FIRST BANCORP /NC/
Form 10-K
March 01, 2019

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2018

Commission File Number 0-15572

FIRST BANCORP

(Exact Name of Registrant as Specified in its Charter)

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

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

Title of each class	Name of each exchange on which registered
Common Stock, No Par Value	The Nasdaq Global Select Market

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933. x YES o NO

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). x YES o NO

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

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

x Large Accelerated Filer o Accelerated Filer o Non-Accelerated Filer

o Smaller Reporting Company o Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

The aggregate market value of the Common Stock, no par value, held by non-affiliates of the registrant, based on the closing price of the Common Stock as of June 30, 2018 as reported by The NASDAQ Global Select Market, was approximately $1,188,000,000.

The number of shares of the registrant's Common Stock outstanding on February 28, 2019 was 29,723,682.

DOCUMENTS INCORPORATED BY REFERENCE

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

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* Information called for by Part III (Items 10 through 14) is incorporated herein by reference to the Registrant's definitive Proxy Statement for the 2019 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission on or before April 30, 2019.

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FORWARD-LOOKING STATEMENTS

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

PART I

Item 1. Business

General Description

First Bancorp (the "Company") is the fourth largest bank holding company headquartered in North Carolina. At December 31, 2018, the Company had total consolidated assets of $5.9 billion, total loans of $4.2 billion, total deposits of $4.7 billion, and shareholders' equity of $0.8 billion. Our principal activity is the ownership and operation of First Bank (the "Bank"), a state-chartered bank with its main office in Southern Pines, North Carolina.

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

The Bank was organized in 1934 and began banking operations in 1935 as the Bank of Montgomery, named for the county in which it operated. Until September 2013, the Bank's main office was in Troy, North Carolina, located in the

center of Montgomery County. In September 2013, the Company and the Bank moved their main offices approximately 45 miles to Southern Pines, North Carolina, in Moore County. As of December 31, 2018, we conducted business from 101 branches covering a geographical area from Florence, South Carolina to the south, to Wilmington, North Carolina to the east, to Kill Devil Hills, North Carolina to the northeast, to Mayodan, North Carolina to the north, and to Asheville, North Carolina to the west. Of the Bank’s 101 branches, 95 branches are in North Carolina and six branches are in South Carolina. Ranked by assets, the Bank was the fourth largest bank headquartered in North Carolina as of December 31, 2018 and the only one with total assets between $4 billion and $35 billion.

As of December 31, 2018, the Bank had three wholly owned subsidiaries, First Bank Insurance Services, Inc. (“First Bank Insurance”), SBA Complete, Inc. (“SBA Complete”), and First Troy SPE, LLC. First Bank Insurance’s primary business activity is the placement of property and casualty insurance coverage. SBA Complete specializes in providing consulting services for financial institutions across the country related to Small Business Administration (“SBA”) loan origination and servicing. First Troy SPE, LLC, which was organized in December 2009, is a holding entity for certain foreclosed properties.

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

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General Business

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

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

We also offer various ancillary services as part of our commitment to customer service. Through First Bank Insurance, we offer the placement of property and casualty insurance. We also offer non-FDIC insured investment and insurance products, including mutual funds, annuities, long-term care insurance, life insurance, and company retirement plans, as well as financial planning services through our investments division called FB Wealth Management Services.

First Bank also offers SBA loans to small business owners throughout the nation, which is supported by First Bank's subsidiary, SBA Complete. SBA Complete specializes in providing consulting services for financial institutions across the country related to SBA loan origination and servicing.

The Company is also the parent to a series of statutory business trusts organized for the purpose of issuing trust preferred debt securities that qualify as regulatory capital. See additional discussion below in the section entitled "Borrowings."

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Territory Served and Competition

Our headquarters are located in Southern Pines, Moore County, North Carolina, where we have a significant concentration of deposits. At the end of 2018, we served regions spread across North Carolina, with additional operations in northeastern South Carolina. The following table presents, for each county where we operated as of December 31, 2018, the number of bank branches operated by the Bank within the county, the approximate amount of deposits with the Bank in the county as of December 31, 2018, our approximate deposit market share at June 30, 2018, and the number of bank competitors located in the county at June 30, 2018.

County	Number of Branches	Deposits (in millions)	Market Share	Number of Competitors
Alamance, NC	1	$ 53	2.5%	15
Beaufort, NC	2	66	9.4%	7
Bladen, NC	1	31	10.2%	4
Brunswick, NC	4	187	8.6%	11
Buncombe, NC	8	538	10.3%	16
Cabarrus, NC	2	52	2.0%	11
Carteret, NC	2	52	3.8%	8
Chatham, NC	2	47	6.8%	9
Chesterfield, SC	1	44	10.7%	6
Columbus, NC	2	50	6.2%	5
Cumberland, NC	1	25	0.6%	14
Dare, NC	1	23	1.6%	8
Davidson, NC	2	133	5.0%	10
Dillon, SC	3	65	22.3%	4
Duplin, NC	3	171	21.1%	6
Florence, SC	2	57	2.4%	12
Forsyth, NC	4	61	0.2%	15
Guilford, NC	6	414	4.3%	17
Harnett, NC	3	130	12.8%	9
Henderson, NC	2	66	3.5%	12
Iredell, NC	3	70	2.4%	19
Lee, NC	3	209	23.4%	9
Madison, NC	1	41	41.2%	1
McDowell, NC	1	58	17.4%	5
Mecklenburg, NC	2	51	0.0%	24
Montgomery, NC	2	137	43.5%	2
Moore, NC	10	481	35.7%	9
New Hanover, NC	5	215	2.2%	19
Onslow, NC	2	100	6.8%	10
Pitt, NC	1	22	0.7%	14
Randolph, NC	3	143	9.4%	11
Richmond, NC	1	62	12.6%	5

Robeson, NC	4	204	18.8%	8
Rockingham, NC	1	24	2.4%	10
Rowan, NC	1	58	4.1%	13
Scotland, NC	1	82	22.6%	6
Stanly, NC	4	111	11.2%	6
Transylvania, NC	1	24	4.7%	6
Wake, NC	3	62	0.2%	31
Brokered Deposits	—	240		
Total	101	$ 4,659		

Historically, our branches and facilities have been primarily located in small to medium-sized communities, whose economies are based primarily on a variety of industries, including services and manufacturing. Leading producers of lumber and rugs are located in Montgomery County, North Carolina. The Pinehurst area within Moore County, North Carolina, is a widely known golf resort and retirement area. The High Point, North Carolina area is widely known for its furniture market. New Hanover and Brunswick Counties, located in the southeastern coastal region of North Carolina, are popular with tourists and have significant retirement populations. Buncombe County, located in the western region of North Carolina, is a highly diverse area with industries in manufacturing, service, and tourism. Additionally, several of the communities served by the Bank are “bedroom” communities of large cities like Charlotte, Raleigh and Greensboro, while several branches are located in medium-sized cities such as Albemarle, Asheboro, Fayetteville, Greenville, Jacksonville, High Point, Southern Pines, and Sanford.

In recent years, we have implemented a branch strategy of expansion into larger, higher growth markets. In 2016, this expansion continued with additional investments in Charlotte, Raleigh and the Triad region of North Carolina. Several seasoned bankers joined the Bank and have led our expansion efforts in these markets. We opened our first full service branch in Charlotte in August 2016, after opening a loan production office there in 2015. In Raleigh, we opened a loan production office early in 2016 and upgraded that location to a full service branch in April 2017. In the Triad region, experienced bankers joined us in early 2016 as we opened our first loan production office in Greensboro. Our expansion into higher growth markets was significantly enhanced by three strategic transactions that we implemented in 2016 and 2017. See discussion below in the section entitled “Mergers and Acquisitions.”

We have three counties that hold significant shares of our deposit base. Buncombe County, the former headquarters of one of our 2017 acquisitions (Asheville Savings Bank), holds 12% of our total deposit base. Moore County, the headquarters of the Company, has total deposits comprising approximately 10% of our deposit base, while Guilford County, the former headquarters of another 2017 acquisition (Carolina Bank), also holds 10% of our deposit base. Accordingly, material changes in competition, the economy or the population of these counties could materially impact the Company. No other county comprises more than 10% of our deposit base.

We compete in our various market areas with, among others, several large interstate bank holding companies. These large competitors have substantially greater resources than our Company, including broader geographic markets, higher lending limits and the ability to make greater use of large-scale advertising and promotions. A significant number of interstate banking acquisitions have taken place in the past few years, thus further increasing the size and financial resources of some of our competitors, some of which are among the largest bank holding companies in the nation. In many of our markets, we also compete against smaller, local banks. With banks of all sizes attempting to maximize yields on earning assets, the competition for high-quality loans remains intense. Accordingly, loan rates in our markets continue to be under competitive pressure. Also, with the continued interest rate increases initiated by the Board of Governors of the Federal Reserve System (“Federal Reserve”), the competitive pressure on increasing rates on deposits has intensified. Many of the markets we operate in are particularly competitive markets, with at least ten other financial institutions having a physical presence within those markets.

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

Despite the competitive market, we believe we have certain advantages over our competition in the areas we serve. We are large enough to be able to more easily absorb higher costs being experienced in the banking industry, particularly regulatory costs and technology costs, than the smaller banks with which we compete. We are also able to originate significantly larger loans than many of our smaller bank competitors. At the same time, we attempt to maintain a banking culture associated with smaller banks – a culture that has a personal and local flavor that appeals to many retail and small business customers. Specifically, we seek to maintain a distinct local identity in each of the

communities we serve and we actively sponsor and participate in local civic affairs. Most lending and other customer-related business decisions can be made without the delays often associated with larger institutions. Additionally, employment of local managers and personnel in various offices and low turnover of personnel enable us to establish and maintain long-term relationships with individual and corporate customers. Also, due to acquisitions of other banks headquartered in North Carolina and South Carolina, we are the only bank headquartered in North Carolina with total assets between $4 billion and $35 billion and the only bank headquartered in either state with total assets between $4 billion and $14 billion. We believe that enhances several of our competitive advantages discussed above, as well as provides scarcity value from an investor viewpoint.

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Lending Policy and Procedures

Conservative lending policies and procedures and appropriate underwriting standards are high priorities of the Bank. Loans are approved under our written loan policy, which provides that lending officers, principally branch managers, have authority to approve loans of various amounts up to $350,000 with lending limits varying depending upon the experience of the lending officer and whether the loan is secured or unsecured. We have seven senior lending officers who have authority to approve secured loans up to $500,000 and each of our five Regional Presidents has authority to approve secured loans up to $1,000,000. Loans up to $5,000,000 are approved by the Bank’s Regional Credit Officers through our Credit Administration Department. The Bank’s President and Chief Credit Officer have authority to approve loans up to $10,000,000, while the President and the Chief Credit Officer have joint authority to approve loans up to $25,000,000. The Bank’s Board of Directors maintains loan authority in excess of the Bank’s in-house limit, currently $25,000,000, and generally approves loans through its Executive Loan Committee. All lending authorities are based on the borrower’s Total Credit Exposure (“TCE”), which is an aggregate of the Bank’s lending relationship to the borrower. TCE is based on the borrower’s total credit exposure with the Bank either directly or indirectly through loan guarantees or other borrowing entities related to the borrower through control or ownership.

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

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

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

To further assess the Bank’s loan portfolio and as a secondary review of the Bank’s Loan Review Department, we also contract with an independent consulting firm to review new loan originations meeting certain criteria, as well as to assign risk grades to existing credits meeting certain thresholds. The consulting firm’s observations, comments, and risk grades, including variances with the Bank’s risk grades, are shared with the audit committee of the Company’s board of directors and are considered by management in setting Bank policy, as well as in evaluating the adequacy of

our allowance for loan losses. For additional information, see “Allowance for Loan Losses and Loan Loss Experience” under Item 7 below.

Investment Policy and Procedures

We have adopted an investment policy designed to maximize our income from funds not needed to meet loan demand, in a manner consistent with appropriate liquidity and risk objectives. Pursuant to this policy, we may invest in U.S. government and government-sponsored enterprises, mortgage-backed securities, state and municipal obligations, public housing authority bonds, and, to a limited extent, corporate bonds. We may also invest up to $60 million in time deposits with other financial institutions. Time deposit purchases from any one financial institution exceeding FDIC insurance coverage limits are evaluated as a corporate bond and are subject to the same due diligence requirements as corporate bonds (described below).

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In making investment decisions, we do not solely rely on credit ratings to determine the credit-worthiness of an issuer of securities, but we use credit ratings in conjunction with other information when performing due diligence prior to the purchase of a security. Securities that are not rated investment grade will not be purchased. Securities rated below Moody's BAA or Standard and Poor's BBB generally will not be purchased. Securities rated below A are periodically reviewed for credit-worthiness. We may purchase non-rated municipal bonds only if such bonds are in our general market area and we determine these bonds have a credit risk no greater than the minimum ratings referred to above. We are also authorized by our Board of Directors to invest a portion of our securities portfolio in high quality corporate bonds, with the amount of such bonds not to exceed 15% of the entire securities portfolio. Prior to purchasing a corporate bond, the Company's management performs due diligence on the issuer of the bond, and the purchase is not made unless we believe that the purchase of the bond bears no more risk to the Company than would an unsecured loan to the same company. On a quarterly basis, we review the financial statements for the corporate bond issuers that we own for any signs of deterioration so that we can take timely action if deemed necessary.

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

Mergers and Acquisitions

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

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

In 2009, FDIC-assisted acquisitions began to occur frequently as banking regulators closed problem banks. In FDIC-assisted transactions, the acquiring bank often does not pay any consideration for the failed bank, and in some

cases receives cash from the FDIC as part of the transaction. In addition, the acquiring bank usually enters into one or more loss share agreements with the FDIC, which affords the acquiring bank significant loss protection. In both 2009 and 2011 we acquired the operations of failed banks in FDIC-assisted transactions. See the Company's Annual Reports on Form 10-K for those years for more information on these acquisitions.

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

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

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In May 2016, we completed the acquisition of SBA Complete. SBA Complete specializes in consulting with financial institutions across the country related to SBA loan origination and servicing. Many community banks do not have the in-house capability to comprehensively originate and service those types of loans, so they contract with SBA Complete for assistance. To learn more about this subsidiary of the Bank, please visit www.sbacomplete.com. Information included on our Internet site is not incorporated by reference into this annual report.

Soon after the acquisition of SBA Complete, we leveraged its capabilities by launching our own SBA Lending Division. Through a network of specialized First Bank loan officers, this Division offers SBA loans to small business owners throughout the United States. We typically sell the portion of each loan that is guaranteed by the SBA at a premium and record the non-guaranteed portion to our balance sheet. To learn more about our SBA Lending Division, please visit www.firstbanksba.com. Information included on our Internet site is not incorporated by reference into this annual report.

In March 2016, we announced an agreement to exchange our seven Virginia branches, with approximately $151 million in loans and $134 million in deposits, for six North Carolina branches of a community bank with a large Virginia presence that included approximately $152 million in loans and $111 million in deposits. Four of the six branches we assumed were in Winston-Salem, with the other two branches located in the Charlotte-metro markets of Mooresville and Huntersville. The Winston-Salem branches we assumed improved the Triad expansion initiative, while the Mooresville and Huntersville branches increased our Charlotte market expansion. This transaction, which was completed in July 2016, resulted in our exit from western Virginia. The opportunity to assume what is essentially a banking franchise in markets where we had recently invested in human capital was the primary factor we considered in entering into the exchange agreement.

In March 2017, we acquired Carolina Bank Holdings, Inc. (“Carolina Bank”), the parent company of Carolina Bank. Carolina Bank was a community bank headquartered in Greensboro with $682 million in assets, with eight branches located in Greensboro, Winston-Salem, Burlington and Asheboro. This acquisition built on the Winston-Salem expansion previously discussed and significantly accelerated our recent expansion initiative in the Greensboro market.

In September 2017, we acquired Bear Insurance Services, an insurance agency based in Albemarle, North Carolina. This acquisition provided us a larger platform for leveraging insurance services throughout our bank branch network and more than doubled our insurance agency revenue.

In October 2017, we acquired ASB Bancorp, Inc. (“Asheville Savings Bank”), the parent company of Asheville Savings Bank, SSB. Asheville Savings Bank operated in the attractive and high-growth market of Asheville, North Carolina, with $798 million in assets and 13 branches located throughout the Asheville market area.

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

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

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Employees

As of December 31, 2018, we had 1,054 full-time and 44 part-time employees. We are not a party to any collective bargaining agreements, and we consider our employee relations to be good.

Supervision and Regulation

As a bank holding company, we are subject to supervision, examination and regulation by the Federal Reserve and the North Carolina Office of the Commissioner of Banks (the "Commissioner"). The Bank is also subject to supervision and examination by the Federal Reserve and the Commissioner. For additional information, see Note 16 to the consolidated financial statements.

Supervision and Regulation of the Company

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

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

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

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

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

Supervision and Regulation of the Bank

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

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

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

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

FDIC Insurance

As a member of the FDIC, our deposits are insured up to applicable limits by the FDIC, and such insurance is backed by the full faith and credit of the United States Government. The basic deposit insurance level is generally $250,000, as specified in FDIC regulations. For this protection, each insured bank pays a quarterly statutory assessment and is subject to the rules and regulations of the FDIC.

The FDIC insurance premium is based on an institution’s total assets minus its Tier 1 capital. An institution’s premiums are determined based on its capital, supervisory ratings and other factors. Premium rates generally may increase if the FDIC deposit insurance fund is strained due to the cost of bank failures and the number of troubled banks. In addition, if the Bank experiences financial distress or operates in an unsafe or unsound manner, its deposit premiums may increase.

We recognized approximately $2.3 million, $2.4 million, and $2.0 million in FDIC insurance expense in 2018, 2017, and 2016, respectively. In November 2018, the FDIC announced that the Deposit Insurance Fund (“DIF”) reserve ratio exceeded the statutory minimum of 1.35% as of September 30, 2018. Among other things, this resulted in the FDIC awarding assessment credits for banks with less than $10 billion in total assets that had contributed to the DIF in prior years. We were notified in January 2019 that we had received $1.35 million in credits that could be used to offset deposit insurance assessments in the future. When the DIF reaches 1.38%, the FDIC will begin to apply the Bank’s credits against our quarterly deposit insurance assessments. The DIF was 1.36% at December 31, 2018.

The FDIC may conduct examinations of and require reporting by FDIC-insured institutions. It may also prohibit an institution from engaging in any activity that it determines by regulation or order to pose a serious risk to the deposit insurance fund and may terminate the Bank's deposit insurance if it determines that the institution has engaged in unsafe or unsound practices or is in an unsafe or unsound condition.

Legislative and Regulatory Guidance and Developments

In addition to the regulations that are described above, new legislation is introduced from time to time in the U.S. Congress that may affect our operations. In addition, the regulations governing the Company and the Bank may be amended from time to time by the Federal Reserve, the FDIC, the Securities and Exchange Commission (the "SEC"), or other agencies, as appropriate. Any legislative or regulatory changes, or changes to accounting standards, in the future could adversely affect our operations and financial condition.

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

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

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

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

In May 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (the “Economic Growth Act”), was enacted to modify or remove certain financial reform rules and regulations, including some of those implemented under the Dodd-Frank Act. While the Economic Growth Act maintains most of the regulatory structure established by the Dodd-Frank Act, it amends certain aspects of the regulatory framework for small depository institutions with assets less than $10 billion and for large banks with assets of more than $50 billion. Many of these changes could result in meaningful regulatory changes for banks and their holding companies.

The Economic Growth Act, among other matters, expands the definition of qualified mortgages which may be held by a financial institution and provides for an alternative capital rule for financial institutions and their holding companies with total consolidated assets of less than $10 billion. The Economic Growth Act instructed the federal banking regulators to establish a single “Community Bank Leverage Ratio” of between 8% and 10%, which has been proposed to be 9% by the federal regulators. The Community Bank Leverage Ratio provides for a simpler calculation of a bank’s capital ratio than the Basel III provisions currently in place (see below). Any qualifying depository institution or its holding company that exceeds the Community Bank Leverage Ratio will be considered to have met generally applicable leverage and risk-based regulatory capital requirements and any qualifying depository institution that exceeds the new ratio will be considered to be “well capitalized” under the prompt corrective action rules. In addition, the Economic Growth Act includes regulatory relief for community banks of certain sizes regarding regulatory examination cycles, call reports, the Volcker Rule (proprietary trading prohibitions), mortgage disclosures and risk weights for certain high-risk commercial real estate loans. We continue to evaluate the impact that the rules issued thus far under the Economic Growth Act will have on the bank, but we currently do not believe that it will be

significant. At this time, we do not expect to opt-in to the ability to utilize the Community Bank Leverage Ratio and will instead continue to use the Basel III standards.

It is difficult at this time to predict when or how any new standards under the Economic Growth Act will ultimately be applied to, or what specific impact the Economic Growth Act and the yet-to-be-written implementing rules and regulations will have on us.

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Regulatory Capital Requirement under Basel III

Effective January 1, 2015, the Company and the Bank became subject to new regulatory capital rules agreed to by the Basel Committee on Banking Supervision in the accord referred to as "Basel III." Under the Basel III Capital Rules, the following were the initial minimum capital ratios applicable to the Company and the Bank as of January 1, 2015:

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

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

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

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

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

- CET1 Capital Ratio of at least 6.50%;
- Tier I Capital Ratio of at least 8.00%;
- Total Capital Ratio of at least 10.00%; and a
- Leverage Ratio of at least 5.00%.

If a bank falls below "well capitalized" status in any of these three ratios, it must ask for FDIC permission to originate or renew brokered deposits. First Bank is well-capitalized under all capital guidelines.

Current Expected Credit Loss Accounting Standard

The Financial Accounting Standards Board ("FASB") has adopted a new accounting standard that will be effective for the Company on January 1, 2020. This standard, referred to as Current Expected Credit Loss (or "CECL"), requires FDIC-insured institutions and their holding companies (banking organizations) to recognize credit losses expected over the life of certain financial assets. CECL covers a broader range of assets than the current method of recognizing credit losses and generally results in earlier recognition of credit losses. Upon adoption of CECL, a banking organization must record a one-time adjustment to its allowance for loan losses as of the beginning of the fiscal year of adoption equal to the difference, if any, between the amount of credit loss allowances under the current methodology and the amount required under CECL. For a banking organization, implementation of CECL is generally likely to reduce retained earnings, and to affect other items, in a manner that reduces its regulatory capital. We continue our ongoing analysis on the impact of this guidance on our consolidated financial statements.

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The Federal Reserve and the FDIC have adopted a rule that provides a banking organization the option to phase-in over a three-year period the effects of CECL on its regulatory capital upon the adoption of the standard.

Liquidity Requirements

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

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

Following the enactment of the Economic Growth Act in May 2018, the Federal Reserve stated that it would no longer require bank holding companies with less than $100 billion in total consolidated assets to comply with the modified version of the LCR. In addition, in October 2018, the federal bank regulators proposed to revise their liquidity requirements so that banking organizations that are not global systematically important banks and have less than $250 billion in total consolidated assets and less than $75 billion in each of off-balance sheet exposure, nonbank assets, cross-jurisdictional activity and short-term wholesale funding would not be subject to any LCR or NSFR requirements.

Financial Privacy and Cybersecurity

The federal banking regulators have adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to non-affiliated third parties. These limitations require disclosure of

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

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

In the ordinary course of business, we rely on electronic communications and information systems to conduct our operations and to store sensitive data. We employ an in-depth, layered, defensive approach that leverages people, processes and technology to manage and maintain cybersecurity controls. We employ a variety of preventative and detective tools to monitor, block, and provide alerts regarding suspicious activity, as well as to report on any suspected advanced persistent threats. Notwithstanding the strength of our defensive measures, the threat from cyber-attacks is severe, attacks are sophisticated and increasing in volume, and attackers respond rapidly to changes in defensive measures. While to date we have not detected a significant compromise, significant data loss or any material financial losses related to cybersecurity attacks, our systems and those of our customers and third-party service providers are under constant threat and it is possible that we could experience a significant event in the future. Risks and exposures related to cybersecurity attacks are expected to remain high for the foreseeable future due to the rapidly evolving nature and sophistication of these threats, as well as due to the expanding use of Internet banking, mobile banking and other technology-based products and services by us and our customers. See Item 1A. Risk Factors for a further discussion of risks related to cybersecurity.

Anti-Money Laundering and the USA Patriot Act

A major focus of governmental policy on financial institutions in recent years has been aimed at combating money laundering and terrorist financing. The USA PATRIOT Act of 2001 (the "USA Patriot Act") substantially broadened the scope of United States anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations on financial institutions, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States.

On May 11, 2016, the Financial Crimes Enforcement Network ("FinCEN") issued new anti-money laundering ("AML") rules governing corporate entities doing business with banks and other financial institutions that are subject to the requirements of the USA Patriot Act. The AML rules impose significant due diligence obligations on financial institutions with respect to opening of new accounts and the monitoring of existing accounts. Under the AML rules, a financial institution must identify persons owning or controlling 25% or more of a "legal entity," whenever the legal entity opens a new account at the bank. The financial institution must also identify an individual who has substantial management authority at the legal entity, such as a CEO, CFO, or managing partner. These new AML rules became

effective in May 2018.

The AML rules codify within the FinCEN regulations the “pillars” that must be included in a financial institutions AML compliance program. Regulators previously communicated their expectations with respect to four of these pillars: (1) the development of internal policies, procedures, and control; (2) the designation of a compliance officer; (3) the establishment of an ongoing employee training program; and (4) the implementation of an independent audit function to test programs. The new beneficial ownership requirement establishes a fifth pillar. Among other things, this new pillar includes the necessity to monitor and update the beneficial ownership of a legal entity, including the need to subject corporate borrowers to due diligence requests from financial institutions for certifications with respect to their beneficial owners. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution, including causing applicable bank regulatory authorities not to approve merger or acquisition transactions when regulatory approval is required or to prohibit such transactions even if approval is not required.

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Office of Foreign Assets Control Regulation

The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others which are administered by the U.S. Treasury Department Office of Foreign Assets Control ("OFAC"). Failure to comply with these sanctions could have serious legal and reputational consequences, including causing applicable bank regulatory authorities not to approve merger or acquisition transactions when regulatory approval is required or to prohibit such transactions even if approval is not required.

Community Reinvestment Act

The Community Reinvestment Act of 1977 ("CRA") requires depository institutions to assist in meeting the credit needs of their market areas consistent with safe and sound banking practice. Under the CRA, each depository institution is required to help meet the credit needs of its market areas by, among other things, providing credit to low- and moderate- income individuals and communities. Depository institutions are periodically examined for compliance with the CRA and are assigned ratings. In order for a financial holding company to commence any new activity permitted by the BHC Act, or to acquire any company engaged in any new activity permitted by the BHC Act, each insured depository institution subsidiary of the financial holding company must have received a rating of at least "satisfactory" in its most recent examination under the CRA. Furthermore, banking regulators take into account CRA ratings when considering a request for an approval of a proposed transaction. First Bank received a rating of "satisfactory" in its most recent CRA examination. In April 2018, the U.S. Department of Treasury issued a memorandum to the federal banking regulators with recommended changes to the CRA's implementing regulations to reduce their complexity and associated burden on banks. We will continue to evaluate the impact of any changes to the regulations implementing the CRA.

Federal Securities Laws

The common stock of the Company is registered with the SEC under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Therefore, the Company is subject to the reporting, information disclosure, proxy solicitation, insider trading limits and other requirements imposed on public companies by the SEC under the Exchange Act. This includes limits on sales of stock by certain insiders and the filing of insider ownership reports with the SEC. The SEC and Nasdaq have adopted regulations under the Sarbanes-Oxley Act of 2002 and the Dodd Frank Act that apply to the Company as a Nasdaq-traded, public company, which seek to improve corporate governance, provide enhanced penalties for financial reporting improprieties and improve the reliability of disclosures in SEC filings.

Tax Cuts and Jobs Act

U.S. tax reform legislation was signed into law on December 22, 2017 and made broad and complex changes to the U.S. Internal Revenue Code, including reducing the U.S. statutory tax rate from 35% to 21% beginning on January 1, 2018. With the adoption of this tax reform, our deferred tax balances were reduced as of December 31, 2017 to reflect the new 21% statutory tax rate.

Beginning January 1, 2018, we applied the federal tax rate of 21% to our taxable earnings. Other provisions of U.S. tax reform that we adopted on January 1, 2018, include, but are not limited to: 1) provisions reducing the dividends received deduction; 2) essentially eliminating U.S. federal income taxes on dividends from foreign subsidiaries; 3) retaining an element of current inclusion of certain earnings of controlled foreign corporations; 4) eliminating the corporate alternative minimum tax ("AMT") and 5) changing how existing AMT credits will be realized.

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Available Information

We maintain a corporate Internet site at www.LocalFirstBank.com, which contains a link within the “Investor Relations” section of the site to each of our filings with the SEC, including our annual reports on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act. These filings are available, free of charge, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. These filings can also be accessed at the SEC’s website located at www.sec.gov. Information included on our Internet site is not incorporated by reference into this annual report.

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Item 1A. Risk Factors

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

Risks Related to Our Business

Unfavorable economic conditions could adversely affect our business.

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

Cybersecurity incidents could disrupt business operations, result in the loss of critical and confidential information, and adversely impact our reputation and results of operations.

Global cybersecurity threats and incidents can range from uncoordinated individual attempts to gain unauthorized access to information technology (IT) systems to sophisticated and targeted measures known as advanced persistent threats, directed at the Company and/or its third party service providers. While we have experienced, and expect to

continue to experience, these types of threats and incidents, none of them to date have been material to the Company. Although we employ comprehensive measures to prevent, detect, address and mitigate these threats (including access controls, employee training, data encryption, vulnerability assessments, continuous monitoring of our IT networks and systems and maintenance of backup and protective systems), cybersecurity incidents, depending on their nature and scope, could potentially result in the misappropriation, destruction, corruption or unavailability of critical data and confidential or proprietary information (our own or that of third parties) and the disruption of business operations. The potential consequences of a material cybersecurity incident include reputational damage, litigation with third parties and increased cybersecurity protection and remediation costs, which in turn could materially adversely affect our results of operations.

Our allowance for loan losses may not be adequate to cover actual losses; we may need to materially increase our allowance for loan losses under CECL.

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

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

In addition, the measure of our allowance for loan losses is dependent on the adoption of new accounting standards. The FASB issued an Accounting Standards Update related to CECL, the new credit impairment model, which will become effective on January 1, 2020 for the Company. This new model requires financial institutions to estimate and develop a provision for credit losses at origination for the lifetime of the loan, as opposed to reserving for probable incurred losses up to the balance sheet date. Under the CECL model, credit deterioration will be reflected in the income statement in the period of origination or acquisition of the loan, with changes in expected credit losses due to further credit deterioration or improvement reflected in the periods in which the expectation changes. Accordingly, the CECL model will likely require financial institutions like the Company to increase their allowances for loan losses. Moreover, the CECL model will likely create more volatility in our level of allowance for loan losses in the periods after adoption.

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

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

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

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

The federal Bank Secrecy Act, the Patriot Act and other laws and regulations require financial institutions, among other duties, to institute and maintain effective anti-money laundering programs and file suspicious activity and currency transaction reports as appropriate. The FINCEN, established by the Treasury to administer the Bank Secrecy

Act, is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. There is also increased scrutiny of compliance with the rules enforced by the OFAC. Federal and state bank regulators also have begun to focus on compliance with Bank Secrecy Act and AML regulations. If our policies, procedures and systems are deemed deficient or the policies, procedures and systems of the financial institutions that we have already acquired or may acquire in the future are deficient, we would be subject to liability, including fines and regulatory actions such as restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans, which would negatively impact our business, financial condition and results of operations. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us.

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Consumers may decide not to use banks to complete their financial transactions.

Technology and other changes are allowing parties to complete financial transactions through alternative methods that historically have involved banks. For example, consumers can now maintain funds that would have historically been held as bank deposits in brokerage accounts, mutual funds or general-purpose reloadable prepaid cards. Consumers can also complete transactions such as paying bills and/or transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries, known as "disintermediation," could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost of deposits as a source of funds could have a material adverse effect on our financial condition and results of operations.

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

Reputation risk, or the risk to our business, earnings and capital from negative public opinion regarding our Company and the financial services industry in general, is inherent in our business. Negative public opinion can result from actual or alleged conduct in any number of activities, including lending practices, corporate governance and acquisitions, and from actions taken by government regulators and community organizations in response to those activities. Negative public opinion can adversely affect our ability to keep and attract clients and employees and can expose us to litigation and regulatory action. Although we have taken steps to minimize reputation risk in dealing with our clients and communities, this risk will always be present given the nature of our business.

We may make future acquisitions, which could dilute current shareholders' stock ownership and expose us to additional risks.

In accordance with our strategic plan, we evaluate opportunities to acquire other banks and branch locations to expand the Company. As a result, we may engage in acquisitions and other transactions that could have a material effect on our operating results and financial condition, including short and long-term liquidity. Our acquisition activities could require us to issue a significant number of shares of common stock or other securities and/or to use a substantial amount of cash, other liquid assets, and/or incur debt. In addition, if goodwill recorded in connection with our potential future acquisitions were determined to be impaired, then we would be required to recognize a charge against our earnings, which could materially and adversely affect our results of operations during the period in which the impairment was recognized.

Our acquisition activities could involve a number of additional risks, some of which are described in more detail elsewhere in this report and include:

- the possibility that expected benefits may not materialize in the timeframe expected or at all, or may be more costly to achieve;
- incurring the time and expense associated with identifying and evaluating potential acquisitions and merger partners and negotiating potential transactions, resulting in management's attention being diverted from the operation of our existing business;
- using inaccurate estimates and judgments to evaluate credit, operations, management, and market risks with respect to the target institution or assets;
- incurring the time and expense required to integrate the operations and personnel of the combined businesses;
- the possibility that we will be unable to successfully implement integration strategies, due to challenges associated with integrating complex systems, technology, banking centers, and other assets of the acquired bank in a manner that minimizes any adverse effect on customers, suppliers, employees, and other constituencies;

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- the possibility of regulatory approval for the acquisition being delayed, impeded, restrictively conditioned or denied due to existing or new regulatory issues surrounding the Company, the target institution or the proposed combined entity as a result of, among other things, issues related to AML and Bank Secrecy Act compliance, fair lending laws, fair housing laws, consumer protection laws, unfair, deceptive, or abusive acts or practices regulations, or CRA requirements, and the possibility that any such issues associated with the target institution, which we may or may not be aware of at the time of the acquisition, could impact the combined entity after completion of the acquisition;
- the possibility that the acquisition may not be timely completed, if at all;
- creating an adverse short-term effect on our results of operations; and
- losing key employees and customers as a result of an acquisition that is poorly received.

If we do not successfully manage these risks, our acquisition activities could have a material adverse effect on our operating results and financial condition, including short- and long-term liquidity.

The soundness of other financial institutions could adversely affect us.

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

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

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

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

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

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

Liquidity risk could impair our ability to fund operations and jeopardize our financial condition.

Liquidity is essential to our business. We rely on a number of different sources in order to meet our potential liquidity demands. Our primary sources of liquidity are increases in deposit accounts, cash flows from loan payments and our securities portfolio. Borrowings also provide us with a source of funds to meet liquidity demands. An inability to raise funds through deposits, borrowings, the sale of loans and other sources could have a substantial negative effect on our liquidity.

Our access to funding sources in amounts adequate to finance our activities or on terms which are acceptable to us could be impaired by factors that affect us specifically, or the financial services industry or economy in general. Factors that could detrimentally impact our access to liquidity sources include adverse regulatory action against us or a decrease in the level of our business activity as a result of a downturn in the markets in which our loans are concentrated. Our ability to borrow could also be impaired by factors that are not specific to us, such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry in light of the recent turmoil faced by banking organizations or deterioration in credit markets.

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

We have goodwill recorded on our balance sheet as an asset with a carrying value as of December 31, 2018 of $234.4 million. Under generally accepted accounting principles, goodwill is required to be tested for impairment at least annually and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The test for goodwill impairment involves comparing the fair value of a company's reporting units to their respective carrying values. We have three reporting units – 1) First Bank with $222.7 million in goodwill, 2) First Bank Insurance with $7.4 million in goodwill, and 3) SBA activities, including SBA Complete and our SBA Lending Division, with $4.3 million in goodwill. The price of our common stock is one of several factors available for estimating the fair value of our reporting units and is most closely associated with our First Bank reporting unit. Subject to the results of other valuation techniques, if the price of our common stock falls below book value, it could indicate that a portion of our goodwill is impaired. Accordingly, for this reason or other reasons that indicate that the goodwill at any of our reporting units is impaired, we may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill is determined, which could have a negative impact on our results of operations.

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

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

We may issue additional shares of stock or equity derivative securities that will dilute the percentage ownership interest of existing shareholders and may dilute the book value per share of our common stock and adversely affect the terms on which we may obtain additional capital.

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Our authorized capital includes 40,000,000 shares of common stock and 5,000,000 shares of preferred stock. As of December 31, 2018, we had 29,724,874 shares of common stock outstanding and had reserved for issuance 9,000 shares underlying options that are or may become exercisable at an average price of $14.35 per share. In addition, as of December 31, 2018, we had the ability to issue 750,707 shares of common stock pursuant to options and restricted stock under our existing equity compensation plans and 53,496 contingently issuable shares that are tied to performance goals associated with a corporate acquisition.

Subject to applicable NASDAQ rules, our board generally has the authority, without action by or vote of the shareholders, to issue all or part of any authorized but unissued shares of stock for any corporate purpose. Such corporate purposes could include, among other things, issuances of equity-based incentives under or outside of our equity compensation plans, issuances of equity in business combination transactions, and issuances of equity to raise additional capital to support growth or to otherwise strengthen our balance sheet. Any issuance of additional shares of stock or equity derivative securities will dilute the percentage ownership interest of our shareholders and may dilute the book value per share of our common stock. Shares we issue in connection with any such offering will increase the total number of outstanding shares and may dilute the economic and voting ownership interest of our existing shareholders.

We may be adversely impacted by the transition from LIBOR as a reference rate.

In 2017, the United Kingdom's Financial Conduct Authority announced that after 2021 it would no longer compel banks to submit the rates required to calculate the London Interbank Offered Rate ("LIBOR"). This announcement indicated that the continuation of LIBOR on the current basis cannot and will not be guaranteed after 2021. Consequently, at this time, it is not possible to predict whether and to what extent banks will continue to provide submissions for the calculation of LIBOR. Similarly, it is not possible to predict whether LIBOR will continue to be viewed as an acceptable market benchmark, what rate or rates may become accepted alternatives to LIBOR, or what the effect of any such changes in views or alternatives may be on the markets for LIBOR-indexed financial instruments.

We have a significant number of loans and borrowings with attributes that are either directly or indirectly dependent on LIBOR. The transition from LIBOR could create considerable costs and additional risk. Furthermore, failure to adequately manage this transition process with our customers could adversely impact our reputation. Although we are currently unable to assess what the ultimate impact of the transition from LIBOR will be, failure to adequately manage the transition could have a material adverse effect on our business, financial condition and results of operations.

Future acquisitions may be delayed, impeded, or prohibited due to regulatory issues.

Future acquisitions by the Company, particularly those of financial institutions, are subject to approval by a variety of federal and state regulatory agencies. The process for obtaining these required regulatory approvals has become substantially more difficult in recent years. Regulatory approvals could be delayed, impeded, restrictively conditioned or denied due to existing or new regulatory issues we have, or may have, with regulatory agencies, including, without limitation, issues related to AML and Bank Secrecy Act compliance, fair lending laws, fair housing laws, consumer protection laws, unfair, deceptive, or abusive acts or practices regulations, CRA issues, and other similar laws and regulations. We may fail to pursue, evaluate or complete strategic and competitively significant acquisition opportunities as a result of our inability, or perceived or anticipated inability, to obtain regulatory approvals in a timely manner, under reasonable conditions or at all. Difficulties associated with potential acquisitions that may result from these factors could have a material adverse effect on our business, and, in turn, our financial condition and results of operations.

We may be exposed to difficulties in combining the operations of acquired businesses into our own operations, which may prevent us from achieving the expected benefits from our acquisition activities.

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We may not be able to fully achieve the strategic objectives and operating efficiencies that we anticipate in our acquisition activities. Inherent uncertainties exist in integrating the operations of an acquired business. In addition, the markets and industries in which the Company and our potential acquisition targets operate are highly competitive. We may lose customers or the customers of acquired entities as a result of an acquisition. We also may lose key personnel from the acquired entity as a result of an acquisition. We may not discover all known and unknown factors when examining a company for acquisition during the due diligence period. These factors could produce unintended and unexpected consequences for us. Undiscovered factors as a result of acquisition, pursued by non-related third party entities, could bring civil, criminal, and financial liabilities against us, our management, and the management of those entities acquired. These factors could contribute to the Company not achieving the expected benefits from its acquisitions within desired time frames.

We are subject to federal and state fair lending laws, and failure to comply with these laws could lead to material penalties.

Federal and state fair lending laws and regulations, such as the Equal Credit Opportunity Act and the Fair Housing Act, impose nondiscriminatory lending requirements on financial institutions. The Department of Justice, the Consumer Finance Protection Bureau and other federal and state agencies are responsible for enforcing these laws and regulations. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. A successful challenge to our performance under the fair lending laws and regulations could adversely impact our CRA rating and result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on or delays in approving merger and acquisition activity and restrictions on expansion activity, which could negatively impact our reputation, business, financial condition and results of operations.

We could experience losses due to competition with other financial institutions.

We face substantial competition in all areas of our operations from a variety of different competitors, both within and beyond our principal markets, many of which are larger and may have more financial resources. Such competitors primarily include national, regional and internet banks within the various markets in which we operate. We also face competition from many other types of financial institutions, including, without limitation, thrifts, credit unions, finance companies, brokerage firms, insurance companies and other financial intermediaries, such as online lenders and banks. The financial services industry could become even more competitive as a result of legislative and regulatory changes and continued consolidation. In addition, as customer preferences and expectations continue to evolve, technology has lowered barriers to entry and made it possible for nonbanks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Banks, securities firms and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. Many of our competitors have fewer regulatory constraints and may have lower cost structures. Additionally, due to their size, many competitors may be able to achieve economies of scale and, as a result, may offer a broader range of products and services as well as better pricing for those products and services than we can.

Our ability to compete successfully depends on a number of factors, including, among other things:

- the ability to develop, maintain, and build upon long-term customer relationships based on top quality service, high ethical standards, and safe, sound assets;
- the ability to expand our market position;
- the scope, relevance, and pricing of products and services offered to meet customer needs and demands;
- the rate at which we introduce new products and services relative to our competitors;
- customer satisfaction with our level of service; and
- industry and general economic trends.

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Failure to perform in any of these areas could significantly weaken our competitive position, which could adversely affect our growth and profitability, which, in turn, could have a material adverse effect on our financial condition and results of operations.

Failure to keep pace with technological change could adversely affect our business.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

New lines of business or new products and services may subject us to additional risk.

From time to time, we may implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or new products and services, we may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business and/or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business and/or new products or services could have a material adverse effect on our business and, in turn, our financial condition and results of operations.

In May 2016, we completed the acquisition of SBA Complete. SBA Complete specializes in consulting with financial institutions across the country related to SBA loan origination and servicing. We leveraged the expertise assumed in the acquisition of SBA Complete to launch our own SBA Lending Division in the third quarter of 2016. These are both relatively new lines of business for the Bank with unique operational, control and accounting risks, which if not properly managed, could result in losses for our Company.

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

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

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

Changes in accounting standards could materially impact our financial statements.

From time to time accounting standards setters change the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can be difficult to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in changes to previously reported financial results or a cumulative charge to retained earnings. See Note 1(v) – Recent Accounting Pronouncements in the notes to consolidated financial statements included in Item 8. Financial Statements.

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

We rely heavily on communications and information systems to conduct our business. Our daily operations depend on the operational effectiveness of our technology. We rely on our systems to accurately track and record our assets and liabilities. Any failure, interruption or breach in security of our computer systems or outside technology, whether due to severe weather, natural disasters, acts of war or terrorism, criminal activity, cyber attacks or other factors, could result in failures or disruptions in general ledger, deposit, loan, customer relationship management, and other systems leading to inaccurate financial records. This could materially affect our business operations and financial condition. While we have disaster recovery and other policies and procedures designed to prevent or limit the effect of any failure, interruption or security breach of our information systems, there can be no assurance that any such failures, interruptions, or security breaches will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our results of operations.

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

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

We rely on certain external vendors.

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

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We are subject to losses due to errors, omissions or fraudulent behavior by our employees, clients, counterparties or other third parties.

We are exposed to many types of operational risk, including the risk of fraud by employees and third parties, clerical recordkeeping errors and transactional errors. Our business is dependent on our employees as well as third-party service providers to process a large number of increasingly complex transactions. We could be materially and adversely affected if employees, clients, counterparties or other third parties caused an operational breakdown or failure, either as a result of human error, fraudulent manipulation or purposeful damage to any of our operations or systems.

In deciding whether to extend credit or to enter into other transactions with clients and counterparties, we may rely on information furnished to us by or on behalf of clients and counterparties, including financial statements and other financial information, which we do not independently verify. We also may rely on representations of clients and counterparties as to the accuracy and completeness of that information and, with respect to financial statements, on reports of independent auditors. For example, in deciding whether to extend credit to a client, we may assume that the client's audited financial statements conform with U.S. Generally Accepted Accounting Principles ("GAAP") and present fairly, in all material respects, the financial condition, results of operations and cash flows of the client. Our financial condition and results of operations could be negatively affected to the extent we rely on financial statements that do not comply with GAAP or are materially misleading, any of which could be caused by errors, omissions, or fraudulent behavior by our employees, clients, counterparties, or other third parties.

Risks Related to the Company's Common Stock

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

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

Future sales of our stock by our shareholders or the perception that those sales could occur may cause our stock price to decline.

Although our common stock is listed for trading in The NASDAQ Global Select Market under the symbol "FBNC", the trading volume in our common stock is lower than that of other larger financial services companies. A public trading

market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of our common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the relatively low trading volume of our common stock, significant sales of our common stock in the public market, or the perception that those sales may occur, could cause the trading price of our common stock to decline or to be lower than it otherwise might be in the absence of those sales or perceptions.

Our stock price can be volatile.

Stock price volatility may make it more difficult for you to resell your common stock when you want and at prices you find attractive. Our stock price can fluctuate significantly in response to a variety of factors including the risk factors discussed elsewhere in this report that are outside of our control and which may occur regardless of our operating results.

An investment in the Company’s common stock is not an insured deposit.

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

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Item 1B. Unresolved Staff Comments

None

Item 2. Properties

The main offices of the Company and the Bank are located in a three-story building in the central business district of Southern Pines, North Carolina and is owned by the Bank. The building houses administrative facilities. The Bank's Operations Division, including customer accounting functions, offices for information technology operations, and offices for loan operations, are primarily housed in two one-story steel frame buildings in Troy, North Carolina. Both of these buildings are owned by the Bank. At December 31, 2018, the Company operated 101 bank branches. The Company owned all of its bank branch premises except eight branch offices for which the land and buildings are leased and nine branch offices for which the land is leased but the building is owned. The Bank also leases one loan production office and five other office locations for administrative functions. The Bank also leases 10 locations for our SBA related activities and leases three properties for our insurance subsidiary. There are no options to purchase or lease additional properties. The Company considers its facilities adequate to meet current needs and believes that lease renewals or replacement properties can be acquired as necessary to meet future needs.

Item 3. Legal Proceedings

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

Item 4. Mine Safety Disclosure

Not applicable.

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PART II

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

Our common stock trades on The NASDAQ Global Select Market under the trading symbol "FBNC". Tables 1 and 22 included in "Management's Discussion and Analysis" below provide historic information on the market price for the Company's common stock. As of December 31, 2018, there were approximately 1,700 shareholders of record and another 7,100 shareholders whose stock is held in "street name."

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Performance Graph

The performance graph shown below compares the Company's cumulative total return to shareholders for the five-year period commencing December 31, 2013 and ending December 31, 2018, with the cumulative total return of the Russell 2000 Index (reflecting overall stock market performance of small-capitalization companies), an index of banks with between $1 billion and $5 billion in assets, and an index of banks with between $5 billion and $10 billion in assets, both as constructed by SNL Securities, LP (reflecting changes in banking industry stocks). In 2017, the Company's total assets increased above $5 billion due to acquisition transactions. The graph and table assume that $100 was invested on December 31, 2013 in each of the Company's common stock, the Russell 2000 Index, and the SNL Bank Indexes, and that all dividends were reinvested.

First Bancorp

Comparison of Five-Year Total Return Performances (1)

Five Years Ending December 31, 2018

	Total Return Index Values (1) December 31,					
	2013	2014	2015	2016	2017	2018
First Bancorp	$100.00	113.12	116.87	171.94	225.92	211.23
Russell 2000	100.00	104.89	100.26	121.63	139.44	124.09
SNL Index-Banks between $1 billion and $5 billion	100.00	104.56	117.04	168.38	179.51	157.27
SNL Index-Banks between $5 billion and $10 billion	100.00	103.01	117.34	168.11	167.48	151.57

(1) Total return indices were provided from an independent source, SNL Securities LP, Charlottesville, Virginia, and assume initial investment of $100 on December 31, 2013, reinvestment of dividends, and changes in market values. Total return index numerical values used in this example are for illustrative purposes only.

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Issuer Purchases of Equity Securities

Pursuant to authorizations by the Company's Board of Directors, the Company has from time to time repurchased shares of common stock in private transactions and in open-market purchases. The Company did not repurchase any shares of its common stock during the quarter ended December 31, 2018.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased (2)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs (1)
Month #1 (October 1, 2018 to October 31, 2018)	—	$ —	—	214,241
Month #2 (November 1, 2018 to November 30, 2018)	—	—	—	214,241
Month #3 (December 1, 2018 to December 31, 2018)	—	—	—	214,241
Total	—	$ —	—	214,241

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(1) All shares available for repurchase are pursuant to publicly announced share repurchase authorizations. As of December 31, 2018, the Company had the authorization to repurchase up to 375,000 shares of the Company's stock (per July 30, 2004 authorization). On February 5, 2019, the Company announced that its Board of Directors had approved the authorization to repurchase up to $25,000,000 of the Company's common stock, which replaces the share authorization noted above. The repurchase authorization has an expiration date of December 31, 2019.

(2) The table above does not include shares that were used by option holders to satisfy the exercise price of the options issued by the Company to its employees and directors pursuant to the Company's stock option plans. There were no such transactions in the three months ended December 31, 2018.

Also see "Additional Information Regarding the Registrant's Equity Compensation Plans" in Item 12.

Item 6. Selected Consolidated Financial Data

Table 1 on page 63 of this report sets forth the selected consolidated financial data for the Company.

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

Management's Discussion and Analysis is intended to assist readers in understanding our results of operations and changes in financial position for the past three years. This discussion should be read in conjunction with the consolidated financial statements and accompanying notes beginning on page 81 of this report and the supplemental financial data contained in Tables 1 through 22 beginning on page 68 of this report. This discussion may contain forward-looking statements that involve risks and uncertainties. Our actual results could differ significantly from those anticipated in forward-looking statements as a result of various factors. The following discussion is intended to assist in understanding the financial condition and results of operations of the Company.

Overview - 2018 Compared to 2017

We reported net income per diluted common share of $3.01 in 2018, a 65.4% increase compared to 2017.

Financial Highlights *($ in thousands except per share data)*	2018	2017	Change
Earnings			
Net interest income	$207,430	164,711	25.9%
Provision (reversal) for loan losses	(3,589)	723	n/m
Noninterest income	61,834	48,908	26.4%
Noninterest expenses	159,375	145,157	9.8%
Income before income taxes	113,478	67,739	67.5%
Income tax expense	24,189	21,767	11.1%
Net income available to common shareholders	$89,289	45,972	94.2%
Net income per common share			
Basic	$3.02	1.82	65.9%
Diluted	3.01	1.82	65.4%
Balances At Year End			
Assets	$5,864,116	5,547,037	5.7%
Loans	4,249,064	4,042,369	5.1%
Deposits	4,659,339	4,406,955	5.7%
Ratios			
Return on average assets	1.57%	1.00%	
Return on average common equity	12.27%	8.62%	
Net interest margin (taxable-equivalent)	4.12%	4.08%	

n/m – not meaningful

For the year ended December 31, 2018, we recorded net income available to common shareholders of $89.3 million, or $3.01 per diluted common share, an increase of 65.4% in earnings per share from the $46.0 million, or $1.82 per diluted common share, for 2017. The higher earnings in 2018 were primarily due to the acquisitions of Carolina Bank on March 3, 2017 and Asheville Savings Bank on October 1, 2017. The assets, liabilities and earnings for the acquisitions were recorded beginning on their respective acquisition dates. Therefore, the year 2018 includes twelve months of earnings from the acquisition compared to only a partial year in 2017. Earnings and earnings per share for 2018 also benefitted from operational efficiencies that were realized in the integration of the acquisitions that became fully realized in the final three quarters of 2018.

Net interest income for the year ended December 31, 2018 amounted to $207.4 million, a 25.9% increase from the $164.7 million recorded in 2017. The increase in net interest income was due to a higher net interest margin realized in 2018 as well growth in interest-earning assets, which for the twelve month period was impacted by assets acquired in the Carolina Bank and Asheville Savings Bank acquisitions. Also, see the section entitled “Net Interest Income” for additional information.

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Our net interest margin (tax-equivalent net interest income divided by average earning assets) was 4.12% for 2018 compared to 4.08% for 2017. The increase in the net interest margin realized in 2018 were a result of asset yields increasing slightly more than liability costs. Interest income for the year ended December 31, 2018 was also positively impacted by approximately $0.8 million in interest recoveries received in the first quarter, which primarily related to the same loans that experienced significant allowance for loan loss recoveries discussed below in "Provisions for Loan Losses and Asset Quality."

We recorded a negative provision for loan losses of $3.6 million (reduction of the allowance for loan losses) in 2018 compared to a provision for loan losses of $0.7 million in 2017. The negative provision for 2018 was due primarily to several large loan recoveries realized in the first quarter of 2018 totaling $3.7 million. Generally, our provisions for loan losses have been low over the past several years due to strong asset quality, including low loan charge-offs.

For the year ended December 31, 2018, noninterest income amounted to $61.8 million compared to $48.9 million for 2017. The primary reasons for the increase in core noninterest income in 2018 were the previously discussed bank acquisitions and an insurance agency acquisition completed late in 2017, as well as higher income derived from the Company's SBA consulting fees and SBA loan sale gains. See the section entitled "Noninterest Income" for additional information.

Noninterest expenses for the year ended December 31, 2018 amounted to $159.4 million compared to $145.2 million in 2017. Most categories of noninterest expense experienced general increases in 2018 due to our growth, primarily due to the previously noted acquisitions. Also impacting expenses were other growth initiatives, including continued growth of SBA Complete and the SBA Lending Division. See the section entitled "Noninterest Expense" for additional information.

For the years ended December 31, 2018 and 2017, our effective tax rates were 21.3% and 32.1%, respectively. The lower effective tax rate in 2018 was due to the Tax Cuts and Jobs Act, which was signed into law in December 2017 and reduced the federal corporate tax rate from 35% to 21%.

Total assets at December 31, 2018 amounted to $5.9 billion, a 5.7% increase from a year earlier. Loan growth for the year ended December 31, 2018 amounted to $207 million, or 5.1%, and deposit growth amounted to $252.4 million, or 5.7%.

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Overview - 2017 Compared to 2016

We reported net income per diluted common share of $1.82 in 2017, a 36.8% increase compared to 2016. The increased earnings were primarily due to the Company's acquisitions of Carolina Bank and Asheville Savings Bank, with loans increasing 49.1% and deposits increasing 49.5% year over year.

Financial Highlights *($ in thousands except per share data)*	2017	2016	Change
Earnings			
Net interest income	$164,711	123,380	33.5%
Provision for loan losses - non-covered	723	(23)	n/m
Noninterest income	48,908	25,551	91.4%
Noninterest expenses	145,157	106,821	35.9%
Income before income taxes	67,739	42,133	60.8%
Income tax expense	21,767	14,624	48.8%
Net income	45,972	27,509	67.1%
Preferred stock dividends	—	(175)	
Net income available to common shareholders	$45,972	27,334	68.2%
Net income per common share			
Basic	$1.82	1.37	32.8%
Diluted	1.82	1.33	36.8%
Balances At Year End			
Assets	$5,547,037	3,614,862	53.5%
Loans	4,042,369	2,710,712	49.1%
Deposits	4,406,955	2,947,353	49.5%
Ratios			
Return on average assets	1.00%	0.80%	
Return on average common equity	8.62%	7.73%	
Net interest margin (taxable-equivalent)	4.08%	4.03%	

n/m – not meaningful

For the year ended December 31, 2017, we reported net income available to common shareholders of $46.0 million, or $1.82 per diluted common share, an increase of 36.8% in earnings per share from the $27.3 million, or $1.33 per diluted common share, in 2016. The higher earnings in 2017 were primarily the result of the growth of the Company, including two acquisitions completed in 2017, as well as other initiatives that increased profitability.

On March 3, 2017, we acquired Carolina Bank, which operated eight branches and three mortgage loan offices, primarily in the Triad region of North Carolina. As of the acquisition date, Carolina Bank had total assets of $682 million, including $497 million in loans and $585 million in deposits.

On October 1, 2017, we acquired Asheville Savings Bank, which operated through 13 branches in the Asheville area. As of the acquisition date, Asheville Savings Bank reported total assets of approximately $798 million, including $606 million in loans and $679 million in deposits.

Net interest income for the year ended December 31, 2017 amounted to $164.7 million, a 33.5% increase from the $123.4 million recorded in 2016. The increase in net interest income was primarily due to the acquisitions of Carolina Bank and Asheville Savings Bank, as well as higher amounts of loans outstanding as a result of organic growth. Also, see the section entitled "Net Interest Income" for additional information.

Our net interest margin was 4.08% for 2017 compared to 4.03% for 2016. Asset yields increased primarily as a result of three Federal Reserve interest rate increases in 2017. Funding costs also increased in 2017, but to a slightly lesser degree.

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We recorded a provision for loan losses of $0.7 million in 2017 compared to a negative provision for loan losses (reduction of the allowance for loan losses) of $23,000 in 2016. The low level of provision for loan losses in both years was primarily due to stable and improving loan quality. Our nonperforming assets to total assets ratio was 0.96% at December 31, 2017 compared to 1.64% at December 31, 2016. We experienced net loan charge-offs of $1.2 million in 2017, compared to $3.7 million in 2016. Annualized net charge-offs to average loans for the year ended December 31, 2017 amounted to 0.04%, compared to 0.14% for 2016.

For the year ended December 31, 2017, noninterest income amounted to $48.9 million compared to $25.6 million for 2016. The primary reasons for the increase in core noninterest income in 2017 were the acquisitions of Carolina Bank and Asheville Savings Bank, as well as income derived from the Company's SBA consulting fees and SBA loan sale gains, which began during the middle of 2016. See the section entitled "Noninterest Income" for additional information.

Noninterest expenses for the year ended December 31, 2017 amounted to $145.2 million compared to $106.8 million in 2016. The increase in noninterest expenses in 2017 related primarily to the Company's acquisition of Carolina Bank and Asheville Savings Bank. Also impacting expenses were other growth initiatives, including continued growth of SBA Complete and the SBA Lending Division, as well as the acquisition of an insurance agency during the third quarter of 2017. See the section entitled "Noninterest Expense" for additional information.

Our effective tax rate for 2017 was 32.1% compared to 34.7% in 2016. The lower effective tax rate was due to the 2017 Tax Cuts and Jobs Act, which was signed into law in December 2017, and required us to revalue our deferred tax assets and liabilities at the new rate. The impact of revaluing our net deferred tax liability was to reduce income tax expense by approximately $1.3 million in the fourth quarter of 2017.

Total assets at December 31, 2017 amounted to $5.5 billion, a 53.5% increase from a year earlier. Total loans at December 31, 2017 amounted to $4.0 billion, a 49.1% increase from a year earlier, and total deposits amounted to $4.4 billion at December 31, 2017, a 49.5% increase from a year earlier.

In addition to the growth realized from the acquisitions of Carolina Bank and Asheville Savings Bank, the Company experienced strong organic loan and deposit growth during 2017. For 2017, organic loan growth (i.e. excluding loan balances assumed from Carolina Bank and Asheville Savings Bank) amounted to $228.0 million, or 8.4%. For 2017, organic deposit growth amounted to $195.1 million, or 6.6%. The strong growth was a result of ongoing internal initiatives to enhance loan and deposit growth, including the Company's recent expansion into higher growth markets. The organic loan growth noted above was driven by Bank's entrance into the North Carolina markets of Charlotte, Raleigh, and the Triad.

Outlook for 2019

We generally believe that the outlook for 2019 is favorable. We expect the national economy, as well as our local economies, to continue to be strong, with unemployment rates remaining at low levels.

The Federal Reserve has increased short-term interest rates by 225 basis points since late 2015. While long-term interest rates have also increased, they have increased less than short-term interest rates. Generally, our interest-earning assets have longer terms than our funding costs, and therefore this is potentially an unfavorable rate scenario for our company because it may result in our asset yields increasing less than our funding costs. Thus far, we have been able to control the rise in our deposit costs and therefore our net interest margin has been stable, and even expanded slightly. But due to competitive pressures, this may not be possible in the future, and we expect that maintaining our recently realized net interest margin will be challenging.

With several consecutive years of low levels of nonperforming assets and low loan charge-offs, we've recorded minimal provisions for loan losses over the past four years and our allowance for loan loss level has trended downward to a low level by historical standards. While we do not currently anticipate a significant rise in delinquencies or loan losses, we believe it is likely that we will need to record higher levels of provisions for loan losses than recent years to provide for loan growth and more normal levels of losses. Any credit deterioration would result in further increases.

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We experienced solid organic loan and deposit growth in 2018. Our local economies are strong, and we continue to experience positive results from our expansion into the larger and higher growth markets in North Carolina. With our positioning in high growth markets and other strategic initiatives, we expect to experience continued loan and deposit growth in 2019.

Critical Accounting Policies

The accounting principles we follow and our methods of applying these principles conform with accounting principles generally accepted in the United States of America and with general practices followed by the banking industry. Certain of these principles involve a significant amount of judgment and may involve the use of estimates based on our best assumptions at the time of the estimation. The allowance for loan losses, intangible assets, and the fair value and discount accretion of acquired loans are three policies we have identified as being more sensitive in terms of judgments and estimates, taking into account their overall potential impact to our consolidated financial statements.

Allowance for Loan Losses

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

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

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

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

Purchased loans are recorded at fair value at the acquisition date. Therefore, amounts deemed uncollectible at the acquisition date represent a discount to the loan value and become a part of the fair value calculation. Subsequent decreases in the amount expected to be collected result in a provision for loan losses with a corresponding increase in the allowance for loan losses. Subsequent increases in the amount expected to be collected are accreted into income over the life of the loan and this accretion is referred to as “loan discount accretion.”

Within the purchased loan portfolio, loans are deemed purchased credit impaired at acquisition if the bank believes it will not be able to collect all contractual cash flows. Performing loans with an unamortized discount or premium that are not deemed purchased credit impaired are considered to be purchased performing loans. Purchased credit impaired loans are individually evaluated as impaired loans, as described above, while purchased performing loans are evaluated as general reserve loans. For purchased performing loan pools, any computed allowance that is in excess of remaining net discounts is a component of the allocated allowance.

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

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

Intangible Assets

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

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

The primary identifiable intangible asset we typically record in connection with a whole bank or bank branch acquisition is the value of the core deposit intangible, whereas when we acquire an insurance agency or a consulting firm, as we did in 2016 and 2017, the primary identifiable intangible asset is the value of the acquired customer list. Determining the amount of identifiable intangible assets and their average lives involves multiple assumptions and estimates and is typically determined by performing a discounted cash flow analysis, which involves a combination of any or all of the following assumptions: customer attrition/runoff, alternative funding costs, deposit servicing costs, and discount rates. We typically engage a third party consultant to assist in each analysis. For the whole bank and bank branch transactions recorded to date, the core deposit intangibles have generally been estimated to have a life ranging from seven to ten years, with an accelerated rate of amortization. For insurance agency acquisitions, the identifiable intangible assets related to the customer lists were determined to have a life of ten to fifteen years, with amortization occurring on a straight-line basis. For SBA Complete, the consulting firm we acquired in 2016, the identifiable intangible asset related to the customer list was determined to have a life of approximately seven years, with amortization occurring on a straight-line basis.

Subsequent to the initial recording of the identifiable intangible assets and goodwill, we amortize the identifiable intangible assets over their estimated average lives, as discussed above. In addition, on at least an annual basis, goodwill is evaluated for impairment by comparing the fair value of our reporting units to their related carrying value, including goodwill. We have three reporting units – 1) First Bank with $222.7 million in goodwill, 2) First Bank Insurance with $7.4 million in goodwill, and 3) SBA activities, including SBA Complete and our SBA Lending Division, with $4.3 million in goodwill. If the carrying value of a reporting unit were ever to exceed its fair value, we would determine whether the implied fair value of the goodwill, using a discounted cash flow analysis, exceeded the carrying value of the goodwill. If the carrying value of the goodwill exceeded the implied fair value of the goodwill, an impairment loss would be recorded in an amount equal to that excess. Performing such a discounted cash flow analysis would involve the significant use of estimates and assumptions.

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In our 2018 goodwill impairment evaluation, we concluded that the goodwill for each of our reporting units was not impaired.

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

Fair Value and Discount Accretion of Acquired Loans

We consider the determination of the initial fair value of acquired loans and the subsequent discount accretion of the purchased loans to involve a high degree of judgment and complexity.

We determine fair value accounting estimates of newly assumed assets and liabilities in accordance with relevant accounting guidance. However, the amount that we realize on these assets could differ materially from the carrying value reflected in our financial statements, based upon the timing of collections on the acquired loans in future periods. Because of inherent credit losses and interest rate marks associated with acquired loans, the amount that we record as the fair values for the loans is generally less than the contractual unpaid principal balance due from the borrowers, with the difference being referred to as the "discount" on the acquired loans. For non-impaired purchased loans, we accrete the discount over the lives of the loans in a manner consistent with the guidance for accounting for loan origination fees and costs.

For purchased credit-impaired ("PCI") loans, the excess of the cash flows initially expected to be collected over the fair value of the loans at the acquisition date (i.e., the accretable yield) is accreted into interest income over the estimated remaining life of the loans using the effective yield method, provided that the timing and the amount of future cash flows is reasonably estimable. Accordingly, such loans are not classified as nonaccrual and they are considered to be accruing because their interest income relates to the accretable yield recognized under accounting for PCI loans and not to contractual interest payments. The difference between the contractually required payments and the cash flows expected to be collected at acquisition, considering the impact of prepayments, is referred to as the nonaccretable difference.

Subsequent to an acquisition, estimates of cash flows expected to be collected are updated periodically based on updated assumptions regarding default rates, loss severities, and other factors that are reflective of current market conditions. If there is a decrease in cash flows expected to be collected, the provision for loan losses is charged, resulting in an increase to the allowance for loan losses. If the Company has a probable increase in cash flows expected to be collected, we will first reverse any previously established allowance for loan losses and then increase

interest income as a prospective yield adjustment over the remaining life of the loan. The impact of changes in variable interest rates is recognized prospectively as adjustments to interest income.

Merger and Acquisition Activity

As previously discussed, in January 2016, we acquired an insurance agency in Sanford, North Carolina, and in May 2016, we acquired SBA Complete, a firm specializing in origination and servicing of SBA loans. In July 2016, we exchanged our seven bank branches located in Virginia to another community bank in return for six of their North Carolina branches. In 2017, we completed two full-bank acquisitions – Carolina Bank and Asheville Savings Bank. Also in 2017, we completed the acquisition of another insurance agency headquartered in Albemarle, North Carolina.

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See Note 2 to the consolidated financial statements for additional information regarding these acquisitions.

FDIC Indemnification Asset

As previously discussed, in 2009 and 2011, we acquired substantially all of the assets and liabilities of two failed banks in FDIC-assisted transactions. For each transaction, we entered into two loss share agreements with the FDIC, which provided the Bank significant loss protection from losses experienced on the loans and foreclosed real estate. One of these loss share agreements expired in July 2014 and one agreement expired in April 2016. On September 22, 2016, we reached a mutual agreement with the FDIC to terminate all loss share agreements, with all future losses and recoveries associated with these failed bank assets being fully borne by the Bank. We recorded a write-off of the remaining indemnification asset of $5.7 million upon the termination of the loss share agreements in the third quarter of 2016.

ANALYSIS OF RESULTS OF OPERATIONS

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

Net Interest Income

Net interest income on a reported basis amounted to $207.4 million in 2018, $164.7 million in 2017, and $123.4 million in 2016. For internal purposes and in the discussion that follows, we evaluate our net interest income on a tax-equivalent basis by adding the tax benefit realized from tax-exempt loans and securities to reported interest income. Net interest income on a tax-equivalent basis amounted to $209.0 million in 2018, $167.3 million in 2017, and $125.4 million in 2016. Management believes that analysis of net interest income on a tax-equivalent basis is useful and appropriate because it allows a comparison of net interest amounts in different periods without taking into account the different mix of taxable versus non-taxable loans and investments that may have existed during those periods. The following is a reconciliation of reported net interest income to tax-equivalent net interest income.

	Year ended December 31,		
($ in thousands)	2018	2017	2016
Net interest income, as reported	$207,430	164,711	123,380
Tax-equivalent adjustment	1,594	2,590	2,054

Net interest income, tax-equivalent	$209,024	167,301	125,434

Table 2 analyzes net interest income on a tax-equivalent basis. Our net interest income on a tax-equivalent basis increased by 24.9% in 2018 and increased by 33.4% in 2017. There are two primary factors that cause changes in the amount of net interest income we record – 1) changes in our loans and deposits balances and 2) our net interest margin. “Net interest margin” is a ratio we use to measure the spread between the yield on our earning assets and the cost of our funding and is calculated by dividing tax-equivalent net interest income by average earning assets.

The increase in net interest income in 2018 compared to 2017 was primarily due to growth in our loans outstanding, with a four basis point increase in our net interest margin also contributing to the increase.

For 2018, average loans increased $740.9 million, or 21.7%, while average deposits increased by $820.1 million, or 22.2%. Most of increases in average loans and deposits were due to the acquisitions of Asheville Savings Bank and Carolina Bank during 2017.

Our net interest margin increased from 4.08% in 2017 to 4.12% in 2018. Asset yields increased by 23 basis points, from 4.32% to 4.55% during 2018, primarily as a result of four Federal Reserve interest rate increases during the year. Funding costs also increased, but to a lesser degree, with the average funding cost increasing by only 16 basis points in 2018, from 0.32% in 2017 to 0.48% in 2018. Interest recoveries totaling $750,000 received in the first quarter of 2018 also contributed slightly to the higher net interest margin.

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The increase in net interest income in 2017 compared to 2016 was also primarily due to growth in our loans outstanding, with most of the growth coming from our Carolina Bank and Asheville Savings Bank acquisitions. For 2017, average loans increased $817.6 million, or 31.4%, while average deposits increased by $869.2 million, or 30.7%.

Our net interest margin increased from 4.03% in 2016 to 4.08% in 2017. Asset yields increased by 11 basis points, from 4.21% to 4.32% during 2017, primarily as a result of three Federal Reserve interest rate increases during the year. Funding costs also increased, but to a lesser degree, with the average funding cost increasing by only 7 basis points in 2017, from 0.25% in 2016 to 0.32% in 2017.

The net interest margin for all periods benefited, by varying amounts, from the net accretion of purchase accounting premiums/discounts associated with acquisitions. As can be seen in the table below, we recorded $7.1 million in 2018, $7.1 million in 2017, and $4.5 million in 2016 in net accretion of purchase accounting premiums/discounts that increased net interest income.

($ in thousands)	Year Ended December 31, 2018	Year Ended December 31, 2017	Year Ended December 31, 2016
Interest income – increased by accretion of loan discount on acquired loans	$ 6,951	6,842	4,447
Interest expense – reduced by premium amortization of deposits	372	384	77
Interest expense – increased by discount accretion of borrowings	(181)	(148)	—
Impact on net interest income	$ 7,142	7,078	4,524

The biggest component of the purchase accounting adjustments in each year was loan discount accretion, which amounted to $7.0 million in 2018, $6.8 million in 2017, and $4.4 million in 2016. In 2018 and 2017, the increase in loan discount accretion was primarily due to the loan discounts recorded in the acquisitions of Carolina Bank and Asheville Savings Bank. During 2017, we recorded an additional $20.7 million in loan discounts related to these acquisitions. Unaccreted loan discount on acquired loans declined from $24.3 million at December 31, 2017 to $17.3 million at December 31, 2018. We expect loan discount accretion on acquired loans to decrease in 2019 as a result of the expected, normal pay downs on loans within the acquired loan portfolios. In addition to the loan discount accretion recorded on acquired loans, we recorded loan discount accretion of $0.9 million, $0.2 million and $0 in 2018, 2017, and 2016, respectively, on the discounts associated with the retained unguaranteed portions of SBA loans sold in the secondary market. At December 31, 2018, 2017, and 2016, unaccreted loan discount on these loans amounted to $5.7 million, $2.6 million, and $0.6 million, respectively. See Note 1(i) to the Consolidated Financial Statements for additional information.

Table 3 presents additional detail regarding the estimated impact that changes in loan and deposit volumes and changes in the interest rates we earned/paid had on our net interest income in 2017 and 2018. In 2017, we acquired Carolina Bank and Asheville Savings Bank, which significantly increased our average volumes for loans and deposits in 2017 and 2018. For 2018, higher loan volume positively impacted interest income by $36.3 million, and higher loan interest rates positively impacted interest income by $8.6 million, with the combined effect driving the increase in total interest income of $53.8 million. Higher volumes and higher rates paid on deposits drove an increase of $6.9 million in interest expense. Slightly higher levels of borrowings and higher rates paid on those borrowings in 2018 also contributed to the $11.1 million increase in total interest expense. Overall, as Table 3 indicates, net interest income grew $42.7 million in 2018, with higher volumes comprising $37.6 million of the increase and higher interest rates resulting in $5.2 million of the increase.

For 2017, higher loan volume positively impacted interest income by $38.6 million, and higher loan interest rates positively impacted interest income by $3.8 million, with the combined effect driving the increase in total interest income of $46.4 million. Higher volumes and higher rates paid on deposits drove an increase of $2.4 million in interest expense. A higher level of borrowings and higher rates paid on those borrowings in 2017 also contributed to the $5.1 million increase in total interest expense. The higher level of borrowings was necessary in 2017 in order to fund our organic loan growth, which outpaced deposit growth. Overall, as Table 3 indicates, net interest income grew $41.3 million in 2017, with higher volumes comprising $38.2 million of the increase and higher interest rates causing $3.1 million of the increase.

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

Provision for Loan Losses

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

For 2018, we recorded total negative provisions for loan losses (reduction of allowance for loan losses) of $3,589,000. For 2017, we recorded total provision for loan losses of $723,000. In 2016, we recorded total negative provisions for loan losses (reduction of allowance for loan losses) of $23,000.

For periods prior to the third quarter 2016 termination of our loss share agreements, we computed and presented the provision for loan losses related to covered loans separately from that of our non-covered loans. Generally, we recorded provisions for loan losses on non-covered loans as a result of net charge-offs and loan growth, while significant recoveries in our previously covered loan portfolios resulted in negative provisions for loan losses. Upon the termination of the loss share agreements, all loans became classified as non-covered and the allowance for loan losses balances were combined into a single amount and no longer presented separately.

For the years ended December 31, 2018, 2017, and 2016, as it relates to non-covered loans, we recorded a negative provision for loan losses of $3.6 million, a provision for loan losses of $0.7 million, and a provision for loan losses of $2.1 million, respectively. The negative provision for 2018 was due primarily to several large loan recoveries realized in the first quarter of 2018 totaling $3.7 million. The generally low levels of provision for loan losses recorded in recent years were primarily the result of a sustained period of stable and improving loan quality trends, which resulted in lower amounts of provision needed to adjust our allowance for loan losses to the appropriate amount. This was because our allowance for loan loss model utilizes the net charge-offs experienced in the most recent years as a significant component of estimating the current allowance for loan losses that is necessary. Thus, older years (and parts thereof) systematically age out and are excluded from the analysis as time goes on. For the last three years, the new periods being added into the model continue to have significantly lower net charge-offs/recoveries than the older periods rolling out of the model. This has resulted in a lower required amount of allowance for loan losses in our modeling. Thus, the low level of net-charge offs (or net recoveries) experienced over the past three years has been the primary reason for the low (or negative) provisions for loan losses recorded.

As it relates to covered loans, we recorded a negative provision for loan losses (reduction of allowance for loan losses) of $2.1 million in 2016. The negative provision in 2016 resulted from improved asset quality and net loan recoveries (recoveries, net of charge-offs) that totaled $1.7 million in 2016.

As shown in Table 14, total net charge-offs (recoveries) for the years ended December 31, 2018, 2017, and 2016, were ($1.3 million), $1.2 million, and $3.7 million, respectively. The declining amount of non-covered net-charge offs in recent years is reflective of improving economic conditions and lower levels of our highest-risk loans.

In 2018, we completed a loan sale of approximately $5.2 million in smaller balance nonperforming loans that resulted in loan charge-offs of $2.2 million. However, this was more than offset by full payoffs on four loans received in the first quarter of 2018 that resulted in recoveries to the allowance for loan losses of $3.3 million

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

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

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Noninterest Income

Our noninterest income amounted to $61.8 million in 2018, $48.9 million in 2017, and $25.6 million in 2016.

Management evaluates noninterest income on a core and non-core basis. As shown in Table 4, core noninterest income excludes gains from acquisitions, foreclosed property write-downs and losses, indemnification asset income (expense), securities gains or losses, and other miscellaneous gains and losses. Core noninterest income amounted to $61.7 million in 2018, a 25.1% increase from the $49.3 million recorded in 2017. The 2017 core noninterest income of $49.3 million was a 40.9% increase from the $35.0 million recorded in 2016.

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

For most categories of noninterest income, our 2017 acquisitions of Carolina Bank and Asheville Savings Bank had the effect of increasing noninterest income in 2017 in comparison to 2016 and in 2018 in comparison to 2017, due to the impact of a full year of income being realized.

Service charges on deposit accounts amounted to $12.7 million, $11.9 million, and $10.6 million in 2018, 2017, and 2016, respectively. In 2018 and 2017, the increase is primarily due to the aforementioned acquisitions.

Other service charges, commissions and fees amounted to $19.9 million in 2018, a 36.5% increase from the $14.6 million in 2017. The 2017 amount of $14.6 million was 22.6% higher than the $11.9 million earned in 2016. This category of noninterest income includes items such as electronic payment processing revenue (which includes fees related to credit card transactions by merchants and customers and fees earned from debit card transactions), ATM charges, safety deposit box rentals, fees from sales of personalized checks, and check cashing fees. The increases in this line item in 2018 and 2017 were due to a combination of the Carolina Bank and Asheville Savings Bank acquisitions, as well as growth in interchange fees from debit and credit cards. In both 2018 and 2017, increased debit and credit card usage by our customers increased this income component, as we earn a small fee each time our customers make a card transaction. We believe the growth in card usage by our customers is due to customer payment preferences, as well as a result of the continued promotion of these products.

Fees from presold mortgages amounted to $2.7 million in 2018, $5.7 million in 2017, and $2.0 million in 2016. In 2018, the declines were primarily due to: i) overall lower volumes in the mortgage industry, ii) our Mortgage Loan Divsision originating a higher percentage of loans with construction components that are held in our loan portfolio and not sold, and iii) mortgage origination employees who left the Company in 2018. In 2017, the higher fees were

primarily due to the acquisition of Carolina Bank in March 2017, which had a significant mortgage loan operation.

Commissions from sales of insurance and financial products amounted to $8.7 million in 2018, $5.3 million in 2017, and $3.8 million in 2016. This line item includes commissions we receive from two primary sources – 1) commissions from the sales of investment, annuity, and long term care insurance products, and 2) commissions from the sale of property and casualty insurance. The following table presents the contribution of each source to the total amount recognized in this line item:

	For the year ended December 31,		
($ in thousands)	2018	2017	2016
Commissions earned from:			
Sales of investments, annuities, and long term care insurance	$2,693	2,152	2,027
Sales of property and casualty insurance	6,038	3,148	1,763
Total	$8,731	5,300	3,790

As can be seen in the above table, sales of property and casualty insurance increased significantly in 2017 and again in 2018, which was due to our September 1, 2017 acquisition of Bear Insurance Services (see Note 2 to the consolidated financial statements for additional information). Sales of investments, annuities and long term care insurance increased in 2018 due to the acquisitions of Asheville Savings Bank and Carolina Bank, each of which had wealth management divisions.

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Another primary reason for the increases in core noninterest income in 2018 and 2017 was the addition of SBA consulting fees and SBA loan sale gains that we began to realize in the last half of 2016. As previously discussed, in 2016, we completed the acquisition of SBA Complete, a firm that specializes in consulting with financial institutions across the country related to SBA loan origination and servicing (see Note 2 to the consolidated financial statements for additional information). We recorded $3.2 million in SBA consulting fees related to this business from the date of the acquisition through December 31, 2016. For the full year of 2017, we recorded $4.0 million in SBA consulting fees, and this amount grew to $4.7 million in 2018.

Additionally, in the third quarter of 2016, we leveraged the expertise we gained from personnel assumed in the SBA Complete acquisition and launched our SBA Lending Division, which offers SBA loans to small business owners throughout the United States. Our SBA Lending Division originated $24.8 million in loans in 2016 and earned $1.4 million from gains on the sales of the guaranteed portions of these loans for 2016. In 2017, we originated $95.4 million in loans and recorded $5.5 million in gains from sales. And in 2018, this division originated $196.8 million in SBA loans and recorded $10.4 million in gains from sales.

Table 4 shows earnings from bank-owned life insurance income were $2.5 million in 2018, $2.3 million in 2017, and $2.1 million in 2016. In 2017, we acquired approximately $23 million in bank-owned life insurance from Carolina Bank and Asheville Savings Bank, increasing our income for this line item in 2017 and 2018.

Noninterest income not considered to be “core” resulted in net increases (reductions) to total noninterest income of $0.2 million in 2018, ($0.4 million) in 2017, and ($9.4 million) in 2016. The components of non-core noninterest income are shown in Table 4 and the significant components thereof are discussed below.

We recorded net losses on foreclosed properties of $0.6 million in 2018, $0.5 million in 2017, and $0.6 million in 2016.

For the year ended December 31, 2016, FDIC indemnification asset expense amounted to $10.3 million, which included the write-off of the remaining indemnification asset of $5.7 million when we terminated the FDIC loss share agreements.

In 2016, the Company recorded a net gain of $1.5 million as a result of a branch exchange transaction with another community bank (see Note 2 of the consolidated financial statements for additional discussion).

“Other gains (losses), net” for the 2018, 2017, and 2016 periods represent the net effects of miscellaneous gains and losses that are non-routine in nature. In 2018, we recorded other gains of $0.7 million, which primarily related to a

gain on the sale of a previously closed branch building.

Noninterest Expenses

Total noninterest expenses totaled $159.4 million, $145.2 million, and $106.8 million for 2018, 2017 and 2016, respectively. Table 5 presents the components of our noninterest expense during the past three years. The primary reason for the increase in noninterest expense in 2018 and 2017 was associated with our growth initiatives, including several acquisitions, including Carolina Bank and Asheville Savings Bank, and market expansion. Line items with the largest fluctuations are further discussed below.

Total personnel expense increased from $82.1 million in 2017 to $92.0 million in 2018, an increase of $9.9 million, or 12.0%. Within personnel expense, salaries expense increased by $8.3 million in 2018 and employee benefits expense increased by $1.6 million in 2018. The primary reason for these increases in personnel expense is due to having a full year of expense for the additional personnel assumed in the 2017 acquisitions of Carolina Bank, Asheville Savings Bank, and Bear Insurance Services. Also, approximately $1.3 million of the increase in personnel expense in 2018 can be attributed to increases in salaries expense related to our SBA lending activities. Also impacting personnel expense was an increase in the 401(k) match offered by the Company to employees that was effective January 1, 2018, which increased from a 100% match up to 4% of an employee’s salary contribution to a 100% match up to 6% of an employee’s salary contribution.

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In 2017, total personnel expense increased to $82.1 million from $62.8 million in 2016, an increase of $19.3 million, or 30.7%. Within personnel expense, salaries expense increased by $15.5 million in 2017 and employee benefits expense increased by $3.7 million in 2017. The primary reason for these increases in personnel expense was due to the additional personnel assumed in the Carolina Bank and Asheville Savings Bank acquisitions. Also, in 2017, we added personnel due to the continued growth of SBA Complete and our SBA Lending Division. Additionally, salary expense for the fourth quarter of 2017 was also impacted by approximately $1.1 million related to one-time bonuses granted to a majority of the Company's employees.

Net occupancy expenses amounted to $10.8 million in 2018, $9.7 million in 2017, and $7.8 million in 2016. The increases in 2018 and 2017 were related to the aforementioned acquisitions and expansion initiatives. Equipment related expenses increased for the same reasons, amounting to $5.6 million, $4.5 million, and $3.6 million, in 2018, 2017, and 2016, respectively.

Merger and acquisition expenses amounted to $2.4 million in 2018, $8.1 million in 2017, and $1.4 million in 2016. The 2018 amount was primarily comprised of severance costs and data processing conversion expenses related to the acquisition of Asheville Savings Bank. The 2017 amount was primarily comprised of professional fees and severance costs incurred in our acquisitions of Carolina Bank and Asheville Savings Bank. In 2016, the amount was comprised of professional fees incurred for our various acquisitions, including Bankingport, SBA Complete, our branch exchange, and our agreement to acquire Carolina Bank, which was announced in 2016.

Intangible amortization expense increased from $1.2 million in 2016 to $4.2 million in 2017 to $6.8 million in 2018, due to the addition of $22.5 million in amortizable intangible assets recorded in connection with the 2017 acquisitions of Carolina Bank, Asheville Savings Bank, and Bear Insurance Services.

FDIC insurance expense amounted to $2.3 million in 2018, $2.4 million in 2017, and $2.0 million in 2016. As discussed previously in the section "FDIC Insurance", in 2019, we received an assessment credit of $1.3 million that will be used to offset future FDIC insurance expense once the DIF reaches 1.38%.

Outside consultant expense amounted to $1.8 million in 2018, $2.5 million in 2017, and $1.7 million in 2016. The increase in 2017 related to various operational activities.

Data processing expenses amounted to $3.2 million, $2.9 million, and $2.0 million, in 2018, 2017, and 2016, respectively. The 2018 and 2017 increases were due primarily to the acquisitions of Carolina Bank and Asheville Savings Bank.

Marketing expense amounted to $3.1 million in 2018, $2.5 million in 2017 and $2.0 million in 2016. In 2018 and 2017, we increased our promotional efforts, primarily in our new and expanded market areas.

Non-credit losses amounted to $1.0 million in 2018, $0.9 million in 2017, and $1.2 million in 2016. These losses primarily related to debit card and credit card fraud losses.

Income Taxes

Table 6 presents the components of income tax expense and the related effective tax rates. We recorded income tax expense of $24.2 million in 2018, $21.8 million in 2017, and $14.6 million in 2016. Our effective tax rates were 21.3% for 2018, 32.1% for 2017, and 34.7% for 2016. The lower effective rates in 2017 and 2018 compared to 2016 were as a result of the Tax Cuts and Jobs Act that was signed into law on December 22, 2017, which reduced the federal statutory income tax rate from 35% to 21%. At December 31, 2017, we revalued our net deferred tax liability, which reduced income tax expense by $1.3 million for 2017, while in 2018, the new income tax rate of 21% reduced our effective tax rate.

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Also, our effective tax rate has partially declined in recent years due lower statutory income tax rates in North Carolina. North Carolina reduced the state income tax rate for corporations from 4.0% in 2016 to 3.0% beginning in 2017. We expect our effective tax rate to be approximately 21.0% in 2019.

Stock-Based Compensation

We recorded stock-based compensation expense of $1.6 million, $1.1 million, and $0.7 million, for the years ended December 31, 2018, 2017, and 2016, respectively. The increases in this expense were due to retention-based restricted stock grants made to certain officers during the years presented. See Note 15 to the consolidated financial statements for more information regarding stock-based compensation.

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ANALYSIS OF FINANCIAL CONDITION AND CHANGES IN FINANCIAL CONDITION

Overview

At December 31, 2018, our total assets amounted to $5.9 billion, a 5.7% increase from 2017. The following table presents detailed information regarding the nature of changes in our loans and deposits in 2017 and 2018:

($ in thousands)	Balance at beginning of period	Internal growth, net	Growth from Acquisitions (1)	Balance at end of period	Total percentage growth	Internal percentage growth (1)
2018						
Loans outstanding	$4,042,369	206,695	—	4,249,064	5.1%	5.1%
Deposits – Noninterest-bearing	1,196,161	123,970	—	1,320,131	10.4%	10.4%
Deposits – Interest-bearing checking	884,254	32,120	—	916,374	3.6%	3.6%
Deposits – Money market	982,822	52,701	—	1,035,523	5.4%	5.4%
Deposits – Savings	454,860	(22,471)	—	432,389	-4.9%	-4.9%
Deposits – Brokered time	239,659	216	—	239,875	0.1%	0.1%
Deposits – Internet time	7,995	(4,567)	—	3,428	-57.1%	-57.1%
Deposits – Time >$100,000 – retail	347,862	99,757	—	447,619	28.7%	28.7%
Deposits – Time <$100,000 – retail	293,342	(29,342)	—	264,000	-10.0%	-10.0%
Total deposits	$4,406,955	252,384	—	4,659,339	5.7%	5.7%
2017						
Loans outstanding	$2,710,712	227,955	1,103,702	4,042,369	49.1%	8.4%
Deposits – Noninterest-bearing	756,003	159,493	280,665	1,196,161	58.2%	21.1%
Deposits – Interest-bearing checking	635,431	13,847	234,976	884,254	39.2%	2.2%
Deposits – Money market	683,680	23,013	276,129	982,822	43.8%	3.4%
Deposits – Savings	209,074	(5,174)	250,960	454,860	117.6%	-2.5%
Deposits – Brokered time	136,466	57,554	45,639	239,659	75.6%	42.2%
Deposits – Internet Time	—	(3,253)	11,248	7,995	n/m	n/m
Deposits – Time >$100,000 – retail	287,939	(12,631)	72,554	347,862	20.8%	-4.4%
Deposits – Time <$100,000 – retail	238,760	(37,765)	92,347	293,342	22.9%	-15.8%
Total deposits	$2,947,353	195,084	1,264,518	4,406,955	49.5%	6.6%

(1)

In 2017, we acquired Carolina Bank, which had $497.5 million in loans and $585.4 million in deposits, and Asheville Savings Bank, which had $606.2 million in loans and $679.1 million in deposits.

n/m – not meaningful

As shown in the table above, in 2018, our total loans outstanding increased $206.7 million, or 5.1%. Internal loan growth has been primarily driven by our expansion in high-growth markets, hiring of experienced bankers, and our emphasis on SBA lending. We expect continued growth in our loan portfolio for 2019.

In 2017, our total loans outstanding increased $1.3 billion, or 49.1%. The loan growth from acquisitions is due to our acquisition of Carolina Bank in March 2017, which had $497.5 million in loans on the date of acquisition, and our acquisition of Asheville Savings Bank in October 2017, which had $606.2 million in loans on the date of acquisition. Carolina Bank operated through eight branches predominately in the Triad region of North Carolina, and Asheville Savings Bank operated through 13 branches in the Asheville area of North Carolina. Internal growth in our loan portfolio amounted to $228.0 million, or 8.4%. Internal loan growth was primarily driven by our recent expansion into high-growth markets and the hiring of experienced bankers in these areas.

During 2018, we experienced an increase in total deposits of $252.4 million, or 5.7%. We experienced internal growth of $186.3 million in our core deposit accounts (checking, money market and savings), and increases of $70.4 million in our retail time deposits, excluding brokered and internet deposits. Total brokered and internet deposits remained consistent from the year earlier. We have generally experienced higher growth in our core transaction accounts compared to time deposits, which we believe is due customers favoring transaction accounts due to their higher liquidity and the fact that transaction accounts have not been paying materially lower interest rates compared to time deposits. However, we have recently seen some of our customers with larger balances transfer funds from their money market accounts to the time deposit > $100,000 category to attain higher interest rates.

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During 2017, we experienced an increase in total deposits of $1.5 billion, or 49.5%. In 2017, we acquired $585.4 million in deposits from the Carolina Bank acquisition and $679.1 million in deposits from the Asheville Savings Bank acquisition. Net internal deposit growth amounted to $195.1 million, or 6.6%. We experienced internal growth of $191.2 million in our core deposit accounts, compared to net declines of $50.4 million in our retail time deposits, excluding brokered and internet deposits. Total brokered deposits amounted to $239.7 million at December 31, 2017, which was a 75.6% increase from the $136.5 million outstanding a year earlier. We increased our reliance of brokered deposits in 2017 to assist in funding the strong organic loan growth we experienced during 2017.

Our overall liquidity increased at December 31, 2018 compared to a year earlier. Our liquid assets (cash and securities) as a percentage of our total deposits and borrowings was 21.03% at December 31, 2018 compared to 20.0% at December 31, 2017. Brokered deposits and borrowings as a percent of overall funding remained substantially unchanged from a year earlier.

At December 31, 2018, our nonperforming assets to total assets ratio was 0.74% compared to 0.96% at December 31, 2017. The decrease is primarily due to on-going resolution of nonperforming assets and improving credit quality.

Distribution of Assets and Liabilities

Table 7 sets forth the percentage relationships of significant components of our balance sheet at December 31, 2018, 2017, and 2016.

Our balance sheet mix has remained relatively stable over the past three years. On the asset side, net loans have consistently comprised 72% to 74% of total assets and interest-earning assets have ranged from 88%-90%. Late in 2018, we used existing cash balances to purchase approximately $150 million in available for sale securities, which resulted in our mix of securities available for sale increasing from 6% of total assets to 9% of total assets at the end of 2018. Intangible assets increased from 2% of total assets in 2016 to 5% as of December 31, 2017, primarily as a result of our two whole-bank acquisitions in 2017, in which we recorded a total of $155.2 million in goodwill and $18.7 million in other intangible assets.

On the liability side, deposits have consistently comprised 79% to 82% of total liabilities and shareholders' equity.

Shareholders' equity increased from 10% of total liabilities and shareholders' equity at December 31, 2016 to 13% at December 31, 2018 due to the common stock issued in connection with our 2017 acquisitions and an increase in retained earnings due to high levels of net income recorded.

Securities

Information regarding our securities portfolio as of December 31, 2018, 2017, and 2016 is presented in Tables 8 and 9.

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

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Total securities amounted to $602.6 million, $461.8 million, and $329.0 million at December 31, 2018, 2017, and 2016, respectively. The increase in securities in 2018 was primarily due to our purchase of approximately $150 million of government-sponsored enterprise securities and mortgage-backed securities that we initiated in order to deploy excess cash into higher yielding assets. The increase in securities in 2017 was partially due to $49.4 million in securities acquired in the acquisition of Carolina Bank in March 2017. Also, in late 2017 we sold $95.0 million in securities that we had acquired from Asheville Savings Bank in October 2017 and then subsequently purchased $150 million in mortgage-backed securities in the fourth quarter of 2017.

The majority of our "government-sponsored enterprise" securities carry one maturity date, often with an issuer call feature. At December 31, 2018, of the $82.7 million in government-sponsored enterprise securities, $70.5 million were issued by the Federal Home Loan Bank system and the remaining $12.2 million were issued by either Fannie Mae, Freddie Mac, or Federal Farm Credit Bank system.

Nearly all of our $437.6 million in total mortgage-backed securities have been issued by Freddie Mac, Fannie Mae, Ginnie Mae, or the SBA, each of which is a government agency or government-sponsored corporation and guarantees the repayment of the securities. Included in the mortgage-backed securities at December 31, 2018, were commercial mortgage-backed securities of $159.6 million that were issued and are guaranteed by Ginnie Mae. Mortgage-backed securities vary in their repayment in correlation with the underlying pools of mortgage loans.

Our investment policy permits to hold up to 15% of our securities portfolio in corporate bonds. These bonds have the most credit risk of any of our securities. At December 31, 2018, our $33.1 million investment in corporate bonds was comprised of the following:

($ in thousands)

	Issuer Ratings		Maturity Date	Amortized Cost	Fair Value
Issuer					
Bank of America	A3	(1)	1/11/2023	$ 7,000	6,879
Citigroup	Baa1	(1)	Various	6,027	5,920
Goldman Sachs	A3	(1)	1/22/2023	5,073	4,937
JP Morgan Chase	A2	(1)	1/25/2023	5,018	4,904
Financial Institutions, Inc.	BBB-	(2)	4/15/2030	4,000	4,058
Wells Fargo	A3	(1)	2/13/2023	3,092	3,001
Eagle Bancorp, Inc.	BBB	(2)	9/1/2024	2,541	2,559
First Citizens Bancorp (South Carolina) Trust Preferred Security	Not Rated		6/15/2034	1,000	880
Total investment in corporate bonds				$ 33,751	33,138

(1) Ratings issued by Moody's
(2) Rating issued by Kroll Bond Rating Agency

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

At December 31, 2018, we held $101.2 million in securities classified as held to maturity, which had a carrying value that exceeded their fair value by $1.3 million. Approximately $52.0 million of the securities held to maturity are mortgage-backed securities that have been issued by either Freddie Mac or Fannie Mae. The remaining $49.2 million in securities held to maturity are comprised almost entirely of municipal bonds issued by state and local governments throughout our market area. We have no significant concentration of bond holdings from one government entity, with the single largest exposure to any one entity being $4.7 million. Management evaluated any unrealized losses on individual securities at each year end and determined them to be of a temporary nature and caused by fluctuations in market interest rates, not by concerns about the ability of the issuers to meet their obligations.

At December 31, 2018, 2017, and 2016, net unrealized losses of $12.4 million, $2.2 million and $3.1 million, respectively, were included in the carrying value of securities classified as available for sale. Management evaluated any unrealized losses on individual securities at each year end and determined them to be of a temporary nature and caused by fluctuations in market interest rates and the overall economic environment, not by concerns about the ability of the issuers to meet their obligations. Net unrealized losses, net of applicable deferred income taxes, have been reported as part of a separate component of shareholders' equity (accumulated other comprehensive income) as of December 31, 2018, 2017, and 2016, respectively.

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The weighted average taxable-equivalent yield for the securities available for sale portfolio was 2.87% at December 31, 2018. The expected weighted average life of the available for sale portfolio using the call date for above-market callable bonds, the maturity date for all other non-mortgage-backed securities, and the expected life for mortgage-backed securities, was 6.1 years.

The weighted average taxable-equivalent yield for the securities held to maturity portfolio was 3.17% at December 31, 2018. The expected weighted average life of the held to maturity portfolio using the call date for above-market callable bonds, the expected life for mortgage-backed securities, and the maturity date for all other securities, was 2.6 years.

The following table provides the names of issuers for which the Company has investment securities totaling in excess of 10% of shareholders' equity and the fair value and amortized cost of these investments as of December 31, 2018. All of these securities are issued by government sponsored corporations.

($ in thousands)

Issuer	Amortized Cost	Fair Value	% of Shareholders' Equity
Fannie Mae	$ 191,839	186,735	25.1%
Ginnie Mae	127,358	123,593	16.7%
Freddie Mac	98,608	95,285	12.9%
Total	$ 417,805	405,613	

Loans

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

The loan portfolio is the largest category of our earning assets and is comprised of commercial loans, real estate mortgage loans, real estate construction loans, and consumer loans. The majority of our loan portfolio is within our 39 county market area, which are located in western, central and eastern North Carolina and three counties in northeastern South Carolina. The diversity of the economic bases of our market areas has historically provided a stable lending environment.

In 2018, loans outstanding increased $206.7 million, or 5.1%. The growth in 2018 was due to organic loan growth, which was concentrated primarily within our higher growth markets and from the SBA Lending Division. In 2017, loans outstanding increased $1.33 billion, or 49.1% to $4.0 billion. The growth in 2017 can be attributed to the

acquisitions of Carolina Bank and Asheville Savings Bank, as well as organic loan growth of $228.0 million.

The majority of our loan portfolio over the years has been real estate mortgage loans, with loans secured by real estate consistently comprising 88% to 91% of our outstanding loan balances. Except for construction, land development and other land loans, the majority of our “real estate” loans are personal and commercial loans where cash flow from the borrower’s occupation or business is the primary repayment source, with the real estate pledged providing a secondary repayment source.

Table 10 presents a five-year history of loans outstanding by type.

Commercial, financial, and agricultural loans have increased from 7% at December 31, 2014 to 11% at December 31, 2018, due primarily to growth in loans made to municipalities and loans originated by our SBA Lending Division.

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Residential real estate loans have declined from 33% of total loans at December 31, 2014 to 25% of total loans at December 31, 2018. This decline was due to a combination of factors including consumers refinancing their home loans held by the Bank with long term fixed rate loans, which we typically sell in the secondary market. Additionally, the Carolina Bank loan portfolio assumed during 2017 had only an 11% mix of residential real estate loans.

Commercial real estate loans as a percentage of total loans has increased steadily over the past five years and amounted to 42% of all loans at December 31, 2017. Consistent with our community banking strategy, we have placed emphases on this type of loan growth and hired a number of experienced community bankers, who have originated a significant amount of business loans secured by real estate. Also, growth in our SBA loan portfolio has contributed to the increase in this category.

Table 11 provides a summary of scheduled loan maturities over certain time periods, with fixed rate loans and adjustable rate loans shown separately. Approximately 13% of our accruing loans outstanding at December 31, 2018 mature within one year and 56% of total loans mature within five years, with both of those measures being consistent with recent years. As of December 31, 2018, the percentages of variable rate loans and fixed rate loans as compared to total performing loans were 35% and 65%, respectively. We intentionally make a blend of fixed and variable rate loans so as to reduce interest rate risk. The mix of fixed rate loans has generally increased over the past several years because many borrowers have desired to lock in a low interest rate during the historically low interest rate environment that has been in effect. While this presents risk to our Company if interest rates rise, we measure our interest rate risk closely and, as discussed in the section "Interest Rate Risk" below, we do not believe that an increase in interest rates would materially negatively impact our net interest income.

Nonperforming Assets

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

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

Table 12 summarizes our nonperforming assets at the dates indicated. Prior to September 2016, we presented nonperforming assets that were subject to the loss share agreements as "covered" and nonperforming assets that were not subject to the loss share agreements as "non-covered." Our loss share agreements with the FDIC were terminated during 2016, and all assets became non-covered.

Since the height of the recession, we have benefited from improving economic conditions and also implemented a combination of strategies to reduce nonperforming assets, including a significant 2013 loan sale. As a result, our nonperforming asset levels have declined steadily over the years, with nonperforming assets amounting to amounting to just 0.74% of total assets at December 31, 2018. This compares to ratios of 0.96% and 1.64% at December 31, 2017 and 2016, respectively. In 2018, our nonperforming asset levels benefitted from a loan sale of approximately $5.2 million in smaller balance nonperforming loans.

Table 12a presents our nonperforming assets at December 31, 2018 by general geographic region.

The following is the composition, by loan type, of all of our nonaccrual loans at each period end:

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($ in thousands)	At December 31, 2018	At December 31, 2017
Commercial, financial, and agricultural	$ 919	1,001
Real estate – construction, land development, and other land loans	2,265	1,822
Real estate – mortgage – residential (1-4 family) first mortgages	10,115	12,201
Real estate – mortgage – home equity loans/lines of credit	1,685	2,524
Real estate – mortgage – commercial and other	7,452	3,345
Installment loans to individuals	139	75
Total nonaccrual loans	$ 22,575	20,968

The nonaccrual table above generally indicates that almost all categories of nonaccrual loans remained relatively level during the year, with the "real estate – mortgage – commercial and other" category experiencing the largest increase.

Management routinely monitors the status of certain large loans that, in management's opinion, have credit weaknesses that could cause them to become nonperforming loans. In addition to the nonperforming loan amounts discussed above, management believes that an estimated $1 to $5 million of loans that were performing in accordance with their contractual terms at December 31, 2018 have the potential to develop problems depending upon the particular financial situations of the borrowers and economic conditions in general. Management has taken these potential problem loans into consideration when evaluating the adequacy of the allowance for loan losses at December 31, 2018 (see discussion below).

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

We provide additional information regarding the classification status of our loans in tables contained in Note 4 to our consolidated financial statements. Those tables indicate that from December 31, 2017 to December 31, 2018 our asset quality improved, with total classified and nonaccrual loans decreasing from $79.4 million at December 31, 2017 to $60.8 million at December 31, 2018. This is consistent with our generally improving asset quality trends.

Foreclosed real estate includes primarily foreclosed properties. Total foreclosed real estate amounted to $7.4 million, $12.6 million, and $9.5 million, at December 31, 2018, 2017, and 2016, respectively. Generally, we have experienced decreases in foreclosed real estate over the past several years primarily due to increased property sales activity and the improvement in our overall asset quality. In 2017, we acquired $3.1 million and $3.9 million of foreclosed real estate in the acquisitions of Carolina Bank and Asheville Savings Bank, respectively.

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

$ in thousands	At December 31, 2018	At December 31, 2017
Vacant land and farmland	$ 2,035	6,032
1-4 family residential properties	2,311	4,229
Commercial real estate	3,094	2,310
Total foreclosed real estate	$ 7,440	12,571

Allowance for Loan Losses and Loan Loss Experience

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

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

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

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

The total allowance for loan losses amounted to $21.0 million at December 31, 2018 compared to $23.3 million at December 31, 2017 and $23.8 million at December 31, 2016.

Our allowance for loan loss is a mathematical model with the primary factors impacting this model being loan growth, net charge-off history, and asset quality trends. Our allowance for loan loss model utilizes the net charge-offs experienced in the most recent years as a significant component of estimating the current allowance for loan losses that is necessary. Thus, older years (and parts thereof) systematically age out and are excluded from the analysis as time goes on. In recent years, the new periods have had significantly lower net charge-offs (and net recoveries in some periods) than the older periods rolling out of the model. This has resulted in a lower required amount of allowance for loan losses in our modeling. The low level of net-charge offs (or net recoveries) experienced over the past several years has been the primary reason for the low (or negative) provisions for loan losses recorded.

The ratio of our allowance to total loans was 0.50%, 0.58%, and 0.88% at December 31, 2018, 2017, and 2016, respectively. The decline in this ratio from December 31, 2017 to December 31, 2018 was a result of the factors discussed above that impacted our relatively low levels of provision for loan losses. The large decline in 2017 was primarily due to the acquisitions of Carolina Bank and Asheville Savings Bank, which had over $1 billion in total loans. Applicable accounting guidance did not allow us to record an allowance for loan losses upon the acquisition of loans – instead the acquired loans were recorded at their discounted fair value, which included the consideration of any expected losses. No allowance for loan losses will be recorded for the acquired loans until the expected credit losses exceed the remaining unamortized discounts – based on an individual basis for purchased credit impaired loans and on a pooled basis for performing acquired loans. See Critical Accounting Policies above for further discussion.

Unaccreted discount on acquired loans, which is available to absorb loan losses, amounted to $17.3 million, $24.3 million, and $12.1 million at December 31, 2018, December 31, 2017, and December 31, 2016, respectively. The ratio of allowance for loan losses plus unaccreted discount on acquired loans amounted to 0.90%, 1.18% and 1.32% at December 31, 2018, December 31, 2017, and December 31, 2016, respectively.

Table 13 sets forth the allocation of the allowance for loan losses at the dates indicated. The allowance for loan losses is available to absorb losses in all categories.

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

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

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

Net loan charge-offs (recoveries) of total loans amounted to ($1.3 million) in 2018, $1.2 million in 2017, and $3.7 million in 2016. The trend of lower net charge-offs is associated with lower levels of nonperforming loans and credit improvements in our underlying loan portfolio. In 2018, we received full payoffs on four loans that had been previously charged-down by approximately $3.3 million and are included in the table as recoveries, contributing significantly to the net recovery position for the year.

Deposits

Deposits are a critical part of our business, as they provide the primary funding source for our loans and investments. Accordingly, as discussed below, we have implemented various strategies and developed competitive products to promote growth of our deposit balances.

At December 31, 2018, deposits outstanding amounted to $4.66 billion, an increase 5.7%, or $252.4 million, from the $4.41 billion at December 31, 2017, all of which was organic growth. We experienced higher growth in our transaction accounts (checking, money market, and savings) compared to time deposits, which we believe is due customers favoring transaction accounts due to their higher liquidity and the fact that transaction accounts have not been paying materially lower interest rates compared to time deposits. However, we have recently seen some of our customers with larger balances transfer funds from their money market accounts to the time deposit > $100,000 category to attain higher interest rates.

At December 31, 2017, deposits outstanding amounted to $4.41 billion, an increase of $1.46 billion from the $2.95 billion at December 31, 2016. During 2017, we acquired Carolina Bank with $585.4 million in deposits and Asheville Savings Bank with $679.1 million in deposits. We also experienced organic growth of totaling $195.1 million in 2017, with the majority of our growth occurring in noninterest-bearing checking accounts. Our higher cost retail time deposits declined by $50.4 million in 2017. Total brokered deposits amounted to $239.7 million at December 31, 2017, which was a 75.6% increase from the $136.5 million outstanding a year earlier. The increased usage of brokered deposits in 2017 was necessary because of high organic loan growth that exceeded deposit growth. This imbalance of growth was largely associated with our growth and expansion into the larger markets of North Carolina – Charlotte, Greensboro and Raleigh. When initially entering markets such as these, our experience has been that we are able to

capture loan market share faster than deposit market share.

The nature of our deposit growth is illustrated in the table on page 48. The following table reflects the mix of our deposits at each of the past three year ends:

	2018	2017	2016
Noninterest-bearing checking accounts	28%	27%	26%
Interest-bearing checking accounts	20%	20%	21%
Money market deposits	22%	22%	23%
Savings deposits	9%	10%	7%
Time deposits - Brokered	5%	6%	5%
Time deposits > $100,000 – retail	10%	8%	10%
Time deposits < $100,000 – retail	6%	7%	8%
Total deposits	100%	100%	100%

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Our deposit mix remains heavily concentrated in transaction and non-time deposit accounts, with time deposits only comprising approximately 20% of total deposits. This is beneficial for us, as these accounts generally carry lower interest rates compared to time deposits. Prior to the very low interest rate environment that we have been in for the past decade, the time deposit concentration was closer to 50%. We believe the lower mix of time deposits has been due to the relatively small gap between the interest rates that we pay on transaction accounts versus the rates we pay on time deposits. It is uncertain whether the interest rate increases over the past two years will result in a significant shift back to time deposits.

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

Table 15 presents the average amounts of our deposits and the average yield paid for those deposits for the years ended December 31, 2018, 2017, and 2016.

As of December 31, 2018, we held approximately $690.9 million in time deposits of $100,000 or more. Table 16 is a maturity schedule of time deposits of $100,000 or more as of December 31, 2018. This table shows that 80% of our time deposits greater than $100,000 mature within one year.

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

Borrowings

We typically utilize borrowings to provide balance sheet liquidity and to fund imbalances in our loan growth compared to our deposit growth. Our borrowings outstanding totaled $406.6 million at December 31, 2018, $407.5 million at December 31, 2017, and $271.4 million at December 31, 2016. Table 2 shows that average borrowings were $406.9 million in 2018, $325.9 million in 2017, and $209.7 million in 2016.

The increase in borrowings from 2016 to 2017 was to fund organic loan growth, which exceeded deposit growth in 2016 and 2017. Additionally, we assumed approximately $42 million of borrowings in our two whole-bank acquisitions in 2017. In 2018, borrowings remained essentially unchanged as deposit growth fully funded our loan growth for the year.

At December 31, 2018, the Company had three sources of readily available borrowing capacity – 1) an approximately $1.04 billion line of credit with the FHLB, of which $353 million and $354 million was outstanding at December 31, 2018 and 2017, respectively, 2) a $35 million federal funds line of credit with a correspondent bank, of which none was outstanding at December 31, 2018 or 2017, and 3) an approximately $127 million line of credit through the Federal Reserve Bank of Richmond's ("FRB") discount window, of which none was outstanding at December 31, 2018 or 2017.

In addition to any outstanding borrowings from the FHLB that reduce the available borrowing capacity of the line of credit, our borrowing capacity was further reduced by $190 million and $198 million at December 31, 2018 and 2017, respectively, as a result of our pledging letters of credit backed by the FHLB for public deposits at each of those dates. Thus, our unused available line of credit with the FHLB amounted to approximately $502 million at December 31, 2018 compared to $384 million a year earlier.

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Our line of credit with the FHLB can be structured as either short-term or long-term borrowings, depending on the particular funding or liquidity need, and is secured by our FHLB stock and a blanket lien on most of our real estate loan portfolio. For the year ended December 31, 2018, the average amount of FHLB borrowings outstanding was approximately $353.2 million with a weighted average interest rate for the year of 1.91%. The maximum amount of short-term FHLB borrowings outstanding at any month-end during 2018 was $353.5 million. For the year ended December 31, 2017, the average amount of FHLB borrowings outstanding was approximately $273.8 million with a weighted average interest rate for the year of 1.19%. The maximum amount of short-term FHLB borrowings outstanding at any month-end during 2017 was $354.0 million.

Our correspondent bank relationship allows us to purchase up to $35 million in federal funds on an overnight, unsecured basis (federal funds purchased). We had no borrowings under this line at December 31, 2018 or 2017. There were no federal funds purchased outstanding at any month-end during 2018 or 2017.

We also have a line of credit with the FRB discount window. This line is secured by a blanket lien on a portion of our commercial and consumer loan portfolio (excluding real estate loans). Based on the collateral that we owned as of December 31, 2018, the available line of credit was approximately $127 million. At December 31, 2018 and 2017, we had no borrowings outstanding under this line.

In addition to the lines of credit described above, we also have of $56.7 million of trust preferred security debt outstanding at December 31, 2018 and 2017. Each of our three issuances have 30 year final maturities and were structured in a manner that allows them to qualify as capital for regulatory capital adequacy requirements. We may call these debt securities at par on any quarterly interest payment, but do not expect to do so. The interest rate on these debt securities adjusts on a quarterly basis at a rate of three-month LIBOR plus 2.70% for $20.6 million, three-month LIBOR plus 1.39% on $25.8 million, and LIBOR + 2.00% for $10.3 million that was assumed in the Carolina Bank acquisition.

Liquidity, Commitments, and Contingencies

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

As noted above, in addition to internally generated liquidity sources, at December 31, 2018, we had the ability to obtain borrowings from the following three sources – 1) an approximately $1 billion line of credit with the FHLB, 2) a $35 million federal funds line with a correspondent bank, and 3) an approximately $127 million line of credit through

the FRB's discount window.

Our overall liquidity increased in 2018 compared to 2017. Our liquid assets (cash and securities) as a percentage of our total deposits and borrowings amounted to 21.0% at December 31, 2018 compared to 20.0% at December 31, 2017.

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

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

Table 18 reflects our contractual obligations and other commercial commitments outstanding as of December 31, 2018. Any of our $353 million in outstanding borrowings with the FHLB may be accelerated immediately by the FHLB in certain circumstances, including material adverse changes in our condition or if our qualifying collateral is less than the amount required under the terms of the borrowing agreement.

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In the normal course of business there are various outstanding commitments and contingent liabilities such as commitments to extend credit, which are not reflected in the financial statements. The following table presents a summary of our outstanding loan commitments as of December 31, 2018:

($ in millions)

Type of Commitment	Fixed Rate	Variable Rate	Total
Outstanding closed-end loan commitments	$210	460	670
Unfunded commitments on revolving lines of credit, credit cards and home equity loans	150	469	619
Total	$360	929	1,289

At December 31, 2018 and 2017, we also had $15.7 million and $15.2 million, respectively, in standby letters of credit outstanding. We had no carrying amount for these standby letters of credit at either of those dates. The nature of the standby letters of credit is that of a stand-alone obligation made on behalf of our customers to suppliers of the customers to guarantee payments owed to the supplier by the customer. The standby letters of credit are generally for terms of one year, at which time they may be renewed for another year if both parties agree. The payment of the guarantees would generally be triggered by a continued nonpayment of an obligation owed by the customer to the supplier. The maximum potential amount of future payments (undiscounted) we could be required to make under the guarantees in the event of nonperformance by the parties to whom credit or financial guarantees have been extended is represented by the contractual amount of the financial instruments discussed above. In the event that we are required to honor a standby letter of credit, a note, already executed by the customer, becomes effective providing repayment terms and any collateral. Over the past two years, we have had to honor only a few standby letters of credit, none of which resulted in any loss to the Company. We expect any draws under existing commitments to be funded through normal operations.

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

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

Capital Resources and Shareholders’ Equity

Shareholders’ equity at December 31, 2018 amount to $764.2 million compared to $693.0 million at December 31, 2017 and $368.1 million at December 31, 2016. The two basic components that typically have the largest impact on our shareholders’ equity are net income, which increases shareholders’ equity, and dividends declared, which decrease

shareholders' equity. Additionally, any stock issuances can significantly increase shareholders' equity, including those associated with acquisitions. Although we have not repurchased any stock since 2014, we have a $25 million authorization currently in place and any stock repurchases would reduce shareholders' equity.

In 2018, the most significant factors that impacted our equity were 1) the $89.3 million net income reported for 2018, which increased equity, and 2) common stock dividends declared of $11.9 million, which reduced equity. See the Consolidated Statements of Shareholders' Equity within the consolidated financial statements for disclosure of other less significant items affecting shareholders' equity.

In 2017, the most significant factors that impacted our equity were 1) the issuances of $284.2 million of common stock in connection with two bank acquisitions, which increased equity, 2) the $46.0 million net income reported for 2017, which increased equity, and 3) common stock dividends declared of $8.3 million, which reduced equity.

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With the acquisition of Carolina Bank in March 2017, we assumed a deferred compensation plan for certain members of Carolina Bank's board of directors that is fully funded by Company stock, which was valued at $7.7 million on the date of acquisition. Subsequent to the acquisition in 2017, approximately $4.5 million of the deferred compensation has been paid to the plan participants. The balances of the related asset and liability were each $3.2 million at December 31, 2018, both of which are presented as components of shareholders' equity.

In 2016, the most significant factors that impacted our equity were 1) the $27.5 million net income reported for 2016, which increased equity, 2) common stock dividends declared of $6.5 million, which reduced equity, and 3) issuances of $5.5 million of common stock in connection with two acquisitions, which increased equity.

Also, on December 22, 2016, we exchanged 728,706 shares of common stock for the same number of shares of our preferred stock, which resulted in $7.3 million in shareholders' equity shifting from preferred stock to common stock, but did not affect our total amount of equity. At December 31, 2018, 2017, and 2016, we had no shares of preferred stock outstanding.

In addition to shareholders' equity, we have supplemented our capital in past years with trust preferred security debt issuances, which because of their structure qualify as regulatory capital. This was necessary in past years because our balance sheet growth outpaced the growth rate of our capital. Additionally, we have purchased several bank branches over the years that resulted in our recording intangible assets, which negatively impacted regulatory capital ratios. As discussed in "Borrowings" above, we currently have $56.7 million in trust preferred securities outstanding, all of which qualify as Tier I capital under both current and forthcoming regulatory standards.

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

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

Table 21 presents our regulatory capital ratios as of December 31, 2018, 2017, and 2016. All of our capital ratios have significantly exceeded the minimum regulatory thresholds for all periods covered by this report.

In this economic environment, our goal is to maintain our capital ratios at levels at least 200 basis points higher than the "well capitalized" thresholds set for banks. At December 31, 2018, our tier 1 leverage ratio was 10.47% compared to

the regulatory well capitalized bank-level threshold of 5.00% and our total risk-based capital ratio was 13.97% compared to the 10.00% regulatory well capitalized threshold.

In addition to regulatory capital ratios, we also closely monitor our ratio of tangible common equity to tangible assets ("TCE Ratio"). Our TCE Ratio was 9.07% at December 31, 2018 compared to 8.23% at December 31, 2017.

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

Off-Balance Sheet Arrangements and Derivative Financial Instruments

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

Derivative financial instruments include futures, forwards, interest rate swaps, options contracts, and other financial instruments with similar characteristics. We have not engaged in significant derivatives activities through December 31, 2018 and have no current plans to do so.

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Return on Assets and Equity

Table 20 shows return on average assets (net income available to common shareholders divided by average total assets), return on average common equity (net income available to common shareholders divided by average common shareholders' equity), dividend payout ratio (dividends per share divided by net income per common share) and shareholders' equity to assets ratio (average total shareholders' equity divided by average total assets) for each of the years in the three-year period ended December 31, 2018.

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

Net interest income is our most significant component of earnings. Notwithstanding changes in volumes of loans and deposits, our level of net interest income is continually at risk due to the effect that changes in general market interest rate trends have on interest yields earned and paid with respect to our various categories of earning assets and interest-bearing liabilities. It is our policy to maintain portfolios of earning assets and interest-bearing liabilities with maturities and repricing opportunities that will afford protection, to the extent practical, against wide interest rate fluctuations. Our exposure to interest rate risk is analyzed on a regular basis by management using standard GAP reports, maturity reports, and an asset/liability software model that simulates future levels of interest income and expense based on current interest rates, expected future interest rates, and various intervals of "shock" interest rates. Over the years, we have been able to maintain a fairly consistent yield on average earning assets (net interest margin), even during periods of changing interest rates. Over the past five calendar years, our net interest margin has ranged from a low of 4.03% (realized in 2016) to a high of 4.58% (realized in 2014). From 2008 until the fourth quarter of 2015, the prime rate of interest had remained at 3.25%. Beginning in December 2015, the Federal Reserve began steadily increasing the prime rate of interest, which resulted in 5.50% rate at December 31, 2018. The consistency of the net interest margin is aided by the relatively low level of long-term interest rate exposure that we maintain. At December 31, 2018, approximately 77% of our interest-earning assets are subject to repricing within five years (because they are either adjustable rate assets or they are fixed rate assets that mature) and substantially all of our interest-bearing liabilities reprice within five years.

Table 17 sets forth our interest rate sensitivity analysis as of December 31, 2018, using stated maturities for all fixed rate instruments except mortgage-backed securities (which are allocated in the periods of their expected payback) and securities and borrowings with call features that are expected to be called (which are shown in the period of their expected call). As illustrated by Table 17, at December 31, 2018, we had $1.4 billion more in interest-bearing liabilities that are subject to interest rate changes within one year than earning assets. This generally would indicate that net interest income would experience downward pressure in a rising interest rate environment and would benefit from a declining interest rate environment. However, this method of analyzing interest sensitivity only measures the magnitude of the timing differences and does not address earnings, market value, or management actions. Also, interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. In addition to the effects of "when" various rate-sensitive products reprice, market rate changes may not result in uniform changes in rates among all products. For example, included in interest-bearing liabilities subject to interest rate changes within one year at December 31, 2018 were deposits totaling $2.4 billion comprised of checking, savings, and certain types of money market deposits with

interest rates set by management. These types of deposits historically have not repriced with, or in the same proportion, as general market indicators.

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

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

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

As it relates to deposits, as noted above, the Federal Reserve made no changes to the short term interest rates it sets directly from 2008 until mid-December 2015, and during that period we were able to reprice many of our maturing time deposits at lower interest rates. We were also able to generally decrease the rates we paid on other categories of deposits as a result of declining short-term interest rates in the marketplace and an increase in liquidity that lessened our need to offer premium interest rates. However, as a result of the nine interest rate increases initiated by the Federal Reserve since 2015 and significant competitive pressures in our market area, we have had to increase deposit rates. Deposit pricing competition intensified in the second half of 2018 and we expect it to continue. However, to date, our deposit costs have risen at a slightly lower rate than the increase in asset yields, and thus our net interest margin expanded slightly in 2017 and 2018.

As previously discussed in the section "Net Interest Income," our net interest income has been impacted by certain purchase accounting adjustments related to the acquired banks. The purchase accounting adjustments related to the premium amortization on loans, deposits and borrowings are based on amortization schedules and are thus systematic and predictable. The accretion of the loan discount on acquired loans amounted to $7.0 million, $6.8 million, and $4.4 million in 2018, 2017, and 2016, respectively, is less predictable and could be materially different among periods. This is because of the magnitude of the discounts that are initially recorded and the fact that the accretion being recorded is dependent on both the credit quality of the acquired loans and the impact of any accelerated loan repayments, including payoffs. If the credit quality of the loans declines, some, or all, of the remaining discount will cease to be accreted into income. If the underlying loans experience accelerated paydowns or improved performance expectations, the remaining discount will be accreted into income on an accelerated basis. In the event of total payoff, the remaining discount will be entirely accreted into income in the period of the payoff. Each of these factors is difficult to predict and susceptible to volatility. The remaining loan discount on acquired loans amounted to $17.3 million at December 31, 2018 compared to $24.3 million at December 31, 2017.

Based on our most recent interest rate modeling, which assumes one interest rate increase for 2019 (federal funds rate = 2.75%, prime = 5.75%), we project that our net interest margin for 2019 will continue to remain fairly stable, but we

believe there is downside risk due to the loan and deposit pricing pressures discussed above.

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

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

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Inflation

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

Current Accounting Matters

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

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

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

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Table 1 Selected Consolidated Financial Data

($ in thousands, except per share and nonfinancial data)	Year Ended December 31,				
	2018	2017	2016	2015	2014
Income Statement Data					
Interest income	$231,207	177,382	130,987	126,655	139,832
Interest expense	23,777	12,671	7,607	6,908	8,223
Net interest income	207,430	164,711	123,380	119,747	131,609
Provision (reversal) for loan losses	(3,589)	723	(23)	(780)	10,195
Net interest income after provision	211,019	163,988	123,403	120,527	121,414
Noninterest income	61,834	48,908	25,551	18,764	14,368
Noninterest expense	159,375	145,157	106,821	98,131	97,251
Income before income taxes	113,478	67,739	42,133	41,160	38,531
Income taxes	24,189	21,767	14,624	14,126	13,535
Net income	89,289	45,972	27,509	27,034	24,996
Preferred stock dividends	—	—	(175)	(603)	(868)
Net income available to common shareholders	89,289	45,972	27,334	26,431	24,128
Earnings per common share – basic	3.02	1.82	1.37	1.34	1.22
Earnings per common share – diluted	3.01	1.82	1.33	1.30	1.19
Per Share Data (Common)					
Cash dividends declared – common	$0.40	0.32	0.32	0.32	0.32
Market Price					
High	43.14	41.76	28.49	19.92	19.65
Low	30.50	26.47	17.15	15.00	15.55
Close	32.66	35.31	27.14	18.74	18.47
Stated book value – common	25.71	23.38	17.66	16.96	16.08
Tangible book value – common	17.12	14.69	13.85	13.56	12.63
Selected Balance Sheet Data (at year end)					
Total assets	$5,864,116	5,547,037	3,614,862	3,362,065	3,218,383
Loans – non-covered	4,249,064	4,042,369	2,710,712	2,416,285	2,268,580
Loans – covered (1)	—	—	—	102,641	127,594
Total loans	4,249,064	4,042,369	2,710,712	2,518,926	2,396,174
Allowance for loan losses	21,039	23,298	23,781	28,583	40,626
Intangible assets	255,480	257,507	79,475	67,171	67,893
Deposits	4,659,339	4,406,955	2,947,353	2,811,285	2,695,906
Borrowings	406,609	407,543	271,394	186,394	116,394
Total shareholders' equity	764,230	692,979	368,101	342,190	387,699

Selected Average Balances					
Assets	$5,693,760	4,590,786	3,422,267	3,230,302	3,219,915
Loans	4,161,838	3,420,939	2,603,327	2,434,602	2,434,331
Earning assets	5,076,335	4,101,949	3,108,918	2,936,624	2,907,098
Deposits	4,516,811	3,696,730	2,827,513	2,687,381	2,723,758
Interest-bearing liabilities	3,663,077	3,025,401	2,324,823	2,218,246	2,294,330
Shareholders' equity	727,920	533,205	360,715	376,287	383,055
Ratios					
Return on average assets	1.57%	1.00%	0.80%	0.82%	0.75%
Return on average common equity	12.27%	8.62%	7.73%	8.04%	7.73%
Net interest margin (taxable-equivalent basis)	4.12%	4.08%	4.03%	4.13%	4.58%
Tangible common equity to tangible assets	9.07%	8.23%	8.16%	8.13%	7.90%
Loans to deposits at year end	91.19%	91.73%	91.97%	89.60%	88.88%
Allowance for loan losses to total loans	0.50%	0.58%	0.88%	1.13%	1.70%
Nonperforming assets to total assets at year end	0.74%	0.96%	1.64%	2.66%	3.54%
Net charge-offs (recoveries) to average total loans	(0.03%)	0.04%	0.14%	0.46%	0.74%
Nonfinancial Data – number of branches	101	104	88	88	87
Nonfinancial Data – number of employees (FTEs)	1,076	1,140	834	812	798

(1) Effective September 22, 2016, all FDIC loss share agreements were terminated, and accordingly, assets previously covered under those agreements became non-covered on that date.

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Table 2 Average Balances and Net Interest Income Analysis

	Year Ended December 31,								
	2018			2017			2016		
($ in thousands)	Average Volume	Avg. Rate	Interest Earned or Paid	Average Volume	Avg. Rate	Interest Earned or Paid	Average Volume	Avg. Rate	Interest Earned or Paid
Assets									
Loans (1) (2)	$4,161,838	5.01%	$208,609	$3,420,939	4.79%	$163,738	$2,603,327	4.66%	$121,322
Taxable securities	419,356	2.54%	10,638	302,892	2.31%	7,007	298,083	2.07%	6,162
Non-taxable securities	50,945	2.91%	1,482	56,065	2.99%	1,677	49,986	3.50%	1,748
Short-term investments, primarily overnight funds	444,196	2.36%	10,478	322,053	1.54%	4,960	157,522	1.11%	1,755
Total interest-earning assets	5,076,335	4.55%	231,207	4,101,949	4.32%	177,382	3,108,918	4.21%	130,987
Cash and due from banks	80,053			79,025			59,835		
Premises and equipment	115,573			98,216			76,418		
Other assets	421,799			311,596			177,096		
Total assets	$5,693,760			$4,590,786			$3,422,267		
Liabilities and Equity									
Interest-bearing checking accounts	$875,751	0.10%	$887	$722,286	0.07%	$477	$583,786	0.06%	$360
Money market accounts	1,023,162	0.32%	3,265	825,015	0.19%	1,569	657,211	0.18%	1,160
Savings accounts	439,880	0.21%	922	385,967	0.19%	715	200,093	0.05%	100
Time deposits >$100,000	641,516	1.30%	8,356	504,349	0.79%	4,005	405,220	0.65%	2,654
Other time deposits	275,904	0.38%	1,061	261,910	0.30%	778	268,854	0.33%	896
Total interest-bearing deposits	3,256,213	0.45%	14,491	2,699,527	0.28%	7,544	2,115,164	0.24%	5,170
Borrowings	406,864	2.28%	9,286	325,874	1.57%	5,127	209,659	1.16%	2,437
Total interest-bearing liabilities	3,663,077	0.65%	23,777	3,025,401	0.42%	12,671	2,324,823	0.33%	7,607
Noninterest-bearing checking accounts	1,260,598			997,203			712,349		
Total sources of funds	4,923,675	0.48%		4,022,604	0.32%		3,037,172	0.25%	
Other liabilities	42,165			34,977			24,380		

Shareholders' equity	727,920			533,205			360,715		
Total liabilities and shareholders' equity	$5,693,760			$4,590,786			$3,422,267		
Net yield on interest-earning assets and net interest income		4.09%	$207,430		4.02%	$164,711		3.97%	$123,380
Net yield on interest-earning assets and net interest income – tax-equivalent (3)		4.12%	$209,024		4.08%	$167,301		4.03%	$125,434
Interest rate spread		3.90%			3.90%			3.88%	
Average prime rate		4.91%			4.10%			3.51%	

(1) Average loans include nonaccruing loans, the effect of which is to lower the average rate shown. Interest earned includes recognized net loan fees (costs) in the amounts of $1,905, $536, and ($457) for 2018, 2017, and 2016, respectively.

(2) Includes accretion of discount on acquired and SBA loans of $7,812, $7,076, and $4,451 in 2018, 2017, and 2016, respectively.

(3) Includes tax-equivalent adjustments of $1,594, $2,590, and $2,054 in 2018, 2017, and 2016, respectively, to reflect the federal and state tax benefit that we receive related to tax-exempt securities and tax-exempt loans, which carry interest rates lower than similar taxable investments/loans due to their tax exempt status. This amount has been computed assuming a 23% tax rate for 2018 and 37% for 2017 and 2016 and is reduced by the related nondeductible portion of interest expense.

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Table 3 Volume and Rate Variance Analysis

($ in thousands)	Year Ended December 31, 2018			Year Ended December 31, 2017		
	Change Attributable to			Change Attributable to		
	Changes in Volumes	Changes in Rates	Total Increase (Decrease)	Changes in Volumes	Changes in Rates	Total Increase (Decrease)
Interest income:						
Loans	$36,299	8,572	44,871	38,618	3,798	42,416
Taxable securities	2,824	807	3,631	105	740	845
Non-taxable securities	(151)	(44)	(195)	197	(268)	(71)
Short-term investments, primarily overnight funds	2,381	3,137	5,518	2,184	1,021	3,205
Total interest income	41,353	12,472	53,825	41,104	5,291	46,395
Interest expense:						
Interest-bearing checking accounts	128	282	410	88	29	117
Money market accounts	505	1,191	1,696	308	101	409
Savings accounts	106	101	207	219	396	615
Time deposits >$100,000	1,438	2,913	4,351	718	633	1,351
Other time deposits	48	235	283	(22)	(96)	(118)
Total interest-bearing deposits	2,225	4,722	6,947	1,311	1,063	2,374
Borrowings	1,561	2,598	4,159	1,590	1,100	2,690
Total interest expense	3,786	7,320	11,106	2,901	2,163	5,064
Net interest income	$37,567	5,152	42,719	38,203	3,128	41,331

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

Table 4 Noninterest Income

($ in thousands)	Year Ended December 31, 2018	2017	2016
Service charges on deposit accounts	$12,690	11,862	10,571
Other service charges, commissions, and fees	19,945	14,610	11,913
Fees from presold mortgage loans	2,735	5,695	2,033
Commissions from sales of insurance and financial products	8,731	5,300	3,790
SBA consulting fees	4,675	4,024	3,199
SBA loan sale gains	10,366	5,479	1,433
Bank-owned life insurance income	2,534	2,321	2,052
Total core noninterest income	61,676	49,291	34,991
Foreclosed property gains (losses), net	(565)	(531)	(625)
FDIC Indemnification asset income (expense), net	—	—	(10,255)
Securities gains (losses), net	—	(235)	3
Gain on branch sale	—	—	1,466
Other gains (losses), net	723	383	(29)

Total	$61,834	48,908	25,551

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Table 5 Noninterest Expenses

($ in thousands)	Year Ended December 31, 2018	2017	2016
Salaries	$75,077	66,786	51,252
Employee benefits	16,888	15,313	11,568
Total personnel expense	91,965	82,099	62,820
Occupancy expense	10,793	9,661	7,838
Equipment related expenses	5,627	4,480	3,608
Merger and acquisition expenses	2,358	8,073	1,431
Amortization of intangible assets	6,763	4,240	1,211
Dues and subscriptions expense (includes software licenses)	3,431	1,969	1,604
Credit/debit card processing expense	3,411	2,797	2,296
Marketing expense	3,065	2,549	1,999
Data processing expense	3,234	2,910	2,010
Telephone and data lines	3,024	2,470	2,311
Stationery and supplies	2,582	2,399	2,066
FDIC insurance expense	2,333	2,350	2,009
Outside consultants	1,820	2,511	1,700
Repossession and collection expenses	1,366	1,736	1,934
Non-credit losses	960	887	1,164
Other operating expenses	16,643	14,026	10,820
Total	$159,375	145,157	106,821

Table 6 Income Taxes

($ in thousands)		2018	2017	2016
Current	- Federal	$19,188	11,286	12,827
	- State	3,187	1,996	1,679
Deferred	- Federal	1,658	7,742	16
	- State	156	743	102
Total tax expense		$24,189	21,767	14,624
Effective tax rate		21.3%	32.1%	34.7%

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Table 7 Distribution of Assets and Liabilities

	As of December 31,		
	2018	2017	2016
Assets			
Interest-earning assets			
Net loans	72%	73%	74%
Securities available for sale	9	6	6
Securities held to maturity	2	2	4
Short-term investments	7	7	6
Total interest-earning assets	90	88	90
Noninterest-earning assets			
Cash and due from banks	1	2	2
Premises and equipment	2	2	2
Intangible assets	4	5	2
Foreclosed real estate	—	—	—
Bank-owned life insurance	2	2	2
Other assets	1	1	2
Total assets	100%	100%	100%
Liabilities and shareholders' equity			
Noninterest-bearing checking accounts	22%	22%	21%
Interest-bearing checking accounts	16	16	17
Money market accounts	18	18	19
Savings accounts	7	8	6
Time deposits of $100,000 or more	12	11	12
Other time deposits	4	5	7
Total deposits	79	80	82
Borrowings	7	7	7
Accrued expenses and other liabilities	1	1	1
Total liabilities	87	88	90
Shareholders' equity	13	12	10
Total liabilities and shareholders' equity	100%	100%	100%

Table 8 Securities Portfolio Composition

	As of December 31,		
($ in thousands)	2018	2017	2016
Securities available for sale:			
Government-sponsored enterprise securities	$82,662	13,867	17,490
Mortgage-backed securities	385,551	295,213	148,065
Corporate bonds	33,138	34,190	33,600
Equity securities	—	—	174
Total securities available for sale	501,351	343,270	199,329

Securities held to maturity:			
Mortgage-backed securities	52,048	63,829	80,585
State and local governments	49,189	54,674	49,128
Total securities held to maturity	101,237	118,503	129,713
Total securities	$602,588	461,773	329,042
Average total securities during year	$470,301	358,957	348,069

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Table 9 Securities Portfolio Maturity Schedule

	As of December 31, 2018		
($ in thousands)	Book Value	Fair Value	Book Yield (1)
Securities available for sale:			
Government-sponsored enterprise securities			
Due after one but within five years	$82,995	82,662	2.97%
Total	82,995	82,662	2.97%
Mortgage-backed securities (2)			
Due after one but within five years	89,498	85,693	2.53%
Due after five but within ten years	232,251	224,996	2.75%
Due after ten years	75,246	74,862	3.13%
Total	396,995	385,551	2.77%
Corporate debt securities			
Due after one but within five years	26,210	25,641	3.27%
Due after five but within ten years	2,541	2,559	5.40%
Due after ten years	5,000	4,938	5.82%
Total	33,751	33,138	3.81%
Total securities available for sale			
Due after one but within five years	198,703	193,996	2.81%
Due after five but within ten years	234,792	227,555	2.78%
Due after ten years	80,246	79,800	3.30%
Total	$513,741	501,351	2.87%
Securities held to maturity:			
Mortgage-backed securities (2)			
Due after one but within five years	$41,550	40,081	2.20%
Due after five but within ten years	10,498	10,160	2.60%
Total	52,048	50,241	2.28%
State and local governments			
Due within one year	2,233	2,240	4.59%
Due after one but within five years	28,488	28,766	4.20%
Due after five but within ten years	16,743	16,932	3.96%
Due after ten years	1,725	1,727	3.23%
Total securities held to maturity	49,189	49,665	4.10%
Total securities held to maturity			

Due within one year	2,233	2,240	4.59%
Due after one but within five years	70,038	68,847	3.01%
Due after five but within ten years	27,241	27,092	3.44%
Due after ten years	1,725	1,727	3.23%
Total	$101,237	99,906	3.17%

(1) Yields on tax-exempt investments have been adjusted to a taxable equivalent basis using a 23.37% tax rate.

(2) Mortgage-backed securities are shown maturing in the periods consistent with their estimated lives based on expected prepayment speeds.

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Table 10 Loan Portfolio Composition

	As of December 31,									
	2018		2017		2016		2015		2014	
($ in thousands)	Amount	% of Total Loans	Amount	% of Total Loans	Amount	% of Total Loans	Amount	% of Total Loans	Amount	% of Total Loans
Commercial, financial, and agricultural	$457,037	11%	$381,130	10%	$261,813	9%	$202,671	8%	$160,878	7%
Real estate – construction, land development & other land loans	518,976	12%	539,020	13%	354,667	13%	308,969	12%	288,148	12%
Real estate – mortgage – residential (1-4 family) first mortgages	1,054,176	25%	972,772	24%	750,679	28%	768,559	31%	789,871	33%
Real estate – mortgage – home equity loans / lines of credit	359,162	8%	379,978	9%	239,105	9%	232,601	9%	223,500	9%
Real estate – mortgage – commercial and other	1,787,022	42%	1,696,107	42%	1,049,460	39%	957,587	38%	882,127	37%
Installment loans to individuals	71,392	2%	74,348	2%	55,037	2%	47,666	2%	50,704	2%
Loans, gross	4,247,765	100%	4,043,355	100%	2,710,761	100%	2,518,053	100%	2,395,228	100%
Unamortized net deferred loan costs (fees)	1,299		(986)		(49)		873		946	
Total loans	4,249,064		4,042,369		2,710,712		2,518,926		2,396,174	

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Table 11 Loan Maturities

	As of December 31, 2018							
	Due within one year		Due after one year but within five years		Due after five years		Total	
($ in thousands)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Variable Rate Loans:								
Commercial, financial, and agricultural	$76,579	6.02%	$34,382	5.79%	$43,606	7.55%	$154,567	6.40%
Real estate – construction only	60,500	6.26%	109,327	5.47%	12,507	5.29%	182,334	5.72%
Real estate – all other mortgage	103,475	5.96%	180,041	5.80%	470,662	4.94%	754,178	5.29%
Real estate – home equity loans/ line of credit	11,329	5.55%	78,422	5.48%	253,646	5.44%	343,397	5.45%
Consumer, primarily installment loans to individuals	3,524	6.46%	30,130	9.12%	2,647	7.61%	36,301	8.75%
Total at variable rates	255,407	6.04%	432,302	5.89%	783,068	5.26%	1,470,777	5.58%
Fixed Rate Loans:								
Commercial, financial, and agricultural	21,147	4.82%	119,692	4.53%	167,429	3.46%	308,268	3.97%
Real estate – construction only	88,781	4.14%	60,770	4.51%	56,161	4.40%	205,712	4.32%
Real estate – all other mortgage	177,754	4.99%	1,197,016	4.62%	830,586	4.42%	2,205,356	4.57%
Consumer, primarily installment loans to individuals	2,773	5.13%	25,105	5.35%	8,498	10.22%	36,376	6.47%
Total at fixed rates	290,455	4.72%	1,402,583	4.62%	1,062,674	4.31%	2,755,712	4.51%
Subtotal	545,862	5.34%	1,834,885	4.92%	1,845,742	4.71%	4,226,489	4.88%
Nonaccrual loans	22,575		—		—		22,575	
Total loans	$568,437		$1,834,885		$1,845,742		$4,249,064	

The above table is based on contractual scheduled maturities. Early repayment of loans or renewals at maturity are not considered in this table.

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Table 12 Nonperforming Assets

($ in thousands)	As of December 31, 2018	2017	2016	2015	2014
Non-covered nonperforming assets (1)					
Nonaccrual loans	$22,575	20,968	27,468	39,994	50,066
Restructured loans - accruing	13,418	19,834	22,138	28,011	35,493
Accruing loans >90 days past due	—	—	—	—	—
Total non-covered nonperforming loans	35,993	40,802	49,606	68,005	85,559
Nonperforming loans held for sale	—	—	—	—	—
Foreclosed real estate	7,440	12,571	9,532	9,188	9,771
Total non-covered nonperforming assets	$43,433	53,373	59,138	77,193	95,330
Purchased credit impaired loans not included above (2)	$17,393	23,165	—	—	—
Covered nonperforming assets (1)					
Nonaccrual loans	$—	—	—	7,816	10,508
Restructured loans – accruing	—	—	—	3,478	5,823
Accruing loans >90 days past due	—	—	—	—	—
Total covered nonperforming loans	—	—	—	11,294	16,331
Foreclosed real estate	—	—	—	806	2,350
Total covered nonperforming assets	—	—	—	12,100	18,681
Total nonperforming assets	$43,433	53,373	59,138	89,293	114,011
Asset Quality Ratios – All Assets					
Nonperforming loans to total loans	0.85%	1.01%	1.83%	3.15%	4.25%
Nonperforming assets to total loans and foreclosed real estate	1.02%	1.32%	2.17%	3.53%	4.73%
Nonperforming assets to total assets	0.74%	0.96%	1.64%	2.66%	3.54%
Asset Quality Ratios – Based on Non-covered Assets only					
Non-covered nonperforming loans to non-covered loans	0.85%	1.01%	1.83%	2.81%	3.77%
Non-covered nonperforming assets to non-covered loans and non-covered foreclosed real estate	1.02%	1.32%	2.17%	3.18%	4.18%
Non-covered nonperforming assets to total non-covered assets	0.74%	0.96%	1.64%	2.37%	3.09%

(1) Covered nonperforming assets consisted of assets that were included in loss share agreements with the FDIC. In 2014, approximately $9.7 million of nonaccrual loans, $2.1 million accruing restructured loans and $3.0 million of foreclosed real estate were transferred from covered to non-covered status upon a scheduled expiration of a FDIC loss-share agreement. In 2016, approximately $7.0 million of nonaccrual loans and $1.6 million of foreclosed real estate were transferred from covered to non-covered status upon expirations/terminations of FDIC loss-share agreements.

(2) In the March 3, 2017 acquisition of Carolina Bank and the October 1, 2017 acquisition of Asheville Savings Bank, the Company acquired $19.3 million and $9.9 million, respectively, in purchased credit impaired loans in

accordance with ASC 310-30 accounting guidance. These loans are excluded from the nonperforming loan amounts.

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Table 12a Nonperforming Assets by Geographical Region

($ in thousands)	Total Nonperforming Loans	Total Loans	Nonperforming Loans to Total Loans
	As of December 31, 2018		
Nonaccrual loans and Troubled Debt Restructurings (1)			
Eastern Region (NC)	$9,042	$884,000	1.02%
Triangle Region (NC)	9,360	904,000	1.04%
Triad Region (NC)	5,919	865,000	0.68%
Charlotte Region (NC)	768	332,000	0.23%
Southern Piedmont Region (NC)	6,100	264,000	2.31%
Western Region (NC)	554	679,000	0.08%
South Carolina Region	1,378	160,000	0.86%
Former Virginia Region	—	2,000	0.00%
Other	2,872	159,000	1.81%
Total nonaccrual loans and troubled debt restructurings	$35,993	$4,249,000	0.85%
Foreclosed Real Estate (1)			
Eastern Region (NC)	$1,748		
Triangle Region (NC)	1,179		
Triad Region (NC)	843		
Charlotte Region (NC)	180		
Southern Piedmont Region (NC)	698		
Western Region (NC)	1,272		
South Carolina Region	496		
Former Virginia Region	1,024		
Other	—		
Total foreclosed real estate	$7,440		

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(1) The counties comprising each region are as follows:

Eastern North Carolina Region - New Hanover, Brunswick, Duplin, Dare, Beaufort, Pitt, Onslow, Carteret

Triangle North Carolina Region - Moore, Lee, Harnett, Chatham, Wake

Triad North Carolina Region - Montgomery, Randolph, Davidson, Rockingham, Guilford, Stanly, Forsyth, Alamance

Charlotte North Carolina Region - Iredell, Cabarrus, Rowan, Mecklenburg

Southern Piedmont North Carolina Region - Richmond, Scotland, Robeson, Bladen, Columbus, Cumberland

Western North Carolina Region – Buncombe, Henderson, Madison, McDowell, Transylvania

South Carolina Region - Chesterfield, Dillon, Florence

Former Virginia Region - Wythe, Washington, Montgomery, Roanoke

Other includes loans originated on a national basis through the Company’s SBA Lending Division

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Table 13 Allocation of the Allowance for Loan Losses

	As of December 31,				
($ in thousands)	2018	2017	2016	2015	2014
Commercial, financial, and agricultural	$2,889	3,111	3,829	4,764	6,911
Real estate – construction, land development	2,243	2,816	2,691	3,790	8,520
Real estate – residential, commercial, home equity, multifamily	14,845	14,449	15,222	18,282	23,103
Installment loans to individuals	952	950	1,145	1,051	1,916
Total allocated	20,929	21,326	22,887	27,887	40,450
Unallocated	110	1,972	894	696	176
Total	$21,039	23,298	23,781	28,583	40,626
Allowance for loan losses related to covered loans included above (1)	$—	—	—	1,799	2,281

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(1) During 2016, all FDIC loss share agreements were terminated, and accordingly, there were no covered loans at December 31, 2018, 2017 and 2016.

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Table 14 Loan Loss and Recovery Experience

($ in thousands)	As of December 31, 2018	2017	2016	2015	2014
Loans outstanding at end of year	$4,249,064	4,042,369	2,710,712	2,518,926	2,396,174
Average amount of loans outstanding	$4,161,838	3,420,939	2,603,327	2,434,602	2,434,331
Allowance for loan losses, at beginning of year	$23,298	23,781	28,583	40,626	48,505
Provision (reversal) for loan losses – non-covered	(3,589)	723	2,109	2,008	7,087
Provision (reversal) for loan losses – covered	—	—	(2,132)	(2,788)	3,108
Total provision (reversal) for loan losses	(3,589)	723	(23)	(780)	10,195
	19,709	24,504	28,560	39,846	58,700
Loans charged off:					
Commercial, financial, and agricultural	(2,128)	(1,622)	(2,033)	(3,039)	(5,179)
Real estate – construction, land development & other land loans	(158)	(589)	(1,101)	(3,616)	(6,071)
Real estate – mortgage – residential (1-4 family) first mortgages	(1,734)	(2,641)	(3,894)	(5,145)	(4,050)
Real estate – mortgage – home equity loans / lines of credit	(711)	(978)	(1,010)	(1,117)	(1,607)
Real estate – mortgage – commercial and other	(1,459)	(1,182)	(1,088)	(3,103)	(4,405)
Installment loans to individuals	(781)	(799)	(1,288)	(2,411)	(1,924)
Total charge-offs	(6,971)	(7,811)	(10,414)	(18,431)	(23,236)
Recoveries of loans previously charged-off:					
Commercial, financial, and agricultural	1,195	1,311	817	934	149
Real estate – construction, land development & other land loans	4,097	2,579	2,690	3,599	3,363
Real estate – mortgage – residential (1-4 family) first mortgages	833	1,076	1,207	678	646
Real estate – mortgage – home equity loans / lines of credit	364	333	279	143	100
Real estate – mortgage – commercial and other	1,503	1,027	1,286	1,390	446
Installment loans to individuals	309	279	406	424	458
Total recoveries	8,301	6,605	6,685	7,168	5,162
Net recoveries (charge-offs)	1,330	(1,206)	(3,729)	(11,263)	(18,074)
Allowance removed related to sold loans	—	—	(1,050)	—	—
Allowance for loan losses, at end of year	$21,039	23,298	23,781	28,583	40,626
Covered net recoveries (charge-offs) included above (1)	$—	—	1,714	2,306	(3,332)

Ratios:

Net charge-offs (recoveries) as a percent of average loans	(0.03%)	0.04%	0.14%	0.46%	0.74%
Allowance for loan losses as a percent of loans at end of year	0.50%	0.58%	0.88%	1.13%	1.70%
Allowance for loan losses as a multiple of net charge-offs	n/m	19.32 x	6.38 x	2.54 x	2.25 x
Provision (reversal) for loan losses as a percent of net charge-offs	n/m	59.95%	(0.62%)	(6.93%)	56.41%
Recoveries of loans previously charged-off as a percent of loans charged-off	119.08%	84.56%	64.19%	38.89%	22.22%

(1) On September 22, 2016, all FDIC loss-share agreements were terminated, and accordingly, assets previously covered under those agreements became non-covered on that date.

n/m – not meaningful

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Table 15 Average Deposits

($ in thousands)	Year Ended December 31, 2018 Average Amount	2018 Average Rate	2017 Average Amount	2017 Average Rate	2016 Average Amount	2016 Average Rate
Interest-bearing checking accounts	$875,751	0.10%	$722,286	0.07%	$583,786	0.06%
Money market accounts	1,023,162	0.32%	825,015	0.19%	657,211	0.18%
Savings accounts	439,880	0.21%	385,967	0.19%	200,093	0.05%
Time deposits >$100,000	641,516	1.30%	504,349	0.79%	405,220	0.65%
Other time deposits	275,904	0.38%	261,910	0.30%	268,854	0.33%
Total interest-bearing deposits	3,256,213	0.45%	2,699,527	0.28%	2,115,164	0.24%
Noninterest-bearing checking accounts	1,260,598	—	997,203	—	712,349	—
Total deposits	4,516,811	0.32%	3,696,730	0.20%	2,827,513	0.18%

Table 16 Maturities of Time Deposits of $100,000 or More

($ in thousands)	As of December 31, 2018 3 Months or Less	Over 3 to 6 Months	Over 6 to 12 Months	Over 12 Months	Total
Time deposits of $100,000 or more	$175,032	174,359	204,638	136,893	690,922

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Table 17 Interest Rate Sensitivity Analysis

($ in thousands)	Repricing schedule for interest-earning assets and interest-bearing liabilities held as of December 31, 2018				
	3 Months or Less	Over 3 to 12 Months	Total Within 12 Months	Over 12 Months	Total
Earning assets:					
Loans (1)	$1,300,310	233,384	1,533,694	2,715,370	4,249,064
Securities available for sale (2)	34,764	86,594	121,358	379,993	501,351
Securities held to maturity (2)	11,985	19,264	31,249	69,988	101,237
Short-term investments	411,127	—	411,127	—	411,127
Total earning assets	$1,758,186	339,242	2,097,428	3,165,351	5,262,779
Percent of total earning assets	33.41%	6.45%	39.85%	60.15%	100.00%
Cumulative percent of total earning assets	33.41%	39.85%	39.85%	100.00%	100.00%
Interest-bearing liabilities:					
Interest-bearing checking accounts	$916,374	—	916,374	—	916,374
Money market accounts	1,035,523	—	1,035,523	—	1,035,523
Savings accounts	432,389	—	432,389	—	432,389
Time deposits of $100,000 or more	175,032	378,997	554,029	136,893	690,922
Other time deposits	77,479	122,030	199,509	64,491	264,000
Borrowings	309,704	50,000	359,704	46,905	406,609
Total interest-bearing liabilities	$2,946,501	551,027	3,497,528	248,289	3,745,817
Percent of total interest-bearing liabilities	78.66%	14.71%	93.37%	6.63%	100.00%
Cumulative percent of total interest-bearing liabilities	78.66%	93.37%	93.37%	100.00%	100.00%
Interest sensitivity gap	$(1,188,315)	(211,785)	(1,400,100)	2,917,062	1,516,962
Cumulative interest sensitivity gap	(1,188,315)	(1,400,100)	(1,400,100)	1,516,962	1,516,962
Cumulative interest sensitivity gap as a percent of total earning assets	(22.58%)	(26.60%)	(26.60%)	28.82%	28.82%
Cumulative ratio of interest-sensitive assets to interest-sensitive liabilities	59.67%	59.97%	59.67%	140.50%	140.50%

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(1) The three months or less category for loans includes $31,296 in adjustable rate loans that are at their contractual rate floors, and approximately $11,604 will reprice higher within the next 100 basis points of increases in the prime rate.

(2) Securities available for sale include government-sponsored enterprise securities, mortgage-backed securities, and corporate bonds. Securities held to maturity include mortgage-backed securities and state and local government securities. For fixed rate mortgage-backed securities, the principal is assumed to reprice equally over the average

life of the underlying security. All other fixed rate securities are assumed to reprice based on maturity date or call date. Variable rate securities are included in the period in which they are subject to reprice.

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Table 18 Contractual Obligations and Other Commercial Commitments

Contractual Obligations As of December 31, 2018	Payments Due by Period ($ in thousands)				
	Total	On Demand or Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
Borrowings	$406,609	303,000	40,000	1,275	62,334
Operating leases	11,304	2,268	3,317	1,637	4,082
Total contractual cash obligations, excluding deposits	417,913	305,268	43,317	2,912	66,416
Deposits	4,659,339	4,457,954	165,706	34,862	817
Total contractual cash obligations, including deposits	$5,077,252	4,763,222	209,023	37,774	67,233

Other Commercial Commitments As of December 31, 2018	Amount of Commitment Expiration Per Period ($ in thousands)				
	Total Amounts Committed	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
Credit cards	$123,707	61,854	61,853		
Lines of credit and loan commitments	1,165,087	468,433	218,423	150,668	327,563
Standby letters of credit	15,705	15,303	400	2	—
Total commercial commitments	$1,304,499	545,590	280,676	150,670	327,563

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Table 19 Market Risk Sensitive Instruments

	Expected Maturities of Market Sensitive Instruments Held at December 31, 2018 Occurring in Indicated Year								
($ in thousands)	2019	2020	2021	2022	2023	Beyond	Total	Average Interest Rate	Estimated Fair Value
Due from banks, interest-bearing	$406,848	—	—	—	—	—	406,848	2.37%	$406,848
Presold mortgages in process of settlement	4,279	—	—	—	—	—	4,279	4.41%	4,279
Debt Securities - at amortized cost (1) (2)	151,015	91,013	81,117	91,127	88,024	112,682	614,978	2.92%	601,257
Loans – fixed (3) (4)	290,455	218,660	299,049	445,146	439,727	1,062,675	2,755,712	4.51%	2,721,947
Loans – adjustable (3) (4)	255,406	107,053	118,326	105,520	101,404	783,068	1,470,777	5.58%	1,457,655
Total	$1,108,003	416,726	498,492	641,793	629,155	1,958,425	5,252,594	4.46%	$5,191,986
Interest-bearing checking accounts	$916,374	—	—	—	—	—	916,374	0.11%	$916,374
Money market accounts	1,035,523	—	—	—	—	—	1,035,523	0.48%	1,035,523
Savings accounts	432,389	—	—	—	—	—	432,389	0.26%	432,389
Time deposits	753,537	117,229	48,477	21,726	13,136	817	954,922	1.39%	949,105
Borrowings – fixed	303,000	40,000	—	—	1,275	8,432	352,707	2.35%	351,990
Borrowings – adjustable	—	—	—	—	—	53,902	53,902	4.60%	50,566
Total	$3,440,823	157,229	48,477	21,726	14,411	63,151	3,745,817	0.83%	$3,735,947

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(1) Tax-exempt securities are reflected at a tax-equivalent basis using a 23.37% tax rate.

(2) Securities with call dates within 12 months of December 31, 2018 that have above market interest rates are assumed to mature at their call date for purposes of this table. Mortgage securities are assumed to mature in the period of their expected repayment based on estimated prepayment speeds.

(3) Excludes nonaccrual loans.
(4) Loans are shown in the period of their contractual maturity.

Table 20 Return on Assets and Common Equity

	For the Year Ended December 31,		
	2018	2017	2016
Return on average assets	1.57%	1.00%	0.80%
Return on average common equity	12.27%	8.62%	7.73%
Dividend payout ratio – common shares	13.25%	17.58%	23.36%
Average shareholders’ equity to average assets	12.78%	11.61%	10.54%

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Table 21 Risk-Based and Leverage Capital Ratios

	As of December 31,		
($ in thousands)	2018	2017	2016
Risk-Based and Leverage Capital			
Common Equity Tier I capital:			
Shareholders' equity	$764,230	692,979	368,101
Intangible assets, net of deferred tax liability	(240,625)	(240,299)	(64,496)
Accumulated other comprehensive income adjustments	11,961	4,146	5,107
Total Common Equity Tier I capital	535,566	456,826	308,712
Tier I capital:			
Trust preferred securities eligible for Tier I capital treatment	52,198	52,054	45,000
Deductions from Tier I capital	—	(89)	(349)
Total Tier I leverage capital	587,764	508,791	353,363
Tier II capital:			
Allowable allowance for loan losses	21,039	23,298	23,781
Other Tier II capital	625	818	703
Tier II capital additions	21,664	24,116	24,484
Total capital	$609,428	532,907	377,847
Total risk weighted assets	$4,361,238	4,262,941	2,828,118
Adjusted fourth quarter average assets	$5,612,092	5,314,246	3,474,518
Risk-based capital ratios:			
Common equity Tier I capital to Tier I risk adjusted assets	12.28%	10.72%	10.92%
Minimum required under Basel III	6.375%	5.75%	5.125%
Fully phased-in minimum under Basel III	7.00%	7.00%	7.00%
Tier I capital to Tier I risk adjusted assets	13.48%	11.94%	12.49%
Minimum required under Basel III	7.875%	7.25%	6.625%
Fully phased-in minimum under Basel III	8.50%	8.50%	8.50%
Total risk-based capital to Tier II risk-adjusted assets	13.97%	12.50%	13.36%
Minimum required under Basel III	9.875%	9.25%	8.625%
Fully phased-in minimum under Basel III	10.50%	10.50%	10.50%
Leverage capital ratios:			
Tier I leverage capital to adjusted fourth quarter average assets	10.47%	9.58%	10.17%
Minimum required under Basel III	4.00%	4.00%	4.00%
Fully phased-in minimum under Basel III	4.00%	4.00%	4.00%

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Table 22 Quarterly Financial Summary (Unaudited)

($ in thousands except per share data)	2018 Fourth Quarter	Third Quarter	Second Quarter	First Quarter	2017 Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Income Statement Data								
Interest income, taxable equivalent	$61,635	58,647	57,102	55,417	53,686	45,713	43,520	37,053
Interest expense	7,346	6,374	5,503	4,554	4,216	3,372	2,911	2,172
Net interest income, taxable equivalent	54,289	52,273	51,599	50,863	49,470	42,341	40,609	34,881
Taxable equivalent, adjustment	443	428	367	356	610	702	693	585
Net interest income	53,846	51,845	51,232	50,507	48,860	41,639	39,916	34,296
Provision (reversal) for loan losses	693	87	(710)	(3,659)				723
Net interest income after provision for losses	53,153	51,758	51,942	54,166	48,860	41,639	39,916	33,573
Noninterest income	14,406	15,376	16,111	15,941	14,862	12,362	11,875	9,809
Noninterest expense	37,666	39,238	38,873	43,598	43,617	34,384	35,084	32,072
Income before income taxes	29,893	27,896	29,180	26,509	20,105	19,617	16,707	11,310
Income taxes	5,998	5,905	6,450	5,836	5,928	6,531	5,553	3,755
Net income available to common shareholders	23,895	21,991	22,730	20,673	14,177	13,086	11,154	7,555
Per Common Share Data								
Earnings per common share – basic	$0.81	0.74	0.77	0.70	0.48	0.53	0.45	0.34
	0.80	0.74	0.77	0.70	0.48	0.53	0.45	0.34

Earnings per common share – diluted								
Cash dividends declared	0.10	0.10	0.10	0.10	0.08	0.08	0.08	0.08
Market Price								
High	41.74	43.14	42.94	37.85	41.76	34.85	32.27	31.31
Low	30.50	39.32	34.70	33.88	34.08	29.73	27.50	26.47
Close	32.66	40.51	40.91	35.65	35.31	34.41	31.26	29.29
Stated book value - common	25.71	24.99	24.20	23.79	23.38	20.73	20.29	19.85
Tangible book value - common	17.18	16.43	15.79	15.17	14.69	14.25	14.16	13.53
Selected Average Balances								
Assets	$5,840,964	5,712,940	5,671,620	5,549,516	5,554,545	4,514,409	4,448,404	3,856,589
Loans	4,222,417	4,191,751	4,133,689	4,099,495	4,048,224	3,404,862	3,327,391	2,903,279
Earning assets	5,238,827	5,105,981	5,042,904	4,917,628	4,899,421	4,040,257	3,989,593	3,478,525
Deposits	4,264,868	4,526,012	4,512,559	4,403,805	4,390,879	3,632,319	3,610,944	3,152,778
Interest-bearing liabilities	3,697,076	3,654,176	3,671,692	3,629,364	3,618,312	2,958,134	2,944,208	2,580,950
Shareholders' equity	754,734	737,560	717,975	701,411	699,558	520,432	496,791	426,842
Ratios (annualized where applicable)								
Return on average assets	1.62%	1.53%	1.61%	1.51%	1.01%	1.15%	1.01%	0.79%
Return on average common equity	12.56%	11.83%	12.70%	11.95%	8.04%	9.98%	9.01%	7.18%
Equity to assets at end of period	13.03%	13.01%	12.68%	12.51%	12.49%	11.16%	11.06%	11.02%
Tangible equity to tangible assets at end of period	9.07%	8.95%	8.59%	8.35%	8.23%	7.95%	7.98%	7.79%
Average loans to average deposits	91.30%	92.60%	91.60%	93.09%	92.20%	93.74%	92.15%	92.09%
Average earning assets to interest-bearing liabilities	141.70%	139.73%	137.35%	135.50%	135.41%	136.58%	135.51%	134.78%

Net interest margin	4.11%	4.06%	4.10%	4.19%	4.01%	4.16%	4.08%	4.07%
Allowance for loan losses to gross loans	0.50%	0.49%	0.56%	0.57%	0.58%	0.72%	0.71%	0.72%
Nonperforming loans as a percent of total loans	0.85%	0.83%	1.03%	0.98%	1.01%	1.27%	1.30%	1.44%
Nonperforming assets as a percent of total assets	0.74%	0.72%	0.90%	0.92%	0.96%	1.16%	1.21%	1.35%
Net charge-offs (recoveries) as a percent of average total loans	0.02%	0.27%	(0.07%)	(0.36%)	0.13%	(0.07%)	(0.06%)	0.13%

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Item 8. Financial Statements and Supplementary Data

First Bancorp and Subsidiaries

Consolidated Balance Sheets

December 31, 2018 and 2017

($ in thousands)	2018	2017
Assets		
Cash and due from banks, noninterest-bearing	$56,050	114,301
Due from banks, interest-bearing	406,848	375,189
Total cash and cash equivalents	462,898	489,490
Securities available for sale	501,351	343,270
Securities held to maturity (fair values of $99,906 in 2018 and $118,998 in 2017)	101,237	118,503
Presold mortgages in process of settlement	4,279	12,459
Loans	4,249,064	4,042,369
Allowance for loan losses	(21,039)	(23,298)
Net loans	4,228,025	4,019,071
Premises and equipment	119,000	116,233
Accrued interest receivable	16,004	14,094
Goodwill	234,368	233,070
Other intangible assets	21,112	24,437
Foreclosed real estate	7,440	12,571
Bank-owned life insurance	101,878	99,162
Other assets	66,524	64,677
Total assets	$5,864,116	5,547,037
Liabilities		
Deposits: Noninterest-bearing checking accounts	$1,320,131	1,196,161
Interest-bearing checking accounts	916,374	884,254
Money market accounts	1,035,523	984,945
Savings accounts	432,389	454,860
Time deposits of $100,000 or more	690,922	593,123
Other time deposits	264,000	293,612

Total deposits	4,659,339	4,406,955
Borrowings	406,609	407,543
Accrued interest payable	1,976	1,235
Other liabilities	31,962	38,325
Total liabilities	5,099,886	4,854,058
Commitments and contingencies (see Note 13)		
Shareholders' Equity		
Preferred stock, no par value per share. Authorized: 5,000,000 shares		
Issued & outstanding: none in 2018 and 2017	—	—
Common stock, no par value per share. Authorized: 40,000,000 shares		
Issued & outstanding: 29,724,874 shares in 2018 and 29,639,374 shares in 2017	434,453	432,794
Retained earnings	341,738	264,331
Stock in rabbi trust assumed in acquisition	(3,235)	(3,581)
Rabbi trust obligation	3,235	3,581
Accumulated other comprehensive income (loss)	(11,961)	(4,146)
Total shareholders' equity	764,230	692,979
Total liabilities and shareholders' equity	$5,864,116	5,547,037

See accompanying notes to consolidated financial statements.

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First Bancorp and Subsidiaries

Consolidated Statements of Income

Years Ended December 31, 2018, 2017 and 2016

($ in thousands, except per share data)	2018	2017	2016
Interest Income			
Interest and fees on loans	$208,609	163,738	121,322
Interest on investment securities:			
Taxable interest income	10,638	7,007	6,162
Tax-exempt interest income	1,482	1,677	1,748
Other, principally overnight investments	10,478	4,960	1,755
Total interest income	231,207	177,382	130,987
Interest Expense			
Savings, checking and money market accounts	5,074	2,761	1,620
Time deposits of $100,000 or more	8,356	4,005	2,654
Other time deposits	1,061	778	896
Borrowings	9,286	5,127	2,437
Total interest expense	23,777	12,671	7,607
Net interest income	207,430	164,711	123,380
Provision (reversal) for loan losses – non-covered	(3,589)	723	2,109
Provision (reversal) for loan losses – covered	—	—	(2,132)
Total provision (reversal) for loan losses	(3,589)	723	(23)
Net interest income after provision for loan losses	211,019	163,988	123,403
Noninterest Income			
Service charges on deposit accounts	12,690	11,862	10,571
Other service charges, commissions and fees	19,945	14,610	11,913
Fees from presold mortgage loans	2,735	5,695	2,033
Commissions from sales of insurance and financial products	8,731	5,300	3,790
SBA consulting fees	4,675	4,024	3,199
SBA loan sale gains	10,366	5,479	1,433
Bank-owned life insurance income	2,534	2,321	2,052
Foreclosed property losses, net	(565)	(531)	(625)
FDIC indemnification asset income (expense), net	—	—	(10,255)
Securities gains (losses), net	—	(235)	3
Gain on branch sale	—	—	1,466
Other gains (losses), net	723	383	(29)
Total noninterest income	61,834	48,908	25,551
Noninterest Expenses			
Salaries	75,077	66,786	51,252

Employee benefits	16,888	15,313	11,568
Total personnel expense	91,965	82,099	62,820
Occupancy expense	10,793	9,661	7,838
Equipment related expenses	5,627	4,480	3,608
Merger and acquisition expenses	2,358	8,073	1,431
Intangibles amortization	6,763	4,240	1,211
Other operating expenses	41,869	36,604	29,913
Total noninterest expenses	159,375	145,157	106,821
Income before income taxes	113,478	67,739	42,133
Income tax expense	24,189	21,767	14,624
Net income	89,289	45,972	27,509
Preferred stock dividends	—	—	(175)
Net income available to common shareholders	$89,289	45,972	27,334
Earnings per common share: Basic	$3.02	1.82	1.37
Earnings per common share: Diluted	3.01	1.82	1.33
Dividends declared per common share	$0.40	0.32	0.32
Weighted average common shares outstanding:			
Basic	29,566,259	25,210,606	19,964,727
Diluted	29,707,431	25,291,382	20,732,917

See accompanying notes to consolidated financial statements.

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First Bancorp and Subsidiaries

Consolidated Statements of Comprehensive Income

Years Ended December 31, 2018, 2017 and 2016

($ in thousands)	2018	2017	2016
Net income	$89,289	45,972	27,509
Other comprehensive income (loss):			
Unrealized gains (losses) on securities available for sale:			
Unrealized holding gains (losses) arising during the period, pretax	(10,179)	639	(1,919)
Tax (expense) benefit	2,379	(234)	683
Reclassification to realized (gains) losses	—	235	(3)
Tax expense (benefit)	—	(87)	1
Postretirement plans:			
Net gain (loss) arising during period	(41)	1,601	(557)
Tax (expense) benefit	10	(593)	115
Amortization of unrecognized net actuarial (gain) loss	21	211	202
Tax expense (benefit)	(5)	(75)	(79)
Other comprehensive income (loss)	(7,815)	1,697	(1,557)
Comprehensive income	$81,474	47,669	25,952

See accompanying notes to consolidated financial statements.

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First Bancorp and Subsidiaries

Consolidated Statements of Shareholders' Equity

Years Ended December 31, 2018, 2017 and 2016

($ in thousands, except per share)	Preferred Stock	Common Stock Shares	Common Stock Amount	Retained Earnings	Stock in rabbi trust assumed in acquisition	Rabbi trust obligation	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances, January 1, 2016	$ 7,287	19,748	$ 133,393	205,060	—	—	(3,550)	342,190
Net income				27,509				27,509
Cash dividends declared ($0.32 per common share)				(6,473)				(6,473)
Preferred stock dividends				(175)				(175)
Conversion of preferred stock to common stock	(7,287)	729	7,287					—
Equity issued pursuant to acquisitions		279	5,509					5,509
Stock option exercises		23	375					375
Stock withheld for payment of taxes		(6)	(166)					(166)
Stock-based compensation		72	889					889
Other comprehensive income (loss)							(1,557)	(1,557)
Balances, December 31, 2016	—	20,845	147,287	225,921	—	—	(5,107)	368,101
Net income				45,972				45,972
Cash dividends declared ($0.32 per common share)				(8,298)				(8,298)
Equity issued pursuant to acquisitions		8,733	284,192		(7,688)	7,688		284,192
Payment of deferred fees					4,107	(4,107)		—
Stock option exercises		18	287					287
Stock withheld for payment of taxes		(7)	(231)					(231)
Stock-based compensation		50	1,259					1,259
				736			(736)	—

Reclassification of accumulated other comprehensive income due to statutory tax changes								
Other comprehensive income (loss)							1,697	1,697
Balances, December 31, 2017	—	29,639	432,794	264,331	(3,581)	3,581	(4,146)	692,979
Net income				89,289				89,289
Cash dividends declared ($0.40 per common share)				(11,882)				(11,882)
Payment of deferred fees					346	(346)		—
Stock option exercises		25	324					324
Stock withheld for payment of taxes		(11)	(406)					(406)
Stock-based compensation		72	1,741					1,741
Other comprehensive income (loss)							(7,815)	(7,815)
Balances, December 31, 2018	$—	29,725	$434,453	341,738	(3,235)	3,235	(11,961)	764,230

See accompanying notes to consolidated financial statements.

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First Bancorp and Subsidiaries

Consolidated Statements of Cash Flows

Years Ended December 31, 2018, 2017 and 2016

($ in thousands)	2018	2017	2016
Cash Flows From Operating Activities			
Net income	$89,289	45,972	27,509
Reconciliation of net income to net cash provided by operating activities:			
Provision (reversal) for loan losses	(3,589)	723	(23)
Net security premium amortization	2,749	2,908	3,341
Loan discount accretion	(7,812)	(7,076)	(4,451)
Purchase accounting accretion and amortization, net	(190)	(236)	—
FDIC indemnification asset expense, net	—	—	10,255
Foreclosed property losses and write-downs, net	565	531	625
Loss (gain) on securities available for sale	—	235	(3)
Other (gains) losses	(723)	(383)	29
Decrease (increase) in net deferred loan costs	(2,285)	975	922
Depreciation of premises and equipment	6,077	5,493	4,602
Stock-based compensation expense	1,569	1,095	714
Amortization of intangible assets	6,763	4,240	1,211
Fees/gains from sale of presold mortgage and SBA loans	(13,101)	(11,174)	(3,466)
Originations of presold mortgage loans in process of settlement	(118,791)	(228,871)	(76,912)
Proceeds from sales of presold mortgage loans in process of settlement	129,519	235,493	81,127
Origination of SBA loans for sale	(196,784)	(95,436)	(24,784)
Proceeds from sales of SBA loans	157,427	77,034	20,021
Gain on sale of branches	—	—	(1,466)
Increase in accrued interest receivable	(1,910)	(1,072)	(120)
Decrease (increase) in other assets	3,525	6,724	(724)
Increase (decrease) in accrued interest payable	741	392	(4)
Increase (decrease) in other liabilities	(6,629)	(10,729)	2,868
Net cash provided by operating activities	46,410	26,838	41,271
Cash Flows From Investing Activities			
Purchases of securities available for sale	(230,794)	(191,260)	(114,396)
Purchases of securities held to maturity	—	(291)	—
Proceeds from maturities/issuer calls of securities available for sale	60,871	37,974	76,939
Proceeds from maturities/issuer calls of securities held to maturity	16,183	22,344	23,368
Proceeds from sales of securities available for sale	—	140,621	8
Purchases of Federal Reserve and Federal Home Loan Bank stock, net	(6,129)	(9,947)	(3,933)
Net increase in loans	(152,972)	(204,631)	(192,393)
Payments related to FDIC loss share agreements	—	—	(1,554)
Payment to FDIC for termination of loss share agreements	—	—	(2,012)
Proceeds from sales of foreclosed real estate	7,532	8,647	7,954
Purchases of premises and equipment	(10,723)	(4,659)	(8,689)

Proceeds from sales of premises and equipment	2,753	151	2,025
Proceeds from branch sale	—	—	26,211
Net cash received (paid) in acquisitions	—	72,519	(53,640)
Net cash used by investing activities	(313,279)	(128,532)	(240,112)
Cash Flows From Financing Activities			
Net increase in deposits	252,756	195,468	158,989
Net increase (decrease) in borrowings	(1,116)	97,263	85,000
Cash dividends paid – common stock	(11,281)	(7,596)	(6,399)
Cash dividends paid – preferred stock	—	—	(233)
Proceeds from stock option exercises	324	287	375
Stock withheld for payment of taxes	(406)	(231)	(166)
Net cash provided by financing activities	240,277	285,191	237,566
Increase (decrease) in Cash and Cash Equivalents	(26,592)	183,497	38,725
Cash and Cash Equivalents, Beginning of Year	489,490	305,993	267,268
Cash and Cash Equivalents, End of Year	$462,898	489,490	305,993
Supplemental Disclosures of Cash Flow Information:			
Cash paid during the period for interest	23,036	12,239	7,653
Cash paid during the period for income taxes	21,162	19,537	11,791
Non-cash: Foreclosed loans transferred to foreclosed real estate	4,148	5,452	8,117
Non-cash: Unrealized gain (loss) on securities available for sale, net of taxes	(7,800)	553	(1,238)

See accompanying notes to consolidated financial statements.

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First Bancorp and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2018

Note 1. Summary of Significant Accounting Policies

(a) Basis of Presentation - The consolidated financial statements include the accounts of First Bancorp (the "Company") and its wholly owned subsidiary - First Bank (the "Bank"). The Bank has three wholly owned subsidiaries that are fully consolidated - First Bank Insurance Services, Inc. ("First Bank Insurance"), SBA Complete, Inc. ("SBA Complete"), and First Troy SPE, LLC. All significant intercompany accounts and transactions have been eliminated. Subsequent events have been evaluated through the date of filing this Form 10-K.

The Company is a bank holding company. The principal activity of the Company is the ownership and operation of the Bank, a state chartered bank with its main office in Southern Pines, North Carolina. The Company is also the parent company for a series of statutory trusts that were formed at various times since 2002 for the purpose of issuing trust preferred debt securities. The trusts are not consolidated for financial reporting purposes; however, notes issued by the Company to the trusts in return for the proceeds from the issuance of the trust preferred securities are included in the consolidated financial statements and have terms that are substantially the same as the corresponding trust preferred securities. The trust preferred securities qualify as capital for regulatory capital adequacy requirements. First Bank Insurance is an agent for property and casualty insurance policies. SBA Complete specializes in providing consulting services for financial institutions across the country related to Small Business Administration ("SBA") loan origination and servicing. First Troy SPE, LLC was formed in order to hold and dispose of certain real estate foreclosed upon by the Bank.

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant estimates made by the Company in the preparation of its consolidated financial statements are the determination of the allowance for loan losses, the valuation of other real estate, the accounting and impairment testing related to intangible assets, and the fair value and discount accretion of acquired loans.

(b) Reclassifications - Certain amounts for prior years have been reclassified to conform to the 2018 presentation. The reclassifications had no effect on net income or shareholders' equity as previously presented, nor did they

materially impact trends in financial information.

(c) Business Combinations – The Company accounts for business combinations using the acquisition method of accounting. The accounts of an acquired entity are included as of the date of acquisition, and any excess of purchase price over the fair value of the net assets acquired is capitalized as goodwill. Under this method, all identifiable assets acquired, including purchased loans, and liabilities assumed are recorded at fair value.

The Company typically issues common stock and/or pays cash for an acquisition, depending on the terms of the acquisition agreement. The value of common shares issued is determined based on the market price of the stock as of the closing of the acquisition.

(d) Cash and Cash Equivalents - The Company considers all highly liquid assets such as cash on hand, noninterest-bearing and interest-bearing amounts due from banks and federal funds sold to be “cash equivalents.”

(e) Securities - Debt securities that the Company has the positive intent and ability to hold to maturity are classified as “held to maturity” and carried at amortized cost. Securities not classified as held to maturity are classified as “available for sale” and carried at fair value, with unrealized gains and losses being reported as other comprehensive income or loss and reported as a separate component of shareholders’ equity.

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A decline in the market value of any available for sale or held to maturity security below cost that is deemed to be other than temporary results in a reduction in carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. Any equity security that is in an unrealized loss position for twelve consecutive months is presumed to be other than temporarily impaired and an impairment charge is recorded unless the amount of the charge is insignificant.

Gains and losses on sales of securities are recognized at the time of sale based upon the specific identification method. Premiums and discounts are amortized into income on a level yield basis, with premiums being amortized to the earliest call date and discounts being accreted to the stated maturity date.

(f) Premises and Equipment - Premises and equipment are stated at cost less accumulated depreciation. Depreciation, computed by the straight-line method, is charged to operations over the estimated useful lives of the properties, which range from 2 to 40 years or, in the case of leasehold improvements, over the term of the lease, if shorter. Maintenance and repairs are charged to operations in the year incurred. Gains and losses on dispositions are included in current operations.

(g) Loans – Loans are stated at the principal amount outstanding less any partial charge-offs plus deferred origination costs, net of nonrefundable loan fees. Interest on loans is accrued on the unpaid principal balance outstanding. Net deferred loan origination costs/fees are capitalized and recognized as a yield adjustment over the life of the related loan.

The Company does not hold a significant amount of interest-only strips, loans, other receivables, or retained interests in securitizations that can be contractually prepaid or otherwise settled in a way that it would not recover substantially all of its recorded investment.

Purchased loans acquired in a business combination are recorded at estimated fair value on their purchase date. No allowance for loan losses is carried over from the seller or otherwise recorded on the purchase date.

The Company follows specific accounting guidance related to purchased impaired loans. A loan is considered to be a purchased credit impaired loan when purchased loans have evidence of credit deterioration since origination and it is probable at the date of acquisition that the Company will not collect all contractually required principal and interest payments. Evidence of credit quality deterioration as of the purchase date may include statistics such as past due, risk grade and nonaccrual status. At the acquisition date, when possible, a stream of expected cash flows is estimated and compared to the estimated fair value in order to determine the accretable yield amount, which is then recognized over the life of the loan based on the effective yield method. Throughout the life of the loan, the stream of expected cash flows may change based on actual results of the loan or the assumptions related to the future performance. Subsequent changes of expected cash flows may result in changes to accretable yield if the present value of expected cash flows exceeds the carrying value or an impairment reserve if the present value of expected cash flows is less than the carrying amount.

For purchased impaired loans for which the timing and amount of cash flows expected to be collected cannot be reasonably estimated, the Company uses the cost recovery method of income recognition. Under the cost recovery method of income recognition, all cash receipts are initially applied to principal, with interest income being recorded only after the carrying value of the loan has been reduced to zero.

For nonimpaired purchased loans, the Company accretes any fair value discount over the life of the loan in a manner consistent with the guidance for accounting for loan origination fees and costs. An allowance for loan losses is recorded for these loans when the estimated credit losses exceed the remaining unamortized discounts, based on pools of similar loans.

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A loan is placed on nonaccrual status when, in management's judgment, the collection of interest appears doubtful. The accrual of interest is discontinued on substantially all loans that become 90 days or more past due with respect to principal or interest. The past due status of loans is based on the contractual payment terms. While a loan is on nonaccrual status, the Company's policy is that all cash receipts are applied to principal. Once the recorded principal balance has been reduced to zero, future cash receipts are applied to recoveries of any amounts previously charged off. Further cash receipts are recorded as interest income to the extent that any interest has been foregone. Loans are removed from nonaccrual status when they become current as to both principal and interest, when concern no longer exists as to the collectability of principal or interest, and when the loan has provided generally six months of satisfactory payment performance. In some cases, where borrowers are experiencing financial difficulties, loans may be restructured to provide terms significantly different from the originally contracted terms. For a nonaccrual loan that has been restructured, if the borrower has six months of satisfactory performance under the restructured terms and it is reasonably assured that the borrower will continue to be able to comply with the restructured terms, the loan may be returned to accruing status. The nonaccrual policy discussed above applies to all loan classifications.

A loan is considered to be impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. A loan is specifically evaluated for an appropriate valuation allowance if the loan balance is above a prescribed evaluation threshold (which varies based on credit quality, accruing status, troubled debt restructured status, and type of collateral) and the loan is determined to be impaired. Impaired loans are measured using either 1) an estimate of the cash flows that the Company expects to receive from the borrower discounted at the loan's effective rate, or 2) in the case of a collateral-dependent loan, the fair value of the collateral less estimated selling costs. Unless restructured, while a loan is considered to be impaired, the Company's policy is that interest accrual is discontinued and all cash receipts are applied to principal. Once the recorded principal balance has been reduced to zero, future cash receipts are applied to recoveries of any amounts previously charged off. Further cash receipts are recorded as interest income to the extent that any interest has been foregone. Impaired loans that are restructured are returned to accruing status in accordance with the restructured terms if the Company believes that the borrower will be able to meet the obligations of the restructured loan terms, and the loan has provided generally six months of satisfactory payment performance. The impairment policy discussed above applies to all loan classifications.

(h) Presold Mortgages in Process of Settlement - As a part of normal business operations, the Company originates residential mortgage loans that have been pre-approved by secondary investors to be sold on a best efforts basis. The terms of the loans are set by the secondary investors, and the purchase price that the investor will pay for the loan is agreed to prior to the funding of the loan by the Company. Generally within three weeks after funding, the loans are transferred to the investor in accordance with the agreed-upon terms. The Company records gains from the sale of these loans on the settlement date of the sale equal to the difference between the proceeds received and the carrying amount of the loan. The gain generally represents the portion of the proceeds attributed to service release premiums received from the investors and the realization of origination fees received from borrowers that were deferred as part of the carrying amount of the loan. Between the initial funding of the loans by the Company and the subsequent reimbursement by the investors, the Company carries the loans on its balance sheet at the lower of cost or market.

(i) SBA Loan Originations – Beginning in 2016, through its SBA Lending Division, the Company began offering loans guaranteed by the Small Business Administration ("SBA") for the purchase of businesses, business startups, business expansion, equipment, and working capital. All SBA loans are underwritten and documented as prescribed

by the SBA. SBA loans are generally fully amortizing and have maturity dates and amortizations of up to 25 years. The portion of SBA loans originated that are guaranteed and intended for sale on the secondary market are classified as held for sale and are carried at the lower of cost or fair value - there were an insignificant amount of these loans held for sale at December 31, 2018 and 2017. The Company generally sells the guaranteed portion of the SBA loan soon after origination and retains the servicing right. When the guaranteed portion of an SBA loan is sold, the Company allocates the carrying basis between the guaranteed portion of the loan sold, the unguaranteed portion of the loans retained, and the servicing asset based on their relative fair values. A gain is recorded for the difference between the proceeds received from the sale and the basis allocated to the sold portion. The servicing asset is included in "Other intangible assets" and is amortized as expense over the life of the loan. Servicing assets are aggregated by year of origination and tested for impairment on a quarterly basis. Servicing fees collected are recorded as noninterest income. The relative fair value allocation also results in a discount that is recorded on the unguaranteed portion of the loan that is retained. This discount is amortized as a yield adjustment over the life of the loan, so long as the loan performs. In the event of default, the remaining discount is available to offset the write-off of the remaining servicing asset and deferred origination costs, with any remaining discount available to offset any loan charge-off.

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Periodically, the Company originates other types of commercial loans and decides to sell them in the secondary market. The Company carries these loans at the lower of cost or fair value at each reporting date. There were no such loans held for sale as of December 31, 2018 or 2017.

(j) Allowance for Loan Losses - The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged-off against the allowance for loan losses when management believes that the collectability of the principal is unlikely. Recoveries on loans previously charged-off are added back to the allowance. The provision for loan losses charged to operations is an amount sufficient to bring the allowance for loan losses to an estimated balance considered adequate to absorb losses inherent in the portfolio. Management's determination of the adequacy of the allowance is based on several factors, including:

1. Risk grades assigned to the loans in the portfolio,
2. Specific reserves for individually evaluated impaired loans,
3. Current economic conditions, including the local, state, and national economic outlook; interest rate risk; trends in loan volume, mix and size of loans; levels and trends of delinquencies,
4. Historical loan loss experience, and
5. An assessment of the risk characteristics of the Company's loan portfolio, including industry concentrations, payment structures, changes in property values, and credit administration practices.

While management uses the best information available to make evaluations, future adjustments may be necessary if economic and other conditions differ substantially from the assumptions used.

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

(k) Foreclosed Real Estate - Foreclosed real estate consists primarily of real estate acquired by the Company through legal foreclosure or deed in lieu of foreclosure. The property is initially carried at the lower of cost (generally the loan balance plus additional costs incurred for improvements to the property) or the estimated fair value of the property less estimated selling costs (also see Note 14). If there are subsequent declines in fair value, which is reviewed routinely by management, the property is written down to its fair value through a charge to expense. Capital expenditures made to improve the property are capitalized. Costs of holding real estate, such as property taxes, insurance and maintenance, less related revenues during the holding period, are recorded as expense.

(l) Income Taxes - Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable

income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax assets are reduced, if necessary, by the amount of such benefits that are not expected to be realized based upon available evidence. The Company's investment tax credits, which are low income housing tax credits and state historic tax credits, are recorded in the period that they are reflected in the Company's tax returns.

(m) Intangible Assets - Business combinations are accounted for using the purchase method of accounting. Identifiable intangible assets are recognized separately and are amortized over their estimated useful lives, which for the Company has generally been seven to ten years and at an accelerated rate. Goodwill is recognized in business combinations to the extent that the price paid exceeds the fair value of the net assets acquired, including any identifiable intangible assets. Goodwill is not amortized, but as discussed in Note 1(s), is subject to fair value impairment tests on at least an annual basis.

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(n) Bank-owned life insurance – The Company has purchased life insurance policies on certain current and past key employees and directors where the insurance policy benefits and ownership are retained by the employer. These policies are recorded at their cash surrender value. Income from these policies and changes in the net cash surrender value are recorded within noninterest income as "Bank-owned life insurance income."

(o) Other Investments – The Company accounts for investments in limited partnerships, limited liability companies ("LLCs"), and other privately held companies using either the cost or the equity method of accounting. The accounting treatment depends upon the Company's percentage ownership and degree of management influence.

Under the cost method of accounting, the Company records an investment in stock at cost and generally recognizes cash dividends received as income. If cash dividends received exceed the Company's relative ownership of the investee's earnings since the investment date, these payments are considered a return of investment and reduce the cost of the investment.

Under the equity method of accounting, the Company records its initial investment at cost. Subsequently, the carrying amount of the investment is increased or decreased to reflect the Company's share of income or loss of the investee. The Company's recognition of earnings or losses from an equity method investment is based on the Company's ownership percentage in the investee and the investee's earnings on a quarterly basis. The investees generally provide their financial information during the quarter following the end of a given period. The Company's policy is to record its share of earnings or losses on equity method investments in the quarter the financial information is received.

All of the Company's investments in limited partnerships, LLCs, and other companies are privately held, and their market values are not readily available. The Company's management evaluates its investments in investees for impairment based on the investee's ability to generate cash through its operations or obtain alternative financing, and other subjective factors. There are inherent risks associated with the Company's investments in such companies, which may result in income statement volatility in future periods.

At December 31, 2018 and 2017, the Company's investments in limited partnerships, LLCs and other privately held companies totaled $7.5 million and $5.3 million, respectively, and were included in other assets.

(p) Stock Option Plan - At December 31, 2018, the Company had two equity-based employee compensation plans, which are described more fully in Note 15. The Company accounts for these plans under the recognition and measurement principles of relevant accounting guidance.

(q) Per Share Amounts - Basic Earnings Per Common Share is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period, excluding unvested shares of restricted stock. Diluted Earnings Per Common Share is computed by assuming the issuance of common shares for all potentially dilutive common shares outstanding during the reporting period. For the years presented, the Company's potentially dilutive common stock issuances related to unvested shares of restricted stock and stock option grants under the Company's equity-based plans. In 2016, the Company's potentially dilutive common stock issuances also included the Company's Series C Preferred stock, which was convertible into common stock on a one-for-one ratio. As discussed in Note 19, on December 22, 2016 each outstanding share of the Company's Series C Preferred stock was exchanged by the holder for an equal number of shares of common stock.

In computing Diluted Earnings Per Common Share, adjustments are made to the computation of Basic Earnings Per Common shares, as follows. As it relates to unvested shares of restricted stock, the number of shares added to the denominator is equal to the number of unvested shares less the assumed number of shares bought back by the Company in the open market at the average market price with the amount of proceeds being equal to the average deferred compensation for the reporting period. As it relates to stock options, it is assumed that all dilutive stock options are exercised during the reporting period at their respective exercise prices, with the proceeds from the exercises used by the Company to buy back stock in the open market at the average market price in effect during the reporting period. The difference between the number of shares assumed to be exercised and the number of shares bought back is included in the calculation of dilutive securities. As it relates to contingently issuable shares, the number of shares that are included in the calculation of dilutive securities is based on the number of shares that are issuable if the end of the reporting period were the end of the contingency period. As it relates to the Series C Preferred Stock for the period of time it was outstanding, it is assumed that the preferred stock was converted to common stock at the beginning of the reporting period. Dividends on the preferred stock are added back to net income in 2016 and the shares assumed to be converted are included in the number of shares outstanding.

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If any of the potentially dilutive common stock issuances have an anti-dilutive effect, the potentially dilutive common stock issuance is disregarded.

The following is a reconciliation of the numerators and denominators used in computing Basic and Diluted Earnings Per Common Share:

	For the Years Ended December 31,								
	2018			2017			2016		
($ in thousands, except per share amounts)	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic EPS Net income available to common shareholders	$89,289	29,566,259	$ 3.02	$45,972	25,210,606	$ 1.82	$27,334	19,964,727	$ 1.37
Effect of dilutive securities	—	141,172		—	80,776		175	768,190	
Diluted EPS per common share	$89,289	29,707,431	$ 3.01	$45,972	25,291,382	$ 1.82	$27,509	20,732,917	$ 1.33

For the years ended December 31, 2018 and 2017, there were no options that were anti-dilutive. For the year ended December 31, 2016, there were 5,000 options that were anti-dilutive because the exercise price exceeded the average market price for the year, and thus are not included in the calculation to determine the effect of dilutive securities.

(r) Fair Value of Financial Instruments - Relevant accounting guidance requires that the Company disclose estimated fair values for its financial instruments. Fair value methods and assumptions are set forth below for the Company's financial instruments.

Cash and Amounts Due from Banks, Federal Funds Sold, Presold Mortgages in Process of Settlement, Accrued Interest Receivable, and Accrued Interest Payable - The carrying amounts approximate their fair value because of the short maturity of these financial instruments.

Available for Sale and Held to Maturity Securities - Fair values are provided by a third-party and are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices

of comparable instruments or matrix pricing.

Loans - For nonimpaired loans, fair values are determined assuming the sale of the notes to a third-party financial investor. Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, financial and agricultural, real estate construction, real estate mortgages and installment loans to individuals. Each loan category is further segmented into fixed and variable interest rate terms. The fair value for each category is determined by discounting scheduled future cash flows using current interest rates with a liquidity discount offered on loans with similar risk characteristics, and includes the Company’s estimate of future credit losses expected to be incurred over the life of the loan. Fair values for impaired loans are primarily based on estimated proceeds expected upon liquidation of the collateral or the present value of expected cash flows.

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Bank-Owned Life Insurance – The carrying value of life insurance approximates fair value because this investment is carried at cash surrender value, as determined by the issuer.

SBA Servicing Asset – The fair value of the Company's SBA servicing asset is estimated based on the present value of the discounted cash flows of the expected servicing income less the estimated cost to service the loans.

Deposits - The fair value of deposits with no stated maturity, such as noninterest-bearing checking accounts, savings accounts, interest-bearing checking accounts, and money market accounts, is equal to the amount payable on demand as of the valuation date. The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered in the marketplace for deposits of similar remaining maturities.

Borrowings - The fair value of borrowings is based on the discounted value of the contractual cash flows. The discount rate is estimated using the rates currently offered by the Company's lenders for debt of similar maturities.

Commitments to Extend Credit and Standby Letters of Credit - At December 31, 2018 and 2017, the Company's off-balance sheet financial instruments had no carrying value. The large majority of commitments to extend credit and standby letters of credit are at variable rates and/or have relatively short terms to maturity. Therefore, the fair value for these financial instruments is considered to be immaterial.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no highly liquid market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on- and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets and liabilities that are not considered financial assets or liabilities include net premises and equipment, intangible assets and other assets such as foreclosed properties, deferred income taxes, prepaid expense accounts, income taxes currently payable and other various accrued expenses. In addition, the income tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of the estimates.

(s) Impairment - Goodwill is evaluated for impairment on at least an annual basis by comparing the estimated fair value of the reporting units to their related carrying value. If the carrying value of a reporting unit exceeds its fair value, the Company determines whether the implied fair value of the goodwill, using various valuation techniques, exceeds the carrying value of the goodwill. If the carrying value of the goodwill exceeds the implied fair value of the goodwill, an impairment loss is recorded in an amount equal to that excess.

The Company reviews all other long-lived assets, including identifiable intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The Company’s policy is that an impairment loss is recognized if the sum of the undiscounted future cash flows is less than the carrying amount of the asset. Any long-lived assets to be disposed of are reported at the lower of the carrying amount or fair value, less costs to sell.

To date, the Company has not recorded any impairment write-downs of its long-lived assets or goodwill.

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(t) Comprehensive Income (Loss) - Comprehensive income (loss) is defined as the change in equity during a period for non-owner transactions and is divided into net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes revenues, expenses, gains, and losses that are excluded from earnings under current accounting standards. The components of accumulated other comprehensive income (loss) for the Company are as follows:

($ in thousands)	December 31, 2018	December 31, 2017	December 31, 2016
Unrealized gain (loss) on securities available for sale	$(12,390)	(2,211)	(3,085)
Deferred tax asset (liability)	2,896	517	1,138
Net unrealized gain (loss) on securities available for sale	(9,494)	(1,694)	(1,947)
Additional pension asset (liability)	(3,220)	(3,200)	(5,012)
Deferred tax asset (liability)	753	748	1,852
Net additional pension asset (liability)	(2,467)	(2,452)	(3,160)
Total accumulated other comprehensive income (loss)	$(11,961		