CAPITAL CITY BANK GROUP INC
Form 10-K
March 06, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2014
OR
o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ____________ to ____________

(Exact name of Registrant as specified in its charter)

Florida	**0-13358**	**59-2273542**
(State of Incorporation)	(Commission File Number)	(IRS Employer Identification No.)

217 North Monroe Street, Tallahassee, Florida	**32301**
(Address of principal executive offices)	(Zip Code)

(850) 671-0300

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $0.01 par value	The Nasdaq Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

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

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

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

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

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

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 definition of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act

Large accelerated filer o Accelerated filer x Non-accelerated filer o Smaller reporting company o

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

The aggregate market value of the registrant's common stock, $0.01 par value per share, held by non-affiliates of the registrant on June 30, 2014, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $155,431,117 (based on the closing sales price of the registrant's common stock on that date). Shares of the registrant's common stock held by each officer and director and each person known to the registrant to own 10% or more of the outstanding voting power of the registrant have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not a determination for other purposes.

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at February 27, 2015
Common Stock, $0.01 par value per share	17,520,576

DOCUMENTS INCORPORATED BY REFERENCE

Portions of our Proxy Statement for the Annual Meeting of Shareowners to be held on April 28, 2015, are incorporated by reference in Part III.

CAPITAL CITY BANK GROUP, INC.

ANNUAL REPORT FOR 2014 ON FORM 10-K

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INTRODUCTORY NOTE

This Annual Report on Form 10-K contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, among others, statements about our beliefs, plans, objectives, goals, expectations, estimates and intentions that are subject to significant risks and uncertainties and are subject to change based on various factors, many of which are beyond our control. The words "may," "could," "should," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan," "target," "goal," and similar expressions are identify forward-looking statements.

All forward-looking statements, by their nature, are subject to risks and uncertainties. Our actual future results may differ materially from those set forth in our forward-looking statements.

In addition to those risks discussed in this Annual Report under Item 1A Risk Factors, factors that could cause our actual results to differ materially from those in the forward-looking statements, include, without limitation:

- legislative or regulatory changes, including the Dodd-Frank Act, Basel III, and the ability to repay and qualified mortgage standards;
- our ability to successfully manage interest rate risk, liquidity risk, and other risks inherent to our industry;
- the effects of security breaches and computer viruses that may affect our computer systems or fraud related to credit or debit card products;
- the accuracy of our financial statement estimates and assumptions, including the estimates used for our loan loss provision and deferred tax asset valuation allowance;
- the frequency and magnitude of foreclosure of our loans;
- the effects of our lack of a diversified loan portfolio, including the risks of geographic and industry concentrations;
- the strength of the United States economy in general and the strength of the local economies in which we conduct operations;
- our need and our ability to incur additional debt or equity financing;
- our ability to declare and pay dividends;
- changes in the securities and real estate markets;
- changes in monetary and fiscal policies of the U.S. Government;
- inflation, interest rate, market and monetary fluctuations;
- the effects of harsh weather conditions, including hurricanes, and man-made disasters;
- our ability to comply with the extensive laws and regulations to which we are subject;
- our ability to comply with the laws for each jurisdiction where we operate;
- the willingness of clients to accept third-party products and services rather than our products and services and vice versa;
- increased competition and its effect on pricing;
- technological changes;
- negative publicity and the impact on our reputation;
- changes in consumer spending and saving habits;
- growth and profitability of our noninterest income;
- changes in accounting principles, policies, practices or guidelines;

- the limited trading activity of our common stock;
- the concentration of ownership of our common stock;
- anti-takeover provisions under federal and state law as well as our Articles of Incorporation and our Bylaws;
- other risks described from time to time in our filings with the Securities and Exchange Commission; and
- our ability to manage the risks involved in the foregoing.

However, other factors besides those listed in *Item 1A Risk Factors* or discussed in this Annual Report also could adversely affect our results, and you should not consider any such list of factors to be a complete set of all potential risks or uncertainties. Any forward-looking statements made by us or on our behalf speak only as of the date they are made. We do not undertake to update any forward-looking statement, except as required by applicable law.

PART I

Item 1. Business

About Us

General

Capital City Bank Group, Inc. ("CCBG") is a financial holding company headquartered in Tallahassee, Florida. CCBG was incorporated under Florida law on December 13, 1982, to acquire five national banks and one state bank that all subsequently became part of CCBG's bank subsidiary, Capital City Bank ("CCB" or the "Bank"). In this report, the terms "Company," "we," "us," or "our" mean CCBG and all subsidiaries included in our consolidated financial statements.

We provide traditional deposit and credit services, asset management, trust, mortgage banking, merchant services, bank cards, data processing, and securities brokerage services through 63 full-service banking locations in Florida, Georgia, and Alabama operated by CCB. The majority of our revenue, approximately 82%, is derived from our Florida market areas while approximately 17% and 1% of our revenue is derived from our Georgia and Alabama market areas, respectively.

Below is a summary of our financial condition and results of operations for the past three years. Our financial condition and results of operations are more fully discussed in our management discussion and analysis on page 29 and our consolidated financial statements on page 59.

Dollars in millions

Year Ended December 31,	Assets	Deposits	Shareowners' Equity	**Revenue**[1]	Net Income
2014	$2,627.2	$2,146.8	$ 272.5	$ 130.8	$ 9.3
2013	2,611.9	2,136.2	276.4	137.3	6.0
2012	2,634.0	2,145.0	246.9	144.2	0.1

(1) Revenue represents interest income plus noninterest income.

Dividends and management fees received from the Bank are CCBG's primary source of income. Dividend payments by the Bank to CCBG depend on the capitalization, earnings and projected growth of the Bank, and are limited by various regulatory restrictions. See the section entitled "Regulatory Matters" in this *Item 1* and Note 14 in the Notes to Consolidated Financial Statements for a discussion of the restrictions.

We had a total of 937 associates at March 1, 2015. Item 6 contains other financial and statistical information about us.

Subsidiaries of CCBG

CCBG's principal asset is the capital stock of the CCB, our wholly owned banking subsidiary, which accounted for approximately 100% of consolidated assets at December 31, 2014, and approximately 100% of consolidated net income for the year ended December 31, 2014. In addition to our banking subsidiary, CCB has three primary wholly owned subsidiaries, Capital City Trust Company, Capital City Banc Investments, Inc., and Capital City Services Company. The nature of these subsidiaries is provided below.

Operating Segment

We have one reportable segment with four principal services: Banking Services (CCB), Data Processing Services (Capital City Services Company), Trust and Asset Management Services (Capital City Trust Company), and Brokerage Services (Capital City Banc Investments, Inc.). Revenues from each of these principal services for the year ended 2014 totaled approximately 92.8%, 1.2%, 3.1%, and 2.9% of our total revenue, respectively. In 2013 and 2012, Banking Services (CCB) revenue was approximately 91.9% and 93.1% of our total revenue for each respective year.

Capital City Bank

CCB is a Florida-chartered full-service bank engaged in the commercial and retail banking business. Significant services offered by the Bank include:

- *Business Banking* – The Bank provides banking services to corporations and other business clients. Credit products are available for a wide variety of general business purposes, including financing for commercial business properties, equipment, inventories and accounts receivable, as well as commercial leasing and letters of credit. We also provide treasury management services, and, through a marketing alliance with Elavon, Inc., merchant credit card transaction processing services.
- *Commercial Real Estate Lending* – The Bank provides a wide range of products to meet the financing needs of commercial developers and investors, residential builders and developers, and community development. Credit products are available to purchase land and/or build structures for business use and for investors who are developing residential or commercial property.
- *Residential Real Estate Lending* – The Bank provides products to help meet the home financing needs of consumers, including conventional permanent and construction/ permanent (fixed, adjustable, or variable rate) financing arrangements, and FHA/VA loan products. The Bank offers both fixed-rate and adjustable rate residential mortgage (ARM) loans. A portion of our loans originated are sold into the secondary market. The Bank offers these products through its existing network of banking offices. We do not originate subprime residential real estate loans.
- *Retail Credit* – The Bank provides a full-range of loan products to meet the needs of consumers, including personal loans, automobile loans, boat/RV loans, home equity loans, and through a marketing alliance with ELAN, we offer credit card programs.
- *Institutional Banking* – The Bank provides banking services to meet the needs of state and local governments, public schools and colleges, charities, membership and not-for-profit associations including customized checking and savings accounts, cash management systems, tax-exempt loans, lines of credit, and term loans.
- *Retail Banking* – The Bank provides a full-range of consumer banking services, including checking accounts, savings programs, automated teller machines (ATMs), debit/credit cards, night deposit services, safe deposit facilities, online banking, and mobile banking. Clients can use Capital City Bank Direct which offers a “live” call center between the hours of 8 a.m. to 6 p.m. Monday through Friday and from 9 a.m. to 12 noon on Saturday. The call center can also be accessed via live chat through the internet. Bank Direct also offers an automated phone system offering 24-hour access to client deposit and loan account information and transfer of funds between linked accounts. The Bank is a member of the “Star” ATM Network that permits banking clients to access cash at ATMs or “point-of-sale” merchants.

Capital City Trust Company

Capital City Trust Company (the “Trust Company”) is the investment management arm of CCB. The Trust Company provides asset management for individuals through agency, personal trust, IRA, and personal investment management accounts. The Trust Company also provides services for the administration of pension, profit sharing, and 401(k) plans. Associations, endowments, and other nonprofit entities hire the Trust Company to manage their investment portfolios. Additionally, a staff of well-trained professionals serves individuals requiring the services of a trustee, personal representative, or a guardian. The market value of trust assets under discretionary management exceeded $726.2 million as of December 31, 2014, with total assets under administration exceeding $851.8 million.

Capital City Banc Investments, Inc.

Capital City Banc Investments, Inc. offers access to retail investment products through INVEST Financial Corporation, a member of FINRA and SIPC. Non-deposit investment and insurance products are: (i) not FDIC insured; (ii) not deposits, obligations, or guarantees by any bank; and (iii) subject to investment risk, including the possible loss of principal amount invested. Capital City Banc Investments, Inc. offers a full line of retail securities products, including U.S. Government bonds, tax-free municipal bonds, stocks, mutual funds, unit investment trusts, annuities, life insurance and long-term health care. We are not an affiliate of INVEST Financial Corporation.

Capital City Services Company

Capital City Services Company (the "Services Company") provides data processing services to financial institutions (including CCB), government agencies, and commercial clients located in North Florida and South Georgia. As of March 1, 2015, the Services Company is providing data processing services to four correspondent banks which have relationships with CCB.

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Underwriting Standards

A core goal of CCB is to support the communities in which it operates. The Bank seeks loans from within its primary market area, which is defined as the counties in which the Bank's offices are located. The Bank will originate loans within its secondary market area, defined as adjacent counties to those in which the Bank has offices. There may also be occasions when the Bank will have opportunities to make loans that are out of both the primary and secondary market areas. These loans will only be approved if the applicant is known to the Bank and applicant's primary business is within our primary or secondary market area. Approval of all loans is subject to the Bank's policies and standards described in more detail below.

The Bank has adopted comprehensive lending policies, underwriting standards and loan review procedures. Management and the Bank's Board of Directors reviews and approves these policies and procedures on a regular basis (at least annually).

Management has also implemented reporting systems to monitor loan originations, loan quality, concentrations of credit, loan delinquencies and nonperforming loans and potential problem loans. Bank management and the Credit Risk Oversight Committee periodically review our lines of business to monitor asset quality trends and the appropriateness of credit policies. In addition, total borrower exposure limits are established and concentration risk is monitored. As part of this process, the overall composition of the portfolio is reviewed to gauge diversification of risk, client concentrations, industry group, loan type, geographic area, or other relevant classifications of loans. Specific segments of the portfolio are monitored and reported to the Bank's Board on a quarterly basis (i.e., commercial real estate) and the Bank has strategic plans in place to supplement Board approved credit policies governing exposure limits and underwriting standards. The Bank recognizes that exceptions to the below-listed policy guidelines may occasionally occur and has established procedures for approving exceptions to these policy guidelines.

Residential Real Estate Loans

The Bank originates 1-4 family, owner-occupied residential real estate loans in its Residential Real Estate line of business. The Bank's policy is to underwrite these loans in accordance with secondary market guidelines in effect at the time of origination, including loan-to-value ("LTV") and documentation requirements. The Bank originates fixed-rate, adjustable-rate and variable- rate residential real estate loans. Over the past five years, the vast majority of residential loan originations have been fixed-rate loans which are sold in the secondary market on a non-recourse basis with related servicing rights (i.e., the Bank does not service sold loans). These loans require private mortgage insurance ("PMI") if the LTV exceeds 80%. Some of the adjustable-rate residential real estate product is retained in the Bank's loan portfolio and loans with LTVs in excess of 85% require PMI. Adjustable rate mortgage ("ARM") loans with an initial fixed interest rate period greater than three years are sold in the secondary market on a non-recourse basis.

The Bank also originates 1-4 family, owner-occupied residential real estate loans throughout its banking office network. These loans are generally not eligible for sale into the secondary market due to not meeting a specific secondary market underwriting requirement. The product offering is a variable rate 3/1 ARM with a maximum term of 30 years and maximum LTV of 80%. The Bank verifies applicants' income, obtains credit reports and independent real estate appraisals in the underwriting process to ensure adequate collateral coverage and that loans are extended to individuals with good credit and income sufficient to repay the loan.

Residential real estate loans also include home equity lines of credit and home equity loans ("HELOCs"). The Bank's home equity portfolio includes revolving open-ended equity loans with interest-only or minimal monthly principal payments and closed-end amortizing loans. Open-ended equity loans typically have an interest only ten year draw period followed by a five year repayment period of 0.75% of principal balance monthly and balloon payment at maturity. As of December 31, 2014, approximately 60% of the Bank's residential home equity loan portfolio consisted of first mortgages. Interest rates may be fixed or adjustable. Adjustable-rate loans are tied to the Prime Rate with a typical margin of 1.0% or more. Appraisals are normally required for all residential real estate loans, both those sold to the secondary market and those maintained in the Bank's loan portfolio.

The Consumer Financial Protection Bureau finalized its ability to repay ("ATR") rule as well as its qualified mortgage rule in January 2013 (with clarifications adopted in July 2013). The ATR rule applies to residential mortgage loan applications received after January 14, 2014. The scope of the rule specifically applies to loans securing 1-4 unit dwellings and includes purchases, refinances and home equity loans for principal or second homes. Under the ATR rules, a lender may not make a residential mortgage loan unless the lender makes a reasonable and good faith determination that is based on verified, documented information at or before consummation that the borrower has a reasonable ability to repay. The eight underwriting factors that must be considered and verified include the following: (1) income and assets: (2) employment status; (3) monthly payment of loan; (4) monthly payment of any simultaneous loan secured by the same property; (5) monthly payment for other mortgage-related obligations like property taxes and insurance; (6) current debt obligations; (7) monthly debt to income ratio; and (8) credit history (although eight factors are delineated, the ATR rule does not dictate that a lender follow a particular underwriting model). Liability for violations of the ATR rule include actual damages, statutory damages and court costs and attorneys' fees.

Additionally, the Consumer Financial Protection Bureau published regulations required by the Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”) related to “qualified mortgages,” which are mortgages for which there is a presumption that the lender has satisfied the ATR rules. Pursuant to Dodd-Frank, qualified mortgages (“QMs”) must have certain product-feature prerequisites and affordability underwriting requirements. Generally, to meet the QM test, the lender must calculate the monthly payments based on the highest payment that will apply in the first five years and the consumer must have a total debt-to-income ratio that is less than or equal to 43%. The QM rule provides a safe harbor to the ATR rules for lenders that make loans that satisfy the definition of a QM and are not higher priced. From time to time, the Bank originates non-qualified mortgages under certain predefined internal and investor underwriting parameters to be sold to either secondary market investors or held in the Bank’s loan portfolio.

Commercial Loans

The Bank’s policy sets forth guidelines for debt service coverage ratios, LTV ratios and documentation standards. Commercial loans are primarily made based on identified cash flows of the borrower with consideration given to underlying collateral and personal or other guarantees. The Bank’s policy establishes debt service coverage ratio limits that require a borrower’s cash flow to be sufficient to cover principal and interest payments on all new and existing debt. The majority of the Bank’s commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory. Many of the loans in the commercial portfolio have variable interest rates tied to the Prime Rate or U.S. Treasury indices.

Commercial Real Estate Loans

The Bank’s policy sets forth guidelines for debt service coverage ratios, LTV ratios and documentation standards. Commercial real estate loans are primarily made based on identified cash flows of the borrower with consideration given to underlying real estate collateral and personal guarantees. The Bank’s policy establishes a maximum LTV specific to property type and minimum debt service coverage ratio limits that require a borrower’s cash flow to be sufficient to cover principal and interest payments on all new and existing debt. Commercial real estate loans may be fixed or variable-rate loans with interest rates tied to the Prime Rate or U.S. Treasury indices. Bank policy requires appraisals for loans in excess of $250,000 that are secured by real property.

Consumer Loans

The Bank’s consumer loan portfolio includes personal installment loans, direct and indirect automobile financing, and overdraft lines of credit. The majority of the consumer loan portfolio consists of indirect and direct automobile loans. The majority of the Bank’s consumer loans are short-term and have fixed rates of interest that are set giving consideration to current market interest rates and the financial strength of the borrower. The Bank’s policy establishes maximum debt-to-income ratios, minimum credit scores, and includes guidelines for verification of applicants’ income and receipt of credit reports.

Lending Limits and Extensions of Additional Credit

The Bank has established an internal lending limit of $10.0 million for the total aggregate amount of credit that will be extended to a client and any related entities within its Board approved policies. This compares to our legal lending limit of approximately $76 million. In practice, the Bank seeks to maintain an internal lending limit of $7.5 million in order to maintain a well-diversified loan portfolio.

Loan Modification and Restructuring

In the normal course of business, CCB receives requests from its clients to renew, extend, refinance, or otherwise modify their current loan obligations. In most cases, this may be the result of a balloon maturity that is typical in most commercial loan agreements, a request to refinance to obtain current market rates of interest, competitive reasons, or the conversion of a construction loan to a permanent financing structure at the completion or stabilization of the property. In these cases, the request is held to the normal underwriting standards and pricing strategies as any other loan request, whether new or renewal.

In other cases, we may modify a loan because of a reduction in debt service capacity experienced by the client (i.e., potentially troubled loan whereby the client may be experiencing financial difficulties). To maximize the collection of loan balances, we evaluate troubled loans on a case-by-case basis to determine if a loan modification would be appropriate. We pursue loan modifications when there is a reasonable chance that an appropriate modification would allow our client to continue servicing the debt.

Expansion of Business

Our philosophy is to build long-term client relationships based on quality service, high ethical standards, and safe and sound banking practices. We maintain a locally oriented, community-based focus, which is augmented by experienced, centralized support in select specialized areas. Our local market orientation is reflected in our network of banking office locations, experienced community executives with a dedicated President for each market, and community boards which support our focus on responding to local banking needs. We strive to offer a broad array of sophisticated products and to provide quality service by empowering associates to make decisions in their local markets.

We have sought to build a franchise in small- to medium-sized markets, located on the outskirts of the larger metropolitan markets where we are positioned as a market leader. Many of our markets are on the outskirts of these larger markets in close proximity to major interstate thoroughfares such as Interstates I-10 and I-75. Our three largest markets are Tallahassee (Leon, Florida), Gainesville (Alachua, Florida), and Macon (Bibb, Georgia). In 13 of 20 markets in Florida and three of five markets in Georgia, we rank within the top 4 banks in terms of market share. Furthermore, in the counties in which we operate, we maintain an average 9.10% market share in the Florida counties and 5.82% in the Georgia counties, suggesting that there is significant opportunity to grow market share within these geographic areas. The larger employers in many of our markets are state and local governments, healthcare providers, educational institutions, and small businesses. While we realize that the markets in our footprint do not provide for a level of potential growth that the larger metropolitan markets may provide, our markets do provide good growth dynamics and have historically grown in excess of the national average. We strive to provide value added services to our clients by being their banker, not just a bank. This element of our strategy distinguishes Capital City Bank from our competitors.

As a result of the contracted credit cycle over the last several years and the overall regulatory environment, we have not pursued additional acquisitions; however, our long-term vision remains to profitably expand our franchise through a combination of organic growth in existing markets and through acquisitions. We have long understood that our core deposit funding base is the predominant driver of our profitability and overall franchise value, and have focused extensively on this component of our organic growth efforts in recent years.

Potential acquisition growth will continue to be focused on Florida, Georgia, and Alabama with a particular focus on financial institutions located on the outskirts of larger, metropolitan areas. Five markets have been identified, four in Florida and one in Georgia, in which management intends to proactively pursue expansion opportunities. These markets include Alachua, Marion, Hernando/Pasco counties in Florida, the western panhandle of Florida, and Bibb and surrounding counties in central Georgia. Our focus on some of these markets may change as we continue to evaluate our strategy and the impact the current economic cycle is having on any individual market. We will also continue to evaluate de novo expansion opportunities in attractive new markets in the event that acquisition opportunities in those markets are not feasible. Other expansion opportunities that will be evaluated include asset management, mortgage banking, and insurance. Embedded in our acquisition strategy is our desire to partner with institutions that are culturally similar, have experienced management and possess either established market presence or have potential for improved profitability through growth, economies of scale, or expanded services. Generally, these target institutions would range in asset size from $100 million to $400 million.

Competition

We operate in a highly competitive environment, especially with respect to services and pricing. In addition, the banking business is experiencing enormous changes. Since 2009, nearly 500 financial institutions have failed in the U.S., including 83 in Georgia and 70 in Florida. Nearly all of the failed banks were community banks. The assets and deposits of many of these failed community banks were acquired mostly by larger financial institutions. We expect consolidation to continue during 2015, but primarily through traditional merger and acquisition activity. We believe that the larger financial institutions acquiring banks in our market areas are less familiar with the markets in which we operate and typically target a different client base. We believe clients who bank at community banks tend to prefer the relationship style service of community banks compared to larger banks. As a result, we believe the reduction of the number of community banks could further enhance our competitive position and opportunities in many of our markets. Larger financial institutions, however, can benefit from economies of scale. Therefore, these larger institutions may be able to offer banking products and services at more competitive prices than us. Additionally, these larger financial institutions may offer financial products that we do not offer.

Our primary market area consists of 20 counties in Florida, five counties in Georgia, and one county in Alabama. In these markets, the Bank competes against a wide range of banking and nonbanking institutions including savings and loan associations, credit unions, money market funds, mutual fund advisory companies, mortgage banking companies, investment banking companies, finance companies and other types of financial institutions. Most of Florida's major banking concerns have a presence in Leon County. CCB's Leon County deposits totaled $782.2 million, or 36.4% of our consolidated deposits at December 31, 2014.

The table below depicts our market share percentage within each county, based on commercial bank deposits within the county.

	Market Share as of June 30,[1]		
County	2014	2013	2012
Florida			
Alachua	4.8 %	4.5 %	4.5 %
Bradford	51.5%	51.8%	52.3%
Citrus	3.6 %	3.6 %	3.3 %
Clay	2.0 %	1.8 %	1.8 %
Dixie	9.9 %	15.1%	18.5%
Gadsden	77.4%	70.2%	62.1%
Gilchrist	42.2%	40.8%	42.1%
Gulf	14.0%	14.0%	13.7%
Hernando	1.8 %	1.9 %	1.9 %
Jefferson	22.1%	19.8%	21.4%
Leon	15.3%	15.3%	16.5%
Levy	28.0%	27.8%	28.7%
Madison	10.3%	9.0 %	9.7 %
Pasco	0.1 %	0.1 %	0.2 %
Putnam	19.5%	18.9%	18.0%
St. Johns	0.9 %	0.9 %	1.1 %
Suwannee	6.8 %	6.8 %	6.9 %
Taylor	22.0%	21.8%	30.8%
Wakulla	13.6%	13.6%	11.7%
Washington	13.6%	13.8%	12.3%
Georgia			
Bibb	3.6 %	3.8 %	3.5 %
Burke	6.8 %	12.7%	8.4 %
Grady	14.3%	14.6%	17.4%
Laurens	9.1 %	9.0 %	10.4%
Troup	5.3 %	5.1 %	7.2 %
Alabama			
Chambers	7.6 %	8.1 %	7.7 %

[1] *Obtained from the FDIC Summary of Deposits Report for the year indicated.*

The following table sets forth the number of commercial banks and offices, including our offices and our competitors' offices, within each of the respective counties.

County	Number of Commercial Banks	Number of Commercial Bank Offices
Florida		
Alachua	17	64
Bradford	3	3
Citrus	12	43
Clay	13	30
Dixie	4	5
Gadsden	2	3
Gilchrist	4	6
Gulf	3	5
Hernando	14	40
Jefferson	2	2
Leon	17	79
Levy	2	11
Madison	5	5
Pasco	21	105
Putnam	6	13
St. Johns	23	64
Suwannee	5	8
Taylor	3	4
Wakulla	3	4
Washington	6	6
Georgia		
Bibb	10	50
Burke	5	10
Grady	5	8
Laurens	10	20
Troup	10	23
Alabama		
Chambers	6	9

Data obtained from the June 30, 2014 FDIC Summary of Deposits Report.

Seasonality

We believe our commercial banking operations are not generally seasonal in nature; however, public deposits tend to increase with tax collections in the fourth and first quarters of each year and decline with spending thereafter.

<u>Regulatory Considerations</u>

We must comply with state and federal banking laws and regulations that control virtually all aspects of our operations. These laws and regulations generally aim to protect our depositors, not necessarily our shareowners or our creditors. Any changes in applicable laws or regulations may materially affect our business and prospects. Proposed legislative or regulatory changes may also affect our operations. The following description summarizes some of the laws and regulations to which we are subject. References to applicable statutes and regulations are brief summaries, do not purport to be complete, and are qualified in their entirety by reference to such statutes and regulations.

The Company

We are registered with the Board of Governors of the Federal Reserve as a financial holding company under the Bank Holding Company Act of 1956. As a result, we are subject to supervisory regulation and examination by the Federal Reserve. The Gramm-Leach-Bliley Act, the Bank Holding Company Act, and other federal laws subject financial holding companies to particular restrictions on the types of activities in which they may engage, and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations.

Permitted Activities

The Gramm-Leach-Bliley Act modernized the U.S. banking system by: (i) allowing bank holding companies that qualify as “financial holding companies” such as CCBG to engage in a broad range of financial and related activities; (ii) allowing insurers and other financial service companies to acquire banks; (iii) removing restrictions that applied to bank holding company ownership of securities firms and mutual fund advisory companies; and (iv) establishing the overall regulatory scheme applicable to bank holding companies that also engage in insurance and securities operations. The general effect of the law was to establish a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms, and other financial service providers. Activities that are financial in nature are broadly defined to include not only banking, insurance, and securities activities, but also merchant banking and additional activities that the Federal Reserve, in consultation with the Secretary of the Treasury, determines to be financial in nature, incidental to such financial activities, or complementary activities that do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

In contrast to financial holding companies, bank holding companies are limited to managing or controlling banks, furnishing services to or performing services for its subsidiaries, and engaging in other activities that the Federal Reserve determines by regulation or order to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is permissible, the Federal Reserve must consider whether the performance of such an activity reasonably can be expected to produce benefits to the public that outweigh possible adverse effects. Possible benefits include greater convenience, increased competition, and gains in efficiency. Possible adverse effects include undue concentration of resources, decreased or unfair competition, conflicts of interest, and unsound banking practices. Despite prior approval, the Federal Reserve may order a bank holding company or its subsidiaries to terminate any activity or to terminate ownership or control of any subsidiary when the Federal Reserve has reasonable cause to believe that a serious risk to the financial safety, soundness or stability of any bank subsidiary of that bank holding company may result from such an activity.

Changes in Control

Subject to certain exceptions, the Bank Holding Company Act and the Change in Bank Control Act, together with the applicable regulations, require Federal Reserve approval (or, depending on the circumstances, no notice of disapproval) prior to any person or company acquiring “control” of a bank or bank holding company. A conclusive presumption of control exists if an individual or company acquires the power, directly or indirectly, to direct the management or policies of an insured depository institution or to vote 25% or more of any class of voting securities of any insured depository institution. A rebuttable presumption of control exists if a person or company acquires 10% or more but less than 25% of any class of voting securities of an insured depository institution and either the institution has registered securities under Section 12 of the Securities Exchange Act of 1934, which we will refer to as the Exchange Act, or no other person will own a greater percentage of that class of voting securities immediately after the acquisition. Our common stock is registered under Section 12 of the Exchange Act.

The Federal Reserve Board maintains a policy statement on minority equity investments in banks and bank holding companies, that generally permits investors to (i) acquire up to 33% of the total equity of a target bank or bank holding company, subject to certain conditions, including (but not limited to) that the investing firm does not acquire 15% or more of any class of voting securities, and (ii) designate at least one director, without triggering the various regulatory requirements associated with control.

As a financial holding company, we are required to obtain prior approval from the Federal Reserve before (i) acquiring all or substantially all of the assets of a bank or bank holding company, (ii) acquiring direct or indirect ownership or control of more than 5% of the outstanding voting stock of any bank or bank holding company (unless we own a majority of such bank’s voting shares), or (iii) merging or consolidating with any other bank or bank holding company. In determining whether to approve a proposed bank acquisition, federal bank regulators will consider, among other factors, the effect of the acquisition on competition, the public benefits expected to be received from the acquisition, the projected capital ratios and levels on a post-acquisition basis, and the acquiring institution’s record of addressing the credit needs of the communities it serves, including the needs of low and moderate income neighborhoods, consistent with the safe and sound operation of the bank, under the Community Reinvestment Act of 1977.

Under Florida law, a person or entity proposing to directly or indirectly acquire control of a Florida bank must also obtain permission from the Florida Office of Financial Regulation. Florida statutes define “control” as either (i) indirectly or directly owning, controlling or having power to vote 25% or more of the voting securities of a bank; (ii) controlling the election of a majority of directors of a bank; (iii) owning, controlling, or having power to vote 10% or more of the voting securities as well as directly or indirectly exercising a controlling influence over management or policies of a bank; or (iv) as determined by the Florida Office of Financial Regulation. These requirements will affect us because CCB is chartered under Florida law and changes in control of CCBG are indirect changes in control of CCB.

Tying

Financial holding companies and their affiliates are prohibited from tying the provision of certain services, such as extending credit, to other services or products offered by the holding company or its affiliates, such as deposit products.

Capital; Dividends; Source of Strength

The Federal Reserve imposes certain capital requirements on financial holding companies under the Bank Holding Company Act, including a minimum leverage ratio and a minimum ratio of “qualifying” capital to risk-weighted assets. These requirements are described below under “Capital Regulations.” Subject to its capital requirements and certain other restrictions, we are generally able to borrow money to make a capital contribution to CCB, and such loans may be repaid from dividends paid from CCB to us. We are also able to raise capital for contributions to CCB by issuing securities without having to receive regulatory approval, subject to compliance with federal and state securities laws.

In accordance with Federal Reserve policy, which has been codified by the Dodd-Frank Act, we are expected to act as a source of financial strength to CCB and to commit resources to support CCB in circumstances in which we might not otherwise do so. In furtherance of this policy, the Federal Reserve may require a financial holding company to terminate any activity or relinquish control of a nonbank subsidiary (other than a nonbank subsidiary of a bank) upon the Federal Reserve’s determination that such activity or control constitutes a serious risk to the financial soundness or stability of any subsidiary depository institution of the financial holding company. Further, federal bank regulatory authorities have additional discretion to require a financial holding company to divest itself of any bank or nonbank subsidiary if the agency determines that divestiture may aid the depository institution’s financial condition.

Capital City Bank

CCB is a banking institution that is chartered by and headquartered in the State of Florida, and it is subject to supervision and regulation by the Florida Office of Financial Regulation. The Florida Office of Financial Regulation supervises and regulates all areas of CCB’s operations including, without limitation, the making of loans, the issuance of securities, the conduct of CCB’s corporate affairs, the satisfaction of capital adequacy requirements, the payment of dividends, and the establishment or closing of banking centers. CCB is also a member bank of the Federal Reserve System, which makes CCB’s operations subject to broad federal regulation and oversight by the Federal Reserve. In addition, CCB’s deposit accounts are insured by the FDIC to the maximum extent permitted by law, and the FDIC has certain enforcement powers over CCB.

As a state-chartered banking institution in the State of Florida, CCB is empowered by statute, subject to the limitations contained in those statutes, to take and pay interest on, savings and time deposits, to accept demand deposits, to make loans on residential and other real estate, to make consumer and commercial loans, to invest, with certain limitations, in equity securities and in debt obligations of banks and corporations and to provide various other banking services for the benefit of CCB's clients. Various consumer laws and regulations also affect the operations of CCB, including state usury laws, laws relating to fiduciaries, consumer credit and equal credit opportunity laws, and fair credit reporting. In addition, the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") prohibits insured state chartered institutions from conducting activities as principal that are not permitted for national banks. A bank, however, may engage in an otherwise prohibited activity if it meets its minimum capital requirements and the FDIC determines that the activity does not present a significant risk to the Deposit Insurance Fund.

Reserves

The Federal Reserve requires all depository institutions to maintain reserves against some transaction accounts (primarily NOW and Super NOW checking accounts). The balances maintained to meet the reserve requirements imposed by the Federal Reserve may be used to satisfy liquidity requirements. An institution may borrow from the Federal Reserve Bank "discount window" as a secondary source of funds, provided that the institution meets the Federal Reserve Bank's credit standards.

Dividends

CCB is subject to legal limitations on the frequency and amount of dividends that can be paid to us. The Federal Reserve may restrict the ability of CCB to pay dividends if such payments would constitute an unsafe or unsound banking practice.

In addition, Florida law and Federal regulation also places restrictions on the declaration of dividends from state chartered banks to their holding companies. Pursuant to the Florida Financial Institutions Code, the board of directors of state-chartered banks, after charging off bad debts, depreciation and other worthless assets, if any, and making provisions for reasonably anticipated future losses on loans and other assets, may quarterly, semi-annually or annually declare a dividend of up to the aggregate net profits of that period combined with the bank's retained net profits for the preceding two years and, with the approval of the Florida Office of Financial Regulation and Federal Reserve, declare a dividend from retained net profits which accrued prior to the preceding two years. Before declaring such dividends, 20% of the net profits for the preceding period as is covered by the dividend must be transferred to the surplus fund of the bank until this fund becomes equal to the amount of the bank's common stock then issued and outstanding. A state-chartered bank may not declare any dividend if (i) its net income (loss) from the current year combined with the retained net income (loss) for the preceding two years aggregates a loss or (ii) the payment of such dividend would cause the capital account of the bank to fall below the minimum amount required by law, regulation, order or any written agreement with the Florida Office of Financial Regulation or a federal regulatory agency.

Insurance of Accounts and Other Assessments

CCB pays its deposit insurance assessments to the Deposit Insurance Fund, which is determined through a risk-based assessment system. Our deposit accounts are currently insured by the Deposit Insurance Fund generally up to a maximum of $250,000 per separately insured depositor.

Under the current assessment system, the FDIC assigns an institution to one of four categories designed to measure risk, with the first category having two sub-categories based on the institution's most recent supervisory and capital evaluations. Total base assessment rates currently range from 0.025% of deposits for an institution in the highest sub-category of the highest category to 0.45% of deposits for an institution in the lowest category.

In addition, all FDIC insured institutions are required to pay assessments to the FDIC at an annual rate of approximately six tenths of a basis point of insured deposits to fund interest payments on bonds issued by the Financing Corporation, an agency of the federal government established to recapitalize the predecessor to the Savings Association Insurance Fund. These assessments will continue until the Financing Corporation bonds mature in 2017 through 2019.

Under the Federal Deposit Insurance Act, or FDIA, the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

Transactions With Affiliates

Pursuant to Sections 23A and 23B of the Federal Reserve Act and Regulation W, the authority of CCB to engage in transactions with related parties or "affiliates" or to make loans to insiders is limited. Loan transactions with an "affiliate" generally must be collateralized and certain transactions between CCB and its "affiliates", including the sale of assets, the payment of money or the provision of services, must be on terms and conditions that are substantially the same, or at least as favorable to CCB, as those prevailing for comparable nonaffiliated transactions. In addition, CCB generally may not purchase securities issued or underwritten by affiliates.

Loans to executive officers, directors or to any person who directly or indirectly, or acting through or in concert with one or more persons, owns, controls or has the power to vote more than 10% of any class of voting securities of a bank, which we refer to as “10% Shareowners”, or to any political or campaign committee the funds or services of which will benefit those executive officers, directors, or 10% Shareowners or which is controlled by those executive officers, directors or 10% Shareowners, are subject to Sections 22(g) and 22(h) of the Federal Reserve Act and their corresponding regulations (Regulation O) and Section 13(k) of the Exchange Act relating to the prohibition on personal loans to executives (which exempts financial institutions in compliance with the insider lending restrictions of Section 22(h) of the Federal Reserve Act). Among other things, these loans must be made on terms substantially the same as those prevailing on transactions made to unaffiliated individuals and certain extensions of credit to those persons must first be approved in advance by a disinterested majority of the entire board of directors. Section 22(h) of the Federal Reserve Act prohibits loans to any of those individuals where the aggregate amount exceeds an amount equal to 15% of an institution’s unimpaired capital and surplus plus an additional 10% of unimpaired capital and surplus in the case of loans that are fully secured by readily marketable collateral, or when the aggregate amount on all of the extensions of credit outstanding to all of these persons would exceed CCB’s unimpaired capital and unimpaired surplus. Section 22(g) identifies limited circumstances in which CCB is permitted to extend credit to executive officers.

Community Reinvestment Act

The Community Reinvestment Act and its corresponding regulations are intended to encourage banks to help meet the credit needs of their service area, including low and moderate income neighborhoods, consistent with the safe and sound operations of the banks. These regulations provide for regulatory assessment of a bank's record in meeting the credit needs of its service area. Federal banking agencies are required to make public a rating of a bank's performance under the Community Reinvestment Act. The Federal Reserve considers a bank's Community Reinvestment Act rating when the bank submits an application to establish bank branches, merge, or acquire the assets and assume the liabilities of another bank. In the case of a financial holding company, the Community Reinvestment Act performance record of all banks involved in the merger or acquisition are reviewed in connection with the filing of an application to acquire ownership or control of shares or assets of a bank or to merge with any other bank or financial holding company. An unsatisfactory record can substantially delay or block the transaction. CCB received a satisfactory rating on its most recent Community Reinvestment Act assessment.

Capital Regulations

The federal banking regulators have adopted risk-based, capital adequacy guidelines for financial holding companies and their subsidiary state-chartered banks. The risk-based capital guidelines are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and financial holding companies, to account for off-balance sheet exposure, to minimize disincentives for holding liquid assets and to achieve greater consistency in evaluating the capital adequacy of major banks throughout the world. Under these guidelines, assets and off-balance sheet items are assigned to broad risk categories each with designated weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

The federal banking regulators adopted risk-based capital adequacy guidelines for U.S. banks. As described above, the federal banking regulators have adopted final rules that became effective January 1, 2015 for community banks. These final rules represent major changes to the current general risk-based capital rule, and are designed to substantially conform to the Basel III international standards. The risk-based capital guidelines are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance sheet exposure, to minimize disincentives for holding liquid assets, and to achieve greater consistency in evaluating the capital adequacy of major banks throughout the world. Under these guidelines, assets and off-balance sheet items are assigned to broad risk categories each with designated weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

Under the final rule, minimum requirements increased for both the quality and quantity of capital held by banking organizations. In this respect, the final rule implements strict eligibility criteria for regulatory capital instruments and improves the methodology for calculating risk-weighted assets to enhance risk sensitivity. Consistent with the international Basel framework, the rule includes a new minimum ratio of Common Equity Tier I Capital to Risk-Weighted Assets of 4.5% and a Common Equity Tier I Capital conservation buffer of 2.5% of risk-weighted assets. The conservation buffer will be phased in beginning on January 1, 2016 through 2019. The rule also, among other things, raises the minimum ratio of Tier I Capital to Risk-Weighted Assets from 4% to 6% and includes a minimum leverage ratio of 4% for all banking organizations.

In computing total risk-weighted assets, bank and bank holding company assets are given risk-weights of 0%, 20%, 50% and 100%. In addition, certain off-balance sheet items are given similar credit conversion factors to convert them to asset equivalent amounts to which an appropriate risk-weight will apply. Most loans will be assigned to the 100% risk category, except for performing first mortgage loans fully secured by 1- to 4-family and certain multi-family residential property, which carry a 50% risk rating. Most investment securities (including, primarily, general obligation claims on states or other political subdivisions of the United States) will be assigned to the 20% category, except for municipal or state revenue bonds, which have a 50% risk-weight, and direct obligations of the U.S. Treasury or obligations backed by the full faith and credit of the U.S. Government, which have a 0% risk-weight. In covering off-balance sheet items, direct credit substitutes, including general guarantees and standby letters of credit backing financial obligations, are given a 100% conversion factor. Transaction-related contingencies such as bid bonds, standby letters of credit backing nonfinancial obligations, and undrawn commitments (including commercial credit lines with an initial maturity of more than one year) have a 50% conversion factor. Short-term commercial letters of credit are converted at 20% and certain short-term unconditionally cancelable commitments have a 0% factor.

The new capital regulations may also impact the treatment of accumulated comprehensive income ("AOCI") for regulatory capital purposes. Under the new rules, AOCI would generally flow through to regulatory capital, however, community banks and their holding companies may make a one-time irrevocable opt-out election to continue to treat ACOI the same as under the old regulations for regulatory capital purposes. This election must be made on the first call report or bank holding company annual report (on form FR Y-9C) filed after January 1, 2015. Additionally, the new rules also permit community banks with less than $15 billion in total assets to continue to count certain non-qualifying capital instruments issued prior to May 19, 2010, including trust preferred securities and cumulative perpetual preferred stock, as Tier I capital (subject to a limit of 25% of Tier I capital). However, non-qualifying capital instruments issued on or after May 19, 2010 will not qualify for Tier I capital treatment.

Federal law and regulations establish a capital-based regulatory scheme designed to promote early intervention for troubled banks and require the FDIC to choose the least expensive resolution of bank failures. The capital-based regulatory framework contains five categories of compliance with regulatory capital requirements, including "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized." T qualify as a "well-capitalized" institution under the new rules in effect as of January 1, 2015, a bank must have a leverage ratio of not less than 5%, a Tier I Common Equity ratio of not less than 6.5%, a Tier I Capital ratio of not less than 8%, and a total risk-based capital ratio of not less than 10%, and the bank must not be under any order or directive from the appropriate regulatory agency to meet and maintain a specific capital level. To qualify as a "well-capitalized" institution under the rules in effect prior to January 1, 2015, a bank must have had a leverage ratio of not less than 5%, a Tier I Capital ratio of not less than 6%, and a total risk-based capital ratio of not less than 10%, and the bank must not have been under any order or directive from the appropriate regulatory agency that required the bank to meet and maintain a specific capital level.

Under the regulations, the applicable agency can treat an institution as if it were in the next lower category if the agency determines (after notice and an opportunity for hearing) that the institution is in an unsafe or unsound condition or is engaging in an unsafe or unsound practice. The degree of regulatory scrutiny of a financial institution will increase, and the permissible activities of the institution will decrease, as it moves downward through the capital categories. Institutions that fall into one of the three undercapitalized categories may be required to (i) submit a capital restoration plan; (ii) raise additional capital; (iii) restrict their growth, deposit interest rates, and other activities; (iv) improve their management; (v) eliminate management fees; or (vi) divest themselves of all or a part of their operations. It should be noted that the minimum ratios referred to above are merely guidelines and the bank regulators possess the discretionary authority to require higher capital ratios.

As of December 31, 2014, we exceeded the requirements contained in the applicable regulations, policies and directives pertaining to capital adequacy to be classified as "well capitalized" under both the prior capital adequacy rules and those now in effect for community banks as of January 1, 2015, and are unaware of any material violation or alleged violation of these regulations, policies or directives (see table below). Rapid growth, poor loan portfolio performance, or poor earnings performance, or a combination of these factors, could change our capital position in a relatively short period of time, making additional capital infusions necessary.

	Actual		**Required For Capital Adequacy Purposes**[(1)]		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2014:						
Tier I Capital:						
CCBG	$269,503	16.67%	$64,656	4.00%	*	*
CCB	261,655	16.24%	64,458	4.00%	96,687	6.00%
Total Capital:						
CCBG	287,042	17.76%	129,313	8.00%	*	*
CCB	279,194	17.33%	128,916	8.00%	161,145	10.00%
Tier I Leverage:						
CCBG	269,503	10.99%	98,090	4.00%	*	*
CCB	261,655	10.70%	97,834	4.00%	122,293	5.00%

(1) Based on the capital adequacy guidelines in effect prior to January 1, 2015.

Prompt Corrective Action

Immediately upon becoming undercapitalized, a depository institution becomes subject to the provisions of Section 38 of the Federal Deposit Insurance Act, which: (i) restrict payment of capital distributions and management fees; (ii) require that the appropriate federal banking agency monitor the condition of the institution and its efforts to restore its capital; (iii) require submission of a capital restoration plan; (iv) restrict the growth of the institution's assets; and (v) require prior approval of certain expansion proposals. The appropriate federal banking agency for an undercapitalized institution also may take any number of discretionary supervisory actions if the agency determines that any of these actions is necessary to resolve the problems of the institution at the least possible long-term cost to the deposit insurance fund, subject in certain cases to specified procedures. These discretionary supervisory actions include: (i) requiring the institution to raise additional capital; (ii) restricting transactions with affiliates; (iii) requiring divestiture of the institution or the sale of the institution to a willing purchaser; and (iv) any other supervisory action that the agency deems appropriate. These and additional mandatory and permissive supervisory actions may be taken with respect to significantly undercapitalized and critically undercapitalized institutions.

Interstate Banking and Branching

The Bank Holding Company Act, amended by the Interstate Banking Act, provides that adequately capitalized and managed financial and bank holding companies are permitted to acquire banks in any state.

State laws prohibiting interstate banking or discriminating against out-of-state banks are preempted. States are not permitted to enact laws opting out of this provision; however, states are allowed to adopt a minimum age restriction requiring that target banks located within the state be in existence for a period of time, up to a maximum of five years, before a bank may be subject to the Interstate Banking Act. Also, the Dodd-Frank Act, added deposit caps which prohibit acquisitions that result in the acquiring company controlling 30% or more of the deposits of insured banks and thrift institutions held in the state in which the target maintains a branch or 10% or more of the deposits nationwide. States have the authority to waive the 30% deposit cap. State-level deposit caps are not preempted as long as they do not discriminate against out-of-state companies, and the federal deposit caps apply only to initial entry acquisitions.

Under the Dodd-Frank Act, national banks and state banks are able to establish branches in any state if that state would permit the establishment of the branch by a state bank chartered in that state. Florida law permits a state bank to establish a branch of the bank anywhere in Florida. Accordingly, under the Dodd-Frank Act, a bank with its headquarters outside the State of Florida may establish branches anywhere within Florida.

Anti-money Laundering

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ("USA PATRIOT Act"), provides the federal government with additional powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing and broadened anti-money laundering requirements. By way of amendments to the Bank Secrecy Act ("BSA"), the USA PATRIOT Act puts in place measures intended to encourage information sharing among bank regulatory and law enforcement agencies. In addition, certain provisions of the USA PATRIOT Act impose affirmative obligations on a broad range of financial institutions.

Among other requirements, the USA PATRIOT Act and the related Federal Reserve regulations require banks to establish anti-money laundering programs that include, at a minimum:

- internal policies, procedures and controls designed to implement and maintain the savings association's compliance with all of the requirements of the USA PATRIOT Act, the BSA and related laws and regulations;
- systems and procedures for monitoring and reporting of suspicious transactions and activities;
- a designated compliance officer;
- employee training;
- an independent audit function to test the anti-money laundering program;
- procedures to verify the identity of each clients upon the opening of accounts; and
- heightened due diligence policies, procedures and controls applicable to certain foreign accounts and relationships.

Additionally, the USA PATRIOT Act requires each financial institution to develop a customer identification program ("CIP") as part of our anti-money laundering program. The key components of the CIP are identification, verification, government list comparison, notice and record retention. The purpose of the CIP is to enable the financial institution to determine the true identity and anticipated account activity of each customer. To make this determination, among other things, the financial institution must collect certain information from customers at the time they enter into the customer relationship with the financial institution. This information must be verified within a reasonable time through documentary and non-documentary methods. Furthermore, all customers must be screened against any

CIP-related government lists of known or suspected terrorists. We and our affiliates have adopted policies, procedures and controls designed to comply with the BSA and the USA PATRIOT Act.

Regulatory Enforcement Authority

Federal and state banking laws grant substantial enforcement powers to federal and state banking regulators. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities.

Federal Home Loan Bank System

CCB is a member of the Federal Home Loan Bank ("FHLB") of Atlanta, which is one of 12 regional Federal Home Loan Banks. Each FHLB serves as a reserve or central bank for its members within its assigned region. It is funded primarily from funds deposited by member institutions and proceeds from the sale of consolidated obligations of the FHLB system. It makes loans to members (i.e. advances) in accordance with policies and procedures established by the board of trustees of the FHLB.

As a member of the FHLB of Atlanta, CCB is required to own capital stock in the FHLB in an amount at least equal to 0.09% (or 9 basis points), which is subject to annual adjustments, of the CCB's total assets at the end of each calendar year (with a dollar cap of $15 million), plus 4.5% of its outstanding advances (borrowings) from the FHLB of Atlanta under the activity-based stock ownership requirement. As of December 31, 2014, CCB was in compliance with this requirement.

Privacy

Under the Gramm-Leach-Bliley Act, federal banking regulators adopted rules limiting the ability of banks and other financial institutions to disclose nonpublic information about consumers to nonaffiliated third parties. The rules require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to nonaffiliated third parties.

Overdraft Fee Regulation

The Electronic Fund Transfer Act prohibits financial institutions from charging consumers fees for paying overdrafts on automated teller machines ("ATM") and one-time debit card transactions, unless a consumer consents, or opts in, to the overdraft service for those type of transactions. If a consumer does not opt in, any ATM transaction or debit that overdraws the consumer's account will be denied. Overdrafts on the payment of checks and regular electronic bill payments are not covered by this rule. Before opting in, the consumer must be provided a notice that explains the financial institution's overdraft services, including the fees associated with the service, and the consumer's choices. Financial institutions must provide consumers who do not opt in with the same account terms, conditions and features (including pricing) that they provide to consumers who do opt in.

Consumer Laws and Regulations

CCB is also subject to other federal and state consumer laws and regulations that are designed to protect consumers in transactions with banks. While the list set forth below is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Check Clearing for the 21st Century Act, the Fair Credit Reporting Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Home Mortgage Disclosure Act, the Fair and Accurate Credit Transactions Act, the Mortgage Disclosure Improvement Act, and the Real Estate Settlement Procedures Act, among others. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. CCB must comply with the applicable provisions of these consumer protection laws and regulations as part of its ongoing customer relations.

The Volcker Rule

Section 619 of the Dodd-Frank Act, commonly known as the Volcker Rule, prohibits us from owning, sponsoring, or having certain relationships with any hedge funds or private equity funds, subject to certain exemptions. The Volcker Rule directed the federal banking, securities and commodities and futures regulatory agencies to undertake a coordinated rulemaking effort to create rules implementing the Volcker Rule. The final interagency rules implementing the Volcker Rule, which were issued in December 2013 and became effective on April 1, 2014, afford financial institutions a two-year conformance period during which they can wind-down, sell, or otherwise conform their respective activities, investments and relationships to the requirements of the Volcker Rule and its implementing regulations. We do not believe that the Volcker Rule or the final interagency rules implementing the Volcker Rule will have a material impact on our investment activities since we do not engage in transactions covered by the regulation.

Future Legislative Developments

Various legislative acts are from time to time introduced in Congress and the Florida legislature. This legislation may change banking statutes and the environment in which our banking subsidiary and we operate in substantial and unpredictable ways. We cannot determine the ultimate effect that potential legislation, if enacted, or implementing regulations with respect thereto, would have upon our financial condition or results of operations or that of our banking subsidiary.

Effect of Governmental Monetary Policies

The commercial banking business in which CCB engages is affected not only by general economic conditions, but also by the monetary policies of the Federal Reserve. Changes in the discount rate on member bank borrowing, availability of borrowing at the "discount window," open market operations, the imposition of changes in reserve requirements against member banks' deposits and assets of foreign banking centers and the imposition of and changes in reserve requirements against certain borrowings by banks and their affiliates are some of the instruments of monetary policy available to the Federal Reserve. These monetary policies are used in varying combinations to influence overall growth and distributions of bank loans, investments and deposits, and this use may affect interest rates charged on loans or paid on deposits. The monetary policies of the Federal Reserve have had a significant effect on the operating results of commercial banks and are expected to continue to do so in the future. The monetary policies of the Federal Reserve are influenced by various factors, including inflation, unemployment, and short-term and long-term changes in the international trade balance and in the fiscal policies of the U.S. Government. Future monetary policies and the effect of such policies on the future business and earnings of CCB cannot be predicted.

Income Taxes

We are subject to income taxes at the federal level and subject to state taxation based on the laws of each state in which we operate. We file a consolidated federal tax return with a fiscal year ending on December 31.

Website Access to Company's Reports

Our Internet website is www.ccbg.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, including any amendments to those reports filed or furnished pursuant to section 13(a) or 15(d), and reports filed pursuant to Section 16, 13(d), and 13(g) of the Exchange Act are available free of charge through our website as soon as reasonably practicable after they are electronically filed with, or furnished to, the Securities and Exchange Commission. The information on our website is not incorporated by reference into this report.

Item 1A. Risk Factors

An investment in our common stock contains a high degree of risk. You should consider carefully the following risk factors before deciding whether to invest in our common stock. Our business, including our operating results and financial condition, could be harmed by any of these risks. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business. The trading price of our common stock could decline due to any of these risks, and you may lose all or part of your investment. In assessing these risks, you should also refer to the other information contained in our filings with the SEC, including our financial statements and related notes.

Risks Related to Our Business

We may incur losses if we are unable to successfully manage interest rate risk.

Our profitability depends to a large extent on Capital City Bank's net interest income, which is the difference between income on interest-earning assets, such as loans and investment securities, and expense on interest-bearing liabilities such as deposits and borrowings. We are unable to predict changes in market interest rates, which are affected by many factors beyond our control, including inflation, recession, unemployment, federal funds target rate, money supply, domestic and international events and changes in the United States and other financial markets. Our net interest income may be reduced if: (i) more interest-earning assets than interest-bearing liabilities reprice or mature during a time when interest rates are declining or (ii) more interest-bearing liabilities than interest-earning assets reprice or mature during a time when interest rates are rising.

Changes in the difference between short- and long-term interest rates may also harm our business. For example, short-term deposits may be used to fund longer-term loans. When differences between short-term and long-term interest rates shrink or disappear, as is likely to continue in the current zero-interest-rate-policy environment, the spread between rates paid on deposits and received on loans could narrow significantly, decreasing our net interest income.

If market interest rates rise rapidly, interest rate adjustment caps may limit increases in the interest rates on adjustable rate loans, thereby reducing our net interest income.

Our loan portfolio includes loans with a higher risk of loss which could lead to higher loan losses and nonperforming assets.

We originate commercial real estate loans, commercial loans, construction loans, vacant land loans, consumer loans, and residential mortgage loans primarily within our market area. Commercial real estate, commercial, construction, vacant land, and consumer loans may expose a lender to greater credit risk than traditional fixed rate fully amortizing loans secured by single-family residential real estate because the collateral securing these loans may not be sold as easily as single-family residential real estate. In addition, these loan types tend to involve larger loan balances to a single borrower or groups of related borrowers and are more susceptible to a risk of loss during a downturn in the business cycle. These loans also have historically had greater credit risk than other loans for the following reasons:

- **Commercial Real Estate Loans**. Repayment is dependent on income being generated in amounts sufficient to cover operating expenses and debt service. These loans also involve greater risk because they are generally not fully amortizing over the loan period, but rather have a balloon payment due at maturity. A borrower's ability to make a balloon payment typically will depend on the borrower's ability to either refinance the loan or timely sell the underlying property. As of December 31, 2014, commercial mortgage loans comprised approximately 35.4% of our total loan portfolio.

- **Commercial Loans**. Repayment is generally dependent upon the successful operation of the borrower's business. In addition, the collateral securing the loans may depreciate over time, be difficult to appraise, be illiquid, or fluctuate in value based on the success of the business. As of December 31, 2014, commercial loans comprised approximately 9.5% of our total loan portfolio.
- **Construction Loans**. The risk of loss is largely dependent on our initial estimate of whether the property's value at completion equals or exceeds the cost of property construction and the availability of take-out financing. During the construction phase, a number of factors can result in delays or cost overruns. If our estimate is inaccurate or if actual construction costs exceed estimates, the value of the property securing our loan may be insufficient to ensure full repayment when completed through a permanent loan, sale of the property, or by seizure of collateral. As of December 31, 2014, construction loans comprised approximately 3.0% of our total loan portfolio.
- **Vacant Land Loans**. Because vacant or unimproved land is generally held by the borrower for investment purposes or future use, payments on loans secured by vacant or unimproved land will typically rank lower in priority to the borrower than a loan the borrower may have on their primary residence or business. These loans are susceptible to adverse conditions in the real estate market and local economy. As of December 31, 2014, vacant land loans comprised approximately 4.6% of our total loan portfolio.
- **HELOCS**. Our open-ended home equity loans have an interest-only draw period followed by a five year repayment period of 0.75% of the principal balance monthly and a balloon payment at maturity. Upon the commencement of the repayment period, the monthly payment can increase significantly, thus, there is a heightened risk that the borrower will be unable to pay the increased payment. Further, these loans also involve greater risk because they are generally not fully amortizing over the loan period, but rather have a balloon payment due at maturity. A borrower's ability to make a balloon payment may depend on the borrower's ability to either refinance the loan or timely sell the underlying property. As of December 31, 2014, HELOCs comprised approximately 15.9% of our total loan portfolio.
- **Consumer Loans**. Consumer loans (such as personal lines of credit) are collateralized, if at all, with assets that may not provide an adequate source of payment of the loan due to depreciation, damage, or loss. As of December 31, 2014, consumer loans comprised approximately 15.1% of our total loan portfolio.

The increased risks associated with these types of loans result in a correspondingly higher probability of default on such loans (as compared to fixed rated fully amortizing single-family real estate loans). Loan defaults would likely increase our loan losses and nonperforming assets and could adversely affect our allowance for loan losses.

We process, maintain, and transmit confidential client information through our information technology systems, such as our online banking service. Cybersecurity issues, such as security breaches and computer viruses, affecting our information technology systems or fraud related to our credit or debit card products could disrupt our business, result in the unintended disclosure or misuse of confidential or proprietary information, damage our reputation, increase our costs, and cause losses.

We collect and store sensitive data, including our proprietary business information and that of our clients, and personally identifiable information of our clients and employees, in our information technology systems. We also provide our clients the ability to bank online. The secure processing, maintenance, and transmission of this information is critical to our operations. Our network, or those of our clients, could be vulnerable to unauthorized access, computer viruses, phishing schemes and other security problems. Financial institutions and companies engaged in data processing have increasingly reported breaches in the security of their websites or other systems, some of which have involved sophisticated and targeted attacks intended to obtain unauthorized access to confidential information, destroy data, disrupt or degrade service, sabotage systems or cause other damage.

We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses. Security breaches and viruses could expose us to claims, litigation and other possible liabilities. Any inability to prevent security breaches or computer viruses could also cause existing clients to lose confidence in our systems and could adversely affect our reputation and our ability to generate deposits.

Additionally, fraud losses related to credit and debit cards have risen in recent years due in large part to growing and evolving schemes to illegally use cards or steal consumer credit card information despite risk management practices employed by the credit and debit card industry. Many issuers of debit and credit cards have suffered significant losses in recent years due to the theft of cardholder data that has been illegally exploited for personal gain.

The potential for credit and debit card fraud against us or our clients and our third party service providers is a serious issue. Credit card fraud is pervasive and the risks of cybercrime are complex and continue to evolve. In view of the recent high-profile retail data breaches involving client personal and financial information, the potential impact on us and any exposure to consumer losses and the cost of technology investments to improve security could cause losses to us or our clients, damage to our brand, and an increase in our costs.

An inadequate allowance for loan losses would reduce our earnings.

We are exposed to the risk that our clients will be unable to repay their loans according to their terms and that any collateral securing the payment of their loans will not be sufficient to assure full repayment. This could result in credit losses that are inherent in the lending business. We evaluate the collectability of our loan portfolio and provide an allowance for loan losses that we believe is adequate based upon such factors as:

- the risk characteristics of various classifications of loans;
- previous loan loss experience;
- specific loans that have loss potential;
- delinquency trends;
- estimated fair market value of the collateral;
- current economic conditions; and
- geographic and industry loan concentrations.

As of December 31, 2014, the Bank's allowance for loan losses was $17.5 million, which represented approximately 1.22% of its total amount of loans. The Bank had $16.8 million in nonaccruing loans as of December 31, 2014. The allowance is based on management's reasonable estimate and may not prove sufficient to cover future loan losses. Although management uses the best information available to make determinations with respect to the allowance for loan losses, future adjustments may be necessary if economic conditions differ substantially from the assumptions used or adverse developments arise with respect to the Bank's nonperforming or performing loans. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require us to recognize additional losses based on their judgments about information available to them at the time of their examination. Accordingly, the allowance for loan losses may not be adequate to cover loan losses or significant increases to the allowance may be required in the future if economic conditions should worsen. Material additions to the Bank's allowance for loan losses would adversely impact our net income and capital in future periods, while having the effect of overstating our current period earnings.

Since we engage in lending secured by real estate and may be forced to foreclose on the collateral property and own the underlying real estate, we may be subject to the increased costs associated with the ownership of real property, which could result in reduced net income.

Since we originate loans secured by real estate, we may have to foreclose on the collateral property to protect our investment and may thereafter own and operate such property, in which case we are exposed to the risks inherent in the ownership of real estate.

The amount that we, as a mortgagee, may realize after a default is dependent upon factors outside of our control, including, but not limited to:

- general or local economic conditions;
- environmental cleanup liability;
- neighborhood values;
- interest rates;
- real estate tax rates;
- operating expenses of the mortgaged properties;
- supply of and demand for rental units or properties;
- ability to obtain and maintain adequate occupancy of the properties;
- zoning laws;
- governmental rules, regulations and fiscal policies; and
- acts of God.

Certain expenditures associated with the ownership of real estate, principally real estate taxes and maintenance costs, may adversely affect the income from the real estate. Therefore, the cost of operating real property may exceed the rental income earned from such property, and we may have to advance funds in order to protect our investment or we may be required to dispose of the real property at a loss.

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

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, and other sources, could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities on terms that are acceptable to us could be impaired by factors that affect us specifically or the financial services industry or economy in general. Factors that could negatively impact our access to liquidity sources include a decrease in the level of our business activity as a result of a downturn in the markets in which our loans are concentrated, adverse regulatory action against us, or our inability to attract and retain deposits. Our ability to borrow could be impaired by factors that are not specific to us, such a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry.

Our future success is dependent on our ability to compete effectively in the highly competitive banking industry.

We face vigorous competition from other banks and other financial institutions, including savings and loan associations, savings banks, finance companies and credit unions for deposits, loans and other financial services in our market area. A number of these banks and other financial institutions are significantly larger than we are and have substantially greater access to capital and other resources, as well as larger lending limits and branch systems, and offer a wider array of banking services. To a limited extent, we also compete with other providers of financial services, such as money market mutual funds, brokerage firms, consumer finance companies, insurance companies and governmental organizations which may offer more favorable financing than we can. Many of our non-bank competitors are not subject to the same extensive regulations that govern our activities. As a result, these non-bank competitors have advantages over us in providing certain services. This competition may reduce or limit our margins and our market share and may adversely affect our results of operations and financial condition.

Risks Related to Regulation and Legislation

We are subject to extensive regulation, including an unprecedented increase in new regulation, which could restrict our activities and impose financial requirements or limitations on the conduct of our business.

Both CCBG and the Bank are subject to extensive regulation, supervision and examination by our regulators, including the Florida Office of Financial Regulation, the Federal Reserve, and the FDIC. Our compliance with these industry regulations is costly and restricts certain of our activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates charged, interest rates paid on deposits, access to capital and brokered deposits and locations of banking offices. If we are unable to meet these regulatory requirements, our financial condition, liquidity and results of operations would be materially and adversely affected.

We are experiencing an unprecedented increase in regulations and supervision. Significant new legislation and regulations affecting the financial services industry have been adopted or proposed in recent years, such as the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, or the Dodd-Frank Act, into law. Congress and our regulators continue to develop, propose and adopt rules and propose new regulatory initiatives, so the cumulative effect of all of the new legislation and regulations on our business and operations remains uncertain.

We must also meet regulatory capital requirements imposed by our regulators. An inability to meet these capital requirements would result in numerous mandatory supervisory actions and additional regulatory restrictions, and could have a negative impact on our financial condition, liquidity and results of operations.

In addition to the regulations of the Florida Office of Financial Regulation, the Federal Reserve, and the FDIC, as a member of the Federal Home Loan Bank, the Bank must also comply with applicable regulations of the Federal Housing Finance Agency and the Federal Home Loan Bank.

The Bank's activities are also regulated under consumer protection laws applicable to our lending, deposit and other activities. Many of these regulations are intended primarily for the protection of our depositors and the Deposit Insurance Fund and not for the benefit of our shareowners. Our failure to comply with these laws and regulations, even if the failure follows good faith effort or reflects a difference in interpretation, could subject us to restrictions on our business activities, fines and other penalties, any of which could adversely affect our results of operations, capital base and the price of our securities. Further, any new laws, rules and regulations could make compliance more difficult or expensive or otherwise adversely affect our business and financial condition. Please refer to the Section entitled "Business – Regulatory Considerations" in this Report.

The new Basel III Capital Standards may have an adverse effect on us.

In 2013, the Federal Reserve Board released its final rules which implement in the United States the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain changes required by the Dodd-Frank Act. Under the final rule, minimum requirements increased for both the quality and quantity of capital held by banking organizations. Consistent with the international Basel framework, the rule includes a new minimum ratio of Common Equity Tier I Capital to Risk-Weighted Assets of 4.5% and a Common Equity Tier I Capital conservation buffer of 2.5% of risk-weighted assets that apply to all supervised financial institutions. The rule also, among other things, raised the minimum ratio of Tier I Capital to Risk-Weighted Assets from 4% to 6% and included a minimum leverage ratio of 4% for all banking organizations. We became subject to the new rules effective January 1, 2015. The impact of the new capital rules requires us to maintain higher levels of capital, which we expect will lower our return on equity.

Compliance with the Consumer Financial Protection Bureau's ability-to-repay rule safe-harbor could adversely impact our growth or profitability.

The Consumer Financial Protection Bureau issued a rule, effective as of January 14, 2014, designed to clarify for lenders how they can avoid monetary damages under the Dodd-Frank Act, which holds lenders accountable for ensuring a borrower's ability to repay a mortgage. Loans that satisfy the "qualified mortgage" safe-harbor will be presumed to have complied with the new ability-to-repay standard. Under the Consumer Financial Protection Bureau's rule, a "qualified mortgage" loan must not contain certain specified features, including but not limited to:

- excessive upfront points and fees (those exceeding 3% of the total loan amount, less "bona fide discount points" for prime loans);
- interest-only payments;
- negative-amortization; and
- terms longer than 30 years.

Also, to qualify as a "qualified mortgage," a borrower's total monthly debt-to-income ratio may not exceed 43%. Lenders must also verify and document the income and financial resources relied upon to qualify the borrower for the loan and underwrite the loan based on a fully amortizing payment schedule and maximum interest rate during the first five years, taking into account all applicable taxes, insurance and assessments. The Consumer Financial Protection Bureau's rule on qualified mortgages could limit our ability or desire to make certain types of loans or loans to certain borrowers, or could make it more expensive and/or time consuming to make these loans, which could adversely impact our growth or profitability.

The Federal Reserve's repeal of the prohibition against payment of interest on demand deposits (Regulation Q) may increase competition for such deposits and ultimately increase interest expense.

A major portion of our net income comes from our interest rate spread, which is the difference between the interest rates we pay on amounts used to fund assets, such as deposits, and the interest rates and fees we receive on our interest-earning assets. Our interest-earning assets include outstanding loans extended to our clients and securities held in our investment portfolio. We fund assets using deposits and other borrowings. Our strategy is to manage the mix of our deposits rather than compete on rate. As a result, approximately 30.7% of our deposits were noninterest-bearing as of December 31, 2014.

In 2011, the Federal Reserve issued final rules to repeal Regulation Q, which had prohibited the payment of interest on demand deposits by institutions that are member banks of the Federal Reserve System. The final rules implement Section 627 of the Dodd-Frank Act, which repealed Section 19(i) of the Federal Reserve Act in its entirety. As a result, banks and thrifts are now permitted to offer interest-bearing demand deposit accounts to commercial clients, which were previously forbidden under Regulation Q. The repeal of Regulation Q may cause increased competition from other financial institutions for these deposits. If we decide to pay interest on demand accounts, we would expect our interest expense to increase. Although Regulation Q has been effective for over three years, the impact may not have been realized yet because of the current zero interest rate policy environment.

Florida financial institutions, such as the Bank, face a higher risk of noncompliance and enforcement actions with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

Since September 11, 2001, banking regulators have intensified their focus on anti-money laundering and Bank Secrecy Act compliance requirements, particularly the anti-money laundering provisions of the USA PATRIOT Act. There is also increased scrutiny of compliance with the rules enforced by the Office of Foreign Assets Control ("OFAC"). Since 2004, federal banking regulators and examiners have been extremely aggressive in their supervision and examination of financial institutions located in the State of Florida with respect to the institution's Bank Secrecy Act/anti-money laundering compliance. Consequently, numerous formal enforcement actions have been instituted against financial institutions.

In order to comply with regulations, guidelines and examination procedures in this area, the Bank has been required to adopt new policies and procedures and to install new systems. If the Bank's policies, procedures and systems are deemed deficient or the policies, procedures and systems of the financial institutions that it has already acquired or may acquire in the future are deficient, the Bank would be subject to liability, including fines and regulatory actions such as restrictions on its ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of its business plan, including its acquisition plans.

Risks Related to Market Events

Our loan portfolio is heavily concentrated in mortgage loans secured by properties in Florida and Georgia which causes our risk of loss to be higher than if we had a more geographically diversified portfolio.

Our interest-earning assets are heavily concentrated in mortgage loans secured by real estate, particularly real estate located in Florida and Georgia. As of December 31, 2014, approximately 75.4% of our loans had real estate as a primary, secondary, or tertiary component of collateral. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower; however, the value of the collateral may decline during the time the credit is extended. If we are required to liquidate the collateral securing a loan during a period of reduced real estate values to satisfy the debt, our earnings and capital could be adversely affected.

Additionally, as of December 31, 2014, substantially all of our loans secured by real estate are secured by commercial and residential properties located in Northern Florida and Middle Georgia. The concentration of our loans in these areas subjects us to risk that a downturn in the economy or recession in these areas, such as the one from which these areas are currently recovering, could result in a decrease in loan originations and increases in delinquencies and foreclosures, which would more greatly affect us than if our lending were more geographically diversified. In addition, since a large portion of our portfolio is secured by properties located in Florida and Georgia, the occurrence of a natural disaster, such as a hurricane, or a man-made disaster could result in a decline in loan originations, a decline in the value or destruction of mortgaged properties and an increase in the risk of delinquencies, foreclosures or loss on loans originated by us. We may suffer further losses due to the decline in the value of the properties underlying our mortgage loans, which would have an adverse impact on our results of operations and financial condition.

Our concentration in loans secured by real estate may increase our credit losses, which would negatively affect our financial results.

Due to the lack of diversified industry within the markets served by the Bank and the relatively close proximity of our geographic markets, we have both geographic concentrations as well as concentrations in the types of loans funded. Specifically, due to the nature of our markets, a significant portion of the portfolio has historically been secured with real estate. As of December 31, 2014, approximately 35.4% and 37.1% of our $1.442 billion loan portfolio was secured by commercial real estate and residential real estate, respectively. As of this same date, approximately 3.0% was secured by property under construction.

In the event we are required to foreclose on a property securing one of our mortgage loans or otherwise pursue our remedies in order to protect our investment, we may be unable to recover funds in an amount equal to our projected return on our investment or in an amount sufficient to prevent a loss to us due to prevailing economic conditions, real estate values and other factors associated with the ownership of real property. As a result, the market value of the real estate or other collateral underlying our loans may not, at any given time, be sufficient to satisfy the outstanding principal amount of the loans, and consequently, we would sustain loan losses.

The fair value of our investments could decline which would cause a reduction in shareowners' equity.

A large portion of our investment securities portfolio as of December 31, 2014 has been designated as available-for-sale pursuant to U.S. generally accepted accounting principles relating to accounting for investments. Such principles require that unrealized gains and losses in the estimated value of the available-for-sale portfolio be "marked to market" and reflected as a separate item in shareowners' equity (net of tax) as accumulated other comprehensive income/loss. Shareowners' equity will continue to reflect the unrealized gains and losses (net of tax) of these investments. The fair value of our investment portfolio may decline, causing a corresponding decline in shareowners' equity.

Management believes that several factors will affect the fair values of our investment portfolio. These include, but are not limited to, changes in interest rates or expectations of changes, the degree of volatility in the securities markets, inflation rates or expectations of inflation and the slope of the interest rate yield curve (the yield curve refers to the differences between shorter-term and longer-term interest rates; a positively sloped yield curve means shorter-term rates are lower than longer-term rates). These and other factors may impact specific categories of the portfolio differently, and we cannot predict the effect these factors may have on any specific category.

Risks Related to an Investment in Our Common Stock

We may be unable to pay dividends in the future.

In 2014, our Board of Directors declared four quarterly cash dividends. These dividends were the first dividends declared since we announced the suspension of our quarterly dividend on our common stock on December 14, 2011. Declarations of any future dividends will be contingent on our ability to earn sufficient profits and to remain adequately capitalized. In addition, due to our contractual obligations with the holders of the trust preferred securities, if we defer the payment of accrued interest owed to the holders of the trust preferred securities, we may not make dividend payments to our shareowners.

Further, under applicable statutes and regulations, the Bank's board of directors, after charging-off bad debts, depreciation and other worthless assets, if any, and making provisions for reasonably anticipated future losses on loans and other assets, may quarterly, semi-annually, or annually declare and pay dividends to CCBG of up to the aggregate net income of that period combined with the Bank's retained net income for the preceding two years and, with the approval of the Florida Office of Financial Regulation and Federal Reserve, declare a dividend from retained net income which accrued prior to the preceding two years. Additional state laws generally applicable to Florida corporations may also limit our ability to declare and pay dividends. Thus, our ability to fund future dividends may be restricted by state law.

Limited trading activity for shares of our common stock may contribute to price volatility.

While our common stock is listed and traded on the Nasdaq Global Select Market, there has been limited trading activity in our common stock. The average daily trading volume of our common stock over the 12-month period ending December 31, 2014 was approximately 26,219 shares. Due to the limited trading activity of our common stock, relativity small trades may have a significant impact on the price of our common stock.

Securities analysts may not initiate coverage or continue to cover our common stock, and this may have a negative impact on its market price.

The trading market for our common stock will depend in part on the research and reports that securities analysts publish about us and our business. We do not have any control over securities analysts and they may not initiate coverage or continue to cover our common stock. If securities analysts do not cover our common stock, the lack of research coverage may adversely affect its market price. If we are covered by securities analysts, and our common stock is the subject of an unfavorable report, our stock price would likely decline. If one or more of these analysts ceases to cover our Company or fails to publish regular reports on us, we could lose visibility in the financial markets, which may cause our stock price or trading volume to decline.

Our directors, executive officers, and principal shareowners, if acting together, have substantial control over all matters requiring shareowner approval, including changes of control. Because Mr. William G. Smith, Jr. is a principal shareowner and our Chairman, President, and Chief Executive Officer and Chairman of the Bank, he has substantial control over all matters on a day to day basis.

Our directors, executive officers, and principal shareowners beneficially owned approximately 39% of the outstanding shares of our common stock as of December 31, 2014. Our principal shareowners include the Estate of Robert H. Smith, who was the brother of William G. Smith, Jr., our Chairman, President and Chief Executive Officer, which beneficially owns 17.5% of our shares. William G. Smith, Jr. beneficially owns 21.7% of our shares. In addition, 2S Partnership beneficially owns 6.0% of our shares, however, its shares were historically deemed to be beneficially owned by Messrs. Smith and Smith. Together, Mr. Smith and the Estate of Robert H. Smith beneficially own approximately 33% of our shares.

Accordingly, these directors, executive officers, and principal shareowners, if acting together, may be able to influence or control matters requiring approval by our shareowners, including the election of directors and the approval of mergers, acquisitions or other extraordinary transactions. In addition, because William G. Smith, Jr. is the Chairman, President, and Chief Executive Officer of CCBG and Chairman of the Bank, he has substantial control over all matters on a day-to-day basis, including the nomination and election of directors.

These directors, executive officers, and principal shareowners may also have interests that differ from yours and may vote in a way with which you disagree and which may be adverse to your interests. The concentration of ownership may have the effect of delaying, preventing or deterring a change of control of our company, could deprive our shareowners of an opportunity to receive a premium for their common stock as part of a sale of our Company and might ultimately affect the market price of our common stock. You may also have difficulty changing management, the composition of the Board of Directors, or the general direction of our Company.

Our Articles of Incorporation, Bylaws, and certain laws and regulations may prevent or delay transactions you might favor, including a sale or merger of CCBG.

CCBG is registered with the Federal Reserve as a financial holding company under the Bank Holding Company Act (“BHCA”). As a result, we are subject to supervisory regulation and examination by the Federal Reserve. The Gramm-Leach-Bliley Act, the BHCA, and other federal laws subject financial holding companies to particular restrictions on the types of activities in which they may engage, and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations.

Provisions of our Articles of Incorporation, Bylaws, certain laws and regulations and various other factors may make it more difficult and expensive for companies or persons to acquire control of us without the consent of our Board of Directors. It is possible, however, that you would want a takeover attempt to succeed because, for example, a potential buyer could offer a premium over the then prevailing price of our common stock.

For example, our Articles of Incorporation permit our Board of Directors to issue preferred stock without shareowner action. The ability to issue preferred stock could discourage a company from attempting to obtain control of us by means of a tender offer, merger, proxy contest or otherwise. Additionally, our Articles of Incorporation and Bylaws divide our Board of Directors into three classes, as nearly equal in size as possible, with staggered three-year terms. One class is elected each year. The classification of our Board of Directors could make it more difficult for a company to acquire control of us. We are also subject to certain provisions of the Florida Business Corporation Act and our Articles of Incorporation that relate to business combinations with interested shareowners. Other provisions in our Articles of Incorporation or Bylaws that may discourage takeover attempts or make them more difficult include:

- Supermajority voting requirements to remove a director from office;

- Provisions regarding the timing and content of shareowner proposals and nominations;
- Supermajority voting requirements to amend Articles of Incorporation unless approval is received by a majority of "disinterested directors";
- Absence of cumulative voting; and
- Inability for shareowners to take action by written consent.

Shares of our common stock are not an insured deposit and may lose value.

The shares of our common stock are not a bank deposit and will not be insured or guaranteed by the FDIC or any other government agency. Your investment will be subject to investment risk, and you must be capable of affording the loss of your entire investment.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We are headquartered in Tallahassee, Florida. Our executive office is in the Capital City Bank building located on the corner of Tennessee and Monroe Streets in downtown Tallahassee. The building is owned by the Bank, but is located on land leased under a long-term agreement.

As of February 27, 2015, the Bank had 63 full-service banking locations. Of the 63 locations, the Bank leases the land, buildings, or both at seven locations and owns the land and buildings at the remaining 56.

Item 3. Legal Proceedings

We are party to lawsuits and claims arising out of the normal course of business. In management's opinion, there are no known pending claims or litigation, the outcome of which would, individually or in the aggregate, have a material effect on our consolidated results of operations, financial position, or cash flows.

Item 4*. *Mine Safety Disclosure.

Not applicable.

PART II

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

Common Stock Market Prices and Dividends

Our common stock trades on the Nasdaq Global Select Market under the symbol "CCBG." We had a total of 1,589 shareowners of record as of February 27, 2015.

The following table presents the range of high and low closing sales prices reported on the Nasdaq Global Select Market and cash dividends declared for each quarter during the past two years.

	2014				**2013**			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Common stock price:								
High	$16.00	$14.98	$14.71	$14.59	$12.69	$13.08	$12.64	$12.54
Low	13.00	13.26	12.60	11.56	11.33	11.06	10.12	10.95
Close	15.54	13.54	14.53	13.28	11.77	11.78	11.53	12.35
Cash dividends per share	0.03	0.02	0.02	0.02	0.00	0.00	0.00	0.00

Florida law and Federal regulations impose restrictions on our ability to pay dividends and limitations on the amount of dividends that the Bank can pay annually to us. See Item 1. "Capital; Dividends; Sources of Strength" and "Dividends" in the Business section on page 12 and 13 and the section entitled "Liquidity and Capital Resources – Dividends" -- in Management's Discussion and Analysis of Financial Condition and Operating Results on page 54 and Note 14 in the Notes to Consolidated Financial Statements.

Performance Graph

This performance graph compares the cumulative total shareholder return on our common stock with the cumulative total shareholder return of the Nasdaq Composite Index and the SNL Financial LC $1B-$5B Bank Index for the past five years. The graph assumes that $100 was invested on December 31, 2009 in our common stock and each of the above indices, and that all dividends were reinvested. The shareholder return shown below represents past performance and should not be considered indicative of future performance.

	Period Ending					
Index	**12/31/09**	**12/31/10**	**12/31/11**	**12/31/12**	**12/31/13**	**12/31/14**
Capital City Bank Group, Inc.	$100.00	$94.53	$73.64	$87.67	$90.76	$120.59
Nasdaq Composite	100.00	118.15	117.22	138.02	193.47	222.16
SNL $1B-$5B Bank Index	100.00	113.35	103.38	127.47	185.36	193.81

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Item 6. Selected Financial Data

(Dollars in Thousands, Except Per Share Data)	2014		2013		2012		2011		2010	
Interest Income	$78,221		$82,152		$89,680		$99,459		$110,495	
Net Interest Income	74,641		77,736		84,312		91,922		97,533	
Provision for Loan Losses	1,905		3,472		16,166		18,996		23,824	
Noninterest Income	52,536		55,111		54,569		57,244		55,870	
Noninterest Expense	114,358		121,405		123,943		124,643		132,961	
Net Income (Loss)	9,260		6,045		108		4,897		(413)	
Per Common Share:										
Basic Net Income (Loss)	$0.53		$0.35		$0.01		$0.29		$(0.02)	
Diluted Net Income (Loss)	0.53		0.35		0.01		0.29		(0.02)	
Cash Dividends Declared	0.09		—		—		0.30		0.49	
Diluted Book Value	15.53		15.85		14.31		14.68		15.15	
Performance Ratios:										
Return on Average Assets	0.36	%	0.24	%	0.00	%	0.19	%	(0.02)	
Return on Average Equity	3.27		2.40		0.04		1.86		(0.16)	
Net Interest Margin (FTE)	3.36		3.54		3.81		4.18		4.32	
Noninterest Income as % of Operating Revenues	41.30		41.48		39.29		38.38		36.42	
Efficiency Ratio	89.68		91.09		88.72		83.24		85.95	
Asset Quality:										
Allowance for Loan Losses	$17,539		$23,095		$29,167		$31,035		$35,436	
Allowance for Loan Losses to Loans	1.22	%	1.65	%	1.93	%	1.91	%	2.01	%
Nonperforming Assets	52,449		85,035		117,648		137,623		123,637	
Nonperforming Assets to Assets	2.00		3.26		4.47		5.21		4.72	
Nonperforming Assets to Loans + OREO	3.55		5.87		7.47		8.14		6.81	
Allowance to Nonperforming Loans	104.60		62.48		45.42		41.37		53.94	
Net Charge-Offs to Average Loans	0.53		0.66		1.16		1.39		1.77	
Capital Ratios:										
Tier I Capital	16.67	%	16.56	%	14.35	%	13.96	%	13.24	%
Total Capital	17.76		17.94		15.72		15.32		14.59	
Tangible Capital	7.38		7.58		6.35		6.51		6.82	
Leverage	10.99		10.46		9.90		10.26		10.10	
Equity to Assets	10.37		10.58		9.37		9.54		9.88	
Dividend Pay-Out	16.98		NM		NM		103.45		NM	
Averages for the Year:										
Loans, Net of Unearned Income	$1,414,000		$1,450,806		$1,556,565		$1,686,995		$1,829,193	
Earning Assets	2,237,623		2,213,686		2,229,621		2,221,317		2,294,282	
Total Assets	2,564,176		2,568,662		2,590,173		2,583,197		2,644,731	
Deposits	2,093,477		2,070,073		2,105,672		2,081,583		2,192,323	
Shareowners' Equity	283,079		251,427		252,960		263,048		264,679	
Year-End Balances:										

Loans, Net of Unearned Income	$1,442,062	$1,399,669	$1,521,302	$1,628,683	$1,758,671
Earning Assets	2,276,781	2,274,019	2,261,781	2,266,193	2,269,185
Total Assets	2,627,169	2,611,903	2,633,984	2,641,312	2,622,053
Deposits	2,146,794	2,136,248	2,144,996	2,172,519	2,103,976
Shareowners' Equity	272,540	276,400	246,889	251,942	259,019
Other Data:					
Basic Average Shares Outstanding	17,424,788	17,324,759	17,204,559	17,139,558	17,075,867
Diluted Average Shares Outstanding	17,488,020	17,399,355	17,219,765	17,140,390	17,076,724
Shareowners of Record[(1)]	1,589	1,651	1,691	1,701	1,768
Banking Locations[(1)]	63	63	66	70	70
Full-Time Equivalent Associates[(1)]	895	891	913	959	975

[(1)]*As of record date. The record date is on or about March 1st of the following year.*

NM – Not Meaningful

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

Management's discussion and analysis ("MD&A") provides supplemental information, which sets forth the major factors that have affected our financial condition and results of operations and should be read in conjunction with the Consolidated Financial Statements and related notes included in the Annual Report on Form 10-K. The MD&A is divided into subsections entitled "Business Overview," "Executive Overview," "Results of Operations," "Financial Condition," "Liquidity and Capital Resources," "Off-Balance Sheet Arrangements," "Fourth Quarter, 2014 Financial Results," and "Accounting Policies." The following information should provide a better understanding of the major factors and trends that affect our earnings performance and financial condition, and how our performance during 2014 compares with prior years. Throughout this section, Capital City Bank Group, Inc., and its subsidiaries, collectively, are referred to as "CCBG," "Company," "we," "us," or "our."

CAUTION CONCERNING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K, including this MD&A section, contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, among others, statements about our beliefs, plans, objectives, goals, expectations, estimates and intentions that are subject to significant risks and uncertainties and are subject to change based on various factors, many of which are beyond our control. The words "may," "could," "should," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan," "target," similar expressions are intended to identify forward-looking statements.

All forward-looking statements, by their nature, are subject to risks and uncertainties. Our actual future results may differ materially from those set forth in our forward-looking statements. Please see the Introductory Note and *Item 1A Risk Factors* of this Annual Report for a discussion of factors that could cause our actual results to differ materially from those in the forward-looking statements.

However, other factors besides those listed in *Item 1A Risk Factors* or discussed in this Annual Report also could adversely affect our results, and you should not consider any such list of factors to be a complete set of all potential risks or uncertainties. Any forward-looking statements made by us or on our behalf speak only as of the date they are made. We do not undertake to update any forward-looking statement, except as required by applicable law.

BUSINESS OVERVIEW

Our Business

We are a financial holding company headquartered in Tallahassee, Florida, and we are the parent of our wholly owned subsidiary, Capital City Bank (the "Bank" or "CCB"). The Bank offers a broad array of products and services through a total of 63 full-service offices located in Florida, Georgia, and Alabama. The Bank offers commercial and retail banking services, as well as trust and asset management, retail securities brokerage and data processing services. Please see the section captioned "About Us" beginning on page 4 for more detailed information about our business.

Our profitability, like most financial institutions, is dependent to a large extent upon net interest income, which is the difference between the interest and fees received on interest earning assets, such as loans and securities, and the interest paid on interest-bearing liabilities, principally deposits and borrowings. Results of operations are also affected by the provision for loan losses, operating expenses such as salaries and employee benefits, occupancy and other operating expenses including income taxes, and noninterest income such as deposit fees, wealth management fees, mortgage banking fees, bank card fees, and data processing fees.

Strategic Review

Our philosophy is to build long-term client relationships based on quality service, high ethical standards, and safe and sound banking practices. We maintain a locally oriented, community-based focus, which is augmented by experienced, centralized support in select specialized areas. Our local market orientation is reflected in our network of banking office locations, experienced community executives with a dedicated President for each market, and community boards which support our focus on responding to local banking needs. We strive to offer a broad array of sophisticated products and to provide quality service by empowering associates to make decisions in their local markets.

We have sought to build a franchise in small-to medium-sized, less competitive markets, located on the outskirts of the larger metropolitan markets where we are positioned as a market leader. Many of our markets are on the outskirts of these larger markets in close proximity to major interstate thoroughfares such as Interstates I-10 and I-75. Our three largest markets are Tallahassee (Leon-Florida), Gainesville (Alachua-Florida), and Macon (Bibb-Georgia). In 13 of 20 markets in Florida and three of five markets in Georgia, we rank within the top four banks in terms of market share. Furthermore, in the counties in which we operate, we maintain an average 9.10% market share in the Florida counties and 5.82% in the Georgia counties, suggesting that there is significant opportunity to grow market share within these geographic areas. The larger employers in many of our markets are state and local governments, healthcare providers, educational institutions, and small businesses. While we realize that the markets in our footprint do not provide for a level of potential growth that the larger metropolitan markets may provide, our markets do provide good growth dynamics and have historically grown in excess of the national average The value of these markets stems from the fact they are less competitive, secondary markets. We strive to provide value added services to our clients by being not just their bank, but their banker. This element of our strategy distinguishes Capital City Bank from our competitors.

Our long-term vision remains to profitably expand our franchise through a combination of organic growth in existing markets and acquisitions. We have long understood that our core deposit funding base is a predominant driver of our profitability and overall franchise value, and have focused extensively on this component of our organic growth efforts in recent years. While we have not been an active acquirer of banks since 2005, this component of our strategy is still in place.

Potential acquisition growth will continue to be focused on Florida, Georgia, and Alabama with a particular focus on financial institutions located on the outskirts of larger, metropolitan areas. Five markets have been identified, four in Florida and one in Georgia, in which management intends to proactively pursue expansion opportunities. These markets include Alachua, Marion, Hernando/Pasco counties in Florida, the western panhandle of Florida, and Bibb and surrounding counties in central Georgia. Our focus on some of these markets may change as we continue to evaluate our strategy and the economic conditions and demographics of any individual market. We will also continue to evaluate de novo expansion opportunities in attractive new markets in the event that acquisition opportunities are not feasible. Other expansion opportunities that will be evaluated include asset management, mortgage banking, and insurance. Embedded in our acquisition strategy is our desire to partner with institutions that are culturally similar, have experienced management and possess either established market presence or have potential for improved profitability through growth, economies of scale, or expanded services. Generally, these target institutions will range in asset size from $100 million to $400 million.

EXECUTIVE OVERVIEW

Our 2014 performance reflects meaningful progress made across all aspects of our business. We reported net income of $9.3 million, or $0.53 per diluted share, compared to $6.0 million, or $0.35 per diluted share in 2013. The growth in net income reflects lower noninterest expense of $7.0 million, a lower loan loss provision of $1.6 million, and lower income taxes of $0.4 million, partially offset by lower net interest income of $3.1 million and noninterest income of $2.6 million.

Below are summary highlights that impacted our performance for the year:

- Margin expansion driven by four consecutive quarters of loan growth and increased deployment of liquidity into the investment portfolio.
- Loan balances grew at an annual rate of 3% reflective of improved loan demand and calling efforts.
- 38% reduction in nonperforming assets -- improvement in credit quality favorably impacted credit costs.
- Core operating costs (excluding OREO) declined 5% year over year.

Efforts to improve our earning asset mix stabilized our net interest margin in 2014. Sequential loan growth for each quarter during 2014 and the deployment of more liquidity into our investment portfolio drove growth in net interest income for the last three quarters of the year. The development of new consumer and business loan programs drove a majority of the growth, but increased production and a slow-down in pay-downs/pay-offs in our real estate portfolios also contributed. The extended low interest rate environment and increased competition for loans continues to pressure asset yields, but we have not changed our risk profile by extending asset durations for yield which positions us better to respond to changing market conditions. Over time, this strategy has produced consistent outcomes and a net interest margin that exceeds our peer median.

We continue to maintain several sources of noninterest income which diversifies our operating revenue. Changing client behavior and regulatory changes have slowed growth in our deposit and bank card fee revenues over the past three years, but growth in other lines of business have helped mitigate the impact. The development of strategic initiatives aimed at segmenting our client base and target marketing to more fully realize the fee income opportunities inherent in our strong core deposit base franchise are ongoing.

Core operating costs (excluding OREO) declined noticeably in 2014 driven by lower pension expense. Reduction in ancillary costs related to the prolonged credit cycle are also being removed from our cost structure and contributed to the decline in 2014. We continue to evaluate strategies aimed at optimizing our delivery systems to improve our operating efficiency.

Our credit quality metrics continued to improve in 2014 reflective of further reduction in the level of our nonperforming assets driven by strong OREO sales and a significant reduction in the level of problem loan inflows. As a result, our loan loss provision has stabilized and OREO costs continue to decline. We continue to believe our disciplined approach to capturing the maximum value possible when disposing of our problem assets has proven to be in the best long-term interest of our shareowners and 2014 further validated that approach.

We realized good progress in 2014 and re-evaluated many aspects of our business in response to a changing industry. We enter 2015 with a great deal of momentum as we focus on strategies aimed at driving loan growth and optimizing our delivery systems to return us to our historical levels of efficiency.

Key components of our 2014 financial performance are summarized below:

Results of Operations

- For 2014, taxable equivalent net interest income decreased $3.2 million, or 4.1%, to $75.1 million driven by a decline in loan income attributable to lower average portfolio balances and unfavorable asset repricing, which was partially offset by a reduction in interest expense. Our net interest margin of 3.36% in 2014 was 18 basis points lower than the 3.54% recorded in 2013. In 2014, compared to 2013, the yield on interest earning assets declined 22 basis points and was partially offset by a decline in the cost of funds of four basis points.

- Total credit costs (loan loss provision plus other real estate owned ("OREO") expenses) were $8.7 million in 2014 compared to $11.7 million for 2013. Favorable problem loan migration, lower loan losses, and improved credit metrics resulted in a $1.6 million decrease in our loan loss provision to $1.9 million for the year. Continued progress in disposing of OREO properties and firming of property values favorably impacted our level of OREO costs which declined by $1.4 million to $6.8 million for the year.

- For 2014, noninterest income totaled $52.5 million, a $2.6 million, or 4.7%, decrease from 2013 primarily reflective of lower deposit fees of $0.9 million, data processing fees of $1.1 million, wealth management fees of $0.4 million and mortgage banking fees of $0.5 million.

- For 2014, noninterest expense totaled $114.4 million, a $7.0 million, or 5.8%, decrease primarily attributable to lower compensation expense of $3.9 million, OREO expense of $1.4 million, and other expense (excluding OREO expenses) of $2.2 million.

Financial Condition

- Average assets totaled approximately $2.564 billion for 2014, consistent with 2013. Average earning assets were approximately $2.238 billion, representing an increase of $23.9 million, or 1.1%, over 2013. Year-over-year, average short-term investments decreased $52.8 million, while investment securities increased $113.5 million and average gross loans declined by $36.8 million. We continue to maintain a strong liquidity position as evidenced by average funds sold of approximately $369.9 million for the year and were able to shift some overnight funds balances into the investment portfolio during the year to improve our mix.

- Average gross loans totaled $1.414 billion, a $36.8 million, or 2.5%, decrease from 2013. We experienced runoff in all loan types except commercial loans and indirect auto loans, which grew year-over year. New loan production increased in 2014 and the levels of payoffs and pay downs declined resulting in average loan growth for the last three quarters of the year.

- Average total deposits for 2014 were $2.093 billion, a decrease of $23.4 million, or 1.1%, over 2013. Increases in average noninterest bearing deposits and savings accounts were partially offset by declines in the remaining product types.

- At year-end 2014, our nonperforming assets totaled $52.4 million, a decrease of $32.6 million from year-end 2013. Nonaccrual loans totaled $16.8 million at year-end 2014, a decrease of $20.2 million from year-end 2013, reflective of loan resolutions which outpaced gross additions. Nonaccrual loan additions slowed again for the third consecutive year, by $21.6 million, or 49%. The balance of OREO totaled $35.7 million at year-end 2014, a decrease of $12.4 million from year-end 2013. We continued to experience progress during 2014 in our efforts to dispose of OREO selling properties totaling $23.8 million compared to $25.9 million in 2013. Nonperforming assets represented 2.00% of total assets at December 31, 2014 compared to 3.26% at December 31, 2013.

- Our allowance for loan losses at year-end 2014 was $17.5 million (1.22% of loans) and provided coverage of 105% of nonperforming loans compared to $23.1 million (1.65% of loans) and 62% of nonperforming loans at year-end 2013. Net charge-offs for 2014 totaled $7.5 million, or 0.53% of average loans compared to $9.5 million, or 0.66% in 2013, reflective of lower residential and construction loan charge-offs.

- Shareowners’ equity decreased by $3.9 million from $276.4 million at December 31, 2013 to $272.5 million at December 31, 2014, attributable to an unfavorable adjustment to pension related OCI reflecting an increase in our pension liabilities driven by a lower discount rate and a change in the mortality tables. We continue to maintain a strong capital base as evidenced by a risk-based capital ratio of 17.76% and a tangible common equity ratio of 7.38% at year-end 2014 compared to 17.94% and 7.58%, respectively, at year-end 2013.

RESULTS OF OPERATIONS

For 2014, we realized net income of $9.3 million, or $0.53 per diluted share compared to $6.0 million, or $0.35 per diluted share, in 2013, and $0.1 million, or $0.01 per diluted share in 2012.

The increase in earnings for 2014 was attributable to lower noninterest expense of $7.0 million, a lower loan loss provision of $1.6 million, and lower income taxes of $0.4 million, partially offset by lower net interest income of $3.1 million and noninterest income of $2.6 million.

The increase in earnings for 2013 as compared to 2012 reflects a lower loan loss provision of $12.7 million, higher noninterest income of $0.5 million, and lower noninterest expense of $2.5 million, partially offset by a reduction in net interest income of $6.6 million and higher income taxes of $3.2 million.

A condensed earnings summary for the last three years is presented in Table 1 below:

Table 1

CONDENSED SUMMARY OF EARNINGS

(Dollars in Thousands, Except Per Share Data)	2014	2013	2012
Interest Income	$78,221	$82,152	$89,680
Taxable Equivalent Adjustments	494	583	616
Total Interest Income (FTE)	78,715	82,735	90,296
Interest Expense	3,580	4,416	5,368
Net Interest Income (FTE)	75,135	78,319	84,928
Provision for Loan Losses	1,905	3,472	16,166
Taxable Equivalent Adjustments	494	583	616
Net Interest Income After Provision for Loan Losses	72,736	74,264	68,146
Noninterest Income	52,536	55,111	54,569
Noninterest Expense	114,358	121,405	123,943
Income (Loss) Before Income Taxes	10,914	7,970	(1,228)
Income Tax Expense (Benefit)	1,654	1,925	(1,336)
Net Income	$9,260	$6,045	$108
Basic Net Income Per Share	$0.53	$0.35	$0.01
Diluted Net Income Per Share	$0.53	$0.35	$0.01

Net Interest Income

Net interest income represents our single largest source of earnings and is equal to interest income and fees generated by earning assets, less interest expense paid on interest bearing liabilities. We provide an analysis of our net interest income, including average yields and rates in Tables 2 and 3 below. We provide this information on a "taxable equivalent" basis to reflect the tax-exempt status of income earned on certain loans and investments, the majority of which are state and local government debt obligations.

In 2014, our taxable equivalent net interest income decreased $3.2 million, or 4.1%. This follows a decrease of $6.6 million, or 7.8%, in 2013, and a decrease of $7.9 million, or 8.5%, in 2012. The decrease in our taxable equivalent net interest income in these years was primarily driven by declines in loan income attributable to lower average portfolio balances and unfavorable asset repricing, which was partially offset by reductions in interest expense. The lower interest expense is primarily attributable to declines in certificates of deposit balances and reflects favorable repricing in all interest-bearing deposit categories.

For 2014, taxable equivalent interest income declined $4.0 million, or 4.9%, from 2013 and $7.6 million, or 8.4% in 2013 from 2012. The decrease for all periods is specifically attributable to both the shift in earning asset mix and lower yields. The reduction in average loans has resulted in the higher yielding interest earning assets being replaced with lower yielding federal funds or investment securities. Lower yields on new loan and investment production and loan portfolio repricing continue to adversely affect net interest income.

These factors produced a 22 basis point decline in the yield on interest earning assets, which decreased from 3.74% in 2013 to 3.52% for 2014. This compares to a 31 basis point decline in 2013 over 2012.

Interest expense decreased $836,000, or 18.9%, from 2013, and $952,000, or 17.7%, in 2013 over 2012. The lower cost of funds when compared to both periods was a result of both certificates of deposit repricing to lower rates, and rate reductions on several deposit products. The rate reductions on deposits reflect our response to a historically low interest rate environment and desire to continue our focus on core banking relationships. The average rate paid on interest-bearing liabilities decreased five basis points from 2013, and declined five basis points in 2013 from 2012, reflecting the factors mentioned above.

Our interest rate spread (defined as the taxable equivalent yield on average earning assets less the average rate paid on interest bearing liabilities) decreased 17 basis points in 2014 compared to 2013 and declined 26 basis points in 2013 compared to 2012. The decrease in both years was primarily attributable to the adverse impact of lower rates and a change in the mix of interest earning assets, which more than offset the repricing of our deposit base.

Our net interest margin (defined as taxable equivalent interest income less interest expense divided by average earning assets) of 3.36% in 2014 was 18 basis points lower than the 3.54% recorded in 2013 and was 27 basis points lower in 2013 than the 3.81% reported in 2012. In 2014, compared to 2013, the yield on earning assets declined 22 basis points and was partially offset by a decline in the cost of funds of four basis points. The earning asset yield decline of 31 basis points in 2013 over 2012 was partially offset by a reduction in the cost of funds by four basis points.

The net interest margin for the fourth quarter of 2014 was 3.43%, a decline of two basis points from the fourth quarter of 2013. The decrease in the margin from the comparable prior year period was attributable to unfavorable asset repricing, partially offset by a lower average cost of funds. Growth in our investment portfolio has partially helped mitigate this decline.

Although down year-over-year, net interest income increased for the third straight quarter and was slightly higher than the fourth quarter of 2013. Historically low interest rates and increased competition for loans continue to put pressure on loan yields, partially offsetting the favorable impact attributable to growth in the loan and investment portfolios.

Our current strategy, which is consistent with our historical strategy, is to not accept greater interest rate risk by reaching further out the curve for yield, particularly given the fact that short term rates are at historical lows. We continue to maintain short duration portfolios on both sides of the balance sheet and believe we are well positioned to respond to changing market conditions. Over time, this strategy has produced fairly consistent outcomes and a net interest margin that is significantly above peer comparisons.

Table 2

AVERAGE BALANCES AND INTEREST RATES

(Taxable Equivalent Basis - Dollars in Thousands)	2014 Average Balance	Interest	Average Rate	2013 Average Balance	Interest	Average Rate	2012 Average Balance
ASSETS							
Loans, Net of Unearned Income[1][2]	$1,414,000	$73,637	5.21%	$1,450,806	$78,484	5.41%	$ 1,556,5
Taxable Investment Securities	362,393	3,423	0.91	232,173	2,344	0.94	223,42
Tax-Exempt Investment Securities[2]	91,324	722	0.79	108,042	830	0.76	65,560
Funds Sold	369,906	933	0.25	422,665	1,077	0.25	384,06
Total Earning Assets	2,237,623	78,715	3.52%	2,213,686	82,735	3.74%	2,229,6
Cash & Due From Banks	45,367			49,978			48,924
Allowance for Loan Losses	(21,234)			(28,167)			(30,95
Other Assets	302,420			333,165			342,58
TOTAL ASSETS	$2,564,176			$2,568,662			$ 2,590,
LIABILITIES							
NOW Accounts	$715,846	$318	0.04%	$719,493	$482	0.07%	$ 771,61
Money Market Accounts	273,092	190	0.07	284,245	211	0.07	280,16
Savings Accounts	227,215	112	0.05	203,864	101	0.05	175,71
Other Time Deposits	206,136	479	0.23	231,354	637	0.28	267,26
Total Interest Bearing Deposits	1,422,289	1,099	0.08%	1,438,956	1,431	0.10%	1,494,
Short-Term Borrowings	44,403	78	0.18	53,922	235	0.44	52,178
Subordinated Notes Payable	62,887	1,328	2.08	62,887	1,420	2.23	62,887
Other Long-Term Borrowings	33,727	1,075	3.19	41,077	1,330	3.24	41,513
Total Interest Bearing Liabilities	1,563,306	3,580	0.23%	1,596,842	4,416	0.28%	1,651,
Noninterest Bearing Deposits	671,188			631,117			610,91
Other Liabilities	46,603			89,276			74,963
TOTAL LIABILITIES	2,281,097			2,317,235			2,337,
SHAREOWNERS' EQUITY							
TOTAL SHAREOWNERS' EQUITY	283,079			251,427			252,96
TOTAL LIABILITIES & EQUITY	$2,564,176			$2,568,662			$ 2,590,
Interest Rate Spread			3.29%			3.46%	
Net Interest Income		$75,135			$78,319		
Net Interest Margin[3]			3.36%			3.54%	

(1) *Average balances include nonaccrual loans. Interest income includes loan fees of $1.6 million for 2014, 2013, and 2012.*

(2) *Interest income includes the effects of taxable equivalent adjustments using a 35% tax rate.*

(3) *Taxable equivalent net interest income divided by average earning assets.*

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Table 3

RATE/VOLUME ANALYSIS[1]

	2014 vs. 2013 Increase (Decrease) Due to Change In			2013 vs. 2012 Increase (Decrease) Due to Change In		
(Taxable Equivalent Basis - Dollars in Thousands)	Total	Volume	Rate	Total	Volume	Rate
Earnings Assets:						
Loans, Net of Unearned Interest[2]	$(4,847)	$(1,991)	$(2,856)	$(7,296)	$(5,828)	$(1,468)
Investment Securities:						
Taxable	1,079	1,315	(236)	(568)	114	(682)
Tax-Exempt[2]	(108)	(128)	20	172	519	(347)
Funds Sold	(144)	(134)	(10)	131	95	36
Total	(4,020)	(938)	(3,082)	(7,561)	(5,100)	(2,461)
Interest Bearing Liabilities:						
NOW Accounts	(164)	(2)	(162)	(152)	(34)	(118)
Money Market Accounts	(21)	(8)	(13)	(44)	4	(48)
Savings Accounts	11	12	(1)	14	14	—
Time Deposits	(158)	(69)	(89)	(495)	(152)	(343)
Short-Term Borrowings	(157)	(41)	(116)	39	7	32
Subordinated Notes Payable	(92)	—	(92)	(57)	—	(57)
Other Long-Term Borrowings	(255)	(238)	(17)	(257)	(13)	(244)
Total	(836)	(346)	(490)	(952)	(174)	(778)
Changes in Net Interest Income	$(3,184)	$(592)	$(2,592)	$(6,609)	$(4,926)	$(1,683)

(1) *This table shows the change in taxable equivalent net interest income for comparative periods based on either changes in average volume or changes in average rates for interest earning assets and interest-bearing liabilities. Changes which are not solely due to volume changes or solely due to rate changes have been attributed to rate changes.*

(2) *Interest income includes the effects of taxable equivalent adjustments using a 35% tax rate to adjust interest on tax-exempt loans and securities to a taxable equivalent basis.*

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Provision for Loan Losses

The provision for loan losses was $1.9 million in 2014 compared to $3.5 million in 2013 and $16.2 million in 2012. The decline in the provision for all periods reflects favorable problem loan migration, lower loan losses, and overall improvement in key credit metrics. We discuss these trends in further detail below under Risk Element Assets and Allowance for Loan Losses.

Noninterest Income

Noninterest income totaled $52.5 million in 2014, $55.1 million in 2013, and $54.6 million in 2012. For 2014, the $2.6 million, or 4.7%, decrease from 2013 reflects lower deposit fees of $0.9 million, data processing fees of $1.1 million, wealth management fees of $0.4 million and mortgage banking fees of $0.5 million, partially offset by higher bank card fees of $0.1 million and other income of $0.2 million. Lower overdraft fees drove the reduction in deposit fees. The loss of a large government processing contract drove the decline in data processing fees. Wealth management declined due to a lower level of client trading activity as well as strong new retail investment product sales in 2013. Lower refinancing activity drove the reduction in mortgage banking fees.

For 2013, the $0.5 million, or 1.0%, increase over 2012 was attributable to higher wealth management fees of $1.0 million partially offset by lower deposit fees of $0.5 million. The increase in wealth management fees was attributable to higher trading activity by our clients, new account growth, as well as strong new retail investment product sales. Lower overdraft fees partially offset by higher business account analysis fees drove the decline in deposit fees.

Noninterest income as a percent of total operating revenues (net interest income plus noninterest income) was 41.30% in 2014, 42.48% in 2013, and 39.29% in 2012.

The table below reflects the major components of noninterest income.

(Dollars in Thousands)	2014	2013	2012
Deposit Fees	$24,320	$25,254	$25,792
Bank Card Fees	10,892	10,786	10,783
Wealth Management Fees	7,808	8,179	7,181
Securities Transactions	1	3	—
Mortgage Banking Fees	3,082	3,534	3,600
Data Processing Fees	1,543	2,674	2,713
Other	4,890	4,681	4,500
Total Noninterest Income	$52,536	$55,111	$54,569

Various significant components of noninterest income are discussed in more detail below.

Deposit Fees. For 2014, deposit service charge fees totaled $24.3 million compared to $25.3 million in 2013 and $25.8 million in 2012. The $0.9 million, or 3.7%, decrease in 2014 compared to 2013 was due to a lower level of overdraft fees generally reflective of improved financial management by our clients. The $0.5 million, or 2.1%, decrease in 2013 compared to 2012 was driven by a lower level of overdraft fees, partially offset by higher business account analysis fees.

Bank Card Fees. Bank card fees totaled $10.9 million in 2014 compared to $10.8 million in 2013 and $10.8 million in 2012. The slight increase in 2014 compared to 2013 reflects higher card spend by our clients. Bank card fees were essentially flat in 2013 compared to 2012 due to a reduction in the interchange rate for PIN based transactions.

Wealth Management Fees. Wealth management fees including both trust fees (i.e., managed accounts, trusts/estates, and retirement plans) and retail brokerage fees (i.e., investment and insurance products) totaled $7.8 million in 2014 compared to $8.2 million in 2013 and $7.2 million in 2012. The $0.4 million, or 4.5%, decrease in 2014 compared to 2013 was attributable to lower fees from our retail brokerage business generally reflective of lower client trading activity as well as strong new retail investment product sales in 2013. The $1.0 million, or 13.9%, increase in 2013 compared to 2012 reflects a $1.2 million increase in retail brokerage fees partially offset by a $0.1 million decrease in trust fees. The growth in retail brokerage fees was driven by higher trading activity by our clients and new account growth. The slight decline in trust fees reflects a decline in trust assets under management primarily attributable to account distributions. At December 31, 2014, total assets under management were approximately $1.278 billion compared to $1.259 billion at December 31, 2013 and $1.124 billion at December 31, 2012.

Mortgage Banking Fees. Mortgage banking fees totaled $3.1 million in 2014 compared to $3.5 million in 2013 and $3.6 million in 2012. The $0.5 million, or 12.8%, decrease in 2014 compared to 2013 was due to a lower level of refinancing activity, partially offset by higher home purchase financing and a higher margin realized for sold loans. The $0.1 million, or 1.8%, decrease in 2013 compared to 2012 was also driven by a slowdown in refinance activity, but was substantially offset by a higher margin realized for sold loans. Refinancing activity represented 14% of our loan production in 2014 compared to 32% and 39% for 2013 and 2012, respectively. Market conditions, housing activity, the level of interest rates and the percent of our fixed-rate production have significant impacts on our mortgage banking fees.

Data Processing Fees. For 2014, data processing fees totaled $1.5 million compared to $2.7 million for both 2013 and 2012. The decrease in 2014 compared to 2013 was attributable to the loss of a large government processing contract that began migrating to another processor in mid-2013, completing the transition in mid-2014. We currently maintain processing arrangements with four banks and two government agencies.

Other. Other noninterest income totaled $4.9 million in 2014 compared to $4.7 million in 2013 and $4.5 million in 2012. The increase in 2014 compared to 2013 reflects higher bank owned life insurance income and working capital financing fees. The increase in 2013 compared to 2012 was due to higher bonus income received from our debit card processor reflecting renegotiation of our processing agreement.

Noninterest Expense

Noninterest expense totaled $114.4 million in 2014 compared to $121.4 million in 2013 and $123.9 million in 2012. For 2014, the $7.0 million, or 5.8%, decrease was attributable to lower compensation expense of $3.9 million, OREO expense of $1.4 million, and other expense (excluding OREO expenses) of $2.2 million, partially offset by higher occupancy expense of $0.5 million. The reduction in compensation expense was primarily due to a decrease in pension plan expense partially offset by higher incentive expense for both cash and stock plans. Lower property carrying costs as well as a reduction in property valuation adjustments were the primary reasons for the reduction in OREO expense. The reduction in other expense was primarily attributable to lower FDIC insurance fees reflective of a favorable premium adjustment and reductions in both legal and professional fees. The increase in occupancy expense was due to higher maintenance contract costs reflective of security and technology upgrades and to a lesser extent higher building maintenance costs attributable to non-recurring expenditures.

For 2013, the $2.5 million, or 2.0%, decrease was attributable to lower occupancy expense of $0.7 million, OREO expense of $2.6 million, and other expense (excluding OREO expenses) of $1.1 million, partially offset by higher compensation of $1.9 million. The reduction in OREO expense was due to lower carrying costs and valuation adjustments reflecting improving property values in our markets. Declines were realized in most of the occupancy expense categories and were generally driven by stronger cost controls and other cost reduction initiatives. Lower legal fees, professional fees, and miscellaneous expense contributed to the reduction in other expense. The increase in compensation expense was attributable to an increase in associate benefit expense of $2.2 million, reflective of higher pension plan expense of $1.0 million and stock compensation expense of $0.9 million, partially offset by a $0.3 million reduction in salary expense.

Our operating efficiency ratio (expressed as noninterest expense as a percent of taxable equivalent net interest income plus noninterest income) was 89.68%, 91.09% and 88.72% in 2014, 2013 and 2012, respectively. A reduction in net interest income as well as elevated expenses for OREO expense, FDIC insurance fees, and pension costs was the primary reasons for the elevated efficiency ratio for all periods.

Expense management is an important part of our culture and strategic focus and we will continue to review and evaluate opportunities to optimize our operations, reduce operating costs and manage our discretionary expenses.

The table below reflects the major components of noninterest expense.

(Dollars in Thousands)	2014	2013	2012
Salaries	$48,896	$48,584	$48,925
Associate Benefits	13,319	17,543	15,317
Total Compensation	62,215	66,127	64,242
Premises	9,126	8,863	9,152
Equipment	8,692	8,468	8,903
Total Occupancy	17,818	17,331	18,055
Legal Fees	3,187	3,663	4,303
Professional Fees	3,732	4,304	4,882
Processing Services	6,062	5,396	3,967
Advertising	1,461	1,719	1,815
Travel and Entertainment	900	870	839
Printing and Supplies	865	994	1,154
Telephone	1,903	1,891	1,896
Postage	1,147	1,309	1,595
Insurance – Other	2,934	4,144	4,104
Intangible Amortization	32	210	431
Other Real Estate	6,811	8,234	10,812
Miscellaneous	5,291	5,213	5,848
Total Other Expense	34,325	37,947	41,646
Total Noninterest Expense	$114,358	$121,405	$123,943

Various significant components of noninterest expense are discussed in more detail below.

Compensation. Compensation expense totaled $62.2 million in 2014, $66.1 million in 2013, and $64.2 million in 2012. For 2014, the $3.9 million, or 5.9%, decrease from 2013 was attributable to lower associate benefit expense of $4.2 million partially offset by higher salary expense of $0.3 million. The decrease in associate benefit expense reflects lower pension plan expense of $5.0 million partially offset by higher stock compensation expense of $0.5 million and associate insurance expense of $0.3 million. The lower level of pension plan expense was attributable to the utilization of a higher discount rate (attributable to higher long-term rates at the end of 2013) for determining pension plan liabilities. Pension plan expense is determined by an external actuarial valuation based on assumptions that are evaluated annually, taking into consideration both current market conditions and anticipated long-term market conditions. A discussion of the sensitivity to these assumptions is detailed in the Critical Accounting Policy section of this report. Improved company performance drove the increase in stock compensation expense and rising health care costs contributed to the increase in associate insurance expense. The increase in salary expense was attributable to higher expense for our cash incentive plans reflective of improved individual and company performance. Lower associate salary expense reflective of reduced headcount partially offset the increase in cash incentives.

For 2013, the $1.9 million, or 2.9%, increase was due to higher associate benefit expense of $2.2 million partially offset by lower salary expense of $0.3 million. The increase in associate benefit expense reflects higher expense for our pension plans of $1.0 million primarily driven by the lower discount rate used for computing plan cost. Higher stock compensation expense of $0.9 million also contributed to the increase reflecting an improvement in company performance. The reduction in salary expense was driven by a reduction in base salary expense of $0.8 million attributable to further reduction in associate headcount that was partially offset by higher cash basis performance pay.

Occupancy. Occupancy expense (including premises and equipment) totaled $17.8 million for 2014, $17.3 million for 2013, and $18.1 million for 2012. For 2014, the $0.5 million, or 2.8%, increase over 2013 reflects higher premises expense of $0.3 million and equipment expense of $0.2 million. Higher building maintenance costs partially attributable to non-recurring expenditures drove the increase in premises expense. Higher maintenance contract costs reflective of security and technology upgrades drove the majority of the increase in equipment expense. For 2013, the $0.7 million, or 4.0%, decline from 2012 was attributable to a reduction in premises expense of $0.3 million and equipment expense of $0.4 million. The decrease in premises expense was primarily driven by lower lease and utility expense. During 2012 and 2013, we did not renew leases on two banking offices. An internal energy efficiency program initiated in early 2013 drove the reduction in utility costs. The decrease in equipment expense reflects lower depreciation expense reflecting full depreciation of our item processing system as well as lower expense for maintenance agreements.

Other. Other noninterest expense totaled $34.3 million in 2014, $37.9 million in 2013, and $41.6 million in 2012. For 2014, the $3.6 million, or 9.5%, decrease from 2013 was primarily attributable to lower OREO expense of $1.4 million, FDIC insurance fees of $1.2 million, legal fees of $0.5 million, and professional fees of $0.6 million. Lower property carrying costs driven by strong property sales during the year as well as a reduction in property valuation adjustments reflective of improving property values were the primary reasons for the reduction in OREO expense. The decrease in FDIC insurance fees was attributable to a favorable premium adjustment due to our improved financial performance. Legal fees declined due to a lower level of legal support needed for problem loan resolutions. Lower audit costs and consulting costs drove the reduction in professional fees.

For 2013, the $3.7 million, or 8.9%, decrease compared to 2012 reflects lower expense for OREO properties of $2.6 million, legal fees of $0.6 million, professional fees of $0.6 million, postage of $0.3 million, printing/supplies of $0.2 million, intangible amortization of $0.2 million, and miscellaneous expense of $0.6 million, partially offset by higher processing services of $1.4 million. OREO expense decreased due to lower property carrying costs and a reduction in net losses from the sale of properties reflecting improving property values in our markets. Lower legal costs to support collection/foreclosure activity and borrower bankruptcy proceedings drove the decline in legal fees. Professional fees decreased due to a reduction in cost for performing our goodwill analysis during the year as well as lower internal audits costs and real estate appraisal costs. The decline in postage costs reflects our initiative to migrate our clients to e-statements. Printing and supplies expense decreased due to stronger cost controls. Full amortization of our remaining core deposit intangible drove the decline in intangible amortization expense. The reduction in miscellaneous expense was attributable to the reclassification of our debit card processing costs to the processing services expense category. Processing services expense increased primarily due to the outsourcing of our item processing system in early 2013 and to a lesser extent the aforementioned reclassification of debit card processing costs.

Income Taxes

For 2014, we realized income tax expense of $1.7 million (effective tax rate of 15.2%) compared to income tax expense of $1.9 million (effective tax rate of 24.2%) in 2013 and an income tax benefit of $1.3 million (effective tax rate of 108.7%) in 2012. The tax provision for 2014 was favorably impacted by a $2.2 million state tax benefit attributable to an adjustment in our reserve for uncertain tax positions associated with prior year matters. These tax matters have been fully resolved and should not impact our tax provision going forward. The tax provisions for 2013 and 2012 were favorably affected by the resolution of state tax contingencies totaling approximately $0.8 million and $0.3, respectively. In 2015, we would expect the effective tax rate to return to a more normalized level of 35% to 36%.

FINANCIAL CONDITION

Average assets totaled approximately $2.564 billion for the year 2014, consistent with 2013. Average interest earning assets were approximately $2.238 billion, representing an increase of $23.9 million, or 1.1%, over 2013. Year-over-year, average short-term investments decreased $52.8 million, while investment securities increased $113.5 million. Average gross loans declined $36.8 million. We discuss these variances in more detail below.

Table 2 provides information on average balances and rates, Table 3 provides an analysis of rate and volume variances and Table 4 highlights the changing mix of our interest earning assets over the last three years.

Loans

In 2014, average loans decreased $36.8 million, or 2.5%, compared to a decrease of $105.8 million, or 6.8%, in 2013. Loans as a percent of average earning assets declined to 63.2% in 2014, down from the 2013 and 2012 levels of 65.5% and 69.8%, respectively. Year-over-year average balances in the loan portfolio experienced runoff in all loan types except commercial loans and indirect auto loans, which grew year-over year. Although our core loan portfolio continues to be impacted by normal amortization, levels of payoffs and pay downs declined in 2014 compared to the prior year, and the loan portfolio began experiencing overall growth beginning in the first quarter of 2014.

Without compromising our credit standards or taking on inordinate interest rate risk, we have modified several lending programs in our business (commercial real estate and consumer portfolios) to try to mitigate the significant impact that consumer and business deleveraging is having on our portfolio. These programs, coupled with economic improvements in our anchor markets, have helped to increase overall production. On a year-over-year basis, period-end loans increased $42.4 million, with the low point of loan balances occurring during the first quarter of 2014. These increases have occurred primarily in the commercial, construction, and indirect auto loan portfolios.

We originate mortgage loans secured by 1-4 family residential properties through our Residential Real Estate line of business, a majority of which are fixed-rate loans that are sold into the secondary market to third party purchasers on a best efforts delivery basis with servicing released. A majority of our adjustable rate loan product is retained in our loan portfolio.

Table 4

SOURCES OF EARNING ASSET GROWTH

(Average Balances – Dollars In Thousands)	2013 to 2014 Change	Percentage Total Change	Components of Average Earning Assets 2014	2013	2012
Loans:					
Commercial, Financial, and Agricultural	$4,174	17.0 %	5.9 %	5.8 %	6.0 %
Real Estate – Construction	(382)	(2.0)	1.8	1.9	1.8
Real Estate – Commercial Mortgage	(64,520)	(270.0)	23.1	26.2	27.5
Real Estate – Residential	(5,961)	(25.0)	14.1	14.5	16.3
Real Estate – Home Equity	(4,512)	(19.0)	10.1	10.5	10.8
Consumer	34,395	145.0	8.2	6.8	7.5
Total Loans	$(36,806)	(154.0)%	63.2 %	65.7 %	69.9 %
Investment Securities:					
Taxable	$130,220	544.0 %	16.2 %	10.5 %	10.0 %
Tax-Exempt	(16,718)	(70.0)	4.1	4.9	2.9
Total Securities	113,502	474.0	20.3	15.4	12.9
Funds Sold	(52,759)	(220.0)	16.5	18.9	17.2
Total Earning Assets	$23,937	100.0 %	100.0%	100.0%	100.0%

Our average loan-to-deposit ratio decreased to 67.5% in 2014 from 70.1% in 2013. The lower loan-to-deposit ratio reflects both the decline in average loan balances, and growth in average deposits.

The composition of our loan portfolio at December 31st for each of the past five years is shown in Table 5. Table 6 arrays our total loan portfolio as of December 31, 2014, based upon maturities. As a percent of the total portfolio, loans with fixed interest rates represent 32.2% as of December 31, 2014, unchanged from December 31, 2013.

Table 5

LOANS BY CATEGORY

(Dollars in Thousands)	2014	2013	2012	2011	2010
Commercial, Financial and Agricultural	$136,925	$126,607	$139,850	$130,879	$157,394
Real Estate – Construction(1)	43,472	36,187	43,740	26,367	43,239
Real Estate – Commercial Mortgage	510,120	533,871	613,625	639,140	671,702
Real Estate – Residential(1)	304,781	315,582	329,947	399,371	430,541
Real Estate – Home Equity	229,572	227,922	236,263	244,263	251,565

Consumer	217,192	159,500	157,877	188,663	204,230
Total Loans, Net of Unearned Income	$1,442,062	$1,399,669	$1,521,302	$1,628,683	$1,758,671

(1) *Includes loans held for sale.*

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Table 6

LOAN MATURITIES

	Maturity Periods			
(Dollars in Thousands)	One Year or Less	Over One Through Five Years	Over Five Years	Total
Commercial, Financial and Agricultural	$56,288	$61,770	$18,867	$136,925
Real Estate – Construction	38,289	2,542	2,641	43,472
Real Estate – Commercial Mortgage	59,368	100,663	350,089	510,120
Real Estate – Residential	29,753	42,290	232,738	304,781
Real Estate – Home Equity	593	46,855	182,124	229,572
Consumer(1)	13,822	193,695	9,675	217,192
Total	$198,113	$447,815	$796,134	$1,442,062
Loans with Fixed Rates	$82,374	$322,696	$59,800	$464,870
Loans with Floating or Adjustable Rates	115,739	125,119	736,334	977,192
Total	$198,113	$447,815	$796,134	$1,442,062

(1) *Demand loans and overdrafts are reported in the category of one year or less.*

Risk Element Assets

Risk element assets consist of nonaccrual loans, OREO, TDRs, past due loans, potential problem loans, and loan concentrations. Table 7 depicts certain categories of our risk element assets as of December 31st for each of the last five years. Activity within our nonperforming asset portfolio is provided below in Table 8.

Nonperforming assets (nonaccrual loans and OREO) totaled $52.4 million at year-end 2014 compared to $85.0 million at year-end 2013. Nonaccrual loans totaled $16.8 million at year-end 2014, a decrease of $20.2 million from year-end 2013, reflective of loan resolutions (charge-offs, transfer of loans to OREO, and payments) and loans restored to an accrual status, which outpaced gross additions. Gross additions declined by $22 million and $17 million in 2014 and 2013, respectively. The balance of OREO totaled $35.7 million at year-end 2014, a decrease of $12.4 million from year-end 2013. We continued to experience progress during 2014 in our efforts to dispose of OREO selling properties totaling $23.8 million compared to $25.9 million in 2013. Nonperforming assets represented 2.00% of total assets at December 31, 2014 compared to 3.26% at December 31, 2013.

We continue to allocate significant resources to reduce our level of nonperforming assets, while mitigating losses and 2014 was another productive year in this respect.

Table 7

RISK ELEMENT ASSETS

(Dollars in Thousands)	2014	2013	2012	2011	2010
Nonaccruing Loans:					
Commercial, Financial and Agricultural	$507	$188	$1,069	$755	$1,059
Real Estate – Construction	424	426	4,071	334	1,907
Real Estate – Commercial Mortgage	5,806	25,227	41,045	42,820	26,874
Real Estate – Residential	6,737	6,440	13,429	25,671	30,189
Real Estate – Home Equity	2,544	4,084	4,034	4,283	4,803
Consumer	751	599	574	1,160	868
Total Nonperforming Loans (“NPLs”)[1]	$16,769	$36,964	$64,222	$75,023	$65,700
Other Real Estate Owned	35,680	48,071	53,426	62,600	57,937
Total Nonperforming Assets (“NPAs”)	$52,449	$85,035	$117,648	$137,623	$123,637
Past Due Loans 30 – 89 Days	$6,792	$7,746	$9,934	$19,425	$24,193
Past Due Loans 90 Days or More (accruing)	—	—	—	224	159
Performing Troubled Debt Restructurings	$44,409	$44,764	$47,474	$37,675	$21,649
Nonperforming Loans/Loans	1.16 %	2.64 %	4.22 %	4.61 %	3.74 %
Nonperforming Assets/Total Assets	2.00	3.26	4.47	5.21	4.72
Nonperforming Assets/Loans Plus OREO	3.55	5.87	7.47	8.14	6.81
Allowance/Nonperforming Loans	104.60 %	62.48 %	45.42 %	41.37 %	53.94 %

(1) *Nonaccrual TDRs totaling $2.2 million and $11.0 million are included in nonaccrual/NPL totals for December 31, 2014 and December 31, 2013, respectively.*

Table 8

NONPERFORMING ASSET ACTIVITY

(Dollars in Thousands)	2014	2013
NPA Beginning Balance:	$85,035	$117,648
Change in Nonaccrual Loans:		
Beginning Balance	36,964	64,222
Additions	22,466	44,070
Charge-Offs	(8,857)	(11,523)
Transferred to OREO	(13,888)	(23,355)
Paid Off/Payments	(9,639)	(18,311)
Restored to Accrual	(10,277)	(18,139)
Ending Balance	16,769	36,964
Change in OREO:		
Beginning Balance	48,071	53,426
Additions[1]	15,271	24,488
Valuation Write-downs	(3,142)	(3,592)
Sales	(23,791)	(25,940)
Other	(729)	(311)
Ending Balance	35,680	48,071
NPA Net Change	(32,586)	(32,613)
NPA Ending Balance	$52,449	$85,035

(1) *The difference in OREO additions and nonaccrual loans transferred to OREO represents loans migrating to OREO status that were not in a nonaccrual status in a prior period.*

Nonaccrual Loans. Nonaccrual loans totaled $16.8 million at year-end 2014, a decrease of $20.2 million from year-end 2013. Gross additions to nonaccrual status during 2014 totaled $22.5 million compared to $44.1 million in 2013. A majority of the year-over-year decrease in nonaccrual loans was realized in the commercial mortgage loan category.

Generally, loans are placed on nonaccrual status if principal or interest payments become 90 days past due and/or management deems the collectability of the principal and/or interest to be doubtful. Once a loan is placed in nonaccrual status, all previously accrued and uncollected interest is reversed against interest income. Interest income on nonaccrual loans is recognized when the ultimate collectability is no longer considered doubtful. Loans are returned to accrual status when the principal and interest amounts contractually due are brought current or when future payments are reasonably assured. If interest on our loans classified as nonaccrual during 2014 had been recognized on a fully accruing basis, we would have recorded an additional $1.5 million of interest income for the year ended December 31, 2014.

Other Real Estate Owned. OREO represents property acquired as the result of borrower defaults on loans or by receiving a deed in lieu of foreclosure. OREO is recorded at the lower of cost or estimated fair value, less estimated selling costs, at the time of foreclosure. Write-downs occurring at foreclosure are charged against the allowance for loan losses. On an ongoing basis, properties are either revalued internally or by a third party appraiser as required by applicable regulations. Subsequent declines in value are reflected as other noninterest expense. Carrying costs related to maintaining the OREO properties are expensed as incurred and are also reflected as other noninterest expense.

OREO totaled $35.7 million at December 31, 2014 versus $48.1 million at December 31, 2013. During 2014, we added properties totaling $15.3 million and partially or completely liquidated properties totaling $23.8 million. Revaluation adjustments for other real estate owned properties during 2014 totaled $3.1 million and were charged to noninterest expense when realized. For 2013, we added properties totaling $24.5 million and partially or completely liquidated properties totaling $26.3 million. Revaluation adjustments for other real estate owned properties during 2013 totaled $3.6 million and were charged to noninterest expense when realized.

The composition of our OREO portfolio as of December 31 is provided in the table below.

(Dollars in Thousands)	2014	2013
Lots/Land	$19,405	$29,821
Residential 1-4	4,430	3,964
Commercial Building	10,197	12,702
Other	1,648	1,584
Total OREO	$35,680	$48,071

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Troubled Debt Restructurings. TDRs are loans on which, due to the deterioration in the borrower's financial condition, the original terms have been modified and deemed a concession to the borrower. From time to time we will modify a loan as a workout alternative. Most of these instances involve a principal moratorium, extension of the loan term, or interest rate reduction.

Loans classified as TDRs at year-end 2014 totaled $46.7 million compared to $55.8 million at year-end 2013. Accruing TDRs make up approximately $44.4 million, or 95%, of our TDR portfolio at year-end 2014 of which $2.1 million was over 30 days past due. The weighted average rate for the loans within the accruing TDR portfolio is 5.2%. During 2014, we modified 28 loan contracts totaling approximately $4.1 million of which four loan contracts totaling $0.4 million have defaulted. Our TDR default rate (default balance as a percentage of average TDRs) during 2014 and 2013 was 16% and 10%, respectively.

The composition of our TDR portfolio as of December 31 is provided in the table below.

	2014		2013	
(Dollars in Thousands)	Accruing	**Nonaccruing**[1]	Accruing	**Nonaccruing**[1]
Commercial, Financial and Agricultural	$838	$ 266	$1,511	$ —
Real Estate – Construction	—	—	156	—
Real Estate – Commercial Mortgage	26,565	—	24,735	10,308
Real Estate – Residential	14,940	1,622	16,441	458
Real Estate – Home Equity	1,856	356	1,576	241
Consumer	211	—	345	—
Total TDRs	$44,410	$ 2,244	$44,764	$ 11,007

(1) *Nonaccruing TDRs are included in nonaccrual/NPL totals and NPA/NPL ratio calculations.*

Activity within our TDR portfolio is provided in the table below.

(Dollars in Thousands)	2014	2013
TDR Beginning Balance:	$55,770	$57,353
Additions	4,978	12,742
Charge-Offs	(370)	(1,018)
Paid Off/Payments	(5,573)	(5,724)
Removal Due to Change in TDR Status	(73)	(1,632)
Defaults	(8,078)	(5,950)
TDR Ending Balance	$46,654	$55,771

Past Due Loans. A loan is defined as a past due loan when one full payment is past due or a contractual maturity is over 30 days past due. Past due loans at year-end 2014 totaled \$6.8 million compared to \$7.7 million at year-end 2013.

Potential Problem Loans. Potential problem loans are defined as those loans which are now current but where management has doubt as to the borrower's ability to comply with present loan repayment terms. At December 31, 2014, we had \$6.4 million in loans of this type which are not included in either of the nonaccrual, TDR or 90 day past due loan categories compared to \$7.4 million at December 31, 2013. Management monitors these loans closely and reviews their performance on a regular basis.

Loan Concentrations. Loan concentrations are considered to exist when there are amounts loaned to multiple borrowers engaged in similar activities which cause them to be similarly impacted by economic or other conditions and such amount exceeds 10% of total loans. Due to the lack of diversified industry within the markets served by the Bank and the relatively close proximity of the markets, we have both geographic concentrations as well as concentrations in the types of loans funded. Specifically, due to the nature of our markets, a significant portion of the loan portfolio has historically been secured with real estate, approximately 75% at year-end 2014 and 79% at year-end 2013. The primary types of real estate collateral are commercial properties and 1-4 family residential properties. At December 31, 2014, commercial real estate and residential real estate mortgage loans (including home equity loans) accounted for 35.4% and 37.1%, respectively, of the total loan portfolio.

The following table summarizes our real estate loan portfolio as segregated by the type of property. Property type concentrations are stated as a percentage of year-end total real estate loans.

	2014		2013	
	Investor Real Estate	Owner Occupied Real Estate	Investor Real Estate	Owner Occupied Real Estate
Vacant Land, Construction, and Land Development	10.0%	—	10.0%	—
Improved Property	22.0%	68.0%	23.2%	66.8%
Total Real Estate Loans	32.0%	68.0%	33.2%	66.8%

A major portion of our real estate loan portfolio is centered in the owner occupied category which carries a lower risk of non-collection than certain segments of the investor category. Approximately 74% of the land/construction category was secured by residential real estate at year-end 2014.

Allowance for Loan Losses

Management believes it maintains the allowance for loan losses at a level sufficient to provide for probable credit losses inherent in the loan portfolio as of the balance sheet date. Credit losses arise from the borrowers' inability or unwillingness to repay, and from other risks inherent in the lending process including collateral risk, operations risk, concentration risk, and economic risk. As such, all related risks of lending are considered when assessing the adequacy of the allowance. The allowance for loan losses is established through a provision charged to expense. Loans are charged-off against the allowance when losses are probable and reasonably quantifiable. The allowance for loan losses is based on management's judgment of overall credit quality. This is a significant estimate based on a detailed analysis of the loan portfolio. The balance can and will change based on revisions to our assessment of the loan portfolio's overall credit quality and other risk factors both internal and external to us.

Management evaluates the adequacy of the allowance for loan losses on a quarterly basis. The allowance consists of two components. The first component consists of amounts reserved for impaired loans. A loan is deemed impaired when, based on current information and events, it is probable that the company will not be able to collect all amounts due (principal and interest payments), according to the contractual terms of the loan agreement. Loans are monitored for potential impairment through our ongoing loan review procedures and portfolio analysis. Classified loans and past due loans over a specific dollar amount, and all troubled debt restructurings are individually evaluated for impairment.

The approach for assigning reserves for the impaired loans is determined by the dollar amount of the loan and loan type. Impairment measurement for loans over a specific dollar are assigned on an individual loan basis with the amount reserved dependent on whether repayment of the loan is dependent on the liquidation of collateral or from some other source of repayment. If repayment is dependent on the sale of collateral, the reserve is equivalent to the recorded investment in the loan less the fair value of the collateral after estimated sales expenses. If repayment is not dependent on the sale of collateral, the reserve is equivalent to the recorded investment in the loan less the estimated cash flows discounted using the loan's effective interest rate. The discounted value of the cash flows is based on the anticipated timing of the receipt of cash payments from the borrower. The reserve allocations for individually measured impaired loans are sensitive to the extent market conditions or the actual timing of cash receipts change. Impairment reserves for smaller-balance loans under a specific dollar amount are assigned on a pooled basis utilizing loss factors for impaired loans of a similar nature.

The second component is a general reserve on all loans other than those identified as impaired. General reserves are assigned to various homogenous loan pools, including commercial, commercial real estate, construction, residential 1-4 family, home equity, and consumer. General reserves are assigned based on historical loan loss ratios determined by loan pool and internal risk rating that are adjusted for various internal and external risk factors unique to each loan pool.

Table 9 analyzes the activity in the allowance over the past five years.

For 2014, our net charge-offs totaled $7.5 million, or 0.53%, of average loans, compared to $9.5 million, or 0.66%, for 2013, and $18.0 million, or 1.16%, for 2012. Lower residential and construction loan charge-offs of $1.6 million and $1.1 million, respectively, drove the decrease in net charge-offs in 2014. Reductions in residential and commercial real estate loan charge-offs of $5.9 million and $2.4 million, respectively, drove the decline in net charge-offs in 2013. At year-end 2014, the allowance for loan losses of $17.5 million was 1.22% of outstanding loans (net of overdrafts) and provided coverage of 105% of nonperforming loans compared to 1.65% and 62%, respectively, at year-end 2013, and 1.93% and 45%, respectively, at year-end 2012.

Table 10 provides an allocation of the allowance for loan losses to specific loan types for each of the past five years. The reserve allocations, as calculated using the above methodology, are assigned to specific loan categories corresponding to the type represented within the components discussed.

The reduction in the allowance for loan losses from December 31, 2013 to December 31, 2014 was primarily attributable to a decline in general reserves reflective of slower problem loan migration, lower loan loss experience, as well as continued improvement in credit quality metrics. A decrease in our impaired loan balance and related reserves contributed to a lesser extent and reflects slower inflow and successful resolutions, as well as lower loss content. It is management's opinion that the allowance at December 31, 2014 is adequate to absorb probable losses inherent in the loan portfolio at year-end. The reduction in the allowance for loan losses from December 31, 2012 to December 31, 2013 was primarily attributable to a decline in impaired loan reserves and to a lesser extent lower general reserves. Successful impaired loan resolutions and slower inflow drove the decrease in impaired loan reserves. The reduction in general reserves was primarily attributable to favorable problem loan migration and lower loan loss experience. In 2013, we incorporated subjective factors of estimation risk into each loan category which eliminated the unallocated portion of the allowance.

Table 9

ANALYSIS OF ALLOWANCE FOR LOAN LOSSES

(Dollars in Thousands)	2014	2013	2012	2011	2010
Balance at Beginning of Year	$23,095	$29,167	$31,035	$35,436	$43,999
Charge-Offs:					
Commercial, Financial and Agricultural	871	748	822	1,843	2,118
Real Estate - Construction	28	1,070	629	114	5,877
Real Estate - Commercial	3,788	3,651	6,031	6,713	8,762
Real Estate - Residential	2,160	3,835	9,719	11,870	12,168
Real Estate - Home Equity	1,379	1,159	2,896	2,727	3,087
Consumer	1,820	1,751	2,125	2,924	3,502
Total Charge-Offs	10,046	12,214	22,222	26,191	35,514
Recoveries:					
Commercial, Financial and Agricultural	214	209	290	387	370
Real Estate - Construction	9	1	43	14	8
Real Estate - Commercial	468	363	682	251	261
Real Estate - Residential	752	838	1,291	478	385
Real Estate - Home Equity	141	294	399	214	555
Consumer	1,001	965	1,483	1,450	1,548
Total Recoveries	2,585	2,670	4,188	2,794	3,127
Net Charge-Offs	7,461	9,544	18,034	23,397	32,387
Provision for Loan Losses	1,905	3,472	16,166	18,996	23,824
Balance at End of Year	$17,539	$23,095	$29,167	$31,035	$35,436
Ratio of Net Charge-Offs to Average Loans Outstanding	0.53 %	0.66 %	1.16 %	1.39 %	1.77 %
	1.22 %	1.65 %	1.93 %	1.91 %	2.01 %

Allowance for Loan Losses as a Percent of Loans at End of Year										
Allowance for Loan Losses as a Multiple of Net Charge-Offs	2.35	x	2.42	x	1.62	x	1.33	x	1.09	x

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Table 10

ALLOCATION OF ALLOWANCE FOR LOAN LOSSES

	2014		2013		2012		2011		2010	
(Dollars in Thousands)	Allow-ance Amount	Percent of Loans in Each Category To Total Loans	Allow-ance Amount	Percent of Loans in Each Category To Total Loans	Allow-ance Amount	Percent of Loans in Each Category To Total Loans	Allow-ance Amount	Percent of Loans in Each Category To Total Loans	Allow-ance Amount	Percent of Loans in Each Category To Total Loans
Commercial, Financial and Agricultural	$784	9.5 %	$699	9.0 %	$1,253	9.2 %	$1,534	8.0 %	$1,544	8.9 %
Real Estate:										
Construction	843	3.0	1,580	2.6	2,856	2.9	1,133	1.6	2,060	2.5
Commercial	5,287	35.4	7,710	38.1	11,081	40.3	10,660	39.2	8,645	38.2
Residential	6,520	21.1	9,073	22.6	8,678	21.7	12,518	24.5	17,046	24.5
Home Equity	2,882	15.9	3,051	16.3	2,945	15.5	2,392	15.0	2,522	14.3
Consumer	1,223	15.1	982	11.4	1,327	10.4	1,887	11.7	2,612	11.6
Not Allocated	—	—	—	—	1,027	—	911	—	1,007	—
Total	$17,539	100.0%	$23,095	100.0%	$29,167	100.0%	$31,035	100.0%	$35,436	100.0%

Investment Securities

In 2014, our average investment portfolio increased $113.5 million, or 33.4%, from 2013 and increased $51.2 million, or 17.7%, from 2012 to 2013. As a percentage of average earning assets, the investment portfolio represented 20.3% in 2014, compared to 15.4% in 2013. In both 2013 and 2014, the increase in the average balance of the investment portfolio resulted from strategically growing investment purchases to better deploy our overnight funds and improve the overall composition of our earning assets. In 2015, we will continue to closely monitor liquidity levels and pledging requirements to assess the need to purchase additional investments, as well as look for new investment products that are prudent relative to our risk profile and the Bank's overall investment strategy.

The investment portfolio is a significant component of our operations and, as such, it functions as a key element of liquidity and asset/liability management. Two types of classifications are approved for investment securities which are Available-for-Sale ("AFS") and Held-for-Maturity ("HTM"). In 2013 and 2014, securities were purchased under both the AFS and HTM designations. As of December 31, 2014, $332.8 million, or 67.1% of the investment portfolio was classified as AFS, with the remaining $163.4 million classified as HTM.

In 2014, average taxable investments increased $130.2 million, or 56.1%, while tax-exempt investments decreased $16.7 million, or 15.5%. Taxable investments increased as part of our overall investment strategy in 2014. Short-term yields improved during the year making these investments more attractive. Average balances of tax-exempt investments decreased as high quality non-taxable securities with attractive spreads were less readily available in 2014. Management will continue to purchase municipal issues as they become available and when it considers the yield to be attractive.

At acquisition, the classification of the security will be determined based on how the purchase will affect the company's asset/liability strategy and future business plans and opportunities. Such decisions will be weighed against multiple factors, including regulatory capital requirements, volatility in earnings or other comprehensive income, and liquidity needs. Securities in the AFS portfolio are recorded at fair value with unrealized gains and losses associated with these securities recorded net of tax, in the accumulated other comprehensive income (loss) component of shareowners' equity. Securities that are HTM will be acquired or owned with the intent of holding them to maturity (final payment date). HTM investments are measured at amortized cost. It is neither management's current intent nor practice to participate in the trading of investment securities for the purpose of recognizing gains and therefore we do not maintain a trading portfolio.

At December 31, 2014, the investment portfolio maintained a net pre-tax unrealized gain of $0.5 million in the AFS portfolio compared to a net pre-tax unrealized gain of $0.3 million at December 31, 2013. At December 31, 2014, there were 157 positions (combined AFS and HTM) with unrealized losses totaling $0.7 million. Of the 157 positions, 84 were Ginnie Mae mortgage-backed securities (GNMA), US Treasuries, or SBA securities, all of which carry the full faith and credit guarantee of the US Government. SBA securities float monthly or quarterly to the prime rate and are uncapped. There were 24 SBA positions and 24 GMNA positions in an unrealized loss position for longer than 12 months, and have unrealized losses of $231,000 and $88,000, respectively. There were 64 municipal bonds in an unrealized loss position that were pre-refunded, or rated "AA-"or better. One of these positions was in an unrealized loss position for longer than 12 months, and had an unrealized loss of $5,000. The remaining nine securities are Federal Farm Credit or Federal Home Loan Bank agency bonds, none of which have been in an unrealized loss position for longer than 12 months. No positions with unrealized losses are considered impaired, and all positions are expected to mature at par or better.

The average maturity of the total portfolio at December 31, 2014 and 2013 was 2.17 and 1.95 years, respectively. Balances in all asset classes increased compared to last year with the exception of GNMA mortgage-backed securities and non-taxable municipal bonds. Purchases of U.S. Treasuries with maturities out to three and one-half years were added in 2014 which extended the average life of the investment portfolio. See Table 12 for a breakdown of maturities by investment type.

The weighted average taxable equivalent yield of the investment portfolio at December 31, 2014 was 1.00% versus 0.94% in 2013. This higher yield was a result of most new purchases being made at higher market rates during 2014. Our bond portfolio contained no investments in obligations, other than U.S. Governments, of any one state, municipality, political subdivision or any other issuer that exceeded 10% of our shareowners' equity at December 31, 2014. New investments continue to be made selectively in short-duration, high quality bonds.

Table 11 and Table 12 present a detailed analysis of our investment securities as to type, maturity and yield at December 31.

Table 11

INVESTMENT SECURITIES BY CATEGORY

(Dollars in Thousands)	2014 Carrying Amount	Percent	2013 Carrying Amount	Percent	2012 Carrying Amount	Percent
Available for Sale						
U.S. Government Treasury	$186,031	37 %	$71,833	18 %	$97,249	33 %
U.S. Government Agency	96,097	19 %	75,146	19 %	51,664	17 %
States and Political Subdivisions	2,287	— %	91,753	23 %	79,879	27 %
Mortgage-Backed Securities	48,388	10 %	2,795	1 %	56,982	19 %

Equity Securities	8,745	2 %	9,893	2 %	11,211	4 %
Total	341,548	68 %	251,420	63 %	296,985	100 %
Held to Maturity						
U.S. Government Treasury	76,179	15 %	43,533	11 %	—	— %
U.S. Government Agency	19,807	4 %	15,794	4 %	—	— %
States and Political Subdivisions	40,878	8 %	33,216	8 %	—	— %
Mortgage-Backed Securities	26,717	5 %	55,668	14 %	—	— %
Total	163,581	32 %	148,211	37 %	—	— %
Total Investment Securities	$505,129	100 %	$399,631	100 %	296,985	100 %

Table 12

MATURITY DISTRIBUTION OF INVESTMENT SECURITIES

	Within 1 year		**1 - 5 years**		**5 - 10 years**		**After 10 years**		**Total**	
(Dollars in Thousands)	**Amount**	**WAY[3]**	**Amount**	**WAY[3]**	**Amount**	**WAY[3]**	**Amount**	**WAY[3]**	**Amount**	**WAY[3]**
Available for Sale										
U.S. Government Treasury	$14,222	0.34 %	$171,809	0.92 %	$—	— %	$—	— %	$186,031	0.88 %
U.S. Government Agency	11,841	0.45	84,256	0.84	—	—	—	—	96,097	0.79
States and Political Subdivisions	20,620	0.81	27,768	1.06	—	—	—	—	48,388	0.95
Mortgage-Backed Securities[1]	136	1.91	2,097	5.08	54	1.54	—	—	2,287	4.81
Other Securities[2]	—	—	—	—	—	—	8,745	5.15	8,745	5.15
Total	$46,819	0.58 %	$285,930	0.94 %	$54	1.54 %	$8,745	5.15 %	$341,548	1.00 %
Held to Maturity										
U.S. Government Treasury	$—	— %	$76,179	0.83 %	$—	— %	$—	— %	$76,179	0.83 %
U.S. Government Agency	—	—	19,807	0.79	—	—	—	—	19,807	0.79
States and Political Subdivisions	17,958	0.60	8,759	0.90	—	—	—	—	26,717	0.70
Mortgage-Backed Securities[1]	3,983	1.24	36,895	1.72	—	—	—	—	40,878	1.67
Total	$21,941	0.72 %	$141,640	1.06 %	$—	— %	$—	— %	$163,581	1.02 %
Total Investment Securities	$68,760	0.63 %	$427,570	0.98 %	$54	1.54 %	$8,745	5.15 %	$505,129	1.01 %

(1) *Based on weighted-average life.*

(2) *Federal Home Loan Bank Stock and Federal Reserve Bank Stock are included in this category for weighted average yield, but do not have stated maturities.*

(3) *Weighted average yield calculated based on current amortized cost balances – not presented on a tax equivalent basis.*

Deposits and Funds Purchased

Average total deposits for the year were $2.093 billion; an increase of $23.4 million, or 1.1%, compared to the same period in 2013 and deposits decreased $35.6 million, or 1.7%, from 2012 to 2013. Increases in noninterest bearing deposits and savings accounts were partially offset by declines in the remaining product types. The decline occurring from 2012 to 2013 was attributable to decreases in NOW accounts and certificates of deposit, and was partially offset by increases in noninterest bearing deposits, money market accounts, and savings accounts.

As is typical, the seasonal inflow of public funds started in the fourth quarter of 2014 and is expected to continue through the first quarter of 2015. Deposit levels remain strong and our mix of deposits continues to improve slightly as higher cost certificates of deposit are replaced with lower rate non-maturity deposits and noninterest bearing demand accounts. Prudent pricing discipline will continue to be the key to managing our mix of deposits. Our strategy is to manage the mix of our deposits rather than compete on rate, which enables us to maintain an exceptionally low cost of funds – 15 basis points in the fourth quarter and 16 basis points for the year 2014.

Average total deposits were $2.077 billion for the fourth quarter of 2014, an increase of $14.5 million, or 0.7%, from the third quarter of 2014. The higher level of deposits when compared to the prior period reflects higher noninterest bearing deposits and NOW accounts (reflecting the inflow of public funds), and savings accounts, partially offset by declines in money markets and certificates of deposit.

Table 2 provides an analysis of our average deposits, by category, and average rates paid thereon for each of the last three years. Table 13 reflects the shift in our deposit mix over the last year and Table 13 provides a maturity distribution of time deposits in denominations of $100,000 and over at December 31, 2014.

Average short-term borrowings, which include federal funds purchased, securities sold under agreements to repurchase, FHLB advances (maturing in less than one year), and other borrowings, decreased $9.5 million, or 17.7% in 2014. The lower balance is attributable to decreases in both repurchase agreements and other borrowed funds by $5.4 million and $4.1 million, respectively. See Note 7 in the Notes to Consolidated Financial Statements for further information on short-term borrowings.

We continue to focus on the value of our deposit franchise, which produces a strong base of core deposits with minimal reliance on wholesale funding.

Table 13

SOURCES OF DEPOSIT GROWTH

(Average Balances - Dollars in Thousands)	2013 to 2014 Change	Percentage of Total Change	Components of Total Deposits 2014	2013	2012
Noninterest Bearing Deposits	$40,071	171.2 %	32.1 %	30.5 %	29.0 %
NOW Accounts	(3,647)	(15.6)	34.2	34.8	36.6
Money Market Accounts	(11,153)	(47.6)	13.0	13.7	13.3
Savings	23,351	99.8	10.9	9.8	8.3
Time Deposits	(25,218)	(107.8)	9.8	11.2	12.8
Total Deposits	$23,404	100.0 %	100.0%	100.0%	100.0%

Table 14

MATURITY DISTRIBUTION OF CERTIFICATES OF DEPOSIT $100,000 OR OVER

(Dollars in Thousands)	2014 Time Certificates of Deposit	Percent
Three months or less	$ 16,830	32.0 %
Over three through six months	13,031	24.8
Over six through twelve months	16,518	31.4
Over twelve months	6,232	11.8
Total	$ 52,611	100.0 %

Market Risk and Interest Rate Sensitivity

Overview. Market risk arises from changes in interest rates, exchange rates, commodity prices, and equity prices. We have risk management policies to monitor and limit exposure to market risk and do not participate in activities that give rise to significant market risk involving exchange rates, commodity prices, or equity prices. In asset and liability management activities, our policies are designed to minimize structural interest rate risk.

Interest Rate Risk Management. Our net income is largely dependent on net interest income. Net interest income is susceptible to interest rate risk to the degree that interest-bearing liabilities mature or reprice on a different basis than interest-earning assets. When interest-bearing liabilities mature or reprice more quickly than interest-earning assets in a given period, a significant increase in market rates of interest could adversely affect net interest income. Similarly, when interest-earning assets mature or reprice more quickly than interest-bearing liabilities, falling interest rates could result in a decrease in net interest income. Net interest income is also affected by changes in the portion of interest-earning assets that are funded by interest-bearing liabilities rather than by other sources of funds, such as noninterest-bearing deposits and shareowners' equity.

We have established a comprehensive interest rate risk management policy, which is administered by management's Asset Liability Management Committee ("ALCO"). The policy establishes limits of risk, which are quantitative measures of the percentage change in net interest income (a measure of net interest income at risk) and the fair value of equity capital (a measure of economic value of equity ("EVE") at risk) resulting from a hypothetical change in interest rates for maturities from one day to 30 years. We measure the potential adverse impacts that changing interest rates may have on our short-term earnings, long-term value, and liquidity by employing simulation analysis through the use of computer modeling. The simulation model captures optionality factors such as call features and interest rate caps and floors imbedded in investment and loan portfolio contracts. As with any method of gauging interest rate risk, there are certain shortcomings inherent in the interest rate modeling methodology used by us. When interest rates change, actual movements in different categories of interest-earning assets and interest-bearing liabilities, loan prepayments, and withdrawals of time and other deposits, may deviate significantly from assumptions used in the model. Finally, the methodology does not measure or reflect the impact that higher rates may have on adjustable-rate loan clients' ability to service their debts, or the impact of rate changes on demand for loan and deposit products.

We prepare a current base case and four alternative interest rate simulations (Down 100, Up 100, Up 200 and Up 300) basis points, at least once per quarter, and report the analysis to ALCO, our Market Risk Oversight Committee ("MROC"), our Enterprise Risk Oversight Committee ("EROC") and the Board of Directors. In addition, more frequent forecasts may be produced when interest rates are particularly uncertain or when other business conditions so dictate.

Our interest rate risk management goal is to avoid unacceptable variations in net interest income and capital levels due to fluctuations in market rates. Management attempts to achieve this goal by balancing, within policy limits, the volume of floating-rate liabilities with a similar volume of floating-rate assets, by keeping the average maturity of fixed-rate asset and liability contracts reasonably matched, by managing the mix of our core deposits, and by adjusting our rates to market conditions on a continuing basis.

The balance sheet is subject to testing for interest rate shock possibilities to indicate the inherent interest rate risk. Average interest rates are shocked by plus or minus 100, 200, and 300 basis points ("bp"), although we may elect not to use particular scenarios that we determined are impractical in a current rate environment. It is management's goal to structure the balance sheet so that net interest earnings at risk over a 12-month period and the economic value of equity at risk do not exceed policy guidelines at the various interest rate shock levels.

We augment our interest rate shock analysis with alternative external interest rate scenarios on a quarterly basis. These alternative interest rate scenarios may include non-parallel rate ramps.

Analysis. Measures of net interest income at risk produced by simulation analysis are indicators of an institution's short-term performance in alternative rate environments. These measures are typically based upon a relatively brief period, usually one year. They do not necessarily indicate the long-term prospects or economic value of the institution.

ESTIMATED CHANGES IN NET INTEREST INCOME[1]

Changes in Interest Rates	+300 bp	+200 bp	+100 bp	-100 bp
Policy Limit	-10.0%	-7.5 %	-5.0%	-5.0%
December 31, 2014	2.7 %	4.0 %	-1.1%	-2.9%
December 31, 2013	11.0 %	10.7%	7.4 %	-1.8%

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The Net Interest Income at Risk position improved for the month ended December 2014, when compared to the same period in 2013 for all rising rate scenarios. Our largest exposure is when rates decline 100 basis points, with a measure of -2.9%, which remains within our policy limit of -5.0%. The year-over-year unfavorable variance is primarily attributable to lower levels of overnight funds, offse