestment yields on increased cash flows, (iv) the effects of the sale of $70 million of bonds to purchase BOLI, the income from which is recognized as noninterest income and (v) a change in the mix of earning assets from higher yielding loans to lower yielding securities. The decrease in net interest income was partially offset by an $8.2 million decrease in interest expense due to (i) a decline in interest rates across the yield curve, (ii) a planned shift in funding sources from higher cost retail deposits to lower cost transaction based accounts and (iii) the benefits from the refinancing of fixed-term advances.

Average interest earning assets increased approximately $419.0 million to $3.73 billion for the three months ended September 30, 2003 compared to $3.31 billion for the same 2002 period. This increase was due to a $431.2 million increase in the Corporation s average securities available for sale. The increase in average securities available for sale was due to the securitization of $286.9 million of mortgage loans held for sale during 2003 and net purchases of securities used to increase earning assets. The Corporation increased its securities available for sale early in the first quarter of 2003 to offset the effects of weak loan demand. Average loans and loans held for sale decreased $40.7 million for the three months ended September 30, 2003, partially due to the securitization of $56.3 million of mortgage loans during the third quarter of 2003 and the June Loan Sale.

Average interest earning assets increased approximately $409.5 million to $3.62 billion for the nine months ended September 30, 2003 compared to $3.21 billion for the same 2002 period. This increase was partially due to a $303.4 million increase in the Corporation s average securities available for sale. The increase in average securities available for sale was due to the securitization of $286.9 million of mortgage loans held for sale and net purchases of securities used to increase earning assets. The Corporation increased its securities available for sale early in the first quarter of 2003 to offset the effects of weak loan demand. Average interest earning assets also increased due to growth in the Corporation s average loan and loans held for sale portfolio, which increased $61.7 million. The increase in average loans and loans held for sale was partially offset by the June Loan Sale, the sale of $11.7 million of credit card loans and the securitization of $286.9 million of mortgage loans held for sale. The decrease in average yield on interest earning assets to 4.67 percent and 5.00 percent for the three and nine months ended September 30, 2003, respectively, compared to 6.06 percent and 6.26 percent for the same 2002 periods, resulted principally from the decrease in the average prime rate to 4.00 percent and 4.16 percent for the three and nine months ended September 30, 2003, respectively, from 4.75 percent for both the three and nine months ended September 30, 2002. The decrease in the average prime rate is attributable to the Federal Reserve s 50 basis point decrease in the Fed Funds rate during the fourth quarter of 2002 and 25 basis point decrease late in the second quarter of 2003. The effect of the Federal Reserve s 25 basis point decrease in the Fed Funds rate late in the second quarter of 2003 is expected to further compress the average yield in future periods. The average yield earned on loans was 5.41 percent and 5.63 percent for the three and nine months ended September 30, 2003, respectively, compared to 6.38 percent and 6.53 percent for the same 2002 periods.

In addition to the increase in average interest earning assets, the Corporation experienced an increase in average interest-bearing liabilities of $467.5 million to $3.38 billion for the three months ended September 30, 2003 and an increase of $426.0 million to $3.27 billion for the first nine months of 2003 as compared to $2.91 billion and $2.84 billion for the same periods in 2002, due to (i) the use of Federal Home Loan Bank (FHLB) advances to fund growth in earning assets and (ii) increases in deposits primarily due to CHAMP and the recently introduced Money Market Max accounts. The average rate paid on interest bearing liabilities decreased to 2.00 percent and 2.25 percent for the three and nine months ended September 30, 2003, respectively, compared to 2.83 percent and 2.97 percent in the same 2002 periods, primarily due to a decline in short-term interest rates. The average rate paid on interest-bearing deposits was 1.80 percent and 2.04 percent for the three and nine months ended September 30, 2003, respectively, down from 2.49 percent and 2.65 percent in the same 2002 periods. Similarly, the rate paid on other borrowed funds decreased to 2.38 percent and 2.64 percent for the three and nine months ended September 30, 2003, respectively, compared to 3.57 percent and 3.68 percent in the same 2002 periods.

The net interest margin (tax adjusted net interest income divided by average interest-earning assets) decreased 71 basis points to 2.86 percent and 66 basis points to 2.97 percent for the three and nine months ended September 30, 2003, respectively, compared to 3.57 percent and 3.63 percent in the same 2002 periods. This decrease reflects the impact of the declining interest rate environment, which had a negative impact on the net interest margin as assets repriced faster than liabilities due to the asset sensitive nature of the balance sheet. In addition, reinvestment rates were lower than rates earned by assets previously held on the balance sheet including the sale of $40.0 million of accruing higher risk loans as a part of the June Loan Sale.

The following table includes for the three months ended September 30, 2003 and 2002 interest income on interest earning assets and related average yields, as well as interest expense on interest bearing liabilities and related average rates paid. In addition, the table includes the net interest margin. Average balances were calculated using daily balances.

Table Four
Average Balances and Net Interest Income Analysis

	Third Quarter 2003			Third Quarter 2002		
(Dollars in thousands)	Average Balance	Interest Income/ Expense	Average Yield/Rate Paid[5]	Average Balance	Interest Income/ Expense	Average Yield/Rate Paid[5]
Interest earning assets:						
Loans and loans held for sale[1][2][3]	**$2,130,236**	**$29,042**	**5.41%**	$2,170,961	$34,888	6.38%
Securities taxable	**1,492,232**	**13,411**	**3.59**	1,049,868	14,091	5.37
Securities nontaxable	**68,198**	**1,214**	**7.12**	79,338	1,423	7.17
Federal funds sold	**2,513**	**6**	**0.91**	1,369	5	1.56
Interest bearing bank deposits	**37,509**	**91**	**0.96**	10,171	45	1.75
Total earning assets[4]	**3,730,688**	**43,764**	**4.67**	3,311,707	50,452	6.06
Cash and due from banks	**84,143**			70,854		
Other assets	**256,383**			204,408		
Total assets	**$4,071,214**			$3,586,969		
Interest bearing liabilities:						
Demand deposits	**851,534**	**1,756**	**0.82**	569,768	1,361	0.95
Savings deposits	**118,942**	**103**	**0.34**	133,123	322	0.96
Other time deposits	**1,230,670**	**8,104**	**2.61**	1,287,930	10,815	3.33
Other borrowings	**1,180,770**	**7,070**	**2.38**	923,570	8,319	3.57
Total interest bearing liabilities	**3,381,916**	**17,033**	**2.00**	2,914,391	20,817	2.83
Noninterest bearing sources:						
Noninterest bearing deposits	**342,155**			287,937		
Other liabilities	**35,181**			51,476		
Shareholders equity	**311,962**			333,165		
Total liabilities and shareholders equity	**$4,071,214**			$3,586,969		
Net interest spread			**2.67**			3.23
Impact of noninterest bearing sources			**0.19**			0.34
Net interest income/ net interest margin		**$26,731**	**2.86%**		$29,635	3.57%

(1) *The preceding analysis takes into consideration the principal amount of nonaccruing loans and only income actually collected and recognized on such loans.*

(2) *Average loan balances are shown net of unearned income.*

(3) *Includes amortization of deferred loan fees of approximately $677 and $509 for the third quarter of 2003 and 2002, respectively.*

(4) *Yields on nontaxable securities and loans are stated on a taxable-equivalent basis, assuming a Federal tax rate of 35 percent, applicable state taxes and TEFRA disallowances for the second quarter of 2003 and 2002. The adjustments made to convert to a taxable-equivalent basis were $531 and $670 for the second quarter of 2003 and 2002, respectively.*

(5) *Annualized*

The following table includes for the nine months ended September 30, 2003 and 2002 interest income on interest earning assets and related average yields, as well as interest expense on interest bearing liabilities and related average rates paid. In addition, the table includes the net interest margin. Average balances were calculated using daily balances.

Table Five
Average Balances and Net Interest Income Analysis

	Nine Months Ended September 30					
	2003			2002		
(Dollars in thousands)	Average Balance	Interest Income/ Expense	Average Yield/Rate Paid[5]	Average Balance	Interest Income/ Expense	Average Yield/Rate Paid[5]
Interest earning assets:						
Loans and loans held for sale[1][2][3]	**$2,140,652**	**$ 90,093**	**5.63%**	$2,078,937	$101,520	6.53%
Securities taxable	**1,350,980**	**41,027**	**4.05**	1,038,135	44,208	5.68
Securities nontaxable	**72,956**	**3,903**	**7.13**	82,446	4,460	7.21
Federal funds sold	**2,266**	**17**	**0.99**	1,081	14	1.76
Interest bearing bank deposits	**51,823**	**430**	**1.11**	8,561	106	1.65
Total earning assets[4]	**3,618,677**	**135,470**	**5.00**	3,209,160	150,308	6.26
Cash and due from banks	**82,892**			85,965		
Other assets	**250,959**			191,266		
Total assets	**$3,952,528**			$3,486,391		
Interest bearing liabilities:						
Demand deposits	**768,914**	**5,679**	**0.99**	571,059	4,156	0.97
Savings deposits	**117,936**	**429**	**0.49**	122,557	1,010	1.10
Other time deposits	**1,277,266**	**26,987**	**2.82**	1,270,253	33,775	3.55
Other borrowings	**1,105,708**	**21,825**	**2.64**	879,948	24,191	3.68
Total interest bearing liabilities	**3,269,824**	**54,920**	**2.25**	2,843,817	63,132	2.97
Noninterest bearing sources:						
Noninterest bearing deposits	**317,371**			267,601		
Other liabilities	**46,285**			48,947		
Shareholders equity	**319,048**			326,026		
Total liabilities and shareholders equity	**$3,952,528**			$3,486,391		
Net interest spread			**2.76**			3.29
Impact of noninterest bearing sources			**0.22**			0.34
Net interest income/ yield on earning assets		**$ 80,550**	**2.97%**		$ 87,176	3.63%

(1) *The preceding analysis takes into consideration the principal amount of nonaccruing loans and only income actually collected and recognized on such loans.*

(2) *Average loan balances are shown net of unearned income.*

(3) *Includes amortization of deferred loan fees of approximately $1,661 and $1,611 for the nine months ended September 30, 2003 and 2002, respectively.*

(4) *Yields on nontaxable securities and loans are stated on a taxable-equivalent basis, assuming a Federal tax rate of 35 percent, applicable state taxes and TEFRA disallowances for the first nine months of 2003 and 2002. The adjustments made to convert to a taxable-equivalent basis were $1,728 and $2,053 for the nine months ended September 30, 2003 and 2002, respectively.*

(5) *Annualized*

The following table presents the changes in net interest income from the three months ended September 30, 2002 to the three months ended September 30, 2003:

Table Six
Volume and Rate Variance Analysis

	Three months ended September 30			
		Increase (Decrease) in Net Interest Income Due to Change in[1]		
(Dollars in thousands)	2002 Income/ Expense	Rate	Volume	2003 Income/ Expense
Interest income:				
Loans and loans held for sale[2]	$34,888	$ (5,242)	$ (604)	$29,042
Securities taxable	14,091	(5,637)	4,957	13,411
Securities nontaxable[2]	1,423	(11)	(198)	1,214
Federal funds sold	5	(3)	4	6
Interest bearing bank deposits	45	(48)	94	91
Total interest income	$50,452	$(10,941)	$4,253	$43,764
Interest expense:				
Demand deposits	$ 1,361	$ (232)	$ 627	$ 1,756
Savings deposits	322	(196)	(23)	103
Other time deposits	10,815	(2,283)	(428)	8,104
Other borrowings	8,319	(3,177)	1,928	7,070
Total interest expense	20,817	(5,888)	2,104	17,033
Net interest income	$29,635	$ (5,053)	$2,149	$26,731

(1) *The changes for each category of income and expense are divided between the portion of change attributable to the variance in rate or volume for that category. The amount of change that cannot be separated is allocated to each variance proportionately.*

(2) *Income on nontaxable securities and loans are stated on a taxable-equivalent basis. Refer to Table Four for further details.*

The following table presents the changes in net interest income from the nine months ended September 30, 2002 to the nine months ended September 30, 2003:

Table Seven
Volume and Rate Variance Analysis

	Nine months ended September 30			
		Increase (Decrease) in Net Interest Income Due to Change in[1]		
(Dollars in thousands)	2002 Income/ Expense	Rate	Volume	2003 Income/ Expense

Interest income:				
Loans and loans held for sale[2]	**$101,520**	**$(14,233)**	**$ 2,806**	**$ 90,093**
Securities taxable	**44,208**	**(14,593)**	**11,412**	**41,027**
Securities nontaxable[2]	**4,460**	**(47)**	**(510)**	**3,903**
Federal funds sold	**14**	**(10)**	**13**	**17**
Interest bearing bank deposits	**106**	**(123)**	**447**	**430**
	$150,308	**$(29,006)**	**$14,168**	**$135,470**
Interest expense:				
Demand deposits	**$ 4,156**	**$ 72**	**$ 1,451**	**$ 5,679**
Savings deposits	**1,010**	**(553)**	**(28)**	**429**
Other time deposits	**33,775**	**(6,955)**	**167**	**26,987**
Other borrowings	**24,191**	**(7,697)**	**5,331**	**21,825**
	63,132	**(15,133)**	**6,921**	**54,920**
	$ 87,176	**$(13,873)**	**$ 7,247**	**$ 80,550**

(1) *The changes for each category of income and expense are divided between the portion of change attributable to the variance in rate or volume for that category. The amount of change that cannot be separated is allocated to each variance proportionately.*

(2) *Income on nontaxable securities and loans are stated on a taxable-equivalent basis. Refer to Table Five for further details.*

Provision for Loan Losses

The provision for loan losses is the amount charged to earnings which is necessary to maintain an adequate and appropriate allowance for loan losses. Accordingly, the factors which influence changes in the allowance for loan losses have a direct effect on the provision for loan losses. The allowance for loan losses changes from period to period as a result of a number of factors, the most significant of which for the Corporation include the following: (i) changes in the amounts of loans outstanding; (ii) changes in the mix of types of loans; (iii) current charge-offs and recoveries of loans; (iv) changes in impaired loan valuation allowances; (v) changes in valuations in certain performing loans which have specific allocations; (vi) changes in credit grades within the portfolio, which arise from a deterioration or an improvement in the performance of the borrower; and (vii) changes in historical loss percentages, which are used to estimate current probable loan losses. In addition, the Corporation considers other, more subjective factors which impact the credit quality of the portfolio as a whole and estimates allocations of allowance for loan losses for these factors, as well. These factors include loan concentrations, economic conditions and operational risks. Changes in these components of the allowance can arise from fluctuations in the underlying percentages used as related loss estimates for these factors, as well as variations in the portfolio balances to which they are applied. The net change in all of these components of the allowance for loan losses results in the provision for loan losses. For a more detailed discussion of the Corporation s process for estimating the allowance for loan losses, see **Allowance for Loan Losses.**

The provision for loan losses increased to $2.4 million for the three months ended September 30, 2003 compared to $1.8 million for the corresponding period in 2002. The increase was primarily due to the impact of the June Loan Sale on the historical loss ratios and allocation factors used in the allowance model as well as an increase in consumer and commercial net charge-offs.

The provision for loan losses for the nine months ended September 30, 2003 amounted to $23.9 million compared to $6.1 million a year ago. The increase in the provision for loan losses was primarily attributable to the following second quarter 2003 events:

(i) As a result of deteriorating financial results of several large commercial relationships and independent appraisals of collateral, the Corporation added $7.5 million to the provision for loan losses. The decrease in appraised values and deteriorating financial results reflect the impact of the continued weakness in the economy on these customers. These loan relationships were sold as part of the June Loan Sale.

(ii) The Corporation made an additional provision of $4.0 million related to the discount taken in the June Loan Sale.

(iii) As a result of the impact of the June Loan Sale on the historical loss ratios used in the allowance model and management s continuous evaluation of the current economic environment and operational risks, the Corporation added $3.5 million to the provision for loan losses.

(iv) The Corporation identified up to 165 residential rental property loans totaling approximately $12.8 million some of which appear to have questionable appraisals and collateral value. These loans were made by one loan officer who is no longer employed by the Corporation or its subsidiaries. The appraisals received by the Corporation were completed by appraisers who were not employees of the Corporation or its subsidiaries. This matter has been reported by management to authorities and is under continuing investigation by management and by those authorities. As a result of management s investigation, during the second quarter of 2003, the Corporation increased the provision for loan losses by approximately $2.4 million. In the third quarter of 2003, $0.4 million of these loans were charged-off. In addition, loans totaling $0.3 million were foreclosed and moved to other real estate owned (OREO) and $0.2 million were paid down or paid-off. As management s investigation continues, it is possible that an additional provision for loan losses may be required with respect to these loans.

Net charge-offs for the three months ended September 30, 2003 amounted to $2.1 million, or 0.40 percent of average loans, compared to $1.2 million, or 0.23 percent of average loans for the same 2002 period. The increase in net charge-offs was primarily due to (i) the previously discussed $0.4 million of residential rental property loan charge-offs which was previously provided for in the allowance for loan losses, (ii) a $0.3 million increase in consumer loan charge-offs and (iii) a $0.3 million increase in commercial loan charge-offs. Net charge-offs for the nine months ended September 30, 2003 amounted to $6.4 million, or 0.41 percent of average loans compared to

$4.2 million, or 0.27 percent of average loans for the same 2002 period. These increases in net charge-offs were due to higher commercial loan charge-offs due to the impact of the continued weak economic environment and the previously discussed $0.4 million of residential rental property loan charge-offs.

During the three and nine months ended September 30, 2003, the Corporation made no changes to its estimated loss percentages for economic factors. As a part of its quarterly assessment of the allowance for loan losses, the Corporation reviews key local, regional and national economic information, and assesses its impact on the allowance for loan losses. Based on its review for the nine months ended September 30, 2003, the Corporation noted that economic conditions continue to be weak; however, management concluded that the impact on borrowers and local industries in the Corporation s primary market area did not change significantly during the period. Accordingly, the Corporation did not modify its loss estimate percentage attributable to economic factors in its allowance for loan losses model.

The Corporation also continuously reviews its portfolio for any concentrations of loans to any one borrower or industry in the area. To analyze its concentrations, the Corporation prepares various reports showing total loans to borrowers by industry, as well as reports showing total loans to one borrower. At the present time, the Corporation does not believe it is overly concentrated to any industry or specific borrower, and therefore has made no allocations of allowances for loan losses for this factor for any of the periods presented.

In addition to reviewing the impact of the economy and any loan concentrations, the Corporation also monitors the amount of operational risk that exists in the portfolio. This would include the front-end underwriting, documentation and closing processes associated with the lending decision. Additional reserves have been set-aside in the allowance model for operational risk due to the differences in underwriting methodologies underlying the loans inherited through mergers. With the implementation of one central loan policy and procedure, this risk appears to be stable. As a result, the percent of additional allocation for the operational reserve has not changed in recent periods.

The provision for loan losses was impacted by changes in allocations of allowance for loan losses to the various loan types. A higher allocation of allowance for loan losses was required for commercial loans in September 2003 over June 2003 due primarily to recent downgrades on commercial loans. This was partially offset by a lower allocation of allowance required for mortgage loans due to a decrease in the reserve factors based on historical loss experience. Consumer loan allocations of the allowance for loan losses have remained essentially unchanged from June 2003 to September 2003.

Management did not make any significant changes in the loss estimation methodology during the quarter that had a significant impact on the provision for loan losses, except as mentioned above.

Noninterest Income

As presented in ***Table Eight***, noninterest income increased $6.1 million to $14.8 million for the three months ended September 30, 2003, as compared to $8.7 million for the period ended September 30, 2002. The increase in noninterest income includes $0.4 million of gains on sale of bank property. The remaining components of the increase were (i) $1.0 million of income recognized from the Corporation s investment in BOLI, (ii) a $1.0 million increase in service charges on deposit accounts resulting from increased NSF fees on a greater volume of overdraft items (see ***Note Eight*** of the consolidated financial statements for a discussion of certain related party transactions which impacted deposit service charges in the three months ended September 30, 2003 and 2002), (iii) a $0.8 million increase in financial management income primarily due to the purchase of a third party benefits administrator in July 2003, (iv) a $0.8 million increase in mortgage services income as the low interest rate environment continued to fuel record mortgage originations and refinance activity, (v) a $0.2 million increase in brokerage revenues due to increased commission and fee income reflecting current market conditions and (vi) a $0.5 million increase in other income due to increased ATM fees, mortgage servicing income and lower write-downs of mortgage servicing rights. In addition, income from equity method investments amounted to $0.1 million in the third quarter of 2003 versus net losses of $2.5 million for the same period in 2002. These improvements were partially offset by a $1.1 million decrease in gains on sales of securities and a $0.1 million decrease in trading gains.

As presented in ***Table Eight***, noninterest income increased $19.3 million to $50.7 million for the nine months ended September 30, 2003 compared to $31.4 million for the same period in 2002. The increase includes a $2.3 million gain on the sale of the credit card portfolio and a $3.6 million increase in gains on the sales of callable agency and mortgage-backed securities. The remaining components of this increase were (i) $2.9 million of income recognized from the Corporation s investment in BOLI, (ii) a $2.2 million increase in service charges on deposit accounts resulting from increased NSF fees on a greater volume of overdraft items (see ***Note Eight*** of the consolidated financial statements for a discussion of certain related party transactions which impacted deposit service charges in the nine months ended September 30, 2003 and 2002), (iii) a $1.3 million increase in mortgage services income, (iv) a $0.7 million increase in trading gains, (v) a $0.6 million increase in financial management income primarily due to the purchase of a third party benefits administrator, (vi) a $0.5 million increase in brokerage revenues, (vii) a $0.3 million increase in insurance service income, and (viii) a $0.4 million increase in other noninterest income due to increased ATM fees, merchant income and mortgage servicing income. In addition, net losses from equity method investments amounted to $0.3 million in the nine months ended September 30, 2003 versus net losses of $5.5 million for the same period in 2002. These results included gains on the sale of bank property of $0.4 million and $1.0 million for the nine months ended September 30, 2003 and September 30, 2002, respectively. Noninterest income was also impacted by the write down of mortgage servicing rights of $0.5 million and $0.2 million for the nine months ended September 30, 2003 and 2002, respectively. The increase in the write down of mortgage servicing rights was due to increasing prepayments in the current low interest rate environment.

Table Eight
Noninterest Income

	Three Months Ended September 30		Increase/(Decrease)		Nine Months Ended September 30		Increase/(Decrease)	
(Dollars in thousands)	**2003**	**2002**	**Amount**	**Percent**	**2003**	**2002**	**Amount**	**Percent**
Service charges on deposit accounts	**$ 5,674**	$ 4,689	$ 985	21.0%	**$16,375**	$14,135	$ 2,240	15.8%
Financial management income	**1,400**	566	834	147.3	**2,466**	1,913	553	28.9
Gain on sale of securities	**270**	1,416	(1,146)	(80.9)	**9,782**	6,168	3,614	58.6
Gain on sale of credit card loan portfolio	**49**		49	NA	**2,262**		2,262	NA
Income (loss) from equity method investments	**78**	(2,525)	2,603	103.1	**(298)**	(5,461)	5,163	(94.5)
Mortgage services income	**1,329**	504	825	163.7	**2,613**	1,320	1,293	98.0
Brokerage services income	**861**	640	221	34.5	**2,159**	1,697	462	27.2
Insurance services income	**2,327**	2,313	14	0.6	**6,993**	6,658	335	5.0
Trading gains	**158**	298	(140)	(47.0)	**1,754**	1,040	714	68.7
Bank owned life insurance	**992**		992	NA	**2,905**		2,905	NA
Gain on sale of property	**382**		382	NA	**382**	1,013	(631)	(62.3)
Other	**1,324**	829	495	59.7	**3,270**	2,869	401	14.0
Total noninterest income	**$14,844**	$ 8,730	$ 6,114	70.0%	**$50,663**	$31,352	$19,311	61.6%

Noninterest Expense

As presented in ***Table Nine***, noninterest expense totaled $26.5 million for the three months ended September 30, 2003 compared to $21.7 million a year ago. The variance includes a (i) $1.8 million increase in professional fees primarily due to $0.5 million of consulting services related to the review and revision of our procedures to comply with the Bank Secrecy Act, (ii) $0.4 million of consulting services to ensure compliance with Section 404 of the Sarbanes-Oxley Act, and (iii) $0.2 million of fees related to the investigation and collection of questionable residential rental property loans. The balance of the increase in professional fees relates to various other consulting services. Noninterest expense was also impacted by a $1.3 million increase in salaries and employee benefits due to additional personnel associated with the purchase of a third party benefits administrator in July and increased commission-based compensation in our mortgage, brokerage and insurance services areas. These increases were partially offset by a $0.6 million decrease in incentive compensation accruals as a result of a revision in estimated payouts. In addition, noninterest expense was impacted by a $0.8 million increase in other operating expense primarily due to increased mortgage servicing fees, non-credit losses and other miscellaneous expenses and a $0.5 million increase in marketing expense associated with the implementation of CHAMP.

As presented in ***Table Nine***, noninterest expense totaled $85.6 million for the nine months ended September 30, 2003 compared to $70.1 million for the corresponding period in 2002. The major contributing factors to this increase were (i) $7.4 million of prepayment costs associated with the refinancing of $50 million of FHLB advances and (ii) a $3.4 million increase in professional fees due to the June Loan Sale, consulting services to ensure compliance with Section 404 of the Sarbanes-Oxley Act, the review and revision of our procedures for compliance with the Bank Secrecy Act, and fees related to the investigation and collection of questionable residential rental property loans. Noninterest expense was also impacted by (i) a $1.8 million increase in other operating expense primarily due to increased mortgage servicing fees, non-credit losses and other miscellaneous expenses, (ii) a $1.6 million increase in marketing expense primarily associated with the implementation of CHAMP, (iii) a $1.5 million increase in salaries and employee benefits due to additional personnel associated with the purchase of a third party benefits administrator in July and (iv) increased commission-based compensation in our mortgage, brokerage and insurance services areas. These increases were partially offset by lower incentive compensation accruals as a result of a revision in estimated payouts.

The efficiency ratio increased to 70.5 percent compared to 62.4 percent for the nine months of 2002. A significant portion of the increase in the efficiency ratio relates to the costs associated with the prepayment of Federal Home Loan Bank advances of $7.4 million and the previously discussed $3.4 million increase in professional fees. In addition, the calculation of the efficiency ratio excludes gains on sale of securities of $9.8 million and $6.2 million for the nine months ended September 30, 2003 and 2002, respectively.

Table Nine
Noninterest Expense

	Three Months Ended September 30		Increase/(Decrease)		Nine Months Ended September 30		Increase/(Decrease)	
(Dollars in thousands)	**2003**	**2002**	**Amount**	**Percent**	**2003**	**2002**	**Amount**	**Percent**
Salaries and employee benefits	**$13,277**	$11,988	$1,289	10.8%	**$39,588**	$38,093	$ 1,495	3.9%
Occupancy and equipment	**4,079**	3,839	240	6.3	**12,158**	12,264	(106)	(0.9)
Data processing	**712**	758	(46)	(6.1)	**2,024**	2,208	(184)	(8.3)
Marketing	**1,173**	630	543	86.2	**3,487**	1,904	1,583	83.1
Postage and supplies	**982**	967	15	1.6	**3,270**	3,234	36	1.1
Professional services	**3,158**	1,393	1,765	126.7	**8,160**	4,774	3,386	70.9
Telephone	**584**	461	123	26.7	**1,700**	1,575	125	7.9
Amortization of intangibles	**127**	88	39	44.3	**289**	278	11	4.0
Prepayment costs on borrowings				NA	**7,366**		7,366	NA
Other	**2,451**	1,616	835	51.7	**7,587**	5,811	1,776	30.6
Total noninterest expense	**$26,543**	$21,740	$4,803	22.1%	**$85,629**	$70,141	$15,488	22.1%

Income Taxes

Total income tax expense for the third quarter of 2003 was $3.2 million for an effective tax rate of 26.5 percent, compared to $3.9 million for an effective tax rate of 27.3 percent for the third quarter of 2002. The income tax expense for the nine months ended September 30, 2003 amounted to $5.3 million for an effective tax rate of 26.5 percent, compared to $11.0 million for an effective tax rate of 27.3 percent for the first nine months of 2002. The decrease in the income tax expense for the three and nine months ended September 30, 2003 was attributable to a decrease in taxable income and the effective tax rate.

Financial Condition

Investment Portfolio

The securities available for sale portfolio increased to $1.60 billion at September 30, 2003 as compared to $1.13 billion at December 31, 2002. The increase in securities available for sale was primarily due to the securitization of $286.9 million of mortgage loans held for sale during the nine months of 2003, as well as the net purchase of $187.1 million of securities used to increase earning assets. The Corporation increased its securities available for sale portfolio early in the first quarter of 2003 to offset the effects of weak loan demand. During 2003, the Corporation changed the mix of the portfolio to stabilize cash flows by selling mortgage backed securities which had produced a lower effective yield due to increased amortization of premiums, and reinvesting the proceeds in fixed-term agency securities and mortgage backed securities of a shorter average life and at a lower coupon.

Loans Held for Sale

Loans held for sale consists primarily of 15 and 30 year mortgage loans which the Corporation intends to sell as whole loans. Loans held for sale decreased to $14.8 million at September 30, 2003 as compared to $158.4 million at December 31, 2002. Loans held for sale was impacted by originations, sales activity and securitizations, which is reflected in the **Consolidated Statement of Cash Flows**.

Loan Portfolio

The Corporation s loan portfolio at September 30, 2003 consisted of six major categories: Commercial Non Real Estate, Commercial Real Estate, Construction, Mortgage, Consumer, and Home Equity. Within these six segments the Corporation targets customers in its footprint, works within most business segments and focuses on a relationship based business model. Pricing is driven by quality, loan size, the Corporation s relationship with the customer and by competition. The Corporation is primarily a secured lender in all these loan categories. The Corporation s loans are generally five years or less in duration with the exception of home equity lines and residential mortgages.

Commercial Non Real Estate

The Corporation s commercial non real estate lending program is generally targeted to serve small-to-middle market businesses with sales of $50 million or less in the Corporation s geographic area. Commercial lending includes commercial, financial, agricultural and industrial loans. In addition, the Corporation has a small loan participation program known as the Strategic Partners program through which loans are purchased and sold (commercial real estate, commercial non real estate and construction loans) with other banks. The Corporation does not usually participate in syndicated loans. Pricing on commercial non real estate loans, driven largely by the Corporation s relationship with the customer and by competition, is usually tied to market indexes, such as the prime rate, the London Interbank Offer Rate (LIBOR) or rates on US Treasury securities.

Commercial Real Estate

Similar to commercial non real estate lending, the Corporation s commercial real estate lending program is generally targeted to serve small-to-middle market business with sales of $50 million or less in the Corporation s geographic area. The real estate loans are both owner occupied and project related. As with commercial non real estate loans, pricing on commercial real estate loans, driven largely by the Corporation s relationship with the customer and by competition, is usually tied to market indexes, such as the prime rate, LIBOR or rates on US Treasury securities.

Construction

Real estate construction loans include both commercial and residential construction/permanent loans, which are intended to convert to permanent loans upon completion of the construction. Loans for commercial construction are usually to in-market developers, builders, businesses, individuals or real estate investors for the construction of commercial structures primarily in the Corporation s market area. From time to time, the Corporation may purchase construction loans in other market areas. Construction loans purchased are typically serviced by other third parties. Loans are made for purposes including, but not limited to, the construction of industrial facilities, apartments, shopping centers, office buildings, homes and warehouses. The properties may be constructed for sale, lease or owner-occupancy.

Mortgage

The Corporation originates 1-4 family residential mortgage loans throughout the Corporation s footprint and in Reston, Virginia, which is a loan production office. The Corporation offers a full line of products, including conventional, conforming, and jumbo fixed rate and adjustable rate mortgages which are originated and sold into the secondary market; however, from time to time a portion of this production is retained.

Consumer

The Corporation offers a wide variety of consumer loan products. Various types of secured and unsecured loans are marketed to qualifying existing customers and to other creditworthy candidates in the Corporation s market area. Unsecured loans, including revolving credits (e.g. checking account overdraft protection and personal lines of credit) are provided and various installment loan products such as vehicle loans are offered. All consumer lending is centrally decisioned and documented.

Home Equity

Home Equity loans and lines are secured by first and second deeds of trust on the borrower s residential real estate. As with all consumer lending, home equity loans are centrally decisioned and documented to ensure the underwriting conforms to the corporate lending policy.

Loan Administration and Underwriting

The Corporation s credit risk policy and procedures are centralized for every loan type. In addition, all mortgage, consumer and home equity loans are centrally decisioned. All loans flow through an independent closing unit to ensure proper documentation. Lastly, all known collection or problem loans are centrally managed by experienced workout personnel. To monitor the effectiveness of policies and procedures, Management maintains a set of asset quality standards for past dues, nonaccrual and watch list loans and monitors the trends of these standards over time. These standards are approved by the Board of Directors and reviewed quarterly for compliance.

The Bank s Chief Credit Officer is responsible for the continuous assessment of the Bank s risk profile as well as making any necessary adjustments to policies and procedures. Commercial loans less than $500,000 may be approved by experienced loan officers, within their loan authority. Commercial and commercial real estate loans are approved by signature authority requiring at least two experienced lenders for any relationships greater than $500,000 and an independent Risk Manager whenever the relationship is greater than $1 million. All relationships greater than $1.5 million receive a comprehensive annual review by the senior lending officers of the Bank, which is then reviewed by the independent Risk Management Officers and the Bank s Officer Loan Committee. Commitments over $5.0 million are further reviewed by senior lending officers of the Bank, the Chief Credit Officer and an Executive Loan Committee comprised of executive and senior management. In addition, commitments over $7.5 million are further reviewed by a Board of Directors Loan Committee. These oversight committees provide policy, process, product and specific relationship direction to the lending personnel. The Corporation has a general target lending limit to one borrower of $10 million; however, at times some loans may exceed that limit.

As described above, the Corporation s loan portfolio consists of loans made for a variety of commercial and consumer purposes. Because commercial loans are made, based to a great extent on the Corporation s assessment of borrowers income, cash flow, character and ability to repay, such loans are viewed as involving a higher degree of credit risk than is the case with residential mortgage loans or consumer loans. To manage this risk, the Corporation s commercial loan portfolio is managed under a defined process which includes underwriting standards and risk assessment, procedures for loan approvals, loan grading, ongoing identification and management of credit deterioration and portfolio reviews to assess loss exposure and to ascertain compliance with the Corporation s credit policies and procedures.

In general, consumer loans (including mortgage and home equity) are deemed less risky than commercial loans. Commercial loans (including commercial real estate, commercial non real estate and construction loans) are generally larger in size and more complex than consumer loans. Commercial real estate loans are deemed less risky than commercial non real estate and construction loans, as the collateral value of real estate generally maintains its value better than non real estate or construction collateral. Consumer loans being smaller in size provide risk diversity across the portfolio. As mortgage loans are secured by first liens on the consumer s residential real estate, they are the Corporation s least risky loan type. Home equity loans are deemed less risky than unsecured consumer loans as home equity loans and lines are secured by first or second deeds of trust on the borrower s residential real estate. A centralized decisioning process is in place to control the risk of the consumer, home equity and mortgage loan portfolio. This process is detailed in the underwriting guidelines which cover each retail loan product type from underwriting, servicing, compliance issues and closing procedures.

Gross loans increased to $2.11 billion at September 30, 2003 as compared to $2.07 billion at December 31, 2002. The increase in loans was primarily due to a $59.1 million increase in construction loans, which includes $24.8 million of 1-4 family construction loans purchased in late September, a $46.5 million increase in home equity loans and a $21.8 million increase in primarily adjustable rate mortgage loans. These increases were partially offset by the sale of $60.9 million in nonaccruing and accruing higher risk loans in connection with the June Loan Sale and the sale of the Corporation s $11.7 million credit card portfolio during the first quarter of 2003.

The Corporation s primary market area includes the state of North Carolina but predominately centers around the Metro region of Charlotte. At September 30, 2003, the majority of the total loan portfolio, as well as a substantial portion of the commercial and real estate loan portfolio, represents loans to borrowers within this Metro region. An economic downturn in our primary market area could adversely affect our business. The diversity of the region s economic base tends to provide a stable lending environment. No significant concentration of credit risk has been identified due to the diverse industrial base in the region.

In the normal course of business there are various outstanding commitments to extend credit, which are not reflected in the consolidated financial statements. At September 30, 2003, the unused portion of preapproved lines of credit totaled $314.7 million, unfunded loan commitments totaled $331.9 million and standby letters of credit aggregated $7.9 million. These amounts represent the Bank s exposure to credit risk, and in the opinion of management, have no more than the normal lending risk that the Bank commits to its borrowers. Management expects that these commitments can be funded through normal operations. The table below summarizes loans in the classifications indicated as of September 30, 2003 and December 31, 2002.

Table Ten
Loan Portfolio Composition

(Dollars in thousands)	**September 30, 2003**	**% of Total Loans**	**June 30, 2003**	**% of Total Loans**	**December 31, 2002**	**% of Total Loans**
Commercial real estate	$ 732,434	34.72%	$ 765,303	37.07%	$ 798,664	38.53%
Commercial non real estate	199,412	9.45	212,753	10.30	223,178	10.77
Construction	275,005	13.04	209,926	10.17	215,859	10.41
Mortgage	258,927	12.27	257,236	12.46	237,085	11.44
Consumer	279,512	13.25	271,734	13.16	280,201	13.52
Home equity	364,191	17.26	347,716	16.84	317,730	15.33
Total loans	2,109,481	100.00	2,064,668	100.00	2,072,717	100.00
Less allowance for loan losses	(23,953)	(1.14)	(23,644)	(1.15)	(27,204)	(1.31)
Unearned income	(190)	(0.01)	(209)	(0.01)	(247)	(0.01)
Loans, net	**$2,085,338**	98.86%	$2,040,815	98.84%	$2,045,266	98.68%

Deposits

Total deposits increased to $2.48 billion at September 30, 2003 as compared to $2.32 billion at December 31, 2002. The increase in deposits was due to a $228.6 million increase in money market accounts, and a $40.7 million increase in low-cost interest checking, savings and noninterest bearing deposits. These increases were partially offset by a $110.4 million planned decrease in time deposits. The ability to generate deposits has been enhanced by the introduction of CHAMP for individuals during the fourth quarter of 2002 and Business CHAMP during the first quarter of 2003. As a result, 2.7 times as many checking accounts were opened during the first nine months of 2003 than the first nine months of 2002. In addition, during the first quarter of 2003 the Corporation introduced a new money market account, the Money Market Max Account. This product has been very successful with total balances at September 30, 2003 of $322.9 million. The emphasis of these programs is to develop new customer relationships to generate additional fee income opportunities, and to shift our funding mix towards lower-cost funding sources.

Other Borrowings

Other borrowings increased to $1.26 billion at September 30, 2003 as compared to $1.04 billion at December 31, 2002. The increase was primarily due to increases in FHLB borrowings, which were at lower rates than comparable retail funding rates. The proceeds of these borrowings were used to fund the growth in earning assets.

Nonperforming Assets

Nonaccrual loans at September 30, 2003 decreased to $13.4 million as compared to $26.5 million at December 31, 2002, primarily due to the June Loan Sale. In addition, classified assets at September 30, 2003 decreased to $39.5 million compared to $89.5 million at December 31, 2002, primarily due to the June Loan Sale. OREO decreased to $6.7 million at September 30, 2003 from $10.3 million at December 31, 2002. This decrease was due to the sale of the two largest properties in the OREO portfolio during the second quarter of 2003. These properties were sold in cash transactions valued at an aggregate of $4.7 million for a gain of $0.3 million. Total nonperforming assets (includes nonaccrual loans and OREO) and loans 90 days or more past due and still accruing decreased to $20.1 million at September 30, 2003 compared to $36.7 million at December 31, 2002. As a result of the June Loan Sale and the aforementioned sale of two OREO properties, the Corporation s asset quality ratios have significantly improved, as the ratio of nonaccrual loans to loans decreased to 0.64 percent at September 30, 2003 from 1.28 percent at December 31, 2002. In addition, the ratio of classified assets as a percentage of loans decreased to 1.87 percent at September 30, 2003 from 4.32 percent at December 31, 2002. Also, the ratio of past due loans over 30 days to total loans decreased to 0.71 percent from 1.20 percent at December 31, 2002, due to the June Loan Sale and continued focused collection efforts.

Nonaccrual loans at September 30, 2003 increased to $13.4 million as compared to $11.1 million at June 30, 2003, primarily due to the addition of several commercial loans to nonaccrual status as some of our customers continue to experience difficulties in this current economic environment. Management is taking steps to remediate these loans. Classified assets at September 30, 2003 decreased to $39.5 million compared to $41.1 million at June 30, 2003. In addition, OREO decreased to $6.7 million at September 30, 2003 from $6.9 million at June 30, 2003. Total nonperforming assets (includes nonaccrual loans and OREO) and loans 90 days or more past due and still accruing increased to $20.1 million at September 30, 2003 compared to $18.3 million at June 30, 2003. The ratio of nonaccrual loans to loans increased to 0.64 percent at September 30, 2003 from 0.54 percent at June 30, 2003. In addition, the ratio of past due loans over 30 days to total loans increased to 0.71 percent from 0.67 percent at June 30, 2003. The ratio of classified assets as a percentage of loans decreased to 1.87 percent at September 30, 2003 from 1.99 percent at June 30, 2003.

Nonaccrual loans at September 30, 2003 were not concentrated in any one industry and primarily consisted of notes with a principal balance of less than $250,000, primarily secured by real estate. These notes represent 12 different banking relationships, and certain banking relationships account for multiple notes. Management anticipates that nonaccrual loans may increase in the near term as some customers continue to experience difficulties in this current economic environment. As discussed elsewhere herein, management has taken current economic conditions into consideration when estimating the allowance for loan losses.

The determination to discontinue the accrual of interest is based on a review of each loan. Generally, accrual of interest is discontinued on loans 90 days past due as to principal or interest unless in management s opinion collection of both principal and interest is assured by way of collateralization, guarantees or other security and the loan is in the process of collection. Management s policy for any accruing loan greater than 90 days past due is to perform an analysis of the loan, including a consideration of the financial position of the borrower and any guarantor, as well as the value of the collateral, and use this information to make an assessment as to whether collectibility of the principal and interest appears probable. If such collectibility is not probable, the loans are placed on nonaccrual status. Loans are returned to accrual status when management determines, based on an evaluation of the underlying collateral together with the borrower s payment record and financial condition, that the borrower has the ability and intent to meet the contractual obligations of the loan agreement.

The table below summarizes the Corporation s nonperforming assets and loans 90 days or more past due and still accruing interest as of the dates indicated.

Table Eleven
Nonperforming and Problem Assets

(Dollars in thousands)	**September 30 2003**	**June 30 2003**	**March 31 2003**	**December 31 2002**	**September 30 2002**
Nonaccrual loans	**$13,398**	$11,144	$30,021	$26,467	$24,418
Other real estate owned	**6,709**	6,866	11,200	10,278	9,675
Total nonperforming assets	**20,107**	18,010	41,221	36,745	34,093
Loans 90 days or more past due and still accruing interest	**21**	312			
Total nonperforming assets and loans 90 days or more past due and still accruing interest	**$20,128**	$18,322	$41,221	$36,745	$34,093
Nonperforming assets as a percentage of:					
Total assets	**0.49%**	0.45%	1.03%	0.98%	0.92%
Total loans and other real estate owned	**0.95**	0.87	1.97	1.76	1.52
Ratio of allowance for loan losses to nonperforming loans	**1.50x**	2.12x	0.88x	1.03x	1.12x

Allowance for Loan Losses

The Corporation s allowance for loan losses consists of three components: (i) valuation allowances computed on impaired loans in accordance with SFAS No. 114; (ii) valuation allowances determined by applying historical loss rates to those loans not considered impaired; and (iii) valuation allowances for factors which management believes are not reflected in the historical loss rates or that otherwise need to be considered when estimating the allowance for loan losses. These three components are estimated quarterly by Credit Risk Management and, along with a narrative analysis, comprise the Corporation s allowance for loan losses model. The resulting estimate is used to determine if the allowance for loan losses recorded by management is adequate and appropriate for each period.

The first component of the allowance for loan losses, the valuation allowance for impaired loans, is computed based on documented reviews performed by the Corporation s Credit Risk Management on individual impaired commercial loans greater than $150,000. Credit Risk Management typically estimates these valuation allowances by considering the fair value of the underlying collateral for each impaired loan using current appraisals or estimates of values. The results of these estimates are shared with the Special Asset Committee of FCB, and are then subject to review by the Loan Committee of the Board of Directors of the Bank. These estimates are updated periodically as circumstances change. Changes in the dollar amount of impaired loans or in the estimates of the fair value of the underlying collateral can impact the valuation allowance on impaired loans and, therefore, the overall allowance for loan losses.

The second component of the allowance for loan losses, the portion attributable to all other loans not considered impaired, is determined by applying historical loss rates to the outstanding balance of loans. For purposes of computing these estimates, the portfolio is segmented as follows: commercial loans (by credit risk grade) and consumer loans, which include mortgage, general consumer, consumer real estate, home equity and consumer unsecured. Commercial loans are segmented further by credit grade, so that separate loss factors are applied to each pool of commercial loans. The historical loss factors applied to the various segments are determined using a migration analysis tool that computes current loss estimates by loan type (or, in the case of commercial loans, by credit grade) using a trailing loss history database. Since the migration analysis is based on trailing data, the percentage loss estimates can change based on actual losses in that trailing period. Changes in commercial loan credit grades or in the mix of the portfolio can also impact this component of the allowance for loan losses from period to period.

The third component of the allowance for loan losses is intended to capture the various risk elements of the loan portfolio which are not sufficiently captured in the historical loss rates. These factors currently include intrinsic risk, operational risk and concentration risk. Intrinsic risk relates to the impact of current economic conditions on the Corporation s borrower base, the effects of which may not be realized by the Corporation in the form of charge-offs for several periods. The Corporation monitors and documents various local, regional and national economic data, and makes subjective estimates of the impact of changes in economic conditions on the allowance for loan losses. Operational risk includes factors such as the likelihood of loss on a loan because of inadequate underwriting. In recent periods, the Corporation has made loss estimates for certain types of loans that were either acquired from other institutions in mergers or were underwritten using policies that are no longer in effect at the Corporation. These identified loans are considered to have higher risk of loss than currently reflected in historical loss rates of the Corporation, so additional estimates of loss are made by management. Concentration risk includes the risk of loss due to extensions of credit to a particular industry, loan type or borrower that may be troubled. The Corporation monitors its portfolio for any excessive concentrations of loans during each period, and if any excessive concentrations are noted, estimates of loss would be made. Losses for all of these factors are estimates since certain loans will generally respond differently to changes in these factors. Accordingly, changes in the allowance for loan losses for these subjective factors can arise from changes in the balance and types of outstanding loans, as well as changes in the underlying conditions which drive a change in the percentage used. As more fully discussed below, the Corporation continually monitors the portfolio in an effort to identify any other factors which may have an impact on loss estimates within the portfolio.

All estimates of the loan portfolio risk, including the adequacy of the allowance for loan losses, are subject to general and local economic conditions, among other factors, which are unpredictable and beyond the Corporation s control. Since a significant portion of the loan portfolio is comprised of real estate loans and loans to area businesses, the Corporation is subject to continued risk that the real estate market and economic conditions could continue to change and could result in future losses and require increases in the provision for loan losses.

Management currently uses several measures to assess and control the loan portfolio risk. For example, all loans over $1.5 million are reviewed by the Bank s Officer Loan Committee, and any issues regarding risk assessments of those credits are addressed by the Bank s Senior Risk Managers and factored into future lending decisions. Commitments over $5.0 million are further reviewed by senior lending officers of the Bank, the Chief Credit Officer and an Executive Loan Committee comprised of executive and senior management. In addition, commitments over $7.5 million are further reviewed by a Board of Directors Loan Committee. The Corporation also maintains an independent credit review function, which has responsibility to review the underwriting, documentation and risk grading process. Loans are reviewed on a sampling basis at regular intervals throughout the year by credit review. The resulting evaluation and report is shared with Executive Management and the Board of Directors Loan and Audit Committees.

At September 30, 2003 the allowance for loan losses was $24.0 million or 1.14 percent of gross loans compared to $27.2 million or 1.31 percent at December 31, 2002. The allowance for loan losses was reduced $20.2 million due to the June Loan Sale. As of March 31, 2003, the loans sold in the June Loan Sale had approximately $8.7 million of allowance allocated to them. As previously discussed (see **Provision for Loan Losses**), during the second quarter of 2003 an additional provision of $7.5 million was recorded due to the deteriorating financial results of these relationships and recently received collateral appraisals. In addition, during the second quarter an additional provision of $4.0 million was recorded for the credit-related discount taken in the June Loan Sale. These loans had a higher percentage of allocated allowance for loan losses due to their higher probable rate of loss. Also, included in the allowance for loan losses was an allocation of $2.4 million related to the previously discussed residential rental properties which have questionable appraisals and collateral values. Due to third quarter charge-offs and foreclosures on these properties, the allocation has been reduced to $1.9 million. The allowance for loan losses was also reduced $0.5 million due to the sale of the Corporation s credit card portfolio and by net charge-offs of $7.2 million. These reductions were partially offset by additional provision expense of $23.9 million (see **Provision for Loan Losses**). As a result of the aforementioned transactions, the Corporation s ratio of the allowance for loan losses to loans was reduced largely due to the significant improvement in the Corporation s asset quality profile. The ratio of allowance for loan losses to nonaccrual loans increased to 1.79 at September 30, 2003 from 1.03 at December 31, 2002, primarily due to the decrease in nonaccrual loans. First Charter monitors the adequacy of the allowance for loan losses to cover inherent losses in the loan portfolio through the use of a loan loss migration model. Management believes the Corporation is adequately reserved based on its assessment of its credit risk profile.

At September 30, 2003 the allowance for loan losses was $24.0 million or 1.14 percent of gross loans compared to $23.6 million or 1.15 percent at June 30, 2003. The increase in the allowance for loan losses was due to changes in allocations of allowance for loan losses to the various loan types. A higher allocation of allowance for loan losses was required for commercial loans in September 2003 over June 2003 due primarily to recent downgrades on certain commercial loans. This was partially offset by a lower allocation of allowance required for mortgage loans due to a decrease in the reserve factors based on historical loss experience. Consumer loan allocations of the allowance for loan losses remained essentially unchanged from June 2003 to September 2003. The decrease in the allowance for loan losses as a percent of total loans from June 30, 2003 was due to changes in the loan portfolio mix and risk factors. As noted in ***Table Ten***, commercial real estate, commercial non real estate and mortgage loans as a percentage of total loans declined from June 30, 2003 to September 30, 2003, whereas construction, consumer and home equity loans as a percentage of total loans increased from June 30, 2003 to September 30, 2003. Construction, mortgage and home equity loans all have lower historical loss rates than commercial and consumer loans, thereby requiring a lower allocation of allowance for loan losses. The ratio of allowance for loan losses to nonaccrual loans decreased to 1.79 at September 30, 2003 from 2.12 at June 30, 2003, primarily due to the addition of several commercial loans to nonaccrual status as some of our customers continue to experience difficulties in this current economic environment.

Management considers the allowance for loan losses adequate to cover inherent losses in the Bank s loan portfolio as of the date of the financial statements. Management believes it has established the allowance in consideration of the current economic environment. While management uses the best information available to make evaluations, future additions to the allowance may be necessary based on changes in economic and other conditions. Additionally, various regulatory agencies, as an integral part of their examination process, periodically review the Bank s allowances for loan losses. Such agencies may require the recognition of adjustments to the allowances based on their judgments of information available to them at the time of their examinations.

Table Twelve
Allowance For Loan Losses

(Dollars in thousands)	Three Months Ended September 30, 2003	Three Months Ended September 30, 2002	Nine Months Ended September 30, 2003	Nine Months Ended September 30, 2002
Balance, beginning of period	**$ 23,644**	$ 27,213	**$ 27,204**	$ 25,843
Loan charge-offs:				
Commercial non real estate	**418**	372	**3,393**	1,301
Commercial real estate	**584**	60	**990**	410
Construction	**17**	160	**(24)**	641
Mortgage	**4**	39	**9**	99
Consumer	**967**	792	**2,257**	2,257
Home equity	**248**	94	**527**	144
Total loans charged-off	**2,238**	1,517	**7,152**	4,852
Recoveries of loans previously charged-off:				
Commercial non real estate	**32**	6	**390**	28
Commercial real estate	**2**	206	**3**	223
Construction				
Mortgage		2		11
Consumer	**112**	66	**314**	258
Home equity				
Other	**1**	7	**34**	127
Total recoveries of loans previously charged-off	**147**	287	**741**	647
Net charge-offs	**2,091**	1,230	**6,411**	4,205
Provision for loan losses	**2,400**	1,750	**23,943**	6,095
Allowance related to loans sold or transferred		(322)	**(20,783)**	(322)
Balance, September 30	**$ 23,953**	$ 27,411	**$ 23,953**	$ 27,411
Average loans	**$2,080,112**	$2,166,161	**$2,108,092**	$2,074,817
Net charge-offs to average loans (annualized)	**0.40%**	0.23%	**0.41%**	0.27%
Allowance for loan losses to gross loans	**1.14**	1.23	**1.14**	1.23

Liquidity

Liquidity is the ability to maintain cash flows adequate to fund operations and meet obligations and other commitments on a timely and cost-effective basis. Liquidity is provided by the ability to attract retail deposits, by current earnings and by a strong capital base that enables the Corporation to use alternative funding sources that complement normal sources. Management s asset-liability policy is to maximize net interest income while continuing to provide adequate liquidity to meet continuing loan demand and deposit withdrawal requirements and to service normal operating expenses.

The Corporation s primary source of funding is from customer deposits, other borrowings, loan repayments and securities available for sale. If additional funding sources are needed, the Bank has access to federal fund lines at correspondent banks and borrowings from the Federal Reserve discount window. In addition to these sources, as described above, the Bank is a member of the FHLB, which provides access to FHLB lending sources. The Bank currently has an available line of credit with the FHLB totaling $1.1 billion with $991.3 million outstanding. At

September 30, 2003, the Bank also had federal funds back-up lines of credit totaling $65.0 million, of which there were no amounts outstanding. At September 30, 2003, the Corporation had lines of credit with SunTrust Bank totaling $25.0 million with $15.0 million outstanding and commercial paper outstanding of $26.5 million.

Another source of liquidity is the securities available for sale portfolio. See **Investment Portfolio** for further discussion. Management believes the Bank s sources of liquidity are adequate to meet loan demand, operating needs and deposit withdrawal requirements.

The Corporation has existing contractual obligations that will require payments in future periods. The following table presents aggregated information about such payments to be made in future periods. The Corporation anticipates refinancing any contractual obligations that are due in less than one year.

Table Thirteen
Contractual Obligations
As of September 30, 2003

	Payments Due by Period				
(Dollars in thousands)	**Less than 1 year**	**1-3 Years**	**4-5 Years**	**Over 5 Years**	**Total**
Other borrowings	$ 733,112	$140,000	$100,000	$288,300	$1,261,412
Lease obligations	1,997	4,360	1,713	10,688	18,758
Equity method investees funding	1,700				1,700
Deposits [1]	2,183,119	230,577	67,333	553	2,481,582
Total Contractual Cash Obligations	$2,919,928	$374,937	$169,046	$299,541	$3,763,452

[1] Deposits with no stated maturity (demand, money market, and savings deposits) are presented in the less than one year category.

Asset-Liability Management and Interest Rate Sensitivity

The primary objective of the Corporation s asset-liability management strategy is to enhance earnings through balance sheet growth while reducing or minimizing the risk caused by interest rate changes. One method used to manage interest rate sensitivity is to measure, over various time periods, the interest rate sensitivity positions, or gaps; however, this method addresses only the magnitude of timing differences and does not address earnings or market value. Management uses an earnings simulation model to assess the amount of earnings at risk due to changes in interest rates. Management believes this method more accurately measures interest rate risk. This model is updated monthly and is based on a range of interest rate shock scenarios. Under the Corporation s policy, the limit for interest rate risk is 10 percent of net interest income when considering an increase or decrease in interest rates of 300 basis points over a twelve-month period. Assuming a 300 basis point pro-rata increase in interest rates over a twelve-month period, the Corporation s sensitivity to interest rate risk would positively impact net interest income by approximately 3.70 percent of net interest income at September 30, 2003. Assuming a 100 basis point pro-rata decrease in interest rates over a twelve-month period, the Corporation s sensitivity to interest rate risk would negatively impact net interest income by approximately 0.31 percent of net interest income at September 30, 2003. Although the Corporation s policy for interest shock scenarios is an increase or decrease of 300 basis points, in the current low interest rate environment the decreased interest rate shock scenario is equal to the Fed Funds rate of 100 basis points. Both of the rate shock scenarios are within Management s acceptable range.

From time to time, the Corporation may use derivative financial instruments including futures, forwards, interest rate swaps, option contracts, and other financial instruments with similar characteristics. At September 30, 2003, the Corporation had no such derivative financial instruments. Refer to ***Note Seven*** of the consolidated financial statements and ***Results of Operations*** for a discussion of the Corporation s use of written over-the-counter covered call options during 2003. The Corporation does not have any special purpose entities or off-balance sheet financing arrangements.

The Corporation is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated financial statements. Commitments to extend credit are agreements to lend to a customer so long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates and may require collateral from the borrower if deemed necessary by the Corporation. Standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party up to a stipulated amount and with specified terms and conditions. Standby letters of credit are recorded as a liability by the Corporation at the fair value of the obligation undertaken in issuing the guarantee. Commitments to extend credit are not recorded as an asset or liability by the Corporation until the instrument is exercised.

The following table presents aggregated information about commitments of the Corporation which could impact future periods.

Table Fourteen
Commitments
As of September 30, 2003

	Amount of Commitment Expiration Per Period				
(Dollars in thousands)	**Less than 1 year**	**1-3 Years**	**4-5 Years**	**Over 5 Years**	**Total Amounts Committed**
Lines of Credit	$ 29,480	$ 2,024	$ 4,630	$278,590	$314,724
Standby Letters of Credit	6,911	980			7,891
Loan Commitments	246,103	61,655	16,660	7,434	331,852
Total Commitments	$282,494	$64,659	$21,290	$286,024	$654,467

Table Fifteen summarizes the expected maturities and weighted average effective yields and rates associated with certain of the Corporation s significant non-trading financial instruments. Cash and cash equivalents, federal funds sold and interest bearing bank deposits, are excluded from ***Table Fifteen*** as their respective carrying values approximate fair values. These financial instruments generally expose the Corporation to insignificant market risk as they have either no stated maturities or an average maturity of less than 30 days and interest rates that approximate market rates. However, these financial instruments could expose the Corporation to interest rate risk by requiring more or less reliance on alternative funding sources, such as long-term debt. The mortgage-backed securities are shown at their weighted average expected life, obtained from an outside evaluation of the average remaining life of each security based on historic prepayment speeds of the underlying mortgages at September 30, 2003. Demand deposits, money market accounts and certain savings deposits are presented in the earliest maturity window because they have no stated maturity.

Table Fifteen
Market Risk
September 30, 2003

(Dollars in thousands)	Total	Expected Maturity 1 Year	2 Years	3 Years	4 Years	5 Years	Thereafter
Assets							
Debt securities							
Fixed rate							
Book value	$1,540,108	$699,197	$256,924	$165,514	$162,145	$176,204	$ 80,124
Weighted average effective yield	3.82%						
Fair value	$1,543,299						
Loans and loans held for sale							
Fixed rate							
Book value	$ 689,489	173,050	134,253	99,576	73,157	37,265	172,188
Weighted average effective yield	6.61%						
Fair value	$ 720,451						
Variable rate							
Book value	$1,410,633	507,883	232,165	147,977	133,860	100,885	287,863
Weighted average effective yield	4.58%						
Fair value	$1,408,390						
Liabilities							
Deposits							
Fixed rate							
Book value	$1,184,806	893,070	155,543	68,307	60,836	6,497	553
Weighted average effective yield	2.34%						
Fair value	$1,188,681						
Variable rate							
Book value	$ 959,367	$952,640	6,635	92			
Weighted average effective yield	0.53%						
Fair value	$ 959,376						
Other borrowings							
Fixed rate							
Book value	$ 578,300	100,031	100,033	65,035	25,037	40	288,124
Weighted average effective yield	3.78%						
Fair value	$ 616,696						
Variable rate							
Book value	$ 683,112	683,112					
Weighted average effective yield	1.18%						
Fair value	$ 683,123						

Capital Resources

At September 30, 2003, total shareholders equity was $302.3 million, representing a book value of $10.20 per share, compared to $324.7 million or a book value of $10.80 per share at December 31, 2002. The decrease was primarily due to cash dividends paid of $16.5 million, the recognition of $12.2 million in after-tax unrealized losses on available for sale securities and the payment of $10.5 million for the purchase and retirement of 565,000 shares of common stock. These decreases were partially offset by net income of $14.6 million, an increase in additional paid in capital of $1.3 million due to the issuance of approximately 78,000 shares in connection with the acquisition of a third party benefits administrator and the receipt of $0.9 million from the sale of approximately 61,000 shares of common stock issued for stock options. The securities available for sale portfolio had an unrealized net gain of $3.7 million (net of tax) at September 30, 2003, compared to an unrealized net gain of $15.9 million (net of tax) at December 31, 2002. At September 30, 2003, the Corporation and the Bank were in compliance with all existing capital requirements. The most recent notifications from the Corporation s and the Bank s various regulators categorized the Corporation and the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no events or conditions since those notifications that management believes have changed either of the entities categories. The Corporation s capital requirements are summarized in the table below:

Table Sixteen
Capital Ratios

	Leverage Capital		Risk-Based Capital			
			Tier 1 Capital		Total Capital	
(Dollars in thousands)	**Amount**	**Percentage(1)**	**Amount**	**Percentage(2)**	**Amount**	**Percentage(2)**
Actual	$277,914	6.86%	$277,914	10.72%	$302,595	11.67%
Required	162,017	4.00	103,731	4.00	207,462	8.00
Excess	115,897	2.86	174,183	6.72	95,133	3.67

(1) Percentage of total adjusted average assets. The FRB minimum leverage ratio requirement is 3 percent to 5 percent, depending on the institution s composite rating as determined by its regulators. The FRB has not advised the Corporation of any specific requirements applicable to it.
(2) Percentage of risk-weighted assets.

Regulatory Matters

The Bank entered into a written agreement on September 25, 2003, with the Federal Reserve Bank of Richmond and the Office of the North Carolina Commissioner of Banks, the Bank s primary federal and state regulatory agencies. The agreement arises out of the previously disclosed regulatory examinations and requires the Bank to take appropriate actions to improve its programs and procedures for complying with the Currency and Foreign Transactions Reporting Act and the anti-money laundering provisions of Regulation H of the Board of Governors of the Federal Reserve System. As it has previously disclosed, the Bank has taken substantial actions, and adopted and implemented a number of policies and procedures, to address the concerns of the regulatory agencies. Management does not believe that compliance with the agreement will have a material effect on First Charter s financial condition, liquidity, capital resources or operations in future periods.

Accounting Matters

In August 2001, the FASB issued Statement of Financial Accounting Standards No. 143 (SFAS No. 143), Accounting for Asset Retirement Obligations , which addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement cost. This standard requires the Corporation to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development and/or normal use of the assets. The Corporation also is to record a corresponding increase to the carrying amount of the related long-lived asset and to depreciate that cost over the life of the asset. The liability is changed at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the initial fair value measurement. This statement is effective for fiscal years beginning after June 15, 2002. Accordingly, the Corporation adopted SFAS No. 143 on January 1, 2003, with no material impact on its consolidated financial statements.

In August 2002, the FASB issued Statement of Financial Accounting Standards No. 146 (SFAS No. 146), Accounting for Costs Associated with Exit or Disposal Activities , which addresses financial accounting and reporting costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). Under EITF Issue No. 94-3, an entity recognized a liability for an exit cost on the date that the entity committed itself to an exit plan. In SFAS No. 146, the FASB acknowledges that an entity s commitment to a plan does not, by itself, create a present obligation to other parties that meets the definition of a liability. An obligation becomes a present obligation when a transaction or event occurs that leaves an entity little or no discretion to avoid the future transfer or use of assets to settle the liability. SFAS No. 146 also establishes that fair value is the objective for the initial measurement of the liability. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002. There was no impact to the Corporation upon adoption.

In October 2002, the FASB issued Statement of Financial Accounting Standards No. 147 (SFAS No. 147), Acquisitions of Certain Financial Institutions , which addresses the financial accounting and reporting for the acquisition of all or part of a financial institution. This standard removes certain acquisitions of financial institutions from the scope of Statement of Financial Accounting Standards No. 72 (SFAS No. 72). This statement requires financial institutions to reclassify goodwill, which was created from a qualified business acquisition, from SFAS No. 72 goodwill to goodwill subject to the provisions of SFAS No. 142. The reclassified goodwill will no longer be amortized but will be subject to an annual impairment test, pursuant to SFAS No. 142. SFAS No. 147 required the Corporation to retroactively restate its previously issued 2002 interim financial statements, to reverse SFAS No.

72 goodwill amortization expense recorded in the first three quarters of the 2002 fiscal year, the year in which the Corporation adopted SFAS No. 142. The Corporation adopted SFAS No. 147 on October 1, 2002. The Corporation had $12.1 million of SFAS No. 72 goodwill which was reclassified and will no longer be amortized. This resulted in the reversal of $716,000 ($520,000 or $0.02 diluted earnings per share, after-tax) of amortization expense for the nine months ended September 30, 2002. In accordance with SFAS No. 147, the Corporation performed a transitional impairment test of this goodwill in the fourth quarter of 2002. As a result of this testing, no impairment charges were recorded. The Corporation performed an annual impairment test of the goodwill in 2003 and will do so in years thereafter.

In October 2002, the FASB issued Financial Accounting Standards Board Interpretation No. 45, (FASB Interpretation No. 45), Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, which establishes disclosure standards for a guarantor about its obligations under certain guarantees that it has issued. Under FASB Interpretation No. 45 a guarantor is required to disclose the nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose, and the events or circumstances that would require the guarantor to perform under the guarantee. The guarantor is also required to disclose the maximum potential amount of future payments under the guarantee, the carrying amount of the liability, if any, for the guarantor s obligations under the guarantee, and the nature and extent of any recourse provisions or available collateral that would enable the guarantor to recover the amounts paid under the guarantee. The initial recognition and measurement of FASB Interpretation No. 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. Accordingly, the Corporation adopted these provisions of FASB Interpretation No. 45 on January 1, 2003. The impact to the Corporation upon adoption was immaterial. The disclosure requirements in FASB Interpretation No. 45 are effective for financial statements of interim or annual periods ending after December 15, 2002. Accordingly, the Corporation adopted the disclosure provisions in 2002 and has made the relevant disclosures in ***Note Twelve*** of the accompanying consolidated financial statements.

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148 (SFAS No. 148), Accounting for Stock-Based Compensation Transition and Disclosure, an amendment of FASB Statement No. 123 . This Statement amends SFAS No. 123, to provide alternative methods of transition for an entity that voluntarily changes to the fair value method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that Statement to require prominent disclosure about the effects on reported net income of an entity s accounting policy with respect to stock-based employee compensation. Finally, this Statement amends APB Opinion No. 28 (APB No. 28), Interim Financial Reporting , to require disclosure about those effects in interim financial information. The Corporation currently has no plans to change its accounting for stock-based employee compensation. The disclosure provisions of this statement, except for the amendment of APB No. 28, are effective for financial statements for fiscal years ending after December 15, 2002. Accordingly, the Corporation adopted the disclosure provisions pursuant to this portion of the interpretation on December 31, 2002 and these disclosures are presented in the notes to the consolidated financial statements. The provisions of this statement related to the amendment of APB Opinion No. 28 are effective for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002. Accordingly, the Corporation adopted the disclosure provisions pursuant to this portion of the interpretation on January 1, 2003, and these disclosures are presented in the notes to the consolidated financial statements.

In January 2003, the FASB issued Financial Accounting Standards Board Interpretation No. 46, (FASB Interpretation No. 46), Consolidation of Variable Interest Entities, which addresses consolidation of variable interest entities by business enterprises. Variable interest entities are equity interests that do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. An enterprise shall consolidate a variable interest entity if that enterprise has a variable interest (or combination of variable interests) that will absorb a majority of expected losses if they occur, receive a majority of the entity s residual returns if they occur, or both. The enterprise that consolidates the variable interest entity is called the primary beneficiary of that entity. Under FASB Interpretation No. 46 an enterprise that holds significant variable interests in a variable interest entity but is not the primary beneficiary is required to disclose the nature, purpose, size, and activities of the variable interest entity, its exposure to loss as a result of the variable interest holder s involvement with the entity, and the nature of its involvement with the entity and date when the involvement began. The primary beneficiary of a variable interest entity is required to disclose the nature, purpose, size, and activities of the variable interest entity, the carrying amount and classification of consolidated assets that are collateral for the variable interest entity s obligations, and any lack of recourse by creditors (or beneficial interest holders) of a consolidated variable interest entity to the general credit of the primary beneficiary. FASB Interpretation No. 46 will be effective for the Corporation beginning December 31, 2003. The Corporation is in the process of evaluating the impact of this Interpretation and does not expect a material effect on its consolidated financial statements.

In April 2003, the FASB issued Statement of Financial Accounting Standards No. 149 (SFAS No. 149), Amendment of Statement 133 on Derivative Instruments and Hedging Activities, which amends and clarifies financial accounting and reporting for derivative instruments and for hedging activities under Statement of Financial Accounting Standards No. 133 (SFAS No. 133). This statement clarifies when a contract with an initial net investment meets the characteristic of a derivative, clarifies when a derivative instrument contains a financing component, amends the definition of an underlying to conform it to language used in Financial Accounting Standards Board Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others , and amends certain other existing pronouncements. This Statement requires that contracts with comparable characteristics be accounted for similarly. This Statement is effective for most contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. For contracts with forward purchases or sales of when-issued securities or other securities that do not yet exist, this Statement is effective for both existing contracts and new contracts entered into after June 30, 2003. All provisions of this Statement should be applied prospectively. The Corporation adopted SFAS No. 149 on July 1, 2003 with no material effect on its consolidated financial statements.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150 (SFAS No. 150), Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity , which establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). This Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. It is to be implemented by reporting the cumulative effect of a change in accounting principle for financial instruments created before the issuance date of the Statement and still existing at the beginning of the interim period of adoption. Accordingly, the Corporation adopted SFAS No. 150 on July 1, 2003, with no effect on its consolidated financial statements. There were no financial instruments issued between June 1, 2003 and June 30, 2003 to which SFAS No. 150 applied.

From time to time, the FASB issues exposure drafts for proposed statements of financial accounting standards. Such exposure drafts are subject to comment from the public, to revisions by the FASB and to final issuance by the FASB as statements of financial accounting standards. Management considers the effect of the proposed statements on the consolidated financial statements of the Corporation and monitors the status of changes to and proposed effective dates of exposure drafts.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

See **Management s Discussion and Analysis of Financial Condition and Results of Operations Asset-Liability Management and Interest Rate Sensitivity** on page 38 for Quantitative and Qualitative Disclosures about Market Risk.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures. As of the end of the period covered by this report, an evaluation of the effectiveness of the Corporation s disclosure controls and procedures (as defined in Rule 13(a)-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act)) was performed under the supervision and with the participation of the Corporation s management, including the Chief Executive Officer and Chief Financial Officer. Based on that evaluation, the Corporation s Chief Executive Officer and Chief Financial Officer have concluded that the Corporation s disclosure controls and procedures are effective to ensure that information required to be disclosed by the Corporation in its reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities Exchange Commission rules and forms.

(b) Changes in internal control over financial reporting. During the last fiscal quarter, there has been no change in the Corporation s internal controls over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) promulgated under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, the Corporation s internal controls over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

The Corporation and the Bank are defendants in certain claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material adverse effect on the consolidated operations, liquidity or financial position of the Corporation or the Bank.

Item 2. Changes in Securities and Use of Proceeds

(c) Recent Sales of Unregistered Securities

On July 7, 2003, the Registrant, through a subsidiary of First Charter Bank, its primary banking subsidiary, acquired all of the outstanding shares of a third party benefits administrator pursuant to a Merger Agreement dated as of the same date (the Merger Agreement). No underwriters were used in connection with this transaction. In connection with this transaction, the Registrant issued an aggregate of 78,441 shares of the Registrant s common stock to John Googe and Jeannie Felts, the shareholders of such acquired entity. The issuance of the shares in connection with this transaction was exempt from the registration requirements of the Securities Act of 1933, as amended, in accordance with Section 4(2) thereof, as a transaction by an issuer not involving a public offering. The Merger Agreement also contemplates additional, subsequent issuances of the Registrant s common stock based upon the future performance of the acquired entity. The Registrant expects the value of these issuances, if earned, to total approximately $880,000.

Item 3. Defaults Upon Senior Securities

Not Applicable.

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

Not Applicable.

Item 5. Other Information

Not Applicable

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit No. (per Exhibit Table in item 601 of Regulation S-K)	**Description of Exhibits**
3.1	Amended and Restated Articles of Incorporation of the Corporation, incorporated herein by reference to Exhibit 3.1 of the Corporation s Annual Report on Form 10-K for the fiscal year ended December 31, 2000 (Commission File No. 0-15829).
3.2	By-laws of the Corporation, as amended, incorporated herein by reference to Exhibit 3.2 of the Corporation s Annual Report on Form 10-K for the fiscal year ended December 31, 1995 (Commission File No. 0-15829).
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

None

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.

FIRST CHARTER CORPORATION
(Registrant)

Date: November 7, 2003

By: /s/ Robert O. Bratton

Robert O. Bratton
Executive Vice President & Chief Financial Officer