2013
Annual Report

FineMark Holdings, Inc.

"The Board of Directors strives to exceed the expectations of both our clients and our shareholders by ensuring extraordinary service, maintaining a conservative credit culture and providing value to both constituencies. We will continue to work with management to achieve this goal."

– David H. Lucas, Chairman of the Board

FINEMARK

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To Our Shareholders

In 2013, FineMark National Bank & Trust maintained its primary focus on providing exceptional client service, delivered by professionals who genuinely care about our clients. By following our *Guiding Principles*, the Bank experienced another year with a growing client base, high quality balance sheet, and for the fourth consecutive year, positive earnings.

Guiding Principles

1. Deliver unparalleled and proactive service to our clients
2. Always do what is right
3. Be a positive role model in corporate and individual citizenship
4. Grow and mentor people from within

FineMark added 26 experienced professionals in 2013. Each has contributed to the quality, growth and momentum of our company. By year-end the Bank surpassed 100 employees. Our people continue to be the backbone of our culture.

Since inception, it has been our goal to establish a strong Collier County presence. However, that could not happen until we found the very best people. In 2013, we hired 12 seasoned professionals with significant experience in the Naples market. Adria Starkey, a 30 year veteran in Naples, is leading the group as Collier County President. In December, the team moved into prime office space on US 41, near Waterside Shops.

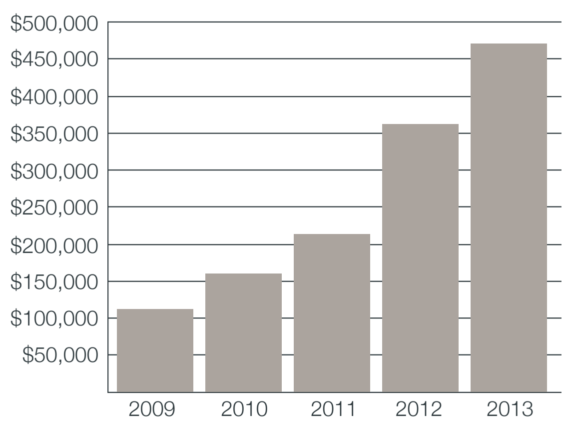
Our first out-of-state office in Scottsdale, Arizona also thrived in 2013. The team moved to its permanent location on East Doubletree Ranch Road during the first quarter. In December, Susan Chicone moved from our Fort Myers office to Scottsdale to become the Managing Executive in Arizona under the leadership of David Highmark.

FineMark continued to realize significant balance sheet growth in 2013. The Bank's primary financial asset, the loan portfolio, totaled $470 million compared to $361 million at year-end 2012. The quality of the loan portfolio remained strong, evidenced by net charge-offs totaling $41,000. This represents .01% of total loans compared to our peer average of .29%. The high loan quality can be attributed to our focus on building deep relationships with our clients and our consistent, conservative credit culture.

Net Loans (in 000s)

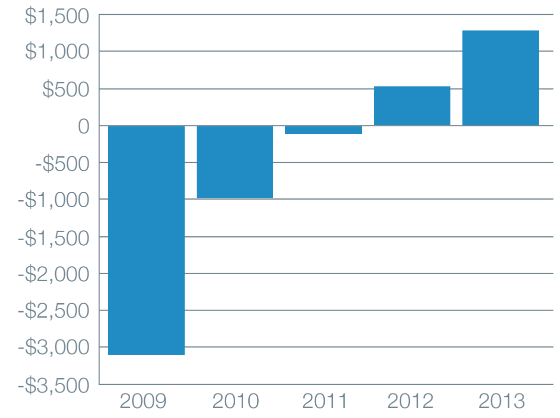
2012	2013
$361,422	$470,142

Loan Growth (in 000s)



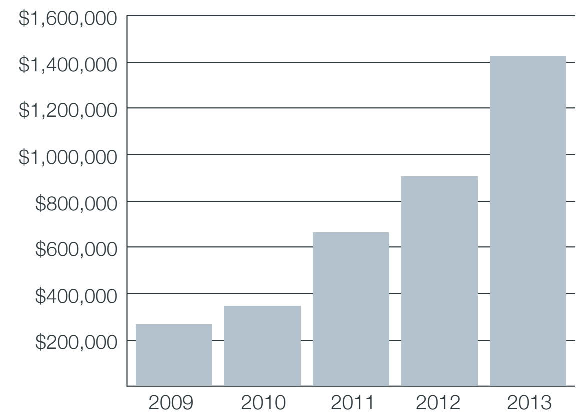
Total earnings declined in 2013 as a direct result of a $1.6 million reduction in gains from securities sales. However, we are pleased the Bank's income from operations nearly tripled to $1.3 million at year-end 2013 from $528,000 at year-end 2012.

Income Before Taxes (in 000s)



Assets under Management & Administration (AUMA) totaled $1.4 billion at year-end 2013, representing a 45% increase over year-end 2012. AUMA increased in all of our markets.

Assets Under Management & Administration (in 000s)



The Bank has experienced impressive compounded annual growth rates over the last five years in loans, deposits, AUMA and total assets of 31%, 28%, 40% and 25%, respectively.

5 Year Growth Rate

Loans	31%
Deposits	28%
AUMA	40%
Total Assets	25%

FineMark has flourished since its inception in February of 2007. We believe this is a direct result of our commitment to our mission *to build extraordinary relationships by going above and beyond* and our vision *to make a positive impact on the individuals, families and communities we serve while being good stewards of FineMark's resources.*

My colleagues, our clients, shareholders and Board of Directors are ultimately responsible for FineMark's success. Thank you for your commitment. We appreciate each of you.

Joe

Joseph R. Catti
President & CEO
FineMark National Bank & Trust

The History of FineMark

2006

- The Board of Directors is Established
- The Name FineMark National Bank & Trust is Selected
- National Charter is Approved in November

2007

- Grand Opening Held in February
- Construction on the Fort Myers Office Located at Riverwalk is Announced and Begins
- Assets Under Management Exceed $100 Million at Year-End

2008

- Riverwalk Construction is Completed in May and the Office Opens
- Construction on the Coconut Point Office in Bonita Springs Begins in July
- In October, FineMark Reaches $100 Million in Total Assets

2009

- The Coconut Point Office Opens
- The Shell Point Office Opens
- Total Assets Exceed $200 Million

I was on a plane in the fall of 2005 and read an article that compared big companies to battleships and small companies to jet skis.

I knew I wanted to be a part of a company that, no matter the size, would always be quick and efficient like a jet ski. **At that moment, the idea to start a bank was born.**"

– Joseph R. Catti, President & CEO

2010

- FineMark Achieves Profitability
- Total Assets Exceed $300 Million in July
- The Bank Earns its 1st 5-Star Rating in September

2011

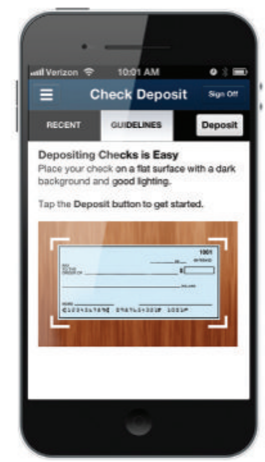
- The Moorings Park Office Opens
- The Vi at Bentley Village Office Opens
- The Palm Beach Office Opens on Royal Palm Way
- The Naples Office Opens on 5th Avenue S.

2012

- The Arizona Office Opens and Moves into a Temporary Space
- FineMark Aquires HSM (Highmark Sports Management)
- Total Loans Exceed $300 Million
- Total Assets Exceed $500 Million

2013

- Arizona Office Moves into Permanent Space
- Naples Office Hires 12 Employees and Signs a Lease on Space at Pelican Bay
- Total Assets Exceed $700 Million at Year-End
- Assets Under Management & Administration Exceed $1.4 Billion at Year-End
- The Bank Earns its 11th Consecutive 5-Star Rating



Naples Expansion

In 2013, FineMark National Bank & Trust added 12 people to its Naples team and moved into a new location on US 41, just north of the Waterside Shops. Adria Starkey was named Collier County President in the Fall, bringing more than 30 years of banking experience to FineMark.

The group joined Keith Embree, who had been working out of a small office on 5th Avenue S. in Naples since 2011. The entire team has strong ties to the area and share FineMark's culture of serving clients and giving back to the community.

"FineMark represents a wonderful opportunity for people seeking exceptional service, delivered by seasoned professionals with deep ties to this area. I am proud to lead a team committed to building strong relationships and **making a difference** in this community."

– Adria D. Starkey, Collier County President

Arizona Moves In

The Arizona team moved into a new building in March of 2013. The office is located at 7600 East Doubletree Ranch Road in Scottsdale. FineMark renovated the space and now occupies over 8,500 square feet.

Mobile Check Deposit

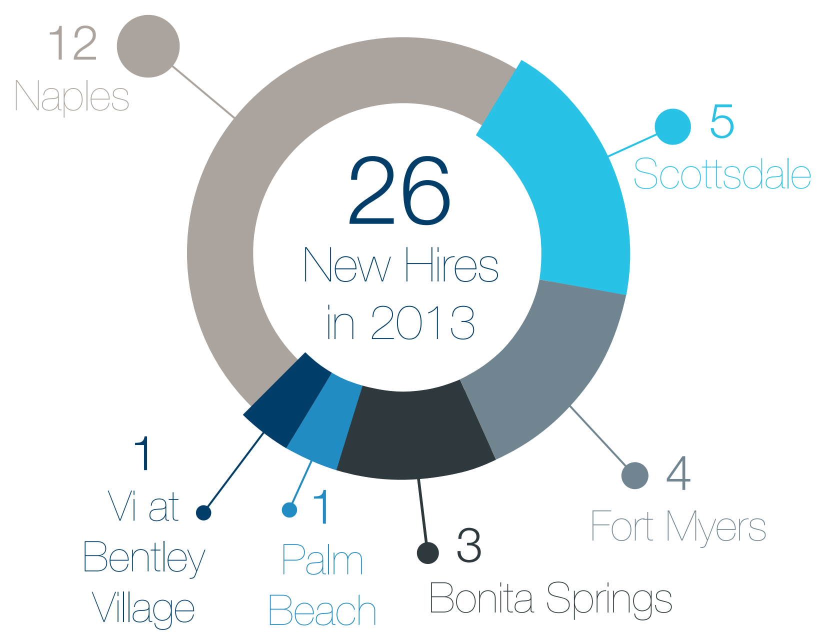
FineMark National Bank & Trust now offers a Mobile Check Deposit service, which allows clients to scan checks from a mobile device and deposit them into a personal checking account, electronically. This service is part of FineMark's Mobile Banking App available for iPhone® and Android™ devices.

5-Star Rating

FineMark National Bank & Trust has been awarded a 5-Star Superior Rating 11 consecutive quarters as of December 31, 2013. The nation's leading independent bank rating and research firm Bauer Financial rates banks on a scale from zero to five.

ATMs

ATMs were installed at the Fort Myers and Bonita Springs offices in 2013. FineMark was hesitant to install ATMs because we enjoy working with our clients face-to-face; however, many people are on the go and ATMs are a convenient option.

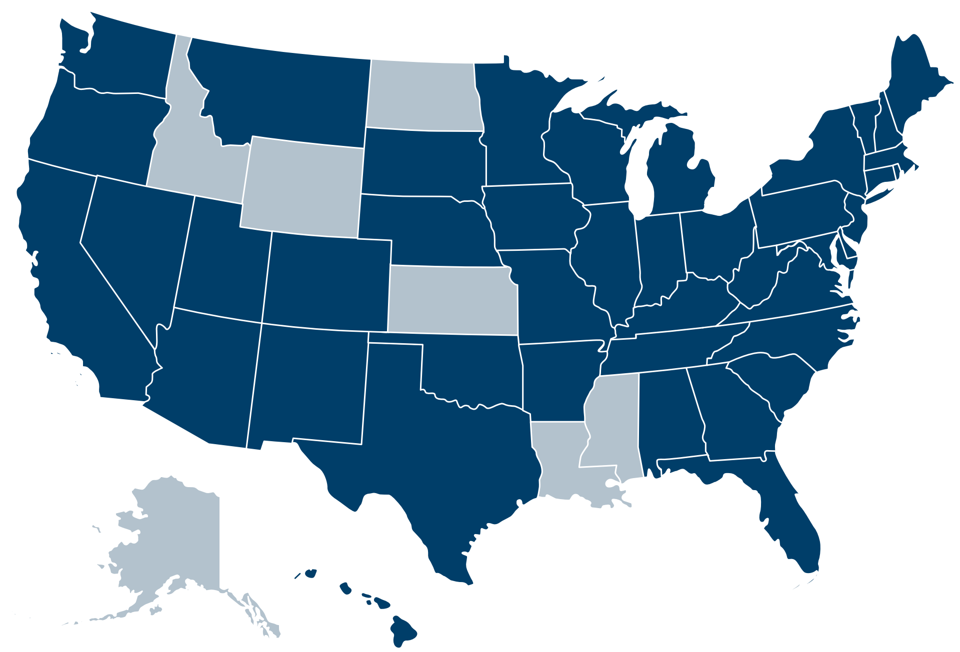


Number of Employees

78
Dec. 2012

103
Dec. 2013

32%
% Increase



FineMark has Clients in 43 States and 8 Countries Worldwide:

Australia
Bahamas
Canada
France
Germany
Norway
South Africa
Switzerland

Our People












"FineMark would just be brick and mortar and its vision merely ink on paper without the extraordinary **people** who bring it to life. I'm often in awe at how my colleagues go **above and beyond** serving clients and the community. They inspire me!"

– Jennifer L. Stevens, Human Resources Director

To make a **positive impact** on the individuals, families and communities we serve while being good stewards of FineMark's resources.

– FineMark's Vision Statement

Giving Back

Giving back is part of the FineMark Culture. The company and the individuals who work here are committed to giving back and being involved in the community. We believe it's our responsibility.

Here are a few of the bank initiatives from 2013:

FineMark helped build two **Habitat for Humanity** homes in 2013 through a Community Contribution Tax Program. The bank sponsored two homes and in exchange, received corporate tax credits. Along with the sponsorship, more than 40 FineMark employees volunteered to help build the homes. The build was such a success that a third home was sponsored and started in early 2014.

Our Coconut Point office in Bonita Springs joined forces with the **Bonita Springs Assistance Office**, a primary social service agency. Every Monday and Wednesday a volunteer from FineMark works at the organization's food pantry, handing out food to families in need. Nine FineMark employees volunteer their time. "We are able to fill an immediate and essential void for these families, which is food, says Janet Bottiglio. "But in return it's a great feeling, knowing we play a role in delivering that assistance."

FineMark employees at Riverwalk once again donated their own money to ensure **four families** would have a Merry Christmas. Gifts were purchased for 10 children and their parents. Our Arizona office also adopted a family through United Way to ensure a young boy and girl would receive gifts on Christmas.

4,944 Employee Volunteer Hours

114 Organizations Supported

2 Homes Built

Children
Families The Arts
Homelessness
Conservation Women
Cancer Disease
The Elderly Hunger

$180,000
In Employee Giving to the United Way

100%
United Way Participation

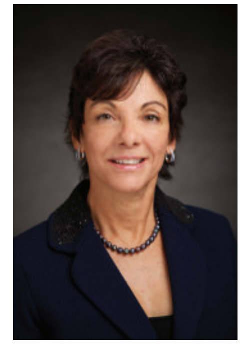
"Thank you **so much** for bringing back my son's **innocence** and making him a believer (in Santa) again."

– 2013 Christmas Family

Board of Directors, FineMark Holdings, Inc.


Richard E. Beightol
RJB Investment, Inc.
Retired Life Ins. Executive


Edward G. Beimfohr
Windels Marx Lane & Mittendorf, LLP


Aurelia J. Bell
Arrowhead Partners, Inc.


John F. Blais, Jr.‡
BlaisCo.

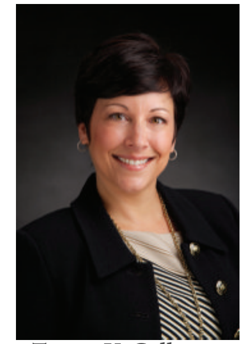

Michael J. Carron, M.D.
Radiology Regional Center


Thomas D. Case II
Case Pearlman
Corporate Benefits


Joseph R. Catti*
President
Chief Executive Officer


Brian J. Eagleston*
Executive Vice President
Chief Financial Officer


Scott A. Edmonds
Bellfield Investment Partners


Tracey U. Galloway
Community Cooperative Ministries, Inc.


William N. Horowitz
Cummings & Lockwood, LLC


Clive Lubner
Clive Daniel Home


David H. Lucas†
The Bonita Bay Group


Vito Manone
Manone Investments, Inc.


Alan D. Reynolds
Stantec


Lee J. Seidler
Bear, Stearns & Co. (Retired)
Chairman, Tisch MS Research Center of New York


William H. Turner
Retired Vice Chairman
Chase Bank

*Bank Employee
†Chairman of the Board
‡Vice Chairman of the Board

Board of Directors, FineMark National Bank & Trust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Senior Vice President
Managing Executive, Coconut Point


Robert M. Arnall*
Executive Vice President
Senior Lending Officer


Aurelia J. Bell
Arrowhead Partners, Inc.


Michael J. Carron, M.D.
Radiology Regional Center


Thomas D. Case II
Case Pearlman
Corporate Benefits


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President
Chief Executive Officer


Brian J. Eagleston*
Executive Vice President
Chief Financial Officer


David A. Highmark*
President, Arizona Operations
President, Sports Management


William N. Horowitz
Cummings & Lockwood, LLC


David H. Lucas†
The Bonita Bay Group


Vito Manone
Manone Investments, Inc.


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Executive Vice President
Chief Fiduciary Officer


Robert A. Parimore*
Executive Vice President
Chief Risk & Compliance Officer


David H. Scaff*
Senior Vice President
President, Palm Beach


Malinda Schneider*
Senior Vice President
Loan Administration Manager


Adria D. Starkey*
Executive Vice President
Collier County President


Jennifer L. Stevens*
Executive Vice President
Human Resources Director


Christopher C. Wilkinson*
Executive Vice President
Chief Investment Officer

***Bank Employee**
†Chairman of the Board

FINEMARK HOLDINGS, INC.

Audited Consolidated Financial Statements

December 31, 2013 and 2012 and the Years then Ended
(Together with Independent Auditor's Report)

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HACKER, JOHNSON & SMITH PA

Fort Lauderdale
Fort Myers
Orlando
Tampa

Certified Public Accountants

Independent Auditors' Report

The Board of Directors and Stockholders
FineMark Holdings, Inc.
Fort Myers, Florida:

We have audited the accompanying consolidated financial statements of FineMark Holdings, Inc. and Subsidiary (the "Company"), which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of earnings, comprehensive (loss) income, shareholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2013 and 2012, and the results of their operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Hacker, Johnson & Smith PA

HACKER, JOHNSON & SMITH PA
Tampa, Florida
March 24, 2014

500 North Westshore Boulevard, Post Office Box 20368, Tampa, Florida 33622-0368, (813) 286-2424
A Registered Public Accounting Firm

FINEMARK HOLDINGS, INC. AND SUBSIDIARY

Consolidated Balance Sheets
($ in thousands, except per share amounts)

Assets	At December 31, 2013	2012
Cash and due from banks	$ 36,560	10,387
Securities available for sale	179,806	124,763
Time deposits	1,245	1,245
Loans held-for-sale	-	639
Loans, net of allowance for loan losses of $5,201 in 2013 and $3,608 in 2012	470,142	360,783
Federal Home Loan Bank stock	4,265	4,382
Federal Reserve Bank stock	1,625	1,220
Premises and equipment, net	11,771	11,325
Accrued interest receivable	1,961	1,605
Deferred tax asset	2,141	1,225
Bank-owned life insurance	8,967	8,690
Other assets	1,942	1,604
Total assets	$ 720,425	527,868
Liabilities and Shareholders' Equity		
Liabilities:		
Noninterest-bearing demand deposits	75,658	60,746
Savings, NOW and money-market deposits	353,653	212,365
Time deposits	137,870	117,308
Total deposits	567,181	390,419
Official checks	2,095	3,667
Other borrowings	4,030	2,942
Federal Home Loan Bank advances	80,505	81,993
Other liabilities	1,449	1,035
Total liabilities	655,260	480,056
Commitments (Notes 4 and 10)		
Shareholders' equity:		
Preferred stock, 9,994,335 shares authorized,$.01 par value, none issued or outstanding	-	-
Preferred stock, Series A, $.01 par value; $1,000 liquidation preference; 5,665 shares authorized, issued and outstanding	5,665	5,665
Common stock, $.01 par value; 50,000,000 shares authorized, 5,300,871 and 3,922,834 shares issued and outstanding in 2013 and 2012	53	39
Additional paid-in capital	60,101	42,674
Retained earnings (accumulated deficit)	358	(1,106)
Accumulated other comprehensive (loss) income	(1,012)	540
Total shareholders' equity	65,165	47,812
Total liabilities and shareholders' equity	$ 720,425	527,868

See Accompanying Notes to Consolidated Financial Statements.

FINEMARK HOLDINGS, INC. AND SUBSIDIARY

Consolidated Statements of Earnings
(in thousands)

	Year Ended December 31, 2013	2012
Interest income:		
Loans	$ 16,344	11,835
Securities	3,545	3,714
Other	63	35
Total interest income	19,952	15,584
Interest expense:		
Deposits	1,969	1,725
Borrowings	1,795	1,780
Total interest expense	3,764	3,505
Net interest income	16,188	12,079
Provision for loan losses	1,634	779
Net interest income after provision for loan losses	14,554	11,300
Noninterest income:		
Trust fees	5,754	3,898
Gain on sale of securities available for sale	992	2,601
Income from bank-owned life insurance	277	287
Gain on sale of loans held-for-sale	116	87
Other fees and service charges	348	454
Total noninterest income	7,487	7,327
Noninterest expenses:		
Salaries and employee benefits	11,988	9,229
Occupancy and equipment	2,408	1,908
Data processing	918	806
Professional fees	802	625
Marketing	975	768
Office supplies	271	192
Other	2,408	1,970
Total noninterest expense	19,770	15,498
Earnings before income taxes	2,271	3,129
Income taxes	750	1,115
Net earnings	1,521	2,014
Preferred stock dividends	57	63
Earnings available to common shareholders	$ 1,464	1,951

See Accompanying Notes to Consolidated Financial Statements.

FINEMARK HOLDINGS, INC. AND SUBSIDIARY

Consolidated Statements of Comprehensive (Loss) Income
(in thousands)

	Year Ended December 31, 2013	Year Ended December 31, 2012
Net Earnings	$ 1,521	2,014
Other comprehensive loss:		
Unrealized holding (loss) gain on available for sale securities	(1,489)	2,415
Reclassification adjustment for gains realized in earnings	(992)	(2,601)
Net change in unrealized gain	(2,481)	(186)
Income tax effect	929	70
Total other comprehensive loss	(1,552)	(116)
Comprehensive (loss) income	$ (31)	1,898

See Accompanying Notes to Consolidated Financial Statements

FINEMARK HOLDINGS, INC. AND SUBSIDIARY

Consolidated Statements of Shareholders' Equity

For the Years Ended December 31, 2013 and 2012
(In thousands)

	Preferred Stock Shares	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2011	5,665	$ 5,665	3,924,005	$ 39	42,513	(3,057)	656	45,816
Stock-based compensation	-	-	-	-	211	-	-	211
Net earnings	-	-	-	-	-	2,014	-	2,014
Change in unrealized gain on securities available for sale, net of tax	-	-	-	-	-	-	(116)	(116)
Stock issued as compensation	-	-	2,675	-	-	-	-	-
Dividends declared	-	-	-	-	-	(63)	-	(63)
Repurchase of common stock	-	-	(19,230)	-	(250)	-	-	(250)
Proceeds from sale of common stock	-	-	15,384	-	200	-	-	200
Balance at December 31, 2012	5,665	5,665	3,922,834	39	42,674	(1,106)	540	47,812
Stock-based compensation	-	-	-	-	213	-	-	213
Net earnings	-	-	-	-	-	1,521	-	1,521
Change in unrealized gain on securities available for sale, net of tax	-	-	-	-	-	-	(1,552)	(1,552)
Dividends declared	-	-	-	-	-	(57)	-	(57)
Proceeds from exercise of stock options	-	-	267,000	3	2,697	-	-	2,700
Tax benefit from stock options exercised	-	-	-	-	69	-	-	69
Proceeds from sale of common stock	-	-	1,111,037	11	14,448	-	-	14,459
Balance at December 31, 2013	5,665	$ 5,665	5,300,871	$ 53	60,101	358	(1,012)	65,165

See Accompanying Notes to Consolidated Financial Statements.

FINEMARK HOLDINGS, INC. AND SUBSIDIARY

Consolidated Statements of Cash Flows

(In thousands)

	Year Ended December 31, 2013	2012
Cash flows from operating activities:		
Net earnings	$ 1,521	2,014
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	1,049	853
Provision for loan losses	1,634	779
Amortization of deferred loan fees and costs	198	146
Amortization of premiums and discounts on securities	2,759	2,526
Gain on sale of securities available for sale	(992)	(2,601)
(Increase) decrease in accrued interest receivable	(356)	64
Increase in other assets	(338)	(600)
Deferred income taxes	13	173
Income from bank-owned life insurance	(277)	(287)
Increase in other liabilities	428	577
(Decrease) increase in official checks	(1,572)	2,769
Stock-based compensation	213	211
Loans held-for-sale:		
Loan originations	(7,376)	(9,411)
Proceeds from loan sales	8,131	8,859
Gain on sale of loans held-for-sale	(116)	(87)
Net cash provided by operating activities	4,919	5,985
Cash flows from investing activities:		
Net increase in loans	(111,191)	(148,460)
Purchase of premises and equipment, net	(1,495)	(1,436)
Securities available for sale:		
Purchases	(162,675)	(116,060)
Proceeds from sales	51,841	108,783
Proceeds from maturities and calls	11,640	43,942
Proceeds from principal repayments	39,903	37,948
Redemption (purchase) of Federal Home Loan Bank stock	117	(1,308)
Purchase of Federal Reserve Bank stock	(405)	(31)
Net cash used in investing activities	(172,265)	(76,622)
Cash flows from financing activities:		
Net increase in deposits	176,762	47,145
Net increase (decrease) in other borrowings	1,088	(765)
Net (repayment) proceeds from Federal Home Loan Bank advances	(1,488)	27,266
Proceeds from sale of common stock	14,459	200
Repurchase of common stock	-	(250)
Proceeds from exercise of stock options	2,700	-
Tax benefit from stock options exercised	69	-
Preferred stock dividends paid	(71)	(64)
Net cash provided by financing activities	193,519	73,532
Net increase in cash and due from banks	26,173	2,895
Cash and due from banks at beginning of year	10,387	7,492
Cash and due from banks at end of year	$ 36,560	10,387

(continued)

FINEMARK HOLDINGS, INC. AND SUBSIDIARY

Consolidated Statements of Cash Flows, Continued

(In thousands)

	Year Ended December 31, 2013	2012
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	$ 3,751	3,497
Income taxes	$ 928	648
Noncash transactions:		
Accumulated other comprehensive (loss) income, net change in unrealized gain on securities available for sale, net of tax	$ (1,552)	(116)
Dividends payable	$ -	14

See Accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

At December 31, 2013 and 2012 and for the Years then Ended

(1) Summary of Significant Accounting Policies

Organization. FineMark Holdings, Inc. (the "Holding Company") was incorporated on May 31, 2006 and owns 100% of the outstanding common stock of FineMark National Bank & Trust (the "Bank") (collectively, the "Company"). The Holding Company's primary activity is the operation of the Bank. The Bank is a nationally-chartered commercial bank and trust company. The Bank offers a variety of banking and financial services to individual and corporate clients through its eight banking offices located in Lee, Collier and Palm Beach County, Florida, and Maricopa County, Arizona. The deposit accounts of the Bank are insured up to the applicable limits by the Federal Deposit Insurance Corporation "FDIC." The Bank also has a trust department which offers investment management, trust administration, estate planning and financial planning services. The assets under advice by the trust department, as well as the obligations associated with those assets, are not included as part of the consolidated financial statements of the Company.

Management has evaluated all significant events occurring subsequent to the consolidated balance sheet date through March 24, 2014, which is the date the consolidated financial statements were available to be issued, determining no events require additional disclosure in the consolidated financial statements.

Basis of Presentation. The accompanying consolidated financial statements include the accounts of the Holding Company and the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation. The accounting and reporting practices of the Company conform to accounting principles generally accepted in the United States of America ("GAAP") and to general practices within the banking industry. The following summarizes the more significant of these policies and practices.

Use of Estimates. In preparing consolidated financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of the deferred tax asset.

Cash. The Bank is required by law or regulation to maintain cash reserves with the Federal Reserve Bank, in accounts with other banks or cash in the vault. The required reserve is predominately based upon the level of demand deposit accounts average balances. At December 31, 2013 and 2012, the Bank had no required reserve balance.

(continued)

FINEMARK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(1) Summary of Significant Accounting Policies, Continued

Securities. Securities may be classified as either trading, held-to-maturity or available-for-sale. Trading securities are held principally for resale and recorded at fair value. Unrealized gains and losses on trading securities are included immediately in earnings. Held-to-maturity securities are those which the Company has the positive intent and ability to hold to maturity and are reported at amortized cost. Available-for-sale securities consist of securities not classified as trading securities nor as held-to-maturity securities. Unrealized holding gains and losses on available-for-sale securities, net of tax are excluded from earnings and reported in accumulated other comprehensive (loss) income. Gains and losses on the sale of available-for-sale securities are recorded on the trade date and are determined using the specific-identification method. Premiums and discounts on securities are recognized in interest income using the interest method over the period to maturity.

Loans Held-for-Sale. Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to earnings. As of December 31, 2013, the Bank had no loans held-for-sale. As of December 31, 2012, fair value exceeded book value for loans held-for-sale.

Loans. Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs.

Commitment and loan origination fees are capitalized and certain direct origination costs are deferred. Both are recognized as an adjustment of the yield of the related loan.

The accrual of interest for all portfolio classes is discontinued at the time the loan is ninety days delinquent unless the loan is well collateralized and in process of collection. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Past due status is based on contractual terms of the loans. All interest accrued but not collected for loans placed on nonaccrual or charged-off is reversed against interest income. The interest on loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

(continued)

(1) Summary of Significant Accounting Policies, Continued

Allowance for Loan Losses. The allowance for credit losses represents the amount which, in management's judgment, will be adequate to absorb credit losses inherent in the loan portfolio as of the consolidated balance sheet date. The adequacy of the allowance is determined by management's evaluation of the loan portfolio based on such factors as the differing economic risks associated with each loan category, the current financial condition of specific borrowers, the economic environment in which borrowers operate, the level of delinquent loans, the value of any collateral and, where applicable, the existence of any guarantees or indemnifications. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any are credited to the allowance. There were no changes in the Company's accounting policies or methodology during the years ended December 31, 2013 or 2012.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific and general components. The specific component affects the gross value of the reserve for loans that are considered impaired. For such loans, an allowance is established when the discounted cash flows or collateral value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers all other loans and is based on historical loss experience adjusted for qualitative factors.

The historical loss component of the allowance is determined by the Company's recognized losses by portfolio segment over the preceding four years. This is supplemented by the risks for each portfolio segment. Risk factors impacting loans in each of the portfolio segments include any deterioration of property values, reduced consumer and business spending as a result of continued high unemployment and reduced credit availability and lack of confidence in a sustainable recovery. The loss experience is adjusted for the following qualitative factors, changes in: lending policies and procedures, regional and local economic and business conditions, the nature and volume of the loan portfolio, lending management and staff, volume and severity of past due loans, the quality of loan review, the value of underlying collateral, as well as the existence of credit concentrations and changes in levels of concentration, the effect of external factors such as competition and legal and regulatory requirements, economic conditions and other trends or uncertainties that could affect management's estimate of probable losses.

(continued)

(1) Summary of Significant Accounting Policies, Continued

Allowance for Loan Losses, continued. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Premises and Equipment. Land is stated at cost. Building, leasehold improvements, furniture and fixtures, equipment, data processing equipment, and software are stated at cost less accumulated depreciation and amortization. Interest costs are capitalized in connection with the construction of new banking offices. Depreciation and amortization expense is computed using the straight-line method over the estimated useful life of each type of asset or lease term, if shorter.

Comprehensive (Loss) Income. Accounting principles generally require that recognized revenue, expenses, gains and losses be included in earnings. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the consolidated balance sheet. Such items, along with net earnings, are components of comprehensive (loss) income.

Transfer of Financial Assets. Transfers of financial assets or a participating interest in an entire financial asset are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. A participating interest is a portion of an entire financial asset that (1) conveys proportionate ownership rights with equal priority to each participating interest holder (2) involves no recourse (other than standard representations and warranties) to, or subordination by, any participating interest holder, and (3) does not entitle any participating interest holder to receive cash before any other participating interest holder.

(continued)

(1) Summary of Significant Accounting Policies, Continued

Income Taxes. There are two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur. Deferred income tax expense results from changes in deferred tax assets and liabilities between periods.

Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Company follows accounting guidance relating to accounting for uncertainty in income taxes, which sets out a consistent framework to determine the appropriate level of tax reserves to maintain for uncertain tax positions. As of December 31, 2013, management is not aware of any uncertain tax positions that would have a material effect on the Company's consolidated financial statements.

The Company recognizes interest and penalties on income taxes as a component of income tax expense.

The Holding Company and the Bank file consolidated income tax returns. Income taxes are allocated proportionately to the Holding Company and the Bank as though separate income tax returns were filed.

Fair Value Measurements. GAAP defines fair value, establishes a framework for measuring fair value and enhances disclosures about fair value measurements.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. GAAP also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

(continued)

(1) Summary of Significant Accounting Policies, Continued

Fair Value Measurements, Continued.

Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities that are not active; and model-driven valuations whose inputs are observable or whose significant value drivers are observable. Valuations may be obtained from, or corroborated by, third-party pricing services.

Level 3: Unobservable inputs to measure fair value of assets and liabilities for which there is little, if any market activity at the measurement date, using reasonable inputs and assumptions based upon the best information at the time, to the extent that inputs are available without undue cost and effort.

The following describes valuation methodologies used for assets measured at fair value:

Securities Available for Sale. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid government bonds, certain mortgage products and exchange-traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. Examples of such instruments, which would generally be classified within Level 2 of the valuation hierarchy, include certain collateralized mortgage and debt obligations and certain high-yield debt securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. Securities classified within Level 3 include certain residual interests in securitizations and other less liquid securities.

Impaired Loans. Estimates of fair value are determined based on a variety of information, including the use of available appraisals, estimates of market value by licensed appraisers or local real estate brokers and the knowledge and experience of the Company's management related to values of properties in the Company's market areas. Management takes into consideration the type, location and occupancy of the property as well as current economic conditions in the area the property is located in assessing estimates of fair value. Accordingly, fair value estimates for impaired loans are classified as Level 3.

Off-Balance Sheet Instruments. In the ordinary course of business the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit, unused lines of credit and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded.

(continued)

(1) Summary of Significant Accounting Policies, Continued

Fair Value of Financial Instruments. The following methods and assumptions were used by the Company in estimating fair values of financial instruments:

Cash and Due from Banks. The carrying amount of cash and due from banks represents fair value.

Time Deposits. The carrying amount of time deposits approximates their fair values.

Securities Available for Sale. Fair values for securities are based on the framework for measuring fair value.

Loans Held-For-Sale. The fair values of loans held-for-sale are based on the framework for measuring fair value.

Loans. For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. Fair values for fixed-rate mortgage (e.g. one-to-four family residential), commercial real estate and commercial loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Federal Home Loan Bank Stock and Federal Reserve Bank Stock. The stock is not publicly traded and the estimated fair value is based on its redemption value.

Accrued Interest Receivable. The carrying amount of accrued interest receivable approximates fair value.

Deposit Liabilities. The fair values disclosed for demand, NOW, money-market and savings deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). Fair values for fixed-rate time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on time deposits to a schedule of aggregated expected monthly maturities of time deposits.

Federal Home Loan Bank Advances. Fair values for Federal Home Loan Bank advances are estimated using discounted cash flow analysis based on current borrowing rates of the Federal Home Loan Bank.

Other Borrowings. The carrying amount of other borrowings approximates fair value.

Off-Balance-Sheet Instruments. Fair values for off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. Fees received are taken into income over the life of the commitment.

(continued)

(1) Summary of Significant Accounting Policies, Continued

Trust Fee Income. For trustee, custodian, investment manager and related activities, the Company charges fees for the various services it renders in these capacities. These fees are recognized as income over the period the services are provided.

Marketing. The Company expenses all marketing as incurred.

Stock-Based Compensation. The Company expenses the fair value of any stock-based compensation. The Company recognizes stock-based compensation in salaries and employee benefits for officers and employees and in other expense for directors in the consolidated statements of earnings. The expense is recognized over the vesting period.

Recent Pronouncements. In January 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2013-01, *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities,* which limits the scope of the new balance sheet offsetting disclosures in ASU 2011-11 to derivatives, repurchase agreements, and securities lending transactions to the extent that they are (1) offset in the financial statements or (2) subject to an enforceable master netting arrangement or similar agreement. The adoption of this guidance had no effect on the Company's consolidated financial statements.

In February 2013, the FASB Issued ASU No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income,* which requires entities to present information about reclassification adjustments from accumulated other comprehensive income in their annual financial statements in a single note or on the face of the financial statements. This guidance is effective prospectively January 1, 2014. Upon adoption, this guidance is not expected to impact the Company’s consolidated financial statements.

In February 2013, the FASB Issued ASU No. 2013-04, *Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date*. ASU 2013-04 provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for obligations within the scope of this ASU, which is effective January 1, 2014. Upon adoption, this guidance is not expected to impact the Company’s consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-10, "*Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes*." ASU No. 2013-10 permits the use of the Fed Funds Effective Swap Rate (OIS) to be used as a U.S. benchmark interest rate for hedge account purposes. The amendment is effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The adoption of this guidance had no effect on the Company's consolidated financial statements.

(continued)

(1) Summary of Significant Accounting Policies, Continued

Recent Pronouncements, Continued. In July 2013, the FASB issued ASU 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists,* which among other things, require an unrecognized tax benefit, or a portion of an unrecognized tax benefit, to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as denoted within the ASU. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Upon adoption, this guidance is not expected to impact the Company's consolidated financial statements.

Recent Regulatory Developments

Basel III Rules. On July 2, 2013, the Federal Reserve Board ("FRB") approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks. Under the final rules, minimum requirements will increase for both the quantity and quality of capital held by the Bank. The rules include a new common equity Tier 1 capital to risk-weighted assets ratio of 4.5% and a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets. The final rules also raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% and require a minimum leverage ratio of 4.0%. The final rules also implement strict eligibility criteria for regulatory capital instruments. On July 9, 2013, the FDIC also approved, as an interim final rule, the regulatory capital requirements for U.S. banks, following the actions of the FRB. The FDIC's rule is identical in substance to the final rules issued by the FRB.

The phase-in period for the final rules will begin for the Bank on January 1, 2015, with full compliance with all of the final rule's requirements phased in over a multi-year schedule. The Bank is currently evaluating the provisions of the final rules and their expected impact on the Bank.

Reclassifications. Certain amounts in the 2012 consolidated financial statements have been reclassified to conform to the 2013 consolidated financial statement presentation.

(continued)

(2) Securities

The carrying amount of securities available-for-sale and their fair values are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At December 31, 2013:				
U.S. Government agency securities	$ 6,498	-	(122)	6,376
Corporate securities	5,525	4	(26)	5,503
Mortgage-backed securities	51,028	23	(1,460)	49,591
Collateralized mortgage obligations	75,756	235	(297)	75,694
Municipal securities	18,721	148	(37)	18,832
Taxable municipal securities	23,896	44	(130)	23,810
Total	$ 181,424	454	(2,072)	179,806
At December 31, 2012:				
U.S. Government agency securities	2,000	4	-	2,004
Corporate securities	7,284	69	(2)	7,351
Mortgage-backed securities	43,338	276	(84)	43,530
Collateralized mortgage obligations	34,493	99	(90)	34,502
Municipal securities	10,226	156	-	10,382
Taxable municipal securities	26,559	435	-	26,994
Total	$ 123,900	1,039	(176)	124,763

(continued)

(2) Securities, Continued

Available-for-sale securities measured at fair value on a recurring basis are summarized below (in thousands):

		Fair Value Measurements Using		
	Fair Value	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2013:				
U.S. Government agency securities	$ 6,376	-	6,376	-
Corporate securities	5,503	-	5,503	-
Mortgage-backed securities	49,591	-	49,591	-
Collateralized mortgage obligations	75,694	-	75,694	-
Municipal securities	18,832	-	18,832	-
Taxable municipal securities	23,810	-	23,810	-
Total	$ 179,806	-	179,806	-
December 31, 2012:				
U.S. Government agency securities	2,004	-	2,004	-
Corporate securities	7,351	-	7,351	-
Mortgage-backed securities	43,530	-	43,530	-
Collateralized mortgage obligations	34,502	-	34,502	-
Municipal securities	10,382	-	10,382	-
Taxable municipal securities	26,994	-	26,994	-
Total	$ 124,763	-	124,763	-

During the years ended December 31, 2013 and 2012, no securities were transferred in or out of Level 1, Level 2 or Level 3.

The scheduled maturities of securities available-for-sale at December 31, 2013 are as follows (in thousands):

	Amortized Cost	Fair Value
Due in less than one year	$ 6,048	6,072
Due from one to five years	39,022	38,835
Due from five to ten years	8,570	8,617
Due in over ten years	1,000	997
Collateralized mortgage obligations	75,756	75,694
Mortgage-backed securities	51,028	49,591
Total	$ 181,424	179,806

(continued)

FINEMARK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(2) Securities, Continued

The following summarized sales of securities available for sale (in thousands):

	Year Ended December 31, 2013	2012
Proceeds from sales of securities	$ 51,841	108,783
Gross gains from sale of securities	$ 992	2,601

Securities available-for-sale with gross unrealized losses at December 31, 2013, aggregated by length of time that individual securities have been in a continuous loss position, is as follows (in thousands):

	Less Than Twelve Months		More Than Twelve Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. Government agency securities	$ 122	6,376	$ -	-
Corporate securities	26	3,971	-	-
Mortgage-backed securities	1,295	41,989	165	4,669
Collateralized mortgage obligations	290	41,305	7	952
Municipal securities	167	20,110	-	-
Total	$ 1,900	113,751	$ 172	5,621

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

The unrealized losses of $2,072,000 on ninety-two investment securities available for sale were caused by market conditions. It is expected that the securities would not be settled at a price less than the par value of the investments. Because the decline in fair value is attributable to changes in market conditions and not credit quality, and because the Company has the ability and intent to hold these investments until a market price recovery or maturity, these investments are not considered other-than- temporarily impaired.

At December 31, 2013 and 2012, securities with a fair value of $109.0 million and $71.6 million, respectively, were pledged to secure repurchase agreements, deposit accounts, Federal Home Loan Bank advances, and to the State of Florida in order to secure public funds and trust operations.

(continued)

(3) Loans

A significant portion of the loan portfolio is concentrated among borrowers in South West Florida and Scottsdale, Arizona and a substantial portion of the portfolio is collateralized by real estate in these areas. In general, the ability of single family residential and consumer borrowers to honor their repayment commitments is generally dependent on the level of overall economic activity within the market area and real estate values. The ability of commercial borrowers to honor their repayment commitments is dependent on the general economy as well as the health of the real estate economic sector in the Company's market areas. However, due to conservative underwriting and regularly reviewing the borrower's financial condition the Company has been able to control its risk.

The components of loans are as follows (in thousands):

	At December 31, 2013	At December 31, 2012
Real estate mortgage loans:		
Commercial real estate	$ 56,094	50,004
Residential real estate	316,906	223,487
Construction and land development	31,726	31,512
Total real estate mortgage loans	404,726	305,003
Commercial	41,663	34,997
Personal	28,549	24,202
Total loans	474,938	364,202
Add (subtract):		
Deferred loan costs, net	405	189
Allowance for loan losses	(5,201)	(3,608)
Loans, net	$ 470,142	360,783

The Company has divided the loan portfolio into three portfolio segments, each with different risk characteristics and methodologies for assessing risk. The portfolio segments identified by the Company are as follows:

Real Estate Mortgage Loans. Real estate mortgage loans are typically segmented into three classes: Commercial real estate, Residential real estate and Construction and land development. Commercial real estate loans are secured by the subject property and are underwritten based upon standards set forth in the policies approved by the Bank's board of directors (the "Board").

(continued)

(3) Loans, Continued

Standards include, among other factors, loan to value limits, cash flow coverage and the general creditworthiness of the obligors. Residential real estate loans are underwritten in accordance with policies set forth and approved by the Board, including repayment capacity and source, value of the underlying property, credit history and stability. Construction and land development loans are to borrowers to finance the construction of owner occupied and leased properties. These loans are categorized as construction and land loans during the construction period, later converting to commercial or residential real estate loans after the construction is complete and amortization of the loan begins. Construction and land development loans are approved based on an analysis of the borrower and guarantor, the viability of the project and on an acceptable percentage of the appraised value of the property securing the loan. Construction and land development loan funds are disbursed periodically based on the percentage of construction completed. The Company carefully monitors these loans with on-site inspections and requires the receipt of lien waivers on funds advanced. Construction and land loans are typically secured by the properties under development or construction, and personal guarantees are typically obtained. Further, to assure that reliance is not placed solely on the value of the underlying property, the Company considers the market conditions and feasibility of proposed projects, the financial condition and reputation of the borrower and guarantors, the amount of the borrower's equity in the project, independent appraisals, cost estimates and pre-construction sale information. The Company also makes loans on occasion for the purchase of land for future development by the borrower. Land real estate loans are extended for either commercial or residential use by the borrower. The Company carefully analyzes the intended use of the property and the viability thereof.

Commercial Loans. Commercial loans are primarily underwritten on the basis of the borrowers' ability to service such debt from income. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. As a general practice, the Company takes as collateral a security interest in any available real estate, equipment, or other chattel, although loans may also be made on an unsecured basis. Collateralized working capital loans typically are secured by short-term assets whereas long-term loans are primarily secured by long-term assets.

Personal. Personal loans are extended for various purposes, including purchases of automobiles, recreational vehicles, and boats. The Company also offers home improvement loans, lines of credit, personal loans, and deposit account collateralized loans. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Personal loans are extended after a credit evaluation, including the creditworthiness of the borrower(s), the purpose of the credit, and the secondary source of repayment. Personal loans are made at fixed and variable interest rates and may be made on terms of up to ten years. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

(continued)

(3) Loans, Continued

An analysis of the change in the allowance for loan losses follows (in thousands):

	Real Estate Mortgage Loans	Commercial	Personal	Total
Year ended December 31, 2013:				
Beginning balance	$ 3,128	339	141	3,608
Provision for loan losses	1,177	69	388	1,634
Charge-offs	(41)	-	-	(41)
Ending balance	$ 4,264	408	529	5,201
Individually evaluated for impairment:				
Recorded investment	$ 4,746	-	2	4,748
Balance in allowance for loan losses	$ -	-	2	2
Collectively evaluated for impairment:				
Recorded investment	$ 399,980	41,663	28,547	470,190
Balance in allowance for loan losses	$ 4,264	408	527	5,199
Year Ended December 31, 2012:				
Beginning balance	2,835	225	124	3,184
Provision for loan losses	648	114	17	779
Charge-offs	(355)	-	-	(355)
Ending balance	$ 3,128	339	141	3,608
Individually evaluated for impairment:				
Recorded investment	$ 3,610	-	9	3,619
Balance in allowance for loan losses	$ 409	-	9	418
Collectively evaluated for impairment:				
Recorded investment	$ 301,393	34,997	24,193	360,583
Balance in allowance for loan losses	$ 2,719	339	132	3,190

(continued)

(3) Loans, Continued

The allowance for loan losses is management's best estimate of inherent risk of loss in the loan portfolio as of the consolidated balance sheet date. The Company makes various assumptions and judgments about the collectability of the loan portfolio and provide an allowance for potential losses based on several factors including economic uncertainty. If the assumptions are wrong, the allowance for loan losses may not be sufficient to cover losses and may cause the Company to increase the allowance in the future. Among the factors that could affect the Company's ability to collect its loans and require it to increase the allowance in the future are: general real estate and economic conditions; regional credit concentration; and industry concentration, for example, in the health care industry. In addition, various regulatory agencies periodically review the allowance for loan losses. Such agencies may require additions to the allowance based on their judgments about information available to them at the time of their examination.

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors.

The Company analyzes loans individually by classifying the loans as to credit risk. Loans classified as substandard or special mention over $50,000 are reviewed regularly by the Company for further deterioration or improvement to determine if they are appropriately classified and whether there is any impairment. All loans are graded upon initial issuance. Further, most commercial and commercial real estate loans are typically reviewed at least annually to determine the appropriate loan grading. In addition, during the renewal process of any loan, as well as if a loan becomes past due, the Company will determine the appropriate loan grade.

Loans excluded from the review process above are generally classified as pass credits until: (a) they become past due; (b) management becomes aware of deterioration in the credit worthiness of the borrower; or (c) the customer contacts the Company for a modification. In these circumstances, the loan is specifically evaluated for potential classification as to special mention, substandard or even charged-off. The Company uses the following definitions for risk ratings:

Pass – A Pass loan's primary source of loan repayment is satisfactory, with secondary sources very likely to be realized if necessary.

Special Mention – A Special Mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in the deterioration of the repayment prospects for the asset or the Company's credit position at some future date. Special Mention loans are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

Substandard – A Substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

(continued)

(3) Loans, Continued

Doubtful – A loan classified Doubtful has all the weaknesses inherent in one classified Substandard with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loss – A loan classified Loss is considered uncollectible and of such little value that continuance as a bankable asset is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is being written off as a basically worthless asset even though partial recovery may be effected in the future.

The following summarizes the loan credit quality (in thousands):

	Real Estate Mortgage Loans					
	Commercial Real Estate	Residential Real Estate	Construction and Land Development	Commercial	Personal	Total
At December 31, 2013:						
Credit Risk Profile by Internally Assigned Grade:						
Pass	$ 53,308	314,884	26,526	41,663	28,384	464,765
Special mention	2,061	-	2,724	-	131	4,916
Substandard	725	2,022	2,476	-	34	5,257
Total	$ 56,094	316,906	31,726	41,663	28,549	474,938
At December 31, 2012:						
Credit Risk Profile by Internally Assigned Grade:						
Pass	46,596	222,957	26,148	34,997	24,043	354,741
Special mention	2,311	72	-	-	150	2,533
Substandard	1,097	458	5,364	-	9	6,928
Total	$ 50,004	223,487	31,512	34,997	24,202	364,202

(continued)

FINEMARK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(3) Loans, Continued

Age analysis of past-due loans is as follows (in thousands):

	Accruing Loans						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Nonaccrual Loans	Total Loans
At December 31, 2013:							
Real estate mortgage loans							
Commercial real estate	$ 254	-	-	254	55,840	-	56,094
Residential real estate	-	-	-	-	315,008	1,898	316,906
Construction and land development	-	-	-	-	31,726	-	31,726
Commercial	5	-	-	5	41,658	-	41,663
Personal	-	-	-	-	28,549	-	28,549
Total	$ 259	-	-	259	472,781	1,898	474,938
At December 31, 2012:							
Real estate mortgage loans							
Commercial real estate	-	-	-	-	49,707	297	50,004
Residential real estate	-	-	-	-	223,161	326	223,487
Construction and land development	-	-	-	-	31,512	-	31,512
Commercial	-	-	-	-	34,997	-	34,997
Personal	-	-	-	-	24,202	-	24,202
Total	$ -	-	-	-	363,579	623	364,202

(continued)

(3) Loans, Continued

Impaired loans are loans for which management considers it probable that the Company will not be able to collect all amounts due according to the contractual terms of the loan agreements. Impaired loans also include loans restructured in a troubled debt restructuring.

The following summarizes the amount of impaired loans (in thousands):

	With No Related Allowance Recorded		With Related Allowance Recorded		
	Recorded Investment	Unpaid Contractual Principle Balance	Recorded Investment	Unpaid Contractual Principle Balance	Recorded Allowance
At December 31, 2013:					
Real estate mortgage loans:					
Residential real estate	$ 2,022	2,502	-	-	-
Construction and land development	2,724	2,724	-	-	-
Personal	-	-	2	2	2
Total	$ 4,746	5,226	2	2	2
At December 31, 2012:					
Real estate mortgage loans:					
Commercial real estate	297	649	-	-	-
Residential real estate	458	920	-	-	-
Construction and land development	-	-	2,855	2,855	409
Commercial	-	17	-	-	-
Personal	-	-	9	9	9
Total	$ 755	1,586	2,864	2,864	418

(continued)

(3) Loans, Continued

The average net investment in impaired loans and interest income recognized and received on impaired loans are as follows (in thousands):

	Average Recorded Investment	Interest Income Recognized	Interest Income Received
Year Ended December 31, 2013:			
Real estate mortgage loans:			
Commercial real estate	$ 151	-	-
Residential real estate	1,169	-	-
Construction and land development	2,758	254	255
Total	$ 4,078	254	255
Year Ended December 31, 2012:			
Real estate mortgage loans:			
Commercial real estate	301	-	-
Residential real estate	315	8	8
Construction and land development	2,791	148	148
Total	$ 3,407	156	156

The Company had no troubled debt restructurings “TDR’s” during the years ended December 31, 2013 or 2012.

The allowance for loan losses on all loans that have been restructured and are considered TDR’s is included in the Company's specific reserve. The specific reserve is determined on a loan by loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if the loan is collateral-dependent. TDR's that have subsequently defaulted are considered collateral-dependent.

(continued)

(3) Loans, Continued

Impaired collateral-dependent loans are carried at fair value when the current collateral value is lower than the carrying value of the loan. Those impaired collateral-dependent loans which are measured at fair value on a nonrecurring basis are as follows (in thousands):

	Fair Value	Level 1	Level 2	Level 3	Total Losses	Losses Recorded During the Year
At December 31, 2013:						
Residential real estate	$ 431	-	-	431	409	-
At December 31, 2012:						
Commercial real estate	297	-	-	297	242	-
Residential real estate	458	-	-	458	409	-
	$ 755	-	-	755	651	-

(4) Premises and Equipment

A summary of premises and equipment follows (in thousands):

	At December 31, 2013	2012
Land	$ 1,630	1,630
Building	6,569	6,098
Leasehold Improvements	3,230	3,076
Furniture, fixtures and equipment	3,535	2,839
Data processing equipment and software	886	735
Total, at cost	15,850	14,378
Less accumulated depreciation and amortization	(4,079)	(3,053)
Premises and equipment, net	$ 11,771	11,325

(continued)

FINEMARK HOLDINGS, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements, Continued

(4) Premises and Equipment, Continued

The Company has a land lease agreement for the Coconut Point office location. This lease expires in 2034 and has two renewal options and rent adjustment clauses during the term of the lease. Rent expense under this operating lease for the years ended December 31, 2013 and 2012 was approximately $236,000 and $242,000, respectively.

The Company has a building lease agreement for the Shell Point office location. The lease expires in 2014 and has five renewal options of three years each and rent adjustment clauses during the term of the lease. The lease also provided for a fifty percent rent discount for the first eighteen months of the term in consideration of renovation costs undertaken by the Company. Rent expense under this operating lease for the years ended December 31, 2013 and 2012 was approximately $27,000 and $27,000, respectively.

The Company has a building lease agreement for the Moorings Park office location. The lease expires in 2016 and has five renewal options of three years each and rent adjustment clauses during the term of the lease. The commencement date was May 1, 2011. Rent expense under this operating lease for the years ended December 31, 2013 and 2012 was approximately $11,000 and $10,000, respectively.

The Company has a building lease agreement for the Bentley Village office location. The lease expires in 2019 and has four renewal options of three years each. The commencement date was July 14, 2011. Rent expense under this operating lease for the years ended December 31, 2013 and 2012 was approximately $2,500 and $2,500, respectively.

The Company had a building lease agreement for the Palm Beach office location which expired in 2013. During 2013, the Company extended the lease term for another three years, until 2016. Rent expense under this operating lease for the years ended December 31, 2013 and 2012 was approximately $100,000 and $91,000, respectively.

In 2012, the Company entered into a building lease agreement for a Naples office location. The lease expired in 2013. Rent expense under this operating lease for the years ended December 31, 2013 and 2012 was approximately $15,000 and $14,000, respectively. In 2013, the Company entered into a building lease agreement for a new Naples office location. The lease commencement date was November 1, 2013, and the term is 12 months. Rent expense under this operating lease for the year ended December 31, 2013 was approximately $21,000.

In 2013, the Company moved from its temporary Arizona location to the permanent location. The lease on the temporary location expired in 2013. Rent expense under this operating lease for the years ended December 31, 2013 and 2012 was approximately $10,000 and $29,000, respectively. The Company's lease on the permanent location commenced on March 1, 2013. The lease includes rent adjustment clauses during the term of the lease and extends for a term of 65 months. The term was later amended to 125 months. Rent expense under this operating lease for the year ended December 31, 2013 was approximately $196,000.

(continued)

(4) Premises and Equipment, Continued

Future minimum rental commitments under these noncancelable leases at December 31, 2013 are approximately as follows (in thousands):

Year Ending December 31,	Minimum Annual Rental Payment
2014	$ 657
2015	551
2016	557
2017	480
2018	392
Thereafter	5,269
	$ 7,906

(5) Investment in Bank-Owned Life Insurance ("BOLI")

The Company enters into agreements to acquire life insurance on key employees by purchasing BOLI. BOLI amounted to $8,967,000 and $8,690,000 at December 31, 2013 and 2012, respectively. BOLI provides a means to mitigate increasing employee benefit costs. The Company expects to benefit from the BOLI contracts as a result of the tax-free growth in cash surrender value and death benefits that are expected to be generated over time. The purchase of the life insurance policies result in an interest sensitive asset on the consolidated balance sheets that provides monthly tax-free income to the Company. BOLI is invested in the "general account" and a "separate account" of quality insurance companies. All carriers were rated "A++" or better by A.M. Best and "Aa2" or better by Moody's at December 31, 2013. BOLI is included in the consolidated balance sheets at its cash surrender value. Increases in BOLI's cash surrender value are reported as a component of noninterest income in the consolidated statements of earnings.

(6) Deposits

The aggregate amount of time deposits with a denomination of $100,000 or more was approximately $123.9 million and $104.4 million at December 31, 2013 and 2012, respectively.

A schedule of maturities of time deposits at December 31, 2013 follows (in thousands):

Year Ending December 31,	Amount
2014	$ 91,964
2015	35,043
2016	5,523
2017	2,836
2018	2,504
	$ 137,870

(continued)

(6) Deposits, continued

At December 31, 2013, securities with a carrying value of $70,562,000 and $33,879,000 were pledged to secure deposits totaling $87,575,000 for sixteen depositors and sixteen Qualified Public Depositors totaling $59,806,000, respectively.

(7) Other Borrowings

The Company enters into repurchase agreements with customers. These agreements require the Company to pledge securities as collateral for the balance in the accounts. At December 31, 2013 and 2012, the balance totaled $4,030,000 and $2,942,000, respectively, and the Company had pledged securities as collateral for these agreements with a carrying value of $4,597,000 and $3,303,000, respectively.

(8) Federal Home Loan Bank Advances

A summary of Federal Home Loan Bank ("FHLB") advances follows ($ in thousands):

Maturing in the Year Ending December 31,	Fixed or Variable Rate	Interest Rate	At December 31, 2013	2012
2015	Fixed	0.53-1.84 %	$ 15,727	15,588
2016	Variable	0.63 *	-	2,500
2016	Fixed	0.72-2.38	19,000	16,500
2017	Fixed	1.51-4.70	11,000	11,000
2018	Fixed	3.63-3.70	8,000	8,000
2022	Fixed	1.86-3.99	17,850	18,762
2026	Fixed	2.01	8,928	9,643
			$ 80,505	81,993

*Represents a floating to fixed rate advance that fixed in 2013.

In 2012, the Company restructured its FHLB advance portfolio to take advantage of low interest rates. The restructured advances have a fixed rate and extended maturity dates.

The Company has entered into a collateral agreement with the FHLB which consists of a blanket lien on qualifying real estate loans.

(continued)

(9) Income Taxes

The components of the income tax expense are as follows (in thousands):

	Year Ended December 31, 2013	2012
Current:		
Federal	$ 720	751
State	17	191
Total current	737	942
Deferred:		
Federal	17	194
State	(4)	(21)
Total deferred	13	173
Total	$ 750	1,115

The reasons for the difference between the statutory Federal income tax rate of 34% and the effective tax rates are summarized as follows (dollars in thousands):

	Year Ended December 31, 2013		2012	
	Amount	% of Pretax Earnings	Amount	% of Pretax Earnings
Income tax expense at statutory rate	$ 772	34.0 %	$ 1,064	34.0 %
Increase (decrease) resulting from:				
State taxes, net of Federal tax benefit	9	0.4	112	3.6
Share-based compensation	57	2.5	47	1.5
Tax-exempt income	(84)	(3.7)	(85)	(2.7)
Other, net	(4)	(0.2)	(23)	(0.8)
	$ 750	33.0 %	$ 1,115	35.6 %

(continued)

(9) Income Taxes, continued

Tax effects of temporary differences that give rise to the deferred tax assets and liabilities are as follows (in thousands):

	At December 31, 2013	2012
Deferred tax assets:		
Allowance for loan losses	$ 1,797	1,179
Organizational and start-up costs	178	200
Share-based compensation	575	558
Unrealized loss on securities available for sale	606	-
Other	22	18
Deferred tax assets	3,178	1,955
Deferred tax liabilities:		
Prepaid expenses	(124)	(138)
Unrealized gain on securities available for sale	-	(323)
Premises and equipment	(913)	(269)
Deferred tax liabilities	(1,037)	(730)
Net deferred tax asset	$ 2,141	1,225

The Company's Federal and state income tax returns filed prior to 2010 are no longer subject to examination by the respective taxing authorities.

(10) Financial Instruments

Commitments to extend credit are agreements to lend to a customer as long as there are no violations of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and normally generate a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Each borrower's creditworthiness is evaluated on a case-by-case basis the same as other extensions of credit.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Under the standby letters of credit, the Company is required to make payments to the beneficiary of the letters of credit upon request by the beneficiary contingent upon the customer's failure to perform under the terms of the underlying contract with the beneficiary. Standby letters of credit extend up to one year. At December 31, 2013 and 2012, there was no liability to beneficiaries resulting from standby letters of credit. At December 31, 2013, a substantial portion of the standby letters of credit were supported by pledged collateral. Should the Company be required to make payments to the beneficiary, repayment from the customer to the Company is required.

(continued)

(10) Financial Instruments, continued

Commitments to extend credit, unused lines of credit and standby letters of credit typically result in loans with a market interest rate when funded. A summary of the amounts of the Company's financial instruments with off-balance sheet risk at December 31, 2013, follows (in thousands):

Commitments to extend credit	$ 27,728
Unused lines of credit	$ 73,400
Standby letters of credit	$ 490

The carrying amounts and estimated fair values of the Company's financial instruments, are as follows (in thousands):

	At December 31,			
	2013		2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and due from banks	$ 36,560	36,560	10,387	10,387
Time Deposits	1,245	1,245	1,245	1,245
Securities available for sale	179,806	179,806	124,763	124,763
Loans held-for-sale	-	-	639	640
Loans, net	470,142	464,567	360,783	357,635
Federal Home Loan Bank stock	4,265	4,265	4,382	4,382
Federal Reserve Bank stock	1,625	1,625	1,220	1,220
Accrued interest receivable	1,961	1,961	1,605	1,605
Financial liabilities:				
Deposits	567,181	567,544	390,419	390,765
Federal Home Loan Bank advances	80,505	82,218	81,993	83,702
Other borrowings	4,030	4,030	2,942	2,942
Off-balance-sheet financial instruments	-	-	-	-

(11) Employee Benefit Plan

The Company has a 401 (k) plan (the "Plan") which is available to all employees electing to participate after meeting certain length-of-service requirements. The Company's expense related to the Plan was approximately $265,000 and $223,000 for the years ended December 31, 2013 and 2012, respectively.

(continued)

(12) Stock-Based Compensation Plans

The Company has a stock incentive plan for directors and employees. Under the plan, 713,100 shares (amended) have been reserved for the granting of stock options or restricted stock awards. All stock options and restricted stock awards must be granted at a price not less than the fair market value of the common stock on the date of grant. Some stock options are fully vested when granted while the majority vests over a one to five year period. All options expire ten years from the date of grant. At December 31, 2013, 55,546 shares remain available for grant. In 2013 and 2012, $191,000 and $204,000 of compensation expense was recognized with a related income tax benefit of $14,000 and $29,000, respectively. At December 31, 2013, there was $343,000 of unrecognized compensation expense related to the nonvested stock options granted under this plan. The cost is expected to be recognized over the next 2.28 years. A summary of the stock option activity under this plan is as follows:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term
Outstanding at December 31, 2011	322,200	$ 10.33	
Granted	324,500	11.00	
Forfeited	(6,500)	10.31	
Outstanding at December 31, 2012	640,200	10.70	
Granted	7,354	13.36	
Exercised	(35,000)	10.87	
Outstanding at December 31, 2013	612,554	$ 10.69	6.86 years
Exercisable at December 31, 2013	264,088	$ 10.49	5.15 years

The fair value of each option granted was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	Year Ended December 31,	
	2013	2012
Risk-free interest rate	.85-1.42%	.85-1.58%
Dividend yield	-	-
Expected stock volatility	11.25%	11.52%
Expected life in years	6.0	5.5-7.0
Per share grant-date fair value of options issued during the year	$1.78-2.01	$1.52-1.92

(continued)

(12) Stock-Based Compensation Plans, continued

On April 25, 2013, the Board of Directors adopted a Non-Qualified Stock Option Plan and made 150,000 options available. All stock options must be granted at a price not less than the fair market value of the common stock on the date of grant. During 2013, 52,500 options were granted and vest over a four year period leaving 97,500 available to grant. All options expire ten years from the date of grant. Compensation expense recognized in 2013 was $14,000 with a related income tax benefit of $5,000. At December 31, 2013, there was $83,000 of total unrecognized compensation expense. A summary of stock option activity under this plan is as follows:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Outstanding at 12/31/12	-	-	
Granted	52,500	$13.30	
Outstanding at 12/31/13	52,500	$13.30	9.41

The fair value of each Non-Qualified Stock Option granted was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	Year Ended December 31, 2013
Risk-free interest rate	0.85 - 1.66%
Dividend yield	-
Expected stock volatility	11.25%
Expected life in years	6.0
Per share grant-date fair value of options issued during the year	$1.78 to 2.05

All stock options granted in 2013 and 2012 were to employees under the plans discussed above. The Company used the guidance of the Securities and Exchange Commission to determine the estimated life of options issued. Expected volatility is based on historical volatility of similar financial institutions. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The dividend yield assumption is based on the Company's history and expectation of dividend payments.

In 2007, the Company granted 10,000 restricted stock awards to employees. These awards vested 50% after three years and 25% in each of the next two years, and became fully vested in 2012. The fair value of this restricted stock was determined to be $100,000. In 2012, 2,175 shares were fully vested and were issued to employees. The total fair value of shares vested and recognized as compensation expense in 2012 was $1,000.

(continued)

(12) Stock-Based Compensation Plans, continued

In 2012, the Company granted 3,000 restricted stock awards to employees. These awards cliff vest after four years. The fair value of this restricted stock was determined to be $33,000. At December 31, 2013, there was $19,000 of total unrecognized compensation expense related to nonvested restricted stock awards. In 2013 and 2012, $8,000 and $6,000, respectively, of compensation expense was recognized with a related income tax benefit of $3,000 and $2,000, respectively.

In addition, in connection with the initial common stock offering, the organizing directors of the Company were granted one common stock option for every two shares purchased. A total of 586,900 stock options were granted to the organizing directors and were fully vested at December 31, 2007. The stock options expire ten years from date of grant and have an exercise price of $10 per share. In 2013, 232,000 options were exercised; 12,500 options had been forfeited prior to 2012. At December 31, 2013, 342,400 options were outstanding.

(13) Related Party Transactions and Economic Dependence

The Company has had transactions in the ordinary course of business, including deposits, borrowings and other transactions, with certain of its directors and executive officers and their associates, all of which were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons, and did not involve more than the normal risk of collectability or present other unfavorable features when granted. Similar transactions may be expected to take place in the ordinary course of business in the future.

The following summarizes these transactions (in thousands):

	At or for the Year Ended December 31, 2013	2012
Loans:		
Beginning balance	$ 9,809	10,879
Additions	4,618	1,504
Repayments	(1,107)	(2,574)
Ending balance	$ 13,320	9,809
Deposits at end of year	$ 81,163	49,079

In 2013 and 2012, the Company purchased a substantial amount of office furniture from a company controlled by a director. It also purchased insurance from a company controlled by a director. Finally, in 2008, the Company entered into a 25 year lease agreement with a director to lease certain premises. All transactions were evaluated to ensure that the terms and conditions are comparable to transactions with other persons, including where appropriate obtaining independent appraisals.

(continued)

(14) Senior Non-Cumulative Perpetual Preferred Stock

On September 21, 2011, the Company entered into a Securities Purchase Agreement with the Secretary of the Treasury, pursuant to which the Company issued and sold to the Treasury 5,665 shares of its Senior Non-Cumulative Perpetual Preferred Stock, Series A, having a liquidation preference of $1,000 per share (the "Series A Preferred Stock"), for proceeds of $5,642,000, net of offering costs of $23,000. The issuance was pursuant to the Treasury's Small Business Lending Fund ("SBLF") program. The Series A Preferred Stock is entitled to receive non-cumulative dividends payable quarterly on each January 1, April 1, July 1 and October 1, commencing October 1, 2011. The dividend rate, which is calculated on the aggregate Liquidation Amount, had been initially set at 5% per annum based upon the current level of "Qualified Small Business Lending" ("QSBL") by the Bank. The dividend rate for future dividend periods will be set based upon the percentage change in qualified lending between each dividend period and the baseline QSBL level established at the time the Agreement was entered into. Such dividend rate may vary from 1% per annum to 5% per annum for the second through tenth dividend periods, and from 1% per annum to 7% per annum for the eleventh through the first half of the nineteenth dividend periods. At December 31, 2013 the interest rate was 1%. If the Series A Preferred Stock remains outstanding for more than four-and-one-half years, the dividend rate will be fixed at 9%. Prior to that time, in general, the dividend rate decreases as the level of the Company's QSBL increases. Such dividends are not cumulative, but the Company may only declare and pay dividends on its common stock (or any other equity securities junior to the Series A Preferred Stock) if it has declared and paid dividends for the current dividend period on the Series A Preferred Stock, and will be subject to other restrictions on its ability to repurchase or redeem other securities.

The SBLF Preferred Stock is non-voting, except in limited circumstances. In the event that the Company misses five dividend payments, whether or not consecutive, the holder of the SBLF Preferred Stock will have the right, but not the obligation, to appoint a representative as an observer on the Company's board of directors. As is more completely described in the Certificate of Designation, holders of the Series A Preferred Stock have the right to vote as a separate class on certain matters relating to the rights of holders of Series A Preferred Stock and on certain corporate transactions. Except with respect to such matters and, if applicable, the election of the additional directors described above, the Series A Preferred Stock does not have voting rights.

The Company may redeem the shares of Series A Preferred Stock, in whole or in part, at any time at a redemption price equal to the sum of the Liquidation Amount per share and the per-share amount of any unpaid dividends for the then-current period, subject to any required prior approval by the Company's primary federal banking regulator.

(continued)

(15) Regulatory Matters

The Company and the Bank are subject to statutory and regulatory limitations on their payment of dividends. The Holding Company's primary source of income from which it may pay dividends will be the dividends that it receives from the Bank.

Beginning in 2012, the Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and percents (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2013, that the Company and the Bank meets all capital adequacy requirements to which it is subject.

(continued)

(15) Regulatory Matters, continued

As of December 31, 2013, the most recent notification from the regulatory authorities categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as adequately capitalized the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage percents as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank's category. The Company's and Bank's actual capital amounts and percents are also presented in the table ($ in thousands):

	Actual		For Capital Adequacy Purposes		For Well Capitalized Purposes	
	Amount	Percent	Amount	Percent	Amount	Percent
As of December 31, 2013:						
Total Capital to Risk-Weighted Assets-						
Bank	$ 63,359	15.56 %	$ 32,583	8.00 %	$ 40,729	10.00 %
Tier I Capital to Risk-Weighted Assets-						
Bank	58,267	14.31	16,292	4.00	24,438	6.00
Tier I Capital to Average Assets-						
Bank	58,267	8.32	28,004	4.00	35,006	5.00
Total Capital to Risk-Weighted Assets-						
Company	71,302	17.39	32,802	8.00	N/A	N/A
Tier I Capital to Risk-Weighted Assets-						
Company	66,177	16.14	16,401	4.00	N/A	N/A
Tier I Capital to Average Assets-						
Company	66,177	9.42	28,115	4.00	N/A	N/A
As of December 31, 2012:						
Total Capital to Risk-Weighted Assets-						
Bank	44,990	13.93	25,831	8.00	32,288	10.00
Tier I Capital to Risk-Weighted Assets-						
Bank	41,382	12.82	12,915	4.00	19,373	6.00
Tier I Capital to Average Assets-						
Bank	41,382	8.22	20,130	4.00	25,163	5.00
Total Capital to Risk-Weighted Assets-						
Company	50,880	15.65	26,011	8.00	N/A	N/A
Tier I Capital to Risk-Weighted Assets-						
Company	47,272	14.54	13,005	4.00	N/A	N/A
Tier I Capital to Average Assets-						
Company	47,272	9.35	20,220	4.00	N/A	N/A

(continued)

(16) Parent Company Only Financial Information

The Holding Company's unconsolidated financial information is as follows (in thousands):

Condensed Balance Sheets

	At December 31,	
Assets	**2013**	**2012**
Cash	$ 5,173	3,153
Loans	2,724	2,855
Accrued interest receivable	13	13
Investment in subsidiary	57,255	41,922
Total Assets	$ 65,165	47,943
Liabilities and Shareholders' Equity		
Accounts Payable	-	117
Dividend Payable	-	14
Shareholders' Equity	65,165	47,812
Total liabilities and shareholders' equity	$ 65,165	47,943

(continued)

(16) Parent Company Only Financial Information, continued

Condensed Statements of Shareholders' Equity

	Year Ended December 31, 2013	2012
Shareholders beginning balance	$ 47,812	45,816
Net earnings	1,521	2,014
Stock-based compensation	213	211
Proceeds from sale of common stock	14,459	200
Repurchase of common stock	-	(250)
Proceeds from exercise of stock options	2,700	-
Tax benefit from stock options exercised	69	-
Preferred stock dividends	(57)	(63)
Change in accumulated other comprehensive (loss) income	(1,552)	(116)
Shareholders ending balance	$ 65,165	47,812

Condensed Statements of Earnings

	Year Ended December 31, 2013	2012
Revenue	$ 94	126
Expenses	682	586
Loss before earnings of subsidiary	(588)	(460)
Earnings of subsidiary	2,109	2,474
Net earnings	$ 1,521	2,014

(continued)

(16) Parent Company Only Financial Information, continued

Condensed Statements of Cash Flows

	Year Ended December 31, 2013	2012
Cash flows from operating activities:		
Net earnings	$ 1,521	2,014
Adjustments to reconcile net earnings to net cash used in operating activities:		
Equity in undistributed earnings of subsidiary	(2,109)	(2,474)
Increase in accrued interest receivable	-	(13)
Decrease in accounts payable	(117)	(3)
Net cash used in operating activities	(705)	(476)
Cash flows from investing activities:		
Net decrease (increase) in loans	131	(2,855)
Capital infusion to subsidiary	(14,563)	-
Net cash used in investing activities	(14,432)	(2,855)
Cash flows from financing activities:		
Preferred stock dividends paid	(71)	(64)
Repurchase of common stock	-	(250)
Proceeds from sale of common stock	14,459	200
Proceeds from exercise of stock options	2,700	-
Tax benefit from stock options exercised	69	-
Net cash provided by (used in) financing activities	17,157	(114)
Net increase (decrease) in cash	2,020	(3,445)
Cash at beginning of the year	3,153	6,598
Cash at end of year	$ 5,173	3,153
Noncash transactions:		
Net change in investment in subsidiary due to change in accumulated other comprehensive (loss) income	$ (1,552)	(116)
Stock-based compensation expense of subsidiary	$ 213	211
Dividends payable	$ -	14

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