SOUTHEASTERN BANKING CORP
Form 10-Q
November 14, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of

the Securities Exchange Act of 1934

For the Quarterly Period Ended September 30, 2011

Commission File Number 000-32627

(Exact name of registrant as specified in its charter)

Georgia	**58-1423423**
(State or other jurisdiction of	**(IRS Employer**
incorporation or organization)	**Identification No.)**

P. O. Box 455, 1010 North Way, Darien, Georgia 31305

(Address of principal executive offices) (Zip Code)

(912) 437-4141

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	x

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

As of November 10, 2011, 3,129,388 shares of the Registrant s common stock, par value $1.25 per share, were outstanding.

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Part I - Financial Information

Item 1. Financial Statements

Southeastern Banking Corporation

Consolidated Balance Sheets

	(Unaudited) September 30, 2011	December 31, 2010
Assets		
Cash and due from banks	**$ 8,289,295**	$ 8,206,514
Interest-bearing deposits in other banks	**87,765,886**	70,511,991
Federal funds sold	**2,150,000**	2,150,000
Cash and cash equivalents	**98,205,181**	80,868,505
Investment securities:		
Available-for-sale, at market value (amortized cost of $64,803,395 and $73,893,247 at September 30, 2011 and December 31, 2010)	**65,958,580**	74,299,903
Loans, gross	**214,889,850**	245,688,555
Unearned income	**(49,205)**	(65,007)
Allowance for loan losses	**(8,563,900)**	(9,915,559)
Net loans	**206,276,745**	235,707,989
Premises and equipment, net	**11,875,560**	12,107,464
Bank-owned life insurance, at cash surrender value	**5,914,329**	5,738,642
Other real estate	**14,825,435**	11,636,290
Other assets	**6,081,549**	7,274,264
Total Assets	**$ 409,137,379**	$ 427,633,057
Liabilities and Shareholders Equity		
Liabilities		
Deposits:		
Noninterest-bearing demand deposits	**$ 64,071,059**	$ 55,377,519
Interest-bearing demand, savings, and time deposits	**293,542,551**	319,817,600
Total deposits	**357,613,610**	375,195,119
U. S. Treasury demand note	**1,048,743**	762,782
Federal Home Loan Bank advances	**5,000,000**	5,000,000
Other liabilities	**2,329,086**	1,869,597
Total liabilities	**365,991,439**	382,827,498
Shareholders Equity		
Common stock, $1.25 par value	**4,475,996**	4,475,996

Additional paid-in-capital	**1,529,687**	1,495,668
Retained earnings	**45,272,296**	47,459,963
Treasury stock, at cost	**(8,894,461)**	(8,894,461)
Accumulated other comprehensive income	**762,422**	268,393
Total shareholders equity	**43,145,940**	44,805,559
Total Liabilities and Shareholders Equity	**$ 409,137,379**	$ 427,633,057
Common shares issued	**3,580,797**	3,580,797
Common shares authorized	**10,000,000**	10,000,000
Common shares outstanding	**3,129,388**	3,129,388
Treasury shares	**451,409**	451,409

See accompanying Notes to Consolidated Financial Statements.

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Southeastern Banking Corporation

Consolidated Statements of Operations

(Unaudited)

Period Ended September 30,	*Three Months* **2011**	2010	*Nine Months* **2011**	2010
Interest income:				
Interest and fees on loans	**$ 3,304,961**	$ 3,497,895	**$ 9,938,252**	$ 10,756,384
Interest on investment securities:				
Taxable	**432,321**	533,041	**1,305,316**	1,792,990
Tax-exempt	**128,210**	180,200	**406,770**	580,585
Other interest income	**53,702**	51,835	**163,544**	112,362
Total interest income	**3,919,194**	4,262,971	**11,813,882**	13,242,321
Interest expense:				
Interest on deposits	**721,470**	1,093,704	**2,448,377**	3,453,226
Interest on Federal Home Loan Bank advances	**33,019**	33,019	**97,981**	159,647
Interest on other borrowings				313
Total interest expense	**754,489**	1,126,723	**2,546,358**	3,613,186
Net interest income	**3,164,705**	3,136,248	**9,267,524**	9,629,135
Provision for loan losses	**2,700,000**	4,450,000	**4,260,000**	10,570,000
Net interest income (loss) after provision for loan losses	**464,705**	(1,313,752)	**5,007,524**	(940,865)
Noninterest income:				
Service charges on deposit accounts	**626,168**	704,391	**1,761,608**	2,050,344
Net loss on sales of investment securities available-for-sale			**(18,191)**	(143,408)
Other noninterest income	**354,096**	324,383	**1,040,874**	1,013,702
Total noninterest income	**980,264**	1,028,774	**2,784,291**	2,920,638
Noninterest expense:				
Salaries and employee benefits	**1,727,271**	1,747,115	**5,089,502**	5,364,874
Occupancy and equipment expense, net	**643,233**	665,640	**1,907,128**	2,020,188
Other-than-temporary impairment loss on debt security				45,059
Net (gain) loss on sales of other real estate	**359**	4,935	**(21,625)**	3,430
Write-downs on other real estate	**256,604**	821,529	**500,216**	1,731,098
Other noninterest expense	**806,051**	770,061	**2,504,261**	2,597,287
Total noninterest expense	**3,433,518**	4,009,280	**9,979,482**	11,761,936
Loss before income tax benefit	**(1,988,549)**	(4,294,258)	**(2,187,667)**	(9,782,163)
Income tax benefit		(1,642,138)		(3,905,624)

Net loss	**$ (1,988,549)**	$ (2,652,120)	**$ (2,187,667)**	$ (5,876,539)
Basic and diluted loss per common share	**$ (0.64)**	$ (0.85)	**$ (0.70)**	$ (1.88)
Basic and diluted weighted average common shares outstanding	**3,129,388**	3,129,388	**3,129,388**	3,132,402

See accompanying Notes to Consolidated Financial Statements.

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Southeastern Banking Corporation

Consolidated Statements of Shareholders Equity

(Unaudited)

	Common Stock		*Additional*			*Accumulated Other*	
	Shares	*Stated Value*	*Paid-In Capital*	*Retained Earnings*	*Treasury Stock*	*Comprehensive Income (Loss)*	*Total*
Balance, December 31, 2009	3,138,531	$ 4,475,996	$ 1,449,696	$ 60,512,342	$ (8,803,031)	$ (1,076,320)	$ 56,558,683
Comprehensive income (loss):							
Net loss				(5,876,539)			(5,876,539)
Unrealized holding gains on investment securities available-for-sale arising during the period, net of tax of $934,649						1,814,319	1,814,319
Reclassification adjustment for net loss on sales of investment securities available-for-sale included in net loss, net of tax benefit of $48,759						94,649	94,649
Reclassification adjustment for other-than-temporary impairment loss on debt security included in net loss, net of tax benefit of $15,321						29,738	29,738
Total comprehensive loss							(3,937,833)
Cash dividends declared, $0.13 per share				(407,416)			(407,416)
Stock-based compensation			35,550				35,550
Purchase of treasury stock	(9,143)				(91,430)		(91,430)
Balance, September 30, 2010	3,129,388	$ 4,475,996	$ 1,485,246	$ 54,228,387	$ (8,894,461)	$ 862,386	$ 52,157,554
Balance, December 31, 2010	3,129,388	$ 4,475,996	$ 1,495,668	$ 47,459,963	$ (8,894,461)	$ 268,393	$ 44,805,559
Comprehensive income (loss):							
Net loss				**(2,187,667)**			**(2,187,667)**
Unrealized holding gains on investment securities available-for-sale arising during the period, net of tax of $248,315						**482,023**	**482,023**
Reclassification adjustment for net loss on sales of investment securities available-for-sale included in net loss, net of tax benefit of $6,185						**12,006**	**12,006**
Total comprehensive loss							**(1,693,638)**

Stock-based compensation			**34,019**				**34,019**
Balance, September 30, 2011	**3,129,388**	**$ 4,475,996**	**$ 1,529,687**	**$ 45,272,296**	**$ (8,894,461)**	**$ 762,422**	**$ 43,145,940**

See accompanying Notes to Consolidated Financial Statements.

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Southeastern Banking Corporation

Consolidated Statements of Cash Flows

(Unaudited)

Nine Months Ended September 30,	**2011**	2010
Cash flows from operating activities:		
Net loss	**$ (2,187,667)**	$ (5,876,539)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation, amortization and accretion, net	**610,860**	766,005
Provision for loan losses	**4,260,000**	10,570,000
Deferred income tax benefit		(208,199)
Net loss on sales of investment securities available-for-sale	**18,191**	143,408
Other-than-temporary impairment loss on debt security		45,059
Increase in cash surrender value of bank-owned life insurance	**(175,687)**	(178,403)
Net (gain) loss on sales of other real estate	**(21,625)**	3,430
Write-downs on other real estate	**500,216**	1,731,098
Stock-based compensation	**34,019**	35,550
Decrease in interest receivable	**134,505**	366,972
Decrease in interest payable	**(204,264)**	(89,165)
Net change in income tax receivable or payable	**9,953**	(3,707,906)
Decrease in prepaid FDIC assessments	**451,000**	503,200
Net (increase) decrease in other assets	**427,407**	(297,588)
Net increase in other liabilities	**409,253**	265,406
Net cash provided by operating activities	**4,266,161**	4,072,328
Cash flows from investing activities:		
Purchase of investment securities available-for-sale	**(296,666,514)**	
Proceeds from sales of investment securities available-for-sale	**474,000**	4,591,930
Proceeds from maturities, calls, and paydowns of investment securities available-for-sale	**305,191,706**	10,905,604
Redemption of restricted equity securities	**154,100**	94,200
Net decrease in loans	**19,864,693**	13,118,582
Capital expenditures, net	**(290,737)**	(178,144)
Proceeds from sales of other real estate	**1,638,815**	355,386
Net cash provided by investing activities	**30,366,063**	28,887,558
Cash flows from financing activities:		
Net increase (decrease) in deposits	**(17,581,509)**	11,713,505
Net increase (decrease) in U. S. Treasury demand note	**285,961**	(139,754)
Repayment of advances from Federal Home Loan Bank		(5,000,000)
Purchase of treasury stock		(91,430)
Dividends paid		(407,416)
Net cash provided by (used in) financing activities	**(17,295,548)**	6,074,905
Net increase in cash and cash equivalents	**17,336,676**	39,034,791
Cash and cash equivalents at beginning of period	**80,868,505**	42,632,459
Cash and cash equivalents at end of period	**$ 98,205,181**	$ 81,667,250

Supplemental disclosure of cash flow information:				
Cash paid (received) during the year for:				
Interest	**$**	**2,750,622**	$	3,702,351
Income taxes paid (refunded), net	**$**	**(9,953)**	$	
Noncash investing and financing transactions:				
Change in unrealized gains (losses) on investment securities available-for-sale	**$**	**748,529**	$	2,937,435
Loans charged-off to allowance for loan losses	**$**	**5,762,581**	$	8,878,129
Real estate acquired through foreclosure	**$**	**5,306,551**	$	3,990,205
Loans made in connection with sales of other real estate	**$**	**21,681**	$	259,718

See accompanying Notes to Consolidated Financial Statements.

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Southeastern Banking Corporation

Notes to Consolidated Financial Statements

(Unaudited)

1. BASIS OF PRESENTATION

Southeastern Banking Corporation (the Company) is a bank holding company whose principal activity is the ownership and management of its wholly-owned commercial bank subsidiary, Southeastern Bank (the Bank). The Company operates within one business segment, community banking, offering a broad range of banking services to consumer and commercial customers through 16 banking offices in southeast Georgia and northeast Florida. The Company, whose tradition of service spans over 120 years, is headquartered in Darien, Georgia.

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) for interim financial information and the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, these financial statements do not include all of the information and footnotes required by U.S. GAAP for complete financial statements and should be read in conjunction with the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

The accounting and reporting policies followed in the presentation of the accompanying unaudited consolidated financial statements are consistent with those described in Note 1 of the notes to the consolidated financial statements included in the Company s 2010 Form 10-K, as updated by the information contained in this Form 10-Q. In the opinion of management, these consolidated financial statements reflect all adjustments necessary to fairly present such information for the periods and dates indicated. Such adjustments, which include transactions typically determined or settled at year-end, are normal and recurring in nature. All significant intercompany accounts and transactions have been eliminated. The consolidated balance sheet as of December 31, 2010 has been extracted from the audited consolidated balance sheet included in the Company s 2010 Form 10-K. Certain reclassifications, with no effect on total assets or net operating results, have been made to prior period amounts to conform to the current period presentation.

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Results of operations for interim periods are not necessarily indicative of trends or results to be expected for the full year, due in part to seasonal variations and unusual or infrequently occurring items.

Earnings (Loss) Per Share

Basic earnings per share are computed by dividing net income by the weighted average number of common shares outstanding during each period. Diluted earnings per share are based on the weighted average number of common shares outstanding adjusted to include the effect of potentially dilutive common shares. Potentially dilutive common shares include incremental shares issuable upon exercise of outstanding stock options using the treasury stock method. In any periods of net loss, diluted loss per share is calculated in the same manner as basic earnings per share. Since they were non-dilutive, 70,250 and 77,500 equivalent shares related to stock options were excluded from the computation of diluted earnings (loss) per share at September 30, 2011 and 2010, respectively.

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Southeastern Banking Corporation

Notes to Consolidated Financial Statements

(Unaudited)

2. NEW ACCOUNTING PRONOUNCEMENTS

In December 2010, the Financial Accounting Standards Board (FASB) issued an accounting standards update addressing differences in the ways entities have disclosed pro forma revenue and earnings in a business combination. If an entity presents comparable financial statements, the guidance requires the entity to disclose revenue and earnings of the combined entity as if the business combination(s) occurring during the current year had occurred as of the beginning of the comparable prior annual reporting period. Supplemental pro forma disclosures must also be expanded to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination(s). The new requirements, which became effective as of January 1, 2011, have not had a material impact on the Company s financial position, results of operations, or cash flows.

In January 2010, the FASB issued an accounting standards update requiring additional disclosures on transfers in and out of the fair value hierarchy and activity within level 3 financial instruments. This update also provides clarification on classification of financial instruments and the discussion of inputs and valuation techniques. The new disclosures and clarification were effective for the Company as of December 31, 2009, except for disclosures related to activity within level 3 financial instruments. The level 3 disclosures were effective the interim reporting period ending March 31, 2011. Adoption of the new disclosure requirements has not had a material impact on the Company s financial position or results of operations.

In May 2011, the FASB issued additional guidance on fair value measurement. The new guidance results in common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards. The amendments do not require additional fair value measurements and are not intended to establish valuation standards or affect valuation practices outside of financial reporting. The amendments clarify the proper application of the highest and best use and valuation premise concepts and the fair value measurement of an instrument classified in shareholders equity. Additionally, the amendments permit a reporting entity that manages financial instruments on the basis of its net exposure, rather than gross exposure, to measure the underlying financial assets and liabilities at the price that would be received to sell a net asset position or transfer a net liability position for a particular risk in an orderly transaction between market participants at the measurement date and clarify that premiums and discounts in fair value measurements relate to the unit of account, and not size, as a characteristic of an entity s holding. Expanded disclosure must be provided about valuation processes used for level 3 instruments, including quantitative information on unobservable inputs and sensitivity of fair value measurement to changes in unobservable inputs; use of nonfinancial assets if that use varies from its highest and best use, and that an asset is measured at fair value on the balance sheets or its fair value is based on highest and best use; and categorization by level of the fair value hierarchy for items not measured at fair value on the balance sheets but for which fair value must be disclosed. The amendments are effective for interim and annual periods beginning after December 15, 2011. Adoption of the new guidance is not expected to have a material impact on the Company s financial position or results of operations.

In July 2010, the FASB issued an accounting standards update requiring more robust disclosures about the credit quality of loans and the allowance for loan losses. The additional disclosures include a rollforward of the allowance for loan losses on a disaggregated basis and more information, by type of loan, on credit quality indicators including aging and troubled debt restructurings (TDRs) as well as any significant purchases and sales. Most of the new disclosure requirements were effective for interim and annual periods beginning after December 15, 2010. The disclosure requirements in the update related to TDRs was delayed and became effective for interim and annual periods beginning after June 15, 2011. The new disclosure requirements have not had a material impact on the Company s financial position or results of operations.

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Southeastern Banking Corporation

Notes to Consolidated Financial Statements

(Unaudited)

In April 2011, the FASB issued an accounting standards update clarifying the accounting guidance on a creditor s evaluation of whether a restructuring constitutes a troubled debt restructuring. It is the objective of the FASB that the clarifying guidance in this update will result in more consistent application of U.S. GAAP for debt restructurings. The amendments in this update are effective for interim and annual periods beginning after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. As a result of applying these amendments, the Company may identify loans that are newly considered impaired under the new guidance. For purposes of measuring impairment of those loans, the Company must apply the amendments prospectively for the first interim or annual period beginning on or after June 15, 2011. Adoption of the new guidance, which became effective as of July 1, 2011, has not had a material impact on the Company s financial position or results of operations.

3. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities as of September 30, 2011 and December 31, 2010 are summarized below.

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2011				
Available-for-sale:				
U. S. Government and agency securities	**$ 7,465,754**	**$ 211,881**	**$ 3,169**	**$ 7,674,466**
U. S. Government-sponsored enterprise securities	**3,792,250**	**118,264**		**3,910,514**
Agency residential mortgage-backed securities	**30,738,582**	**827,941**	**24,108**	**31,542,415**
Obligations of states and political subdivisions	**13,377,102**	**526,696**		**13,903,798**
Corporate debt obligations	**9,429,707**	**85,728**	**588,048**	**8,927,387**
Total investment securities	**$ 64,803,395**	**$ 1,770,510**	**$ 615,325**	**$ 65,958,580**
December 31, 2010				
Available-for-sale:				
U. S. Government and agency securities	$ 4,551,010	$ 187,524	$	$ 4,738,534
U. S. Government-sponsored enterprise securities	33,549,865	118,203	31	33,668,037
Agency residential mortgage-backed securities	10,323,420	642,201		10,965,621
Obligations of states and political subdivisions	16,587,458	370,210	136,664	16,821,004
Corporate debt obligations	8,881,494	20,710	795,497	8,106,707
Total investment securities	$ 73,893,247	$ 1,338,848	$ 932,192	$ 74,299,903

Southeastern Banking Corporation

Notes to Consolidated Financial Statements

(Unaudited)

The amortized cost and fair value of debt securities by contractual maturity at September 30, 2011 are shown in the table below. In some cases, issuers may have the right to call or prepay obligations without call or prepayment penalties prior to the contractual maturity date. Agency-issued mortgage-backed securities and U.S. Small Business Administration (SBA) participation certificates (included in U. S. Government and agency securities) are shown separately from other debt securities due to customary prepayment features which cause average lives to differ significantly from contractual maturities.

	Available-for-Sale	
September 30, 2011	Amortized Cost	Fair Value
Due within one year	**$ 2,042,050**	**$ 2,068,582**
Due from one to five years	**9,855,593**	**10,157,869**
Due from five to ten years	**4,111,044**	**4,288,532**
Due after ten years	**10,590,372**	**10,226,716**
	26,599,059	**26,741,699**
Agency residential mortgage-backed securities	**30,738,582**	**31,542,415**
SBA participation certificates	**7,465,754**	**7,674,466**
Total investment securities	**$ 64,803,395**	**$ 65,958,580**

Securities with carrying values of $49,277,556 and $65,127,641 at September 30, 2011 and December 31, 2010, respectively, were pledged to secure public deposits as required by law and certain borrowing arrangements.

Gains and losses on sales and calls of investment securities for the three months and nine months ended September 30, 2011 and 2010 consist of the following:

	Three Months		*Nine Months*	
Period Ended September 30,	**2011**	2010	**2011**	2010
Gross realized gains	**$**	$	**$**	$
Gross realized losses			**(18,191)**	(143,408)
Net realized gain (loss)	**$**	$	**$ (18,191)**	$ (143,408)

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Southeastern Banking Corporation

Notes to Consolidated Financial Statements

(Unaudited)

The following table shows the gross unrealized losses and fair value of the Company s investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2011 and December 31, 2010.

	Less Than Twelve Months		Over Twelve Months		
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Total Unrealized Losses
September 30, 2011					
Available-for-sale:					
U.S. Government and federal agency securities	**$ 1,555,610**	**$ 3,169**	**$**	**$**	**$ 3,169**
U.S. Government-sponsored enterprise securities					
Agency residential mortgage-backed securities	**4,488,450**	**24,108**			**24,108**
Obligations of states and political subdivisions					
Corporate debt obligations	**1,030,363**	**21,618**	**3,882,211**	**566,430**	**588,048**
Total investment securities	**$ 7,074,423**	**$ 48,895**	**$ 3,882,211**	**$ 566,430**	**$ 615,325**
December 31, 2010					
Available-for-sale:					
U.S. Government and federal agency securities	$	$	$	$	$
U.S. Government-sponsored enterprise securities	22,099,730	31			31
Agency residential mortgage-backed securities					
Obligations of states and political subdivisions	978,233	28,015	834,049	108,649	136,664
Corporate debt obligations	2,325,199	132,946	4,284,304	662,551	795,497
Total investment securities	$ 25,403,162	$ 160,992	$ 5,118,353	$ 771,200	$ 932,192

Management evaluates investment securities for other-than-temporary impairment on a quarterly basis, and more frequently when conditions warrant. This analysis requires management to consider various factors, including the duration and magnitude of the decline in value; the financial condition of the issuer or issuers; structure of the security; and, notwithstanding classification of the portfolio as available-for-sale, the Company s intent to sell the security or whether it s more likely than not that the Company would be required to sell the security before the anticipated recovery in market value. As of September 30, 2011, the Company concluded that there was no other-than-temporary impairment in its investment securities.

The Bank is a member of the Federal Home Loan Bank of Atlanta (the FHLB), and ownership of FHLB stock is a membership requirement. This restricted equity investment amounted to $1,019,600 and $1,173,700 at September 30, 2011 and December 31, 2010, respectively. The Company carries the stock, which is included in other assets on its balance sheet, at cost and regularly evaluates it for other-than-temporary impairment. As of September 30, 2011, the Company concluded that there was no impairment in its holdings in FHLB stock.

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Southeastern Banking Corporation

Notes to Consolidated Financial Statements

(Unaudited)

4. LOANS AND ALLOWANCE FOR LOAN LOSSES

The composition of the Company s loan portfolio at September 30, 2011 and December 31, 2010 is shown below:

	September 30, 2011		December 31, 2010	
	Balance	**Percent of Total**	Balance	Percent of Total
Commercial real estate:				
Construction and development	**$ 64,994,478**	**30.2%**	$ 86,972,052	35.4%
Owner-occupied	**37,533,867**	**17.5**	35,300,711	14.4
Non owner-occupied	**27,905,306**	**13.0**	29,523,640	12.0
Residential real estate - mortgage	**45,997,850**	**21.4**	48,686,595	19.8
Other commercial, financial, and agricultural	**28,644,127**	**13.3**	33,504,726	13.6
Consumer, including credit cards	**9,814,222**	**4.6**	11,700,831	4.8
Loans, gross	**214,889,850**	**100.0%**	245,688,555	100.0%
Unearned income	**(49,205)**		(65,007)	
Allowance for loan losses	**(8,563,900)**		(9,915,559)	
Net loans	**$ 206,276,745**		$ 235,707,989	

In accordance with U.S. GAAP, the loan portfolio was disaggregated into four segments and further disaggregated into classes for certain disclosures. A portfolio segment is defined as the level in which an entity develops and documents a systematic method for determining its allowance for loan losses. The segments used in the portfolio include commercial real estate; residential real estate mortgage; other commercial, financial, agricultural; and consumer. Commercial real estate has been divided into three classes, including construction and development, owner-occupied, and non owner-occupied credits. All land and lot development loans have been included in the construction and development class, regardless of whether the underlying real estate is zoned commercial or residential. This classification of construction and development loans corresponds with definitions used by banking regulators for examination and other purposes.

Aging of past due loans is presented by segment in the following table. Balances presented are based on book balance, or recorded investment.

	Current	**Accruing 30 89 Days Past Due**	**Accruing 90+ Days Past Due**	**Total Accruing Past Due**	**Nonaccrual**	**Total**
September 30, 2011						
Commercial real estate:						
Construction and development	**$ 41,605,657**	**$ 638,251**	**$ 16,092**	**$ 654,343**	**$ 22,734,478**	**$ 64,994,478**
Owner-occupied	**36,908,555**	**206,972**		**206,972**	**418,340**	**37,533,867**
Non owner-occupied	**27,787,446**	**37,902**		**37,902**	**79,958**	**27,905,306**
Residential real estate - mortgage	**39,868,074**	**1,513,644**	**58,740**	**1,572,384**	**4,557,392**	**45,997,850**
Other commercial, financial, and agricultural	**27,915,600**	**466,140**		**466,140**	**262,387**	**28,644,127**

Consumer, including credit cards	**9,119,958**	**434,882**		**434,882**	**259,382**	**9,814,222**
Loans, gross	**$ 183,205,290**	**$ 3,297,791**	**$ 74,832**	**$ 3,372,623**	**$ 28,311,937**	**$ 214,889,850**
December 31, 2010						
Commercial real estate:						
Construction and development	$ 64,560,275	$ 553,271	$ 18,555	$ 571,826	$ 21,839,951	$ 86,972,052
Owner-occupied	33,422,584	1,197,251		1,197,251	680,876	35,300,711
Non owner-occupied	28,745,303	81,151		81,151	697,186	29,523,640
Residential real estate - mortgage	43,425,467	678,612	75,848	754,460	4,506,668	48,686,595
Other commercial, financial, and agricultural	32,925,618	155,384		155,384	423,724	33,504,726
Consumer, including credit cards	10,890,188	410,570	26,536	437,106	373,537	11,700,831
Loans, gross	$ 213,969,435	$ 3,076,239	$ 120,939	$ 3,197,178	$ 28,521,942	$ 245,688,555

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In accordance with bank regulatory guidance, a loan is placed on nonaccrual status if:

- it is maintained on a cash basis because of deterioration in the financial condition of the borrower,
- payment in full of principal or interest is not expected, or
- principal or interest has been in default for a period of 90 days or more unless the loan is both well secured and in the process of collection.

Internal risk-ratings, or grades, are assigned to each loan based on an analysis of the financial strength, collateral, and other credit attributes underlying each loan. Management analyzes the resulting ratings, as well as other external statistics and factors such as delinquency, to track the migration performance of the portfolio balances. The rating methodology complies with the asset classification system promulgated by the federal banking agencies. Loan grades range from one to eight, with one-graded loans having the least credit risk, as defined below:

Pass (Grades 1 -4) - Loans included in or migrating towards a pass grade of one to four carry the lowest risk of loss. Such loans are well-protected by the current net worth and paying capacity of the obligor (or guarantors, if any) or by the fair value, less selling costs, of underlying collateral.

Special Mention (Grade 5) Loans in this category have potential weaknesses requiring additional monitoring. These loans are not adversely classified and do not currently have sufficient risk to warrant adverse classification. Substantially all special mention loans are performing.

Substandard (Grade 6) These loans are inadequately supported by the current worth and paying capacity of the obligor or collateral pledged, if any. A distinct possibility of loss exists if the underlying deficiencies are not corrected. At September 30, 2011 and December 31, 2010, all nonaccrual loans were graded substandard.

Doubtful (Grade 7) These loans have all the weaknesses of a substandard loan with the added detriment that full collection or liquidation is highly questionable and improbable on the basis of currently known facts, conditions, and values.

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Loss (Grade 8) These loans are deemed uncollectible and have, at best, nominal value. Maintaining these loans on the books, without establishment of specific valuation allowances, is not warranted.

Loans considered doubtful or loss are normally charged-off upon such determination and hence, no balances apply to these categories. Risk ratings of the loan portfolio are shown in the next table.

	Pass (1 4)	**Special Mention (5)**	**Substandard (6)**	**Doubtful (7)**	**Loss (8)**	**Total**
September 30, 2011						
Commercial real estate:						
Construction and development	**$ 28,814,138**	**$ 8,457,943**	**$ 27,722,397**	**$**	**$**	**$ 64,994,478**
Owner-occupied	**33,341,014**	**3,016,914**	**1,175,939**			**37,533,867**
Non owner-occupied	**16,075,569**	**8,638,697**	**3,191,040**			**27,905,306**
Residential real estate - mortgage	**34,184,052**	**3,785,254**	**8,028,544**			**45,997,850**
Other commercial, financial, and agricultural	**25,183,210**	**2,932,373**	**528,544**			**28,644,127**
Consumer, including credit cards	**8,377,352**	**1,114,363**	**322,507**			**9,814,222**
Loans, gross	**$ 145,975,335**	**$ 27,945,544**	**$ 40,968,971**	**$**	**$**	**$ 214,889,850**

	Pass (1 4)	Special Mention (5)	Substandard (6)	Doubtful (7)	Loss (8)	Total
December 31, 2010						
Commercial real estate:						
Construction and development	$ 35,170,540	$ 21,525,120	$ 30,276,392	$	$	$ 86,972,052
Owner-occupied	31,702,978	2,649,760	947,973			35,300,711
Non owner-occupied	22,531,694	3,242,934	3,749,012			29,523,640
Residential real estate - mortgage	35,813,611	5,194,612	7,678,372			48,686,595
Other commercial, financial, and agricultural	30,000,682	610,926	2,893,118			33,504,726
Consumer, including credit cards	10,988,957	240,987	470,887			11,700,831
Loans, gross	$ 166,208,462	$ 33,464,339	$ 46,015,754	$	$	$ 245,688,555

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Activity in the allowance for loan losses is summarized by loan segment below:

As of and for the Nine Months Ended September 30, 2011	Commercial Real Estate	Residential Real Estate	Other Commercial, Financial, & Agricultural	Consumer	Unallocated	Total
Allowance for loan losses:						
Balance, beginning of year	$ 7,442,941	$ 1,747,843	$ 405,830	$ 262,223	$ 56,722	$ 9,915,559
Provision for loan losses	2,868,437	1,384,676	46,716	(52,220)	12,391	4,260,000
Charge-offs	(4,558,904)	(973,800)	(66,370)	(163,507)		(5,762,581)
Recoveries	18,417	35,363	16,948	80,194		150,922
Ending balance	$ 5,770,891	$ 2,194,082	$ 403,124	$ 126,690	$ 69,113	$ 8,563,900
Ending balance, individually evaluated for impairment	$ 2,736,204	$ 1,380,321	$ 26,866	$	n/a	$ 4,143,391
Ending balance, collectively evaluated for impairment	$ 3,034,687	$ 813,761	$ 376,258	$ 126,690	$ 69,113	$ 4,420,509
Loan, gross:						
Ending balance	$ 130,433,651	$ 45,997,850	$ 28,644,127	$ 9,814,222	n/a	$ 214,889,850
Ending balance, individually evaluated for impairment	$ 32,125,463	$ 7,119,412	$ 84,299	$	n/a	$ 39,329,174
Ending balance, collectively evaluated for impairment	$ 98,308,188	$ 38,878,438	$ 28,559,828	$ 9,814,222	n/a	$ 175,560,676

Within the commercial real estate segment, activity included:

As of & for the Nine Months Ended September 30, 2011	Construction & Development	Owner-Occupied	Non Owner-Occupied	Total Commercial Real Estate
Allowance for loan losses:				
Balance, beginning of year	$ 7,133,461	$ 124,729	$ 184,751	$ 7,442,941

Provision for loan losses	2,406,703	410,326	51,408	2,868,437
Charge-offs	(4,341,944)	(170,431)	(46,529)	(4,558,904)
Recoveries	18,417			18,417
Ending balance	$ 5,216,637	$ 364,624	$ 189,630	$ 5,770,891
Ending balance, individually evaluated for impairment	$ 2,366,445	$ 247,640	$ 122,119	$ 2,736,204
Ending balance, collectively evaluated for impairment	$ 2,850,192	$ 116,984	$ 67,511	$ 3,034,687
Loan, gross:				
Ending balance	$ 64,994,478	$ 37,533,867	$ 27,905,306	$ 130,433,651
Ending balance, individually evaluated for impairment	$ 27,155,677	$ 1,858,705	$ 3,111,081	$ 32,125,463
Ending balance, collectively evaluated for impairment	$ 37,838,801	$ 35,675,162	$ 24,794,225	$ 98,308,188

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A loan is considered impaired when it is probable, based on current information and events, the Company will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. Impaired loans include loans placed on nonaccrual status as well as TDRs, loans past due 90 days or more and still accruing, and other accruing loans individually evaluated for impairment. All of the Company s impaired loans have a valuation allowance. Impaired loans comprised the following at September 30, 2011 and December 31, 2010:

	September 30, 2011	December 31, 2010
Nonaccrual loans	**$ 28,311,937**	$ 28,521,942
Troubled debt restructurings not included above	**6,774,918**	12,669,230
Loans past due 90 days or more and still accruing	**74,832**	120,939
Other accruing loans individually evaluated for impairment	**6,946,021**	4,520,331
Total impaired loans	**$ 42,107,708**	$ 45,832,442
Valuation allowance related to total impaired loans	**$ 4,246,000**	$ 3,580,409

Total impaired loans are disaggregated by segment and class below:

As of and for the Nine Months Ended September 30, 2011	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**
Impaired loans with a valuation allowance:			
Commercial real estate:			
Construction and development	**$ 27,972,186**	**$ 38,463,450**	**$ 2,426,245**
Owner-occupied	**2,083,260**	**2,243,201**	**248,376**
Non owner-occupied	**3,191,039**	**3,191,040**	**122,337**
Residential real estate - mortgage	**8,262,426**	**9,647,226**	**1,403,856**
Other commercial, financial, and agricultural	**339,415**	**463,135**	**31,497**
Consumer, including credit cards	**259,382**	**388,863**	**13,689**
Total impaired loans	**$ 42,107,708**	**$ 54,396,915**	**$ 4,246,000**
Average investment in impaired loans	**$ 40,857,455**		

As of December 31, 2010	Recorded Investment	Unpaid Principal Balance	Related Allowance
Impaired loans with a valuation allowance:			
Commercial real estate:			

Construction and development	$ 30,017,176	$ 39,673,998	$ 2,459,478
Owner-occupied	1,337,701	1,483,080	35,631
Non owner-occupied	3,749,011	3,869,208	117,131
Residential real estate - mortgage	7,544,914	8,558,866	881,587
Other commercial, financial, and agricultural	2,751,545	2,882,978	80,651
Consumer, including credit cards	432,095	812,241	5,931
Total impaired loans	$ 45,832,442	$ 57,280,371	$ 3,580,409

Impaired loans with a valuation allowance include pools of impaired loans. At September 30, 2011, these pools had a recorded investment, or book balance, of $2,778,534, unpaid principal balance of $3,609,045, and related allowance of $102,609. The recorded investment, unpaid principal and related allowance in such pools totaled $3,135,061, $4,179,940, and $106,737, respectively, at December 31, 2010. Cash basis interest income actually recognized on nonaccrual loans during the nine months ended September 30, 2011 approximated $47,127. Nonaccrual loans included in impaired loans averaged approximately $28,697,644 in the first nine months of 2011.

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The following table summarizes the carrying balances of TDRs as of September 30, 2011 and December 31, 2010.

	September 30, 2011	December 31, 2010
Performing	**$ 6,771,953**	$ 12,669,230
Nonperforming	**7,893,947**	7,204,307
Total troubled debt restructurings	**$ 14,665,900**	$ 19,873,537
Unfunded commitments to borrowers whose loans were modified in troubled debt restructurings	**$**	$ 17,918

The following tables summarize loans that were modified and recognized as TDRs during the periods indicated.

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
For the Three Months Ended September 30, 2011:			
Commercial real estate:			
Construction and development	1	$ 271,935	$ 271,935
Owner-occupied			
Non owner-occupied			
Residential real estate - mortgage			
Other commercial, financial, and agricultural			
Consumer, including credit cards			
Total	1	$ 271,935	$ 271,935
For the Nine Months Ended September 30, 2011:			
Commercial real estate:			
Construction and development	2	$ 492,513	$ 492,513
Owner-occupied	2	1,253,349	1,253,349
Non owner-occupied			
Residential real estate - mortgage			
Other commercial, financial, and agricultural			
Consumer, including credit cards			
Total	4	$ 1,745,862	$ 1,745,862

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The following tables summarize how loans that were considered troubled debt restructurings were modified during the periods indicated.

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
For the Three Months Ended September 30, 2011:			
Rate concession		$	$
Term concession	1	271,935	271,935
Rate and term concessions			
Required principal paydowns concession			
Other			
Total	1	$ 271,935	$ 271,935
For the Nine Months Ended September 30, 2011:			
Rate concession		$	$
Term concession	4	1,745,862	1,745,862
Rate and term concessions			
Required principal paydowns concession			
Other			
Total	4	$ 1,745,862	$ 1,745,862

There was one loan in the amount of $271,935 modified as troubled debt restructurings within the previous 12-month period for which there was a payment default during the three months ended September 30, 2011. Other than that one loan, there were no loans modified as troubled debt restructurings within the previous 12-month period for which there was a payment default during the nine months ended September 30, 2011.

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5. FAIR VALUE

Determination of Fair Value

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and for disclosure purposes. Accounting guidance on fair value measurements and disclosures specifies that the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best defined using quoted market prices, but in many instances, quoted market prices for the Company s various financial instruments may not be available. Under these circumstances, fair values are estimated using present value or other variation techniques. Those techniques are significantly affected by the underlying assumptions, including the discount rate and estimates of future cash flows; accordingly, the resulting fair value estimate may not be realized in an immediate settlement of the instrument.

Recent fair value guidance clarifies that exit prices based on orderly transactions between market participants under current market conditions, not forced liquidations or distressed sales, should be the basis for determining fair value. If the volume and level of activity for the asset or liability has declined significantly, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In this instance, determining the price at which willing market participants would transact depends on the various facts and circumstances and requires significant judgment. The resulting fair value is a reasonable point within the determined range that best indicates fair value under current conditions.

Fair Value Hierarchy

In accordance with accounting guidance, the Company groups its financial assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities trade and the reliability of the assumptions used to determine fair value:

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

Level 2 Valuation is based on inputs other than level 1 prices that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability. Level 2 inputs may incorporate interest rates and yield curves that are observable at commonly quoted intervals, volatilities, prepayment speeds, credit risks, and default rates.

Level 3 Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments whose valuation requires significant management judgment or estimation. Level 3 valuation also includes observable inputs for single dealer nonbinding quotes not corroborated by observable market data.

A financial instrument s categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Risk premiums that a market participant would require must be considered.

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Assets and Liabilities Measured at Fair Value on a Recurring Basis

Fair value is the primary basis of accounting for investment securities available-for-sale. The Company does not currently measure any other assets or liabilities at fair value on a recurring basis. When quoted market prices for identical securities are available in an active market, these securities are classified within level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, such as U.S. Treasury notes, or exchange-traded equities. If quoted market prices for identical securities are not available, then fair values are estimated using matrix models, quoted prices of securities with similar characteristics, or discounted cash flows. Examples of such instruments, which would generally be classified within level 2, include U.S. Government-sponsored enterprise securities, agency mortgage-backed securities, obligations of states and political subdivisions, and certain corporate debt obligations. Due to limited activity and less transparency regarding input factors, one corporate debt obligation was classified in level 3 at September 30, 2011 and December 31, 2010.

Securities measured at fair value on a recurring basis are presented in the next table.

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Carrying Value
September 30, 2011				
Investment securities available-for-sale:				
Debt securities:				
U. S. Government and agency securities	$	$ 7,674,466	$	$ 7,674,466
U. S. Government-sponsored enterprise securities		3,910,514		3,910,514
Agency residential mortgage-backed securities		31,542,415		31,542,415
Obligations of states and political subdivisions		13,903,798		13,903,798
Corporate debt obligations		8,427,387	500,000	8,927,387
Total investment securities	$	$ 65,458,580	$ 500,000	$ 65,958,580
December 31, 2010				
Investment securities available-for-sale:				
Debt securities:				
U. S. Government and agency securities	$	$ 4,738,534	$	$ 4,738,534
U. S. Government-sponsored enterprise securities		33,668,037		33,668,037
Agency residential mortgage-backed securities		10,965,621		10,965,621
Obligations of states and political subdivisions		16,821,004		16,821,004
Corporate debt obligations		7,606,707	500,000	8,106,707
Total investment securities	$	$ 73,799,903	$ 500,000	$ 74,299,903

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The corporate debt obligation measured at fair value using level 3 inputs at September 30, 2011 and December 31, 2010 comprised one trust preferred security with a cost basis of $500,000, for which there is currently no active market. Like the Company s other corporate debt holdings, this security is also an issue of a bank/bank holding company domiciled in the southeastern United States. No transfers or activity involving other securities occurred within the level 3 category during the first nine months of 2011. Should transparency in input factors diminish, additional obligations could be classified as level 3 assets in the future. No transfers were made between level 1 or 2 assets measured at fair value on a recurring basis during the first nine months of 2011.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Certain instruments are measured at fair value on a nonrecurring basis; in other words, these instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances for example, when evidence of impairment exists. Such instruments include impaired loans and other real estate. Loan impairment is reported when full payment under the original loan terms is not expected. Impaired loans are carried at the present value of estimated future cash flows using the loan s existing rate or the fair value of collateral if the loan is collateral-dependent. When management believes the uncollectibility of all or any portion of a loan is confirmed, a loss is charged against the allowance. Any necessary increase to the allowance resulting from impaired loans is recorded as a component of the provision for loan losses. During the first nine months of 2011, the Company recognized losses of $5,315,588 on impaired loans outstanding through the allowance for loan losses. At September 30, 2011, impaired loans with an aggregate outstanding book balance of $42,107,708 were measured and reported net of specific allowances at a fair value of $37,861,708. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the loan impairment as a level 2 instrument. When an appraised value is not available or management determines the fair value of the collateral is impaired beyond appraised value and no observable market price exists, the Company records the loan impairment in level 3. Given the current difficulties in obtaining comparable sales and other observable inputs due to high inventories and distressed sales prevalent in the market, particularly for certain real estate collateral, the Company classified all impaired loans in level 3 at September 30, 2011.

Other real estate is recorded at fair value upon transfer of the underlying loan to foreclosed balances. Fair value is based upon independent market prices, appraised values, or management s estimate of collateral value. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company classifies other real estate as level 2; otherwise, other real estate is classified as level 3. Any write-down to fair value at foreclosure is charged to the allowance for loan losses while subsequent devaluations resulting primarily from updated appraisals or observations of comparable sales prices are included in noninterest expense. During the nine months ended September 30, 2011, devaluations (or write-downs) of other real estate totaled $500,216. Given the current difficulties in obtaining comparable sales and other observable inputs due to high inventories and distressed sales prevalent in the market, particularly for certain real estate types, the Company classified all foreclosed real estate in level 3 at September 30, 2011.

Level 3 assets also include FHLB stock, which is only redeemable with the issuer at par and cannot be traded in the market; as such, no observable market data for this holding is available. The Company evaluated its holding in FHLB stock at September 30, 2011 and determined no impairment charge was necessary. Other assets are similarly evaluated under fair value accounting on a nonrecurring basis.

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The table below presents the Company s outstanding assets for which a nonrecurring change in fair value was recorded during the nine months ended September 30, 2011 and 2010, aggregated by the level in the fair value hierarchy within which those measurements fall. Assets reviewed for impairment such as level 3 FHLB stock, but for which no corresponding impairment charge was recorded, are not included in these totals.

	Fair Value Measurements Using				
September 30, 2011	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Net Carrying Value**	**Total Gains (Losses) for the Nine Months**
Assets:					
Impaired loans	$	$	**$ 37,861,708**	**$ 37,861,708**	**$ (5,315,588)**
Other real estate			**2,448,225**	**2,448,225**	**(500,216)**
Total fair value of assets on a nonrecurring basis	$	$	**$ 40,309,933**	**$ 40,309,933**	**$ (5,815,804)**
September 30, 2010					
Assets:					
Impaired loans	$	$	$ 46,559,479	$ 46,559,479	$ (9,654,999)
Other real estate			6,564,618	6,564,618	(1,702,598)
Total fair value of assets on a nonrecurring basis	$	$	$ 53,124,097	$ 53,124,097	$ 11,357,597

As disclosed on the prior page, the loss amount shown for impaired loans include charge-offs as well as the provision allocated for these loans for the first nine months of 2011. The loss amount for other real estate does not include charge-offs recognized on these credits prior to foreclosure of the underlying collateral. No transfers were made between level 1, 2, and 3 assets evaluated under fair value accounting on a nonrecurring basis. Additionally, no nonrecurring change in fair value was recognized on any liabilities during the first nine months of 2011.

Fair Value of Financial Instruments

Methodologies for estimating the fair value of financial assets and liabilities that are measured at fair value on a recurring or nonrecurring basis are discussed above. For certain other financial assets and liabilities, fair value approximates carrying value due to the nature of the financial instrument. These instruments include cash and cash equivalents, demand and other non-maturity deposits, and overnight borrowings. The following methods and assumptions were used in estimating the fair value of other financial instruments:

Variable rate loans that reprice frequently and have no significant change in credit risk are fairly valued at their carrying amounts. For fixed rate loans, fair values are estimated based on discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The Company did not use an incremental market risk and liquidity discount in deriving loan fair values as management has no present intention to sell any portion of the loan portfolio. Impaired loans are valued using discounted cash flow analyses or underlying collateral values, as discussed.

Fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies current interest rates to a schedule of aggregated expected maturities. The intangible value of long-term relationships with depositors is not considered in estimating fair values.

The U. S. Treasury demand note and other variable rate borrowings are fairly valued at their carrying amounts. Fair values for other borrowings, including FHLB advances with fixed rates, are based on quoted market prices for similar instruments or estimated using discounted cash flow analysis and the Company s current incremental borrowing rate for similar instruments.

The carrying amount of accrued interest and other financial assets approximates their fair values.

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The table below presents the fair value of financial assets and liabilities carried on the Company s consolidated balance sheet, including those financial assets and liabilities that are not measured and reported at fair value on a recurring or nonrecurring basis:

	September 30, 2011		December 31, 2010	
	Carrying Amount	**Fair Value**	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	**$ 98,205,181**	**$ 98,205,181**	$ 80,868,505	$ 80,868,505
Investment securities available-for-sale	**65,958,580**	**65,958,580**	74,299,903	74,299,903
Net loans	**206,276,745**	**206,034,344**	235,707,989	237,411,612
Accrued interest receivable	**1,352,621**	**1,352,621**	1,487,126	1,487,126
Other financial assets	**1,019,600**	**1,019,600**	1,173,700	1,173,700
Financial liabilities:				
Deposits	**$ 357,613,610**	**$ 358,280,111**	$ 375,195,119	$ 376,619,703
U.S. Treasury demand note	**1,048,743**	**1,048,743**	762,782	762,782
FHLB advances	**5,000,000**	**5,128,190**	5,000,000	5,191,353
Accrued interest payable	**1,083,652**	**1,083,652**	1,287,916	1,287,916

Bank premises and equipment, customer relationships, deposit base, and other information needed to compute the Company s aggregate fair value are not included in the table above. Accordingly, the fair values above are not intended to represent the underlying market value of the Company.

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CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements set forth in this Quarterly Report on Form 10-Q (this Report) or incorporated herein by reference, including matters discussed in Item 2 under the caption Management s Discussion and Analysis of Financial Condition and Results of Operations, are forward-looking statements within the meaning of federal securities laws, including, without limitation, statements regarding the Company s outlook on earnings, stock performance, asset quality, capital position, plans regarding nonperforming assets, economic conditions, real estate markets, and projected growth, and are based upon management s beliefs as well as assumptions based on data currently available to management. When words like anticipate , believe , intend , plan , may , continue , project , would , expect , estimate , could , should , will , and similar exp should be considered forward-looking statements. These forward-looking statements are subject to significant risks and uncertainties. Investors are cautioned against placing undue reliance on such statements. Actual results may differ materially from those set forth in forward-looking statements. Factors that could cause actual results to differ materially from those described in the forward-looking statements include: (1) difficult economic conditions, both generally and in local markets, may persist, resulting in, among other things, further deterioration in credit quality, a reduction in demand for credit, or additional declines in real estate values; (2) the severe decline in the real estate and lending market, particularly in the Company s coastal markets and primarily comprising acquisition and development loans, may continue to negatively affect financial results; (3) the allowance for loan losses may not be adequate to cover eventual loss; (4) future losses will be realized if proceeds received upon liquidation of nonperforming assets are less than carrying values of such assets; (5) restrictions or conditions imposed by regulators on the Company s operations may make it more difficult for the Company to achieve its goals; (6) the Company s recovery of its deferred tax asset could be delayed for an extended period; (7) the Company s ability to raise any needed capital in a prolonged economic downturn may be impaired if market disruption and volatility continue or worsen; (8) legislative or regulatory changes, including changes in accounting standards and compliance requirements, may adversely affect the Company s business, revenue, and profit margins; (9) poor financial results may negatively affect liquidity, including liquidity from core deposits; (10) competitive pressures among depository and other financial institutions may increase significantly, resulting in lost business relationships or reduced margins; (11) changes in the interest rate environment may reduce margins or the volumes or values of loans made; (12) competitors may have greater financial resources and develop products that enable them to compete more successfully; (13) the Company s ability to attract and retain key personnel can be affected by increased competition for experienced employees in the banking industry; (14) adverse changes may occur in the bond markets, affecting portfolio valuation and causing impairment; (15) war or terrorist activities may cause further deterioration in the economy or cause instability in credit markets; (16) economic, governmental, or other factors may prevent growth in the Company s markets; (17) changes in consumer spending and savings habits could impede the Company s ability to grow its loan and deposit portfolios; (18) the Company may be unfavorably impacted by litigation, which depends on judicial interpretations of law and findings of juries; (19) the dividend suspension may adversely affect the market price of the Company s stock; (20) third party vendors who provide key components of the Company s business infrastructure may have system failures or other difficulties which could materially affect operations; and (21) the risk factors discussed from time to time in the Company s periodic reports filed with the SEC, including but not limited to, this Report. The Company undertakes no obligation to, and does not intend to, update or revise these statements following the date of this filing, whether as a result of new information, future events or otherwise, except as may be required by law.

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

This Analysis should be read in conjunction with the 2010 Annual Report on Form 10-K and the Consolidated Financial Statements & related Notes included in this Report. The Company s accounting policies, which are described in detail in Form 10-K, are integral to understanding the results reported. The Company s accounting policies require management s judgment in valuing assets, liabilities, commitments and contingencies. A variety of factors could affect the ultimate value that is obtained when earning income, recognizing an expense, recovering an asset or relieving a liability. This Analysis contains forward-looking statements with respect to business and financial matters. Actual results may vary significantly from those contained in these forward-looking statements. See the sections entitled Critical Accounting Estimates and Cautionary Notice Regarding Forward-Looking Statements within this Report.

Description of Business

Southeastern Banking Corporation, with assets exceeding $409 million, is a financial services company with operations in southeast Georgia and northeast Florida. Southeastern Bank (the Bank), the Company s wholly-owned commercial bank subsidiary chartered in 1888, offers a full line of commercial and retail services to meet the financial needs of its customer base through its 16 branch locations and ATM network. Services offered include traditional deposit and credit services, long-term mortgage originations, and credit cards. The Bank also offers 24-hour delivery channels, including internet and telephone banking and through an affiliation with a third party broker-dealer, provides insurance and investment brokerage services.

The table below provides a summary of the Bank s markets as of September 30, 2011.

Market/ County	*Number of Offices*	*Total Loans[1]*	*Total Deposits[1]*	*Market Share (%)[2]*	*Market Share Rank[2]*
Georgia					
McIntosh	2	$ 74,445	$ 64,144	72.0	1
Brantley	2	17,193	55,155	70.8	1
Bryan	1	16,244	7,370	1.8	5
Camden	3	29,217	47,881	19.7	2
Charlton	1	2,852	53,380	55.3	1
Coffee	2	9,308	21,202	3.2	9
Glynn	1	41,937	18,304	1.2	15
Jeff Davis	1	2,584	22,187	17.0	3
	13	$ 193,780	$ 289,623	8.7	3
Florida					
Nassau	3	$ 21,110	$ 67,991	7.6	5
Totals	16	$ 214,890	$ 357,614	8.5	3

[1] Dollar amounts are presented in thousands as of September 30, 2011.

[2] Based on the FDIC Summary of Deposits report as of June 30, 2011.

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FINANCIAL CONDITION

Overview

Consolidated assets totaled $409.1 million at September 30, 2011, a decrease of $18.5 million (or 4.3%) since December 31, 2010. The decline in total assets was driven largely by a $23.2 million (or 33.5%) decrease in public funds on deposit at the Bank. In addition to the decline in total assets, the Company realized a significant shift in its asset mix since the end of 2010. Net loans decreased $29.4 million (or 12.5%) and cash and cash equivalents increased $17.3 million (or 21.4%) since December 31, 2010. The Company elected to retain liquidity rather than reinvest its funds in riskier financial assets during this weakened economic environment. This shift from higher-yielding loans to lower-yielding earning assets had a detrimental impact on the Company s net interest margin and earnings. The elevated level of nonperforming assets further hampered the Company s profitability in the first nine months of 2011, and this factor is expected to continue to create a drag on earnings through the remainder of 2011 and into the first half of 2012.

Total deposits decreased by $17.6 million (or 4.7%) since year end to $357.6 million at September 30, 2011. Noninterest-bearing demand deposits increased $8.7 million (or 15.7%) while interest-bearing demand, savings and time deposits decreased $26.3 million (8.2%) during the first nine months of 2011. As noted above, the decline in total deposits is due primarily to a $23.2 million (or 33.5%) decrease in public funds on deposit at the Bank. At September 30, 2011, public funds deposits represented approximately 12.9% of total deposits compared to 18.4% of total deposits at December 31, 2010. Although the Bank made progress in reducing its funding concentration with large public fund accounts, management expects public funds to increase slightly during the fourth quarter of 2011 as local municipalities collect annual property tax assessments. At September 30, 2011, noninterest-bearing demand deposits represented 17.9% of total deposits compared to 14.8% at December 31, 2010. Shareholders equity decreased $1.7 million (or 3.7%) during the first nine months of 2011. At September 30, 2011, shareholders equity represented 10.5% of total assets which, with the decline in total assets, remained consistent with the Company s capital-to-asset ratio at the end of 2010. Refer to the Liquidity and Capital Resources section of this Analysis for details on deposits and other funding sources as well as the higher cash balances being maintained currently.

Investment Securities

The amortized cost and estimated fair value of investment securities, all available-for-sale, are summarized in the following table.

Investment Securities by Category

September 30, 2011 *(Dollars in thousands)*	***Amortized Cost***	***Unrealized Gains***	***Unrealized Losses***	***Fair Value***
U. S. Government and agency securities	**$ 7,466**	**$ 212**	**$ 3**	**$ 7,675**
U. S. Government-sponsored enterprise securities	**3,792**	**118**		**3,910**
Agency residential mortgage-backed securities	**30,739**	**828**	**24**	**31,543**
Obligations of states and political subdivisions	**13,377**	**527**		**13,904**
Corporate debt obligations	**9,429**	**86**	**588**	**8,927**
Total investment securities	**$ 64,803**	**$ 1,771**	**$ 615**	**$ 65,959**

The amortized cost of investment securities decreased $9.1 million (or 12.3%) since December 31, 2010 primarily due to a decrease in the need for securities to pledge as collateral on public deposits. While there was a decrease in the amount of funds invested in securities during the first nine months of 2011, there was significant volume in trading activity within the portfolio during the period in short-term (one-to-three months) Agency discount notes and U.S. Treasury Bills acquired to collateralize public funds. Purchases of securities in the first nine months of 2011 totaled $296.7 million and redemptions totaled $305.2 million. With the relief from pledging requirements abated, the Company began investing funds in the two-to-five year time horizon to improve its yield on earning assets in the third quarter of 2011.

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Approximately 65% of the carrying value of the Company s securities portfolio, including mortgage-backed securities, is supported by the U.S. Government, a U.S. Government agency or a U.S. Government-sponsored enterprise (GSE) at September 30, 2011. On August 5, 2011, Standard & Poor s rating agency lowered the long-term rating of the U.S. Government, its federal agencies and GSEs from AAA to AA+ . The rating agency maintained the AAA rating for short-term (one year or less) obligations of the U.S. Government, its federal agencies and GSEs. Despite this downgrade, management believes the credit quality of the investment portfolio remains fundamentally sound. The Company does not own any collateralized debt obligations, widely known as CDOs, secured by subprime residential mortgage-backed securities. Additionally, the Company does not own any private label mortgage-backed securities. The Company held $31.4 million in residential mortgage-backed securities and collateralized mortgage obligations issued by Fannie Mae (FNMA) and Freddie Mac (FHLMC), both a GSE, at September 30, 2011. Residential mortgage-backed securities issued by FNMA and FHLMC are collateralized foremost by the underlying mortgages and secondly, by FNMA and FHLMC themselves. Management continues to monitor the viability of both FNMA and FHLMC as going concerns: In early 2011, the U.S. Treasury again reiterated its support for FNMA and FHLMC although changes are expected in the business model going forward.

At September 30, 2011, the corporate bond portfolio included debt issuances of banks and bank holding companies domiciled in the southeastern United States. The $502 thousand net unrealized loss on the corporate portfolio is largely reflective of the illiquidity and risk premiums reflected in the market for bank-issued securities due to pervasive capital, asset quality, and other issues which have continued to afflict the banking industry. Although a) major rating agencies have downgraded certain of these securities since our acquisition and b) recent profitability and near-term profit forecasts by industry analysts reflect continuing pressure due to loan losses and other issues, the Company currently expects the issuers of these bonds to settle the securities at par. Since year end, the net unrealized loss position in the portfolio improved $272 thousand (or 35.2%). During 2011, the Company sold one B+ rated corporate debt obligation for $474 thousand and recorded an $18 thousand loss on the sale. In 2010, the Company sold four B+ holdings of this same issuer and recorded a $141 thousand loss on the sales. Also, in 2010, the Company recorded a $45 thousand other-than-temporary impairment charge in its holdings to this same issuer, which is further discussed in the Company s 2010 Form 10-K. The Company held no residual investments in obligations of this issuer at September 30, 2011.

At September 30, 2011, all holdings in the municipal bond portfolio were rated investment grade securities except for twelve non-rated issues with fair values aggregating $3.2 million. The majority, or 84%, of the non-rated issues were based in Georgia. In analyzing non-rated municipals, management considers debt service coverage and whether the bonds support essential services such as water/sewer systems and education.

Management evaluates investment securities for other-than-temporary impairment on a quarterly basis, and more frequently when conditions warrant. This analysis requires management to consider various factors, including the duration and magnitude of the decline in value; the financial condition of the issuer or issuers; structure of the security; and, notwithstanding classification of the portfolio as available-for-sale, the Company s intent to sell the security or whether it s more likely than not that the Company would be required to sell the security before the anticipated recovery in market value. At September 30, 2011, management reviewed securities with an unrealized loss and concluded that no material individual securities were other-than-temporarily impaired. Impairment charges could become necessary in the future if the economic crisis facing the banking industry does not fully abate and various issuers financial condition weakens.

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Loans

Loans, net of unearned income, decreased $30.8 million (or 12.5%) since the end of 2010 to $214.8 million at September 30, 2011. The net loans-to-deposits ratio aggregated 60.1% at September 30, 2011 versus 65.5% at December 31, 2010 and 68.8% a year ago. Due to economic uncertainties within the Company s markets, particularly in the real estate sector, and resultant concerns regarding credit opportunities, management expects loan volumes to flatten or decline further for the remainder of 2011. The table below summarizes the categorical changes within the loan portfolio since the end of 2010.

Loans by Category *(Dollars in thousands)*	***September 30, 2011***	*December 31, 2010*	*September 30, 2010*
Commercial, financial, and agricultural[1]	**$ 28,644**	$ 33,505	$ 31,814
Real estate construction[3]	**64,995**	86,972	91,691
Real estate commercial mortgage	**65,439**	64,824	65,291
Real estate residential mortgage[2,3]	**45,998**	48,687	49,404
Consumer, including credit cards	**9,814**	11,701	12,007
Loans, gross	**214,890**	245,689	250,207
Unearned income	**(49)**	(65)	(78)
Net loans	**$ 214,841**	$ 245,624	$ 250,129

1 Includes obligations of states and political subdivisions.
2 Typically have final maturities of 15 years or less.
3 To comply with recent regulatory guidelines, certain loans that formerly would have been classified as real estate mortgage, are now being coded as real estate - construction. Comparable loans from prior periods have not been reclassified to reflect this change. The majority of real estate construction loans are residential in nature.

Commercial real estate loans, which included construction and development loans, represented approximately 60.7% and 61.8% of the total loan portfolio at September 30, 2011 and December 31, 2010, respectively. Due to continued instability of real estate values, loans in the commercial real estate portfolio may have a greater risk of uncollectibility than other loans. Additionally, because a substantial portion of the loan portfolio is secured by real estate in southeast Georgia and northeast Florida, the loan portfolio is particularly susceptible to changes in market conditions in those areas.

The largest change within the portfolio since the end of 2010 was in construction and development loans, which declined $22.0 million (or 25.3%) due primarily to collections, foreclosures and charge-offs of delinquent loans during the first nine months of 2011. These loans, which are primarily loans for the acquisition and development of residential properties, are concentrated in the Company s coastal markets. With the exception of existing commitments, the Company is only originating new construction and development loans to customers with extraordinary equity injections, outside financial strength, or other performance metrics with low dependence on the underlying collateral.

Many commercial and commercial real estate loans with floating rates have reached their contractual floors. Additionally, many recent originations and renewals have been priced at fixed rather than adjustable rates, unless floors applied. Loans with floating rates that had reached a contractual floor approximated $91.2 million at September 30, 2011 compared to $105.8 million at December 31, 2010 and $104.0 million at September 30, 2010. The average yield on these particular outstanding loans, which included all loan types, was 5.75% or 250 basis points above the Company s prime rate of interest (3.25%), at September 30, 2011. Management continues to shorten maturity options on commercial credits as feasible, a move that should mitigate the Company s interest sensitivity position when the prime rate adjusts upward.

Although the Company s loan portfolio is diversified, significant portions of its loans are collateralized by real estate. At September 30, 2011, loans with real estate as the primary collateral comprised approximately 83.4% of the loan portfolio. As required by policy, real estate loans are collateralized

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based on certain loan-to-appraised value ratios at origination. A geographic concentration in loans exists given the Company s operations within a regional area of southeast Georgia and northeast Florida. The Company continues to closely monitor real estate valuations in its markets and consider any implications on the allowance for loan losses and the related provision.

On an aggregate basis, commitments to extend credit and standby letters of credit approximated $28.8 million at September 30, 2011, compared to $31.7 million at year-end 2010 and $36.3 million at September 30, 2010. The decline in overall commitments results from the Company s decision to reduce its exposure to higher risk areas, including acquisition and development lending, as well as customer decisions not to renew their lines. Because a substantial amount of these contracts expire without being drawn upon, total contractual amounts do not necessarily represent future credit exposure or liquidity requirements.

Nonperforming Assets

Nonperforming assets, which consist of nonaccrual loans, restructured loans, foreclosed real estate, and other repossessions, totaled $49.3 million at September 30, 2011. The aggregate balance of nonperforming assets declined 5.6% since December 31, 2010 and 8.0% since September 30, 2010. As a percent of total assets, nonperforming assets totaled 12.1% at September 30, 2011 versus 12.2% at December 31, 2010 and 12.7% at September 30, 2010. Nonperforming assets materially and adversely affected the Company s business, resources, and operating results during the first nine months of 2011, and management expects continuing adverse effects until real estate markets, particularly coastal markets, improve. Construction and development loans secured by land tracts and lots remained the primary factor in the nonperforming trends. Summary information about nonperforming assets and accruing loans past due 90 days or more is provided in the following table.

Nonperforming Assets[1] *(Dollars in thousands)*	***September 30, 2011***	*December 31, 2010*	*September 30, 2010*
Nonaccrual loans:			
Commercial, financial, and agricultural	**$ 262**	$ 424	$ 306
Real estate construction	**22,735**	21,840	24,843
Real estate commercial mortgage	**498**	1,378	1,567
Real estate residential mortgage	**4,558**	4,507	3,726
Consumer, including credit cards	**259**	373	295
Total nonaccrual loans	**28,312**	$ 28,522	30,737
Troubled debt restructured loans[2]	**6,772**	12,669	13,271
Total nonperforming loans	**35,084**	$ 41,191	44,008
Foreclosed real estate[3]	**14,232**	11,034	9,565
Other repossessed assets	**15**	15	35
Total nonperforming assets	**$ 49,331**	$ 52,240	$ 53,608
Accruing loans past due 90 days or more	**$ 75**	$ 121	$ 106
Ratios:			
Nonperforming loans to net loans[4]	**16.3%**	16.8%	17.6%
Nonperforming assets to net loans[4] plus foreclosed/repossessed assets	**21.5%**	20.4%	20.6%

1 See Note 4 to the consolidated financial statements for definitional variance between impaired and nonperforming loans and also, categorization differences resulting from disaggregation of loan portfolio required in footnote disclosure.

2 Does not include restructured loans reported as nonaccrual.

[3] Includes only other real estate acquired through foreclosure or in settlement of debts previously contracted.
[4] Net of unearned income.

Nonaccrual Loans

Nonaccrual loans decreased $210 thousand (or 0.7%) in the first nine months of 2011. Since the end of 2010, approximately $13.3 million of loans were placed on nonaccrual status, $5.6 million charged-off, 5.4 million transferred out by foreclosure or repossession, and $2.5 million reduced by payments or other activity.

Loans restructured in troubled debt restructurings that are on nonaccrual status at September 30, 2011 totaled $7.9 million, a 9.6% increase compared to $7.2 million at December 31, 2010.

At September 30, 2011, real estate-secured loans comprised 98.7% of total nonaccrual balances. The collateral underlying nonaccrual balances is presented in the following table.

Nonaccrual Loans by Collateral Type *(Dollars in thousands)*	***September 30, 2011***	*December 31, 2010*
Collateral type:		
Real estate:		
Land tracts	**$ 6,555**	$ 6,027
Lots within developments	**11,841**	11,682
Residential dwellings	**9,029**	8,828
Commercial buildings	**510**	1,385
Total real estate	**$ 27,935**	27,922
Equipment	**249**	442
Other	**128**	158
Total nonaccrual loans	**$ 28,312**	$ 28,522

Relationships above $250,000 comprised 85.7% or $24.3 million of nonaccrual balances at September 30, 2011. The table below presents nonaccrual loans by relationship tiers.

Nonaccrual Loans by Relationship Tiers *(Dollars in thousands)*	***Number of Relationships***	***Balances***	***Percent of Total Balance***	***Average Balance within Tier***
September 30, 2011				
Relationship tier:				
£ $250,000	**145**	**$ 4,032**	**14.3%**	**$ 28**
> $250,000 - £ $750,000	**4**	**1,363**	**4.8%**	**341**
> $750,000	**9**	**22,917**	**80.9%**	**2,546**
Total	**158**	**$ 28,312**	**100.0%**	**179**
December 31, 2010				
Relationship tier:				
£ $250,000	145	$ 4,244	14.88%	$ 29
> $250,000 - £ $750,000	5	2,223	7.79%	445
> $750,000	9	22,055	77.33%	2,451

Total	159	$ 28,522	100.00%	179

At September 30, 2011, the largest relationship within this group had a $4.37 million book balance. Unless pricing and demand in the real estate markets improve, management expects other borrowers, including other borrowers with collateral-dependent loan balances above $250,000, may also stop servicing their loans.

Management continues to evaluate collateral underlying nonaccrual loans and adjusts valuations based on appraisal and similar information available. Unfortunately, valuation estimates can change, resulting in additional charge-offs and provisioning for loan losses. The Company has adopted the following policy for obtaining updated appraisals for impaired loans, which is differentiated based on terms, loan balance and status of the loan.

Impaired loans with interest-only payment terms or on nonaccrual status with:

Balances greater than or equal to $250,000 Updated external appraisals are obtained at least every two years. For such loans, internal evaluations are required for each year in which an external appraisal is not obtained.

Balances less than $250,000 Updated external appraisals are obtained at least every two years on more complex properties. For less complex properties, such as single-family residences, internal evaluations are permitted on an annual basis.

Impaired loans with amortizing principal and interest terms that are performing:

The underlying collateral on these loans are reevaluated each time the loan matures and is considered for renewal, or when the terms of the loan are materially modified. The decision of whether to order an external appraisal or perform an internal evaluation varies based on the age of original appraisal, the complexity of property, and the credit risk characteristics of the loan relationship.

Troubled Debt Restructurings

Troubled debt restructurings (TDRs) are loans where concessions were granted by the Company to borrowers experiencing financial difficulties. At September 30, 2011, the Company had $14.7 million in TDRs. Based on performance in accordance with the restructured terms, the Company has elected to accrue interest on $6.8 million in TDRs outstanding at September 30, 2011. Certain TDRs are on nonaccrual status due to a lack of performance or management s concern regarding future repayment ability or performance. The TDRs that are on nonaccrual status at September 30, 2011 totaled $7.9 million. These TDRs are included in nonaccrual loans in this Report.

Since the end of 2010, the amount of accruing TDRs outstanding decreased $5.9 million (or 46.5%). The material changes in accruing TDRs during the first nine months of 2011 include: two loans totaling approximately $4.7 million were placed on nonaccrual status; one loan with a balance of $2.3 million was upgraded out of TDR status based on performance; and three loans totaling $1.5 million were added to the pool of TDRs. At September 30, 2011, the specific allowance allocated to the accruing TDR balance totaled $1.1 million.

Foreclosed Real Estate

During the first nine months of 2011, the balance of real estate acquired through foreclosure or in settlement of debts previously contracted increased $3.2 million (or 28.9%) to $14.2 million at September 30, 2011. Of the $14.8 million reported as other real estate owned on the Company s consolidated balance sheet at September 30, 2011, $594 thousand is not categorized as foreclosed real estate . This property is under a lease-purchase agreement with a local municipality. Foreclosures, sales, and subsequent devaluations within foreclosed real estate balances totaled $5.3 million, $1.6 million, and $500 thousand, respectively, during the first nine months of 2011.

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The following table summarizes the foreclosed real estate portfolio by real estate type.

Foreclosed Real Estate by Type *(Dollars in thousands)*	***September 30, 2011***	*December 31, 2010*
Real estate:		
Land tracts	**$ 8,326**	$ 5,584
Lots within developments	**2,637**	2,025
Residential dwellings	**2,414**	2,986
Commercial buildings	**855**	439
Total foreclosed real estate	**$ 14,232**	$ 11,034

Approximately 82.3% of these holdings were located in Georgia with the balance in Nassau County, Florida at September 30, 2011. At September 30, 2011, the Company owned eight properties valued in excess of $500,000 per property with an aggregate basis of $8.1 million, representing 57.1% of the total foreclosed real estate portfolio. The Company s foreclosed real estate holdings can be viewed via a link from its website at www.southeasternbank.com or directly at www.liveatthecoast.com.

Although foreclosed properties continue to be marketed aggressively, when estimating their carrying value, management expects to incur carrying costs for at least one year. Any additional devaluation subsequent to foreclosure will be charged to operations. Under state law, all foreclosed property is required to be appraised annually commencing within one year from acquisition by an independent appraiser knowledgeable in the fair market value of such assets, and if the book value of the property does not exceed two percent of the statutory capital base of the Bank (or $782 thousand at September 30, 2011), the appraisals may be made by a qualified officer of the Bank. The Company has adopted the following policy for obtaining subsequent reevaluations for foreclosed properties, which is differentiated primarily based on the carrying value of the property.

Balances less than $100,000 New internal evaluations or external appraisals will be obtained as needed by management in order to make informed decisions in a deteriorating market environment.

Balances greater than $100,000 but less than $250,000 New internal evaluations will be prepared on at least an annual basis. Management may elect to order an external appraisal in certain situations.

Balances of $250,000 and greater An updated external appraisal will be obtained on at least an annual basis. However, management made elect to utilize an internal evaluation in lieu of an external appraisal in the following situations:

If, based on the previous external appraisal, an understanding of the changes in market conditions since that appraisal, or recent sales or appraisals of similar properties in the same market, management determines that the carrying balance of the property is significantly below market value.

If recent sales of comparable properties in the same market are readily available, and management concludes the valuation assumptions can be supported by market data.

If the property is under an executed sales contract at the appraisal anniversary date. In this situation, the expected net proceeds from the sales contract will represent the market value of the property.

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Other Potential Problem Loans

Loans past due 90 days or more and still accruing interest totaled $75 thousand, or less than 1% of total loans, at September 30, 2011. Loans past due 30-89 days represented 1.53% of total loans at September 30, 2011, totaling $3.3 million. In aggregate, approximately 73.3% of these past due loans were secured by real estate.

Accruing loans classified as individually impaired under accounting guidance to creditors on impairment of loans totaled $6.9 million at September 30, 2011, up $2.4 million or 53.7% from the end of 2010. These loans are predominately to borrowers whose loan repayment was expected to come foremost from sales of underlying real estate collateral. Due to lagging sales and lingering distress in the real estate markets, payment of principal and interest on these loans has come from borrower reserves or other resources, constituting a change in the initial source of payment/terms of these loans. Although these loans continue to perform and management has no evidence to suggest that the borrowers might cease to perform in the future, their performance has been through other resources and the value of the underlying collateral has diminished. Management reviews all classified loans with total credit exposure of $250,000 or more on a monthly basis and evaluates underlying collateral, assuming salvage values and estimating any allowance necessary to cover projected losses at worse case scenario liquidation. After adjustments for collateral value shortfalls, the allowance for loan losses allocated to these classified credits totaled $1.5 million at September 30, 2011.

Allowance for Loan Losses

The Company continuously reviews its loan portfolio and maintains an allowance for loan losses available to absorb estimated losses inherent in the portfolio. Management prepares a comprehensive analysis of the allowance for loan losses on a monthly basis. This analysis is divided into two components: specific allowances for individual loans and general allowances for pools of loans based on similar risk characteristics such as loan type, credit risk grades and delinquency status. Such evaluation considers numerous factors, including, but not limited to, net charge-off trends, internal risk ratings, loss forecasts, collateral values, geographic location, delinquency rates, nonperforming loans, underwriting practices, industry conditions, and economic trends. The Bank s Board of Directors is responsible for affirming the allowance methodology and assessing the general and specific allowance factors in relation to estimated and actual net charge-off trends.

Specific Reserves

The first component of the allowance for loan loss methodology covers the measurement of specific allowances for individual impaired loans as required by FASB ASC 310-10-35, *Accounting by Creditors for Impairment of a Loan*. Specific allowances for loan losses are established for large impaired loans evaluated on an individual basis. The specific allowance established for these loans is based on a thorough analysis of the most probable source of repayment, including the present value of the loan s expected future cash flows, the loan s estimated market value, or the estimated fair value of the underlying collateral.

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The following table summarizes the impaired loans and the allowance for loan losses allocated to those loans by loan type as of September 30, 2011 and December 31, 2010.

(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
September 30, 2011			
Impaired loans with a valuation allowance:			
Commercial real estate:			
Construction and development	**$ 27,972**	**$ 38,464**	**$ 2,426**
Owner-occupied	**2,083**	**2,243**	**248**
Non owner-occupied	**3,191**	**3,191**	**122**
Residential real estate mortgage	**8,263**	**9,647**	**1,404**
Other commercial, financial, and agricultural	**340**	**463**	**32**
Consumer, including credit cards	**259**	**389**	**14**
Total impaired loans	**$ 42,108**	**$ 54,397**	**$ 4,246**
Related allowance as a % of impaired loans	**10.08%**		
Recorded investment of impaired loans as a % of unpaid principal balance of impaired loans	**77.4%**		
December 31, 2010			
Impaired loans with a valuation allowance:			
Commercial real estate:			
Construction and development	$ 30,017	$ 39,674	$ 2,459
Owner-occupied	1,338	1,483	36
Non owner-occupied	3,749	3,869	117
Residential real estate mortgage	7,545	8,559	882
Other commercial, financial, and agricultural	2,752	2,883	81
Consumer, including credit cards	432	812	6
Total impaired loans	$ 45,833	$ 57,280	$ 3,581
Related allowance as a % of impaired loans	7.81%		
Recorded investment of impaired loans as a % of unpaid principal balance of impaired loans	80.0%		

The aggregate amount of impaired loans decreased $3.7 million since the end of 2010. However, due to further weakness in real estate valuations, the allowance allocated to this category of loans increased $665 thousand from 7.81% at December 31, 2010 to 10.08% of impaired loans at September 30, 2011. At September 30, 2011, the Company s recorded investment in impaired loans represented 77.4% of the unpaid principal balance on those loans. The Company has effectively already recognized a $12.3 million or 22.6% discount (through partial charge-offs and/or application of payments received to principal rather than interest and fees) on those impaired loans.

General Reserves

The second component of the allowance for loan loss methodology addresses all loans that are not individually evaluated for impairment. General reserves are established for loans grouped into pools based on similar credit risk characteristics. Credit risk is a dynamic risk that fluctuates due to changes in borrowers repayment capacity, changes in interest rates, market changes, and other economic changes. For loans evaluated collectively in the general reserve component of the allowance for loan loss, the loan portfolio is segmented into groups of loans with common credit risk characteristics.

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The loan segment groups currently used, and a description of their specific risks, are summarized as follows:

Commercial, financial, and agricultural

Unsecured commercial Loans in this category are entirely reliant on the repayment capacity of the business and any guarantors. Risks common to commercial loans are potential industry and geographic concentrations. Deteriorating economic conditions increase the potential risk of cash flow difficulties in the ongoing business, which could impair the likelihood of repayment.

Equipment In addition to risks common to unsecured commercial loans noted above, collateralized equipment may depreciate faster than the repayment of the loan, which means the outstanding balance on the loan may exceed the value of the collateral at some point during the loan term. Also, if repossession becomes necessary, it can be difficult to find the collateral. There is industry risk when financing equipment. For example, the logging industry has endured significant turmoil over the past decade, which has added to the credit risk for the financing of logging equipment.

Farm real estate Loans in this category include farm and timber loans secured by real estate. These loans are susceptible to deterioration in the primary source of repayment, which is often the cash flow of the ongoing operation of farm or timber production. These industries tend to be cyclical in nature. In addition, there is the risk that weather can hamper production and harvesting, which can have immediate and unforeseen adverse impacts on the borrower s financial condition. There is also some risk of deterioration in collateral value.

Other commercial Loans in this category include the following:

Farm other than real estate These loans bear many of the same inherent risks as farm real estate loans and unsecured commercial loans.

Business assets includes assigned notes, inventory, accounts receivable, furniture, fixtures, etc. Monitoring the condition and existence of this collateral can be difficult. Deteriorating economic conditions increase the risk of cash flow difficulties in the ongoing business, which could impair the likelihood of repayment.

Real estate construction

This category includes loans for the acquisition, development or construction of residential and commercial properties. Risks in this category include geographic, industry and borrower concentrations. Repayment is often dependent on the resale of the underlying collateral. Construction loans bear unique risks, including the potential for cost overruns. Consumer residential construction loans bear the risk that the borrower will be unable to secure long-term financing arrangements. Contract construction loans bear the risk that the contract to purchase will not be honored after construction is completed. Speculative construction loans bear the risk that demand will soften and values will deteriorate such that the borrower cannot sell the property in a timely fashion or at a price sufficient to repay the debt in full.

Real estate commercial mortgage

Owner-occupied This category includes loans secured by commercial buildings that house the borrower s primary business, and the primary source of repayment is the cash flow of the borrower and not the rental income or sale of the collateral. These loans are deemed to bear less credit risk than non owner-occupied commercial real estate loans because there is a source of repayment apart from the collateral. Nevertheless, as with risks associated with other commercial loans, the cash flow of these businesses is often detrimentally impacted during economic downturns potentially to such a degree that the primary source of repayment is not sufficient to service the debt.

Non owner-occupied This category includes loans secured by hotels, apartment buildings, and other commercial buildings for which the repayment of the loan is dependent

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predominantly on the rental income or sale of the real estate. Deteriorating economic conditions can reduce occupancy rates and the sales potential of investment properties. Loans secured by buildings purchased for investment and resale bear the risk that real estate market conditions could deteriorate and detrimentally impact the value of the collateral to a degree that jeopardizes full repayment.

Real estate residential mortgage

These loans are susceptible to risk factors common to the consumer loans described below that reduce a consumer s capacity to repay. This includes increased unemployment and increases in the cost of living. Declining real estate values can reduce or eliminate the borrower s equity in their homes which can affect the value of home equity lines of credit and second mortgages.

Consumer, including credit cards

Consumer unsecured Loans in this category are susceptible to many of the same risks as consumer credit cards, especially overdraft protection lines of credit, which also have no maturity dates. There is no collateral, so a bankruptcy filing results in immediate charge-off. Risks common to consumer loans include unemployment and changes in local economic conditions.

Credit cards Loans in this category are revolving unsecured lines of credit. They are susceptible to delinquency due to strains on consumers in the form of such factors as unemployment, inflation, and lifestyle changes. They have no maturity date, which adds to the risks of changes in repayment capacity over time.

Other consumer Loans in this category include the following:

Vehicles, boats, recreational vehicles, mobile homes and other depreciating collateral Loans in this category have the same collateral risks as those in the commercial equipment pool. They also have the risks common to unsecured consumer loans, including a weakened capacity to pay due to unforeseen changes in cash flow.

Securities Loans in this category are susceptible to weakening collateral positions when the value of the securities declines to unacceptable levels. Security values can be volatile.

On each loan, credit risk ratings are assigned at loan origination and re-evaluated on performing credits at each renewal thereafter. Risk ratings are reviewed for loans past due over 30 days on a monthly basis and updated as necessary. Secured loans that reach 90 days past due are placed in nonaccrual status and downgraded to substandard. In addition, during the normal course of monitoring loan relationships, when the Company obtains information that reflects deterioration in the repayment capacity of a particular borrower, the risk grading for the loan is reviewed for accuracy and updated at that time.

In addition to the Company s internal reviews of risk rating, as discussed above, the Company has established an external loan review function, which is currently carried out by an independent loan review firm. On a quarterly basis, the firm reviews a sample of the portfolio to independently evaluate the following: 1) timely and accurate assignment of risk ratings; 2) compliance with the Company s loan policy; and 3) documentation and enforceability of borrower obligations and the Company s interest in collateral. On an annual basis, at a minimum, the external loan review plan includes:

All loan relationships with balances in excess of $500,000;

All loan relationships with balances in excess of $50,000 with a risk rating of substandard or worse.

General reserve factors for each loan segment are established based on an analysis of historical charge-off experience and expected loss-given-default derived from the Company s internal risk rating process. At September 30, 2011, management used a trailing ten-quarter historical average loss rate for each pool of

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loans. At December 31, 2010, management used a trailing six-quarter historical average loss rate for each pool of loans. At December 31, 2009, management used a trailing four-quarter historical average loss rate for each pool of loans. The historical period has been gradually expanded to continue to include loss rates incurred early in the cycle. Management believes that excluding those losses would not provide an accurate estimate that best reflects the inherent risk in the loan portfolio. Other adjustments may be made to the historical loss rates for the pools after an assessment of internal and external influences on credit quality that are not fully reflected in the historical loss or risk rating data. These influences typically include recent loss experience in specific portfolio segments, trends in loan quality, changes in market focus, and concentrations of credit. This element necessarily requires a high degree of managerial judgment to anticipate the impact that economic trends, legislative or governmental actions, or other unique market and/or portfolio issues will have on credit losses.

The following table summarizes the historical loss rates and adjustments made for qualitative/ environmental factors used in assessing the general reserves for all loans not individually evaluated for impairment at September 30, 2011 and December 31, 2010.

	September 30, 2011		*December 31, 2010*	
Loan Segment	***10-Quarter Historical Loss Rate***	***Adjustments for Qualitative/ Environmental Factors***	*6-Quarter Historical Loss Rate*	*Adjustments for Qualitative/ Environmental Factors*
Commercial, financial, and agricultural	**0.03 1.94%**	**0.04 - 0.06%**	0.22 2.85%	0.04 0.06%
Real estate construction	**7.28%**	**0.04%**	7.96%	0.04%
Real estate commercial mortgage:				
Owner-occupied	**0.29%**	**0.04%**	0.22%	0.04%
Non owner-occupied	**0.23%**	**0.04%**	0.22%	0.04%
Real estate residential mortgage	**2.02%**	**0.04%**	2.03%	0.04%
Consumer, including credit cards	**4.93 5.20%**	**0.08%**	4.14 5.74%	0.08%

Unallocated allowances relate to inherent losses that are not included elsewhere in the allowance. The qualitative factors associated with unallocated allowances include the inherent imprecision in models and lagging or incomplete data. Because of their subjective nature, these risk factors are carefully reviewed by management and revised as conditions indicate.

Deterioration in the real estate portfolio, particularly land acquisition and development loans, has been the overriding factor in the provisions made to the allowance for loan losses since 2008. Management expects additional provisions to be made to the allowance for loan losses in the fourth quarter of 2011 as updated appraisals are obtained on coastal real estate collateral. Net charge-offs represented 3.22% of average loans (annualized) for the first nine months of 2011, a 129 basis point decrease from 4.51% for the same period in 2010.

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A summary of recent activity in the allowance for loan losses is presented in the following table.

Allowance for Loan Losses ***Nine Months Ended September 30,*** *(Dollars in thousands)*	***2011***	*2010*	*2009*
Allowance for loan losses at beginning of year	**$ 9,916**	$ 7,170	$ 4,929
Provision for loan losses	**4,260**	10,570	3,540
Charge-offs:			
Commercial, financial, and agricultural	**66**	395	280
Real estate construction	**4,342**	7,101	1,711
Real estate commercial mortgage	**217**	119	99
Real estate residential mortgage	**974**	1,088	168
Consumer, including credit cards	**164**	175	205
Total charge-offs	**5,763**	8,878	2,463
Recoveries:			
Commercial, financial, and agricultural	**17**	24	30
Real estate construction	**19**	43	196
Real estate commercial mortgage			
Real estate residential mortgage	**35**	11	5
Consumer, including credit cards	**80**	53	63
Total recoveries	**151**	131	294
Net charge-offs	**5,612**	8,747	2,169
Allowance for loan losses at end of period	**$ 8,564**	$ 8,993	$ 6,300
Net loans outstanding[1] at end of period	**$ 214,841**	$ 250,129	$ 282,104
Average net loans outstanding[1] at end of period	**$ 233,113**	$ 258,460	$ 282,922
Ratios:			
Allowance to net loans	**3.99%**	3.60%	2.23%
Net charge-offs to average loans[2]	**3.22%**	4.51%	1.02%
Provision to average loans[2]	**2.44%**	5.45%	1.67%
Recoveries to total charge-offs	**2.62%**	1.48%	11.94%

1 Net of unearned income.
2 Annualized.

A loan is charged-off the Company s books at any point in time when it is no considered a bankable asset within the parameters of policy. The Company s charge-off policy is differentiated between unsecured and secured loans. The general parameters of the Company s charge-off policy are as follows:

- An unsecured loan is charged-off when it is 90 days past due.

- A partially-secured loan is written-down to the fair value of the collateral when the loan reaches 90 days past due.

- A fully-secured loan, is not written-down when the loan reaches 90 days past due.

The following are situations in which the Company might elect to record a specific reserve against an impaired loan rather than charge-off a portion of the loan:

- The loan is an accruing TDR and performing as agreed.

- The loan has already been written-down by the confirmed loss (the deficiency between the fair value of the collateral and the current balance of the loan), and an additional specific reserve is required above and beyond the initial write-down due to conservative discounts for such factors as estimated market deterioration, margining collateral according to federal supervisory limits, selling costs/commissions, etc.

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There is outside financial repayment capacity in the form of either recurring cash flow or liquidity of the borrowers or guarantors.

The Company is currently in the process of re-evaluating the fair value of the collateral. A write-down decision would be premature in such instances.

The Company is negotiating or employing an alternative repayment plan.
If none of the above conditions are true, the loan will be written-down to the fair value of the collateral.

The following table summarizes the amount of impaired loans for which we have recorded partial charge-offs and the amount charged-off as of September 30, 2011 and December 31, 2010.

(Dollars in thousands)	**September 30, 2011** Recorded Investment	**September 30, 2011** Unpaid Principal Balance	**September 30, 2011** Amount Partially Charged-off	December 31, 2010 Recorded Investment	December 31, 2010 Unpaid Principal Balance	December 31, 2010 Amount Partially Charged-off
Impaired loans with a partial charge-off:						
Commercial real estate:						
Construction and development	**$ 16,339**	**$ 26,629**	**$ 10,214**	$ 15,122	$ 24,341	$ 9,209
Owner-occupied	**194**	**266**	**50**	217	265	44
Non owner-occupied						
Residential real estate mortgage	**1,885**	**3,146**	**1,205**	1,876	2,570	658
Other commercial, financial, and agricultural				12	27	11
Consumer, including credit cards				73	339	265
Total impaired loans	**$ 18,418**	**$ 30,041**	**$ 11,469**	$ 17,300	$ 27,542	$ 10,187
Partial charge-offs as a % of unpaid principal balance			**38.2%**			37.0%

Partial charge-offs taken on impaired loans are reflected in the charge-off history for each general reserve loan pool used in our loan loss methodology. By recognizing a partial charge-off, we are absorbing the loss through the allowance for loan losses and reducing our recorded investment in the loan. These partial charge-offs reduce our coverage ratio which is the ratio of the allowance for loan losses to total nonperforming loans. The following table illustrates the impact that these partial charge-offs had on our coverage ratio as of September 30, 2011.

As of September 30, 2011 *(Dollars in thousands)*	**As Reported**	**Partial Charge-offs**	**Proforma Adjusted**
Allowance for loan losses	**$ 8,564**	**$ 11,469**	**$ 20,033**
Nonperforming loans	**35,084**	**11,469**	**46,553**
Coverage ratio	**24.4%**		**43.0%**

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RESULTS OF OPERATIONS

The Company recorded a net loss of $1.99 million for the three months ended September 30, 2011 compared to a net loss of $2.65 million during the same period in 2010. On a per share basis, the third quarter loss totaled $0.64 at September 30, 2011, a $0.21 per share improvement from the $0.85 net loss per share at September 30, 2010. Major variances in the Company s results of operations for the three months ended September 30, 2011 compared to the same period in 2010 included:

$28 thousand improvement in net interest income;

$1.75 million decline in the provision for loan losses;

$49 thousand decrease in noninterest income;

$576 thousand decrease in noninterest expenses; and

Nonrecognition of income tax benefits for both regulatory and financial accounting purposes in 2011 compared to a $1.64 million benefit recognized in the third quarter of 2010.

The Company recorded a net loss of $2.19 million for the first nine months of 2011 compared to a net loss of $5.88 million during the same period in 2010. On a per share basis, the year-to-date loss totaled $0.70 at September 30, 2011, a $1.18 per share improvement from the $1.88 net loss per share at September 30, 2010. Major variances in the Company s results of operations for the first nine months of 2011 compared to the same period in 2010 included:

$362 thousand reduction in net interest income;

$6.31 million decline in the provision for loan losses;

$136 thousand decrease in noninterest income;

$1.78 million decrease in noninterest expenses; and

Nonrecognition of income tax benefits for both regulatory and financial accounting purposes in 2011 compared to a $3.91 million benefit recognized in the first nine months of 2010.

Variations in net interest income and noninterest income and expenses are further discussed in the following subsections of this Analysis; the variation in the provision for loan losses is separately discussed within the Financial Condition section.

Net Interest Income

Net interest income declined $362 thousand (or 3.8%) during the first nine months of 2011 compared to 2010. Interest income declined $1.43 million (or 10.8%) during the first nine months of 2011 compared to 2010 due to a shift in earning assets from higher-yielding loans to lower-yielding cash and cash equivalents, an increase in nonaccrual loans, and the prolonged low interest rate environment. The decrease in interest income was offset in part by a $1.07 million (or 29.5%) decrease in interest expense as rates paid on deposit accounts continued to re-price downward. Reductions in the cost of funds in the current economic cycle have not kept pace with declines in asset yields since liquidity constraints have compelled other banks in our markets to rely more heavily on deposits, particularly time certificates, for funding; this reliance has kept deposit rates higher than national averages. In addition, new competitor banks in several of our markets have advertised higher deposit rates attempting to increase their market share.

Net interest income and resultant margins and spreads are projected to remain below 2010 levels for the remainder of 2011 due to: a) yield reductions on a year-over-year basis, due largely to higher cash equivalent balances and shortened maturities on investment securities; b) overall lower average balances on loans; and c) increases in nonperforming assets, particularly nonaccrual loans and foreclosed real estate, also on an average basis.

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The net interest margin approximated 3.30% for the nine months ended September 30, 2011 versus 3.43% during the same period in 2010. The interest rate spread decreased 1 basis point to 3.12% compared to 3.13% in 2010. The average yield on earning assets declined 48 basis points to 4.18% in the first nine months of 2011 compared to 2010 while the average rate paid for interest-bearing liabilities decreased 47 basis points to 1.06% in the first nine months of 2011 compared to 2010. Comparative details about average balances, income/expense, and average yields earned and rates paid on interest-earning assets and liabilities for the nine months ended September 30, 2011 and 2010 are provided in the following table.

Average Balances[7]		**2011**			2010	
Nine Months Ended September 30, (Dollars in thousands)	***Average Balances***	***Income/ Expense***	***Yields/ Rates***	*Average Balances*	*Income/ Expense*	*Yields/ Rates*
Assets						
Interest-earning assets:						
Net loans[1,2,4]	**$ 233,113**	**$ 10,073**	**5.78%**	$ 258,460	$ 10,871	5.62%
Taxable investment securities[3]	**59,269**	**1,305**	**2.94%**	50,131	1,793	4.77%
Tax-exempt investment securities[3,4]	**12,611**	**617**	**6.54%**	17,919	873	6.50%
Other interest-earning assets[5]	**84,296**	**164**	**0.26%**	64,779	112	0.23%
Total interest-earning assets	**$ 389,289**	**$ 12,159**	**4.18%**	$ 391,289	$ 13,649	4.66%
Liabilities						
Interest-bearing liabilities:						
Interest-bearing demand deposits[6]	**$ 126,454**	**$ 478**	**0.51%**	$ 116,282	$ 635	0.73%
Savings	**57,187**	**205**	**0.48%**	54,756	298	0.73%
Time certificates	**132,159**	**1,765**	**1.79%**	137,510	2,520	2.45%
FHLB advances	**5,000**	**98**	**2.62%**	6,374	160	3.34%
Other short-term borrowings	**662**			657		
Total interest-bearing liabilities	**$ 321,462**	**$ 2,546**	**1.06%**	$ 315,579	$ 3,613	1.53%
Excess of interest-earning assets over interest-bearing liabilities	**$ 67,827**			$ 75,710		
Interest rate spread			**3.12%**			3.13%
Net interest income		**$ 9,613**			$ 10,036	
Net interest margin			**3.30%**			3.43%

1 Average loans are shown net of unearned income. Nonperforming loans are included. Income on nonaccrual loans, if recognized, is recorded on a cash basis.
2 Includes loan fees and late charges.
3 Securities are presented on an amortized cost basis. Investment securities with original maturities of three months or less are included, as applicable.
4 Interest income on tax-exempt loans and securities is presented on a taxable-equivalent basis, using a federal income tax rate of 34%. No adjustments have been made for any state tax benefits or the nondeductible portion of interest expense.
5 Includes interest-bearing deposits in other banks, federal funds sold and FHLB stock.
6 Includes NOW and money market accounts.
7 Averages presented generally represent average daily balances.

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The following table summarizes the changes in interest income and interest expense attributable to volume and rates between the two reporting periods.

Interest Differential[1] *Nine Months Ended September 30,* *(Dollars in thousands)*	***2011 Compared to 2010 Increase (Decrease) Due to*** ***Volume***	***Rate***	***Net***
Interest income:			
Net loans[2,3]	**$ (1,066)**	**$ 268**	**$ (798)**
Taxable investment securities	**327**	**(815)**	**(488)**
Tax-exempt investment securities[3]	**(259)**	**3**	**(256)**
Other interest-earning assets[4]	**34**	**18**	**52**
Total interest income	**(964)**	**(526)**	**(1,490)**
Interest expense:			
Interest-bearing demand deposits[5]	**56**	**(213)**	**(157)**
Savings	**13**	**(106)**	**(93)**
Time certificates	**(98)**	**(657)**	**(755)**
FHLB advances	**(34)**	**(28)**	**(62)**
Other short-term borrowings			
Total interest expense	**(63)**	**(1,004)**	**(1,067)**
Net change in net interest income	**$ (901)**	**$ 478**	**$ (423)**

1 Changes in net interest income are attributed to either changes in average balances (volume change) or changes in average rates (rate change) for earning assets and sources of funds on which interest is received or paid. Volume change is calculated as change in volume times the previous rate while rate change is change in rate times the previous volume. Thus, changes that are not solely due to volume have been consistently attributed to rate.

2 Includes loan fees. See the average balances table on the previous page for more details.

3 Interest income on tax-exempt loans and securities is presented on a taxable-equivalent basis, using a federal income tax rate of 34%. No adjustments have been made for any state tax benefits or the nondeductible portion of interest expense.

4 Includes interest-bearing deposits in other banks, federal funds sold and FHLB stock.

5 Includes NOW and money market accounts.

The decline in interest income is due primarily to declines in the volume of loans outstanding and the yield on taxable investment securities for the nine months ended September 30, 2011 compared to 2010. The decline in interest expense is due primarily to declines in rates paid on deposits.

Provision for Loan Losses

The provision for loan losses is discussed in detail with the allowance for loan losses in the Financial Condition section of the Analysis.

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Noninterest Income

Noninterest income declined $137 thousand (or 4.7%) during the first nine months of 2011 compared to 2010. Excluding losses on sales of investment securities, noninterest income decreased $262 thousand (or 8.5%). A summary of the changes in noninterest income by category follows:

	Three Months Ended September 30,			Nine Months Ended September 30,		
(Dollars in thousands)	***2011***	*2010*	***Pct. Chg.***	***2011***	*2010*	***Pct. Chg.***
Noninterest income:						
Service charges on deposit accounts	**$ 209**	$ 217	-3.7%	**$ 620**	$ 642	-3.5%
Return check and stop payment fees	**417**	487	-14.4%	**1,142**	1,408	-18.9%
Insurance commissions	**16**	22	-26.6%	**52**	74	-29.3%
Gain/ (loss) on sale of securities				**(18)**	(143)	-87.3%
Mortgage origination fees	**20**	10	100.6%	**26**	46	-43.5%
Bank card and credit card fees	**155**	136	14.4%	**470**	409	15.1%
Earnings on bank-owned life insurance	**59**	60	-1.5%	**176**	178	-1.5%
Other noninterest income	**104**	97	7.3%	**316**	307	3.2%
Total noninterest income	**$ 980**	$ 1,029	-4.7%	**$ 2,784**	$ 2,921	-4.7%
Noninterest income (annualized) as a percentage of average assets	**0.93%**	0.95%		**0.87%**	0.91%	

For the first nine months of 2011, return check and stop payment fee income declined $266 thousand (or 18.9%) compared to 2010. Lower volume of overdraft fees, as well as regulatory changes impacting the collection of these fees, were the main factors in the year-to-date decline. These regulatory changes, which stem largely from amendments to Federal Reserve Regulation E, became effective July 2010; as a result of the Regulation E amendment, this income category will continue to decline in 2011 when compared to prior periods.

Fee income for credit life insurance sales decreased $22 thousand (or 29.3%) in the first nine months of 2011 compared to 2010 due to a decline in new consumer loan volume in 2011.

As discussed in the Financial Condition section of this Analysis, the Company recognized a net loss of $18 thousand on the sale of one corporate bond in the first quarter of 2011, a $125 thousand (or 87.3%) decrease compared to losses recognized on investment activities during the same period in 2010.

Fee income on mortgage originations declined $20 thousand (or 43.5%) in the first nine months of 2011 compared to the same period in 2010 due to a decline in volume of mortgage loan originations. In 2010, the Company either eliminated or reassigned its mortgage origination personnel due to insufficient activity to support the department.

For the first nine months of 2011, fees earned on bank card and credit card activity increased $61 thousand (or 15.1%) due to an increase in volume of card transactions and a change in vendors that allowed the Company to earn more per card transaction than in prior years. However, due to recent regulatory restrictions on card transaction fees enacted by the Dodd-Frank Act, the Company expects to see a decline in card fee income going forward.

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Noninterest Expense

Noninterest expense decreased $1.78 million (or 15.2%) in the first nine months of 2011 compared to the same period in 2010. Excluding other operational losses, other than temporary impairment losses on securities, gains, losses and write-downs on other real estate owned, and gains and losses on other assets, noninterest expense decreased $422 thousand (or 4.3%) from $9.77 million in the first nine months of 2010 compared to $9.35 million for the same period in 2011 as management has focused its efforts on cost savings initiatives and operational efficiencies. A summary of the changes in noninterest expense by category follows:

	Three Months Ended			*Nine Months Ended*		
	September 30,			*September 30,*		
(Dollars in thousands)	***2011***	2010	*Pct. Chg.*	***2011***	*2010*	*Pct. Chg.*
Noninterest expenses:						
Salaries and wages	**$ 1,338**	$ 1,362	-1.7%	**$ 3,925**	$ 4,157	-5.6%
Employee benefits	**389**	385	1.0%	**1,164**	1,208	-3.6%
Net occupancy expense of premises	**285**	301	-5.2%	**860**	891	-3.5%
Furniture and equipment expense	**358**	365	-1.9%	**1,048**	1,129	-7.2%
FDIC insurance expense	**134**	109	23.4%	**492**	550	-10.6%
Legal and accounting fees	**153**	132	15.8%	**428**	401	6.7%
Taxes and insurance	**56**	55	3.0%	**187**	172	8.5%
Director and committee fees	**27**	27	3.4%	**82**	80	2.9%
Advertising, marketing and supplies	**80**	92	-13.4%	**259**	290	-10.6%
Postage and courier	**65**	67	-2.4%	**200**	208	-3.5%
Service charges and fees	**136**	139	-2.5%	**413**	405	1.9%
Foreclosure and repossession expenses	**77**	55	39.5%	**185**	184	0.5%
Other operational losses	**40**	51	-21.9%	**150**	205	-27.0%
Other than temporary impairment loss on debt securities					45	-100.0%
(Gain)/ loss on sale of other real estate owned	**1**	5	-92.7%	**(22)**	3	-730.5%
Write-downs on other real estate owned	**257**	821	-68.8%	**500**	1,731	-71.1%
(Gain)/ loss on other assets	**1**	14	-95.9%	**3**	8	-54.2%
Other noninterest expense	**37**	29	25.3%	**105**	95	10.9%
Total noninterest expense	**$ 3,434**	$ 4,009	-14.4%	**$ 9,979**	$ 11,762	-15.2%
Noninterest expense as a percentage of average assets (annualized)	**3.26%**	3.68%		**3.12%**	3.65%	

Combined, salaries and employee benefits declined $276 thousand (or 5.1%) during the first nine months of 2011 compared to 2010. The decrease is due in part to a 4.0% decrease in the employee workforce from 150 at September 30, 2010 to 144 at September 30, 2011. The Company has also been diligent in managing salaries and employee benefits costs.

Combined, net occupancy, furniture and equipment expenses declined $112 thousand (or 5.5%) during the first nine months of 2011 compared to 2010. The Company realized costs savings related to a data line communications upgrade and a decline in depreciation/amortization expense on fully-depreciated/amortized equipment and software. In July 2011, the Company replaced its AS/400 equipment and software, while its other fully-depreciated assets remain in good working condition and have not been replaced as management curtailed spending on high dollar capital expenditures.

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Expense for FDIC insurance decreased $58 thousand (or 10.6%) during the first nine months of 2011 compared to 2010. The decrease is due to a one-time accounting adjustment to the amortization of the Company s prepaid FDIC insurance assessment made in 2011. The change in amortization was made to mirror the changes made by the FDIC to the assessment base from total deposits to total assets.

As discussed in the Financial Condition section of this Analysis, the Company recognized an other than temporary impairment loss of $45 thousand on a corporate bond in the first nine months of 2010. The Company sold the residual balance of the bond in 2011.

Write-downs on other real estate owned decreased $1.23 million (or 71.1%) in the first nine months of 2011 compared to 2010. These write-downs correlate with receipt of updated appraisals of foreclosed property held for sale. Management expects further write-downs to occur in the fourth quarter of 2011 as updated appraisals are obtained. As further discussed in the Financial Condition section of this Analysis, real estate values in coastal Georgia and northeast Florida remain depressed. Management anticipates that losses and other costs associated with foreclosed real estate will remain elevated unless the Company s coastal real estate markets stabilize and demand for properties improves.

Income Taxes

A valuation allowance is recorded for deferred tax assets if, based on available evidence, it is more likely than not that all or some portion of the underlying tax benefits may not be realizable. All sources of taxable income available to utilize the deferred tax assets are considered in making this assessment, including taxable income in carryback years, future reversals of existing temporary differences, any tax planning strategies, and future taxable income (exclusive of reversing temporary differences and carryforwards). The predictability of future taxable income is the most subjective of these four sources. The presence of cumulative losses in recent years, or a significant loss in a single year, is considered significant negative evidence, rendering reliance on future taxable income to fully realize a deferred tax asset difficult. Judgment is a critical element in making this assessment.

During 2010, the Company sustained a significant operating loss due predominantly to provisions and other charges on nonperforming assets. The positive evidence supporting future earnings as a source of utilizing the deferred tax assets was insufficient to overcome the negative evidence due to the sheer size of the loss to be absorbed. As a result, the Company recorded a $4.78 million valuation allowance against the balance of its net deferred tax assets at December 31, 2010.

Until the Company returns to a period of sustained profitability, the Company will not record income tax expense or benefits or deferred tax assets or liabilities. Once the Company returns to sustained profitability, management expects to be able to reverse the valuation allowance against its deferred tax assets.

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LIQUIDITY AND CAPITAL RESOURCES

Management believes the Company has the funding capacity, from operating activities or otherwise, to meet its financial commitments over the next 12 months. Liquidity is managed to ensure sufficient cash flow to satisfy demands for credit, deposit withdrawals, and other corporate needs. Liquidity is vital to any financial institution and its importance cannot be overstated, particularly during periods of economic crisis. Overall liquidity position is determined by the types of assets, and their duration, on the balance sheet; encumbrances; borrowing capacity from customer deposits or other sources; and retained earnings. In short, assets, predominantly loans and investment securities, are funded by customer deposits, borrowed funds, and retained earnings. During the last few years, in an effort to improve its on-balance sheet liquidity, the Company has increased its most liquid assets, namely cash and cash equivalents. Cash and cash equivalents, which variously comprise cash and due from banks, interest-bearing deposits in other banks and federal funds sold, increased $17.3 million (or 21.4%) at September 30, 2011 compared to the end of 2010. Cash and cash equivalents represented 24.0% of total assets at September 30, 2011 versus 18.9% at December 31, 2010.

Cash flows from the loan and securities portfolios represent important components of the Company s overall liquidity position. At September 30, 2011, loans (excluding nonaccrual loans) and investment securities with carrying values of approximately $86.6 million were scheduled to mature in one year or less. Of course, loans are subject to refinancing prior to maturity or renewal at maturity, certain securities are subject to early calls or prepayments prior to maturity, and securities may be pledged to secure public funds and other borrowing arrangements. These characteristics may have an impact on the actual cash flows from the loan and securities portfolios. At September 30, 2011, approximately $49.3 million (or 74.7%) of the Company s securities portfolio was pledged. However, when adjusted for overpledging due to cyclical variations in public funds and contingency pledging to the Federal Reserve Bank discount window, approximately $19.4 million of the securities pledged was unencumbered at September 30, 2011. The entities to which the excess collateral is pledged have no legal claim on such collateral unless amounts are owed under other obligations.

The Company has long benefited from a relatively large, stable deposit base. Customer-based core deposits (total deposits less time deposits with balances of $250,000 or more), traditionally the Company s largest and most cost-effective source of funding, comprised 94.6% of total deposits at September 30, 2011. The Company does not currently accept brokered deposits or other out-of-market deposits. Alternative sources of funding have traditionally encompassed U.S. Treasury demand notes, Federal Reserve discount window borrowings, federal funds purchased, and FHLB advances. At September 30, 2011, these alternative sources of funding totaled $6.05 million, or 1.5% of total assets.

The Company has also historically generated net cash flows from operations. For the nine months ended September 30, 2011, net cash provided by operating activities amounted to $4.3 million compared to $4.1 million for the same period in 2010. The consolidated statements of cash flows within this Form 10-Q provide a summary of cash flows provided by or used in operating, investing, and financing activities.

In the third quarter of 2009, the FDIC announced a plan to restore its Deposit Insurance Fund balances depleted as a result of recent bank failures. The restoration plan required all FDIC-insured banks to prepay their risk-based assessments for the years 2010, 2011, and 2012. The assessments, usually due quarterly, were instead estimated for the three future years and paid prior to December 31, 2009. The Company paid the required assessment on December 29, 2009 and concurrently recorded a prepaid asset within other assets on the consolidated balance sheets. This prepaid asset totaled $674 thousand at September 30, 2011. Any differences between the prepaid and actual amounts due each quarter will be funded using existing available liquidity.

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Deposits

The distribution of total deposits at September 30, 2011 and certain comparable quarter-end dates is summarized in the following table.

	September 30, 2011		*December 31, 2010*		*September 30, 2010*	
Deposits *(Dollars in thousands)*	***Balances***	***Percent of Total***	*Balances*	*Percent of Total*	*Balances*	*Percent of Total*
Noninterest-bearing demand	**$ 64,071**	**17.9%**	$ 55,377	14.8%	$ 57,092	15.7%
Interest-bearing demand[1]	**107,319**	**30.0%**	127,631	34.0%	112,206	30.9%
Savings	**59,593**	**16.7%**	54,033	14.4%	54,897	15.1%
Time < $100,000	**65,646**	**18.4%**	68,538	18.3%	70,164	19.3%
Time $100,000 to $250,000	**41,647**	**11.6%**	44,268	11.8%	42,269	11.6%
Time > $250,000	**19,338**	**5.4%**	25,348	6.7%	26,857	7.4%
Total interest-bearing deposits	**293,543**	**82.1%**	319,818	85.2%	306,393	84.3%
Total deposits	**$ 357,614**	**100.0%**	$ 375,195	100.0%	$ 363,485	100.0%

[1] Includes NOW and money market accounts.

Total deposits decreased approximately $17.6 million (4.7%) since the end of 2010. During the period, noninterest-bearing deposits increased approximately $8.7 million (or 15.7%) while interest-bearing deposits decreased approximately $26.3 million (or 8.2%). Within interest-bearing deposits, time certificate balances decreased approximately $11.5 million (or 8.3%) and NOW, money market, and savings balances decreased approximately $14.8 million (or 8.1%). As previously noted, the decline in total deposits is due primarily to a $23.2 million (or 33.5%) decrease in public funds on deposit at the Bank. No single factor precipitated the 4.7% increase in noninterest-bearing deposits since year-end as these balances tend to be somewhat cyclical. However, noninterest-bearing deposits will continue to be protected by unlimited FDIC deposit insurance until December 31, 2012 under provisions of the Dodd-Frank Act, and that insurance protection may have been a factor in the increase in these balances.

Approximately 81.0% of total deposits at September 30, 2011 were based in the Company s 13 Georgia branches and the remaining 19.0% were from the three Florida branches. Deposits with one local governmental entity amounted to approximately $15.1 million (or 4.2%) and $24.4 million (or 6.5%) of the Company s total deposits at September 30, 2011 and December 31, 2010, respectively. At September 30, 2011, public funds deposits represented approximately 12.9% of total deposits compared to 18.4% of total deposits at December 31, 2010. Although the Bank made progress in reducing its funding concentration with large public fund accounts, management expects public funds to increase slightly during the fourth quarter of 2011 as local municipalities collect annual property tax assessments.

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As shown in the following table, approximately 93.6% of time deposits at September 30, 2011 were scheduled to mature within the next twelve months.

Maturities of Time Deposits *September 30, 2011* *(Dollars in thousands)*	*< $100,000*	*Balances* *$100,000 to $250,000*	*> $250,000*	*Total*
Months to maturity:				
3 or less	**$ 15,095**	**$ 10,163**	**$ 10,634**	**$ 35,892**
Over 3 through 12	**44,401**	**29,538**	**8,704**	**82,643**
Over 12 through 36	**5,046**	**1,346**		**6,392**
Over 36	**1,104**	**600**		**1,704**
Total	**$ 65,646**	**$ 41,647**	**$ 19,338**	**$ 126,631**

FHLB Advances

Advances outstanding with the FHLB totaled $5.0 million at September 30, 2011, unchanged from December 31, 2010. The advances outstanding included a $2.5 million fixed rate advance due July 30, 2012 with an effective rate of 2.35% and another $2.5 million fixed rate advance due July 29, 2013 with an effective rate of 2.89%. At September 30, 2011, the two advances were collateralized by cash balances held at the FHLB. Additional funding is not currently available from the FHLB.

Other Commitments

The Company had no material plans or commitments for capital expenditures as of September 30, 2011.

Capital Adequacy

Federal banking regulators have established certain capital adequacy standards required to be maintained by banks and bank holding companies. These regulations define capital as either Tier 1 (primarily realized shareholders equity) or Tier 2 (for the Company, a portion of the allowance for loan losses). The Company and the Bank are subject to a minimum Tier 1 capital ratio (Tier 1 capital to risk-weighted assets) of 4%, total capital ratio (Tier 1 plus Tier 2 to risk-weighted assets) of 8%, and Tier 1 leverage ratio (Tier 1 to average quarterly assets) of 4%. To be considered a well-capitalized institution, the Tier 1 capital, total capital, and Tier 1 leverage ratios must equal or exceed 6%, 10%, and 5%, respectively. Banks and bank holding companies are prohibited from including unrealized gains and losses on debt securities in the calculation of risk-based capital but are permitted to include up to 45 percent of net unrealized pre-tax holding gains on equity securities in Tier 2 capital. The Company did not have any unrealized gains on equity securities includible in the risk-based capital calculations for any of the periods presented. At September 30, 2011, the Company s Tier 1, total capital, and Tier 1 leverage ratios totaled 16.79%, 18.07%, and 10.13%, respectively. On a stand-alone basis, at September 30, 2011, the Bank s same capital ratios totaled 16.34%, 17.61%, and 9.85%, respectively. The Company is committed to maintaining its well-capitalized status and stress tests its capital position on a regular basis to gauge its ability to withstand deterioration in asset quality and operating performance.

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The consolidated regulatory capital ratios for the most recent periods are presented in the following table.

Capital Ratios *(Dollars in thousands)*	***September 30, 2011***	*December 31, 2010*	*September 30, 2010*
Tier 1 capital:			
Total shareholders equity	**$ 43,146**	$ 44,806	$ 52,158
Accumulated other comprehensive (income) loss	**(762)**	(269)	(862)
Total Tier 1 capital	**42,384**	44,537	51,296
Tier 2 capital:			
Portion of allowance for loan losses	**3,222**	3,585	3,634
Total risk-based capital	**$ 45,606**	$ 48,122	$ 54,930
Risk-weighted assets	**$ 252,389**	$ 280,441	$ 285,355
Risk-based ratios:			
Tier 1 capital[1]	**16.79%**	15.88%	17.98%
Total risk-based capital	**18.07%**	17.16%	19.25%
Tier 1 leverage ratio	**10.13%**	10.29%	11.87%
Shareholders equity to assets	**10.55%**	10.48%	12.32%

[1] The Company s tier 1 common equity ratio is the same as its tier 1 capital ratio.

To preserve capital, no dividends were declared or paid in the first nine months of 2011, a $0.13 per share decline from the same period in 2010. The Company has suspended future dividend payments and treasury stock purchases until operating performance improves and credit losses abate. Regulatory approval will be required prior to payment of future dividends or treasury stock purchases.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements and the related disclosures in conformity with accounting principles generally accepted in the United States requires that management make estimates and assumptions which affect the reported amounts of assets and liabilities and disclosure of contingent assets and 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. Management believes that its determination of the allowance for loan losses and the fair value of assets affect its most significant judgments and estimates used in the preparation of the consolidated financial statements. The Company s accounting policies are described in detail in Note 1 of the Consolidated Financial Statements provided in Item 8 of the Company s Annual Report on Form 10-K for the year ended December 31, 2010. There have been no material changes in the Company s critical accounting policies since December 31, 2010.

The following is a brief description of the Company s critical accounting estimates involving significant management valuation judgment. Management has discussed these critical accounting policies with the Audit Committee.

<u>Allowance for Loan Losses</u>

The allowance for loan losses represents management s estimate of losses inherent in the existing loan portfolio. The allowance for loan losses is increased by the provision for loan losses charged to expense and reduced by loans charged off, net of recoveries. The allowance for loan losses is determined based on management s assessment of several factors including, but not limited to, reviews and evaluations of specific loans, changes in the nature and volume of the loan portfolio, current economic conditions and the related impact on segments of the loan portfolio, historical loan loss experiences and the level of classified and nonperforming loans.

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Loans are considered impaired if, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The measurement of impaired loans is based on either the fair value of the underlying collateral, the present value of the future cash flows discounted at the historical effective interest rate stipulated in the loan agreement, or the estimated market value of the loan. In measuring the fair value of the collateral, management uses assumptions (e.g., discount rate) and methodologies (e.g., comparison to the recent selling price of similar assets) consistent with those that would be utilized by unrelated third parties.

Management s assessment is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available. Changes in various internal and external environmental factors including, but not limited to, the financial condition of individual borrowers, economic conditions, historical loss experience, or the condition of the various markets in which collateral may be sold may affect the required level of the allowance for loan losses and the associated provision for loan losses. Should these environmental factors change; a different amount may be reported for the allowance for loan losses and the associated provision for loan losses.

Estimates of Fair Value

The estimation of fair value is significant to a number of the Company s assets, including, but not limited to, investment securities, other real estate owned and other repossessed assets. These are all recorded at either fair value or at the lower of cost or fair value. Fair values are volatile and may be influenced by a number of factors. Circumstances that could cause estimates of the fair value of certain assets and liabilities to change include a change in prepayment speeds, discount rates or market interest rates. Management s estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the consolidated financial statements in the period they are determined to be necessary.

Fair values for most investment securities are based on quoted market prices. If quoted market prices are not available, fair values are based on the quoted prices of similar instruments. The fair values of other real estate owned are typically determined based on appraisals by third parties, less estimated costs to sell.

Recent Accounting Pronouncements

A summary of recent pronouncements and the related impact on the Company s consolidated financial statements, if any, are discussed in Note 2. In management s opinion, there are no recent accounting pronouncements that have had or will have had a material impact on our earnings or financial position as of or for the quarter ended September 30, 2011.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

The normal course of business activity exposes the Company to interest rate risk. Fluctuations in interest rates may result in changes in the fair market value of the Company s financial instruments, cash flows, and net interest income. The Asset/Liability Committee periodically reviews the Company s exposure to interest rate risk and formulates strategy based on acceptable levels of interest rate risk. The overall objective of this process is to optimize the Company s financial position, liquidity, and net interest income, while limiting volatility to net interest income from changes in interest rates.

The Company uses simulation modeling to test the interest rate sensitivity of net interest income and the balance sheet. Contractual maturity and repricing characteristics of loans are incorporated into the model, as are prepayment assumptions, maturity data, and call options within the investment portfolio. Non-maturity deposit accounts are modeled based on past experience. Simulation results quantify interest rate risks under various interest rate scenarios over a twelve-month period. Based on the latest analysis, the Company is slightly asset sensitive, meaning earnings are expected to increase as interest rates rise and decrease if interest rates fall. The simulation model estimates changes in net interest income based on various gradual and shocked/instantaneous rate change scenarios, as shown in the table below.

	Effect on Net Interest Income			
	Over Next 12 Months		*Over Next 24 Months*	
Market Rate Change	*Gradual*	*Immediate Shock*	*Gradual*	*Immediate Shock*
+400 basis points	**8.10%**	**17.08%**	**8.24%**	**12.08%**
+300 basis points	**5.07%**	**9.03%**	**3.95%**	**5.32%**
+200 basis points	**2.59%**	**3.22%**	**0.97%**	**0.77%**
+100 basis points	**0.91%**	**0.56%**	**-0.59%**	**-1.14%**
-100 basis points	**0.36%**	**0.10%**	**0.85%**	**0.16%**
-200 basis points	**0.08%**	**-3.24%**	**-0.66%**	**-2.94%**

The level of the Company s asset sensitivity has decreased compared to the prior year due largely to the increase in cash and cash equivalent balances and the level of above-market interest rate floors placed on adjustable rate loans.

Limitations inherent with simulation modeling include: a) in a down rate environment, competitive and other factors constrain timing of parallel rate reductions on various deposit products whereas loans tied to Prime and other variable indexes reprice instantaneously and securities with call or other prepayment features are likely to be redeemed prior to stated maturity and replaced at lower rates (lag effect); and b) potential changes in balance sheet mix, for example, unscheduled pay-offs of large commercial loans and significant increases in nonaccrual loans, are oftentimes difficult to forecast.

The Company has not in the past, but may in the future, utilize interest rate swaps, financial options, financial futures contracts, or other rate protection instruments to reduce interest rate and market risks.

Impact of Inflation

The effects of inflation on the local economy and the Company s operating results have been relatively modest the last several years. Because substantially all the Company s assets and liabilities, including cash, securities, loans, and deposits, are monetary in nature, their values are less sensitive to the effects of inflation than to changing interest rates. As discussed in the preceding section, the Company attempts to control the impact of interest rate fluctuations by managing the relationship between its interest sensitive assets and liabilities.

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Item 4. Controls and Procedures

A review and evaluation was performed by the Company s management, including the Company s principal executive officer and principal financial officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures as of the end of the period covered by this Quarterly Report. Based on that review and evaluation, the Company s principal executive officer and principal financial officer have concluded that the Company s current disclosure controls and procedures, as designed and implemented, were effective as of the end of the period covered by this report in alerting them on a timely basis to material information relating to the Company required to be included in the Company s reports filed or submitted under the Securities Exchange Act of 1934. There have been no changes in the Company s internal control over financial reporting that occurred during the Company s most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

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Part II - Other Information

Item 1. Legal Proceedings.

The nature of the business of the Company and the Bank ordinarily results in a certain amount of litigation. Accordingly, we are party to a limited number of lawsuits incidental to our respective businesses. In our opinion, the ultimate disposition of these matters will not have a material adverse impact on our consolidated financial position or results of operations.

Item 1A. Risk Factors.

There were no material changes to the Company s risk factors during the first nine months of 2011.

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

None

Item 3. Defaults Upon Senior Securities.

Not Applicable

Item 4. (Removed and Reserved).

Item 5. Other Information.

Not Applicable

Item 6. Exhibits.

31.1	Rule 13a-14(a) Certification of CEO.
31.2	Rule 13a-14(a) Certification of Treasurer.
32	Section 1350 Certification of CEO and Treasurer.
101	Interactive Data File.

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Signatures

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

SOUTHEASTERN BANKING CORPORATION
(Registrant)

By: /s/ DONALD J. TORBERT, JR.
Donald J. Torbert, Jr., Treasurer
(Principal Accounting Officer)

Date: November 14, 2011