Atlantic Coast Financial CORP
Form 10-K
March 14, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2013 **Commission file number: 001-35072**

ATLANTIC COAST FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

Maryland	**65-1310069**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
10151 Deerwood Park Blvd **Building 200, Suite 100** **Jacksonville, Florida**	**32256**
(Address of principal executive offices)	(Zip Code)

(800) 342-2824
(Registrant's telephone number, including area code)

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

Title of class	Name of each exchange on which registered
Common Stock, $0.01 par value	The NASDAQ Stock Market, LLC

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

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

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

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

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate website, if any, every interactive data file required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding twelve months (or for such shorter period that the Registrant was required to submit and post such files).

YES x NO ¨.

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ¨ Accelerated Filer ¨ Non-Accelerated Filer ¨ Smaller Reporting Company x

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

As of March 3, 2014, there were outstanding 15,509,061 shares of the Registrant’s common stock, par value $0.01 per share. The aggregate market value of common stock outstanding held by non-affiliates of the Registrant as of June 30, 2013 was $11,164,193.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s definitive proxy statement to be delivered to stockholders in connection with the Annual Meeting of Stockholders to be held May 19, 2014 are incorporated by reference into Part III of this Annual Report on Form 10-K.

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PART I.

ITEM 1. BUSINESS

General

This Form 10-K contains forward-looking statements within the meaning of the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. Statements in this filing that are not strictly historical are forward-looking and are based upon current expectations that may differ materially from actual results. These forward-looking statements, identified by words such as "expects," "anticipates," "believes," "estimates," "targets," "intends," "plans," "goal" and other similar expressions or future or conditional verbs such as "will," "may," "might," "should," "would" and "could," involve risks and uncertainties that could cause actual results to differ materially from those anticipated by the statements made herein. These risks and uncertainties involve risks and uncertainties that could cause actual results to differ materially from those anticipated by the statements made herein. These risks and uncertainties involve general economic trends and changes in interest rates, increased competition, changes in demand for financial services, the state of the banking industry generally, the uncertainties associated with newly developed or acquired operations, and market disruptions.

Atlantic Coast Financial Corporation wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and advise readers that various factors could affect financial performance and could cause Atlantic Coast Financial Corporation's actual results for future periods to differ materially from those anticipated or projected. Atlantic Coast Financial Corporation undertakes no obligation to publicly release revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unforeseen events, except as required to be reported under the rules and regulations of the Securities and Exchange Commission.

Atlantic Coast Financial Corporation

Atlantic Coast Financial Corporation (the Company), a thrift holding company headquartered in Jacksonville, Florida, is a Maryland corporation. Through our principal subsidiary Atlantic Coast Bank (the Bank), a federally chartered thrift supervised by the Office of the Comptroller of the Currency, we serve the northeastern Florida and southeastern Georgia markets.

On February 3, 2011, the Company completed a conversion from the mutual holding company structure and a related public offering. As a result of the conversion, Atlantic Coast Federal, MHC (the MHC) and Atlantic Coast Federal Corporation, the former holding companies of the Bank, were merged into the Company. The Bank is 100% owned by the Company and the Company is 100% owned by public stockholders. The Company sold a total of 1,710,857 shares of common stock, par value $0.01 per share, in the subscription and community offerings, including 68,434 shares to Atlantic Coast Financial Corporation's employee stock ownership plan (ESOP). All shares were sold at a price of $10.00 per share, raising $17.1 million in gross proceeds. Conversion related expenses of $2.7 million were offset against the gross proceeds, resulting in $14.4 million of net proceeds, which included $0.7 million loaned by the Company to a trust for the ESOP. Concurrent with the completion of the offering, shares of Atlantic Coast Federal Corporation common stock owned by public stockholders were exchanged for 0.1960 of a share of the Company's common stock.

On December 3, 2013, the Company raised $48.3 million in gross proceeds by issuing 12,880,000 shares of its common stock in a public offering, which included the issuance of an additional 1,680,000 shares as a result of the exercise of the underwriters' over-allotment option, at a price to the public of $3.75 per share. Net proceeds from the public offering were $44.9 million after underwriting discounts and offering expenses of $3.4 million. The Company contributed $44.0 million of the net proceeds of the offering to the Bank.

The Company does not maintain offices separate from those of the Bank or utilize personnel other than certain of the Bank's officers. Any officer that serves as a director of the Company is not separately compensated for his service as a director.

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Atlantic Coast Bank

Atlantic Coast Bank was established in 1939 as a credit union to serve the employees of the Atlantic Coast Line Railroad. On November 1, 2000, after receiving the necessary regulatory and membership approvals, Atlantic Coast Federal Credit Union converted to a federal mutual savings bank (and subsequently a stock savings bank) known as Atlantic Coast Bank. The conversion has allowed Atlantic Coast Bank to diversify its customer base by marketing products and services to individuals and businesses in its market area. Unlike a credit union, Atlantic Coast Bank may make loans to customers who do not have a deposit relationship with Atlantic Coast Bank. Following the conversion, management of Atlantic Coast Bank continued its emphasis on residential mortgage lending and commercial real estate lending.

Effective August 10, 2012, the Bank's Board of Directors consented to the issuance of a Consent Order (the Order) by the Office of the Comptroller of the Currency (the OCC). Among other things, the Order calls for the Bank to achieve and maintain certain capital levels. See Note 19 in *Item 8. Financial Statements and Supplementary Data (Notes to Financial Statements)* contained in this report for further description of the provisions contained in the Order. The Bank was in compliance with the Order at December 31, 2013. As of that date, Tier 1 leverage ratio, Tier 1 risk-based capital ratio and Total risk-based capital ratio were 9.73%, 19.22%, and 20.47%, respectively.

The Bank has traditionally focused on attracting retail deposits from the general public and investing those funds primarily in warehouse lines of credit secured by one- to four-family residential loans originated under purchase and assumption agreements by third party originators (warehouse loans held-for-investment), and, to a lesser extent, first mortgages on owner occupied, one- to four-family residences, home equity loans and automobile and other consumer loans originated for retention in our loan portfolio. In addition, we have been increasing our focus on small business lending through our Small Business Administration (SBA) lending programs, as well as commercial business and owner occupied commercial real estate loans to small businesses. The Company typically sells the guaranteed portion of loans originated through SBA lending, rather than hold the loans in portfolio. Loans are currently obtained principally through retail staff, business development officers and brokers. The Company originates multi-family residential loans and commercial construction and residential construction loans in its market area. The Company also invests in investment securities, primarily those issued by U.S. government-sponsored agencies or entities, including Fannie Mae, Freddie Mac and Ginnie Mae.

Revenues are derived principally from interest on loans and other interest-earning assets, such as investment securities. To a lesser extent, revenue is generated from service charges, gains on the sale of loans and other income.

The Bank offers a variety of deposit accounts having a wide range of interest rates and terms, which generally include savings accounts, money market accounts, demand deposit accounts and time deposit accounts with terms ranging from 90 days to five years. In accordance with the Consent Order (see *Recent Events*) interest rates paid on deposits are limited and subject to national rates published weekly by the Federal Deposit Insurance Corporation (FDIC). Deposits are primarily solicited in the Bank’s market area of the Jacksonville metropolitan statistical area (MSA) and southeastern Georgia to fund loan demand, or other liquidity needs.

The Bank’s address is 10151 Deerwood Park Boulevard, Building 200 Suite 100, Jacksonville, Florida, 32256 and its telephone number is (800) 342-2824. Its internet website is www.atlanticcoastbank.net. The Bank’s website is not a part of this Annual Report.

Recent Events

Changes in the Company’s Executive Management Team and Board of Directors

On September 10, 2013, the Company announced its decision to name John K. Stephens, Jr. as President and Chief Executive Officer, and a director of the Company and the Bank. On September 13, 2013, Thomas B. Wagers, Sr. informed the Company that he was resigning from his positions as Interim President, Chief Executive Officer and Chief Financial Officer of the Company and the Bank, effective October 21, 2013. On September 23, 2013, the Board of Directors appointed James D. Hogan as the Company’s interim Chief Financial Officer, and as a director of the Company and the Bank. On February 11, 2014 the Board of Directors named John C. Lent as the Company’s Chief Financial Officer, contingent upon receipt of regulatory non-objection from the OCC and the FRB. Mr. Lent will succeed Mr. Hogan who will retire as interim Chief Financial Officer of the Company and the Bank, effective upon Mr. Lent’s receipt of regulatory non-objection.

Additionally, three members of the Board of Directors decided not to stand for re-election, and the Company’s stockholders elected three new directors at the Company’s annual meeting on August 16, 2013.

Capital Raise

In November 2011, the Company’s Board of Directors began a review of the strategic alternatives. Following the June 2013 rejection by stockholders of the proposed merger of the Company with Bond Street Holdings, Inc., the Company's newly restructured Board of Directors began evaluating alternatives to raise capital. As a result of that, the Company completed an equity capital raise through a public offering on December 3, 2013. The Company raised $48.3 million in gross proceeds by issuing 12,880,000 shares of its common stock in a public offering, which included the issuance of an additional 1,680,000 shares as a result of the exercise of the underwriters’ over-allotment option, at a price to the public of $3.75 per share. Net proceeds from the public offering were $44.9 million after underwriting discounts and offering expenses of $3.4 million. The Company contributed $44.0 million of the net proceeds of the offering to the Bank to maintain capital ratios at required levels and to support growth in the Bank's loan and investment portfolios. The Company also intends to use the remaining net proceeds of the offering for general corporate purposes.

Bulk Sale of Non-Performing Assets

On December 27, 2013, the Company completed the sale of approximately $13.2 million of its non-performing assets to real estate investment firms. The sale included non-accrual loans with a carrying value of $10.6 million and other real estate owned (OREO) with a carrying value of $2.6 million, for a combined purchase price of $6.9 million.

Market Area

The Bank operates seven branches and one administrative office in the greater Jacksonville, Florida market and four branches in the southeastern Georgia market. The Bank branches are located in Jacksonville Beach, Orange Park, Neptune Beach, Westside, Southside and Julington Creek in the Jacksonville MSA as well as in Waycross (2), Douglas and Garden City (Savannah area), Georgia. The Bank’s primary lending area is in the Jacksonville MSA with our deposit customers residing in both the Jacksonville MSA and southeastern Georgia markets. In addition, we have SBA lending offices in St. Augustine and Orlando, Florida, which make small business loans in northeastern and central Florida, southeastern Georgia, South Carolina and North Carolina.

Florida Market Area

The city of Jacksonville ranks as the 11th largest city in the United States in terms of population with more than 825,000 residents. When including the three beach cities of Atlantic Beach, Neptune Beach and Jacksonville Beach and Clay, Baker, Nassau and St. Johns counties, the Jacksonville MSA has more than 1.3 million residents. From 2000 to 2010, the Jacksonville MSA population grew approximately 11% and is estimated to continue growing at a similar rate. The annual median household income for the city of Jacksonville is $44,800, which is slightly higher than the median household income for the state of Florida. The Jacksonville MSA's cost of living index is 6.2% less than the Florida average and 8.3% less than the national average, and residents have a median age of approximately 36 years. The Jacksonville MSA, with deposits of $48 billion as of June 30, 2013, is the third largest market in Florida by deposits, with an above average compounded annual deposit growth rate of 7.6% from 2008 to 2013 compared to 3.2% for the state of Florida.

Jacksonville has a diversified industry base with manufacturing, aerospace, information technology and life sciences as major industries. It is generally less dependent on tourism and lower-skill retail industries, and hence more resilient, than other areas in Florida. Jacksonville has the third largest military presence in the United States as the MSA is home to four major military facilities, further stabilizing the area's population and economy. Further, the Port of Jacksonville is the third largest port in Florida and the 17th largest port in the United States, and is being deepened to accommodate substantial planned growth. The port also benefits from Jacksonville's location at the crossroads of three major railroads; CSX Transportation, Norfolk Southern Railway, and Florida East Coast Railway. The Jacksonville area also receives national and regional exposure as a result of being the host city for numerous professional and college sporting events such as The Players Championship, the annual Florida-Georgia NCAA football game, and the NCAA basketball tournament.

Due to the Jacksonville MSA's improving economy, the unemployment rate has declined from 11.4% at its peak in January 2010 to 5.6% at December 31, 2013. The northeast Florida economy is trending up with single family home sales increasing from 12,586 in 2008, to 17,718 in 2012 and 21,884 in 2013. Average median home prices have followed this upward trend increasing from $125,000 in December 2011 to $135,000 in December 2012 and $170,600 in December 2013. In addition, auto sales for the region have increased during 2013 by 7.5%.

Georgia Market Area

Atlantic Coast Bank was established in Waycross, the county seat of Ware County, Georgia. Waycross has a population of 14,725 with a median household income of $23,399. The unemployment rate has improved from 11.9% in January 2013 to 9.4% in December 2013. One of the largest employers in Waycross is the Satilla Regional Medical Center, with over 1,000 employees and 100 physicians. Satilla Regional Medical Center became part of the Mayo Clinic Health System in 2012. The Okefenokee National Wildlife Refuge is located in Waycross, and is the largest, intact, un-fragmented, freshwater and black water wilderness attraction in North America. Waycross began as a crossroads for southeastern travel and became a hub for rail traffic in the mid-1800s. Today, it's home to the largest CSX Transportation rail yard on the East Coast. Atlantic Coast Bank began as a credit union in Waycross for the Atlantic Coast Line Railroad and then the Seaboard System Railroad, which became part of CSX Transportation in 1986.

Garden City, Georgia has a population of 8,800 with an annual median household income of $37,600 and is part of the Savannah MSA. The unemployment rate was 6.7% at December 31, 2013. The city is home to the Port of Savannah, as well as most of the heavy industry in Chatham County, Georgia. The Port of Savannah boasts the largest concentration of import distribution centers on the East Coast and has the largest single container terminal in North America. The terminal is the fourth busiest container port in the United States, with two railroads on terminal; CSX Transportation and Norfolk Southern Railway.

Douglas, Georgia has a population of 11,600 with an annual median household income of $28,000 and is a city in Coffee County. The unemployment rate was 10.4% at December 31, 2013. Wal-Mart is the biggest employer in the area, with a retail store in Douglas and a distribution center which employs over 1,600 people. Agriculture plays a major role in the area with products that include peanuts, corn, tobacco, and cotton. Poultry is also a major part of the economy with a processing plant, operated by Pilgrim’s, in the area.

Competition

The Bank is competitive in attracting deposits but faces strong competition as it relates to originating real estate and other loans. Historically, most of our direct competition for deposits has come from credit unions, community banks, large commercial banks and thrift institutions within our primary market areas. There are more than 157 FDIC Insured Banks with 667 offices and branches operating in Atlantic Coast Bank's markets. The majority of these competitors are in the Jacksonville MSA market (Duval, Clay, and St. Johns Counties), with 168 offices and branches in the Georgia markets. Duval County had the largest number of institutions and branches within the Bank's markets. In recent years, competition also has come from institutions that largely deliver their services over the internet. Electronic banking such as this has the competitive advantage of lower infrastructure costs. Particularly during times of extremely low or extremely high interest rates, we have faced significant competition for investors' funds from short-term money market securities and other corporate and government securities. During periods of increasing volatility in interest rates, competition for interest-bearing deposits increases as customers, particularly time-deposit customers, tend to move their accounts between competing businesses to obtain the highest rates in the market. The Bank competes for these deposits by offering convenient locations, superior service, competitive rates and attractive deposit products. An arrangement that gives all of our customers' access to over 900 ATMs at no charge, and our "High Tide" deposit account, which gives customers the ability to obtain refunds for ATM surcharges, continue to provide the Bank with a positive competitive advantage. As of June 30, 2013 (the most recent date for which market share peer data is available), Atlantic Coast Bank was ranked number 11 in Duval county market share, holding $236 million, or less than 1% of total deposits in the county. In Ware County, Georgia, Atlantic Coast Bank is ranked number one with 25% of deposit market share. The Bank holds approximately 3% of total deposit market share in Clay County, Florida and Coffee County, Georgia and holds less than 1% of total deposit market share in St. John's County, Florida and Chatham County, Georgia.

Competition within our geographic markets also affects our ability to obtain loans through origination or purchase as well as originating loans at rates that provide an attractive yield. Competition for loans comes principally from mortgage bankers, commercial banks, other thrift institutions, nationally based homebuilders and credit unions. Internet based lenders also have become a greater competitive factor in recent years. Such competition for the origination and purchase of loans may limit future growth and earnings prospects.

Atlantic Coast Bank's website enables customers to open accounts online, which should help the Bank's competitiveness in the electronic banking arena.

Lending Activities

General

Historically, the Bank has originated portfolio one- to four-family residential first and second mortgage loans, home-equity loans and commercial real estate loans, and to a lesser extent commercial and residential construction loans, multi-family real estate loans, commercial business loans, automobile and other consumer loans. We have not originated any land loans since 2008. We have not and currently do not originate or purchase sub-prime loans, low or no documentation loans (Alt-A), or offer teaser rate (low, temporary introductory rate) loans. Our current strategy has been to expand our warehouse lending, small business lending, primarily through the SBA, and to emphasize originating commercial business and owner occupied commercial real estate loans to small businesses.

The Bank originates commercial loans through the SBA's 7(a) and 504 Programs. 7(a) loans are guaranteed by the SBA up to 75% of the loan amount up to a maximum guaranty cap of $3,750,000. The Bank typically, but not always, sells the guaranteed portion of the 7(a) loan into the secondary market at a premium. The Bank earns a 1% servicing fee on the 75% of the loan amount sold. These loans are non-recourse, other than for an allegation of fraud or misrepresentation on the part of the lender. The Bank generally retains the unguaranteed portion of SBA 7(a) loans. At December 31, 2013, SBA 7(a) loans totaled $10.8 million, or 2.9%, of gross portfolio loans.

In the 504 program, the Bank and the SBA are in different lien positions. The typical structure of a 504 loan is that the Bank is in a first lien position at a 50% loan-to-value (LTV), and the SBA is in a second lien position at a 40% LTV. The remaining 10% is an equity investment from the borrower. At December 31, 2013, SBA 504 loans totaled $13.4 million, or 3.5%, of gross portfolio loans.

The Bank also originates warehouse loans held-for-investment with mortgage banking companies which permit the mortgage banker to originate one- to four-family residential mortgage loans for sale in the secondary market. The third-party originator sells the loans and servicing rights to investors in order to repay the warehouse balance outstanding. The Bank earns interest until the loan is sold and typically earns fee income as well. Loans originated within the warehouse lending program generally have commitments to purchase from investors, are sold with no recourse, and are sold with servicing released to the investor. The weighted average number of days outstanding of warehouse loans held-for-investment was 19 days during 2013.

At December 31, 2013, the net loan portfolio totaled $372.0 million, which constituted 50.7% of total assets. Loans carry either a fixed or adjustable rate of interest. Mortgage loans have a longer-term amortization, with maturities generally up to 30 years, with principal and interest due each month. Consumer loans are generally shorter in term and amortize monthly or have interest payable monthly. Warehouse loans are underwritten and funded on an individual loan basis. A percentage of loans are randomly selected for advanced quality control or a third-party fraud-risk analysis report in addition to the standard underwriting process. SBA loans are underwritten in accordance with SBA guidelines and the Bank's commercial credit policy. Commercial real estate, commercial business, multi-family and nonresidential construction loans have generally larger loan balances and involve a greater degree of credit risk than one- to four-family residential mortgage loans.

At December 31, 2013, the maximum amount we could have loaned to any one borrower and related entities under applicable regulations was approximately $11.9 million. At December 31, 2013, there were no portfolio loans or group of portfolio loans to related borrowers with outstanding balances in excess of this amount.

The following table presents the composition of Atlantic Coast Bank's net portfolio loans, and other loans (held-for-sale and warehouse), in dollar amounts and in percentages at the dates indicated:

	At December 31, 2013 Amount	Percent		2012 Amount	Percent		2011 Amount	Percent	
	(Dollars in Thousands)								
Real estate loans:									
One- to four-family	$ 167,455	44.9	%	$ 193,057	45.3	%	$ 238,464	46.3	%
Commercial	48,356	12.9	%	58,193	13.7	%	72,683	14.1	%
Other (land and multi-family)	15,790	4.2	%	19,908	4.7	%	29,134	5.7	%
Total real estate loans	231,601	62.0	%	271,158	63.7	%	340,281	66.1	%
Real estate construction loans:									
One- to four-family		0.0	%		0.0	%	2,044	0.4	%
Commercial	2,582	0.7	%	5,049	1.2	%	4,083	0.8	%
Acquisition and development		0.0	%		0.0	%		0.0	%
Total real estate construction loans	2,582	0.7	%	5,049	1.2	%	6,127	1.2	%
Other portfolio loans:									
Home equity	52,767	14.1	%	63,867	15.0	%	74,199	14.4	%
Consumer	53,290	14.3	%	61,558	14.4	%	70,838	13.8	%
Commercial	33,029	8.9	%	24,308	5.7	%	23,182	4.5	%
Total other portfolio loans	139,086	37.3	%	149,733	35.1	%	168,219	32.7	%
Total portfolio loans	$ 373,269	100.0	%	$ 425,940	100.0	%	$ 514,627	100.0	%
Less:									
Allowance for portfolio loan losses	$ (6,946)			$ (10,889)			$ (15,526)		
Net deferred portfolio loan costs	5,633			6,150			6,606		
Total portfolio loans, net	$ 371,956			$ 421,201			$ 505,707		
Total other loans (held-for-sale and warehouse)	$ 22,179			$ 72,568			$ 61,619		

	At December 31, 2010 Amount	Percent	2009 Amount	Percent

(Dollars in Thousands)

Real estate loans:								
One- to four-family	$	256,729	46.2	%	$	306,968	49.3	%
Commercial		72,048	13.0	%		77,403	12.4	%
Other (land and multi-family)		29,868	5.4	%		37,591	6.0	%
Total real estate loans		358,645	64.6	%		421,962	67.7	%
Real estate construction loans:								
One- to four-family		7,589	1.4	%		4,189	0.7	%
Commercial		5,825	1.0	%		8,022	1.3	%
Acquisition and development		1,652	0.3	%		3,148	0.5	%
Total real estate construction loans		15,066	2.7	%		15,359	2.5	%
Other portfolio loans:								
Home equity		85,082	15.3	%		93,929	15.1	%
Consumer		75,745	13.6	%		73,870	11.9	%
Commercial		21,268	3.8	%		17,848	2.8	%
Total other portfolio loans		182,095	32.7	%		185,647	29.8	%
Total portfolio loans	$	555,806	100.0	%	$	622,968	100.0	%
Less:								
Allowance for portfolio loan losses	$	(13,344)			$	(13,810)		
Net deferred portfolio loan costs		7,290				5,213		
Total portfolio loans, net	$	549,752			$	614,371		
Total other loans (held-for-sale and warehouse)	$	49,318			$	8,990		

Portfolio Loans Maturities and Yields

The following table summarizes the scheduled repayments of our portfolio loans at December 31, 2013:

	One- to Four-family		Commercial Real Estate		Other Real Estate [1]	
	Amount	Weighted Average Rate (%)	Amount	Weighted Average Rate (%)	Amount	Weighted Average Rate (%)
	(Dollars in Thousands)					
1 year or less (3)	$ 18	6.63 %	$ 3,043	5.84 %	$ 415	7.50 %
Greater than 1 to 3 years	941	7.87	4,449	6.29	8,080	8.50
Greater than 3 to 5 years	1,627	5.43	9,829	6.41	1,040	8.99
Greater than 5 to 10 years	4,398	6.22	16,465	5.67	1,393	4.00
Greater than 10 to 20 years	19,623	5.70	11,483	5.61	2,695	8.75
More than 20 years	140,848	5.31	3,087	5.72	2,167	3.00
Total portfolio loans	$ 167,455		$ 48,356		$ 15,790	

	One to Four family Construction [2]		Commercial Construction [2]		Acquisition and Development	
	Amount	Weighted Average Rate (%)	Amount	Weighted Average Rate (%)	Amount	Weighted Average Rate (%)
	(Dollars in Thousands)					
1 year or less (3)	$	%	$	%	$	%
Greater than 1 to 3 years						
Greater than 3 to 5 years						
Greater than 5 to 10 years			1,150	5.92		
Greater than 10 to 20 years			748	4.33		
More than 20 years			684	5.75		
Total portfolio loans	$		$ 2,582		$	

	Home Equity		Consumer		Commercial	
	Amount	Weighted Average Rate (%)	Amount	Weighted Average Rate (%)	Amount	Weighted Average Rate (%)
	(Dollars in Thousands)					
1 year or less (3)	$ 338	5.65 %	$ 953	6.54 %	$ 9,615	5.27 %
Greater than 1 to 3 years	675	7.40	3,640	10.60	1,016	6.65
Greater than 3 to 5 years	1,883	6.73	5,925	8.58	2,933	6.48
Greater than 5 to 10 years	7,448	6.90	5,763	8.81	10,160	5.99
Greater than 10 to 20 years	12,416	6.31	25,723	8.29	1,092	5.35
More than 20 years	30,007	5.09	11,286	12.28	8,213	6.20
Total portfolio loans	$ 52,767		$ 53,290		$ 33,029	

	Total	
	Amount	Weighted Average Rate (%)
	(Dollars in Thousands)	
1 year or less (3)	$ 14,382	5.55 %
Greater than 1 to 3 years	18,801	8.21
Greater than 3 to 5 years	23,237	7.05
Greater than 5 to 10 years	46,777	6.33
Greater than 10 to 20 years	73,780	6.79
More than 20 years	196,292	5.69
Total portfolio loans	$ 373,269	

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(1) Land and multi-family.

(2) Construction loans include notes that cover both the construction period and the end permanent financing, and therefore, the schedule shows maturities for periods greater than one year

(3) Demand loans, loans having no stated schedule of repayments and no stated maturity are reported as due in one year or less.

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The following table sets forth the scheduled repayments of fixed- and adjustable-rate portfolio loans at December 31, 2013 that are contractually due after December 31, 2014:

	Due After December 31, 2014		
	Fixed Rate	Adjustable Rate	Total
	(Dollars in Thousands)		
Real estate loans:			
One- to four-family	$ 91,684	$ 75,753	$ 167,437
Commercial	28,295	17,018	45,313
Other (land and multi-family)	11,202	4,173	15,375
Total real estate loans	131,181	96,944	228,125
Real estate construction loans:			
One- to four-family			
Commercial	530	2,052	2,582
Acquisition and development			
Total real estate construction loans	530	2,052	2,582
Other portfolio loans:			
Home equity	16,112	36,317	52,429
Consumer	51,119	1,218	52,337
Commercial	9,550	13,864	23,414
Total other portfolio loans	76,781	51,399	128,180
Total portfolio loans	$ 208,492	$ 150,395	$ 358,887

<u>One- to Four-Family Real Estate Portfolio Lending</u>

At December 31, 2013, one- to four-family residential mortgage loans totaled $167.4 million, or 44.9%, of gross portfolio loans. Generally, one- to four-family residential loans are underwritten based on the applicant’s employment, income, credit history and the appraised value of the subject property. The Bank underwrites all loans on a fully indexed, fully amortizing basis. The Bank will generally lend up to 80% of the lesser of the appraised value or purchase price for one- to four-family residential loans. Should a loan be granted with a loan-to-value ratio in excess of 80%, private mortgage insurance would be required to reduce overall exposure to below 80%. Historically, such collateral requirements protected the Bank from loss in the event of foreclosure. However, given the low market value of residential real estate over the last three years there is now a greater risk of loss if actions such as foreclosure or short sale become necessary to collect the loan and private mortgage insurance was not purchased.

The Bank added $16.1 million and $1.5 million of one- to four-family residential home loans to its portfolio during 2013 and 2012, respectively.

Properties securing one- to four-family residential mortgage loans are generally appraised by independent fee appraisers. Borrowers are required to obtain title and hazard insurance, and flood insurance, if necessary, in an amount not less than the value of the property improvements. Historically, the Bank originated one- to four-family mortgage loans on both a fixed-rate and adjustable-rate basis, however, more recently the majority of originated loans were fixed rate due to the low interest rate environment. Management’s pricing strategy for one- to four-family mortgage loans includes setting interest rates that are competitive with other local financial institutions and consistent with the Bank’s internal needs. Adjustable-rate loans are tied to a variety of indices including rates based on U.S. Treasury securities. The majority of adjustable-rate loans carry an initial fixed rate of interest for either three or five years which then converts to an interest rate that is adjusted based upon the applicable index and in accordance with the note. As of December 31, 2013, the total amount of one- to four-family residential mortgage loans allowing for interest only payments totaled $26.8 million, or 7.2% of the total portfolio loans, and 16.0% of the total one- to four-family mortgage loan portfolio. We do not currently originate or purchase interest-only one- to four-family residential mortgage loans and discontinued such activity in December 2007.

The Bank's home mortgages are structured with a five to 35 year maturity, with amortizations up to 35 years. Substantially all of the one- to four-family mortgage loans originated are secured by properties located in southeastern Georgia and the metropolitan Jacksonville area. During 2008 and continuing into 2013, the Bank implemented stricter underwriting guidelines that limited the origination of one- to four-family residential mortgage loans secured by investment property due to the continued weak real estate values and credit quality in our market area.

All of the residential real estate loans contain a "due on sale" clause allowing the Bank to declare the unpaid principal balance due and payable upon the sale of the security property, subject to certain laws. Loans originated or purchased are generally underwritten and documented pursuant to Freddie Mac or Fannie Mae guidelines.

Prior to 2008, we originated investor loans for one- to four-family properties on a limited basis, but since that time the majority of our lending activity has focused on owner-occupied property. We have not in the past, nor do we currently, originate sub-prime loans, option-arms, Alt-A loans, or similar loans.

Commercial Real Estate Lending

The Bank offers commercial real estate loans for both permanent financing and construction. Our current strategy has been to focus primarily on permanent financing to owner occupied businesses. These loans are typically secured by small retail establishments, office buildings, or income producing properties located in the Bank's primary market area. At December 31, 2013, permanent commercial real estate loans totaled $48.4 million, or 12.9%, of gross portfolio loans.

The Bank originates both fixed-rate and adjustable-rate commercial real estate loans. The interest rate on adjustable-rate loans is tied to a variety of indices, including rates based on the prime rate and U.S. Treasury securities. The majority of the Bank's adjustable-rate loans carry an initial fixed-rate of interest, for either three or five years, and then convert to an interest rate that is adjusted annually based upon the index. Loan-to-value ratios on commercial real estate loans generally do not exceed 80% of the appraised value of the property securing the loan. These loans require monthly payments, amortize up to 25 years, and generally have maturities of up to 10 years and may carry pre-payment penalties.

Loans secured by commercial real estate are underwritten based on the cash flow of the borrower or income producing potential of the property and the financial strength of the borrower and guarantors. Loan guarantees are generally obtained from financially capable parties based on a review of personal financial statements. The Bank requires commercial real estate borrowers with aggregate balances in excess of $500,000 to submit financial statements, including rent rolls if applicable, annually. The net operating income, which is the income derived from the operation of the property less all operating expenses, must be sufficient to cover the payments related to the outstanding debt. The Bank generally requires an income-to-debt service ratio of 1.2 times debt. Rent or lease assignments are required in order for us to be assured the cash flow from the project will be used to repay the debt. Appraisals on properties securing commercial real estate loans are performed by independent state-licensed fee appraisers approved by the Board of Directors. The majority of the properties securing commercial real estate loans are located in the Bank's market area.

Loans secured by commercial real estate properties are generally larger and involve a greater degree of credit risk than one- to four-family residential mortgage loans. Because payments on loans secured by commercial real estate properties are often dependent on the successful operation and management of the owner's business or successful management of the property, repayment of such loans may be subject to adverse conditions in the real estate market or the economy. If the cash flow from the project is reduced, or if leases are not obtained or renewed, the borrower's ability to repay the loan may be impaired.

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Other Real Estate Loans

As of December 31, 2013, other real estate secured loans totaled $15.8 million, or 4.2%, of gross portfolio loans and consisted mainly of land loans, but also included loans secured by multi-family property. In an effort to prevent potential exposure to additional credit risk due to the weak real estate values and credit quality in our market area, the Bank no longer originates new land loans. Loans to commercial and individual borrowers secured by land totaled $12.6 million, or 3.4% of gross portfolio loans as of December 31, 2013. Generally, these loans carry a higher rate of interest than do residential permanent loans. The Bank generally underwrote land loans based on the borrower's ability to repay, credit history and the appraised value of the subject property.

The Bank also offers loans secured by multi-family residential real estate. These loans are secured by real estate located in the Bank's primary market area. At December 31, 2013, multi-family residential loans totaled $3.2 million, or 0.8% of gross portfolio loans. Multi-family residential loans are generally originated with adjustable interest rates based on the prime rate or U.S. Treasury securities. Loan-to-value ratios on multi-family residential loans do not exceed 75% of the appraised value of the property securing the loan. These loans require monthly payments and amortize over a period of up to 30 years. Loans secured by multi-family residential real estate are underwritten based on the income producing potential of the property and the financial strength of the borrower. The net operating income must be sufficient to cover the payments related to the outstanding debt. Rent or lease assignments are required in order for us to be assured the cash flow from the project will be used to repay the debt. Appraisals on properties securing multi-family residential loans are performed by independent state licensed fee appraisers approved by the Board of Directors.

Loans secured by land and multi-family real estate properties generally involve a greater degree of credit risk than one- to four-family residential mortgage loans. Because payments on loans secured by multi-family real estate properties are often dependent on the successful operation or management of the properties, repayment of such loans may be subject to adverse conditions in the real estate market or the economy. If the cash flow from the project is reduced, or if leases are not obtained or renewed, the borrower's ability to repay the loan may be impaired.

Real Estate Construction Lending

As of December 31, 2013, real estate construction loans totaled $2.6 million, or 0.7% of gross portfolio loans. The real estate construction portfolio consists of both residential and commercial construction loans. Residential construction loans are generally made for the construction of pre-sold builder homes to individual borrowers. As of December 31, 2013, the Bank had no residential construction loans. Residential construction only loans are underwritten according to the terms available for permanent financing on the secondary market. Generally, construction loans are limited to a loan to value ratio not to exceed 80% based on the lesser of construction costs or the appraised value of the property upon completion. The Bank also offers construction-to-permanent loans.

Construction only loans to builders generally have a term of 12 months with a variable interest rate tied to the prime rate as published in The Wall Street Journal plus a margin ranging from 0.5% to 1.5% and a floor of 6.0%, with a loan-to-value ratio of no more than 80% of the cost of the construction or appraised value of the property, whichever is less. As of December 31, 2013, we had loans to three builders for the construction of pre-sold or speculative one- to four-family residential property and lot inventory that totaled $0.5 million. The Bank has not originated construction only loans since 2007.

Home-Equity Lending

The Bank generally originates fixed-term fully amortizing home equity loans. At December 31, 2013, the portfolio totaled $52.8 million, or 14.1%, of gross portfolio loans. Historically the Bank originated open-ended, interest only home equity lines of credit. Due to the decline of both real estate values in our market area and the increased risk inherent with second lien real estate financing, the Bank ceased originating home equity lines of credit in January 2009. The Bank generally underwrites one- to four-family home equity loans based on the applicant's employment and credit history and the appraised value of the subject property. Presently, the Bank will lend up to 80% of the appraised value less any prior liens. In limited circumstances, the Bank may lend up to 90% of the appraised value less any prior liens. This ratio may be reduced in accordance with internal guidelines given the risk and credit profile of the borrower. Properties securing one- to four-family mortgage loans are generally appraised by independent fee appraisers. The Bank requires a title search and hazard insurance, and flood insurance, if necessary, in an amount not less than the value of the property improvements. Currently, home equity loans are retained in our loan portfolio.

The Bank's home equity lines of credit carry an adjustable interest rate based upon the prime rate of interest and generally have an interest rate floor. As of December 31, 2013, interest only lines of credit totaled $32.1 million, or 60.8% of the total home equity loan portfolio, and 14.6% of total loans collateralized by one- to four-family residential property. All home equity lines have a maximum draw period of 10 years with a repayment period of up to 20 years following such draw period depending on the outstanding balance.

Consumer Loans

The Bank currently offers a variety of consumer loans, primarily manufactured home loans and automobile loans. At December 31, 2013, consumer loans totaled $53.3 million, or 14.3% of gross portfolio loans.

The most significant component of the Bank's consumer loan portfolio consists of manufactured home loans originated primarily through an on-site financing broker after being underwritten by Atlantic Coast Bank. Loans secured by manufactured homes totaled $35.8 million, or 9.6% of gross portfolio loans as of December 31, 2013. Manufactured home loans have a fixed rate of interest and may carry terms up to 25 years. Down payments are required, and the amounts are based on several factors, including the borrower's credit history. The Bank has not originated manufactured home loans since early in 2011, and does not intend to originate such loans in the future.

The second most significant component of our consumer loan portfolio consists of automobile loans. The loans are originated primarily through our branch network and are underwritten by Atlantic Coast Bank. Loans secured by automobiles totaled $7.8 million, or 2.1% of gross portfolio loans as of December 31, 2013. Automobile loans have a fixed rate of interest and may carry terms up to six years. Down payments are required, and the amounts are based on several factors, including the borrower's credit history.

Consumer loans, except for those secured by manufactured homes, have shorter terms to maturity and are principally fixed rate, thereby reducing exposure to changes in interest rates, and carry higher rates of interest than one- to four-family residential mortgage loans. Consumer loans have an inherently greater risk of loss because they are predominantly secured by rapidly depreciable assets, such as automobiles or manufactured homes. In these cases, repossessed collateral for a defaulted loan may not provide an adequate source of repayment of the outstanding loan balance. As a result, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy.

Commercial Business Lending

The Bank also offers commercial business loans which may be secured by assets other than real estate. At December 31, 2013, commercial business loans totaled $33.0 million, or 8.9% of gross portfolio loans. The purpose of these loans is to provide working capital, inventory financing, or equipment financing. Generally, working capital and inventory loans carry a floating rate of interest based on the prime rate plus a margin and mature annually. Loans to finance equipment generally carry a fixed rate of interest and terms of up to seven years. The collateral securing these types of loans is other business assets such as inventory, accounts receivable, and equipment. Once a loan is in the portfolio, the credit department monitors based on size, risk rating and payment status. Relationships with aggregate exposure of $500,000 or greater and lines of credit (regardless of amount) are required to submit financial statements annually. The Bank reviews the performance of these companies and affirms or changes their risk rating accordingly. Loans with risk ratings of monitor or special mention are reviewed and documented quarterly and loans rated substandard are reviewed monthly. Loans that become past due 30 days or more are monitored daily and risk ratings adjusted accordingly. Commercial business loans generally have higher interest rates than residential mortgage loans of like duration because they have a higher risk of default since their repayment generally depends on the successful operation of the borrower's business and the sufficiency of any collateral. In addition, the Bank originates commercial loans through the 7(a) Program and the 504 Program of the SBA.

Loan Originations, Purchases, and Sales

The Bank originates portfolio loans through its branch network, the internet and its call center. Referrals from current customers, advertisements, real estate brokers, mortgage loan brokers and builders are also important sources of loan originations. While the Bank originates both adjustable-rate loans and fixed-rate loans, origination volume is dependent upon customer loan demand within the Bank's market area. Demand is affected by local competition, the real estate market and the interest rate environment.

The Bank shut down its internal mortgage origination division in 2012, and moved to a referral model to originate mortgages. However, with the success of the Company's capital raise in December 2013, the Bank reentered the business of originating one- to four-family residential loans for investment, and intends to continue originating such loans internally.

Prior to 2008 the Bank occasionally purchased pools of residential loans originated by other banks when organic growth was not sufficient. These loan purchases were made following the Bank's underwriting standards, such as loan-to-value ratios and borrower credit scores. During 2013, the Bank reentered the business of purchasing pools of residential loans originated by other banks, and intends to continue purchasing such loans to supplement organic growth. The Bank purchased $16.3 million of these pooled loans during the year ended December 31, 2013. Similarly, prior to 2008 the Bank also participated in commercial real estate loans originated by other banks. These participation loans were subject to the Bank's usual underwriting standards as described above applicable to this type of loan. The Bank has not participated in a commercial real estate loan originated by another bank since May 2007.

From time-to-time the Bank may sell residential loans from our portfolio to enhance liquidity or to appropriately manage interest rate risk. The Bank has also utilized the services of a national loan sale advisor to sell non-performing residential mortgage loans. The Bank sold $10.6 million of these non-performing loans during the year ended December 31, 2013.

Loans Held-for-Sale

Beginning in 2008 and continuing into 2012, the Bank began to regularly sell originated, conforming one- to four-family residential loans, both fixed rate and adjustable rate, including the related servicing, to other financial institutions in the secondary market for favorable fees. The Bank has not originated residential loans to be held-for-sale since 2012, but intends to originate such loans again beginning early in 2014.

Beginning in 2010, the Bank began to sell the guaranteed portion of the internally originated SBA loans to investors, while maintaining the servicing rights. The Bank intends to continue originating such loans for the foreseeable future.

Warehouse Loans Held-for-Investment

Beginning in 2010, the Bank began to originate warehouse loans held-for-investment and permit third-party originators to sell the loans and servicing rights to investors in order to repay the warehouse balance outstanding. The Bank intends to continue originating such loans for the foreseeable future.

Loan Approval Procedures and Authority

Individual loan authority ranges from $100,000 to $750,000 with lending authority based on the individual lender’s lending and loan underwriting experience. Loans which exceed an individual lender’s authority may be approved using combined authority with another officer on loan amounts up to and including $1.0 million. Loans exceeding $1.0 million and up to and including $5.0 million must be approved by our management loan committee. Loans exceeding $5.0 million must be approved by the Board of Directors.

Non-Performing and Problem Assets

General

When a borrower fails to make a timely payment on a loan, contact is made initially in the form of a reminder letter sent at either 10 or 15 days depending on the terms of the loan agreement. If a response is not received within a reasonable period of time, contact by telephone is made in an attempt to determine the reason for the delinquency and to request payment of the delinquent amount in full or to establish an acceptable repayment plan to bring the loan current.

Modifications are considered at the request of the borrower or upon the Bank’s determination that a modification of terms may be beneficial to the Bank. Generally, the borrower and any guarantors must provide current financial information and communicate to the Bank the underlying cause of their financial hardship and expectations for the near future. The Bank must then verify the hardship and structure a modification that addresses the situation accordingly.

If the borrower is unable to make or keep payment arrangements, additional collection action is taken in the form of repossession of collateral for secured, non-real estate loans and small claims or legal action for unsecured loans. If the loan is secured by real estate, a letter of intent to foreclose is sent to the borrower when an agreement for an acceptable repayment plan cannot be established or agreed upon. The letter of intent to foreclose allows the borrower up to 30 days to bring the account current. Once the loan becomes delinquent and an acceptable repayment plan has not been established, foreclosure action is initiated on the loan.

Delinquent Loans

Total portfolio loans past due 60 days or more totaled $4.8 million, or 1.3% of total portfolio loans at December 31, 2013. Real estate loans 60 days or more past due totaled $3.8 million, or 1.0% of total loans at December 31, 2013. There were no construction loans 60 days or more past due at December 31, 2013. Other portfolio loans (consisting of home equity, consumer, and commercial non-real estate) 60 days or more past due totaled $0.9 million, or 0.3% of total loans at December 31, 2013.

Non-Performing Assets

Non-performing assets consist of non-performing portfolio loans, accruing portfolio loans past due 90 days and more, and foreclosed assets. Loans to a customer whose financial condition has deteriorated are considered for non-performing status whether or not the loan is 90 days and over past due. Generally, all loans past due 90 days and over are classified as non-performing. For portfolio loans classified as non-performing, interest income is not recognized until actually collected. At the time the loan is placed on non-performing status, interest previously accrued but not collected is reversed and charged against current income.

The following table sets forth the amounts and categories of the Bank’s non-performing assets:

	At December 31,				
	2013	2012	2011	2010	2009
	(Dollars in Thousands)				
Non-performing portfolio loans					
Real estate loans:					
One- to four-family	$ 2,677	$ 10,555	$ 16,108	$ 10,184	$ 12,343
Commercial		8,643	14,238	7,228	3,895
Other (land and multi-family)	75	595	5,153	3,748	9,638
Real estate construction loans:					
One- to four-family					
Commercial		739	2,362	1,682	4,988
Acquisition and development					404
Other portfolio loans:					
Home equity	400	2,212	4,091	2,403	2,973
Consumer	229	969	983	679	909
Commercial		1,171	3,680	2,201	
Total non-performing portfolio loans	3,381	24,884	46,615	28,125	35,150
Real estate owned					
Real estate loans:					
One- to four-family	191	1,592	886	1,532	1,000
Commercial	3,251	1,868	1,346	3,921	2,403
Other (land and multi-family)	1,783	4,441	2,917	4,192	1,562
Real estate construction loans:					
One- to four-family					63
Commercial		164	395		
			295	295	

Acquisition and development														
Other portfolio loans:														
Home equity														
Consumer														
Commercial														
Total real estate owned		5,225			8,065			5,839			9,940			5,028
Total non-performing assets		8,606			32,949			52,454			38,065			40,178
Troubled debt restructurings classified as impaired portfolio loans	$	21,909		$	22,407		$	19,337		$	26,295		$	20,148
Ratios														
Non-performing portfolio loans to total portfolio loans		0.9	%		5.8	%		8.9	%		5.0	%		5.6 %
Non-performing portfolio loans to total assets		0.5	%		3.2	%		5.9	%		3.4	%		3.9 %
Non-performing assets to total assets		1.2	%		4.3	%		6.7	%		4.6	%		4.4 %

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At December 31, 2013, the Bank had $3.4 million in non-performing portfolio loans, or 0.9% of total portfolio loans. Our largest concentration of non-performing portfolio loans at December 31, 2013 was $2.7 million in non-performing one- to four-family residential real estate loans. At December 31, 2013, one of the non-performing one- to four-family residential real estate loans was a jumbo loan (loan amount exceeds $417,000) totaling $0.4 million.

Real estate acquired as a result of foreclosure is classified as OREO. At the time of foreclosure or repossession, the property is recorded at estimated fair value less selling costs, with any write-down charged against the allowance for portfolio loan losses. As of December 31, 2013, the Bank had real estate owned of $5.2 million, a decrease of $2.9 million from December 31, 2012.

Portfolio loans for which the terms have been modified as a result of the borrower's financial difficulties are considered troubled debt restructurings (TDR). Portfolio loans modified as TDRs with market rates of interest are classified as impaired portfolio loans in the year of restructure and until the loan has performed for 12 months in accordance with the modified terms. TDRs which do not perform in accordance with modified terms are reported as non-performing portfolio loans. As of December 31, 2013 and 2012 such portfolio loans totaled $0.1 million and $3.1 million, respectively.

Classified Assets

Banking regulations provide for the classification of portfolio loans and other assets, such as other real estate owned, debt and equity securities considered by the Bank and regulators to be of lesser quality, as “substandard,” “doubtful” or “loss.” An asset is considered “substandard” if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. “Substandard” assets include those characterized by the “distinct possibility” the insured institution will sustain “some loss” if the deficiencies are not corrected. Assets classified as “doubtful” have all of the weaknesses inherent in those classified “substandard,” with the added characteristic that the weaknesses present make “collection or liquidation in full,” on the basis of currently existing facts, conditions, and values, “highly questionable and improbable.” Assets classified as “loss” are those considered not collectable and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted.

When an insured institution classifies problem assets as either substandard or doubtful, it may establish general allowances for portfolio loan losses in an amount deemed prudent by management and reviewed by the Board of Directors. General allowances represent loss allowances which have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When an insured institution classifies problem assets as “loss,” it is required either to establish a specific allowance for losses equal to 100% of that portion of the asset so classified or to charge off such amount. Our determination as to the classification of our assets and the amount of its valuation allowances is subject to review by the OCC and the FDIC, which may order the establishment of additional general or specific loss allowances.

In connection with the filing of the Bank’s regulatory reports with the OCC and in accordance with its classification of assets policy, management regularly reviews the problem assets in the portfolio to determine whether any assets require classification in accordance with applicable regulations. The total amount of classified assets (consisting primarily of portfolio loans and real estate owned) represented 30.5% of the Bank‘s equity capital and 2.7% of the Bank’s total assets at December 31, 2013.

There were no portfolio loans considered doubtful or loss at December 31, 2013 and 2012. Assets considered substandard were $20.0 million, down from $45.5 million at year end 2012. The Bank also designates certain portfolio loans as special mention when it is determined a loan relationship should be monitored more closely. Portfolio loans are considered as special mention for a variety of reasons including changes in recent borrower financial condition, changes in borrower operations, changes in value of available collateral, concerns regarding changes in economic conditions in a borrower's industry, and other matters. A portfolio loan considered as special mention in many instances may be performing in accordance with the loan terms. Special mention portfolio loans were $3.1 million and $2.8 million at December 31, 2013 and 2012, respectively. As of December 31, 2013 $3.4 million of classified portfolio loans were on non-performing status, as compared to $24.9 million at year end 2012.

Allowance for Portfolio Loan Losses

An allowance for portfolio loan losses (the allowance) is maintained to reflect probable incurred losses in the loan portfolio. The allowance is based on ongoing assessments of the estimated losses incurred in the loan portfolio and is established as these losses are recognized through a provision for portfolio loan losses (provision expense) charged to earnings. Generally, portfolio loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The reasonableness of the allowance is reviewed and established by management, within the context of applicable accounting and regulatory guidelines, based upon its evaluation of then-existing economic and business conditions affecting the Bank's key lending areas. Senior credit officers monitor those conditions continuously and reviews are conducted quarterly with the Bank's senior management and the Board of Directors.

Management's methodology for assessing the reasonableness of the allowance consists of several key elements, which include a general loss component by type of portfolio loan and specific allowances for identified problem portfolio loans. The allowance also incorporates the results of measuring impaired portfolio loans.

At December 31, 2013, the allowance was $6.9 million or 1.8% of total portfolio loans and 205.4% of total non-performing portfolio loans.

The following table sets forth activity in the Company’s allowance for the years indicated:

	At December 31, 2013	2012	2011	2010	2009
	(Dollars in Thousands)				
Balance at beginning of year	$ 10,889	$ 15,526	$ 13,344	$ 13,810	$ 10,598
Charge-offs:					
Real estate loans:					
One- to four-family	(4,485)	(6,347)	(6,005)	(10,235)	(8,350)
Commercial	(2,452)	(2,756)	(2,274)	(1,314)	(3,822)
Other (land and multi-family)	(790)	(1,906)	(729)	(2,735)	(3,605)
Real estate construction loans:					
One- to four-family					(50)
Commercial		(1,145)		(3,342)	
Acquisition and development					
Other portfolio loans:					
Home equity	(2,017)	(3,215)	(3,404)	(2,000)	(4,715)
Consumer	(2,131)	(1,567)	(1,471)	(1,773)	(1,408)
Commercial	(880)	(1,769)	(242)	(697)	(590)
Total charge-offs	(12,755)	(18,705)	(14,125)	(22,897)	(22,540)
Recoveries:					
Real estate loans:					
One- to four-family	961	1,036	483	687	252
Commercial		3	21	3	
Other (land and multi-family)	63	8	36	124	18
Real estate construction loans:					
One- to four-family					
Commercial					
Acquisition and development					
Other portfolio loans:					
Home equity	395	223	119	102	240
Consumer	289	305	262	276	351
Commercial	78	2	3	9	18
Total recoveries	1,786	1,577	924	1,201	879
Net charge-offs	(10,969)	(17,128)	(13,201)	(21,696)	(21,661)
Provision for portfolio loan losses	7,026	12,491	15,383	21,230	24,873

Balance at end of year	$ 6,946		$ 10,889		$ 15,526		$ 13,344		$ 13,810	
Net charge-offs to average portfolio loans during this year [1]	2.8	%	3.2	%	2.3	%	3.5	%	3.1	%
Net charge-offs to average non-performing portfolio loans during this year	77.0	%	47.9	%	35.3	%	68.6	%	60.6	%
Allowance for portfolio loan losses to non-performing portfolio loans	205.4	%	43.8	%	33.3	%	47.4	%	39.3	%
Allowance for portfolio loan losses as % of total portfolio loans (end of year) [1]	1.8	%	2.5	%	3.0	%	2.4	%	2.2	%

(1) Total portfolio loans are net of deferred fees and costs and purchase premiums or discounts.

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The following table summarizes the allocation of the allowance by portfolio loan category at the dates indicated. The allowance allocated to each category is not necessarily indicative of future losses in any particular category and does not restrict the use of the allowance to absorb losses in other categories:

	At December 31, 2013		2012		2011	
	Amount of Allowance for Portfolio Loan Loss	Percent of Loans in Each Category to Total Portfolio Loans	Amount of Allowance for Portfolio Loan Loss	Percent of Loans in Each Category to Total Portfolio Loans	Amount of Allowance for Portfolio Loan Loss	Percent of Loans in Each Category to Total Portfolio Loans
	(Dollars in Thousands)					
Real estate loans:						
One- to four-family	$ 3,188	44.9 %	$ 4,166	45.3 %	$ 6,030	46.3 %
Commercial	827	12.9 %	958	13.7 %	3,143	14.1 %
Other (land and multi-family)	282	4.2 %	986	4.7 %	1,538	5.7 %
Real estate construction loans:						
One- to four-family		0.0 %		0.0 %	120	0.4 %
Commercial	125	0.7 %	50	1.2 %		0.8 %
Acquisition and development		0.0 %		0.0 %		0.0 %
Other portfolio loans:						
Home equity	1,046	14.1 %	2,636	15.0 %	3,125	14.4 %
Consumer	1,223	14.3 %	1,448	14.4 %	885	13.8 %
Commercial	214	8.9 %	645	5.7 %	685	4.5 %
Unallocated	41	0.0 %		0.0 %		0.0 %
Total	$ 6,946	100.0 %	$ 10,889	100.0 %	$ 15,526	100.0 %

	At December 31, 2010		2009	
	Amount of Allowance for Portfolio Loan Loss	Percent of Loans in Each Category to Total Portfolio Loans	Amount of Allowance for Portfolio Loan Loss	Percent of Loans in Each Category to Total Portfolio Loans
	(Dollars in Thousands)			
Real estate loans:				
One- to four-family	$ 5,860	46.2 %	$ 3,446	49.3 %
Commercial	2,443	13.0 %	575	12.4 %

Other (land and multi-family)		1,019	5.4	%		1,305	6.0	%
Real estate construction loans:								
One- to four-family		18	1.4	%		47	0.7	%
Commercial		37	1.0	%		3,332	1.3	%
Acquisition and development			0.3	%		110	0.5	%
Other portfolio loans:								
Home equity		1,663	15.3	%		2,240	15.1	%
Consumer		1,922	13.6	%		2,447	11.9	%
Commercial		382	3.8	%		318	2.8	%
Unallocated			0.0	%			0.0	%
Total	$	13,344	100.0	%	$	13,810	100.0	%

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Investment Activities

General

The Bank is required by federal regulations to maintain an amount of liquid assets, such as cash and short-term securities, for the purposes of meeting operational needs. The Bank is also permitted to make certain other securities investments. Cash flow projections are regularly reviewed and updated to assure that adequate liquidity is provided.

The Bank is authorized to invest in various types of liquid assets, including U.S. Treasury obligations, securities of various federal agencies and government sponsored enterprises, certain certificates of deposit of insured banks and savings institutions, certain bankers' acceptances, repurchase agreements and federal funds. Subject to various restrictions, federal savings associations may also invest their assets in investment grade commercial paper and corporate debt securities and mutual funds whose assets conform to the investments that a federally chartered savings association is otherwise authorized to make directly.

The Board of Directors has adopted an investment policy which governs the nature and extent of investment activities, and the responsibilities of management and the board. Investment activities are directed by the Chief Financial Officer in coordination with the Company's Asset/Liability Committee. Various factors are considered when making decisions, including the marketability, maturity and tax consequences of the proposed investment. The maturity structure of investments will be affected by various market conditions, including the current and anticipated short and long term interest rates, the level of interest rates, the trend of new deposit inflows, and the anticipated demand for funds through deposit withdrawals and loan originations and purchases.

The structure of the investment portfolio is intended to provide liquidity when loan demand is high, assist in maintaining earnings when loan demand is low and maximize earnings while managing risk, including credit risk, reinvestment risk, liquidity risk and interest rate risk.

Investment Securities

The Bank invests in investment securities, for example United States government sponsored enterprises and state and municipal obligations, as part of its asset liability management strategy.

Accounting principles generally accepted in the United States of America (U.S. GAAP) requires investments be categorized as "held-to-maturity," "trading securities" or "available-for-sale," based on management's intent as to the ultimate disposition of each security. Securities are classified as held-to-maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities are classified as available-for-sale when they might be sold before maturity. As of December 31, 2013, $159.7 million of investment securities were classified as available-for-sale, while $19.3 million of investment securities were classified as held-to-maturity. As of December 31, 2012, $159.7 million of investment securities were classified as available-for-sale, while no investment securities were classified as held-to-maturity.

Management evaluates investment securities for other-than-temporary impairment (OTTI) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. In determining OTTI, management considers many factors, including: (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, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Company has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at the determination date.

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When OTTI is determined to have occurred, the amount of the OTTI recognized in earnings depends on whether we intend to sell the security or it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss. If we intend to sell the security or it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss, the OTTI recognized in earnings is equal to the entire difference between its amortized cost basis and its fair value at the balance sheet date. If we do not intend to sell the security and it is not more likely than not that we will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the OTTI is separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized as a charge to earnings. The amount of the OTTI related to other factors is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment. The Company recorded no OTTI for the year ended December 31, 2013.

As of December 31, 2013 the Company's security portfolio consisted of 40 securities available-for-sale, 31 of which were in an unrealized loss position, and 2 securities held-to-maturity, both of which were in an unrealized loss position. Nearly all unrealized losses were related to debt securities whose underlying collateral is residential mortgages. However, all of these debt securities were issued by government sponsored organizations as discussed below.

As of December 31, 2013, $178.0 million, or approximately 99.5% of the debt securities held by the Company were issued by U.S. government-sponsored entities and agencies, primarily Fannie Mae, Freddie Mac and Ginnie Mae, institutions which the government has affirmed its commitment to support. The decline in fair value was attributable to changes in interest rates and not credit quality. The Company currently does not have the intent to sell these securities and it is not more likely than not it will be required to sell the securities before their anticipated recovery. Therefore, the Company does not consider these debt securities to be other-than-temporarily impaired as of December 31, 2013.

During the year ended December 31, 2013 the Company did not record OTTI related to non-agency collateralized mortgage-backed securities or collateralized mortgage obligations. As of December 31, 2013 the Bank held no non-agency collateralized mortgage-backed securities or collateralized mortgage obligations.

The following table sets forth the composition of the investment securities portfolio, excluding Federal Home Loan Bank stock at the dates indicated:

	At December 31, 2013			2012			2011		
	Carrying Amount	% of Total Investment Securities		Carrying Amount	% of Total Investment Securities		Carrying Amount	% of Total Investment Securities	
	(Dollars in Thousands)								
Securities available-for-sale:									
U.S. Government sponsored enterprises	$ 4,318	2.4	%	$	0.6	%	$	0.0	%
State and municipal	972	0.5	%	979	0.6	%	930	0.7	%
Mortgage-backed securities	130,914	73.1	%	119,647	74.9	%	76,089	60.0	%

residential											
U.S. Government collateralized mortgage obligation		23,528	13.2	%		39,119	24.5	%		49,802	39.3	%
Total securities available-for-sale	$	159,732	89.2	%	$	159,745	100.0	%	$	126,821	100.0	%
Securities held-to-maturity:												
Mortgage-backed securities residential		19,266	10.8	%			0.0	%			0.0	%
Total securities held-to-maturity		19,266	10.8	%			0.0	%			0.0	%
Total investment securities	$	178,998	100.0	%	$	159,745	100.0	%	$	126,821	100.0	%

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Portfolio Maturities and Yields

The composition and scheduled maturities of the investment securities portfolio at December 31, 2013, are summarized in the following table:

	More than Five Years through Ten Years		More than Ten Years		Total Investment Securities		
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Fair Value	Weighted Average Yield
Securities available-for-sale:							
U.S. Government sponsored enterprises	$	%	$ 5,000	3.00 %	$ 5,000	$ 4,318	3.00 %
State and municipal	942	4.18			942	972	4.18
Mortgage-backed securities residential	30,975	2.58	106,043	2.69	137,018	130,914	2.67
U.S. Government collateralized mortgage obligations	782	3.50	23,549	2.16	24,331	23,528	2.20
Total securities available-for-sale	$ 32,699	2.64 %	$ 134,592	2.61 %	$ 167,291	$ 159,732	2.62 %
Securities held-to-maturity:							
Mortgage-backed securities residential	$	%	$ 19,266	3.00 %	$ 19,266	$ 19,258	3.00 %
Total securities held-to-maturity	$	%	$ 19,266	3.00 %	$ 19,266	$ 19,258	3.00 %
Total investment securities (1)	$ 32,699	2.64 %	$ 153,858	2.66 %	$ 186,557	$ 178,990	2.66 %

(1) At December 31, 2013, the Company did not have any scheduled maturities one year or less, or more than one year through five years.

Maturities are based on the final contractual payment dates, and do not reflect the impact of prepayments or early redemptions that may occur. State and municipal investment securities yields have not been adjusted to a tax equivalent basis.

Sources of Funds

General

The Bank’s sources of funds are deposits, payment of principal and interest on loans, interest earned on or maturation of investment securities, borrowings, and funds provided from operations.

Capital Raise Transaction

On December 3, 2013, the Company raised $48.3 million in gross proceeds in a public offering. Net proceeds from the public offering were $44.9 million after underwriting discounts and offering expenses of $3.4 million. The Company contributed $44.0 million of the net proceeds of the offering to the Bank to maintain capital ratios at required levels and to support growth in the Bank's loan and investment portfolios. The Company also intends to use the remaining net proceeds of the offering for general corporate purposes.

Deposits

The Bank offers a variety of deposit accounts to consumers with a wide range of interest rates and terms. Deposits consist of time deposit accounts, savings, money market and demand deposit accounts. The Bank's origin as a credit union enables it to enjoy the benefit of long-term deposit customers. As a community bank the Bank has historically paid higher rates on deposit accounts than large regional or national banks. The Bank relies primarily on competitive pricing policies, marketing and customer service to attract and retain these deposits. Additionally, the Bank has purchased time deposit accounts from brokers at costs and terms which are comparable or better to time deposits originated in the branch offices. The Bank had no brokered deposits at December 31, 2013. Under the Order, the Bank may not increase brokered deposits without prior written approval.

The variety of deposit accounts offered has allowed the Bank to be competitive in obtaining funds and to respond with flexibility to changes in consumer demand. Pricing of deposits are managed to be consistent with overall asset/liability management, liquidity and growth objectives. Management considers numerous factors including: (1) the need for funds based on loan demand, current maturities of deposits and other cash flow needs; (2) rates offered by market area competitors for similar deposit products; (3) current cost of funds and yields on assets; and (4) the alternative cost of funds on a wholesale basis, in particular the cost of advances from the Federal Home Loan Bank of Atlanta (FHLB). Interest rates are reviewed regularly by senior management as a part of its asset-liability management actions. Based on historical experience, management believes the Bank's deposits are a relatively stable source of funds. Despite this stability, the Bank's ability to attract and maintain these deposits and the rates paid on them has been and will continue to be significantly affected by market conditions.

The following table sets forth the distribution of total deposit accounts, by account type, for the years ended December 31, 2013, 2012 and 2011:

	2013			2012			2011		
	Average Balance	Percent	Weighted Average Rate	Average Balance	Percent	Weighted Average Rate	Average Balance	Percent	Weig Aver Rate
	(Dollars in Thousands)								
Noninterest bearing demand	$ 42,264	8.59 %	%	$ 40,466	8.06 %	%	$ 38,155	7.50 %	
Savings	70,096	14.24 %	0.33 %	76,310	15.19 %	0.45 %	69,420	13.65 %	0.62
Interest-bearing demand	71,757	14.58 %	0.30 %	75,440	15.02 %	0.47 %	74,716	14.69 %	1.10
Money market demand	104,228	21.17 %	0.47 %	118,005	23.49 %	0.49 %	119,062	23.42 %	0.75
Total transaction accounts	288,345	58.58 %	0.33 %	310,221	61.76 %	0.41 %	301,353	59.26 %	0.71
Certificates of deposit	203,920	41.42 %	1.16 %	192,109	38.24 %	1.48 %	207,167	40.74 %	1.95
Total deposits	$ 492,265	100.00 %	0.67 %	$ 502,330	100.00 %	0.82 %	$ 508,520	100.00 %	1.21

As of December 31, 2013, the aggregate amount of outstanding certificates of deposit in amounts greater than or equal to $100,000 were approximately $96.3 million. The following table sets forth the maturity of those certificates as of December 31, 2013:

	Amounts Maturing
	(Dollars in Thousands)
Three months or less	$ 27,124
Over three months through six months	15,353
Over six months through one year	36,073
Over one year to three years	13,733
Over three years	4,056
Total	$ 96,339

Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase (reverse repurchase agreements) with a carrying value of $92.8 million are secured by mortgage-backed securities as part of a structured transaction with a carrying amount of $115.8 million at December 31, 2013. The reverse repurchase agreements have maturities occurring from January 2014 to July 2018.

Under the reverse repurchase agreements, the lender has the option to terminate individual advances in whole the following quarter; there is no termination penalty if terminated by the lender. There have been no early terminations.

Under the terms of a revised agreement the Company entered into in 2012 with the counterparty on $77.8 million of the $92.8 million the Bank is required to pledge additional collateral if its capital ratios decrease below the Prompt Corrective Action (PCA) defined levels of well-capitalized or adequately capitalized. The Company was above the PCA defined levels of well-capitalized at December 31, 2013. However, the Company was required to increase pledged collateral by $4.0 million during 2013 due to capital ratios falling below the PCA defined levels of well-capitalized at December 31, 2012. Failure to maintain required collateral levels is in violation of the default provision under the terms of the agreement and could result in a termination penalty. At December 31, 2013, the fair value of $77.8 million of the debt exceeded the carrying value by approximately $7.1 million, which approximates the termination penalty.

Information concerning reverse repurchase agreements for the years indicated is summarized as follows:

	As of and For the Years Ended December 31,								
	2013			2012			2011		
	(Dollars in Thousands)								
Balance at end of period	$	92,800		$	92,800		$	92,800	
Average balance outstanding	$	92,800		$	92,800		$	92,800	
Maximum month-end balance	$	92,800		$	92,800		$	92,800	
Weighted average coupon interest rate during the period		5.10	%		5.10	%		5.10	%
Weighted average coupon interest rate at end of period		5.10	%		5.10	%		5.10	%
Weighted average maturity (months)		30			42			54	

Federal Home Loan Bank Advances

Although deposits are the primary source of funds, the Bank may utilize borrowings when it is a less costly source of funds, and can be invested at a positive interest rate spread, when additional capacity is required to fund loan demand or when they meet asset/liability management goals. Borrowings have historically consisted primarily of advances from the FHLB; however the Bank also has the ability to borrow from the Federal Reserve Bank of Atlanta (the FRB) under the Secondary Credit program.

Advances from the FHLB may be obtained upon the security of mortgage loans and mortgage-backed securities. These advances may be made pursuant to several different credit programs, each of which has its own interest rate, range of maturities and call features. At December 31, 2013, the Company had $110.0 million in FHLB advances outstanding. The Bank's borrowing capacity with the FHLB has decreased from $5.2 million at December 31, 2012 to $5.0 million at December 31, 2013.

During 2012, the FHLB notified the Bank that the Bank was required to collateralize the excess of the fair value of the FHLB advances over the book value. As of December 31, 2013, fair value exceeded the book value of the individual advances by $10.5 million, which was collateralized entirely by investment securities. Additionally, during 2012 the Bank was notified by the FRB that it is no longer eligible to borrow under the Primary Credit program and that it no longer has daylight overdraft capacity available, although the Bank has not participated in these programs in the past.

The following table sets forth information as to FHLB advances for the years indicated:

As of and For the Years Ended December 31,		
2013	2012	2011
(Dollars In Thousands)		

Average balance outstanding	$	110,000		$	135,000		$	146,841
Maximum month-end balance	$	110,000		$	135,000		$	170,500
Balance at end of year	$	110,000		$	135,000		$	135,000
Weighted average coupon interest rate during the year		4.11	%		3.88	%		3.80 %
Weighted average coupon interest rate at end of year		4.11	%		3.88	%		3.88 %
Weighted average maturity (months)		39			43			55

During the first quarter 2013, the Company prepaid advances scheduled for maturity in the third and fourth quarter of 2013 totaling $25.0 million, resulting in a prepayment penalty of $0.5 million.

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Subsidiary and Other Activities

At December 31, 2013, the Company did not have any active subsidiaries other than Atlantic Coast Bank. The Company has one inactive subsidiary, Atlantic Coast Development LLC, and the Bank has one inactive subsidiary, First Community Financial Services.

Employees

At December 31, 2013, the Bank had a total of 135 employees, including 7 part-time employees. The Company's employees are not represented by any collective bargaining group.

Supervision and Regulation

General

Atlantic Coast Bank is examined and supervised by the OCC and is subject to examination by the FDIC. This regulation and supervision establishes a comprehensive framework of activities in which an institution may engage and is intended primarily for the protection of the FDIC's deposit insurance fund and depositors. Under this system of federal regulation, financial institutions are periodically examined to ensure that they satisfy applicable standards with respect to their capital adequacy, assets, management, earnings, liquidity and sensitivity to market interest rates. Following completion of its examination, the federal agency critiques the institution's operations and assigns its rating (known as an institution's CAMELS rating). Under federal law, an institution may not disclose its CAMELS rating to the public. Atlantic Coast Bank also is a member of and owns stock in the Federal Home Loan Bank of Atlanta, which is one of the twelve regional banks in the Federal Home Loan Bank System. Atlantic Coast Bank is also regulated to a lesser extent by the Board of Governors of the Federal Reserve Board System, governing reserves to be maintained against deposits and other matters. The OCC examines Atlantic Coast Bank and prepares reports for the consideration of its Board of Directors on any operating deficiencies. Atlantic Coast Bank's relationship with its depositors and borrowers is also regulated to a great extent by federal law and, to a much lesser extent, state law, especially in matters concerning the ownership of deposit accounts and the form and content of Atlantic Coast Bank's mortgage documents.

Any change in these laws or regulations, whether by the FDIC, the OCC or Congress, could have a material adverse impact on Atlantic Coast Financial Corporation and Atlantic Coast Bank and their operations.

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the Office of Thrift Supervision's (the OTS) functions relating to federal savings associations, including rulemaking authority, were transferred to the OCC. At the same time, responsibility for the regulation and supervision of savings and loan holding companies was transferred to the Federal Reserve, which also supervises bank holding companies.

As a savings and loan holding company, Atlantic Coast Financial Corporation is required to comply with the rules and regulations of the Federal Reserve Board, and is required to file certain reports with and is subject to examination by the Federal Reserve Board. Atlantic Coast Financial Corporation is also subject to the rules and regulations of the Securities and Exchange Commission under the federal securities laws.

Set forth below is a brief description of certain regulatory requirements that are or will be applicable to Atlantic Coast Financial Corporation and Atlantic Coast Bank. The description below is limited to certain material aspects of the statutes and regulations addressed, and is not intended to be a complete description of such statutes and regulations and their effects on Atlantic Coast Financial Corporation and Atlantic Coast Bank.

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Regulatory Agreements with the OCC and Federal Reserve Board

Consent Order and Supervisory Agreement. Effective December 10, 2010, the Company, Atlantic Coast Bank and the OTS entered into a supervisory agreement (the OTS Supervisory Agreement). The OTS Supervisory Agreement was assumed by the Federal Reserve Board as to restrictions that relate to the Company (the Supervisory Agreement). As it relates to the Bank, the OTS Supervisory Agreement was replaced by a Consent Order (the Order) with the OCC effective August 10, 2012. Among other things, the Order calls for the Bank to achieve and maintain certain capital levels. See Note 19 in *Item 8. Financial Statements and Supplementary Data (Notes to Financial Statements)* contained in this report for further description of the provisions contained in the Order, as well as *Item 1A. Risk Factors* for a discussion of the risks associated with the Order. The Bank was in compliance with the Order at December 31, 2013, but remains under the provisions of the order. As a result of entering into the Order to achieve and maintain specific capital levels, the Bank's capital classification under the PCA rules as of December 31, 2013 was well-capitalized.

The Supervisory Agreement between the Company and the Federal Reserve Board provides, among other things, that: (1) the Company must comply with regulatory prior notification requirements with respect to changes in directors and senior executive officers; (2) the Company cannot declare or pay dividends or make any other capital distributions without prior written Federal Reserve Board approval; (3) the Company will not be permitted to enter into, renew, extend or revise any contractual arrangement relating to compensation or benefits for any senior executive officers or directors, unless it provides 30 days prior written notice of the proposed transaction to the Federal Reserve Board; (4) the Company may not make any golden parachute payment or prohibited indemnification payment without Federal Reserve Board prior written approval; (5) the Company may not incur, issue, renew or rollover any debt or debt securities, increase any current lines of credit, guarantee the debt of any entity, or otherwise incur any additional debt without the prior written non-objection of the Federal Reserve Board.

Dodd-Frank Wall Street Reform and Consumer Protection Act

In 2010, Congress enacted the Dodd-Frank Act which significantly changed Atlantic Coast Bank regulatory structure and affected the lending, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act eliminated Atlantic Coast Bank's former primary federal regulator, the OTS, and required Atlantic Coast Bank to be regulated by the OCC (the primary federal regulator for national banks). The Dodd-Frank Act also authorizes the Board of Governors of the Federal Reserve Board System to supervise and regulate all savings and loan holding companies like Atlantic Coast Financial Corporation in addition to bank holding companies which it regulates. The Dodd-Frank Act also requires the Federal Reserve Board to set minimum capital levels for all depository institution holding companies that are as stringent as those required for the insured depository subsidiaries, and the components of Tier 1 capital would be restricted to capital instruments that are currently considered to be Tier 1 capital for insured depository institutions. Savings and loan holding companies are subject to a five year transition period before the holding company capital requirement will apply. The legislation also established a floor for capital of insured depository institutions that cannot be lower than the standards in effect today, and directs the federal banking regulators to implement new leverage and capital requirements within 18 months that take into account off-balance sheet activities and other risks, including risks relating to securitized products and derivatives.

The Dodd-Frank Act also created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions such as Atlantic Coast Bank, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. Banks and savings institutions with $10 billion or less in assets will be examined by their applicable bank regulators. The new legislation also weakens the federal preemption available for national banks and federal savings associations, and gives state attorneys general the ability to enforce applicable federal consumer protection laws.

The legislation also broadened the base for FDIC insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a financial institution. The Dodd-Frank Act also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor. The Dodd-Frank Act requires companies to give stockholders a non-binding vote on executive compensation and change-in-control payments. The legislation also directs the Federal Reserve Board to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded or not. Further, the legislation requires that originators of securitized loans retain a percentage of the risk for transferred loans, directs the Federal Reserve Board to regulate pricing of certain debit card interchange fees and contains a number of reforms related to mortgage origination.

Many of the provisions of Dodd-Frank involve delayed effective dates and/or require implementing regulations. Accordingly, it will be some time before management can assess the full impact on operations. However, there is a significant possibility that the Dodd-Frank Act will, at a minimum, result in an increased regulatory burden and compliance, operating and interest expense for Atlantic Coast Bank and Atlantic Coast Financial Corporation.

Federal Banking Regulation

Business Activities. A federal savings bank derives its lending and investment powers from the Home Owners' Loan Act, as amended, and the regulations of the OCC. Under these laws and regulations, Atlantic Coast Bank may invest in mortgage loans secured by residential and nonresidential real estate, commercial business loans and consumer loans, certain types of debt securities and certain other assets, subject to applicable limits. Atlantic Coast Bank also may establish subsidiaries that may engage in activities not otherwise permissible for Atlantic Coast Bank, including real estate investment and securities and insurance brokerage. The Dodd-Frank Act authorizes, for the first time, the payment of interest on commercial checking accounts.

Capital Requirements. OCC regulations require savings banks to meet three minimum capital standards: a 1.5% tangible capital ratio, a 4% leverage ratio (3% for savings banks receiving the highest rating on the CAMELS rating system) and an 8% risk-based capital ratio.

The risk-based capital standard for savings banks requires the maintenance of Tier 1 (core) and total capital (which is defined as core capital and supplementary capital) to risk-weighted assets of at least 4% and 8%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, are multiplied by a risk-weight factor of 0% to 100%, assigned by the OCC, based on the risks believed inherent in the type of asset. Core capital is defined as common stockholders' equity (including retained earnings), certain non-cumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries, less intangibles other than certain mortgage servicing rights and credit card relationships. The components of supplementary capital currently include cumulative preferred stock, long-term perpetual preferred stock, mandatory convertible securities, subordinated debt and intermediate preferred stock, the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets and up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair values. Overall, the amount of supplementary capital included as part of total capital cannot exceed 100% of core capital. Additionally, a savings bank that retains credit risk in connection with an asset sale may be required to maintain additional regulatory capital because of the purchaser's recourse to the savings bank.

On July 2, 2013, the Federal Reserve approved final rules that substantially amend the regulatory risk-based capital rules applicable to the Company and the Bank. The FDIC and the OCC have subsequently approved these rules. The final rules were adopted following the issuance of proposed rules by the Federal Reserve in June 2012 and implement the "Basel III" regulatory capital reforms and changes required by the Dodd-Frank Act. "Basel III" refers to two consultative documents released by the Basel Committee on Banking Supervision in December 2009, the rules text released in December 2010, and loss absorbency rules issued in January 2011, which include significant changes to bank capital, leverage and liquidity requirements.

The rules include new risk-based capital and leverage ratios, which would be phased in from 2015 to 2019, and would refine the definition of what constitutes "capital" for purposes of calculating those ratios. The new minimum capital level requirements applicable to the Company and the Bank under the final rules would be: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6% (increased from 4%); (iii) a total capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4% for all institutions.

The final rules also establish a "capital conservation buffer" above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital.

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The capital conservation buffer will be phased-in over four years beginning on January 1, 2016, as follows: the maximum buffer will be 0.625% of risk-weighted assets for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter. This will result in the following minimum ratios beginning in 2019: (i) a common equity Tier 1 capital ratio of 7.0%; (ii) a Tier 1 capital ratio of 8.5%; and (iii) a total capital ratio of 10.5%.

Under the final rules, institutions are subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

Basel III provided discretion for regulators to impose an additional buffer, the "countercyclical buffer," of up to 2.5% of common equity Tier 1 capital to take into account the macro-financial environment and periods of excessive credit growth. However, the final rules permit the countercyclical buffer to be applied only to "advanced approach banks" (i.e. , banks with $250 billion or more in total assets or $10 billion or more in total foreign exposures), which currently excludes the Company and Atlantic Coast Bank. The final rules also implement revisions and clarifications consistent with Basel III regarding the various components of Tier 1 capital, including common equity, unrealized gains and losses, as well as certain instruments that will no longer qualify as Tier 1 capital, some of which will be phased out over time. However, the final rules provide that small depository institution holding companies with less than $15 billion in total assets as of December 31, 2009 (which includes the Company) will be able to permanently include non-qualifying instruments that were issued and included in Tier 1 or Tier 2 capital prior to May 19, 2010 in additional Tier 1 or Tier 2 capital until they redeem such instruments or until the instruments mature.

In addition, the final rules provide for smaller banking institutions (less than $250 billion in consolidated assets) an opportunity to make a one-time election to opt out of including most elements of accumulated other comprehensive income in regulatory capital. Importantly, the opt-out excludes from regulatory capital not only unrealized gains and losses on available-for-sale debt securities, but also accumulated net gains and losses on cash-flow hedges and amounts attributable to defined benefit postretirement plans. The opt-out election must be elected on the first Call Report filed after January 1, 2015.

The final rules also contain revisions to the prompt corrective action framework, which is designed to place restrictions on insured depository institutions, including Atlantic Coast Bank, if their capital levels begin to show signs of weakness. These revisions take effect January 1, 2015. Under the prompt corrective action requirements, which are designed to complement the capital conservation buffer, insured depository institutions will be required to meet the following increased capital level requirements in order to qualify as "well-capitalized:"(i) a new common equity Tier 1 capital ratio of 6.5%; (ii) a Tier 1 capital ratio of 8% (increased from 6%); (iii) a total capital ratio of 10% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 5% (increased from 4%).

The final rules set forth certain changes for the calculation of risk-weighted assets, which we will be required to utilize beginning January 1, 2015. The standardized approach final rule utilizes an increased number of credit risk exposure categories and risk weights, and also addresses: (i) an alternative standard of creditworthiness consistent with Section 939A of the Dodd-Frank Act; (ii) revisions to recognition of credit risk mitigation; (iii) rules for risk weighting of equity exposures and past due loans; (iv) revised capital treatment for derivatives and repo-style transactions; and (v) disclosure requirements for top-tier banking organizations with $50 billion or more in total assets that are not subject to the "advance approach rules" that apply to banks with greater than $250 billion in consolidated assets.

At December 31, 2013, Atlantic Coast Bank was in compliance with the minimum capital ratios. Additionally, as a result of entering into the Order to achieve and maintain specific capital levels, Atlantic Coast Bank's capital classification under the PCA rules was well-capitalized.

Loans-to-One Borrower. Generally, a federal savings bank may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of unimpaired capital and surplus. An additional amount may be loaned, equal to

10% of unimpaired capital and surplus, if the loan is secured by readily marketable collateral, which generally does not include real estate. As of December 31, 2013, Atlantic Coast Bank was in compliance with the loans-to-one borrower limitations.

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Qualified Thrift Lender Test. As a federal savings bank, Atlantic Coast Bank must satisfy the qualified thrift lender, or "QTL," test. Under the QTL test, Atlantic Coast Bank must maintain at least 65% of its "portfolio assets" in "qualified thrift investments" in at least nine months of the most recent 12 months. "Portfolio assets" generally means total assets of a savings institution, less the sum of specified liquid assets up to 20% of total assets, goodwill and other intangible assets, and the value of property used in the conduct of the savings bank's business.

"Qualified thrift investments" include various types of loans made for residential and housing purposes, investments related to such purposes, including certain mortgage-backed and related securities, and loans for personal, family, household and certain other purposes up to a limit of 20% of portfolio assets. "Qualified thrift investments" also include 100% of an institution's credit card loans, education loans and small business loans. Atlantic Coast Bank also may satisfy the QTL test by qualifying as a "domestic building and loan association" as defined in the Internal Revenue Code.

A savings bank that fails the qualified thrift lender test must operate under specified restrictions set forth in the Home Owners' Loan Act. The Dodd-Frank Act makes noncompliance with the QTL test subject to agency enforcement action for a violation of law. At December 31, 2013, Atlantic Coast Bank held 79.2% of its "portfolio assets" in "qualified thrift investments," and satisfied this test.

Capital Distributions. OCC regulations govern capital distributions by a federal savings bank, which include cash dividends, stock repurchases and other transactions charged to the capital account. A savings bank must file an application for approval of a capital distribution if:

- the total capital distributions for the applicable calendar year exceed the sum of the savings bank's net income for that year to date plus the savings bank's retained net income for the preceding two years;
- the savings bank would not be at least adequately capitalized following the distribution;
- the distribution would violate any applicable statute, regulation, agreement or OCC-imposed condition; or
- the savings bank is not eligible for expedited treatment of its filings.

Even if an application is not otherwise required, every savings bank that is a subsidiary of a holding company must still file a notice with the Federal Reserve Board at least 30 days before the Board of Directors declares a dividend or approves a capital distribution.

The OCC or Federal Reserve Board may disapprove a notice or application if:

- the savings bank would be undercapitalized following the distribution;
- the proposed capital distribution raises safety and soundness concerns; or
- the capital distribution would violate a prohibition contained in any statute, regulation or agreement.

In addition, the Federal Deposit Insurance Act provides that an insured depository institution may not make any capital distribution, if after making such distribution the institution would be undercapitalized.

Liquidity. A federal savings bank is required to maintain a sufficient amount of liquid assets to ensure its safe and sound operation.

Community Reinvestment Act and Fair Lending Laws. All savings banks have a responsibility under the Community Reinvestment Act and related regulations of the OCC to help meet the credit needs of their communities, including low- and moderate-income neighborhoods. In connection with its examination of a federal savings bank, the OCC is required to assess the association's record of compliance with the Community Reinvestment Act. In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit lenders from discriminating in their lending practices on the basis of characteristics specified in those statutes. An association's failure to comply with the provisions of the Community Reinvestment Act could, at a minimum, result in denial of certain corporate applications such as branches or mergers, or in restrictions on its activities. The failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in enforcement actions by the OCC, as well as other federal regulatory agencies and the Department of Justice. Atlantic Coast Bank received a "satisfactory" Community Reinvestment Act rating in its most recent federal examination.

Transactions with Related Parties. A federal savings bank's authority to engage in transactions with its affiliates is limited by OCC regulations and by Sections 23A and 23B of the Federal Reserve Board Act and it's implementing Regulation W. An affiliate is a company that controls, is controlled by, or is under common control with an insured depository institution such as Atlantic Coast Bank. Atlantic Coast Financial Corporation is an affiliate of Atlantic Coast Bank. In general, loan transactions between an insured depository institution and its affiliate are subject to certain quantitative and collateral requirements. In this regard, transactions between an insured depository institution and its affiliate are limited to 10% of the institution's unimpaired capital and unimpaired surplus for transactions with any one affiliate and 20% of unimpaired capital and unimpaired surplus for transactions in the aggregate with all affiliates. Collateral in specified amounts ranging from 100% to 130% of the amount of the transaction must usually be provided by affiliates in order to receive loans from the institution. In addition, OCC regulations prohibit a savings bank from lending to any of its affiliates that are engaged in activities that are not permissible for bank holding companies and from purchasing the securities of any affiliate, other than a subsidiary. Finally, transactions with affiliates must be consistent with safe and sound banking practices, not involve low-quality assets and be on terms that are as favorable to the institution as comparable transactions with non-affiliates. The OCC requires savings banks to maintain detailed records of all transactions with affiliates.

Atlantic Coast Bank's authority to extend credit to its directors, executive officers and 10% stockholders, as well as to entities controlled by such persons, is currently governed by the requirements of Sections 22(g) and 22(h) of the Federal Reserve Board Act and Regulation O of the Federal Reserve Board. Among other things, these provisions require that extensions of credit to insiders (i) be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features, and (ii) not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of Atlantic Coast Bank's capital. In addition, extensions of credit in excess of certain limits must be approved by Atlantic Coast Bank's Board of Directors. Atlantic Coast Bank is in compliance with Regulation O.

Enforcement. The OCC has primary enforcement responsibility over federal savings institutions and has the authority to bring enforcement action against all "institution-affiliated parties," including stockholders, attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an insured institution. Formal enforcement action by the OCC may range from the issuance of a capital directive or cease and desist order, to removal of officers and/or directors of the institution and the appointment of a receiver or conservator. Civil money penalties cover a wide range of violations and actions, and range up to $25,000 per day, unless a finding of reckless disregard is made, in which case penalties may be as high as $1 million per day. The FDIC also has the authority to terminate deposit insurance or to recommend to the OCC that enforcement action be taken with respect to a particular savings institution. If action is not taken by the OCC, the FDIC has authority to take action under specified circumstances.

Standards for Safety and Soundness. Federal law requires each federal banking agency to prescribe certain standards for all insured depository institutions. These standards relate to, among other things, internal controls, information systems and audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, compensation, and other operational and managerial standards as the agency deems appropriate. The federal banking agencies adopted Interagency Guidelines Prescribing Standards for Safety and Soundness to implement the safety and soundness standards required under federal law. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. The guidelines address internal controls and information systems, internal audit systems, credit underwriting, loan documentation, interest rate risk exposure, asset growth, compensation, fees and benefits. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard. If an institution fails to meet these standards, the appropriate federal banking agency may require the institution to submit a compliance plan.

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Prompt Corrective Action Regulations. Under the prompt corrective action regulations, the OCC is required and authorized to take supervisory actions against undercapitalized savings banks. For this purpose, a savings bank is placed in one of the following five categories based on the savings bank's capital:

- well-capitalized (at least 5% leverage capital, 6% Tier 1 risk-based capital and 10% total risk-based capital);
- adequately capitalized (at least 4% leverage capital (3% for savings banks with a composite examination rating of 1), 4% Tier 1 risk-based capital and 8% total risk-based capital);
- undercapitalized (less than 4% leverage capital (3% for savings banks with a composite examination rating of 1), 4% Tier 1 risk-based capital or 8% total risk-based capital);
- significantly undercapitalized (less than 6% total risk-based capital, 3% Tier 1 risk-based capital or 3% leverage capital); or
- critically undercapitalized (less than 2% tangible capital).

Generally, the OCC is required to appoint a receiver or conservator for a savings bank that is "critically undercapitalized" within specific time frames. The regulations also provide that a capital restoration plan must be filed with the OCC within 45 days of the date a savings bank receives notice that it is "undercapitalized," "significantly undercapitalized" or "critically undercapitalized." The criteria for an acceptable capital restoration plan include, among other things, the establishment of the methodology and assumptions for attaining adequately capitalized status on an annual basis, procedures for ensuring compliance with restrictions imposed by applicable federal regulations, the identification of the types and levels of activities the savings bank will engage in while the capital restoration plan is in effect, and assurances that the capital restoration plan will not appreciably increase the current risk profile of the savings bank. Any holding company for the savings bank required to submit a capital restoration plan must guarantee the lesser of: an amount equal to 5% of a savings bank's assets at the time it was notified or deemed to be undercapitalized by the OCC, or the amount necessary to restore the savings bank to adequately capitalized status. This guarantee remains in place until the OCC notifies the savings bank that it has maintained adequately capitalized status for each of four consecutive calendar quarters, and the OCC has the authority to require payment and collect payment under the guarantee. Failure by a holding company to provide the required guarantee will result in certain operating restrictions on the savings bank, such as restrictions on the ability to declare and pay dividends, pay executive compensation and management fees, and increase assets or expand operations. The OCC may also take any one of a number of discretionary supervisory actions against undercapitalized savings banks, including the issuance of a capital directive and the replacement of senior executive officers and directors.

As a result of entering into the Order to achieve and maintain specific capital levels, the Bank's capital classification under the PCA rules as of December 31, 2013, was well-capitalized.

Insurance of Deposit Accounts. Atlantic Coast Bank is a member of the Deposit Insurance Fund, which is administered by the FDIC. Deposit accounts in Atlantic Coast Bank are insured by the FDIC. The Dodd-Frank Act increased the general individual deposit insurance available on deposit accounts from $100,000 to $250,000.

The FDIC imposes an assessment for deposit insurance on all depository institutions. Under the FDIC's risk-based assessment system, insured institutions are assigned to risk categories based on supervisory evaluations, regulatory capital levels and certain other factors. An institution's assessment rate depends upon the category to which it is assigned and certain adjustments specified by FDIC regulations, with institutions deemed less risky paying lower rates. Assessment rates (inclusive of possible adjustments) currently range from 2 ½ to 45 basis points of each institution's total assets less tangible capital. The FDIC may increase or decrease the scale uniformly, except that no adjustment can deviate more than two basis points from the base scale without notice and comment rulemaking.

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In 2009, the FDIC, in response to pressures on the Deposit Insurance Fund caused by bank and savings association failures, required all insured depository institutions to prepay their estimated assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012. The estimated assessments were based on assumptions established by the FDIC, including an assumed 5% annual growth rate and certain assumed assessment rate increases. That pre-payment, which was due on December 30, 2009 and amounted to $6.4 million for Atlantic Coast Bank, was recorded as a prepaid expense at December 31, 2009 and is being amortized to expense over three years. Any unused prepaid assessments would be returned to the institution in June 2013.

The Dodd-Frank Act increased the minimum target Deposit Insurance Fund ratio from 1.15% of estimated insured deposits to 1.35% of estimated insured deposits. The FDIC must seek to achieve the 1.35% ratio by September 30, 2020. Insured institutions with assets of $10 billion or more are supposed to fund the increase. The Dodd-Frank Act eliminated the 1.5% maximum fund ratio, instead leaving it to the discretion of the FDIC and the FDIC has exercised that discretion by establishing a long term fund ratio of 2%.

The FDIC has authority to increase insurance assessments. Any significant increases would have an adverse effect on the operating expenses and results of operations of Atlantic Coast Bank. Management cannot predict what assessment rates will be in the future.

Insurance of deposits may be terminated by the FDIC upon a finding that an institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. We do not currently know of any practice, condition or violation that may lead to termination of our deposit insurance.

In addition to the FDIC assessments, the Financing Corporation (FICO) is authorized to impose and collect, with the approval of the FDIC, assessments for anticipated payments, issuance costs and custodial fees on bonds issued by the FICO in the 1980s to recapitalize the former Federal Savings and Loan Insurance Corporation. The bonds issued by the FICO are due to mature in 2017 through 2019. For the quarter ended December 31, 2012, the annualized FICO assessment was equal to 64 basis points for each $100 in domestic deposits maintained at an institution.

Prohibitions Against Tying Arrangements. Federal savings banks are prohibited, subject to some exceptions, from extending credit to or offering any other service, or fixing or varying the consideration for such extension of credit or service, on the condition that the customer obtain some additional service from the institution or its affiliates or not obtain services of a competitor of the institution.

Federal Home Loan Bank System. Atlantic Coast Bank is a member of the Federal Home Loan Bank System, which consists of 12 regional Federal Home Loan Banks. The Federal Home Loan Bank System provides a central credit facility primarily for member institutions as well as other entities involved in home mortgage lending. As a member of the Federal Home Loan Bank of Atlanta, Atlantic Coast Bank is required to acquire and hold shares of capital stock in the Federal Home Loan Bank. As of December 31, 2013, Atlantic Coast Bank was in compliance with this requirement.

Federal Reserve System

Federal Reserve Board regulations require savings banks to maintain non-interest-earning reserves against their transaction accounts, such as negotiable order of withdrawal and regular checking accounts. At December 31, 2013, Atlantic Coast Bank was in compliance with these reserve requirements.

Other Regulations

Interest and other charges collected or contracted for by Atlantic Coast Bank are subject to state usury laws and federal laws concerning interest rates. Atlantic Coast Bank's operations are also subject to federal laws applicable to credit transactions, such as the:

- Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- Home Mortgage Disclosure Act, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- Fair Credit Reporting Act, governing the use and provision of information to credit reporting agencies;
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies;
- Truth in Savings Act; and
- Rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

The operations of Atlantic Coast Bank also are subject to the:

- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- Electronic Funds Transfer Act and Regulation E promulgated thereunder, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services;
- Check Clearing for the 21st Century Act (also known as "Check 21"), which gives "substitute checks," such as digital check images and copies made from that image, the same legal standing as the original paper check;
- The USA PATRIOT Act, which requires savings banks to, among other things, establish broadened anti-money laundering compliance programs, and due diligence policies and controls to ensure the detection and reporting of money laundering. Such required compliance programs are intended to supplement existing compliance requirements that also apply to financial institutions under Atlantic Coast Bank Secrecy Act and the Office of Foreign Assets Control regulations; and

The Gramm-Leach-Bliley Act, which places limitations on the sharing of consumer financial information by financial institutions with unaffiliated third parties. Specifically, the Gramm-Leach-Bliley Act requires all financial institutions offering financial products or services to retail customers to provide such customers with the financial institution's privacy policy and provide such customers the opportunity to "opt out" of the sharing of certain personal financial information with unaffiliated third parties.

Holding Company Regulation

General. Atlantic Coast Financial Corporation is a unitary savings and loan holding company, subject to regulation and supervision by the Federal Reserve Board. The Federal Reserve Board has enforcement authority over Atlantic Coast Financial Corporation and its non-savings institution subsidiaries. Among other things, this authority permits the Federal Reserve Board to restrict or prohibit activities that are determined to be a risk to Atlantic Coast Bank.

Atlantic Coast Financial Corporation's activities are limited to those activities permissible for financial holding companies (if elected) or for multiple savings and loan holding companies. A financial holding company may engage in activities that are financial in nature, including underwriting equity securities and insurance, incidental to financial activities or complementary to a financial activity. A savings and loan holding company must elect such status in order to engage in activities permissible for a financial holding company, must meet the qualitative requirements for a bank holding company to qualify as a financial holding company and conduct the activities in accordance with the requirements that would apply to a financial holding company's conduct of the activity. A multiple savings and loan holding company is generally limited to activities permissible for bank holding companies under Section 4(c)(8) of Atlantic Coast Bank Holding Company Act, subject to the prior approval of the Federal Reserve Board, and certain additional activities authorized by Federal Reserve Board regulations.

Federal law prohibits a savings and loan holding company, directly or indirectly, or through one or more subsidiaries, from acquiring control of another savings institution or holding company thereof, without prior written approval of the Federal Reserve Board. It also prohibits the acquisition or retention of, with specified exceptions, more than 5% of the equity securities of a company engaged in activities that are not closely related to banking or financial in nature or acquiring or retaining control of an institution that is not federally insured. In evaluating applications by holding companies to acquire savings institutions, the Federal Reserve Board must consider the financial and managerial resources and future prospects of the savings institution involved, the effect of the acquisition on the risk to the insurance fund, and the convenience and needs of the community and competitive factors.

Capital. Savings and loan holding companies are not currently subject to specific regulatory capital requirements. The Dodd-Frank Act, however, required the Federal Reserve Board to promulgate consolidated capital requirements for depository institution holding companies that are no less stringent, both quantitatively and in terms of components of capital, than those applicable to institutions themselves. Instruments such as cumulative preferred stock and trust preferred securities will no longer be includable as Tier 1 capital as is currently the case with bank holding companies. Instruments issued by May 19, 2010 will be grandfathered for companies with consolidated assets of $15 billion or less. There is a five-year transition period (from the July 21, 2010 effective date of the Dodd-Frank Act) before the capital requirements will apply to savings and loan holding companies. The Company had no cumulative preferred stock or trust preferred securities outstanding as of December 31, 2013 and 2012.

Source of Strength. The Dodd-Frank Act also extended the "source of strength" doctrine to savings and loan holding companies. The regulatory agencies must issue regulations requiring that all bank and savings and loan holding companies serve as a source of strength to their subsidiary depository institutions by providing capital, liquidity and other support in times of financial stress. Federal Reserve Board policies also provide that holding companies should pay dividends only out of current earnings and only if the prospective rate of earnings retention by the holding company appears consistent with the organization's capital needs, asset quality and overall financial condition.

Dividends. Atlantic Coast Bank must notify the OCC thirty (30) days before declaring any dividend to the Company. The financial impact of a holding company on its subsidiary institution is a matter that is evaluated by the OCC and the agency has authority to order cessation of activities or divestiture of subsidiaries deemed to pose a threat to the safety and soundness of the institution.

Federal Securities Laws

Atlantic Coast Financial Corporation common stock is registered with the Securities and Exchange Commission. Atlantic Coast Financial Corporation is subject to the information, proxy solicitation, insider trading restrictions and other requirements under the Securities Exchange Act of 1934.

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The registration under the Securities Act of 1933 of shares of common stock issued in Atlantic Coast Financial Corporation's public offering does not cover the resale of those shares. Shares of common stock purchased by persons who are not affiliates of Atlantic Coast Financial Corporation may be resold without registration. Shares purchased by an affiliate of Atlantic Coast Financial Corporation are subject to the resale restrictions of Rule 144 under the Securities Act of 1933. If Atlantic Coast Financial Corporation meets the current public information requirements of Rule 144 under the Securities Act of 1933, each affiliate of Atlantic Coast Financial Corporation that complies with the other conditions of Rule 144, including those that require the affiliate's sale to be aggregated with those of other persons, would be able to sell in the public market, without registration, a number of shares not to exceed, in any three-month period, the greater of 1% of the outstanding shares of Atlantic Coast Financial Corporation, or the average weekly volume of trading in the shares during the preceding four calendar weeks. In the future, Atlantic Coast Financial Corporation may permit affiliates to have their shares registered for sale under the Securities Act of 1933.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 addresses, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. As directed by the Sarbanes-Oxley Act, the Company's Chief Executive Officer and Chief Financial Officer will be required to certify that the Company's quarterly and annual reports do not contain any untrue statement of a material fact. The rules adopted by the Securities and Exchange Commission under the Sarbanes-Oxley Act have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of internal control over financial reporting; they have made certain disclosures to the Company's auditors and the audit committee of the Board of Directors about internal control over financial reporting; and they have included information in the Company's quarterly and annual reports about their evaluation and whether there have been changes in internal control over financial reporting or in other factors that could materially affect internal control over financial reporting. The Company has existing policies, procedures and systems designed to comply with these regulations, and it is further enhancing and documenting such policies, procedures and systems to ensure continued compliance with these regulations.

Change in Control Regulations

Under the Change in Bank Control Act, no person may acquire control of a savings and loan holding company such as the Company unless the Federal Reserve Board has been given 60 days' prior written notice and has not issued a notice disapproving the proposed acquisition, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the competitive effects of the acquisition. Control, as defined under federal law, means ownership, control of or holding irrevocable proxies representing more than 25% of any class of voting stock, control in any manner of the election of a majority of the institution's directors, or a determination by the regulator that the acquirer has the power, directly or indirectly, to exercise a controlling influence over the management or policies of the institution. Acquisition of more than 10% of any class of a savings and loan holding company's voting stock constitutes a rebuttable determination of control under the regulations under certain circumstances including where, as will be the case with the Company, the issuer has registered securities under Section 12 of the Securities Exchange Act of 1934.

In addition, federal regulations provide that no company may acquire control of a savings and loan holding company without the prior approval of the Federal Reserve Board. Any company that acquires such control becomes a "savings and loan holding company" subject to registration, examination and regulation by the Federal Reserve Board.

Federal Taxation

General

Atlantic Coast Bank and Atlantic Coast Financial Corporation are subject to federal income taxation in the same general manner as other corporations, with some exceptions discussed below. The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to Atlantic Coast Financial Corporation or Atlantic Coast Bank.

Method of Accounting

For federal income tax purposes, Atlantic Coast Financial Corporation currently reports its income and expenses on the accrual method of accounting and uses a tax year ending December 31 for filing its federal and state income tax returns.

Alternative Minimum Tax

The Internal Revenue Code of 1986, as amended, imposes an alternative minimum tax (AMT) at a rate of 20% on a base of regular taxable income plus certain tax preferences (alternative minimum taxable income or AMTI). The AMT is payable to the extent such AMTI is in excess of an exemption amount and the AMT exceeds the regular income tax. Net operating losses generally can offset no more than 90% of AMTI. Certain payments of AMT may be used as credits against regular tax liabilities in future years. Atlantic Coast Financial Corporation and Atlantic Coast Bank have been subject to the AMT and have $0.5 million available as credits for carryover.

Net Operating Loss Carryovers

Generally, a financial institution may carry back net operating losses to the preceding two taxable years and forward to the succeeding 20 taxable years. However, as a result of recent legislation, subject to certain limitations, the carryback period for net operating losses incurred in 2008 or 2009 (but not both years) has been expanded to five years. At December 31, 2013, Atlantic Coast Financial Corporation and Atlantic Coast Bank have $20.9 million in net operating loss carryovers for federal income tax purposes which begin to expire in 2019. The utilization of these net operating loss carryovers will be restricted due to IRS limitations. See Note 14 in *Item 8. Financial Statements and Supplementary Data (Notes to Financial Statements)* contained in this report for additional information.

Internal Revenue Code § 382

Under the rules of Internal Revenue Code § 382 (IRC § 382), a change in the ownership of a company limits the gross amount of net operating loss carryover a company can use per year (annual limitation). After a change in ownership occurs, recognition of certain losses during years one to five will have an adverse effect on the utilization of the annual limitation on net operating losses. Those recognized losses will be applied to the annual limitation before the net operating losses are applied.

Corporate Dividends-Received Deduction

Atlantic Coast Financial Corporation may exclude from its federal taxable income 100% of dividends received from Atlantic Coast Bank as a wholly owned subsidiary.

State Taxation

Net Operating Loss Carryovers

A corporation may carry back Georgia net operating losses to the preceding two taxable years and forward to the succeeding 20 taxable years; however, net operating losses in Florida may only be carried forward for 20 taxable years. Through December 31, 2013, Atlantic Coast Financial Corporation and Atlantic Coast Bank had a Florida and Georgia net operating loss carryover of $7.1 million, which begins to expire in 2018. The utilization of these net operating loss carryovers will be restricted due to IRS limitations. See Note 14 in *Item 8. Financial Statements and Supplementary Data (Notes to Financial Statements)* contained in this report for additional information.

Income Taxation

Atlantic Coast Financial Corporation and Atlantic Coast Bank are subject to Georgia corporate income tax which is assessed at the rate of 6%. Atlantic Coast Financial Corporation and Atlantic Coast Bank are subject to Florida corporate income tax which is assessed at the rate of 5.5%. For both states, taxable income generally means federal taxable income subject to certain modifications provided for in the applicable state statutes.

Atlantic Coast Financial Corporation and Atlantic Coast Bank are not currently under audit with respect to their state income tax returns and their state income tax returns have not been audited for the past five years. As a Maryland business corporation, Atlantic Coast Financial Corporation is required to file annual returns and pay annual fees to the State of Maryland.

Available Information

The Company makes available financial information, news releases and other information on the Company's Web site at www.atlanticcoastbank.net. There is a link to obtain all filings made by the Company with the Securities and Exchange Commission including the Company's annual reports on Form 10-K, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities and Exchange Act of 1934. The reports or amendments are available free of charge as soon as reasonably practicable after the Company files such reports and amendments with, or furnishes them to, the Securities and Exchange Commission. Stockholders of record may also contact the Company's Chief Financial Officer, 10151 Deerwood Park Boulevard, Building 200, Suite 100, Jacksonville, Florida, 32256 or call (904) 998-5501 to obtain a copy of these reports without charge.

ITEM 1A. RISK FACTORS

Our business, and an investment in our common stock, involves risks. Summarized below are the risk factors which management believes are material to our business and could negatively affect operating results, financial condition and the trading value of our common stock. Other risks factors not currently known to management, or risk factors that are currently deemed to be immaterial or unlikely, also could adversely affect the business. In assessing the following risk factors, the reader should also refer to the other information contained in this Annual Report on Form 10-K and the Company's other filings with the Securities and Exchange Commission.

Risks Relating to Our Business and Operations

If our non-performing assets increase, our earnings may be reduced.

At December 31, 2013, our non-performing assets totaled $8.6 million, or 1.17% of total assets. Our non-performing assets may increase in future periods. Our non-performing assets adversely affect our net income in various ways. We do not record interest income on non-performing loans or real estate owned. We must establish the allowance for losses inherent in the loan portfolio that are both probable and reasonably estimable through the current period provision expenses, which are recorded as a charge to income. From time to time, we also write down the value of properties in our OREO portfolio to reflect changing market values. Additionally, there are substantial collections costs such as legal fees associated with the resolution of problem assets as well as carrying costs such as taxes, insurance and maintenance related to OREO. Further, the resolution of non-performing assets requires the active involvement of management, which can distract them from our overall supervision of operations and other income-producing activities.

Atlantic Coast Bank has entered into the Order with the OCC, which requires Atlantic Coast Bank to develop strategic and capital plans to achieve and maintain specific capital levels, to implement liquidity and concentration risk management programs, to revise its problem asset reduction plan and to develop policies and procedures to prevent future violations of law or regulation. The Order will limit business activities that Atlantic Coast Bank might otherwise engage in. While subject to the Order, Atlantic Coast Bank's management and Board of Directors will be required to focus a substantial amount of time on complying with its terms, which could adversely affect our financial performance. Non-compliance with the Order may lead to additional corrective actions by the OCC which could negatively impact our operations and financial performance.

Effective August 10, 2012, Atlantic Coast Bank entered into the Order with the OCC, which replaces the Supervisory Agreement, a similar agreement entered into with the OTS on December 10, 2010. The Order provides, among other things, that:

- the Order replaces and therefore terminates the Supervisory Agreement entered into between the Bank and the OTS on December 10, 2010;
- within 10 days of the date of the Order, the Board of Directors had to establish a compliance committee that will be responsible for monitoring and coordinating Atlantic Coast Bank's adherence to the provisions of the Order;
- within 90 days of the date of the Order, the Board of Directors had to develop and submit to the OCC for receipt of supervisory non-objection of at least a two-year strategic plan to achieve objectives for Atlantic Coast Bank's risk profile, earnings performance, growth, balance sheet mix, off-balance sheet activities, liability structure, capital and liquidity adequacy and updating such plan each year by January 31 beginning on January 31, 2014;
- until such time as the OCC provides written supervisory non-objection of Atlantic Coast Bank's strategic plan, Atlantic Coast Bank will not significantly deviate from products, services, asset composition and size, funding sources, structures, operations, policies, procedures and markets of Atlantic Coast Bank that existed prior to the Order without receipt of prior non-objection from the OCC;
- by December 31, 2012, Atlantic Coast Bank needed to achieve and maintain a total risk based capital ratio of 13.00% of risk weighted assets and Tier 1 capital ratio of 9.00% of adjusted total assets;
- within 60 days of the date of the Order, the Board of Directors needed to develop and implement an effective internal capital planning process to assess Atlantic Coast Bank's capital adequacy in relation to its overall risks and to ensure maintenance of appropriate capital levels, which should be no less than total risk based capital ratio of 13.00% of risk weighted assets and Tier 1 capital ratio of 9.00% of adjusted total assets;
- Atlantic Coast Bank may not accept, renew or roll over any brokered deposit unless it has applied for and been granted a waiver of this prohibition by the FDIC;
- within 90 days of the date of the Order, the Board of Directors had to forward to the OCC for receipt of written supervisory non-objection a written capital plan for Atlantic Coast Bank covering at least a two year period that achieves and maintains total risk based capital ratio of 13.00% of risk weighted assets and Tier 1 capital of 9.00% ratio of adjusted total assets in addition to certain other requirements;
- Atlantic Coast Bank may declare or pay a dividend or make a capital distribution only when it is in compliance with its approved capital plan and would remain in compliance with its approved capital plan after payment of such dividends or capital distribution and receives prior written approval of the OCC;
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following receipt of written no supervisory objection of its capital plan, the Board of Directors will monitor Atlantic Coast Bank’s performance against the capital plan and shall review and update the plan annually no later than January 31 of each year, beginning with January 31, 2014;

- if Atlantic Coast Bank fails to achieve and maintain the required capital ratios by December 31, 2012, fails to submit a capital plan within 90 days of the date of the Order or fails to implement a written capital plan for which the OCC has provided a written determination of no supervisory objection, then, at the sole discretion of the OCC, Atlantic Coast Bank may be deemed undercapitalized for purposes of the Order;

- within 30 days of the date of the Order, the Board of Directors had to revise and maintain a comprehensive liquidity risk management program which assesses on an ongoing basis, Atlantic Coast Bank's current and projected funding needs, and that ensures that sufficient funds or access to funds exist to meet those needs;

- within 60 days of the date of the Order, the Board of Directors had to revise its problem asset reduction plan (PARP), the design of which will be to eliminate the basis of criticism of those assets criticized as "doubtful," "substandard" or "special mention" during the OCC's most recent report of examination as well as any subsequent examination or review by the OCC and any other internal or external loan reviews;

- within 60 days of the date of the Order, the Board of Directors had to revise its written concentration management program for identifying, monitoring, and controlling risks associated with asset and liability concentrations, including off-balance sheet concentrations;

- Atlantic Coast Bank's concentration management program will include a contingency plan to reduce or mitigate concentrations deemed imprudent for Atlantic Coast Bank's earnings, capital, or in the event of adverse market conditions, including strategies to reduce the current concentrations to Board of Directors established limits and a restriction on purchasing bank owned life insurance (BOLI) until such time as the BOLI exposure has been reduced below regulatory guidelines of 25.00% of total capital; and

- the Board of Directors was to immediately take all necessary steps to ensure that Atlantic Coast Bank's management corrects each violation of law, rule or regulation cited in the OCC's most recent report of examination and within 60 days of the date of the Order, the Board of Directors had to adopt, implement, and thereafter ensure Bank adherence to specific procedures to prevent future violations and Atlantic Coast Bank's adherence to general procedures addressing compliance management of internal controls and employee education regarding laws, rules and regulations.

While subject to the Order, Atlantic Coast Bank's management and Board of Directors have been required, and will continue to be required, to focus a substantial amount of time on complying with its terms, which could adversely affect our financial performance. While Atlantic Coast Bank was in compliance with the requirements under the Order at December 31, 2013, Atlantic Coast Bank's Capital and Strategic Plan has not received supervisory non-objection and, therefore, Atlantic Coast Bank may not significantly deviate from the products, services, asset composition and size, funding sources, structures, operations, policies, procedures and markets of Atlantic Coast Bank that existed prior to the Consent Order without receipt of prior non-objection from the OCC.

Atlantic Coast Bank's capital classification as of December 31, 2013, was well-capitalized.

We are subject to a Supervisory Agreement with the FRB that limits our ability to pay dividends or make other capital distributions, to compensate senior management, and to incur additional debt.

We are subject to a Supervisory Agreement with the FRB that assumed the restrictions that relate to the Company contained in the Supervisory Agreement that we entered into with the OTS on December 10, 2010. The Supervisory Agreement provides, among other things, that:

- we must comply with regulatory prior notification requirements with respect to changes in directors and senior executive officers;

- we cannot declare or pay dividends or make any other capital distributions without prior written approval from the FRB;

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- we will not be permitted to enter into, renew, extend or revise any contractual arrangement relating to compensation or benefits for any senior executive officers or directors, unless we provide 30 days prior written notice of the proposed transaction to the FRB;

- we may not make any golden parachute payment or prohibited indemnification payment without prior written approval from the FRB; and

- we may not incur, issue, renew or roll over any debt or debt securities, increase any current lines of credit, guarantee the debt of any entity, or otherwise incur any additional debt without the prior written non-objection of the FRB.

The Supervisory Agreement may have the effect of restricting or delaying our business, adding costs or negatively impacting our operations and financial performance.

Atlantic Coast Bank's borrowings from reverse repurchase agreements and FHLB advances materially impacts Atlantic Coast Bank's net interest margin and exposes Atlantic Coast Bank's capital and results of operations to significant risk.

As of December 31, 2013, Atlantic Coast Bank had $92.8 million of reverse repurchase agreements comprised of structured notes with two different counterparties in amounts totaling $77.8 million and $15.0 million, respectively. The individual agreements take the form of term repurchase agreements with maturities beginning in 2014 and final maturities in 2018 ($26.5 million of which matured during January and February 2014). The interest rate terms are generally variable based on an index with an associated cap, such as 9.50% minus 3 month LIBOR, with a cap of 5.50%. The counterparties to the reverse repurchase agreements have an option to lock in interest rates at a fixed rate each quarter. Due to the low LIBOR interest rate environment that has existed over the last two years, each of the counterparties has exercised their options to fix the rate at ceiling maximums. The weighted average coupon interest rate of the reverse repos as of December 31, 2013 was 5.10%, and the weighted average maturity was 30 months.

Atlantic Coast Bank has $110.0 million of FHLB advances, with fixed interest rate terms. The weighted average rate of the FHLB advances as of December 31, 2013 was 4.11%, and the weighted average maturity was 39 months.

Due to the unusually low long term interest rate environment being promoted by the Federal Reserve, yields on the investment securities collateralizing the reverse repos and the yields on the loans collateralizing the FHLB advances have been decreasing. At December 31, 2013 the weighted average coupon on the securities collateralizing the reverse repurchase agreements, was approximately 2.68%, and the weighted average coupon on the loans and securities collateralizing the FHLB borrowings was approximately 5.52% and 2.66%, respectively. Given the announced intentions of the FRB to hold interest rates at their current levels until certain economic measures are reached, the reverse repurchase agreements and the FHLB advances are expected to have a negative impact to our net interest margin and represent a barrier to returning to profitability. Atlantic Coast Bank has the option to terminate the reverse repurchase agreements at the market rate of the debt, which as of December 31, 2013 exceeded the principal balance outstanding by $9.1 million. Additionally, Atlantic Coast Bank has the option to prepay the FHLB advances prior to maturity at fair value, which as of December 31, 2013 exceeded the book value of the advances by $10.5 million.

Based on reductions by the FHLB in the assessed value of loan collateral pledged for Atlantic Coast Bank's FHLB debt and increased prepayment speed of residential loans a shortfall in loan collateral now exists. To the extent new loan collateral is not available, Atlantic Coast Bank will have to acquire and pledge investment securities in order to meet collateral requirements which may reduce earnings and total available liquidity.

Due to Atlantic Coast Bank's credit rating with the FHLB, the assessed value of loan collateral was decreased during 2012. In addition the largest loan category pledged as collateral for the FHLB debt, one- to four-family residential mortgages has experienced faster prepayments due to the low mortgage interest rate environment. Beginning in March

2013 the FHLB assessed value of pledged loan balances fell below the outstanding loan balance resulting in a collateral short fall. Since that time, in order to meet collateral requirements, Atlantic Coast Bank has pledged collateral eligible securities to the FHLB of $31.2 million. To the extent that an additional collateral shortfall occurs, Atlantic Coast Bank will have to pledge either additional collateral eligible securities or cash. Due to current low yields available on such securities as compared to yields available on higher interest-earning assets such as loans it is likely interest income will be less and earnings will be negatively impacted. Further, pledging investment securities or cash that otherwise could be available for liquidity needs may impact Atlantic Coast Bank's ability to meet loan growth or other liquidity needs and result in further restrictions by the OCC.

Reduced borrowing capacity with the FHLB and the FRB could impact Atlantic Coast Bank's ability to meet liquidity demands and will require increased investment of readily marketable assets, such as mortgage backed securities in order to maintain a sufficient secondary source of liquidity which may reduce earnings.

During 2012, Atlantic Coast Bank's borrowing capacity with the FHLB was reduced following an FHLB credit and collateral review and a reduction in Atlantic Coast Bank's credit rating. Atlantic Coast Bank's additional borrowing capacity was $5.0 million at December 31, 2013.

During 2012, Atlantic Coast Bank was notified by the FRB that it is no longer eligible to borrow under the Primary Lending program and that it no longer has daylight overdraft capacity available. The FRB informed Atlantic Coast Bank that it may be eligible to participate in the FRB's Secondary Lending program when other sources of liquidity are unavailable. Atlantic Coast Bank currently does not utilize services of the FRB that would necessitate use of daylight overdrafts; therefore, this change is not expected to have a material impact on banking operations. Prior to the notice from the FRB, Atlantic Coast Bank utilized the FRB Primary Lending in its contingent liquidity but had not borrowed under the program for liquidity or other business purposes. In order to maintain sufficient sources of available liquidity Atlantic Coast Bank intends to increase its holdings of readily marketable investment securities such as agency backed mortgage backed securities or increase the balances maintained in cash or cash equivalents. Presently, due to the unusually low interest rate environment such investment will result in lower earnings than available from loans or interest earning assets and will likely result in reduced earnings. Further Atlantic Coast Bank may be unable to meet liquidity needs for loan growth demands or unusual levels of deposit withdrawals.

We have experienced net losses for each of the last six fiscal years, and may not return to profitability in the near future.

We have experienced cumulative net losses of $74.7 million since 2008, which includes net losses in 2013, 2012 and 2011 of $11.4 million, $6.7 million and $10.3 million, respectively. The losses have been primarily caused by a significant increase in non-performing assets, which necessitated a provision expense of $7.0 million, $12.5 million $15.4 million for the years ended December 31, 2013, 2012 and 2011, respectively. We charged-off $11.0 million, $17.1 million and $13.2 million of loans during the years ended December 31 2013, 2012 and 2011, respectively. Non-performing loans (generally loans 90 days or more past due in principal or interest payments) decreased to $3.4 million, or 0.89% of total loans, at December 31, 2013 from $24.9 million, or 5.76% of total loans, at December 31, 2012. We did not recognize other than temporary impairment (OTTI) losses on our investment portfolio for the years ended December 31, 2013 and 2012. However, we experienced OTTI losses in our investment portfolio of $0.2 million for the year ended December 31, 2011. As a result of these factors and other conditions such as interest expense related to our long-term debt and weakness in our local economy, we may not be able to generate sustainable net income or achieve profitability in the near future.

We may be unable to successfully implement our business strategy and as a result, our financial condition and results of operations may be negatively affected.

Our future success will depend upon management's ability to successfully implement its business strategy, which includes managing non-performing assets and operating expenses, reentering the mortgage banking market, and continuing to grow our warehouse lending and small business lending businesses, as well as our banking services to small businesses. While we believe we have the management resources and internal systems in place to successfully implement our strategy, it will take time to fully implement our strategy. Further, until such time as Atlantic Coast Bank is able to obtain supervisory non-objection to its strategic plan from the OCC, we may not significantly deviate from our products, services, asset composition and size, funding sources or other business activities without receiving prior non-objection from the OCC. We expect that it may take a significant period of time before we can achieve the intended results of our business strategy. During the period we are implementing our plan our results of operations may be negatively impacted. In addition, even if our strategy is successfully implemented, it may not produce positive results.

Additionally, future success in the expansion of the mortgage banking, warehouse and small business lending platforms will depend on management's ability to attract and retain highly skilled and motivated loan originators. Atlantic Coast Bank competes against many institutions with greater financial resources to attract these qualified individuals. Failure to recruit and retain adequate talent could reduce our ability to compete successfully and adversely affect our business and profitability.

A significant portion of our loan portfolio is secured by real estate, and events that negatively impact the real estate market hurt our business.

As of December 31, 2013, approximately 80.3% of our loans had real estate as a primary or secondary component of collateral. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. A continued weakening of the real estate market in our primary market area has resulted in an increase in the number of borrowers who have defaulted on their loans and a reduction in the value of the collateral securing their loans, which in turn has adversely affected our profitability and asset quality. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, our earnings and capital could be adversely affected. Acts of nature, including hurricanes, tornados, earthquakes, fires and floods, which may cause uninsured damage and other loss of value to real estate that secures these loans, may also negatively impact our financial condition.

New mortgage lending rules may constrain Atlantic Coast Bank's residential mortgage lending business.

Over the course of 2013, the Consumer Financial Protection Bureau has issued several rules on mortgage lending, notably a rule requiring all home mortgage lenders to determine a borrower's ability to repay the loan. Loans with certain terms and conditions and that otherwise meet the definition of a "qualified mortgage" may be protected from liability. In either case, Atlantic Coast Bank may find it necessary to tighten its mortgage loan underwriting standards, which may constrain our ability to make loans consistent with our business strategies.

The geographic concentration in loans secured by one- to four-family residential real estate may increase credit losses, which could increase the level of provision expense.

As of December 31, 2013, approximately 59% of our total loan portfolio was secured by first or second liens on one- to four-family residential property, primarily in southeastern Georgia and northeastern Florida. Approximately $133.4 million, or 35.9%, of our loan portfolio was secured by one- to four-family residential property in Florida and $63.9 million, or 17.2%, of such properties in Georgia. The downturn in the local and national economy beginning in 2008, and continuing through December 2013, particularly affecting real estate values and employment, have adversely affected our loan customers' ability to repay their loans. In the event we are required to foreclose on a property securing a mortgage loan or pursue other remedies in order to protect our investment, we may not be able to recover funds in an amount equal to any remaining loan balance as a result of prevailing economic conditions, real estate values and other factors associated with the ownership of real property. In particular, the state of Florida follows a judicial foreclosure process that often takes up to two years to complete, thereby potentially increasing our risk of loss due to the property's deterioration in value during this period. As a result, the market value of the real estate or other collateral underlying the loans may not, at any given time, be sufficient to satisfy the outstanding principal amount of the loans. Consequently, we would sustain loan losses and potentially incur a higher provision expense.

Our loan portfolio possesses increased risk due to our number of commercial real estate, commercial business, construction and multi-family loans and consumer loans, which could increase the level of provision expense.

Our outstanding commercial real estate, commercial business, construction, multi-family, manufactured home, automobile and other consumer loans accounted for approximately 41% of our total loan portfolio as of December 31, 2013. Generally, management considers these types of loans to involve a higher degree of risk compared to first mortgage loans on one- to four-family, owner occupied residential properties. Historically, these loans have had higher risks than loans secured by residential real estate for the following reasons:

- *Commercial Real Estate and Commercial Business Loans*. Repayment is dependent on income being generated by the rental property or business in amounts sufficient to cover operating expenses and debt service. This risk has been exacerbated by the economic downturn in commercial real estate and commercial land values, particularly in our markets;

- *Multi-Family Real Estate Loans*. Repayment is dependent on income being generated by the rental property in amounts sufficient to cover operating expenses and debt service;

- *Single Family Construction Loans*. Repayment is dependent upon the successful completion of the project and the ability of the contractor or builder to repay the loan from the sale of the property or obtaining permanent financing;

- *Commercial and Multi-Family Construction Loans*. Repayment is dependent upon the completion of the project and income being generated by the rental property or business in amounts sufficient to cover operating expenses and debt service; and

- *Consumer Loans*. Consumer loans (such as automobile and manufactured home loans) are collateralized, if at all, with assets that may not provide an adequate source of repayment of the loan due to depreciation, damage or loss.

If these non-residential loans become non-performing, we may have to increase our provision expense which would negatively affect our results of operations.

Our loan portfolio possesses increased risk due to portfolio lending during a period of rising real estate values, high sales volume activity and historically low interest rate environment.

Much of our portfolio lending is in one- to four-family residential properties generally located throughout southeastern Georgia and northeastern Florida. As a result of lending during a period of rising real estate values and historically low interest rates, based on the Company's most recent analysis, approximately 27% of the residential loan portfolio collateral is deficient due to the significant decline in real estate values since origination.

High loan-to-value ratios on a portion of our residential mortgage loan portfolio expose us to greater risk of loss.

Many of our residential mortgage loans are secured by liens on mortgage properties, and due to the decline in real estate values since 2007, we believe many of our borrowers may have reduced equity, with loan-to-value ratios having depreciated on average to 79% from an average of 71% at the date the loan was originated. The pressure on home values remains high due to uncertainty of the economic recovery and the impact of distressed asset sales. Residential loans with high loan-to-value ratios will be more sensitive to declining property values than those with lower combined loan-to-value ratios and, therefore, may experience a higher incidence of default and severity of losses. In addition, if the borrowers sell their homes, such borrowers may be unable to repay their loans in full from the sale. As a result, these loans may experience higher rates of delinquencies, defaults and losses.

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Repayment risk associated with our adjustable rate loans may increase as interest rates rise.

Given the historically low interest rate environment in recent years, our adjustable rate loans have not been subject to an interest rate environment that causes them to adjust to the maximum level. As interest rates rise, such loans may involve repayment risks resulting from potentially increasing payment obligations by borrowers due to re-pricing. At December 31, 2013, there were $154.7 million in adjustable rate loans, which made up approximately 40.8% of the loan portfolio.

If the allowance is not sufficient to cover actual losses, income and capital will be negatively affected.

Our allowance was $6.9 million, or 1.8% of total loans, at December 31, 2013. In the event loan customers do not repay their loans according to their terms and the collateral security for the payments of these loans is insufficient to pay any remaining loan balance, we may experience significant loan losses. Such credit risk is inherent in the lending business, and failure to adequately assess such credit risk could have a material adverse effect on our financial condition and results of operations. Management makes various assumptions and judgments about the collectability of the loan portfolio, including the creditworthiness of the borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of the loans. In determining the amount of the allowance, management reviews the loan portfolio and our historical loss and delinquency experience, as well as overall economic conditions. For larger balance non-homogeneous real estate loans, the estimate of impairment is based on the underlying collateral if collateral dependent, and if such loans are not collateral dependent, the estimate of impairment is based on a cash flow analysis. If management’s assumptions are incorrect, the allowance may be insufficient to cover probable incurred losses in the loan portfolio, resulting in additions to the allowance. The allowance is also periodically reviewed by the OCC, who may require us to increase the amount. Additions to the allowance would be made through increased provision expense and would negatively affect our net income and results of operations.

Interest rate volatility could significantly reduce our profitability.

Our earnings largely depend on the relationship between the yield on our earning assets, primarily loans and investment securities, and the cost of funds, primarily deposits and borrowings. This relationship, commonly known as the net interest margin, is susceptible to significant fluctuation and is affected by economic and competitive factors that influence the yields and rates, and the volume and mix of our interest-earning assets and interest-bearing liabilities.

Interest rate risk can be defined as an exposure to movement in interest rates that could have an adverse impact on our net interest income. Interest rate risk arises from the imbalance in the re-pricing, maturity and/or cash flow characteristics of assets and liabilities. We are subject to interest rate risk to the degree that its interest bearing liabilities re-price or mature more slowly or more rapidly or on a different basis than its interest earning assets. Significant fluctuations in interest rates could have a material adverse impact on our business, financial condition, results of operations or liquidity.

Our interest rate risk measurement and management techniques incorporate the re-pricing and cash flow attributes of its balance sheet and off-balance sheet instruments as they relate to current and potential changes in interest rates. The level of interest rate risk, measured in terms of the potential future effect on net interest income, is determined through the use of modeling and other techniques under multiple interest rate scenarios. Management’s objectives are to measure, monitor and develop strategies in response to the interest rate risk profile inherent in our balance sheet.

Future changes in interest rates could impact our financial condition and results of operations.

The FRB maintained the federal funds rate at the historically low rate of 0.25% during 2012 and 2013 and is expected to continue this policy in 2013. The federal funds rate has a direct correlation to general rates of interest, including our interest-bearing deposits. Our mix of asset and liabilities are considered to be sensitive to interest rate changes. Generally, customers may prepay the principal amount of their outstanding loans at any time. The speeds at which such prepayments occur, as well as the amount of such prepayments, are within our customers' discretion. If customers prepay the principal amount of their loans, and we are unable to lend those funds to other borrowers or invest the funds at the same or higher interest rates, our interest income will be reduced. A similar prepayment risk exists for our investment portfolio which is primarily made up of mortgage-related securities, with the added impact of accelerated recognition of premiums paid to acquire the investment security. A significant reduction in interest income could have a negative impact on our results of operations and financial condition. On the other hand, if interest rates rise, net interest income might be reduced because interest paid on interest-bearing liabilities, including deposits, increases more quickly than interest received on interest-earning assets, including loans and mortgage-backed and related securities. In addition, rising interest rates may negatively affect income because higher rates may reduce the demand for loans and the value of mortgage-related investment securities.

At December 31, 2013, we had $202.8 million in long-term borrowings, comprised of $110.0 million of FHLB advances and $92.8 million of reverse repos, with the earliest maturities beginning in 2013 and final maturities occurring in 2018. The weighted average coupon interest rate of the long-term borrowings as of December 31, 2013 was 4.56%, and accounted for approximately 73.9% of interest expense for the year ended December 31, 2013. Given the announced intentions of the FRB to hold interest rates at their current levels until certain economic measurements are achieved, the long term borrowings are expected to have a negative impact to the net interest margin.

Operating expenses are high as a percentage of our net interest income and non-interest income, making it more difficult to maintain profitability.

Non-interest expense, which consists primarily of the costs associated with operating our business, represents a high percentage of the income we generate. The cost of generating our income is measured by our efficiency ratio, which represents non-interest expense divided by the sum of our net interest income and our non-interest income. If we are able to lower our efficiency ratio, our ability to generate income from our operations will be more effective. For the years ended December 31, 2013, 2012 and 2011, our efficiency ratio was 119.5%, 79.6% and 85.7%, respectively. Generally, this means we spent approximately $1.20, $0.80 and $0.86 during those periods to generate $1.00 of income.

If we are unable to generate additional non-interest income from sales of SBA loans or mortgage loans originated for sale, it could have a material adverse effect on our business as service charges and deposit fees are expected to continue to be under pressure.

For the year ended December 31, 2013, our service charges and deposit fees were $3.0 million, or 47.2% of total non-interest income, while gains from the sale of SBA loans were $0.7 million, or 10.9% of total non-interest income. Gains earned from the sale of SBA loans and from the sale of mortgage loans originated for sale are expected to be an increasingly larger part of our non-interest income under our business strategy. If our plans to increase SBA lending or reenter the mortgage banking business result in less loan originations or smaller levels of gains, our operating results could be materially affected.

If economic conditions deteriorate or the economic recovery remains slow over an extended period of time in our primary market areas of Jacksonville, Florida and Ware County, Georgia, our results of operation and financial condition could be adversely impacted as borrowers' ability to repay loans declines and the value of the collateral securing the loans decreases.

Financial results may be adversely affected by changes in prevailing economic conditions, including decreases in real estate values, changes in interest rates, which may cause a decrease in interest rate spreads, adverse employment conditions, the monetary and fiscal policies of the federal and the Georgia and Florida state governments and other significant external events. We held approximately 25% of the deposits in Ware County, the county in which Waycross, Georgia is located, as of December 31, 2013. We had less than 1% of the deposits in the Jacksonville, Florida, metropolitan statistical area as of December 31, 2013. Additionally, our market share of loans in Ware County is significantly greater than our share of the loan market in the Jacksonville metropolitan statistical area. As a result of the concentration in Ware County, we may be more susceptible to adverse market conditions in that market. Due to the significant portion of real estate loans in the loan portfolio, decreases in real estate values could adversely affect the value of property used as collateral. At December 31, 2013, we had $133.4 million, or approximately 35.9%, of our loan portfolio secured by one- to four-family residential property in Florida and $63.9 million, or approximately 17.2%, of such properties in Georgia. Adverse changes in the economy may also have a negative effect on the ability of borrowers to make timely repayments of their loans, which would have an adverse impact on earnings. The unemployment rate for the Jacksonville, Florida metropolitan statistical area was an estimated 5.6% as of December 31, 2013. The unemployment rate for Ware County, Georgia was an estimated 9.3% as of December 31, 2013.

The United States economy remains weak and unemployment levels are high. Continuing economic weakness, particularly in our geographic market area, will adversely affect our business and financial results.

The United States experienced a severe economic recession in 2008 and 2009, the effects of which have continued through 2013. Recent growth has been slow and unemployment remains at high levels and as a result economic recovery is expected to be slow. Loan portfolio quality has deteriorated at many financial institutions reflecting, in part, the weak United States economy and high unemployment rates. In addition, the value of real estate collateral supporting many commercial loans and home mortgages has declined and growth in future values are uncertain. The real estate downturn also has resulted in reduced demand for the construction of new housing and increased delinquencies in construction, residential and commercial mortgage loans. Bank and bank holding company stock prices have declined substantially, and it is significantly more difficult for banks and bank holding companies to raise capital or borrow funds.

Future negative developments in the financial services industry and the domestic and international credit markets may significantly affect the markets in which we do business, the market for and value of our loans and investments, and our ongoing operations, costs and profitability. We could experience reduced demand for our products and services, increases in loan delinquencies, problem assets or foreclosures, and the collateral for our loans may decline further in value. Moreover, future declines in the stock market in general, or stock values of financial institutions and their holding companies specifically, could adversely affect our stock performance.

A return to recessionary conditions in Florida could negatively impact our ability to originate mortgage loans for sale or grow our portfolio loans in our primary market area, and combined with strong competition, could further reduce our ability to obtain loans and also decrease our yield on loans.

From 2000 to mid-2007, the Jacksonville metropolitan statistical area had been one of the fastest growing economies in the United States. The area experienced substantial growth in population, new business formation and public works spending. Due to the considerable slowing of economic growth and migration into our market area from mid-2007 to 2011, and the resulting downturn in the real estate market, growth in the first mortgage loan origination business was negatively impacted. While the northeastern Florida economy has recently been trending upward with increases in single family home sales, a return to the recessionary conditions with decreased home sales, or decreased lending opportunities, could negatively impact our ability to originate mortgage loans for sale or grow our portfolio loans, negatively impacting our income.

In addition, we are located in a competitive market that affects our ability to obtain loans through origination or purchase as well as originating them at rates that provide an attractive yield. Competition for loans comes principally from mortgage bankers, commercial banks, other thrift institutions, nationally based homebuilders and credit unions. Internet based lenders have also become a greater competitive factor in recent years. Such competition for the origination and purchase of loans may limit our future growth and earnings prospects.

We may not be able to realize our deferred tax asset.

We recognize deferred tax assets and liabilities based on differences between the financial statement carrying amounts and the tax bases of assets and liabilities. In 2009, we established a valuation allowance for our net federal and state deferred tax asset after evaluating the positive and negative evidence in accordance with U.S. GAAP. U.S. GAAP requires more weight be given to objective evidence, and since realization is dependent on future operating results, our three year cumulative operating loss carried more weight than forecasted earnings.

Under the rules of Internal Revenue Code § 382 (IRC § 382), a change in the ownership of the Company occurred during the first quarter of 2013. During the second quarter of 2013, the Company became aware of the change in ownership based on applicable filings made by stockholders with the Securities and Exchange Commission. In accordance with IRC § 382, the Company determined the gross amount of net operating loss carryover that it could utilize was limited to approximately $325,000 per year. The Company also determined it was in a net unrealized built-in loss position (NUBIL) at the time of the ownership change. Due to the Company's NUBIL position recognition of certain losses during the next one to five years will have an adverse effect on the utilization of the existing net operating losses, as the recognized losses will be applied to the annual limitation before the net operating losses are applied. As a result of the limitation, the Company wrote off approximately $46.3 million of federal net operating loss carryover, all of which had been previously reserved for with a valuation allowance.

As of December 31, 2013, we evaluated the expected realization of our federal and state deferred tax assets which, prior to a valuation allowance, totaled $17.5 million and was primarily comprised of future tax benefits associated with the allowance for portfolio loan losses, net operating loss carryover, and the net unrealized loss on securities available-for-sale. Based on this evaluation it was concluded that a valuation allowance continues to be required for the federal deferred tax asset. The realization of the deferred tax asset is dependent upon generating taxable income. The Company also continues to maintain a valuation allowance for the state deferred tax asset. If the valuation allowance is reduced or eliminated, future tax benefits will be recognized as a reduction to income tax expense which will have a positive non-cash impact on our net income and stockholders' equity.

Strong competition in our primary market area may reduce our ability to attract and retain deposits and also increase our cost of funds.

Atlantic Coast Bank operates in a very competitive market for the attraction of deposits, the primary source of our funding. Historically, our most direct competition for deposits has come from credit unions, community banks, large commercial banks and thrift institutions within our primary market areas. In recent years competition has also come from institutions that largely deliver their services over the internet. Such competitors have the competitive advantage of lower infrastructure costs and substantially greater resources and lending limits and may offer services we do not provide. Particularly during times of extremely low or extremely high interest rates, we have faced significant competition for investors' funds from short-term money market securities and other corporate and government securities. During periods of regularly increasing interest rates, competition for interest-bearing deposits increases as customers, particularly time deposit customers, tend to move their accounts between competing businesses to obtain the highest rates in the market. As a result, we incur a higher cost of funds in an effort to attract and retain customer deposits. We strive to grow our lower cost deposits, such as non-interest-bearing checking accounts, in order to reduce our cost of funds.

Wholesale funding sources may be unavailable to replace deposits at maturity and support our liquidity needs or growth.

Atlantic Coast Bank must maintain sufficient funds to respond to the needs of depositors and borrowers. As a part of our liquidity management, we use a number of funding sources in addition to non-maturity deposit growth and repayments and maturities of loans and investments. Ongoing financial difficulties and restrictions by the FRB, the OCC and the FHLB may limit these sources, which include FHLB advances, proceeds from the sale of loans and liquidity resources of the holding company. At December 31, 2013, we had $110.0 million of FHLB advances outstanding, and the remaining borrowing capacity was $5.0 million.

In the past brokered deposits have been solicited as a source of funds. However, under the Consent Order with the OCC entered into in August 2012, we cannot accept, renew or roll over any brokered deposits without prior regulatory approval. We had no brokered deposits at December 31, 2013.

Our financial flexibility will be severely constrained if we are unable to maintain our access to funding or if adequate financing is not available to accommodate future growth at acceptable interest rates. If we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs. In this case, our operating margins and profitability would be adversely affected.

Our deposit insurance premiums could be substantially higher in the future, which could have a material adverse effect on our future earnings.

The FDIC insures deposits at FDIC-insured depository institutions, such as Atlantic Coast Bank, up to $250,000 per account. The amount of a particular institution's deposit insurance assessment is based on that institution's risk classification under an FDIC risk-based assessment system. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to its regulators. Recent market developments and bank failures significantly depleted the FDIC's Deposit Insurance Fund, and reduced the ratio of reserves to insured deposits. As a result of recent economic conditions and the enactment of the Dodd-Frank Act, banks are now assessed deposit insurance premiums based on the bank's average consolidated total assets, and the FDIC has modified certain risk-based adjustments which increase or decrease a bank's overall assessment rate. This has resulted in increases to the deposit insurance assessment rates and thus raised deposit premiums for insured depository institutions. If these increases are insufficient for the Deposit Insurance Fund to meet its funding requirements, further special assessments or increases in deposit insurance premiums may be required. We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. If there are additional bank or financial institution failures, we may be required to pay even higher FDIC premiums than the recently increased levels. If our financial condition deteriorates or if the bank regulators otherwise have supervisory concerns about us, then our assessments could rise. Any future additional assessments, increases or required prepayments in FDIC insurance premiums could reduce our profitability, may limit our ability to pursue certain business opportunities, or otherwise negatively impact our operations.

The downgrade of the U.S. credit rating could negatively impact our business, results of operations and financial condition.

Recent U.S. debt ceiling and budget deficit concerns together with signs of deteriorating sovereign debt conditions in Europe have increased the possibility of additional credit-rating downgrades and economic slowdowns in the United States. Although U.S. lawmakers passed legislation to raise the federal debt ceiling in 2011, Standard & Poor's Ratings Services lowered its long-term sovereign credit rating on the United States from "AAA" to "AA+" in August 2011. The impact of any further downgrades to the U.S. government's sovereign credit rating or its perceived creditworthiness could adversely affect the United States and global financial markets and economic conditions. In January 2013, the U.S. government adopted legislation to suspend the debt limit until May 19, 2013. As of May 19, 2013, the debt limit was increased above the previous statutory limit. Moody's and Fitch have each warned that they may downgrade the U.S. government's rating if the federal debt is not stabilized. A downgrade of the U.S. government's credit rating or a default by the U.S. government to satisfy its debt obligations likely would create broader financial turmoil and uncertainty, which would weigh heavily on the global banking system. It is possible that any such impact could have a material adverse effect on our business, results of operations and financial condition.

We operate in a highly regulated environment and may be adversely affected by changes in laws and regulations.

Atlantic Coast Bank is currently subject to extensive regulation, supervision and examination by the OCC, and by the FDIC, which insures Atlantic Coast Bank's deposits. As a savings and loan holding company, we are currently subject to regulation and supervision by the FRB. Such regulation and supervision govern the activities in which financial institutions and their holding companies may engage and are intended primarily for the protection of the federal deposit insurance fund and depositors. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operations of financial institutions, the classification of assets by financial institutions and the adequacy of financial institutions' allowance for loan losses.

Our operations are also subject to extensive regulation by other federal, state and local governmental authorities, and are subject to various laws and judicial and administrative decisions that impose requirements and restrictions on operations. These laws, rules and regulations are frequently changed by legislative and regulatory authorities. In the future, changes to existing laws, rules and regulations, or any other new laws, rules or regulations could make compliance more difficult or expensive or otherwise adversely affect our business, financial condition or prospects.

Financial reform legislation has, among other things, eliminated the OTS, tightened capital standards and created a new Consumer Financial Protection Bureau, and will result in new laws and regulations that are expected to increase our costs of operations.

The Dodd-Frank Act requires various federal agencies to adopt a broad range of new implementing rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies are given significant discretion in drafting the implementing rules and regulations, and consequently many of the details and much of the impact of the Dodd-Frank Act may not be known for many months or years.

Among other things, as a result of the Dodd-Frank Act:

- the OCC became the primary federal regulator for federal savings banks such as Atlantic Coast Bank (replacing the OTS), and the FRB now supervises and regulates all savings and loan holding companies that were formerly regulated by the OTS, including the Company;
- effective July 21, 2011, the federal prohibition on paying interest on demand deposits has been eliminated, thus allowing businesses to have interest-bearing checking accounts. This change has increased our interest expense;
- the FRB is required to set minimum capital levels for depository institution holding companies that are as stringent as those required for their insured depository subsidiaries, and the components of Tier 1 capital are required to be restricted to capital instruments that are currently considered to be Tier 1 capital for insured depository institutions. There is a five-year transition period (from the July 21, 2010 effective date of the Dodd-Frank Act) before the capital requirements will apply to savings and loan holding companies. However, recently proposed rules would not provide such a transition period for savings and loan holding companies;
- the federal banking regulators are required to implement new leverage and capital requirements that take into account off-balance sheet activities and other risks, including risks relating to securitized products and derivatives;
- a new Consumer Financial Protection Bureau has been established, which has broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. Banks and savings institutions with $10 billion or less in assets, like Atlantic Coast Bank, will be examined by their applicable bank regulators; and
- federal preemption rules that have been applicable for national banks and federal savings banks have been weakened, and state attorneys general have the ability to enforce federal consumer protection laws.

In addition to the risks noted above, we expect that our operating and compliance costs, and possibly our interest expense, could increase as a result of the Dodd-Frank Act and the implementing rules and regulations. The need to comply with additional rules and regulations, as well as state laws and regulations to which we were not previously subject, will also divert management's time from managing our operations. Higher capital levels would reduce our ability to grow and increase our interest-earning assets which would adversely affect our return on stockholders' equity.

The short-term and long-term impact of the changing regulatory capital requirements and anticipated new capital rules are uncertain.

On July 2, 2013, the federal banking agencies issued final capital rules that substantially amend the regulatory risk-based capital rules applicable to us. The rules implement the “Basel III” regulatory capital reforms and changes required by the Dodd-Frank Act. The rules phase in over time beginning in 2015 and will become fully effective in 2019. The rules apply both to our Company, which currently is not subject to formal capital rules, and Atlantic Coast Bank.

The final rules increase capital requirements and generally include two new capital measurements that will affect us, a risk-based common equity Tier 1 ratio and a capital conservation buffer. Common Equity Tier 1 (CET1) capital is a subset of Tier 1 capital and is limited to common equity (plus related surplus), retained earnings, accumulated other comprehensive income and certain other items. Other instruments that have historically qualified for Tier 1 treatment, including noncumulative perpetual preferred stock, are consigned to a category known as Additional Tier 1 capital. Tier 2 capital consists of instruments that have historically been placed in Tier 2, as well as cumulative perpetual preferred stock. The final rules adjust all three categories of capital by requiring new deductions from and adjustments to capital. Beginning in 2015, our minimum capital requirements will be (i) a CET1 ratio of 4.5%, (ii) a Tier 1 capital (CET1 plus Additional Tier 1 capital) of 6% (up from 4%) and (iii) a total capital ratio of 8% (the current requirement). Our leverage ratio requirement will remain at the 4% level now required of Atlantic Coast Bank. Beginning in 2016, a capital conservation buffer will phase in over three years, ultimately resulting in a requirement of 2.5% on top of the CET1, Tier 1 and total capital requirements, resulting in a CET1 ratio of 7%, a Tier 1 ratio of 8.5%, and a total capital ratio of 10.5%. Failure to satisfy any of these three capital requirements will result in limits on paying dividends, engaging in share repurchases and paying discretionary bonuses. These limitations will establish a maximum percentage of eligible retained income that could be utilized for such actions. While the final rules will result in higher regulatory capital standards, it is difficult at this time to predict when or how any new standards will ultimately be applied to us. As of December 31, 2013, the Bank would have been in compliance with the minimum capital requirements set forth in Basel III.

In addition to the higher required capital ratios that will begin to take effect in 2015, the new capital rules require new deductions from and adjustments to capital that will result in even more stringent capital requirements and changes in the ways we do business. Among other things, commercial real estate loans that do not meet certain new underwriting requirements must be risk-weighted at 150%, rather than the current 100%. There are also new risk weights for unsettled transactions and derivatives. We also will be required to hold capital against short-term commitments that are not unconditionally cancelable; currently, there are no capital requirements for these off-balance sheet assets.

In addition, in the current economic and regulatory environment, bank regulators may impose capital requirements that are more stringent than those required by applicable existing regulations. The application of more stringent capital requirements for Atlantic Coast Bank could, among other things, result in lower returns on equity, require the raising of additional capital, and result in regulatory actions if we were to be unable to comply with such requirements. Implementation of changes to asset risk weightings for risk based capital calculations, items included or deducted in calculating regulatory capital or additional capital conservation buffers, could result in management modifying our business strategy and could limit our ability to make distributions, including paying dividends or buying back our shares.

The federal banking agencies are likely to issue new liquidity standards that could result in our having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets.

As part of the Basel III capital process, the Basel Committee on Banking has finalized a new liquidity standard, a Liquidity Coverage Ratio, which requires a banking organization to hold sufficient “high quality liquid assets” to meet liquidity needs for a 30 calendar day liquidity stress scenario, and a Net Stable Funding Ratio, which imposes a similar requirement over a one-year period, is under consideration. The U.S. banking regulators have said that they intend to adopt such liquidity standards, although they have not yet proposed a rule. New rules could restrict our operations and adversely affect our results and financial condition.

New regulations could adversely impact our earnings due to, among other things, increased compliance costs or costs due to noncompliance.

The Consumer Financial Protection Bureau has issued a rule, effective as of January 14, 2014, designed to clarify for lenders how they can avoid monetary damages under the Dodd-Frank Act, which would hold lenders accountable for ensuring a borrower's ability to repay a mortgage. Loans that satisfy this "qualified mortgage" safe-harbor will be presumed to have complied with the new ability-to-repay standard. Under the Consumer Financial Protection Bureau's rule, a "qualified mortgage" loan must not contain certain specified features, including but not limited to: (i) excessive upfront points and fees (those exceeding 3% of the total loan amount, less "bona fide discount points" for prime loans); (ii) interest-only payments; (iii) negative-amortization; and (iv) terms longer than 30 years. Also, to qualify as a "qualified mortgage," a borrower's total monthly debt-to-income ratio may not exceed 43%. Lenders must also verify and document the income and financial resources relied upon to qualify the borrower for the loan and underwrite the loan based on a fully amortizing payment schedule and maximum interest rate during the first five years, taking into account all applicable taxes, insurance and assessments. The Consumer Financial Protection Bureau's rule on qualified mortgages could limit our ability or desire to make certain types of loans or loans to certain borrowers, or could make it more expensive and/or time consuming to make these loans, which could adversely impact our growth or profitability.

Additionally, on December 10, 2013, five financial regulatory agencies, including our primary federal regulator, the Federal Reserve, adopted final rules (the Final Rules) implementing the so-called Volcker Rule embodied in Section 13 of the Bank Holding Company Act, which was added by Section 619 of the Dodd-Frank Act. The Final Rules prohibit banking entities from, among other things, (1) engaging in short-term proprietary trading for their own accounts, and (2) having certain ownership interests in and relationships with hedge funds or private equity funds (covered funds). The Final Rules are intended to provide greater clarity with respect to both the extent of those primary prohibitions and of the related exemptions and exclusions. The Final Rules also require each regulated entity to establish an internal compliance program that is consistent with the extent to which it engages in activities covered by the Volcker Rule, which must include (for the largest entities) making regular reports about those activities to regulators. Community banks, such as the Company, have been afforded some relief under the Final Rules. If such banks are engaged only in exempted proprietary trading, such as trading in U.S. government, agency, state and municipal obligations, they are exempt entirely from compliance program requirements. Moreover, even if a community bank engages in proprietary trading or covered fund activities under the rule, they need only incorporate references to the Volcker Rule into their existing policies and procedures. The Final Rules are effective April 1, 2014, but the conformance period has been extended from its statutory end date of July 21, 2014 until July 21, 2015. Management is currently evaluating the Final Rules, which are lengthy and detailed.

We are subject to losses due to the errors or fraudulent behavior of employees or third parties.

We are exposed to many types of operational risk, including the risk of fraud by employees and outsiders, clerical recordkeeping errors and transactional errors. Our business is dependent on our employees as well as third-party service providers to process a large number of increasingly complex transactions. We could be materially adversely affected if one of our employees causes a significant operational breakdown or failure, either as a result of human error or where an individual purposefully sabotages or fraudulently manipulates our operations or systems or if one of our third-party service providers experiences an operational breakdown or failure. When we originate loans, we rely upon information supplied by loan applicants and third parties, including the information contained in the loan application, property appraisal and title information, if applicable, and employment and income documentation provided by third parties. If any of this information is misrepresented and such misrepresentation is not detected prior to loan funding, we generally bear the risk of loss associated with the misrepresentation. Any of these occurrences could result in a diminished ability of us to operate our business, potential liability to customers, reputational damage and regulatory intervention, which could negatively impact our business, financial condition and results of operations.

We rely on our management team for the successful implementation of our business strategy.

Since June 11, 2013, when the proposed merger between the Company and Bond Street Holdings, Inc. was rejected by the stockholders of the Company, the Chief Executive Officer, the Chief Financial Officer and the Chairman of the Board of Directors' have resigned from their positions. The Company named a new Chief Executive Officer of the Company and the Bank, named an interim Chief Financial Officer of the Company and the Bank, and started a search for a permanent Chief Financial Officer. Early in 2014, the Company named a new permanent Chief Financial Officer, contingent upon receipt of regulatory non-objection from the OCC and the FRB. Additionally, three members of the Board of Directors decided not to stand for re-election, and the Company's stockholders elected three new directors at the Company's annual meeting on August 16, 2013.

Additional turnover of key management and directors, or the loss of other senior managers could have a disproportionate impact on the Company and may have a material adverse effect on our ability to implement our business plan and comply with the terms of the Consent Order the Board of Directors of the Bank agreed to with the Office of the Comptroller of the Currency on August 10, 2012. As we are a relatively small bank with a relatively small management team, certain members of our senior management team have more responsibility than his or her counterpart typically would have at a larger institution with more employees, and we have fewer management-level personnel who are in a position to assume the responsibilities of our executive management team.

Risks Relating to Ownership of Our Common Stock

Our stock price may be volatile due to limited trading volume.

Our common stock is traded on the Nasdaq Global Market. However, the average daily trading volume in the common stock is relatively small, approximately 16,000 shares per day in 2013, and sometimes significantly less than that. As a result, trades involving a relatively small number of shares may have a significant effect on the market price of the common stock, and it may be difficult for investors to acquire or dispose of large blocks of stock without significantly affecting the market price. If our Market Value of Publicly Held Shares (as defined under Nasdaq rules) falls below \$5.0 million or the price per share of the common stock falls below \$1.00 for a specified amount of time, under applicable Nasdaq rules, we will generally have 180 calendar days from the date of the receipt of the notification from Nasdaq that we have failed to comply with its applicable listing standards to regain compliance with those standards. If we are unable to regain compliance, we may have to transfer the listing of our common stock to the Nasdaq Capital Market or begin trading on the over-the-counter market, which may adversely affect the trading market for our shares.

Our ability to pay dividends is limited.

We have not paid dividends to our common stockholders since July 2009. Our ability to pay dividends is limited by the Supervisory Agreement with the FRB, regulatory requirements and the need to maintain sufficient consolidated capital to meet the capital needs of the business, including capital needs related to future growth. Our primary source of funds available for the payment of dividends is the dividend payments we receive from Atlantic Coast Bank. Atlantic Coast Bank, in turn, is subject to the Consent Order and regulatory requirements, which potentially limits its ability to pay dividends to us, and by Atlantic Coast Bank's need to maintain sufficient capital for its operations and obligations. We cannot assure you that we will be able to pay dividends to common stockholders in the future, and, if we are able to pay dividends, we cannot assure you as to the amount or timing of any such dividends. If we are able to pay dividends in the future, we cannot assure you that those dividends will be maintained, at the same level or at all, in future periods.

We may need additional financing in the future, and any additional financing may result in restrictions on our operations or substantial dilution to our stockholders.

We may need to obtain additional financing in the future for a variety of reasons, including meeting our regulatory obligations, conducting our ongoing operations, or funding expansion, as well as to respond to unanticipated situations. We may try to raise additional funds through public or private financings, strategic relationships or other arrangements. Our ability to obtain additional financing will depend on a number of factors, including market conditions, our operating performance and investor interest. Additional funding may not be available to us on acceptable terms or at all. If we succeed in raising additional funds through the issuance of equity or convertible securities, it could result in substantial dilution to existing stockholders.

We may issue additional shares of common stock, preferred stock or equity, debt or derivative securities, which could adversely affect the value or voting power of your shares of common stock.

In addition to the securities that we expect to issue upon the exercise of outstanding stock options and the vesting of restricted stock, we may also issue shares of capital stock in future offerings, acquisitions or other transactions, or may engage in recapitalizations or similar transactions in the future, the result of which could cause stockholders to suffer further dilution in book value, market value or voting rights. Our Board of Directors has authority to engage in some of these transactions particularly additional equity, debt or derivative securities offerings or issuances without stockholder approval. If our Board of Directors decides to approve transactions that result in dilution, the value and voting power of shares of our common stock could decrease.

Our articles of incorporation, bylaws, and certain laws and regulation may prevent or delay transactions you might favor, including our sale or merger or our issuance of stock or sale of assets.

Certain laws and regulations, provisions of our articles of incorporation, bylaws, and various other factors may make it more difficult and expensive for companies or persons to acquire control of us without the consent of our Board of Directors. It is possible, however, that you would want a takeover attempt to succeed because, for example, a potential buyer could offer a premium over the then prevailing price of our common stock and could provide you with an opportunity to liquidate your investment.

We are registered with the Federal Reserve as a bank holding company under the Bank Holding Company Act of 1956 (the BHCA). As a result, we are subject to supervisory regulation and examination by the Federal Reserve. The BHCA and other federal laws subject bank holding companies to particular restrictions on the types of activities in which they may engage and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations. These laws may discourage certain persons from acquiring control of us. Additionally, federal and state approval requirements may delay or prevent certain persons from acquiring us.

As a Maryland corporation, we are subject to Maryland General Corporation Law (MGCL). Subject to certain exceptions, MGCL provides that a “business combination” between a Maryland corporation and an “interested stockholder,” or an affiliate of an interest stockholder, is prohibited for five years after the most recent date on which the interested stockholder becomes an interested stockholder, and after the five-year prohibition, any business combination between a Maryland corporation and an interested stockholder generally must be recommended by the Board of Directors and approved by the affirmative vote of at least: (i) 80% of the votes entitled to be cast by holders of outstanding shares of voting stock, and (ii) two-thirds of the votes entitled to be cast by holders of voting stock other than the shares held by the interested stockholder or an affiliate or associate of the interested stockholder. The supermajority vote requirements do not apply, however, if the corporation’s common stockholders receive a minimum price, as defined under the MGCL, for their shares in the form of cash or other consideration in the same form as previously paid by the interested stockholder for its shares.

The MGCL generally defines an interested stockholder as: (i) any person who beneficially owns 10% or more of the voting power of the voting stock after the date on which the corporation had 100 or more beneficial owners of its stock; or (ii) an affiliate or associate of the corporation at any time after the date on which it had 100 or more beneficial owners of its stock who, within the two-year period prior to the date in question, was the beneficial owner of 10% or more of the voting power of the corporation’s then-outstanding voting stock. A person is not an interested stockholder under the statute if the Board of Directors approved in advance the transaction by which the person otherwise would have become an interested stockholder. The business combinations covered by the MGCL generally include mergers, consolidations, statutory share exchanges, or, in certain circumstances, certain transfers of assets, certain stock issuances and transfers, liquidation plans and reclassifications involving interested stockholders and their affiliates, or issuances or reclassifications of equity securities.

Certain provisions of our articles of incorporation and bylaws may discourage takeover attempts or make them more difficult, including:

- our classified Board of Directors;
- notice and information requirements for stockholders to nominate candidates for election to the Board of Directors or to propose business to be acted on at the annual meeting of stockholders;
- requirement that a special meeting called by stockholders may be called only by the holders of at least a majority of all votes entitled to be cast at the meeting;
- limitations on voting rights;
- restrictions on removing directors from office;
- authorized but unissued shares;
- stockholder voting requirements for amendments to the articles of incorporation and bylaws; and
- consideration of other factors by the Board of Directors when evaluating change in control transactions.

Our Board of Directors may issue shares of preferred stock that would adversely affect the rights of our common stockholders.

Our authorized capital stock includes 25,000,000 shares of preferred stock of which no preferred shares are issued and outstanding. Our Board of Directors, in its sole discretion, may designate and issue one or more series of preferred stock from the authorized and unissued shares of preferred stock. Subject to limitations imposed by law or our articles of incorporation, our Board of Directors is empowered to determine:

- the designation of, and the number of, shares constituting each series of preferred stock;
- the dividend rate for each series;
- the terms and conditions of any voting, conversion and exchange rights for each series;
- the amounts payable on each series on redemption or our liquidation, dissolution or winding-up;
- the provisions of any sinking fund for the redemption or purchase of shares of any series; and
- the preferences and the relative rights among the series of preferred stock.

We could issue preferred stock with voting and conversion rights that could adversely affect the voting power of the shares of our common stock and with preferences over the common stock with respect to dividends and in liquidation.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

At December 31, 2013, Atlantic Coast Bank had eleven full-service offices, one drive-up facility, an office space for the Small Business Administration lending office site, and a leased office space for the home and executive office site. Atlantic Coast Bank owns all locations except the regional office in Jacksonville, FL and the branch location in Orange Park, FL, both of which are leased. The Company is currently negotiating to renew its home and executive office site in Jacksonville, Florida prior to the expiration of the lease. The net book value of the investment in premises, equipment and fixtures, excluding computer equipment, was approximately $14.0 million at December 31, 2013.

The following table provides a list of the Bank's main and branch offices:

Location	Owned or Leased	Lease Expiration Date	Net Book Value December 31, 2013 (Dollars in Thousands)	
HOME AND EXECUTIVE OFFICE:				
FLORIDA REGIONAL CENTER 10151 Deerwood Park Blvd Building 200, Suite 100 Jacksonville, FL 32256	Leased	April 2014	$	49
BRANCH OFFICES:				
505 Haines Avenue Waycross, GA 31501	Owned			1,346
Drive-up Facility 400 Haines Avenue Waycross, GA 31501	Owned			75
2110 Memorial Drive Waycross, GA 31501	Owned			541
1390 South Gaskin Avenue Douglas, GA 31533	Owned			387
213 Hwy 80 West Garden City, GA 31408	Owned			265
10328 Deerwood Park Blvd. Jacksonville, FL 32256	Owned			1,036
8048 Normandy Blvd. Jacksonville, FL 32221	Owned			929
1567 Kingsley Avenue Orange Park, FL 32073	Leased	January 2018		532
930 University Avenue, North Jacksonville, FL 32211	Owned			938
1700 South Third Street Jacksonville Beach, FL 32200	Owned			1,475
1425 Atlantic Blvd. Neptune Beach, FL 32233	Owned			3,531
2766 Race Track Road Jacksonville, FL 32259	Owned			1,879

276 Paseo Reyes Drive St. Augustine, FL 32095	Owned	1,270

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Management believes the Company's facilities are suitable for their purpose and adequate to support its business. Atlantic Coast Bank continuously reviews its branch locations in order to improve the visibility and accessibility of the Bank's locations.

ITEM 3. LEGAL PROCEEDINGS

From time to time, the Company is involved as plaintiff or defendant in various legal actions arising in the normal course of business. Management does not anticipate incurring any material liability as a result of litigation at December 31, 2013, other than the litigation described below.

Litigation Related to the Merger Agreement with Bond Street Holdings, Inc.

As described in our previous filings with the Securities and Exchange Commission, two putative class action lawsuits related to our proposed merger with Bond Street Holdings, Inc. (Bond Street) were originally filed against the Company, the Bank, Bond Street and its bank subsidiary, Florida Community Bank, N.A. (Florida Community Bank) and certain directors of the Company. The two prior lawsuits were voluntarily dismissed and a new combined federal court action was filed on May 20, 2013.

On June 5, 2013, Plaintiff Jason Laugherty, individually and on behalf of a putative class of similarly situated stockholders, the Company, the Bank, Bond Street, Florida Community Bank, and individual defendants Forrest W. Sweat, Jr., Charles E. Martin, Jr., Thomas F. Beeckler, G. Thomas Frankland, John J. Linfante, W. Eric Palmer, and H. Dennis Woods, entered into a Memorandum of Understanding (the MOU) regarding the settlement in principle of a putative class action lawsuit filed in the United States District Court for the District of Maryland (the Action). The Action was filed in response to the Merger Agreement and alleged claims against the Company, the Bank, Bond Street, Florida Community Bank and certain directors of the Company for breaches of fiduciary duties, aiding and abetting breaches of fiduciary duties, and violations of federal proxy disclosure laws relating to the proposed merger.

Under the terms of the MOU, the Company, the Bank, Bond Street and Florida Community Bank, the other named individual director defendants, and the Plaintiff reached an agreement in principle to settle the class action lawsuit and to release the defendants from all claims in the Action and the prior lawsuits relating to the proposed merger, subject to the approval of the United States District Court for the District of Maryland and the consummation of the proposed merger. Under the terms of the MOU, Plaintiff's counsel also reserved the right to seek an award of attorney's fees and expenses if the proposed merger was not approved by the Company's stockholders.

On June 7, 2013, the parties to the MOU submitted a joint motion to stay the Action and/or to extend case deadlines pending consummation of the proposed merger and the filing of a motion for a preliminary approval of settlement. The court granted the motion and stayed the Action pending consummation of the merger. The vote on the proposed merger transaction was unsuccessful, and on November 13, 2013 the Plaintiff filed a notice of voluntary dismissal, which was approved by the judge.

ITEM 4. MINE SAFETY DISCLOSURES

None.

Part II.

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Atlantic Coast Financial Corporation's common stock is traded on the NASDAQ Global Market under the symbol "ACFC." As of March 3, 2014, there were 15,509,061 shares of common stock issued and outstanding, with approximately 1,860 stockholders, including beneficial stockholders.

The Company began paying quarterly dividends in May 2005 using earnings from investments and un-invested proceeds received from the minority stock offering completed on October 4, 2004. On September 25, 2009, the Company announced that it had suspended its regular quarterly cash dividend. Future dividend payments by the Company will be primarily dependent on dividends it receives from its subsidiary, Atlantic Coast Bank. Under the OCC regulations, the dollar amount of dividends Atlantic Coast Bank may pay is dependent upon its capital position and recent earnings. Under normal circumstances, if Atlantic Coast Bank satisfies its capital requirements it may make dividend payments up to the limits prescribed in the OCC regulations. However, under the Consent Order entered into with the OCC on August 10, 2012, dividends or other capital distributions cannot be declared or paid prior to receiving a written non-objection from the OCC. The Consent Order also requires Atlantic Coast Bank obtain approval of the OCC 30 days prior to declaring a dividend payment or distribution of capital. It is unlikely the Company will pay dividends to stockholders in the near future.

The following table sets forth the quarterly high and low sales prices and dividends declared on, the Company's common stock for the years ended December 31, 2013 and 2012:

	High	Low	Dividends
Fiscal 2013:			
Fourth quarter (October 1 December 31)	$ 4.44	$ 3.00	$ 0.00
Third quarter (July 1 September 30)	5.25	3.46	0.00
Second quarter (April 1 June 30)	6.88	4.38	0.00
First quarter (January 1 March 31)	4.95	1.81	0.00
Fiscal 2012:			
Fourth quarter (October 1 December 31)	$ 3.30	$ 1.46	$ 0.00
Third quarter (July 1 September 30)	2.75	1.37	0.00
Second quarter (April 1 June 30)	2.63	1.80	0.00
First quarter (January 1 March 31)	3.19	2.05	0.00

The Company did not repurchase any shares of its common stock during the year end December 31, 2013.

The table below sets forth information, as of December 31, 2013, regarding equity compensation plans categorized by those plans that have been approved by stockholders and those plans that have not been approved by stockholders. The number and exercise price of the stock awards have been adjusted to reflect the 0.1960 exchange ratio as a result of the completion of the second step conversion.

	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (1)	Weighted Average Exercise Price (2) of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (3)
Equity compensation plans approved by	83,755	$ 50.98	53,688

stockholders				
Equity compensation plans not approved by stockholders				
Total	83,755	$	50.98	53,688

(1) Consists of options to purchase 83,755 shares of common stock under the Atlantic Coast Financial Corporation 2005 Stock Option Plan.

(2) The weighted average exercise price reflects the weighted average exercise price of stock options awarded from the Atlantic Coast Financial Corporation 2005 Stock Option Plan.

(3) Consists of stock options for 53,688 shares of common stock available to be granted from the Atlantic Coast Financial Corporation 2005 Stock Option Plan.

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ITEM 6. SELECTED FINANCIAL DATA

The following is a summary of selected consolidated financial data of Atlantic Coast Financial Corporation at and for the years indicated (prior to February 3, 2011, the selected financial data reflects information of Atlantic Coast Federal Corporation, the Company's predecessor). The summary should be read in conjunction with the consolidated financial statements and accompanying notes to the consolidated financial statements contained in Item 8. Financial Statements and Supplementary Data herein.

Selected Consolidated Balance Sheet Data

	At December 31,				
	2013	2012	2011	2010	2009
	(Dollars in Thousands)				
Total assets	$ 733,633	$ 772,619	$ 788,967	$ 827,442	$ 905,561
Cash and cash equivalents	114,194	67,828	41,017	8,550	37,144
Investment securities (available-for-sale and held-to-maturity)	178,998	159,745	126,821	149,090	177,938
Portfolio loans, net	371,956	421,201	505,707	549,752	614,371
Other loans (held-for-sale and warehouse)	22,179	72,568	61,619	49,318	8,990
Federal Home Loan Bank stock, at cost	5,879	7,260	9,600	10,158	10,023
Deposits	460,098	499,760	508,411	528,497	555,444
Total borrowings	202,800	227,800	227,800	247,800	287,694
Total stockholders' equity	65,525	40,260	46,294	44,791	56,541

Selected Consolidated Statement of Operations Data

	Years Ended December 31,				
	2013	2012	2011	2010	2009
	(Dollars in Thousands)				
Total interest and dividend income	$ 28,836	$ 33,505	$ 38,281	$ 44,855	$ 48,718
Total interest expense	12,695	14,270	16,756	21,192	26,935
Net interest income	16,141	19,235	21,525	23,663	21,783
Provision for portfolio loan losses	7,026	12,491	15,383	21,230	24,873
Net interest income (loss) after provision for portfolio loan losses	9,115	6,744	6,142	2,433	(3,090)
Total noninterest income	6,328	10,096	11,232	8,262	4,165
Total noninterest expense	26,849	23,357	28,085	24,891	24,300
(Loss) income before income tax expense (benefit)	(11,406)	(6,517)	(10,711)	(14,196)	(23,225)
Income tax expense (benefit)		150	(424)		6,110
Net loss	$ (11,406)	$ (6,667)	$ (10,287)	$ (14,196)	$ (29,335)

Loss per common share:					
Basic	$ (3.23)	$ (2.67)	$ (4.13)	$ (5.51)	$ (11.43)
Diluted	$ (3.23)	$ (2.67)	$ (4.13)	$ (5.51)	$ (11.43)
Dividends declared per common share	$	$	$	$	$ 0.10

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Selected Consolidated Financial Ratios and Other Data

	At or For the Year Ended December 31, 2013		2012		2011		2010		2009	
Performance Ratios:										
Return (loss) on assets (ratio of net income (loss) to average total assets)	(1.55)	%	(0.85)	%	(1.27)	%	(1.58)	%	(3.01)	%
Return (loss) on equity (ratio of net income (loss) to average equity)	(30.45)	%	(14.51)	%	(19.24)	%	(25.85)	%	(38.40)	%
Dividend Payout ratio		%		%		%		%	(0.9)	%
Interest rate spread information:										
Interest rate spread (1)	2.18	%	2.42	%	2.67	%	2.66	%	2.14	%
Net interest margin (2)	2.31	%	2.58	%	2.83	%	2.79	%	2.37	%
Ratio of operating expense to average total assets	3.64	%	2.99	%	3.48	%	2.77	%	2.49	%
Efficiency ratio (3)	119.49	%	79.63	%	85.74	%	77.97	%	93.65	%
Ratio of average interest-earning assets to average interest-bearing liabilities	107.14	%	108.11	%	107.07	%	105.58	%	107.92	%
Asset Quality Ratios:										
Non-performing assets to total assets at end of year	1.17	%	4.26	%	6.65	%	4.60	%	4.44	%
Allowance for portfolio loan losses to non-performing portfolio loans	205.44	%	43.76	%	33.31	%	47.45	%	39.29	%
Allowance for portfolio loan losses to total portfolio loans	1.83	%	2.52	%	2.98	%	2.37	%	2.22	%
Net charge-offs to average outstanding portfolio loans	2.77	%	3.59	%	2.25	%	3.47	%	3.11	%
Non-performing portfolio loans to total portfolio loans	0.89	%	5.76	%	8.94	%	4.99	%	5.64	%
Capital Ratios:										
Total capital to risk weighted assets	20.5	%	9.8	%	10.9	%	10.1	%	11.4	%
Tier 1 capital to risk weighted assets	19.2	%	8.6	%	9.7	%	8.8	%	10.2	%
Tier 1 capital to adjusted assets	9.7	%	5.1	%	5.8	%	5.5	%	6.1	%
Average equity to average assets	5.1	%	5.9	%	6.6	%	6.1	%	7.8	%
Other Data:										
Number of full-service offices	11		11		11		11		11	
Number of loans	6,835		7,889		8,831		9,815		11,094	
Number of deposit accounts	35,960		37,681		39,094		39,606		39,282	

(1) Interest rate spread represents the difference between the weighted-average yield on interest-earning assets and the weighted-average cost of interest-bearing liabilities for the period.
(2) Net interest margin represents net interest income divided by average interest earning assets.
(3) Efficiency ratio represents noninterest expense as a percentage of net interest income plus noninterest income.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General Description of Business

The principal business of the Company and the Bank consists of attracting retail deposits from the general public and investing those funds primarily in warehouse loans held-for-investment, which are secured by one- to four-family residences originated under purchase and assumption agreements by third party originators, and, to a lesser extent, first mortgages on owner occupied, one- to four-family residences, home equity loans and automobile and other consumer loans originated for retention in our loan portfolio. In addition we have been increasing our focus on small business lending through our SBA lending programs, as well as commercial business and owner occupied commercial real estate loans to small businesses. Loans are obtained principally through retail staff and, brokers. The Company sells the guaranteed portion of loans originated through SBA lending, rather than hold the loans in portfolio. The Company also originates multi-family residential loans and commercial construction and residential construction loans, but no longer emphasizes the origination of such loans unless they are connected with SBA lending. The Company also invests in investment securities, primarily those issued by U.S. government-sponsored agencies or entities, including Fannie Mae, Freddie Mac and Ginnie Mae.

Revenues are derived principally from interest on loans and other interest-earning assets, such as investment securities. To a lesser extent, revenue is generated from service charges, gains on the sale of loans and other income.

The Company offers a variety of deposit accounts having a wide range of interest rates and terms, which generally include savings accounts, money market accounts, demand deposit accounts and time deposit accounts with terms ranging from 90 days to five years. In accordance with the Order entered into with the OCC on August 10, 2012, interest rates paid on deposit are limited and subject to national rates published weekly by the FDIC. Deposits are primarily solicited in the Bank's market area of the Jacksonville metropolitan area and southeastern Georgia when necessary to fund loan demand, or other liquidity needs.

See *Item 1. Business* and *Item 8. Financial Statements and Supplementary Data (Notes to Financial Statements)* contained in this report for further information related to financial condition and results of operation.

Business Strategy

<u>Overview</u>

Our primary objective is to operate a community-oriented financial institution, serving customers in our primary market areas while providing stockholders with a solid long-term return on capital. Accomplishing this objective will require financial strength based on a strong capital position, and the implementation of business strategies designed to return the Company to profitability consistent with safety and soundness considerations. Beginning late in 2011, the Company explored multiple strategic alternatives to raise capital, and on December 3, 2013 completed a public offering. Additionally, the Company completed a bulk sale of non-performing assets on December 27, 2013. As a result of the capital raise, operating strategies are now focused on increasing revenues from mortgage banking, through the Bank's internal mortgage origination activity, warehouse lending activity, traditional small business commercial lending, and SBA lending activity. The Company will continue to grow its warehouse lending and small business lending activities that maximize profits with lower capital requirements. In addition, the Company will focus on a conservative credit culture designed to keep non-performing assets at a low level. Finally, the Company seeks to increase non-maturity deposits to improve our cost of funds and to reduce our cost structure. As agreed to by the Company in the Order, the Bank cannot make significant changes to its current products, services, asset composition and size, funding sources, and other business activities without receiving non-objection from the OCC to its strategic and capital plan. The Bank received non-objection to its strategic and capital plan from the OCC on January 8, 2014.

See Note 19 in *Item 8. Financial Statements and Supplementary Data (Notes to Financial Statements)* contained in this report for further description of the provisions contained in the Order, as well as *Item 1A. Risk Factors* for a discussion of the risks associated with the Order.

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The following are the key elements of our business strategy:

Continuing To Strengthen Our Capital Position and Results of Operations. On December 3, 2013, the Company raised $48.3 million in gross proceeds by issuing 12,880,000 shares of its common stock in a public offering, which included the issuance of an additional 1,680,000 shares as a result of the exercise of the underwriters' over-allotment option, at a price to the public of $3.75 per share. Net proceeds from the public offering were $44.9 million after underwriting discounts and offering expenses of $3.4 million. The Company contributed $44.0 million of the net proceeds of the offering to the Bank to maintain capital ratios at required levels and to support growth in the Bank's loan and investment portfolios. The Company also intends to use the remaining net proceeds of the offering for general corporate purposes.

On December 27, 2013, the Company completed the sale of approximately $13.2 million of its non-performing assets to real estate investment firms. The sale included non-accrual loans with a carrying value of $10.6 million and OREO with a carrying value of $2.6 million, for a combined purchase price of $6.9 million.

In addition to the capital raise transaction and bulk sale of non-performing assets, management has also pursued, and will continue to pursue, various options to aid in the steady improvement of the Company's financial condition and results of operations.

Continuing Our Proactive Approach To Reducing Non-performing Assets By Aggressive Resolution And Disposition Initiatives. As a result of the decline in our local economy beginning in 2008, the Bank experienced a substantial increase in our non-performing assets from $9.6 million at December 31, 2007 to a peak of $52.5 million at December 31, 2011. However, as a result of management's proactive strategy and the December 27, 2013 bulk sale transaction, our non-performing assets were $8.6 million at December 31, 2013 as compared to $33.0 million at December 31, 2012. Management will continue to use a proactive strategy to reduce non-performing assets through loan work out programs and enhanced collection practices.

- *An aggressive charge-off policy.* Beginning in 2009, management implemented an aggressive charge-off strategy for one- to four-family residential mortgage loans and home equity loans by taking partial or full charge-offs in the period that such loans became non-accruing, generally when loans are 90 days or more past due.

- *Loan work out programs.* We remain committed to working with responsible borrowers to renegotiate residential loan terms. The Bank had $21.9 million in troubled debt restructurings at December 31, 2013. Troubled debt restructurings avoid the expense of foreclosure proceedings, and holding and disposition expenses of selling foreclosed property, and provide us increased interest income.

- *Enhanced collection practices*. Beginning in 2009, due to the elevated delinquency of our one- to four-family residential mortgage loans and the increasing complexity of working out these types of loans, management engaged the services of a national third party servicer for certain loans. Initially, one- to four-family residential mortgage loans, and any associated home equity loans that were 60 days past due, were assigned to the third party servicer for collection. Subsequently, the Bank assigned other one- to four-family residential mortgage loans to the third party servicer irrespective of delinquency status, if it was determined the loan may have higher than normal collection risk. At December 31, 2013, the outstanding balance of loans assigned to the third party servicer was $67.4 million. In addition, starting in 2012 and continuing through 2013, the Company increased resources internally to focus on workouts of non-performing one- to four-family residential loans which has led to decreased levels of non-performing loans and improved recoveries.

- *Non-performing asset sales.* In order to reduce the expenses of the foreclosure process, including the sale of foreclosed property, the Bank has sold certain non-performing loans through national loan sales of distressed assets, which may mitigate future losses. During 2013, the Bank sold $13.2 million of non-performing assets through bulk distressed asset sales resulting in losses on such sales of $6.3 million. The Bank does not intend to use bulk distressed asset sales in the foreseeable future. Also as a part of the Bank's work out program the Bank continues to accept short sales of residential property by borrowers where such properties are sold at a loss and the proceeds of such sales are paid to us when this action represents the least costly resolution for the Company.

- *Credit risk management.* The Bank is also enhancing credit administration by improving internal risk management processes. In 2010, an independent risk committee of our Board of Directors was established to evaluate and monitor system, market and credit risk. In 2012, in connection with a requirement by the Order, the Bank established a broad problem asset resolution program and developed enhanced asset workout plans for each criticized asset.

Increasing Revenue By Renewing Our Internal Mortgage Originations, Expanding Our Warehouse Lending Operations, And Increasing Our Emphasis On Commercial Lending To Small Businesses. Atlantic Coast Bank has emphasized the origination of one- to four-family residential mortgage loans in northeastern Florida and southeastern Georgia. At December 31, 2013, our one- to four-family residential loan portfolio was $167.5 million, or 44.9%, of our loan portfolio. During 2012, management shifted our business model to emphasize growth in warehouse lending and to continue to increase production in its small business lending initiative.

- *Internal mortgage originations strategy*. With the success of the Company's capital raise in December 2013, the Bank reentered the business of originating one- to four-family residential loans for investment, and intends to continue originating such loans internally

- *Warehouse lending strategy.* In the latter part of 2009, the Bank began a program for warehouse lending where we finance lines of credit secured by one- to four-family residential loans originated under purchase and assumption agreements by third-party originators and hold a lien position for a short duration (usually less than 30 days) while earning interest (and often a fee) until a sale is completed to an investor. Management expects to modestly expand this aspect of mortgage banking in the future.

- *Commercial lending strategy.* Management also plans to increase commercial business lending and owner-occupied commercial real estate lending with an emphasis on small businesses. The Bank intends to participate in government programs relating to commercial business loans such as the SBA and the U.S. Department of Agriculture (USDA). The Company generally sells the guaranteed portion of SBA loans to investors at attractive premiums. Our focus on owner-occupied commercial real estate loans will be to professional service businesses. The Bank does not intend to originate or purchase higher risk loans such as commercial real estate development projects, or land acquisition and development loans.

Strengthening Our Retail Franchise By Growing Noninterest-bearing Deposits and Reducing Our Overall Cost of Deposits. We believe a successful retail franchise results from a strong core customer base that focuses on noninterest-bearing deposits within an overall deposit strategy that offers interest rates that are competitive to its markets, but in line with the overall interest rate environment. Therefore, we remain committed to generating lower-cost and more stable noninterest-bearing deposits and offering our customers other deposit products with interest rates that are fair and meet their financial needs. The Bank compliments its attractive deposit products with excellent customer service and a comprehensive marketing program. The Bank will continue to build a core customer base by offering noninterest-bearing and other non-maturity deposits to individuals, businesses and municipalities located in our market area. Our noninterest-bearing deposits decreased 17.0% to $34.8 million at December 31, 2013 from $41.9 million at December 31, 2012. Additionally, at December 31, 2013, noninterest-bearing deposits comprised 7.6% of our total deposits, compared to 8.4% of our total deposits at December 31, 2012. Total cost of deposits (interest expense on deposits as compared to total average deposits) for the full year of 2013 was 0.67% as compared to 0.82% for 2012. In addition to improving our interest rate spread noninterest-bearing deposits also contributes noninterest income from account related services.

Reducing Our Operating Expense Base. The Company has historically operated with a high cost structure as it has implemented growth and new business activities. In order to improve profitability in 2013, we implemented numerous expense reduction initiatives in order to reduce operating costs that do not add value to our other business strategies. We intend to continue this focus in order to eliminate non-value added expenses and activities.

Critical Accounting Policies

Certain accounting policies are important to the presentation of the Company's financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Estimates associated with these policies are susceptible to material changes as a result of changes in facts and circumstances, including, but without limitation, changes in interest rates, performance of the economy, financial condition of borrowers and laws and regulations. Management believes that its critical accounting policies include determining the allowance, determining fair value of securities available-for-sale, other real estate owned and accounting for deferred income taxes. These accounting policies are discussed in detail in Note 1 in *Item 8. Financial Statements and Supplementary Data (Notes to Financial Statements)* contained in this report.

<u>Allowance for Portfolio Loan Losses</u>

An allowance is maintained to reflect probable incurred losses in portfolio loans. The allowance is based on ongoing assessments of the estimated losses incurred in portfolio loans and is established as these losses are recognized through provision expense charged to earnings. Generally, portfolio loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Due to the decline in real estate values in our markets since 2008 and the weak United States economy in general, we believe it is likely that collateral for non-performing one- to four-family residential and home equity loans, will not be sufficient to fully repay such loans. Therefore the Company charges one- to four-family residential and home equity loans down by the expected loss amount at the time they become non-performing, which is generally 90 days past due. This process accelerates the recognition of charge-offs on one- to four-family residential and home equity loans but has no impact on the impairment evaluation process.

The reasonableness of the allowance is reviewed and established by management, within the context of applicable accounting and regulatory guidelines, based upon its evaluation of then-existing economic and business conditions affecting the Bank's key lending areas. Senior credit officers monitor those conditions continuously and reviews are conducted quarterly with the Bank's senior management and the Board of Directors.

Management's methodology for assessing the reasonableness of the allowance consists of several key elements, which include a general loss component by type of portfolio loan and specific allowances for identified problem portfolio loans. The allowance also incorporates the results of measuring impaired portfolio loans.

The general loss component of the allowance is calculated by applying loss factors, adjusted for other qualitative factors to outstanding unimpaired loan balances. Loss factors are based on the Bank's recent loss experience, including recent short sales and sales of non-performing loans. Qualitative factors consider current market conditions that may impact real estate values within the Bank's primary lending areas, and other significant factors that, in management's judgment, may affect the ability to collect loans in the portfolio as of the evaluation date. Other significant qualitative factors that exist as of the balance sheet date that are considered in determining the adequacy of the allowance include the following: (1) Current delinquency levels and trends; (2) Non-performing asset levels, trends, and related charge-off history; (3) Economic trends   local and national; (4) Changes in loan policy; (5) Expertise of management and staff of the Bank; (6) Volumes and terms of loans; and (7) Concentrations of credit considering the impact of recent short sales and sales of non-performing loans.

The impact of the general loss component on the allowance began increasing during 2008 and has remained at an elevated level through the end of 2013. The increase reflected the deterioration of market conditions, and the increase in the portfolio loan loss experience that has resulted from management's proactive approach to recognizing losses on impaired one- to four-family and home equity loans in the period the impairment is identified.

The specific loss component of the allowance generally relates to portfolio loans that have been classified as doubtful, substandard, or special mention according to the Company's internal asset classification system. Substandard portfolio loans include those characterized by the distinct possibility the Company may sustain some loss if the deficiencies are not corrected. Portfolio loans classified as doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Portfolio loans that do not currently expose the Company to sufficient risk to warrant classification in one of the aforementioned categories, but possess weaknesses that deserve management's close attention are deemed to be special mention. Risk ratings are updated any time the facts and circumstances warrant.

For portfolio loans that are also identified as impaired, an allowance is established when the discounted cash flows, collateral value, or observable market price of the impaired loan is lower than the carrying value. A portfolio 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 according to the contractual terms of the loan agreement. Factors used by management to determine impairment include payment status, collateral value and the probability of collecting scheduled principal or interest payments when due. Portfolio 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, the borrower, and the amount of the shortfall in relation to the principal or interest owed. TDRs with borrowers where the Bank has granted a concession to the borrower because of their financial difficulties are considered impaired portfolio loans. Impairment is measured on a loan-by-loan basis for non-homogeneous portfolio loans such as commercial real estate, commercial real estate construction, and commercial business loans 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.

Management also evaluates the allowance based on a review of certain large balance individual loans. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows management expects to receive on impaired loans which may be susceptible to significant change and risks. The determination of the fair value of collateral considers recent trends in valuation as indicated by short sales and sales of non-performing portfolio loans of the applicable loan category. No specific allowance is recorded unless fair value is less than carrying value.

Large groups of smaller balance homogeneous portfolio loans, such as individual consumer and residential loans are collectively evaluated for impairment and are excluded from the specific impairment evaluation. For these portfolio loans, the allowance is calculated in accordance with the general loss policy described above. Accordingly, individual consumer and residential loans are not separately identified for impairment disclosures, unless the loan has been modified as a troubled debt restructuring as discussed below.

The allowance was $6.9 million, or 1.8% of total loans outstanding, and $10.9 million, or 2.5% of total loans outstanding at December 31, 2013 and 2012, respectively. The provision expense for each quarter of 2013, 2012 and 2011, and the total for the respective years is as follows:

	2013	2012	2011
	(Dollars in Millions)		
First quarter	$ 1.2	$ 3.5	$ 2.8
Second quarter	1.2	3.7	3.0
Third quarter	1.3	3.5	4.4
Fourth quarter	3.3	1.8	5.2
Total provision for portfolio loan losses	$ 7.0	$ 12.5	$ 15.4

As this information illustrates, the amount of the allowance and related provision expense can vary over long-term and short-term periods. Changes in economic conditions, the composition of the loan portfolio and individual borrower conditions can dramatically impact the required level of allowance, particularly for larger individually evaluated loan relationships, in relatively short periods of time. The allowance allocated to individually evaluated loan relationships was $1.0 million and $2.2 million at December 31, 2013 and 2012, respectively, a decrease of $1.2 million. Given the rapidly changing and uncertain real estate market coupled with changes in borrowers' financial condition, changes in collateral values, and the overall economic uncertainty, management believes there could be significant changes in individual specific loss allocations in future periods as these factors are difficult to predict and can vary widely as more information becomes available or as projected events change.

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Troubled Debt Restructurings

Portfolio loans for which the terms have been modified as a result of the borrower's financial difficulties are classified as TDRs. TDRs are measured for impairment based upon the present value of estimated future cash flows using the loan's interest rate at inception of the loan or the appraised value of the collateral if the loan is collateral dependent. Impairment of homogeneous portfolio loans, such as one- to four-family residential loans, that have been modified as TDRs is calculated in the aggregate based on the present value of estimated future cash flows.

A portfolio loan that is modified as a TDR with a market rate of interest is classified as an impaired loan and reported as a TDR in the year of restructure and until the loan has performed for twelve months in accordance with the modified terms. The policy for returning a non-performing portfolio loan to accrual status is the same for any loan irrespective of whether the loan has been modified. As such, portfolio loans which are non-performing prior to modification continue to be accounted for as non-performing portfolio loans until they have demonstrated the ability to maintain sustained performance over a period of time, but no less than six months, and are reported as impaired non-performing portfolio loans.

Fair Value of Investment Securities

Investment securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported separately in other comprehensive income (loss), net of tax. Investment securities held-to-maturity are carried at amortized cost. The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

Management evaluates investment securities for OTTI at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. In determining OTTI, management considers many factors, including: (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, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Company has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at the determination date.

When OTTI is determined to have occurred, the amount of the OTTI recognized in earnings depends on whether we intend to sell the security or it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss. If we intend to sell the security or it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss, the OTTI recognized in earnings is equal to the entire difference between its amortized cost basis and its fair value at the balance sheet date. If we do not intend to sell the security and it is not more likely than not that we will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the OTTI is separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized as a charge to earnings. The amount of the OTTI related to other factors is recognized in other comprehensive income (loss), net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment. The Company recorded no OTTI for the year ended December 31, 2013.

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Other Real Estate Owned

Assets acquired through or in lieu of loan foreclosure are initially recorded at fair value based on an independent appraisal, less estimated selling costs, at the date of foreclosure, establishing a new cost basis. If fair value declines subsequent to foreclosure, the asset value is written down through expense. Costs relating to improvement of property are capitalized, whereas costs relating to holding of the property are expensed.

Deferred Income Taxes

After converting to a federally chartered savings association, the Bank became a taxable organization. Income tax expense, or benefit, is the total of the current year income tax due, or refundable, and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary difference between carrying amounts and tax basis of assets and liabilities, computed using enacted tax rates and operating loss carryovers. The Company's principal deferred tax assets result from the allowance for portfolio loan losses and operating loss carryovers. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized. The Internal Revenue Code and applicable regulations are subject to interpretation with respect to the determination of the tax basis of assets and liabilities for credit unions that convert charters and become a taxable organization. Since the Bank's transition to a federally chartered savings bank, the Company has recorded income tax expense based upon management's interpretation of the applicable tax regulations. Positions taken by the Company in preparing our federal and state tax returns are subject to the review of taxing authorities, and the review by taxing authorities of the positions taken by management could result in a material adjustment to the financial statements.

All available evidence, both positive and negative, is considered when determining whether or not a valuation allowance is necessary to reduce the carrying amount to a balance that is considered more likely than not to be realized. The determination of the realizability of deferred tax assets is highly subjective and dependent upon judgment concerning management's evaluation of such evidence. Positive evidence considered includes the probability of achieving forecasted taxable income and the ability to implement tax planning strategies to accelerate taxable income recognition. Negative evidence includes the Company's cumulative losses. Following the initial establishment of a valuation allowance, if the Company is unable to generate sufficient pre-tax income in future periods or otherwise fails to meet forecasted operating results, an additional valuation allowance may be required. Any valuation allowance is required to be recorded during the period identified. As of December 31, 2013, the Company had a valuation allowance of $17.5 million which fully reserved for the deferred tax asset.

Under the rules of Internal Revenue Code § 382 (IRC § 382), a change in the ownership of the Company occurred during the first quarter of 2013. During the second quarter of 2013, the Company became aware of the change in ownership based on applicable filings made by stockholders with the Securities and Exchange Commission. In accordance with IRC § 382, the Company determined the gross amount of net operating loss carryover that it could utilize was limited to approximately $325,000 per year. The deferred tax asset is discussed in detail in Note 14 in *Item 8. Financial Statements and Supplementary Data (Notes to Financial Statements)* contained in this report.

Comparison of Financial Condition at December 31, 2013 and 2012

General

Total assets decreased $39.0 million, or 5.0%, to $733.6 million at December 31, 2013 as compared to $772.6 million at December 31, 2012. The primary reason for the decrease in assets was a decrease in net portfolio loans of $49.2 million and other loans of $50.4 million, partially offset by an increase in cash and cash equivalents of $46.4 million and an increase in investment securities of $19.3 million. Prior to the successful completion of its capital raise on December 3, 2013, the Company's priority was to continue to manage its balance sheet consistent with its capital preservation strategy as well as to strengthen the Company's balance sheet liquidity. Total deposits decreased $39.7

million, or 7.9%, to $460.1 million at December 31, 2013 from $499.8 million at December 31, 2012. Noninterest-bearing demand accounts decreased $7.1 million, interest-bearing demand accounts decreased $4.5 million, savings and money market accounts decreased by $9.2 million and time deposits decreased by a total of $18.9 million during the year ended December 31, 2013. Total borrowings decreased by $25.0 million to $202.8 million at December 31, 2013 from $227.8 million at December 31, 2012 due to the repayment of $25.0 million of FHLB advances. Stockholders' equity increased by $25.2 million to $65.5 million at December 31, 2013 from $40.3 million at December 31, 2012 due to net proceeds from the capital raise of $44.9 million, partially offset by net loss of $11.4 million for the year ended December 31, 2013 and a decrease in other comprehensive income of $8.3 million for the same time period.

Following is a summarized comparative balance sheet as of December 31, 2013 and 2012:

	December 31, 2013	December 31, 2012	Increase / (Decrease) Amount	%
	(Dollars in Thousands)			
Assets:				
Cash and cash equivalents	$ 114,194	$ 67,828	$ 46,366	68.4 %
Investment securities (available-for-sale and held-to-maturity)	178,998	159,745	19,253	12.1 %
Portfolio loans	378,902	432,090	(53,188)	-12.3 %
Allowance for portfolio loan losses	6,946	10,889	(3,943)	-36.2 %
Portfolio loans, net	371,956	421,201	(49,245)	-11.7 %
Other loans (held-for-sale and warehouse)	22,179	72,568	(50,389)	-69.4 %
Other Assets	46,306	51,277	(4,971)	-9.7 %
Total assets	$ 733,633	$ 772,619	$ (38,986)	-5.0 %
Liabilities and stockholders' equity:				
Deposits:				
Noninterest-bearing demand	$ 34,782	$ 41,904	$ (7,122)	-17.0 %
Interest-bearing demand	68,954	73,490	(4,536)	-6.2 %
Savings and money market	172,552	181,708	(9,156)	-5.0 %
Time	183,810	202,658	(18,848)	-9.3 %
Total deposits	460,098	499,760	(39,662)	-7.9 %
Securities sold under agreements to repurchase	92,800	92,800		
Federal Home Loan Bank advances	110,000	135,000	(25,000)	-18.5 %
Accrued expenses and other liabilities	5,210	4,799	411	8.6 %
Total liabilities	668,108	732,359	(64,251)	-8.8 %
Total stockholders' equity	65,525	40,260	25,265	62.8 %
Total liabilities and stockholders' equity	$ 733,633	$ 772,619	$ (38,986)	-5.0 %

Cash and Cash Equivalents

Cash and cash equivalents increased $46.4 million to $114.2 million at December 31, 2013 from $67.8 million at December 31, 2012. Prior to the Company's successful completion of its capital raise on December 3, 2013, the Bank increased its cash and cash equivalent holdings during the year in order to raise the amount of immediately available liquidity sources in response to reduced contingent sources of liquidity from the FHLB and the FRB.

Investment Securities

Investment securities, both available-for-sale and held-to-maturity, are comprised primarily of debt securities of U.S. Government-sponsored enterprises, and mortgage-backed securities. The investment portfolio increased $19.3 million to $179.0 million at December 31, 2013, from $159.7 million at December 31, 2012. As of December 31, 2013, $159.7 million of investment securities were classified as available-for-sale, while $19.3 million of investment securities were classified as held-to-maturity. As of December 31, 2012, $159.7 million of investment securities were classified as available-for-sale, while no investment securities were classified as held-to-maturity.

As of December 31, 2013, approximately $115.8 million of investment securities were pledged as collateral for the reverse repurchase agreements and $31.2 million were pledged to the FHLB as collateral for advances and estimated prepayment fees. At December 31, 2013, $178.0 million, or 99.5%, of the debt securities held by the Company were issued by U.S. government-sponsored entities and agencies, primarily Fannie Mae, Freddie Mac and Ginnie Mae, institutions which the government has affirmed its commitment to support.

Portfolio Loans

Below is a comparative composition of net portfolio loans as of December 31, 2013 and December 31, 2012, excluding loans held-for-sale and warehouse loans held-for-investment:

	December 31, 2013		% of Total Loans		December 31, 2012		% of Total Loans	
	(Dollars in Thousands)							
Real estate loans:								
One- to four-family	$	167,455	44.9	%	$	193,057	45.3	%
Commercial		48,356	12.9	%		58,193	13.7	%
Other (land and multi-family)		15,790	4.2	%		19,908	4.7	%
Total real estate loans		231,601	62.0	%		271,158	63.7	%
Real estate construction loans:								
One- to four-family			0.0	%			0.0	%
Commercial		2,582	0.7	%		5,049	1.2	%
Acquisition and development			0.0	%			0.0	%
Total real estate construction loans		2,582	0.7	%		5,049	1.2	%
Other portfolio loans:								
Home equity		52,767	14.1	%		63,867	15.0	%
Consumer		53,290	14.3	%		61,558	14.4	%
Commercial		33,029	8.9	%		24,308	5.7	%
Total other portfolio loans		139,086	37.3	%		149,733	35.1	%
Total loans		373,269	100.0	%		425,940	100.0	%
Allowance for portfolio loan losses		(6,946)				(10,889)		
Net deferred loan costs		5,633				6,150		
Loans, net	$	371,956			$	421,201		

Total gross portfolio loans declined $52.6 million, or 12.4%, to $373.3 million at December 31, 2013 as compared to $425.9 million at December 31, 2012 primarily due to principal amortization and increased prepayments of one- to four-family residential and home equity loans during 2013, consistent with the low interest rate environment for one- to four-family mortgages. Total portfolio loans also declined due to a bulk sale of non-performing assets on December 27, 2013, which included non-performing loans of $10.6 million, gross loan charge-offs of $12.7 million and transfers to OREO of non-performing loans of $10.5 million during 2013. Portfolio loan originations increased $13.2 million to $33.8 million for the year ended December 31, 2013 from $20.6 million for the year ended December 31, 2012.

Small business loan originations, including SBA portfolio loans and small business loans originated internally and held-for-sale (SBA loans held-for-sale), were $9.9 million during 2013. The Company sells the guaranteed portion of SBA loans held-for-sale upon completion of loan funding and approval by the SBA. The unguaranteed portion of SBA loans held-for-sale at December 31, 2013 and December 31, 2012 was $5.0 million and $3.3 million, respectively. The Company plans to continue to expand this business line going forward.

As a result of the Company's successful capital raise on December, 2013, growth in mortgage origination, the SBA portfolio, and other small business loan production is expected to exceed principal amortization and loan payoffs. Additionally, due to the favorable interest rate environment, production of warehouse loans held-for-investment will continue to be a strategic focus, but there is no certainty that the balance of such loans will increase.

The composition of the Bank's portfolio loans is heavily weighted toward one- to four-family residential mortgage loans. As of December 31, 2013, first mortgages (including residential construction loans), second mortgages and home equity loans totaled $220.2 million, or 59.0% of total gross portfolio loans. Approximately $32.0 million, or 60.6% of loans recorded as home equity loans are in a first lien position. Accordingly, $199.4 million, or 90.6% of loans collateralized by one- to four-family residential loans were in a first lien position as of December 31, 2013.

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The composition of the Bank's loan portfolio by state as of December 31, 2013 was as follows:

	Florida	Georgia	Other States	Total
	(Dollars in Thousands)			
One- to four-family first mortgages	$ 107,974	$ 37,565	$ 21,916	$ 167,455
One- to four-family second mortgages	25,412	26,375	980	52,767
One- to four-family construction loans				
	$ 133,386	$ 63,940	$ 22,896	$ 220,222

Allowance for Portfolio Loan Losses

The allowance was $6.9 million, or 1.8% of total loans at December 31, 2013 compared to $10.9 million, or 2.5% of total loans at December 31, 2012. The activity in the allowance for the years ended December 31, 2013 and 2012 was as follows:

	December 31, 2013	December 31, 2012
	(Dollars in Thousands)	
Balance at beginning of year	$ 10,889	$ 15,526
Charge-offs:		
Real estate loans:		
One- to four-family	(4,485)	(6,347)
Commercial	(2,452)	(2,756)
Other (land and multi-family)	(790)	(1,906)
Real estate construction loans:		
One- to four-family		
Commercial		(1,145)
Acquisition and development		
Other portfolio loans:		
Home equity	(2,017)	(3,215)
Consumer	(2,131)	(1,567)
Commercial	(880)	(1,769)
Total charge-offs	(12,755)	(18,705)
Recoveries:		
Real estate loans:		
One- to four-family	961	1,036
Commercial		3
Other (land and multi-family)	63	8
Real estate construction loans:		
One- to four-family		
Commercial		
Acquisition and development		
Other portfolio loans:		
Home equity	395	223
Consumer	289	305
Commercial	78	2
Total recoveries	1,786	1,577

Net charge-offs		(10,969)		(17,128)
Provision for portfolio loan losses		7,026		12,491
Balance at end of year	$	6,946	$	10,889
Net charge-offs to average outstanding portfolio loans		2.77 %		3.59 %

Net charge-offs during 2013 decreased compared to 2012 primarily due to $3.2 million less in charge-offs related to one-to-four family residential loans and home equity loans, $1.0 million less in charge-offs related to collateral-dependent commercial real estate property, $0.9 million less in charge-offs related to construction loans, and $1.0 million less in charge-offs related to collateral-dependent commercial land loans.

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On December 27, 2013, the Company completed a bulk sale transaction, which included non-performing loans of $10.6 million. The bulk sale resulted in $4.7 million in charge-offs, $2.3 million of which had not been reserved for previously. The Company seeks to reduce non-performing loans in the least costly way possible, including workout, troubled debt restructurings, short sales and when necessary foreclosure, disposal of collateral, and bulk sale. Portfolio loans the Company holds for sale are recorded at the lower of cost or fair market value on an aggregate basis and reported as held-for-sale. As of December 31, 2013, the Company had no non-performing loans held-for-sale.

It is the Company's policy to charge-off one- to four-family first mortgages and home equity loans to the estimated fair value of the collateral at the time the loan becomes non-performing. During the year ended December 31, 2013, charge-offs included partial charge-offs of $1.6 million of one- to four-family first mortgages and home equity loans identified as non-performing, a decrease of $2.2 million as compared to $3.8 million for the year ended December 31, 2012, principally attributable to decreased losses on first mortgages and home equity loans.

Below is a comparative composition of non-performing assets as of December 31, 2013 and 2012:

	December 31, 2013			December 31, 2012		
	(Dollars in Thousands)					
Non-performing assets:						
Real estate loans:						
One- to four-family	$	2,677		$	10,555	
Commercial					8,643	
Other (land and multi-family)		75			595	
Real estate construction loans:						
One- to four-family						
Commercial					739	
Acquisition and development						
Other portfolio loans:						
Home equity		400			2,212	
Consumer		229			969	
Commercial					1,171	
Total non-performing loans		3,381			24,884	
Other real estate owned		5,225			8,065	
Total non-performing assets	$	8,606		$	32,949	
Non-performing loans to total loans		0.9	%		5.8	%
Non-performing assets to total assets		1.2	%		4.3	%

Non-performing loans were $3.4 million or 0.9% of total loans at December 31, 2013 as compared to $24.9 million or 5.8% of total loans at December 31, 2012. The decrease in non-performing loans was primarily due to a bulk sale of non-performing assets on December 27, 2013, which included non-performing loans of $10.6 million, the transfer of $10.5 million in non-performing loans to OREO, and the return to performing status of a $1.0 million residential mortgage loan. Additionally, the decrease is due to fewer performing loans becoming non-performing loans.

During 2012 and continuing into 2013 the market for disposing of non-performing assets has become more active. These types of transactions may result in additional losses over the amounts provided for in the allowance, however, the Company continues to attempt to reduce non-performing assets through the least costly means possible. The allowance is determined by the information available at the time such determination is made and reflects management's best estimate of loss.

As of December 31, 2013, total non-performing one- to four-family residential and home equity loans of $3.1 million was comprised of $4.5 million in contractual balances that had been written-down to the estimated fair value of their collateral, less estimated selling costs, at the date that the loan was classified as non-performing. Further declines in the fair value of the collateral, or a decision to sell such loans as distressed assets, could result in additional losses. As of December 31, 2013, and December 31, 2012, all non-performing loans were classified as non-accrual, and there were no loans 90 days past due and accruing interest as of December 31, 2013 and 2012.

OREO decreased $2.9 million to $5.2 million at December 31, 2013 from $8.1 million at December 31, 2012 as the foreclosed asset sales of $11.2 million, including $2.6 million in a bulk sale transaction, and OREO write-downs of $2.2 million, exceeded transfers from non-performing loans into OREO of $10.5 million during 2013. Historically, the Company does not incur additional material losses after non-performing loans are moved to OREO, or as a result of the sale of OREO. However, due to the bulk sale of certain OREO in 2013, the Company recorded a net loss on the sale of foreclosed assets of $3.6 million for the year ended December 31, 2013. The Company recorded a net loss on the sale of foreclosed assets of $0.4 million for the year ended December 31, 2012. The Company does not intend to sell non-performing loans through bulk sale transactions in the near term.

Impaired Loans

The following table shows impaired loans segregated by performing and non-performing status and the associated specific reserve as of December 31, 2013 and 2012:

	December 31, 2013		December 31, 2012	
	Balance	Specific Reserve	Balance	Specific Reserve
	(Dollars in Thousands)			
Performing	$ 263	$	$ 6,465	$
Non-performing (1)	131		11,196	286
Troubled debt restructuring by category:				
Troubled debt restructurings performing for less than 12 months commercial	13,008	123	7,632	214
Troubled debt restructurings performing for less than 12 months residential	8,767	1,227	12,383	1,688
Total impaired loans	$ 22,169	$ 1,350	$ 37,676	$ 2,188

(1) Balance includes non-performing TDR loans of $0.1 million and $2.4 million as of December 31, 2013 and December 31, 2012, respectively. There are no specific reserves for such loans as of December 31, 2013 and December 31, 2012, respectively.

No portfolio loans were added to performing impaired loans during 2013. The decline in non-performing impaired loans was primarily due to a bulk sale of non-performing assets, which included non-performing impaired loans of $2.8 million, the transfer of $6.4 million of non-performing impaired loans to OREO during the year, and other sales of non-performing impaired loans of $2.5 million, partially offset by additions to non-performing impaired loans of $1.5 million during 2013.

Impaired loans include large non-homogeneous loans where it is probable that the Bank will not receive all principal or interest when contractually due. Impaired loans also include TDRs where the borrower has performed for less than 12 months under the terms of the modification and/or the TDR loan is at less than market rate at the time of restructure. TDR loans totaled $21.9 million as of December 31, 2013 as compared to $22.4 million at December 31, 2012.

A portfolio loan that is modified as a TDR with a market rate of interest is classified as an impaired loan and reported as a TDR in the year of restructure and until the loan has performed for twelve (12) months in accordance with the modified terms. At December 31, 2013, approximately $12.3 million of restructured loans, previously disclosed as

TDRs, have demonstrated 12 months of performance under restructured terms and are no longer reported as impaired loans.

Other Loans

Other loans was comprised of loans secured by one- to four-family residential homes originated internally (mortgage loans held-for-sale), small business loans originated internally (SBA loans held-for-sale), and warehouse loans held-for-investment.

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The following table shows other loans, segregated by held-for-sale and warehouse loans held-for-investment, as of December 31, 2013 and 2012:

	December 31, 2013	December 31, 2012
	(Dollars in Thousands)	
Other loans:		
Held-for-sale	$ 1,656	$ 4,089
Warehouse loans held-for-investment	20,523	68,479
Total other loans	$ 22,179	$ 72,568

Other loans decreased $50.4 million, or 69.4% to $22.2 million at December 31, 2013 as compared to $72.6 million at December 31, 2012 primarily due to a decrease in warehouse loan originations and the weighted average number of days outstanding of warehouse loans held-for-investment. The decrease in warehouse loan originations is the result of a decline in home purchase and refinance volume, due to rising interest rates.

During 2012, the Company phased out its internally generated one- to four-family residential mortgage business in favor of a referral program whereby the Bank earns a fee for closed loans. As a result, the Company did not internally originate or sell any mortgage loans held-for-sale during the year ended December 31, 2013 as compared to originations of $27.0 million and sales of $29.6 million during the year ended December 31, 2012. The gain recorded on sale of mortgage loans held-for-sale during 2012 was $0.7 million. With the success of the Company's capital raise in December 2013, the Bank reentered the business of originating one- to four-family residential loans, and beginning early in 2014 intends to originate some of those loans to be held-for-sale.

During the year ended December 31, 2013 the Company internally originated $6.4 million and sold $9.6 million of SBA loans held-for-sale compared to originations of $12.7 million and sales of $7.8 million during the year ended December 31, 2012. The gain recorded on sales of SBA loans held-for-sale during 2013 and 2012 was $0.6 million and $0.8 million, respectively.

Loans originated and sold under the Company's warehouse lending program were $823.3 million and $871.3 million, respectively, for the year ended December 31, 2013 as compared to originations and sales of $900.4 million and $889.8 million, respectively, for the year ended December 31, 2012. Loan sales under the warehouse lending program, which are done at par, earned interest on outstanding balances for the years ended December 31, 2013 and 2012 of $1.6 million and $2.2 million, respectively. For the year ended December 31, 2013, the weighted average number of days outstanding of warehouse loans held-for-investment was 19 days.

Deferred Income Taxes

As of both December 31, 2013 and 2012 the Company concluded that, while improved operating results are expected as the economy continues to improve and the Bank's non-performing assets remain at low levels, a more likely than not conclusion of realization of the Company's deferred tax asset could not be supported due to the variability of the credit related costs and the impact of its high debt costs on profitability. Consequently the Company has recorded a valuation allowance of $17.5 million for the entire amount of the net federal and state deferred tax assets as of December 31, 2013. Until such time as the Company determines it is more likely than not that it is able to generate taxable income, no tax benefits will be recorded in future periods to reduce net losses before taxes. However, at such time in the future that the Company records taxable income or determines that realization of the deferred tax asset is more likely than not, some of the valuation allowance may be available as a tax benefit. The future realization of the Company's net operating loss carryovers is limited to $325,000 per year. The deferred tax asset is discussed in detail in Note 14 in *Item 8. Financial Statements and Supplementary Data (Notes to Financial Statements)* contained in this report.

Deposits

Total deposits were $460.1 million at December 31, 2013, a decrease of $39.7 million from $499.8 million at December 31, 2012. Non-maturing deposits and time deposits decreased by $20.8 million and $18.9 million, respectively, during 2013. Non-maturing deposits decreased to $276.3 million at December 31, 2013 due to a $7.1 million decrease in noninterest-bearing demand deposits, a $4.5 million decrease in interest-bearing demand deposits, and a $9.2 million decrease in savings and money market deposits as the Bank sought to manage the balance sheet by actively reducing deposit rates, while maintaining relationship customers. Time deposits decreased to $183.8 million as of December 31, 2013 due to a decrease of $17.8 million in our standard certificates of deposit, a decrease of $21.1 million in deposits originally acquired through a national internet deposit program and broker deposit declines of $5.0 million, partially offset by an increase of $25.0 million related to a retail certificates of deposit promotion.

As a part of its capital preservation strategy, the Bank strategically lowered rates on time deposits beginning in the second half of 2009 in order to reduce those deposits consistent with loan balance decreases. As a result of the successful capital raise, the Bank will actively seek to grow deposits to meet liquidity needs during 2014. Management believes near term deposit growth will be moderate with an emphasis on core deposit growth. The Bank may supplement core deposit growth, if needed, with strategic retail certificates of deposit promotions, certificates of deposit sourced through a well-known national non-broker internet deposit program, which has been successfully utilized in the past, or the creation of new business deposit products. Dramatic changes in the short-term interest rate environment could affect the availability of deposits in our local market and, therefore, cause the Bank to change its strategy. Under the Consent Order, the Bank may not renew or increase brokered deposits without prior written non-objection from the OCC. At December 31, 2013 the Bank did not have any brokered deposits, and management does not intend to use brokered deposits in the near term. The prohibition not to renew or increase brokered deposits also prevents the Bank from offering deposit rates higher than 75 basis points over the FDIC published national average rate for comparable deposit types.

Securities Sold Under Agreements to Repurchase

The Company has reverse repurchase agreements with a carrying amount of $92.8 million as of December 31, 2013 and 2012. Collateral for $77.8 million of the structured notes are subject to a reduction of 12.0% after applying values set by the counterparties. Collateral for $15.0 million of the structured notes are subject to a reduction of 9.0% after applying values set by the counterparties. Under the terms of the agreements the counterparties require that the Company provide additional collateral for the borrowings as protection for their market risk when the fair value of the borrowings exceeds the contractual amounts. As a result, the Company had $115.8 million and $116.9 million in securities posted as collateral for these instruments as of December 31, 2013 and 2012, respectively. The Company will be required to post additional collateral if the gap between the market value of the liability and the contractual amount of the liability increases.

Information concerning reverse repurchase agreements as of December 31, 2013 and 2012 is summarized as follows:

	December 31, 2013 (Dollars in Thousands)			December 31, 2012		
Average daily balance	$	92,800		$	92,800	
Weighted average coupon interest rate during the period		5.10	%		5.10	%
Maximum month-end balance during the period	$	92,800		$	92,800	
Weighted average coupon interest rate at end of period		5.10	%		5.10	%
Weighted average maturity (months)		30			42	

Under the agreements to repurchase, the lender has the option to terminate individual advances in whole the following quarter; there is no termination penalty if terminated by the lender. There have been no early terminations.

Under the terms of a revised agreement the Company entered into on August 2, 2012 with the counterparty on $77.8 million of the $92.8 million the Bank is required to pledge additional collateral if its capital ratios decrease below the PCA defined levels of well-capitalized or adequately capitalized. The Company was above the PCA defined levels of well-capitalized at December 31, 2013. However, the Company was required to increase pledged collateral by $4.0 million during 2013 due to capital ratios falling below the PCA defined levels of well-capitalized at December 31, 2012. Failure to maintain required collateral levels is in violation of the default provision under the terms of the agreement and could result in a termination penalty. At December 31, 2013, the fair value of $77.8 million of the debt exceeded the carrying value by approximately $7.1 million, which approximates the termination penalty.

Federal Home Loan Bank Advances

FHLB borrowings at December 31, 2013 and 2012 were $110.0 million and $135.0 million, respectively. The FHLB advances had a weighted-average maturity of 39 months and a weighted-average rate of 4.11% at December 31, 2013. During the first quarter 2013, the Company prepaid advances scheduled for maturity in the third and fourth quarter of 2013 totaling $25.0 million, resulting in a prepayment penalty of $0.5 million. This prepayment reduced interest expense by $0.8 million during 2013 and reduced the amount of collateral required to secure the debt.

The Bank’s remaining borrowing capacity with the FHLB is $5.0 million at December 31, 2013. The minimal borrowing capacity was due to the declining balance of outstanding loans used as collateral as a result of normal loan payments and payoffs. In addition, effective August 31, 2012, the FHLB required that the Bank collateralize the excess of the fair value of the FHLB advances over the book value with cash and securities. As of December 31, 2013, fair value exceeded the book value of the individual advances by $10.5 million, which was collateralized entirely by investment securities. Due to the Bank’s financial condition, the FHLB discounts the value of the collateral pledged for advances at rates higher than those used for banks with stronger credit. Accordingly, the amount of required collateral is elevated compared to some of our peers. The Bank intends to supplement its loan collateral with investment securities as needed to secure the FHLB borrowings, or prepay advances to reduce the amount of collateral required to secure the debt. Unpledged securities available for collateral amounted to $26.9 million as of December 31, 2013. In the event the Bank prepays additional advances prior to maturity, it must do so at fair value. To the extent it is required to purchase additional securities to collateralize the FHLB debt, the Company’s profitability may decrease as liquidity may not be available for higher interest-earning asset growth.

Stockholders’ Equity

Stockholders’ equity increased by $25.2 million to $65.5 million at December 31, 2013 from $40.3 million at December 31, 2012 primarily due to the capital raise on December 3, 2013 which resulted in $44.9 million in net proceeds, partially offset by the net loss of $11.4 million and a decrease in accumulated other comprehensive income (loss) of $8.3 million for the year ended December 31, 2013. The decrease in accumulated other comprehensive income (loss) was due to a negative change in the fair value of investment securities available-for-sale because of an increase in interest rates during 2013.

Beginning in 2009, the Company implemented strategies to preserve capital including the suspension of cash dividends and its stock repurchase program. Resumption of these programs is not expected to occur in the near term. The Company’s equity to assets ratio increased to 8.9% at December 31, 2013, from 5.2% at December 31, 2012. As of December 31, 2013, the Bank’s Tier 1 capital to adjusted assets ratio was 9.73%, Total risk based capital to risk-weighted assets ratio was 20.47% and Tier 1 capital to risk-weighted assets ratio was 19.22%. These ratios as of December 31, 2012 were 5.13%, 9.78%, and 8.52%, respectively. The Bank is currently deemed well-capitalized for regulatory supervision purposes.

Comparison of Results of Operations for the Years Ended December 31, 2013 and 2012.

General

Net loss for the year ended December 31, 2013 was $11.4 million, as compared to a net loss of $6.7 million for the year ended December 31, 2012. The net loss for 2013 increased compared with 2012 due to a decrease in net interest income of $3.1 million, a decrease in noninterest income of $3.8 million, and an increase in noninterest expense of $3.5 million, partially offset by a reduction in the provision expense of $5.5 million. Net interest income declined in 2013 due to a reduction in portfolio loans, held-for-sale loans and warehouse loans held-for-investment outstanding and the impact of lower interest rates on funds reinvested in investment securities, partially offset by decreased interest expense for deposits and FHLB borrowings. Noninterest income decreased due to a decrease in gains on sales of investment securities, as well as reductions in gains on sales of loans held-for-sale. Noninterest expense increased during 2013 compared to 2012 due to costs associated with the bulk sale of non-performing assets on December 27, 2013, additional professional and outside services expense associated with the proposed merger which was rejected by stockholders, the FHLB prepayment penalty, and higher FDIC insurance expense partially offset by lower compensation costs.

Average Balances, Net Interest Income, Yields Earned and Rates Paid

The following table sets forth certain information for the years ended December 31, 2013 and 2012. The average yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the years presented.

	Year Ended December 31,					
	2013			2012		
	Average Balance	Interest	Average Yield / Cost	Average Balance	Interest	Average Yield / Cost
	(Dollars in Thousands)			(Dollars in Thousands)		
Interest-earning assets:						
Loans (1)	$ 444,213	$ 25,905	5.83 %	$ 529,518	$ 30,223	5.71 %
Investment securities (2)	165,289	2,576	1.56 %	148,279	3,021	2.04 %
Other interest-earning assets (3)	90,074	355	0.39 %	67,766	261	0.39 %
Total interest-earning assets	699,576	28,836	4.12 %	745,563	33,505	4.49 %
Noninterest-earning assets	38,008			36,192		
Total assets	$ 737,584			$ 781,755		
Interest-bearing liabilities:						
Interest-bearing demand accounts	$ 71,757	$ 219	0.30 %	$ 75,440	$ 355	0.47 %
Savings deposits	70,096	234	0.33 %	76,310	346	0.45 %
Money market accounts	104,229	487	0.47 %	118,005	583	0.49 %
Time deposits	203,920	2,368	1.16 %	192,109	2,845	1.48 %
Securities sold under agreements to repurchase	92,800	4,796	5.17 %	92,800	4,809	5.18 %
Federal Home Loan Bank advances	110,068	4,591	4.17 %	135,000	5,332	3.95 %
Total interest-bearing liabilities	652,870	12,695	1.94 %	689,664	14,270	2.07 %
Noninterest-bearing liabilities	47,191			46,147		
Total liabilities	700,061			735,811		
Total stockholders' equity	37,523			45,944		
Total liabilities and stockholders' equity	$ 737,584			$ 781,755		
Net interest income		$ 16,141			$ 19,235	
Net interest spread			2.18 %			2.42 %
Net interest-earning assets	$ 46,706			$ 55,899		
Net interest margin (4)			2.31 %			2.58 %
Average interest-earning assets to average interest-bearing liabilities		107.15 %			108.11 %	

(1) Includes portfolio loans and other loans. Calculated net of deferred loan fees. Non-accrual loans included as loans carrying a zero yield.

(2) Calculated based on carrying value. State and municipal investment securities yields have not been adjusted to full tax equivalents, as the numbers would not change materially from those presented in the table.

(3) Includes Federal Home Loan Bank stock at cost and term deposits with other financial institutions.

(4) Net interest income divided by average interest-earning assets.

Rate/Volume Analysis

The following table presents the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities for the year ended December 31, 2013 as compared to the year ended December 31, 2012. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (1) changes in volume multiplied by the old rate; and (2) changes in rate, which are changes in rate multiplied by the old volume; and (3) changes not solely attributable to rate or volume have been allocated proportionately to the change due to volume and the change due to rate.

	Increase / (Decrease)		
	Due to Volume	Due to Rate	Total Increase / (Decrease)
	(Dollars in Thousands)		
Interest-earning assets:			
Loans	$ (4,962)	$ 644	$ (4,318)
Investment securities	320	(765)	(445)
Other interest-earning assets	88	6	94
Total interest-earning assets	(4,554)	(115)	(4,669)
Interest-bearing liabilities:			
Interest-bearing demand accounts	(17)	(119)	(136)
Savings deposits	(26)	(86)	(112)
Money market accounts	(66)	(30)	(96)
Time deposits	167	(644)	(477)
Securities sold under agreements to repurchase	-	(13)	(13)
Federal Home Loan Bank advances	(1,027)	286	(741)
Total interest-bearing liabilities	(969)	(606)	(1,575)
Net interest income	$ (3,585)	$ 491	$ (3,094)

Interest Income

Total interest income decreased $4.7 million to $28.8 million for the year ended December 31, 2013 from $33.5 million for the year ended December 31, 2012 primarily due to the decrease in interest income on loans and investment securities. Interest income on loans decreased to $25.9 million for the year ended December 31, 2013 from $30.2 million in 2012. This decrease was due to a decline in the average balance of loans, which decreased $85.3 million to $444.2 million for the year ended December 31, 2013 from $529.5 million in the prior year, partially offset by an increase in average yield on loans of 12 basis points to 5.83% for the year ended December 31, 2013. The average balance of loans declined due to the reduction in portfolio loans outstanding, and the decrease in warehouse loans held-for-investment outstanding. Both warehouse loan originations decreased and the weighted average number of days warehouse loans held-for-investment are outstanding decreased during 2013, resulting in reduced interest income and decreased fee income. The decrease in warehouse loan originations is the result of a decline in home purchase and refinance volume, due to rising interest rates. Interest income earned on securities decreased $0.4 million to $2.6 million for the year ended December 31, 2013 from $3.0 million in 2012. This decrease was due to lower yields on reinvested securities and increased amortization of purchase premiums due to higher prepayments. The impact of the decline in yield by 48 basis points to 1.56% was partially offset by an increase in the average balance of securities of $17.0 million to $165.3 million for the year ended December 31, 2013. The proceeds from our capital raise in December 2013 should facilitate a change in the mix of interest-earning assets back into higher yielding loans and investment securities, while still meeting liquidity targets.

Interest Expense

Interest expense declined by $1.6 million to $12.7 million for the year ended December 31, 2013 from $14.3 million in 2012 primarily due to the decrease in interest expense on deposits and FHLB advances. The decrease in interest expense on deposits for the year ended December 31, 2013, as compared to 2012, was primarily due to lower average rates paid on interest-bearing deposits. The average cost of deposits decreased 15 basis points to 0.67% for the year ended December 31, 2013 as compared to 0.82% in 2012 due to the low interest rate environment. During the first quarter of 2013, the Company prepaid advances scheduled for maturity in the third and fourth quarter of 2013 totaling $25.0 million. This prepayment reduced interest expense by $0.8 million for 2013. The Bank's overall cost of funds, including noninterest-bearing deposits, was 1.83% for the year ended December 31, 2013 down from 1.95% for 2012, primarily due to lower cost of deposits. The Bank's cost of funds is elevated relative to the current interest rate environment due to the structured rates associated with the reverse repurchase agreements and FHLB advances which are at interest rates significantly above market rates.

Net Interest Income

Net interest income decreased $3.1 million to $16.1 million for the year ended December 31, 2013 from $19.2 million for the year ended December 31, 2012, due to the decrease in portfolio loans, held-for-sale loans and warehouse loans held-for-investment outstanding and the impact of lower interest rates on funds reinvested in investment securities, partially offset by decreased interest expense for deposits and FHLB borrowings. Our net interest rate spread, which is the difference between the interest rate earned on interest-earning assets and the interest rate paid on interest-bearing liabilities, decreased 24 basis points to 2.18% for the year ended December 31, 2013 as compared to 2.42% in 2012. Our net interest margin, which is net interest income expressed as a percentage of our average interest-earning assets, decreased 27 basis points to 2.31% for the year ended December 31, 2013 as compared to 2.58% in 2012. The decline in both the net interest rate spread and the net interest margin primarily reflected the impact of the Bank's high fixed-interest rate debt, which has a weighted average rate of 4.56%, combined with declining balances of interest-earning assets and the change in mix due to higher levels of lower yielding cash equivalent balances to meet liquidity needs.

Provision for Portfolio Loan Losses

Provision expense was $7.0 million and $12.5 million during the years ended December 31, 2013 and 2012, respectively. The decline in the provision expense during 2013 compared with 2012 reflected reduced non-performing loans and a decline in early-stage delinquencies of one- to four-family residential and home equity loans. Net charge-offs for the year ended December 31, 2013 were $11.0 million as compared to $17.1 million in 2012. The decrease in net charge-offs in 2013 compared with 2012 primarily reflected $3.2 million less in charge-offs related to one-to-four family residential loans and home equity loans, $1.0 million less in charge-offs related to collateral-dependent commercial real estate property, $0.9 million less in charge-offs related to construction loans, and $1.0 million less in charge-offs related to collateral-dependent commercial land loans. Consistent with the Company's policy to charge-down one- to four-family first mortgages and home equity loans to the estimated fair value of the collateral at the time the loan becomes non-performing, net charge-offs in 2013 included $1.6 million of partial charge-offs as compared to $3.8 million in 2012.

Noninterest Income

The components of noninterest income for the years ended December 31, 2013 and 2012 were as follows:

	2013	2012	Increase / (Decrease) Amount	Percentage
	(Dollars in Thousands)			
Service charges and fees	$ 2,988	$ 3,344	$ (356)	-10.6 %
Gain on sale of loans held-for-sale	692	1,830	(1,138)	-62.2 %
Gain on securities available-for-sale		2,410	(2,410)	-100.0 %
Bank owned life insurance earnings	380	444	(64)	-14.4 %
Interchange fees	1,571	1,584	(13)	-0.8 %
Other	697	484	213	44.0 %
	$ 6,328	$ 10,096	$ (3,768)	-37.3 %

Noninterest income for the year ended December 31, 2013 decreased $3.8 million to $6.3 million as compared to $10.1 million in 2012. The decrease in noninterest income was primarily due to reductions in gains on sales of investment securities, as well as reductions in gains on sales of loans held-for-sale from mortgage origination activity following a reorganization of this business in the second half of 2012 in order to reduce non-interest expense, and service charges and fees.

Gains on sales of investment securities decreased $2.4 million during the year ended December 31, 2013, as the Company did not sell any investment securities during the year. For the year ended December 31, 2013, gains on sales of loans held-for-sale was entirely related to SBA loans held-for-sale, and included $47,000 in net gains recognized for the servicing of SBA loans held-for-sale. For the year ended December 31, 2012, gains on sales of mortgage loans held-for-sale was $713,000, gains on sales of SBA loans held-for-sale was $786,000, and net gains recognized for the servicing of SBA loans held-for-sale was $331,000. The Company expects gains on sales of SBA loans to represent the majority of gains on loan sales in the future as the Company emphasizes small business lending. Management expects growth in the business activity of internally originated mortgage loans held-for-sale to be moderate in the near term.

Service charges and fees, which are earned primarily based on transaction services for deposit account customers decreased as a result of decreased non-sufficient funds (NSF) activity. The Company expects continued decline in NSF fees in 2014 as compared to 2013 as the Bank's volume of overdrafts and NSF activity is decreasing.

Noninterest Expense

The components of noninterest expense for the years ended December 31, 2013 and 2012 were as follows:

	2013	2012	Increase / (Decrease) Amount	Percentage
	(Dollars in Thousands)			
Compensation and benefits	$ 8,382	$ 9,012	$ (630)	-7.0 %
Occupancy and equipment	1,905	2,002	(97)	-4.8 %
FDIC insurance premiums	1,671	1,458	213	14.6 %
Foreclosed assets, net	3,609	406	3,203	788.9 %
Data processing	1,430	1,398	32	2.3 %
Outside professional services	2,663	2,437	226	9.3 %
Collection expense and repossessed asset losses	2,337	2,695	(358)	-13.3 %

Other		4,852		3,949		903	22.9	%
	$	26,849	$	23,357	$	3,492	15.0	%

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Noninterest expense increased $3.5 million to $26.9 million for the year ended December 31, 2013 from $23.4 million for the year ended December 31, 2012. Noninterest expense for the year ended December 31, 2013 primarily reflected additional costs associated with the bulk sale of non-performing assets on December 27, 2013, as well as the write-down of OREO to facilitate two additional asset sales early in 2014. Noninterest expense was also higher in 2013 due to additional professional and outside services expense associated with the proposed merger which was rejected by stockholders, the FHLB prepayment penalty, higher FDIC insurance expense partially offset by lower compensation costs. The costs associated with the bulk sale transaction and the write-down of OREO amounted to $3.8 million during 2013. The costs associated with the proposed merger amounted to $1.3 million during 2013.

With the Company’s strengthened capital position, management expects to reduce its risk-related operating expenses, like FDIC insurance costs, accounting costs, foreclosed asset collection expenses and D&O insurance costs, in 2014.

Income Tax

The Company recorded no income tax expense for the year ended December 31, 2013 and $0.2 million in income tax expense for the year ended December 31, 2012. The recognition of future tax benefits or the reversal of the valuation reserve is dependent upon the Company’s ability to generate future taxable income. The future realization of the Company’s net operating loss carryovers is limited to $325,000 per year, and the effects of the limitation on the existing deferred tax asset are currently being analyzed. See *Deferred Income Taxes* at page 70 for additional information.

Comparison of Results of Operations for the Years Ended December 31, 2012 and 2011.

General

Net loss for the year ended December 31, 2012 was $6.7 million, as compared to a net loss of $10.3 million for the year ended December 31, 2011. The net loss for 2012 declined compared with 2011 due to a decrease in the provision expense of $2.9 million and a decrease in noninterest expense of $4.7 million, primarily related to a reduction in compensation and benefits, partially offset by a decrease in net interest income of $2.3 million, due to lower average balances and yields of interest-earning assets, and a decrease in noninterest income of $1.1 million, primarily due to lower gains on the sale of investment securities.

Average Balances, Net Interest Income, Yields Earned and Rates Paid

The following table sets forth certain information for the years ended December 31, 2012 and 2011. The average yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the years presented.

	Year Ended December 31, 2012				2011			
	Average Balance	Interest	Average Yield / Cost		Average Balance	Interest	Average Yield / Cost	
	(Dollars in Thousands)				(Dollars in Thousands)			
Interest-earning assets:								
Loans (1)	$ 529,518	$ 30,223	5.71	%	$ 585,918	$ 33,675	5.75	%
Investment securities (2)	148,279	3,021	2.04	%	144,912	4,485	3.09	%
Other interest-earning assets (3)	67,766	261	0.39	%	29,960	121	0.41	%
Total interest-earning assets	745,563	33,505	4.49	%	760,790	38,281	5.03	%
Noninterest-earning assets	36,192				46,995			
Total assets	$ 781,755				$ 807,785			
Interest-bearing liabilities:								
Interest-bearing demand accounts	$ 75,440	$ 355	0.47	%	$ 74,716	$ 820	1.10	%
Savings deposits	76,310	346	0.45	%	69,420	430	0.62	%
Money market accounts	118,005	583	0.49	%	119,062	887	0.75	%
Time deposits	192,109	2,845	1.48	%	207,167	4,041	1.95	%
Securities sold under agreements to repurchase	92,800	4,809	5.18	%	92,800	4,786	5.16	%
Federal Home Loan Bank advances	135,000	5,332	3.95	%	146,841	5,576	3.80	%
Other borrowings				%	537	216	40.28	%
Total interest-bearing liabilities	689,664	14,270	2.07	%	710,543	16,756	2.36	%
Noninterest-bearing liabilities	46,147				43,779			
Total liabilities	735,811				754,322			
Total stockholders' equity	45,944				53,463			
Total liabilities and stockholders' equity	$ 781,755				$ 807,785			
Net interest income		$ 19,235				$ 21,525		
Net interest spread			2.42	%			2.67	%
Net interest-earning assets	$ 55,899				$ 50,247			

Net interest margin (4)		2.58 %		2.83 %
Average interest-earning assets to average interest-bearing liabilities	108.11 %		107.07 %	

(1) Includes portfolio loans and other loans. Calculated net of deferred loan fees. Non-accrual loans included as loans carrying a zero yield.
(2) Calculated based on carrying value. State and municipal investment securities yields have not been adjusted to full tax equivalents, as the numbers would not change materially from those presented in the table.
(3) Includes Federal Home Loan Bank stock at cost and term deposits with other financial institutions.
(4) Net interest income divided by average interest-earning assets.

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Rate/Volume Analysis

The following table presents the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities for the year ended December 31, 2012 as compared to the year ended December 31, 2011. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (1) changes in volume multiplied by the old rate; and (2) changes in rate, which are changes in rate multiplied by the old volume; and (3) changes not solely attributable to rate or volume have been allocated proportionately to the change due to volume and the change due to rate.

	Increase / (Decrease) Due to Volume		Due to Rate		Total Increase / (Decrease)	
	(Dollars in Thousands)					
Interest-earnings assets:						
Loans	$	(3,221)	$	(231)	$	(3,452)
Securities available-for-sale		102		(1,566)		(1,464)
Other interest-earning assets		146		(6)		140
Total interest-earning assets		(2,973)		(1,803)		(4,776)
Interest-bearing liabilities:						
Interest-bearing demand accounts		8		(473)		(465)
Savings deposits		40		(124)		(84)
Money market accounts		(8)		(296)		(304)
Time deposits		(277)		(919)		(1,196)
Securities sold under agreements to repurchase				23		23
Federal Home Loan Bank advances		(462)		218		(244)
Other borrowings		(216)				(216)
Total interest-bearing liabilities		(915)		(1,571)		(2,486)
Net interest income	$	(2,058)	$	(232)	$	(2,290)

Interest Income

Total interest income decreased $4.8 million to $33.5 million for the year ended December 31, 2012 from $38.3 million for the year ended December 31, 2011 primarily due to the decrease in interest income on loans and securities available-for-sale. Interest income on loans decreased to $30.2 million for the year ended December 31, 2012 from $33.7 million in 2011. This decrease was due to a decline in the average balance of loans, which decreased $56.4 million to $529.5 million for the year ended December 31, 2012 from $585.9 million in the prior year, combined with a slight decrease in average yield on loans of 4 basis points to 5.71% for the year ended December 31, 2012. Interest income earned on securities decreased $1.5 million to $3.0 million for the year ended December 31, 2012 from $4.5 million in 2011. This decrease was due to the lower interest rates available on new purchases of securities and higher premium amortization due to increased prepayments. The impact of the decline in yield by 105 basis points to 2.04% was partially offset by an increase in the average balance of securities of $3.4 million to $148.3 million for the year ended December 31, 2012.

Interest Expense

Interest expense declined by $2.5 million to $14.3 million for the year ended December 31, 2012 from $16.8 million in 2011 primarily due to the decrease in interest expense on deposits. The decrease in interest expense on deposits for the year ended December 31, 2012, as compared to 2011, was primarily due to lower average rates paid on interest-bearing deposits. The average cost of deposits decreased 39 basis points to 0.82% for the year ended December 31, 2012 as compared to 1.21% in 2011 due to the low interest rate environment. The Bank's overall cost of funds, including noninterest-bearing deposits, was 1.95% for the year ended December 31, 2012 down from 2.24% for 2011, primarily due to lower cost of deposits. The Bank's cost of funds is elevated relative to the current interest rate environment due to the reverse repurchase agreements and FHLB advances.

Net Interest Income

Net interest income decreased $2.3 million to $19.2 million for the year ended December 31, 2012 from $21.5 million for the year ended December 31, 2011, due to the decrease in interest income resulting from a reduction in average outstanding interest-earning assets and lower average yields earned on those assets, partially offset by decreased interest expense on deposits. Our net interest rate spread, which is the difference between the interest rate earned on interest-earning assets and the interest rate paid on interest-bearing liabilities, decreased 25 basis points to 2.42% for the year ended December 31, 2012 as compared to 2.67% in 2011. Our net interest margin, which is net interest income expressed as a percentage of our average interest-earning assets, decreased 25 basis points to 2.58% for the year ended December 31, 2012 as compared to 2.83% in 2011. The decline in both the net interest rate spread and the net interest margin primarily reflected the impact of the Bank's high fixed- interest rate debt, which has a weighted average rate of 4.45%, combined with declining interest earning assets.

Provision for Portfolio Loan Losses

Provision expense was $12.5 million and $15.4 million during the years ended December 31, 2012 and 2011, respectively. Net charge-offs for the year ended December 31, 2012 were $17.1 million as compared to $13.2 million in 2011. Included in charge-offs for 2012 was approximately $4.6 million of specific reserves established in prior years and accordingly did not result in additional provision expense. Consistent with the Company's policy to charge-down one- to four-family first mortgages and home equity loans to the estimated fair value of the collateral at the time the loan becomes non-performing, net charge-offs in 2012 included $3.8 million of partial charge-offs as compared to $6.1 million in 2011.

Noninterest Income

The components of noninterest income for the years ended December 31, 2012 and 2011 were as follows:

	2012	2011	Increase / (Decrease) Amount	Percentage
	(Dollars in Thousands)			
Service charges and fees	$ 3,344	$ 3,765	$ (421)	-11.2 %
Gain on sale of loans held-for-sale	1,767	1,784	(17)	-1.0 %
Loss on sale of portfolio loans		(14)	14	100.0 %
Gain on securities available-for-sale	2,410	3,388	(978)	-28.9 %
Other-than-temporary impairment losses, net		(186)	186	100.0 %
Bank owned life insurance earnings	444	674	(230)	-34.1 %
Interchange fees	1,584	1,400	184	13.1 %
Other	547	421	126	29.9 %
	$ 10,096	$ 11,232	$ (1,136)	-10.1 %

Noninterest income for the year ended December 31, 2012 decreased $1.1 million to $10.1 million as compared to $11.2 million in 2011. The decrease in noninterest income was primarily due to reductions in gains on sales of investment securities, service charges and fees, and BOLI.

Gains on sales of investment securities decreased $1.0 million during the year ended December 31, 2012. BOLI earnings declined in the year ended December 31, 2012 as compared to 2011 following the termination of certain BOLI policies in the fourth quarter of 2011 totaling $9.1 million of investment. Service charges and fees, which are earned primarily based on transaction services for deposit account customers decreased as a result of decreased NSF activity.

For the year ended December 31, 2012, gains on sales of loans held-for-sale included $1.1 million in sales of SBA loans, which primarily consisted of $0.3 million in net gains recognized for the servicing of SBA loans and $0.7 million in gains on the sale one- to four-family residential loans sold to the secondary market. For the year ended December 31, 2011, gains on sales of mortgages originated for sale was $1.3 million and gains on sales of SBA loans was $0.5 million.

Noninterest Expense

The components of noninterest expense for the years ended December 31, 2012 and 2011 were as follows:

	2012		2011		Increase / (Decrease) Amount		Percentage	
	(Dollars in Thousands)							
Compensation and benefits	$	9,012	$	12,078	$	(3,066)	-25.4	%
Occupancy and equipment		2,002		2,311		(309)	-13.4	%
FDIC insurance premiums		1,458		1,199		259	21.6	%
Foreclosed assets, net		406		998		(592)	-59.3	%
Data processing		1,398		1,579		(181)	-11.5	%
Outside professional services		2,437		2,444		(7)	-0.3	%
Collection expense and repossessed asset losses		2,695		2,454		241	9.8	%
Other		3,949		5,022		(1,073)	-21.4	%
	$	23,357	$	28,085	$	(4,728)	-16.8	%

Noninterest expense decreased $4.7 million to $23.4 million for the year ended December 31, 2012 from $28.1 million for the year ended December 31, 2011. Noninterest expense for the year ended December 31, 2012 included lower compensation and benefits expense of $3.1 million primarily due to a reorganization of the Company’s mortgage banking operations during 2011, including reducing management positions and closing under-performing mortgage origination offices. The cost of foreclosed assets decreased $0.6 million for the year ended December 31, 2012 as compared to 2011 primarily due to gains on sales of OREO in 2012.

Income Tax

The Company recorded income tax expense of $0.2 million for the year ended December 31, 2012 related to a recent IRS examination of the 2008 tax return which resulted in the disallowance of certain bad debt expense deductions for which the Company had originally received a credit of $0.4 million. The recognition of future tax benefits or the reversal of the valuation reserve is dependent upon the Company’s ability to generate future taxable income.

Liquidity

Management maintains a liquidity position it believes will adequately provide funding for loan demand and deposit run-off that may occur in the normal course of business. Atlantic Coast Financial Corporation relies on a number of different sources in order to meet its potential liquidity demands. The primary sources of funds are increases in deposit accounts, cash flows from loan payments and securities sales and borrowings. The scheduled amortization of loans and securities as well as proceeds from borrowings, are predictable sources of funds. In addition, warehouse loans held-for-investment repay rapidly with an average duration of approximately 20 days, with repayments generally funding advances. Other funding sources, however, such as inflows from new deposits, mortgage and investment securities prepayments and mortgage loan sales are greatly influenced by market interest rates, economic conditions and competition.

While primary sources of funds continue to be adequate to meet demands, the Bank has limited contingent liquidity sources available to meet potential funding requirements. As a result, management has increased the amount of cash and cash equivalents held during 2013 to an average of $84.1 million from an average of $64.3 million during the year ended December 31, 2012. As of December 31, 2013 and 2012, the Company had additional borrowing capacity of $5.0 million and $5.2 million, respectively, with the FHLB. During 2012, the Company's borrowing capacity was reduced following an FHLB credit and collateral review. Also, during 2012, the Bank was notified by the FRB that it is no longer eligible to borrow under the Primary Credit program and that it no longer has daylight overdraft capacity available, although the Bank has not participated in these programs in the past. Unpledged marketable investment securities were approximately $26.9 million and $21.6 million as of December 31, 2013 and 2012, respectively. The Company also utilizes a non-brokered internet certificate of deposit listing service to meet funding needs at interest rates equal to or less than local market rates. During 2013, the Bank decreased deposits from this service by $21.1 million, but expects it will continue to utilize the program, as necessary, to supplement retail deposit production.

Threats to the Bank's liquidity position include rapid declines in deposit balances due to market volatility caused by major changes in interest rates or negative public perception about the Bank, or the financial services industry in general. In addition, the amount of investment securities that would otherwise be available to meet liquidity needs is limited due to the collateral requirements of our long term debt. Specifically, the Bank's reverse repurchase agreements which total $92.8 million at December 31, 2013 have collateral requirements in excess of the debt. Under the terms of the agreement with the counterparty on $77.8 million of the $92.8 million of long-term debt, the Bank is required to pledge additional collateral if its capital ratios decrease below the PCA defined levels of well-capitalized or adequately capitalized. The Company was above the PCA defined levels of well-capitalized at December 31, 2013. However, the Company was required to increase pledged collateral by $4.0 million during 2013 due to capital ratios falling below the PCA defined levels of well-capitalized at December 31, 2012. Additionally, the collateral requirements of the FHLB debt are supplemented with investment securities collateral and the Bank is required to collateralize the prepayment penalty amount using investment securities.

During 2013, cash and cash equivalents increased $46.4 million from $67.8 million as of December 31, 2012 to $114.2 million as of December 31, 2013 as a result of the capital raise completed on December 3, 2013, and as a part of the Bank's strategy to strengthen its overall liquidity position. Cash from operating activities of $4.3 million and cash from investing activities of $61.8 million was more than cash used in financing activities of $19.7 million. Primary sources of cash were from repayment of warehouse loans held-for-investment of $871.3 million, proceeds from the sale of common stock of $44.9 million, net decreases in portfolio loans of $42.8 million, proceeds from maturities and payments of investment securities of $31.7 million, proceeds from the sale of OREO of $9.6 million, and proceeds from the sale of loans held-for-sale of $9.6 million. Primary uses of cash included funding of warehouse loans held-for-investment of $823.3 million, purchases of investment securities of $60.9 million, net decreases in deposits of $39.7 million, and the repayment of FHLB advances of $25.0 million.

During 2012, cash and cash equivalents increased $26.8 million from $41.0 million as of December 31, 2011 to $67.8 million as of December 31, 2012 as part of the Bank's strategy to strengthen its overall liquidity position. Cash from operating activities of $5.7 million and cash from investing activities of $29.8 million was more than cash used in financing activities of $8.7 million. Primary sources of cash were from repayment of warehouse loans held-for-investment of $889.8 million, proceeds from sales of securities available-for-sale of $82.2 million, net decreases in loans of $60.2 million, proceeds from maturities and payments of investment securities of $38.1 million, proceeds from the sale of loans held-for-sale of $37.1 million, and proceeds from the sale of OREO of $6.5 million. Primary uses of cash included funding of warehouse loans held-for-investment of $900.5 million, purchases of investment securities of $151.7 million, originations of loans held-for-sale of $35.5 million, and net decreases in deposits of $8.7 million.

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Contractual Obligations and Commitments

The following table presents the Company's longer-term, non-deposit related, contractual obligations, commitments to extend credit to borrowers and purchase commitments, in aggregate and by payment due dates:

	December 31, 2013				
	Less Than 1 Year	1 Through 3 Years	4 Through 5 years	More Than 5 Years	Total
	(Dollars in Thousands)				
Federal Home Loan Bank advances	$	$ 40,000	$ 65,000	$ 5,000	$ 110,000
Operating leases (premises and equipment)	322	407	190		919
Borrowings and operating leases	322	40,407	65,190	5,000	110,919
Undistributed portion of loans closed					3,090
Unused lines of credit					47,803
Total loan commitments					50,893
Loan purchase commitment					
Security repurchase commitment	26,500	15,000	51,300		92,800
Total purchase commitments	26,500	15,000	51,300		92,800
Total contractual obligations and loan commitments	$ 26,822	$ 55,407	$ 116,490	$ 5,000	$ 254,612

Capital Resources

At December 31, 2013, stockholders' equity totaled $65.5 million. During 2013 the Company's Board of Directors declared no regular quarterly dividends. The decision to pay dividends in the future is dependent on operating results, capital and liquidity requirements and currently is subject to regulatory approval.

As of December 31, 2013 Atlantic Coast Financial Corporation held no treasury stock. The Company suspended its repurchase program in March 2009. Initiation of future share repurchase programs is dependent on liquidity, opportunities for alternative investments and capital requirements.

Atlantic Coast Bank's actual capital levels and ratios in comparison to well-capitalized levels and required capital levels under the Consent Order were as follows:

	Actual		Required to be Well-Capitalized Under Prompt Corrective Action		Required Capital Levels Under the Consent Order	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in Millions)					
December 31, 2013						
	$ 77.0	20.47 %	$ 37.6	10.00 %	$ 48.9	13.00 %

Total capital (to risk weighted assets)									
Tier 1 (core) capital (to risk weighted assets)	72.3	19.22	%	22.6	6.00	%	n/a	n/a	
Tier 1 (core) capital (to adjusted total assets)	72.3	9.73	%	37.1	5.00	%	66.9	9.00	%

As described in *Item 1A. Risk Factors* and *Item 1. Business - Supervision and Regulation*, the Company entered into a Consent Order with the OCC, which requires the Bank to develop strategic and capital plans to achieve and maintain specific capital levels, to implement liquidity and concentration risk management programs, to revise its problem asset reduction plan and to develop policies and procedures to prevent future violations of law or regulation. The Bank was in compliance with the Order at December 31, 2013, with respect to the required capital levels. The Bank's capital classification under the PCA rules as of December 31, 2013 was well-capitalized.

Inflation

The effects of price changes and inflation can vary substantially for most financial institutions. While management believes that inflation affects the growth of total assets and our profitability, management believes that it is difficult to assess the overall impact. Management believes this to be the case due to the fact that generally neither the timing nor the magnitude of inflationary changes in the consumer price index (CPI) coincides with changes in interest rates. The price of one or more components of the CPI may fluctuate considerably and thereby influence the overall CPI without having corresponding effect on interest rates or upon the cost of those goods and services normally purchased by us. In years of high inflation and high interest rates, intermediate and long-term interest rates tend to increase, thereby adversely impacting the market values of investment securities, mortgage loans and other long-term fixed rate loans. In addition, higher short-term interest rates caused by inflation tend to increase the cost of funds. In years of low inflation and low interest rates, the opposite may occur.

Off-Balance Sheet Arrangements

As a financial services provider, we routinely are a party to various financial instruments with off-balance-sheet risks, such as commitments to extend credit and unused lines of credit. While these contractual obligations represent our potential future cash requirements, a significant portion of commitments to extend credit may expire without being drawn upon. Such commitments are subject to the same credit policies and approval process accorded to loans we make. In addition, we enter into commitments to sell mortgage loans. For additional information, see Note 13 in *Item 8. Financial Statements and Supplementary Data (Notes to Financial Statements)* contained in this report.

Future Accounting Pronouncements

See Note 1 in *Item 8. Financial Statements and Supplementary Data (Notes to Financial Statements)* contained in this report for a discussion of recently issued or proposed accounting pronouncements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Bank is subject to interest rate risk to the extent that its interest-bearing liabilities, primarily deposits, re-price more rapidly or at different rates than its interest-earning assets. In order to address the potential for adverse effects of material prolonged increases or decreases in interest rates on our results of operations, management has adopted an asset and liability management policy. The Board of Directors sets the asset and liability policy for the Company, which is implemented by the Asset/Liability Committee (ALCO). The purpose of the ALCO is to communicate, coordinate and control asset/liability management consistent with our business plan and board approved policies. The ALCO establishes and monitors the volume and mix of assets and funding sources taking into account relative costs and spreads, interest rate sensitivity and liquidity needs. The objectives are to manage assets and funding sources to produce results that are consistent with liquidity, capital adequacy, growth, risk, and profitability goals.

The ALCO generally meets at least quarterly, but more frequently if needed, to review, among other things, economic conditions and interest rate outlook, current and projected liquidity needs and capital position, anticipated changes in the volume and mix of assets and liabilities and interest rate exposure limits versus current projections pursuant to income simulations. The ALCO recommends appropriate strategy changes based on this review. The ALCO also is responsible for reviewing and reporting the effects of the policy implementations and strategies to the Board of Directors at least quarterly. A key element of our asset/liability plan is to protect net earnings by managing the maturity or re-pricing mismatch between our interest-earning assets and rate-sensitive liabilities. Historically, the Company has sought to reduce exposure to its earnings through the use of adjustable rate loans, the sale of certain fixed rate loans in the secondary market, and by extending funding maturities through the use of the FHLB advances.

In part, the Bank measures its exposure to interest rate risk using an analytical model referred to as Net Portfolio Value (NPV) that estimates the value of the net cash flows of interest-earning assets and its interest-bearing liabilities under different interest rate scenarios.

The Bank also measures interest rate risk by estimating the impact of interest rate changes on its net interest income which is defined as the difference between the interest income we earn on our interest-earning assets, such as loans and securities, and the interest we pay on our interest-bearing liabilities, such as deposits and borrowings. In our model, we estimate what our net interest income would be for a rolling forward twelve-month period using historical data for assumptions such as loan prepayment rates and deposit decay rates, the current term structure for interest rates, and current deposit and loan offering rates. We then calculate what the net interest income would be for the same period in the event of an instantaneous 100, 200 and 300 basis point increase or a 100 basis point decrease in market interest rates. Given the current relatively low level of market interest rates, the Bank does not consider interest rate decreases of greater than 100 basis points in either of the two models used to measure interest rate risk.

				Net Present Value as a Percentage of Present Value of Assets (PVA) (3)		Net Interest Income		
		Estimated Increase / (Decrease) in Net Present Value					Increase / (Decrease) in Estimated Net Interest Income	
Change in Interest Rates Basis Points (1)	Estimated Net Present Value (2)	Amount	Percent	Net Present Value Ratio (4)	Increase / (Decrease) Basis Points	Estimated Net Interest Income	Amount	Percent
(Dollars in Thousands)								
As of December 31, 2013:								
+300	$ 53,411	$ (18,980)	-26.2 %	7.71 %	(192)	$ 18,600	$ (78)	-0.4 %
+200	59,606	(12,785)	-17.7 %	8.38 %	(125)	18,626	(52)	-0.3 %
+100	67,304	(5,087)	-7.0 %	9.20 %	(43)	18,652	(26)	-0.1 %
0	72,391			9.63 %		18,678		
-100	74,408	2,017	2.8 %	9.69 %	6	18,550	(128)	-0.7 %
As of December 31, 2012:								
+300	$ 31,035	$ 2,850	10.1 %	4.16 %	62	$ 19,897	$ 1,860	10.3 %
+200	34,583	6,398	22.7 %	4.53 %	99	18,903	866	4.8 %
+100	32,097	3,912	13.9 %	4.11 %	57	18,470	433	2.4 %
0	28,185			3.54 %		18,037		
-100	18,409	(9,776)	-34.7 %	2.29 %	(125)	17,602	(435)	-2.4 %

(1) Assumes an instantaneous uniform change in interest rates at all maturities.
(2) Net Present Value is the discounted present value of expected cash flows from assets, liabilities and off-balance sheet contracts. Discount rates are unique to each class of asset and liability and are principally estimated as spreads over wholesale rates.
(3) PVA represents the discounted present value of incoming cash flows on interest-earning assets.
(4) Net Present Value Ratio represents Net Present Value divided by PVA.

The Company's greatest risk is due to a negative change in interest rates, which would decrease net interest income at a greater rate than a positive change in interest rates. However, in an upward rate environment the Company's net present value of cash flows and net interest income would decline, whereas only net interest income would decline in a downward rate environment. This is due to several factors including, but not limited to, the decreasing asset base, the average life of assets being extended in comparison to the average life of liabilities, as a decrease in the prepayment speed of one- to four-family residential and home equity loans would likely occur, and the high level of fixed rate debt at interest rates well above market. The Company's exposure to interest risk will continue to be at an elevated level as long as interest rates remain low, which magnifies the impact of the cost of the Company's long term debt and increased investment in lower rate investment securities along with an overall decline in interest-earning assets.

The change in the net present value of cash flows, as compared to December 31, 2012, is attributable to the increase in long-term treasury rates, which results in reduced estimated prepayment speeds of one- to four-family residential and home equity loans. The 10-year treasury rate as of December 31, 2013 and December 31, 2012 was 3.04% and 1.78%, respectively.

Certain shortcomings are inherent in the methodologies used in determining interest rate risk through changes in net portfolio value and net interest income. Modeling changes require making certain assumptions that may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. In this regard, the net portfolio value and net interest income information presented assume that the composition of our interest-sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and assume that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration or re-pricing of specific assets and liabilities. Accordingly, although interest rate-risk calculations provide an indication of our interest rate risk exposure at a particular point in time, such measurements are not intended to and do not provide a precise forecast of the effect of changes in market interest rates on our net interest income and will differ from actual results.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Atlantic Coast Financial Corporation

We have audited the accompanying consolidated balance sheets of Atlantic Coast Financial Corporation and its subsidiary as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income (loss), stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Atlantic Coast Financial Corporation and its subsidiary as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

Jacksonville, Florida
March 14, 2014

Member of the RSM International network of Independent accounting, tax and consulting firms.

ATLANTIC COAST FINANCIAL CORPORATION
CONSOLIDATED BALANCE SHEETS
December 31, 2013 and 2012
(Dollars in Thousands, Except Share Information)

	2013	2012
ASSETS		
Cash and due from financial institutions	$ 2,889	$ 7,490
Short-term interest-earning deposits	111,305	60,338
Total cash and cash equivalents	114,194	67,828
Investment securities:		
Securities available-for-sale	159,732	159,745
Securities held-to-maturity	19,266	
Total investment securities	178,998	159,745
Portfolio loans, net of allowance of $6,946 in 2013 and $10,889 in 2012	371,956	421,201
Other loans:		
Held-for-sale	1,656	4,089
Warehouse held-for-investment	20,523	68,479
Total other loans	22,179	72,568
Federal Home Loan Bank stock, at cost	5,879	7,260
Land, premises and equipment, net	14,253	14,584
Bank owned life insurance	16,143	15,764
Other real estate owned	5,225	8,065
Accrued interest receivable	1,826	2,035
Other assets	2,980	3,569
Total assets	$ 733,633	$ 772,619
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing demand	$ 34,782	$ 41,904
Interest-bearing demand	68,954	73,490
Savings and money market	172,552	181,708
Time	183,810	202,658
Total deposits	460,098	499,760
Securities sold under agreements to repurchase	92,800	92,800
Federal Home Loan Bank advances	110,000	135,000
Accrued expenses and other liabilities	5,210	4,799
Total liabilities	668,108	732,359
Commitments and contingent liabilities		
Preferred stock: $0.01 par value; 25,000,000 shares authorized, none issued and outstanding at December 31, 2013 and December 31, 2012		
Common stock: $0.01 par value; 100,000,000 shares authorized, 15,509,061 issued and outstanding at December 31, 2013 and 2,629,061 issued and outstanding at December 31, 2012	155	26
Additional paid-in capital	100,794	56,132
Common stock held by:		
	(1,769)	(1,873)

Employee stock ownership plan shares of 81,437 at December 31, 2013 and 86,227 at December 31, 2012				
Benefit plans		(317)		(338)
Retained deficit		(25,779)		(14,373)
Accumulated other comprehensive income (loss)		(7,559)		686
Total stockholders' equity		65,525		40,260
Total liabilities and stockholders' equity	$	733,633	$	772,619

The accompanying notes are an integral part of these consolidated financial statements.

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ATLANTIC COAST FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
Years Ended December 31, 2013, 2012 and 2011
(Dollars in Thousands, Except Share Information)

	2013	2012	2011
Interest and dividend income:			
Loans, including fees	$ 25,905	$ 30,223	$ 33,675
Securities and interest-earning deposits in other financial institutions	2,931	3,282	4,606
Total interest and dividend income	28,836	33,505	38,281
Interest expense:			
Deposits	3,308	4,129	6,178
Securities sold under agreements to repurchase	4,591	4,809	4,786
Federal Home Loan Bank advances	4,796	5,332	5,576
Other borrowings			216
Total interest expense	12,695	14,270	16,756
Net interest income	16,141	19,235	21,525
Provision for portfolio loan losses	7,026	12,491	15,383
Net interest income after provision for portfolio loan losses	9,115	6,744	6,142
Noninterest income:			
Service charges and fees	2,988	3,344	3,765
Gain on sale of loans held-for-sale	692	1,830	1,784
Gain on sale of securities available-for-sale (includes $2,410 and $3,388 accumulated other comprehensive income reclassifications for unrealized net gains for the years ended December 31, 2012 and 2011, respectively)		2,410	3,388
Other-than-temporary-impairment loss:			
Total impairment loss			(234)
Portion of loss recognized in other comprehensive income			48
Reclassification from other comprehensive income			
Net impairment loss recognized in earnings			(186)
Bank owned life insurance earnings	380	444	674
Interchange fees	1,571	1,584	1,400
Other	697	484	407
Total noninterest income	6,328	10,096	11,232
Noninterest expense:			
Compensation and benefits	8,382	9,012	12,078
Occupancy and equipment	1,905	2,002	2,311
FDIC insurance premiums	1,671	1,458	1,199
Foreclosed assets, net	3,609	406	998
Data processing	1,430	1,398	1,579
Outside professional services	2,663	2,437	2,444
Collection expense and repossessed asset losses	2,337	2,695	2,454
Other	4,852	3,949	5,022
Total noninterest expense	26,849	23,357	28,085

Loss before income tax expense (benefit)		(11,406)		(6,517)		(10,711)
Income tax expense (benefit)				150		(424)
Net loss	$	(11,406)	$	(6,667)	$	(10,287)
Loss per common share:						
Basic	$	(3.23)	$	(2.67)	$	(4.13)
Diluted	$	(3.23)	$	(2.67)	$	(4.13)

The accompanying notes are an integral part of these consolidated financial statements.

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ATLANTIC COAST FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
Years Ended December 31, 2013, 2012 and 2011
(Dollars in Thousands, Except Share Information)

	2013	2012	2011
Net loss	$ (11,406)	$ (6,667)	$ (10,287)
Other comprehensive income (loss):			
Change in securities available-for-sale:			
Unrealized holding gains (losses) arising during the period	(8,245)	2,980	1,515
Less reclassification adjustments for (gains) losses recognized in income		(2,410)	(3,388)
Net unrealized gains (losses)	(8,245)	570	(1,873)
Income tax effect			
Net of tax effect	(8,245)	570	(1,873)
Other-than-temporary-impairment recorded in other comprehensive income			234
Less other-than-temporary-impairment associated with credit loss realized in income			(186)
Total other-than-temporary-impairment			48
Income tax effect			
Net of tax effect			48
Total other comprehensive income (loss)	(8,245)	570	(1,825)
Comprehensive loss	$ (19,651)	$ (6,097)	$ (12,112)

The accompanying notes are an integral part of these consolidated financial statements.

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ATLANTIC COAST FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Years Ended December 31, 2013, 2012 and 2011
(Dollars in Thousands, Except Share Information)

	Common Stock	Additional Paid-In Capital	Employee Stock Ownership Plan Shares	Benefit Plans	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance at December 31, 2010	$ 148	$ 61,406	$ (1,397)	$ (88)	$ 2,581	$ 1,941	$ (19,800)	$ 44,791
Second-step conversion and offering	(122)	(5,249)	(684)	(1)			19,800	13,744
Employee stock ownership plan shares earned, 4,790 shares		(75)	104					29
Management restricted stock expense		106						106
Stock options expense		60						60
Directors deferred compensation		(55)						(55)
Shares purchased for and distribution from Rabbi Trust		(7)		(262)				(269)
Net income (loss)					(10,287)			(10,287)
Other comprehensive loss						(1,825)		(1,825)
Balance at December 31, 2011	26	56,186	(1,977)	(351)	(7,706)	116		46,294
Employee stock ownership plan shares earned, 4,790 shares		(93)	104					11
Management restricted stock expense		22						22

Stock options expense		36						36
Distribution from Rabbi Trust		(19)		13				(6)
Net loss					(6,667)			(6,667)
Other comprehensive income						570		570
Balance at December 31, 2012	26	56,132	(1,873)	(338)	(14,373)	686		40,260
Issuance of common stock in public offering, 12,880,000 shares, net of offering expenses	129	44,740						44,869
Employee stock ownership plan shares earned, 4,790 shares		(84)	104					20
Management restricted stock expense		3						3
Stock options expense		24						24
Distribution from Rabbi Trust		(21)		21				
Net loss					(11,406)			(11,406)
Other comprehensive loss						(8,245)		(8,245)
Balance at December 31, 2013	$ 155	$ 100,794	$ (1,769)	$ (317)	$ (25,779)	$ (7,559)	$	$ 65,525

The accompanying notes are an integral part of these consolidated financial statements.

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ATLANTIC COAST FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2013, 2012 and 2011
(Dollars in Thousands, Except Share Information)

	2013	2012	2011
Cash flows from operating activities:			
Net loss	$ (11,406)	$ (6,667)	$ (10,287)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Provision for portfolio loan losses	7,026	12,491	15,383
Loss on sale of portfolio loans	128	63	14
Gain on sale of loans held-for-sale	(692)	(1,830)	(1,784)
Originations of loans held-for-sale	(6,458)	(35,529)	(97,645)
Proceeds from sales of loans held-for-sale	9,582	37,105	117,012
Foreclosed assets, net	3,609	406	998
Gain on sale of securities available-for-sale		(2,410)	(3,388)
Other than temporary impairment loss on securities available for sale			186
Loss on disposal of equipment		9	44
Employee stock ownership plan compensation expense	20	11	29
Share-based compensation expense	27	58	166
Amortization of premiums and deferred fees, net of accretion of discounts on securities and loans	1,038	814	795
Depreciation expense	638	772	1,073
Net change in cash surrender value of bank owned life insurance	(379)	(444)	(728)
Net change in accrued interest receivable	209	408	399
Net change in other assets	589	2,078	2,710
Net change in accrued expenses and other liabilities	411	(1,663)	108
Net cash provided by operating activities	4,342	5,672	25,085
Cash flows from investing activities:			
Proceeds from maturities and payments of investment securities	31,737	38,120	37,022
Proceeds from sales of securities available-for-sale		82,159	140,399
Purchase of securities available-for-sale	(41,441)	(151,692)	(155,050)
Purchase of securities held-to-maturity	(19,496)		
Funding of warehouse loans held-for-investment	(823,311)	(900,457)	(643,497)
Proceeds from repayments of warehouse loans held-for-investment	871,267	889,762	612,586
Purchase of portfolio loans	(16,342)		
Proceeds from sales of portfolio loans	5,897	3,278	1,168
Net change in portfolio loans	42,816	60,178	26,221
Expenditures on premises and equipment	(306)	(412)	(214)
Proceeds from sales of premises and equipment		1	
Proceeds from surrender of bank owned life insurance			8,986

Proceeds from sale of other real estate owned		9,615		6,519		5,869
Redemption of Federal Home Loan Bank stock		1,381		2,340		558
Net cash from investing activities		61,817		29,796		34,048
Cash flows from financing activities:						
Net decrease in deposits		(39,662)		(8,651)		(20,086)
Proceeds from Federal Home Loan Bank advances						166,000
Repayment of Federal Home Loan Bank advances		(25,000)				(181,000)
Proceeds from other borrowings						3,309
Repayment of other borrowings						(8,309)
Proceeds from sale of common stock in public offering, net of offering expenses		44,869				
Proceeds from sale of common stock in second-step conversion and offering						13,744
Directors deferred compensation						(55)
Shares purchased for and distributions from Rabbi Trust				(6)		(269)
Net cash used in financing activities		(19,793)		(8,657)		(26,666)
Net increase in cash and cash equivalents		46,366		26,811		32,467
Cash and cash equivalents, beginning of year		67,828		41,017		8,550
Cash and cash equivalents, end of year	$	114,194	$	67,828	$	41,017
Supplemental disclosures of cash flow information:						
Interest paid	$	12,708	$	14,292	$	16,789
Income taxes paid	$		$		$	
Supplemental disclosures of non-cash information:						
Loans transferred to other real estate	$	10,385	$	9,151	$	2,766
Loans transferred to held-for-sale	$		$		$	

The accompanying notes are an integral part of these consolidated financial statements.

ATLANTIC COAST FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2013, 2012 and 2011

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Financial Statement Presentation

The accompanying consolidated financial statements include Atlantic Coast Financial Corporation (the Company) and its wholly owned subsidiary, Atlantic Coast Bank (the Bank). The consolidated financials also include First Community Financial Services, Inc. (FCFS), an inactive wholly owned subsidiary of Atlantic Coast Bank. All significant inter-company balances and transactions have been eliminated in consolidation. The principal activity of the Company is the ownership of the Bank's common stock, as such, the terms "Company" and "Bank" are used interchangeably throughout this Annual Report on Form 10-K. The consolidated balance sheets as of December 31, 2013 and 2012, and the consolidated financial statements for the years ended December 31, 2013, 2012 and 2011 have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). In the opinion of management, all adjustments (all of which are normal and recurring in nature) considered necessary for (i) a fair presentation and (ii) to make such statements not misleading, have been included.

On February 3, 2011, the second step conversion of Atlantic Coast Federal, MHC into a stock holding company structure and related stock offering of Atlantic Coast Financial Corporation was completed. As a result of the second step conversion, Atlantic Coast Financial Corporation, a Maryland corporation, became the holding company for the Bank. As part of the second step conversion, Atlantic Coast Federal Corporation, a Federal corporation, was merged into Atlantic Coast Financial Corporation, with Atlantic Coast Financial Corporation as the surviving entity. In connection with the conversion, the Company sold 1,710,857 shares of common stock at $10.00 per share, inclusive of 68,434 shares issued to the Atlantic Coast Financial Corporation employee stock ownership plan (ESOP). In addition, pursuant to an exchange ratio of 0.1960, the Company exchanged 4,687,466 shares of common stock held by stockholders of Atlantic Coast Federal Corporation, the predecessor of the Company, for 918,324 shares of Atlantic Coast Financial Corporation common stock, net of fractional shares. As a result of the stock sale and exchange the Company had 2,629,181 shares of common stock issued and outstanding as of February 3, 2011. The reorganization was accounted for as a change in corporate form with no resulting change in the historical basis of the Company's assets, liabilities and equity. Direct offering costs totaling $2.7 million were deducted from the proceeds of the shares sold in the offering. Net proceeds of $14.4 million were raised in the stock offering, which included $0.7 million loaned by the Company to a trust for the ESOP enabling it to purchase 68,434 shares of common stock in the stock offering for allocation under such plan. Average shares and earnings per share for the year ended December 31, 2010 have been restated to reflect the second step conversion and offering completed February 3, 2011. Financial information presented in this report is derived in part from the consolidated financial statements of Atlantic Coast Federal Corporation prior to February 3, 2011.

Nature of Operations

The Bank provides a broad range of banking services to individual and business customers primarily in northeastern Florida and southeastern Georgia. The Bank's primary deposit products are checking, savings, and certificates of deposit, and its primary lending products are residential mortgage, home equity and other consumer loans, and commercial loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets, and commercial and residential real estate. Commercial loans are generally expected to be repaid from the cash flows from the operations of the business. There are no significant concentrations of loans to any one industry or customer. However, the customers' ability to repay their loans is dependent on the real estate and general economic conditions in the area.

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Operating Segments

The chief decision-makers monitor operating results and make resource allocation decisions on a company-wide basis. Accordingly, the Company does not have multiple operating segments.

Reclassifications

Certain items in the prior year financial statements were reclassified to conform to the current presentation. The reclassifications have no effect on net income (loss) or stockholders' equity as previously reported.

Use of Estimates

To prepare financial statements in conformity with U.S. GAAP management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ. Estimates associated with the allowance for portfolio loan losses, realization of deferred tax assets, and the fair values of securities and other financial instruments are particularly susceptible to material change in the near term.

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents is defined to include cash on hand, deposits with other financial institutions with maturities less than 90 days and short-term interest-earning deposits in investment companies. The Company reports net cash flows for customer loan transactions and deposit transactions.

Restrictions on Cash

The Bank was not required to maintain cash on hand or on deposit with the Federal Reserve as of December 31, 2013 and 2012 to meet regulatory reserve and clearing requirements.

As of December 31, 2013 the Bank had $0.7 million of cash pledged to The Independent BankersBank (TIB). As of December 31, 2012 the Bank had $1.5 million of cash pledged to the Federal Home Loan Bank of Atlanta (FHLB) and $3.0 million of cash pledged to TIB. These amounts are reported, in their respective years, on the consolidated balance sheets in short-term interest-earning deposits.

Investment Securities

Investment securities are classified as held-to-maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Investment securities are classified as available-for-sale when they might be sold before maturity and are carried at fair value, with unrealized holding gains and losses reported separately in other comprehensive income (loss), net of tax. The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). As of December 31, 2013, $159.7 million in investment securities were classified as available-for-sale and $19.3 million in investment securities were classified as held-to-maturity. All investment securities were classified as available-for-sale as of December 31, 2012.

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Interest income from investment securities includes amortization of purchase premium or discount. Premiums and discounts on investment securities are amortized on the level-yield method without anticipating prepayments. Gains and losses on sales of investment securities are recorded on the settlement date, which is not materially different from the trade date, and are determined using the specific identification method. There were no unsettled investment securities transactions at December 31, 2013 and 2012.

Management evaluates investment securities for other-than-temporary impairment (OTTI) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. In determining OTTI, management considers many factors, including: (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, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Company has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at the determination date.

When OTTI is determined to have occurred, the amount of the OTTI recognized in earnings depends on whether we intend to sell the security or it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss. If we intend to sell the security or it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss, the OTTI recognized in earnings is equal to the entire difference between its amortized cost basis and its fair value at the balance sheet date. If we do not intend to sell the security and it is not more likely than not that we will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the OTTI is separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized as a charge to earnings. The amount of the OTTI related to other factors is recognized in other comprehensive income (loss), net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment. The Company recorded no OTTI for the years ended December 31, 2013 and 2012.

Portfolio Loans

Portfolio loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of unearned loan fees and costs, premiums on loans purchased, and an allowance for portfolio loan losses.

The Bank may also purchase portfolio loans that conform to our underwriting standards, principally one- to four-family residential mortgages, in the form of whole loans for interest rate risk management and portfolio diversification and to supplement our organic growth.

Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method over the estimated life of the portfolio loan. Interest income includes amortization of purchase premiums or discounts on portfolio loans purchased. Premiums and discounts are amortized on the level yield-method over the estimated life of the portfolio loan.

Accrual of interest income on mortgage and commercial loans is discontinued, and the loan is placed on non-performing status at the time the loan is 90 days delinquent unless the credit is well secured and in process of collection. Past due status is based on the contractual terms of the portfolio loan. In all cases, portfolio loans are placed on non-performing or charged-off at an earlier date if collection of principal or interest is considered doubtful.

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Portfolio loans for which the terms have been modified to grant a concession to the borrower as a result of the borrower's financial difficulties are considered troubled debt restructurings (TDR). TDRs are measured for impairment based upon the present value of estimated future cash flows using the loans existing rate at inception of the loan or the appraised value of the collateral if the loan is collateral dependent. Impairment of homogeneous loans, such as one- to four-family residential loans, that have been modified as TDRs is calculated in the aggregate based on the present value of estimated future cash flows. Homogeneous loans modified as TDRs with market rates of interest are classified as impaired loans in the year of restructure and until the loan has performed for 12 months in accordance with the modified terms.

All interest accrued but not received on portfolio loans placed on non-performing status is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Portfolio loans are returned to accrual status when all the principal or interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Portfolio Loan Losses

An allowance for portfolio loan losses (the allowance) is maintained to reflect probable incurred losses in the loan portfolio. The allowance is based on ongoing assessments of the estimated losses incurred in the loan portfolio and is established as these losses are recognized through a provision for portfolio loan losses (provision expense) charged to earnings. Generally, portfolio loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Due to the decline in real estate values in our markets since 2008 and the weak United States economy in general, we believe it is likely that collateral for non-performing one- to four-family residential and home equity loans, will not be sufficient to fully repay such loans. Therefore, the Company charges one- to four-family residential and home equity loans down by the expected loss amount at the time they become non-performing, which is generally 90 days past due. This process accelerates the recognition of charge-offs on one- to four-family residential and home equity loans but has no impact on the impairment evaluation process.

The reasonableness of the allowance is reviewed and established by management, within the context of applicable accounting and regulatory guidelines, based upon its evaluation of then-existing economic and business conditions affecting the Bank’s key lending areas. Senior credit officers monitor those conditions continuously and reviews are conducted quarterly with the Bank’s senior management and the Board of Directors.

When establishing the allowance, management categorizes loans into risk categories generally based on the nature of the collateral and the basis of repayment. These risk categories and the relevant risk characteristics are as follows:

Real Estate Loans

One- to four-family residential loans have historically had less risk than other loan types as they tend to be smaller balance loans without concentrations to a single borrower or group of borrowers. Repayment depends on the individual borrower's capacity. Given the rapid deterioration in the market value of residential real estate over the last several years, there is now a greater risk of loss if actions such as foreclosure or short sale become necessary to collect the loan and private mortgage insurance was not purchased. In addition, depending on the state in which the collateral is located, the risk of loss may increase, due to the time required to complete the foreclosure process on a property.

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Commercial real estate loans generally have greater credit risks compared to one- to four-family residential real estate loans, as they usually involve larger loan balances secured by non-homogeneous or specific use properties. Repayment of these loans typically relies on the successful operation of a business or the generation of lease income by the property and is therefore more sensitive to adverse conditions in the economy and real estate market.

Other real estate loans include loans secured by multi-family residential real estate and land. Generally these loans involve a greater degree of credit risk than residential real estate loans, but are normally smaller individual loan balances than commercial real estate loans; land loans due to the lack of cash flow and reliance on borrower's capacity and multi-family due to the reliance on the successful operation of the project. Both loan types are also more sensitive to adverse economic conditions.

Real Estate Construction Loans

Real estate construction loans, including one- to four-family, commercial and acquisition and development loans, generally have greater credit risk than traditional one- to four-family residential real estate loans. The repayment of these loans can be dependent on the sale of the property to third parties or the successful completion of the improvements by the builder for the end user. In the event a loan is made on property that is not yet approved for the planned development, there is the risk that approvals will not be granted or will be delayed. Construction loans also run the risk that improvements will not be completed on time or in accordance with specifications and projected costs. Included in construction loans are Small Business Administration (SBA) construction loans, which generally have less credit risk than traditional construction loans due to a portion of the balance being guaranteed upon completion of the construction.

Other Portfolio Loans

Home equity loans and home equity lines are similar to one- to four-family residential loans and generally carry less risk than other loan types as they tend to be smaller balance loans without concentrations to a single borrower or group of borrowers. However, similar to one- to four-family residential loans, risk of loss has increased over the last several years due to deterioration of the real estate market.

Consumer loans often are secured by depreciating collateral, including automobiles and mobile homes, or are unsecured and may carry more risk than real estate secured loans. Consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy.

Commercial loans are secured by business assets or may be unsecured and repayment is directly dependent on the successful operation of the borrower's business and the borrower's ability to convert the assets to operating revenue. These possess greater risk than most other types of loans should the repayment capacity of the borrower not be adequate.

Management's methodology for assessing the reasonableness of the allowance consists of several key elements, which include a general loss component by type of portfolio loan and specific allowances for identified problem portfolio loans. The allowance also incorporates the results of measuring impaired portfolio loans.

The general loss component of the allowance is calculated by applying loss factors, adjusted for other qualitative factors to outstanding unimpaired loan balances. Loss factors are based on the Bank's recent loss experience, including recent short sales and sales of non-performing loans. Qualitative factors consider current market conditions that may impact real estate values within the Bank's primary lending areas, and other significant factors that, in management's judgment, may affect the ability to collect loans in the portfolio as of the evaluation date. Other significant qualitative factors that exist as of the balance sheet date that are considered in determining the adequacy of the allowance include the following: (1) Current delinquency levels and trends; (2) Non-performing asset levels, trends, and related charge-off history; (3) Economic trends local and national; (4) Changes in loan policy; (5) Expertise of management and staff of the Bank; (6) Volumes and terms of loans; and (7) Concentrations of credit considering the impact of recent short sales and sales of non-performing loans.

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The impact of the general loss component on the allowance began increasing during 2008 and has remained at an elevated level through the end of 2013. The increase reflected the deterioration of market conditions, and the increase in the portfolio loan loss experience that has resulted from management's proactive approach to recognizing losses on impaired one- to four-family and home equity loans in the period the impairment is identified.

The specific loss component of the allowance generally relates to portfolio loans that have been classified as doubtful, substandard, or special mention according to the Company's internal asset classification system. Substandard portfolio loans include those characterized by the distinct possibility the Company may sustain some loss if the deficiencies are not corrected. Portfolio loans classified as doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Portfolio loans that do not currently expose the Company to sufficient risk to warrant classification in one of the aforementioned categories, but possess weaknesses that deserve management's close attention are deemed to be special mention. Risk ratings are updated any time the facts and circumstances warrant.

For portfolio loans that are also identified as impaired, an allowance is established when the discounted cash flows, collateral value, or observable market price of the impaired loan is lower than the carrying value. A portfolio 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 according to the contractual terms of the loan agreement. Factors used by management to determine impairment include payment status, collateral value and the probability of collecting scheduled principal or interest payments when due. Portfolio 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, the borrower, and the amount of the shortfall in relation to the principal or interest owed. TDRs with borrowers where the Bank has granted a concession to the borrower because of their financial difficulties are considered impaired portfolio loans. Impairment is measured on a loan-by-loan basis for non-homogeneous portfolio loans such as commercial real estate, commercial real estate construction, and commercial business loans 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.

Management also evaluates the allowance based on a review of certain large balance individual loans. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows management expects to receive on impaired loans which may be susceptible to significant change and risks. The determination of the fair value of collateral considers recent trends in valuation as indicated by short sales and sales of non-performing portfolio loans of the applicable loan category. No specific allowance is recorded unless fair value is less than carrying value.

Large groups of smaller balance homogeneous portfolio loans, such as individual consumer and residential loans are collectively evaluated for impairment and are excluded from the specific impairment evaluation. For these portfolio loans, the allowance is calculated in accordance with the general loss policy described above. Accordingly, individual consumer and residential loans are not separately identified for impairment disclosures, unless the loan has been modified as a troubled debt restructuring as discussed below.

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Portfolio loans are charged off against the allowance account when the following conditions are present:

Real Estate Loans

One- to four-family loans balances are charged down by the expected loss amount at the time they become non-performing, which is generally 90 days past due. Due to declining real estate values in our markets and the weakness of the U.S. economy in general, impairment allowances on non-performing collateral dependent loans, particularly one- to four-family residential loans, likely will not be recoverable and represent a confirmed loss. This process accelerates the recognition of charge-offs but has no impact on the impairment evaluation procedures. Additional losses, if any, are charged off against the allowance once a property is foreclosed or a short sale occurs.

Commercial real estate loans and other real estate loans, including commercial land and multi-family loans, typically have specific reserves established once a loan is classified as substandard unless the collateral is adequate to cover the balance of the loan plus selling costs. Generally, the specific reserve on a loan will be charged off once the property has been foreclosed and title to the property transferred to the Bank.

Real Estate Construction Loans

Real estate construction loans include one- to four-family, commercial and acquisition and development loans. These loans typically have specific reserves established once a loan is classified as substandard unless the collateral is adequate to cover the balance of the loan plus selling costs. Generally, the specific reserve on a loan will be charged off once the property has been foreclosed and title to the property transferred to the Bank.

Other Portfolio Loans

First lien position home equity loans are charged down by the expected loss amount at the time they become non-performing, which is generally 90 days past due. In the case of second lien position loans the entire loan balance is charged off. Due to declining real estate values in our markets and the deterioration of the U.S. economy in general, impairment allowances on non-performing collateral dependent loans, particularly one- to four-family residential loans, likely will not be recoverable and represent a confirmed loss. This process accelerates the recognition of charge-offs but has no impact on the impairment evaluation procedures. Additional losses, if any, are charged off against the allowance once a property is foreclosed or a short sale occurs.

Consumer loans including auto, manufactured housing, unsecured, and other secured loans are charged-off, net of expected recovery when the loan becomes significantly past due over a range of up to 180 days, depending on the type of loan. Loans with non-real estate collateral are written down to the value of the collateral, less cost to sell, when repossession of collateral has occurred.

Commercial loans secured by business assets, including inventory and receivables, will typically have specific reserves established once a loan is classified as substandard. The specific reserve will be charged off once the outcomes of attempts to legally collect the collateral are known and have been exhausted.

Troubled Debt Restructurings

Portfolio loans for which the terms have been modified to grant a concession to the borrower as a result of the borrower's financial difficulties are classified as TDRs. TDRs are measured for impairment based upon the present value of estimated future cash flows using the loan's interest rate at inception of the loan or the appraised value of the collateral if the loan is collateral dependent. Impairment of homogeneous portfolio loans, such as one- to four-family residential loans, that have been modified as TDRs is calculated in the aggregate based on the present value of estimated future cash flows.

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

A portfolio loan that is modified as a TDR with a market rate of interest is classified as an impaired loan and reported as a TDR in the year of restructure and until the loan has performed for twelve months in accordance with the modified terms. The policy for returning a non-performing portfolio loan to accrual status is the same for any loan irrespective of whether the loan has been modified. As such, portfolio loans which are non-performing prior to modification continue to be accounted for as non-performing portfolio loans until they have demonstrated the ability to maintain sustained performance over a period of time, but no less than six months, and are reported as impaired non-performing portfolio loans.

Other Loans (Loans Held-for-Sale and Warehouse Loans Held-for-Investment)

Other loans is comprised of loans secured by one- to four-family residential homes originated internally and held-for-sale (mortgage loans held-for-sale), small business loans originated internally and held-for-sale (SBA loans held-for-sale), and warehouse lines of credit secured by one- to four-family residential loans originated under purchase and assumption agreements by third party originators (warehouse loans held-for-investment).

The Company originates mortgage loans held-for-sale with the intent to sell the loans and the servicing rights to investors. Mortgage loans held-for-sale are carried at the lower of cost or market in the aggregate with adjustments for unrealized losses recorded in a valuation account by a charge against current earnings. Sales in the secondary market are recognized when full acceptance has been received.

The Company originates SBA loans held-for-sale through the 7(a) Program and the 504 Program of the SBA. SBA loans held-for-sale are carried at the lower of cost or market in the aggregate with adjustments for unrealized losses recorded in a valuation account by a charge against current earnings. The 7(a) loans are guaranteed up to 75% of the loan amount up to maximum guaranty cap of $3,750,000. The Company's average loan size is $462,000. The Company typically sells the guaranteed portion of the 7(a) loans to investors, while maintaining the servicing rights. These loans are non-recourse to the lender, other than an allegation of fraud or misrepresentation on the part of the lender. In the 504 program the Company, the SBA and the borrower are in various lien positions. The typical structure of a 504 loan is the Bank is at a 50% loan-to-value (LTV), the SBA is in second position at 40% LTV, while the remaining 10% is an equity injection from the borrower.

The Company originates warehouse loans held-for-investment and permits the third-party originator to sell the loans and servicing rights to investors in order to repay the warehouse balance outstanding. Warehouse loans held-for-investment possess less risk than other types of loans as they are secured by one- to four-family residential loans which tend to be smaller balance loans without concentrations to a single borrower or group of borrowers. Additionally, the Company generally holds warehouse loans held-for-investment for a short duration of time. Due to these risk characteristics, as well as other factors, management has determined that no allowance is necessary.

Loan Commitments and Related Financial Instruments

Financial instruments include off-balance sheet credit instruments including commitments to make loans and unused lines of credit, issued to meet customers' financing needs. The face amount for these items represents the exposure to loss, before considering collateral or ability to repay. Such financial instruments are recorded when they are funded.

Concentration of Credit Risk

Much of the Company's business activity is with customers in northeast Florida and southeast Georgia. Additionally, approximately 85% of the Company's portfolio loans are originated to borrowers in Florida and Georgia, with the majority of those originations occurring in northeast Florida and southeast Georgia. Therefore, the Company's exposure to credit risk is significantly affected by changes in the economy and real estate markets in northeast Florida and southeast Georgia.

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Federal Home Loan Bank Stock

Atlantic Coast Bank is a member of the FHLB. Members are required to own a certain amount of FHLB stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock has no quoted market value, is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of cost. Both cash and stock dividends are reported as income.

Land, Premises, and Equipment

Land is carried at cost. Buildings and furniture, fixtures and equipment are carried at cost, less accumulated depreciation and amortization. Premises and equipment are depreciated using the straight-line and accelerated methods over the estimated useful lives of the assets. Buildings and related components have useful lives ranging from 15 to 39 years. Furniture, fixtures, and equipment have useful lives ranging from 1 to 15 years. Interest expense associated with the construction of new facilities is capitalized at the weighted average cost of funds.

Bank Owned Life Insurance

The Company has purchased life insurance policies on certain employees. Bank owned life insurance (BOLI) is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement. The Office of the Comptroller of the Currency (the OCC) has a policy to restrict federal savings institutions from investing more than 25% of total capital in bank owned life insurance without first notifying and obtaining authorization from the OCC. The Bank was in compliance with this policy as of December 31, 2013.

Other Real Estate Owned and Foreclosed Assets

Assets acquired through or in lieu of loan foreclosure are initially recorded at fair value based on an independent appraisal, less estimated selling costs, at the date of foreclosure, establishing a new cost basis. If fair value declines subsequent to foreclosure, the asset value is written down through expense. Costs relating to improvement of property are capitalized, whereas costs relating to holding of the property are expensed.

Long-Term Assets

Premises and equipment, non-maturity deposit and other intangible assets, and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. 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.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and amount or range of loss can be reasonably estimated. Management does not believe there are currently any such matters that will have a material effect on the consolidated financial statements.

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Derivatives

Historically, the Company's derivatives consisted mainly of interest rate swap agreements, which were used as part of its asset/liability management to help manage interest rate risk. All of the Company's interest rate swaps matured during 2011. The Company does not use derivatives for trading purposes.

Income Taxes

Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. The Company files consolidated income tax returns and allocates tax liabilities and benefits among subsidiaries pursuant to a tax sharing agreement. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Company recognizes interest expense and/or penalties related to income tax matters in income tax expense.

Earnings (Loss) Per Common Share

Basic earnings (loss) per common share is computed by dividing net earnings (loss) by the weighted average number of common shares outstanding for the period. The basic weighted average common shares and common stock equivalents are computed using the treasury stock method. The basic weighted average common shares outstanding for the period is adjusted for average unallocated employee stock ownership plan shares, average director's deferred compensation shares and average unearned restricted stock awards. Diluted earnings (loss) per common share is computed by dividing net earnings (loss) by the weighted average number of common shares outstanding for the period increased for the dilutive effect of unvested stock options and stock awards. The dilutive effect of the unvested stock options and stock awards is calculated under the treasury stock method utilizing the average market value of the Company's stock for the period.

Dividends

Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the Company or by the Company to shareholders.

Comprehensive Income

Comprehensive income consists of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes the net change in unrealized appreciation and depreciation on investment securities available-for-sale, net of taxes, which are recognized as separate components of equity, and the amount of the total OTTI related to factors other than credit loss, net of taxes, which are recognized as separate components of equity.

Benefit Plans

Profit-sharing and 401(k) plan expense is the amount contributed as determined by the Board of Directors. Deferred compensation plan expense is allocated over years of service.

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Rabbi Trusts

Vested but unpaid benefits for the executive deferred compensation plan, director retirement plan and the supplemental executive retirement plan for certain executives is funded with the Company's own common stock held in Rabbi Trusts. Unpaid benefits are recorded as contra accounts to stockholders' equity at cost and are reduced as benefits are paid out by the Trustee over the terms defined by the plans.

Employee Stock Ownership Plan

Since the Company sponsors the ESOP with an employer loan, neither the ESOP's loan payable or the Company's loan receivable are reported in the Company's consolidated balance sheet. Likewise, the Company does not recognize interest income or interest cost on the loan. Unallocated shares held by the ESOP are recorded as unearned ESOP shares in the consolidated statement of changes in stockholders' equity. As shares are committed to be released for allocation, the Company recognizes compensation expense equal to the average market price of the shares for the period. Dividends on allocated ESOP shares reduce retained earnings; dividends on unearned ESOP shares are used to reduce the ESOP loan balance at the Company.

In connection with the second step conversion, the Company sold 1,710,857 shares of common stock at $10.00 per share, inclusive of 68,434 shares issued to the Atlantic Coast Financial Corporation employee stock ownership plan. The Company loaned $0.7 million to a trust for the ESOP, enabling it to purchase 68,434 shares of common stock in the stock offering for allocation under such plan.

Stock-Based Compensation

The Company records compensation cost for restricted stock or stock options awarded to employees in return for employee service. The cost is measured at the grant-date fair value of the award and recognized as compensation expense over the employee service period, which is normally the vesting period. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards.

Impact of Certain Accounting Pronouncements

In January 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-04, *Receivables Troubled Debt Restructurings by Creditors* (ASU 2014-04). ASU 2014-04 will eliminate diversity in practice regarding the timing of derecognition for residential mortgage loans when an in substance repossession or foreclosure has occurred. Additionally, ASU 2014-04 requires both interim and annual disclosure of properties that are in the process of foreclosure. The new guidance is effective for interim and annual periods beginning after December 15, 2014, with retrospective disclosure necessary for all comparative periods presented. The adoption of this guidance will result in additional disclosures, but is not expected to have any impact on the Company's financial statements or results of operations.

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* (ASU 2013-11). ASU 2013-11 requires that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, be presented in the financial statements as a reduction of a deferred tax asset for a net operating loss carryover, a similar tax loss, or a tax credit carryover, with specified exceptions. The new guidance is effective for interim and annual periods beginning after December 15, 2013. The adoption of this guidance will not result in additional disclosures, and management does not expect the guidance to have a material impact on the Company’s financial statements or results of operations.

In February 2013, the FASB issued ASU 2013-02, *Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income* (ASU 2013-02). ASU 2013-02 requires new footnote disclosures of items reclassified from accumulated other comprehensive income (loss) to net income (loss). The new guidance was effective for interim and annual periods beginning after December 15, 2012. The Company adopted the guidance for the first quarter of 2013, resulting in additional disclosures within the statements of operations, related to reclassifications from accumulated other comprehensive income (loss) to net income (loss). There was no impact on the Company’s financial statements or results of operations.

NOTE 2. CAPITAL RAISE TRANSACTION & BULK SALE OF NON-PERFORMING ASSETS

On December 3, 2013, the Company raised $48.3 million in gross proceeds by issuing 12,880,000 shares of its common stock in a public offering, which included the issuance of an additional 1,680,000 shares as a result of the exercise of the underwriters’ over-allotment option, at a price to the public of $3.75 per share. Net proceeds from the public offering were $44.9 million after underwriting discounts and offering expenses of $3.4 million. The Company contributed $44.0 million of the net proceeds of the offering to the Bank to maintain capital ratios at required levels and to support growth in the Bank's loan and investment portfolios. The Company also intends to use the remaining net proceeds of the offering for general corporate purposes.

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 2. CAPITAL RAISE TRANSACTION & BULK SALE OF NON-PERFORMING ASSETS (continued)

On December 27, 2013, the Company completed the sale of approximately $13.2 million of its non-performing assets to real estate investment firms. The sale included non-accrual loans with a carrying value of $10.6 million and other real estate owned (OREO) with a carrying value of $2.6 million, for a combined purchase price of $6.9 million.

In addition to the capital raise transaction and bulk sale of non-performing assets, management has also pursued, and will continue to pursue, various options to aid in the steady improvement of the Company's financial condition and results of operations.

NOTE 3. REJECTED MERGER AGREEMENT WITH BOND STREET HOLDINGS, INC.

On February 25, 2013, the Company and the Bank entered into an Agreement and Plan of Merger (the Merger Agreement) with Bond Street Holdings, Inc. (Bond Street) and its bank subsidiary, Florida Community Bank, N.A. (Florida Community Bank). Pursuant to the Merger Agreement, the Company was to be merged with and into Bond Street (the Merger) and the Bank was then to merge with and into Florida Community Bank.

On April 22, 2013, the Company and the Bank entered into Amendment Number 1 to the Merger Agreement (the Amended Merger Agreement) with Bond Street and Florida Community Bank. Under the terms of the Amended Merger Agreement, each share of the Company's common stock issued and outstanding immediately prior to the completion of the merger would have been converted into the right to receive $5.00 in cash at closing.

On June 11, 2013, the proposed merger was rejected by the stockholders of the Company. On June 24, 2013, the Company provided notice to Bond Street that it was terminating the Merger Agreement pursuant to provisions of the Merger Agreement that permitted either the Company or Bond Street to terminate the Merger Agreement if stockholders of the Company did not approve the Merger Agreement by June 21, 2013. Prior to the rejection of the Merger, the Company incurred $1.3 million of merger-related costs.

Litigation Relating to the Merger

As described in our previous filings with the Securities and Exchange Commission, two putative class action lawsuits related to our proposed merger with Bond Street were originally filed against the Company, the Bank, Bond Street and its bank subsidiary, Florida Community Bank and certain directors of the Company. The two prior lawsuits were voluntarily dismissed and a new combined federal court action was filed on May 20, 2013.

On June 5, 2013, Plaintiff Jason Laugherty, individually and on behalf of a putative class of similarly situated stockholders, the Company, the Bank, Bond Street, Florida Community Bank, and individual defendants Forrest W. Sweat, Jr., Charles E. Martin, Jr., Thomas F. Beeckler, G. Thomas Frankland, John J. Linfante, W. Eric Palmer, and H. Dennis Woods, entered into a Memorandum of Understanding (the MOU) regarding the settlement in principle of a putative class action lawsuit filed in the United States District Court for the District of Maryland (the Action). The Action was filed in response to the Merger Agreement and alleged claims against the Company, the Bank, Bond Street, Florida Community Bank and certain directors of the Company for breaches of fiduciary duties, aiding and abetting breaches of fiduciary duties, and violations of federal proxy disclosure laws relating to the proposed merger.

Under the terms of the MOU, the Company, the Bank, Bond Street and Florida Community Bank, the other named individual director defendants, and the Plaintiff reached an agreement in principle to settle the class action lawsuit and to release the defendants from all claims in the Action and the prior lawsuits relating to the proposed merger, subject to the approval of the United States District Court for the District of Maryland and the consummation of the proposed merger. Under the terms of the MOU, Plaintiff's counsel also reserved the right to seek an award of attorney's fees and expenses if the proposed merger was not approved by the Company's stockholders.

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 3. REJECTED MERGER AGREEMENT WITH BOND STREET HOLDINGS, INC. (continued)

On June 7, 2013, the parties to the MOU submitted a joint motion to stay the Action and/or to extend case deadlines pending consummation of the proposed merger and the filing of a motion for a preliminary approval of settlement. The court granted the motion and stayed the Action pending consummation of the merger. The vote on the proposed merger transaction was unsuccessful, and on November 13, 2013 the Plaintiff filed a notice of voluntary dismissal, which was approved by the judge.

NOTE 4. FAIR VALUE

Asset and liability fair value measurements (in this note and Note 5) have been categorized based upon the fair value hierarchy described below:

- Level 1 Valuation is based upon quoted market prices for identical instruments in active markets.
- Level 2 Valuation is based upon quoted market prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect estimates or assumptions that market participants would use in pricing the assets or liabilities. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2013 and 2012 are summarized below:

	Fair Value Hierarchy Total	Level 1	Level 2	Level 3
	(Dollars in Thousands)			
December 31, 2013				
Assets:				
Securities available-for-sale:				
U.S. Government-sponsored enterprises	$ 4,318		$ 4,318	
State and municipal	972		972	
Mortgage-backed securities residential	130,914		130,914	
Collateralized mortgage obligations U.S. Government	23,528		23,528	
Total	$ 159,732		$ 159,732	
December 31, 2012				

Assets:				
Securities available-for-sale:				
State and municipal	$	979	$	979
Mortgage-backed securities residential		119,647		119,647
Collateralized mortgage obligations U.S. Government		39,119		39,119
Total	$	159,745	$	159,745

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 4. FAIR VALUE (continued)

The fair values of securities available-for-sale are determined by quoted market prices, if available (Level 1). For securities available-for-sale where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities available-for-sale where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Discounted cash flows are calculated using spread to swap and LIBOR curves that are updated to incorporate loss severities, volatility, credit spread and optionality. During times when trading is less liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations.

The Company had no assets measured at Level 3 fair value on a recurring basis as of December 31, 2013 and 2012. The table below presents a reconciliation of all assets measured at Level 3 fair value on a recurring basis as of December 31, 2011:

	2011 (Dollars in Thousands)	
Investment securities available-for-sale:		
Balance of recurring Level 3 assets at beginning of year	$	6,734
Total realized and unrealized gains (losses):		
Included in earnings realized		186
Included in earnings unrealized		(186)
Included in other comprehensive income		(12)
Proceeds from sales		(6,722)
Balance of recurring Level 3 assets at end of year	$	

Market conditions for certain debt securities have resulted in unreliable or unavailable fair values, often resulting in transfers in and/or out of Level 3 fair value. The Company determined that no debt securities were evaluated as Level 3 fair value as of December 31, 2013 and 2012.

Assets and liabilities measured at fair value on a non-recurring basis as of December 31, 2013 and 2012 are summarized below:

			Fair Value Hierarchy				
	Total (Dollars in Thousands)		Level 1	Level 2	Level 3	
December 31, 2013						
Assets:						
Other real estate owned	$	5,225			$	5,225
December 31, 2012						

Assets:				
Other real estate owned	$	8,065	$	8,065
Impaired loans collateral dependent (reported on the consolidated balance sheets in portfolio loans, net)		9,784		9,784

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 4. FAIR VALUE (continued)

Quantitative information about Level 3 fair value measurements as of December 31, 2013 and 2012 is summarized below:

	Fair Value Estimate		Valuation Techniques	Unobservable Input	Range (Weighted Average) (1)
	(Dollars in Thousands)				
December 31, 2013					
Assets:					
Other real estate owned	$	5,225	Broker price opinions, appraisal of collateral (2) (3)	Appraisal adjustments (4) Liquidation expenses	0.0% to 64.4% (26.6%) 10.0% (10.0%)
December 31, 2012					
Assets:					
Other real estate owned	$	8,065	Broker price opinions, appraisal of collateral (2) (3)	Appraisal adjustments (4) Liquidation expenses	0.0% to 44.0% (2.1%) 8.0% to 10.0% (8.8%)
Impaired loans collateral dependent (reported on the consolidated balance sheets in portfolio loans, net)		9,784	Appraisal of collateral (2)	Appraisal adjustments (4) Liquidation expenses	0.0% (0.0%) 8.0% to 10.0% (8.9%)

(1) The range and weighted average of other appraisal adjustments and liquidation expenses are presented as a percent of the appraised value.

(2) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various level 3 inputs which are not identifiable.

(3) Includes qualitative adjustments by management and estimated liquidation expenses.

(4) Appraisals may be adjusted by management for qualitative factors such as economic conditions and liquidation expenses.

The fair value of OREO is determined using inputs which include current and prior appraisals and estimated costs to sell (Level 3). Assets acquired through or in lieu of loan foreclosure are initially recorded at fair value based on appraisals, as adjusted, less estimated selling costs at the date of foreclosure, establishing a new cost basis. At the initial time of transfer to OREO, an impairment loss is recognized through the allowance in cases where the carrying amount exceeds the new cost basis. Subsequent declines in fair value are recorded directly as an adjustment to current earnings through noninterest expense. Costs relating to improvement of property may be capitalized, whereas costs relating to the holding of property are expensed. Write-downs on other real estate owned for the years ended December 31, 2013, 2012 and 2011 were $2.3 million, $0.9 million, and $0.9 million, respectively. The fair values of impaired loans that are collateral dependent are based on a valuation model which incorporates the most current real estate appraisals available, as well as assumptions used to estimate the fair value of all non-real estate collateral as defined in the Bank’s internal loan policy (Level 3).

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 5. FAIR VALUE OF FINANCIAL INSTRUMENTS

Carrying amount and estimated fair value of financial instruments, not previously presented, as of December 31, 2013 and 2012 were as follows:

	Carrying Amount	Estimated Fair Value	Fair Value Hierarchy Level 1	Level 2	Level 3
	(Dollars in Thousands)				
December 31, 2013					
Assets:					
Cash and due from financial institutions	$ 2,889	$ 2,889	$ 2,889	$	$
Short-term interest-earning deposits	111,305	111,305	111,305		
Securities held-to-maturity	19,266	19,258		19,258	
Portfolio loans, net	371,956	382,762		382,762	
Loans held-for-sale	1,656	1,869		1,869	
Warehouse loans held-for-investment	20,523	20,523		20,523	
Federal Home Loan Bank stock, at cost	5,879	5,879			5,879
Accrued interest receivable	1,826	1,826		1,826	
Liabilities:					
Deposits	460,098	460,432		460,432	
Securities sold under agreements to repurchase	92,800	101,949		101,949	
Federal Home Loan Bank advances	110,000	120,494		120,494	
Accrued interest payable (reported on consolidated balance sheets in accrued expenses and other liabilities)	1,107	1,107		1,107	
December 31, 2012					
Assets:					

Cash and due from financial institutions	$ 7,490	$ 7,490	$ 7,490	$	$
Short-term interest-earning deposits	60,338	60,338	60,338		
Portfolio loans, net	421,201	435,040		425,256	9,784
Loans held-for-sale	4,089	4,527		4,527	
Warehouse loans held-for-investment	68,479	68,479		68,479	
Federal Home Loan Bank stock, at cost	7,260	7,260			7,260
Accrued interest receivable	2,035	2,035		2,035	
Liabilities:					
Deposits	499,760	500,469		500,469	
Securities sold under agreements to repurchase	92,800	107,034		107,034	
Federal Home Loan Bank advances	135,000	150,707		150,707	
Accrued interest payable (reported on consolidated balance sheets in accrued expenses and other liabilities)	1,120	1,120		1,120	

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 5. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

Carrying amount is the estimated fair value for cash and cash equivalents, accrued interest, demand and savings deposits and variable rate loans or deposits that re-price frequently and fully. Fair value of securities held-to-maturity is based on quoted market prices. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent re-pricing or re-pricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life without considering the need for adjustments for market illiquidity or credit risk. Fair value of loans held-for-sale is based on quoted market prices, where available, or is determined based on discounted cash flows using current market rates applied to the estimated life and credit risk. Carrying amount is the estimated fair value for warehouse loans held-for-investment, due to the rapid repayment of the loans (generally less than 30 days). Fair value of the FHLB advances and securities sold under agreements to repurchase (reverse repurchase agreements) is based on current rates for similar financing. It was not practicable to determine the fair value of the FHLB stock due to restrictions placed on its transferability. The estimated fair value of other financial instruments and off-balance-sheet commitments approximate cost and are not considered significant to this presentation.

The Bank is a member of the FHLB and as such, is required to maintain a minimum investment in stock of the FHLB that varies with the level of advances outstanding with the FHLB. The stock is bought from and sold to the FHLB based upon its $100.00 par value. The stock does not have a readily determinable fair value and as such, is classified as restricted stock, carried at cost and evaluated for impairment. Accordingly, the stock’s value is determined by the ultimate recoverability of the par value rather than by recognizing temporary declines. The determination of whether the par value will ultimately be recovered is influenced by criteria such as the following: (a) the significance of the decline in net assets of the FHLB as compared to the capital stock amount and the length of time this situation has persisted, (b) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance (c) the impact of legislative and regulatory changes on the customer base of the FHLB and (d) the liquidity position of the FHLB. The Company did not consider the FHLB stock to be impaired as of December 31, 2013.

NOTE 6. INVESTMENT SECURITIES

The following table summarizes the amortized cost and fair value of the investment securities and the corresponding amounts of unrealized gains and losses therein as of December 31, 2013 and 2012:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Carrying Amount
	(Dollars in Thousands)				
December 31, 2013					
Securities available-for-sale:					
U.S. Government sponsored enterprises	$ 5,000	$	$ (682)	$ 4,318	$ 4,318
State and municipal	942	30		972	972
	137,018	115	(6,219)	130,914	130,914

Mortgage-backed securities residential										
Collateralized mortgage obligations U.S. Government		24,331		27		(830)		23,528		23,528
Total securities available-for-sale		167,291		172		(7,731)		159,732		159,732
Securities held-to-maturity (1):										
Mortgage-backed securities residential		19,266				(8)		19,258		19,266
Total securities held-to-maturity		19,266				(8)		19,258		19,266
Total investment securities	$	186,557	$	172	$	(7,739)	$	178,990	$	178,998
December 31, 2012										
Securities available-for-sale:										
State and municipal	$	943	$	42	$	(6)	$	979	$	979
Mortgage-backed securities residential		118,970		847		(170)		119,647		119,647
Collateralized mortgage obligations U.S. Government		39,146		127		(154)		39,119		39,119
Total securities available-for-sale		159,059		1,016		(330)		159,745		159,745
Total investment securities	$	159,059	$	1,016	$	(330)	$	159,745	$	159,745

(1) Investment securities held-to-maturity are carried at amortized cost.

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 6. INVESTMENT SECURITIES (continued)

The amortized cost and fair value of investment securities, both available-for-sale and held-to-maturity, segregated by contractual maturity as of December 31, 2013, is shown below:

	Amortized Cost	Fair Value
	(Dollars in Thousands)	
Due in one year or less	$	$
Due from more than one to five years		
Due from more than five to ten years	942	972
Due after ten years		
U.S. Government-sponsored enterprises	5,000	4,318
Mortgage-backed securities residential (1)	156,284	150,172
Collateralized mortgage obligations U.S. Government	24,331	23,528
	$ 186,557	$ 178,990

(1) Investment securities held-to-maturity, included in Mortgage-backed securities residential, are carried at amortized cost.

Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Investment securities not due at a single maturity date, include mortgage-backed securities and collateralized mortgage obligations, are shown separately.

The following table summarizes the investment securities, both available-for-sale and held-to-maturity with unrealized losses as of December 31, 2013 and 2012, aggregated by investment category and length of time in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in Thousands)					
December 31, 2013						
U.S. Government sponsored enterprises	$ 4,318	$ (682)	$	$	$ 4,318	$ (682)
State and municipal						
Mortgage-backed securities residential (1)	76,480	(3,033)	51,531	(3,186)	128,011	(6,219)
Collateralized mortgage obligations U.S.	32,275	(547)	8,204	(292)	40,479	(838)

Government												
	$	113,073	$	(4,262)	$	59,735	$	(3,478)	$	172,808	$	(7,739)
December 31, 2012												
State and municipal	$		$		$	454	$	(6)	$	454	$	(6)
Mortgage-backed securities residential		61,172		(170)						61,172		(170)
Collateralized mortgage obligations U.S. Government		13,207		(78)		5,054		(76)		18,261		(154)
	$	74,379	$	(248)	$	5,508	$	(82)	$	79,887	$	(330)

(1) Investment securities held-to-maturity, included in Mortgage-backed securities residential as of December 31, 2013, are carried at amortized cost.

The increase in unrealized losses during 2013 is due to an increase in interest rates, which started in late May and continued through the end of the year. The 10-year treasury rate as of December 31, 2013 and 2012 was 3.04% and 1.78%, respectively.

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 6. INVESTMENT SECURITIES (continued)

Other-Than-Temporary Impairment

Management evaluates investment securities for OTTI at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation.

As of December 31, 2013 the Company's security portfolio consisted of 40 securities available-for-sale, 31 of which were in an unrealized loss position, and 2 securities held-to-maturity, both of which were in an unrealized loss position. Nearly all unrealized losses were related to debt securities whose underlying collateral is residential mortgages. However, all of these debt securities were issued by government sponsored organizations as discussed below.

As of December 31, 2013, $178.0 million, or approximately 99.5% of the debt securities held by the Company were issued by U.S. government-sponsored entities and agencies, primarily Fannie Mae, Freddie Mac and Ginnie Mae, institutions which the government has affirmed its commitment to support. The decline in fair value was attributable to changes in interest rates and not credit quality. The Company currently does not have the intent to sell these securities and it is not more likely than not it will be required to sell the securities before their anticipated recovery. Therefore, the Company does not consider these debt securities to be other-than-temporarily impaired as of December 31, 2013.

During the years ended December 31, 2013 and 2012, the Company did not record OTTI related to non-agency collateralized mortgage-backed securities or collateralized mortgage obligations. During the year ended December 31, 2011, the Company recorded OTTI of $0.2 million related to non-agency collateralized mortgage-backed securities or collateralized mortgage obligations, all of which had been disposed of by the end of 2011. The amount in 2011 related to the sale of securities during the period for which OTTI had been recognized.

Proceeds from Investment Securities

Proceeds from sales, payments, maturities and calls of securities available-for-sale were $31.7 million, $120.3 million and $177.4 million for the years ended December 31, 2013, 2012 and 2011, respectively. No gross gains were realized during the year ended December 31, 2013. Gross gains of $2.4 million and $3.7 million were realized during the years ended December 31, 2012 and 2011, respectively. No gross losses were realized during the years ended December 31, 2013 and 2012, respectively, while gross losses of $0.3 million were realized during the year ended December 31, 2011. Gains and losses on sales of securities are recorded on the settlement date, which is not materially different from the trade date, and determined using the specific identification method.

There were no proceeds from payments, maturities and calls of securities held-to-maturity for the years ended December 31, 2013, 2012 and 2011, respectively. The Company did not sell investment securities classified as held-to-maturity during the years ended December 31, 2013, 2012 and 2011, respectively, and currently intends to hold such securities until maturity.

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 7. PORTFOLIO LOANS

Following is a comparative composition of net portfolio loans as of December 31, 2013 and 2012:

	2013	% of Total Loans		2012	% of Total Loans	
	(Dollars in Thousands)					
Real estate loans:						
One- to four-family	$ 167,455	44.9	%	$ 193,057	45.3	%
Commercial	48,356	12.9	%	58,193	13.7	%
Other (land and multi-family)	15,790	4.2	%	19,908	4.7	%
Total real estate loans	231,601	62.0	%	271,158	63.7	%
Real estate construction loans:						
One- to four-family		0.0	%		0.0	%
Commercial	2,582	0.7	%	5,049	1.2	%
Acquisition and development		0.0	%		0.0	%
Total real estate construction loans	2,582	0.7	%	5,049	1.2	%
Other portfolio loans:						
Home equity	52,767	14.1	%	63,867	15.0	%
Consumer	53,290	14.3	%	61,558	14.4	%
Commercial	33,029	8.9	%	24,308	5.7	%
Total other portfolio loans	139,086	37.3	%	149,733	35.1	%
Total portfolio loans	373,269	100.0	%	425,940	100.0	%
Allowance for portfolio loan losses	(6,946)			(10,889)		
Net deferred portfolio loan costs	5,633			6,150		
Portfolio loans, net	$ 371,956			$ 421,201		

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 7. PORTFOLIO LOANS (continued)

The following table presents the contractual aging of the recorded investment in past due loans by class of portfolio loans as of December 31, 2013 and 2012:

	Current	30 59 Days Past Due	60 89 Days Past Due	> 90 Days Past Due	Total Past Due	Total
	(Dollars in Thousands)					
December 31, 2013						
Real estate loans:						
One- to four-family	$ 162,134	$ 1,550	$ 1,289	$ 2,482	$ 5,321	$ 167,455
Commercial	48,272	84			84	48,356
Other (land and multi-family)	15,668	47		75	122	15,790
Total real estate loans	226,074	1,681	1,289	2,557	5,527	231,601
Real estate construction loans:						
One- to four-family						
Commercial	2,582					2,582
Acquisition and development						
Total real estate construction loans	2,582					2,582
Other portfolio loans:						
Home equity	51,686	639	148	294	1,081	52,767
Consumer	51,810	983	387	110	1,480	53,290
Commercial	33,016	13			13	33,029
Total other portfolio loans	136,512	1,635	535	404	2,574	139,086
Total portfolio loans	$ 365,168	$ 3,316	$ 1,824	$ 2,961	$ 8,101	$ 373,269
December 31, 2012						
Real estate loans:						
One- to four-family	$ 179,242	$ 3,598	$ 1,658	$ 8,559	$ 13,815	$ 193,057
Commercial	49,922	101		8,170	8,271	58,193

Other (land and multi-family)	19,289	24		595	619	19,908
Total real estate loans	248,453	3,723	1,658	17,324	22,705	271,158
Real estate construction loans:						
One- to four-family						
Commercial	4,310			739	739	5,049
Acquisition and development						
Total real estate construction loans	4,310			739	739	5,049
Other portfolio loans:						
Home equity	60,342	1,008	305	2,212	3,525	63,867
Consumer	59,451	987	418	702	2,107	61,558
Commercial	22,937	200		1,171	1,371	24,308
Total other portfolio loans	142,730	2,195	723	4,085	7,003	149,733
Total portfolio loans	$ 395,493	$ 5,918	$ 2,381	$ 22,148	$ 30,447	$ 425,940

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 7. PORTFOLIO LOANS (continued)

Non-performing portfolio loans, including non-accrual portfolio loans, as of December 31, 2013 and 2012 were $3.4 million and $24.9 million, respectively. There were no portfolio loans over 90 days past-due and still accruing interest as of December 31, 2013 or 2012. Non-performing portfolio loans include both smaller balance homogeneous loans that are collectively evaluated for impairment and larger individually evaluated loans classified as impaired loans.

The following table presents performing and non-performing loans by class of portfolio loans as of December 31, 2013 and 2012:

	Performing	Non-performing	Total
	(Dollars in Thousands)		
December 31, 2013			
Real estate loans:			
One- to four-family	$ 164,778	$ 2,677	$ 167,455
Commercial	48,356		48,356
Other (land and multi-family)	15,715	75	15,790
Total real estate loans	228,849	2,752	231,601
Real estate construction loans:			
One- to four-family			
Commercial	2,582		2,582
Acquisition and development			
Total real estate construction loans	2,582		2,582
Other portfolio loans:			
Home equity	52,367	400	52,767
Consumer	53,061	229	53,290
Commercial	33,029		33,029
Total other portfolio loans	138,457	629	139,086
Total portfolio loans	$ 369,888	$ 3,381	$ 373,269
December 31, 2012			
Real estate loans:			
One- to four-family	$ 182,502	$ 10,555	$ 193,057
Commercial	49,550	8,643	58,193
Other (land and multi-family)	19,313	595	19,908
Total real estate loans	251,365	19,793	271,158

Real estate construction loans:			
One- to four-family			
Commercial	4,310	739	5,049
Acquisition and development			
Total real estate construction loans	4,310	739	5,049
Other portfolio loans:			
Home equity	61,655	2,212	63,867
Consumer	60,589	969	61,558
Commercial	23,137	1,171	24,308
Total other portfolio loans	145,381	4,352	149,733
Total portfolio loans	$ 401,056	$ 24,884	$ 425,940

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 7. PORTFOLIO LOANS (continued)

The Company utilizes an internal asset classification system for portfolio loans other than consumer and residential loans as a means of reporting problem and potential problem loans. Under the risk rating system, the Company classifies problem and potential problem loans as "Special Mention", "Substandard", and "Doubtful" which correspond to risk ratings five, six and seven, respectively. Substandard portfolio loans, or risk rated six, include those characterized by the distinct possibility the Company may sustain some loss if the deficiencies are not corrected. Portfolio loans classified as Doubtful, or risk rated seven, have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Portfolio loans that do not currently expose the Company to sufficient risk to warrant classification in one of the aforementioned categories, but possess weaknesses that deserve management's close attention are deemed to be Special Mention, or risk rated five. Risk ratings are updated any time the facts and circumstances warrant.

The Company evaluates consumer and residential loans based on whether the loans are performing or non-performing as well as other factors. One- to four-family residential loan balances are charged down by the expected loss amount at the time they become non-performing, which is generally 90 days past due. Consumer loans including automobile, manufactured housing, unsecured, and other secured loans are charged-off, net of expected recovery when the loan becomes significantly past due over a range of up to 180 days, depending on the type of loan.

The following table presents the risk category of commercial and other real estate portfolio loans evaluated by internal asset classification as of December 31, 2013 and 2012:

	Pass	Special Mention	Substandard	Doubtful	Total
	(Dollars in Thousands)				
December 31, 2013					
Real estate loans:					
Commercial	$ 41,838	$ 2,651	$ 3,867	$	$ 48,356
Other (land and multi-family)	9,628	392	5,770		15,790
Total real estate loans	51,466	3,043	9,637		64,146
Real estate construction loans:					
Commercial	2,582				2,582
Total real estate construction loans	2,582				2,582
Other portfolio loans:					
Commercial	32,466	93	470		33,029
Total other portfolio loans	32,466	93	470		33,029

Total portfolio loans	$	86,514	$	3,136	$	10,107	$		$	99,757
December 31, 2012										
Real estate loans:										
Commercial	$	43,542	$	2,308	$	12,343	$		$	58,193
Other (land and multi-family)		13,004		413		6,491				19,908
Total real estate loans		56,546		2,721		18,834				78,101
Real estate construction loans:										
Commercial		4,310				739				5,049
Total real estate construction loans		4,310				739				5,049
Other portfolio loans:										
Commercial		22,342		104		1,862				24,308
Total other portfolio loans		22,342		104		1,862				24,308
Total portfolio loans	$	83,198	$	2,825	$	21,435	$		$	107,458

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 7. PORTFOLIO LOANS (continued)

When establishing the allowance, management categorizes loans into risk categories generally based on the nature of the collateral and the basis of repayment. Activity in the allowance for the years ended December 31, 2013, 2012 and 2011 was as follows:

	Beginning Balance	Charge-Offs	Recoveries	Provision Expense	Ending Balance
	(Dollars in Thousands)				
December 31, 2013					
Real estate loans:					
One- to four-family	$ 4,166	$ (4,485)	$ 961	$ 2,546	$ 3,188
Commercial	958	(2,452)		2,321	827
Other (land and multi-family)	986	(790)	63	23	282
Total real estate loans	6,110	(7,727)	1,024	4,890	4,297
Real estate construction loans:					
One- to four-family					
Commercial	50			75	125
Acquisition and development					
Total real estate construction loans	50			75	125
Other portfolio loans:					
Home equity	2,636	(2,017)	395	32	1,046
Consumer	1,448	(2,131)	289	1,617	1,223
Commercial	645	(880)	78	371	214
Total other portfolio loans	4,729	(5,028)	762	2,020	2,483
Unallocated				41	41
Total	$ 10,889	$ (12,755)	$ 1,786	$ 7,026	$ 6,946
December 31, 2012					
Real estate loans:					
One- to four-family	$ 6,030	$ (6,347)	$ 1,036	$ 3,447	$ 4,166
Commercial	3,143	(2,756)	3	568	958
Other (land and multi-family)	1,538	(1,906)	8	1,346	986
Total real estate loans	10,711	(11,009)	1,047	5,361	6,110
Real estate construction loans:					
One- to four-family	120			(120)	
Commercial		(1,145)		1,195	50
Acquisition and development					

Total real estate construction loans		120		(1,145)				1,075		50
Other portfolio loans:										
Home equity		3,125		(3,215)		223		2,503		2,636
Consumer		885		(1,567)		305		1,825		1,448
Commercial		685		(1,769)		2		1,727		645
Total other portfolio loans		4,695		(6,551)		530		6,055		4,729
Unallocated										
Total	$	15,526	$	(18,705)	$	1,577	$	12,491	$	10,889
December 31, 2011										
Real estate loans:										
One- to four-family	$	5,860	$	(6,005)	$	483	$	5,692	$	6,030
Commercial		2,443		(2,274)		21		2,953		3,143
Other (land and multi-family)		1,019		(729)		36		1,212		1,538
Total real estate loans		9,322		(9,008)		540		9,857		10,711
Real estate construction loans:										
One- to four-family		18						102		120
Commercial		37						(37)		
Acquisition and development										
Total real estate construction loans		55						65		120
Other portfolio loans:										
Home equity		1,663		(3,404)		119		4,747		3,125
Consumer		1,922		(1,471)		262		172		885
Commercial		382		(242)		3		542		685
Total other portfolio loans		3,967		(5,117)		384		5,461		4,695
Unallocated										
Total	$	13,344	$	(14,125)	$	924	$	15,383	$	15,526

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 7. PORTFOLIO LOANS (continued)

The following table presents ending balances for the allowance and portfolio loans based on the impairment method as of December 31, 2013:

	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total Ending Balance
	(Dollars in Thousands)		
Allowance for portfolio loan losses:			
Real estate loans:			
One- to four-family	$ 799	$ 2,389	$ 3,188
Commercial	106	721	827
Other (land and multi-family)	92	190	282
Total real estate loans	997	3,300	4,297
Real estate construction loans:			
One- to four-family			
Commercial		125	125
Acquisition and development			
Total real estate construction loans		125	125
Other portfolio loans:			
Home equity	321	725	1,046
Consumer	29	1,194	1,223
Commercial	3	211	214
Total other portfolio loans	353	2,130	2,483
Unallocated		41	41
Total ending allowance for portfolio loan losses balance	$ 1,350	$ 5,596	$ 6,946
Portfolio loans:			
Real estate loans:			
One- to four-family	$ 6,701	$ 160,754	$ 167,455
Commercial	6,481	41,875	48,356
Other (land and multi-family)	7,124	8,666	15,790
Total real estate loans	20,306	211,295	231,601
Real estate construction loans:			

One- to four-family			
Commercial		2,582	2,582
Acquisition and development			
Total real estate construction loans		2,582	2,582
Other portfolio loans:			
Home equity	1,141	51,626	52,767
Consumer	94	53,211	53,290
Commercial	628	32,401	33,029
Total other portfolio loans	1,863	137,238	139,086
Total ending portfolio loans balance	$ 22,169	$ 351,115	$ 373,269

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 7. PORTFOLIO LOANS (continued)

The following table presents ending balances for the allowance and portfolio loans based on the impairment method as of December 31, 2012:

	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total Ending Balance
	(Dollars in Thousands)		
Allowance for portfolio loan losses:			
Real estate loans:			
One- to four-family	$ 1,116	$ 3,050	$ 4,166
Commercial	165	793	958
Other (land and multi-family)	156	830	986
Total real estate loans	1,437	4,673	6,110
Real estate construction loans:			
One- to four-family			
Commercial		50	50
Acquisition and development			
Total real estate construction loans		50	50
Other portfolio loans:			
Home equity	384	2,252	2,636
Consumer	59	1,389	1,448
Commercial	308	337	645
Total other portfolio loans	751	3,978	4,729
Unallocated			
Total ending allowance for portfolio loan losses balance	$ 2,188	$ 8,701	$ 10,889
Portfolio loans:			
Real estate loans:			
One- to four-family	$ 7,966	$ 185,091	$ 193,057
Commercial	15,034	43,159	58,193
Other (land and multi-family)	8,507	11,401	19,908
Total real estate loans	31,507	239,651	271,158
Real estate construction loans:			

One- to four-family			
Commercial	739	4,310	5,049
Acquisition and development			
Total real estate construction loans	739	4,310	5,049
Other portfolio loans:			
Home equity	2,957	60,910	63,867
Consumer	467	61,091	61,558
Commercial	2,006	22,302	24,308
Total other portfolio loans	5,430	144,303	149,733
Total ending portfolio loans balance	$ 37,676	$ 388,264	$ 425,940

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 7. PORTFOLIO LOANS (continued)

Portfolio loans for which the concessions have been granted as a result of the borrower's financial difficulties are considered a TDR. These concessions, which in general are applied to all categories of portfolio loans, may include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, or a combination of these or other actions intended to maximize collection. The resulting TDR impairment is included in specific reserves.

For homogeneous loan categories, such as one- to four-family residential loans and home equity loans, the amount of impairment resulting from the modification of the loan terms is calculated in aggregate by category of portfolio loan. The resulting impairment is included in specific reserves. If an individual homogeneous loan defaults under terms of the TDR and becomes non-performing, the Bank follows its usual practice of charging the loan down to its estimated fair value and the charge-off is considered as a factor in determining the amount of the general component of the allowance.

For larger non-homogeneous loans, each loan that is modified is evaluated individually for impairment based on either discounted cash flow or, for collateral dependent loans, the appraised value of the collateral less selling costs. If the loan is not collateral dependent, the amount of the impairment, if any, is recorded as a specific reserve in the allowance. If the loan is collateral dependent, the amount of the impairment is charged off. There was an allocated allowance for loans individually evaluated for impairment of approximately $0.1 million and $0.5 million at December 31, 2013 and 2012, respectively.

A portfolio loan that is modified as a TDR with a market rate of interest is classified as an impaired loan and reported as a TDR in the year of restructure and until the loan has performed for twelve months in accordance with the modified terms. The policy for returning a non-performing loan to accrual status is the same for any loan irrespective of whether the loan has been modified. As such, loans which are non-performing prior to modification continue to be accounted for as non-performing loans until they have demonstrated the ability to maintain sustained performance over a period of time, but no less than six months, and are reported as impaired non-performing loans. Following this period such a modified loan is returned to accrual status and is classified as impaired and reported as a performing TDR until the loan has performed for twelve months in accordance with the modified terms. TDRs classified as impaired loans as of December 31, 2013 and 2012 were as follows:

	2013	2012
	(Dollars in Thousands)	
Real estate loans:		
One- to four-family	$ 6,701	$ 7,966
Commercial	6,481	7,635
Other (land and multi-family)	6,864	2,053
Total real estate loans	20,046	17,654

Real estate construction loans:				
One- to four-family				
Commercial				
Acquisition and development				
Total real estate construction loans				
Other portfolio loans:				
Home equity		1,141		2,957
Consumer		94		467
Commercial		628		1,329
Total other portfolio loans		1,863		4,753
Total TDRs classified as impaired loans	$	21,909	$	22,407

There were no commitments to lend additional amounts on TDRs as of December 31, 2013 and 2012.

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 7. PORTFOLIO LOANS (continued)

The Company is proactive in modifying residential, home equity and consumer loans in early stage delinquency because management believes modifying the loan prior to it becoming non-performing results in the least cost to the Bank. The Bank also modifies larger commercial and commercial real estate loans as TDRs rather than pursuing other means of collection when it believes the borrower is committed to the successful repayment of the loan and the business operations are likely to support the modified loan terms.

The following table presents information on TDRs during the year ended December 31, 2013:

	Number of Contracts	Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investments
	(Dollars in Thousands)		
Troubled debt restructuring:			
Real estate loans:			
One- to four-family	9	$ 1,802	$ 1,802
Commercial	1	362	362
Other (land and multi-family)	3	5,756	5,756
Total real estate loans	13	7,920	7,920
Other portfolio loans:			
Home equity	6	281	281
Consumer	10	276	276
Commercial	4	302	302
Total other portfolio loans	20	859	859
Total troubled debt restructurings	33	$ 8,779	$ 8,779

	Number of Contracts	Recorded Investments
	(Dollars in Thousands)	
Troubled debt restructuring that subsequently defaulted:		
Other portfolio loans:		
Consumer	2	1
Total troubled debt restructurings that subsequently defaulted	2	$ 1

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 7. PORTFOLIO LOANS (continued)

The following tables present information on troubled debt restructurings and subsequent defaults during the year ended December 31, 2012:

	Number of Contracts	Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investments
	(Dollars in Thousands)		
Troubled debt restructuring:			
Real estate loans:			
One- to four-family	24	$ 3,177	$ 3,071
Commercial	4	2,998	2,998
Other (land and multi-family)	6	858	702
Total real estate loans	34	7,033	6,771
Other portfolio loans:			
Home equity	14	2,062	1,859
Consumer	9	425	425
Commercial	2	83	83
Total other portfolio loans	25	2,570	2,367
Total troubled debt restructurings	59	$ 9,603	$ 9,138

	Number of Contracts	Recorded Investments
	(Dollars in Thousands)	
Troubled debt restructuring that subsequently defaulted:		
Real estate loans:		
One- to four-family	2	$ 189
Commercial	1	217
Other (land and multi-family)	1	201
Total real estate loans	4	607
Other portfolio loans:		
Consumer	1	117
Total troubled debt restructurings that subsequently defaulted	5	$ 724

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 7. PORTFOLIO LOANS (continued)

The following table presents information about impaired portfolio loans as of December 31, 2013:

	Recorded Investment		Unpaid Principal Balance		Related Allowance	
	(Dollars in Thousands)					
With no related allowance recorded:						
Real estate loans:						
One- to four-family	$		$		$	
Commercial		3,600		3,600		
Other (land and multi-family)		5,770		5,770		
Total real estate loans		9,370		9,370		
Real estate construction loans:						
One- to four-family						
Commercial						
Acquisition and development						
Total real estate construction loans						
Other portfolio loans:						
Home equity						
Consumer						
Commercial		377		377		
Total other portfolio loans		377		377		
Total with no related allowance recorded	$	9,747	$	9,747	$	
With an allowance recorded:						
Real estate loans:						
One- to four-family	$	6,701	$	6,701	$	799
Commercial		2,881		2,881		106
Other (land and multi-family)		1,354		1,529		92
Total real estate loans		10,936		11,111		997
Real estate construction loans:						
One- to four-family						
Commercial						
Acquisition and development						

Total real estate construction loans						
Other portfolio loans:						
Home equity		1,141		1,141		321
Consumer		94		94		29
Commercial		251		251		3
Total other portfolio loans		1,486		1,486		353
Total with an allowance recorded	$	12,422	$	12,597	$	1,350

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 7. PORTFOLIO LOANS (continued)

The following table presents information about impaired portfolio loans as of December 31, 2012:

	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in Thousands)		
With no related allowance recorded:			
Real estate loans:			
One- to four-family	$	$	$
Commercial	12,073	12,758	
Other (land and multi-family)	6,490	6,493	
Total real estate loans	18,563	19,251	
Real estate construction loans:			
One- to four-family			
Commercial	739	4,988	
Acquisition and development			
Total real estate construction loans	739	4,988	
Other portfolio loans:			
Home equity			
Consumer			
Commercial	1,117	2,814	
Total other portfolio loans	1,117	2,814	
Total with no related allowance recorded	$ 20,419	$ 27,053	$
With an allowance recorded:			
Real estate loans:			
One- to four-family	$ 7,966	$ 8,071	$ 1,116
Commercial	2,961	2,961	165
Other (land and multi-family)	2,017	2,195	156
Total real estate loans	12,944	13,227	1,437
Real estate construction loans:			
One- to four-family			
Commercial			
Acquisition and development			
Total real estate construction loans			

Other portfolio loans:						
Home equity		2,957		3,160		384
Consumer		467		467		59
Commercial		889		889		308
Total other portfolio loans		4,313		4,516		751
Total with an allowance recorded	$	17,257	$	17,743	$	2,188

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 7. PORTFOLIO LOANS (continued)

The following table presents interest income on impaired portfolio loans by class of portfolio loans for the years ended December 31, 2013, 2012 and 2011:

	Average Balance		Interest Income Recognized		Cash Basis Interest Income Recognized
	(Dollars in Thousands)				
December 31, 2013					
Real estate loans:					
One- to four-family	$	7,334	$	255	$
Commercial		10,758		412	
Other (land and multi-family)		7,816		303	
Total real estate loans		25,908		970	
Real estate construction loans:					
One- to four-family					
Commercial		370			
Acquisition and development					
Total real estate construction loans		370			
Other portfolio loans:					
Home equity		2,049		81	
Consumer		281		19	
Commercial		1,317		41	
Total other portfolio loans		3,647		141	
Total	$	29,925	$	1,111	$
December 31, 2012					
Real estate loans:					
One- to four-family	$	9,594	$	362	$
Commercial		17,179		502	
Other (land and multi-family)		7,461		319	
Total real estate loans		34,234		1,183	
Real estate construction loans:					
One- to four-family		228			
Commercial		1,551			
Acquisition and development					
Total real estate construction loans		1,779			
Other portfolio loans:					
Home equity		2,458		127	
Consumer		393		33	

Commercial		3,028		50	
Total other portfolio loans		5,879		210	
Total	$	41,892	$	1,393	$
December 31, 2011					
Real estate loans:					
One- to four-family	$	13,522	$	982	$
Commercial		19,523		454	
Other (land and multi-family)		5,776		546	
Total real estate loans		38,821		1,982	
Real estate construction loans:					
One- to four-family		228			
Commercial		2,022			
Acquisition and development					
Total real estate construction loans		2,250			
Other portfolio loans:					
Home equity		1,834		189	
Consumer		316		47	
Commercial		3,480		263	
Total other portfolio loans		5,630		499	
Total	$	46,701	$	2,481	$

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 7. PORTFOLIO LOANS (continued)

The Company has originated portfolio loans with directors and executive officers and their associates. These loans totaled approximately $0.1 million and $1.6 million as of December 31, 2013 and 2012. The activity on these loans during the years ended December 31, 2013 and 2012 was as follows:

	2013		2012	
	(Dollars in Thousands)			
Beginning balance	$	1,563	$	1,587
New portfolio loans and advances on existing portfolio loans				2
Effect of changes in related parties		(1,349)		71
Repayments		(77)		(97)
Ending balance	$	137	$	1,563

NOTE 8. OTHER LOANS

Other loans was comprised mortgage loans held-for-sale, SBA loans held-for-sale, and warehouse loans held-for-investment. The Company originates mortgage loans held-for-sale with the intent to sell the loans and the servicing rights to investors. The Company originates SBA loans held-for-sale with the intent to sell the guaranteed portion of the loans to investors, while maintaining the servicing rights. The Company originates warehouse loans held-for-investment and permits the third-party originator to sell the loans and servicing rights to investors in order to repay the warehouse balance outstanding.

The Company did not internally originate any mortgage loans held-for-sale during the year ended December 31, 2013. The Company internally originated approximately $27.0 million and $97.6 million of mortgage loans held-for-sale during the years ended December 31, 2012 and 2011, respectively. The gain recorded on sale of mortgage loans held-for-sale during the years ended December 31, 2012 and 2011 was $0.7 million and $1.3 million, respectively.

During the years ended December 31, 2013, 2012 and 2011, the Company internally originated approximately $6.5 million, $12.7 million and $9.5 million, respectively, of SBA loans held-for-sale. The gain recorded on sales of SBA loans held-for-sale was $0.6 million, $0.8 million and $0.4 million during the years ended December 31, 2013, 2012 and 2011, respectively. Additionally, the Company recognized gains on the servicing of these loans of $47,000, $331,000 and $171,000 during the years ended December 31, 2013, 2012 and 2011, respectively.

During the years ended December 31, 2013, 2012 and 2011, the Company originated approximately $823.3 million, $900.4 million and $643.5 million, respectively, of warehouse loans held-for-investment through third parties. As of December 31, 2013 and 2012, the balance in warehouse loans held-for-investment did not include any past due, non-performing, classified, restructured, or impaired loans. The weighted average number of days outstanding of warehouse loans held-for-investment was 19 days and 24 days for the years ended December 31, 2013 and 2012, respectively. Warehouse loans held-for-investment possess less risk than other types of loans as they are secured by one- to four-family residential loans which tend to be smaller balance loans without concentrations to a single borrower or group of borrowers. Additionally, the Company generally holds warehouse loans held-for-investment for a short duration of time. Due to these risk characteristics, as well as other factors, management has determined that no allowance is necessary.

ATLANTIC COAST FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
Years Ended December 31, 2013, 2012 and 2011

NOTE 9. LAND, PREMISES, AND EQUIPMENT, NET

Land, premises, and equipment, net at December 31, 2013 and 2012 are summarized as follows:

	2013	2012
	(Dollars in Thousands)	
Land	$ 7,176	$ 7,176
Buildings and leasehold improvements	12,112	12,100
Furniture, fixtures, and equipment	10,589	10,457
Land, premises, and equipment	29,877	29,733
Accumulated depreciation and amortization	(15,624)	(15,149)
Land, premises, and equipment, net	$ 14,253	$ 14,584

Depreciation expense was $0.6 million, $0.8 million and $1.1 million for the years ended December 31, 2013, 2012 and 2011, respectively

NOTE 10. DEPOSITS

Time deposits of $100,000 or more were approximately $96.3 million and $108.1 million at December 31, 2013 and 2012, respectively.

Deposit amounts in excess of $250,000 are generally not insured by the Federal Deposit Insurance Corporation (FDIC).

Scheduled maturities of time deposits at December 31, 2013 were as follows:

	(Dollars in Thousands)
2014	$ 147,247
2015	19,347
2016	6,122
2017	4,311
2018	6,783
Thereafter	
Total time deposits	$ 183,810

The Company did not have any brokered certificate of deposits at December 31, 2013. Brokered certificate of deposits were $5.0 million at December 31, 2012. Under Atlantic Coast Bank's Consent Order with the OCC (the Order), dated August 10, 2012, the Bank may not increase brokered deposits without prior written approval (see Note 19).

Deposits from directors, executive officers and their associates at December 31, 2013 and 2012 were approximately $0.7 million and $0.9 million, respectively.

Interest expense on customer deposit accounts for the years ending December 31, 2013, 2012 and 2011 is summarized as follows:

	2013	2012	2011
	(Dollars in Thousands)		
Interest-bearing demand	$ 219	$ 355	$ 820
Savings and money market	721	929	1,317
Time	2,368	2,845	4,041
Total interest expense on deposits	$ 3,308	$ 4,129	$ 6,178

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 11. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Company has reverse repurchase agreements with a carrying amount of $92.8 million as of December 31, 2013 and 2012. Under the terms of the agreements the collateral is subject to a haircut determined by the counterparty and must be pledged in amounts equal to the debt plus the fair market value of the debt that is in excess of the principal amount of the debt. As a result, the Company had $115.8 million and $116.9 million in investment securities posted as collateral for these instruments as of December 31, 2013 and 2012, respectively. The Company will be required to post additional collateral if the gap between the market value of the liability and the contractual amount of the liability increases. In the event the Bank prepays the agreements prior to maturity, it must do so at fair value, which as of December 31, 2013 exceeded the book value of the individual agreements by $9.1 million.

Information concerning reverse repurchase agreements as of and for the years ended December 31, 2013 and 2012 is summarized as follows:

	2013			2012		
	(Dollars in Thousands)					
Average daily balance	$	92,800		$	92,800	
Weighted average coupon interest rate during the period		5.10	%		5.10	%
Maximum month-end balance during the period	$	92,800		$	92,800	
Weighted average coupon interest rate at end of period		5.10	%		5.10	%
Weighted average maturity (months)		30			42	

The reverse repurchase agreements as of December 31, 2013 mature as follows:

	Amount Maturing (Dollars in Thousands)	
2014	$	26,500
2015		10,000
2016		5,000
2017		25,000
2018		26,300
Thereafter		
Total	$	92,800

Under the agreements to repurchase, the lender has the option to terminate individual advances in whole the following quarter; there is no termination penalty if terminated by the lender. There have been no early terminations.

Under the terms of a revised agreement the Company entered into on August 2, 2012 with the counterparty on $77.8 million of the $92.8 million the Bank is required to pledge additional collateral if its capital ratios decrease below the Prompt Corrective Action (PCA) defined levels of well-capitalized or adequately capitalized. The Company was above the PCA defined levels of well-capitalized at December 31, 2013. However, the Company was required to increase pledged collateral by $4.0 million during 2013 due to capital ratios falling below the PCA defined levels of well-capitalized at December 31, 2012. Failure to maintain required collateral levels is in violation of the default provision under the terms of the agreement and could result in a termination penalty. At December 31, 2013, the fair value of $77.8 million of the debt exceeded the carrying value by approximately $7.1 million, which approximates the termination penalty.

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 12. FEDERAL HOME LOAN BANK ADVANCES

As of December 31, 2013 and 2012, advances from the FHLB were as follows:

	2013		2012	
	(Dollars in Thousands)			
Maturities July 2015 through March 2018, fixed rate at rates from 3.74% to 4.42%	$	110,000	$	110,000
Maturities September 2013 through December 2013, fixed rate at rates from 2.62% to 3.25%				25,000
Total	$	110,000	$	135,000

During the first quarter 2013, the Company prepaid advances scheduled for maturity in the third and fourth quarter of 2013 totaling $25.0 million, resulting in a prepayment penalty of $0.5 million. The FHLB advances had a weighted-average maturity of 39 months and a weighted-average rate of 4.11% at December 31, 2013. The Company had $93.2 million in portfolio loans and $27.3 million in investment securities posted as collateral for these advances as of December 31, 2013.

The advances at December 31, 2013 mature as follows:

	Amount Maturing (Dollars in Thousands)	
2014	$	
2015		20,000
2016		20,000
2017		65,000
2018		5,000
Thereafter		
Total	$	110,000

The Bank's remaining borrowing capacity with the FHLB is $5.0 million at December 31, 2013. The minimal borrowing capacity was due to the declining balance of outstanding loans used as collateral as a result of normal loan payments and payoffs. In addition, effective August 31, 2012, the FHLB required that the Bank collateralize the excess of the fair value of the FHLB advances over the book value with cash and securities. As of December 31, 2013, fair value exceeded the book value of the individual advances by $10.5 million, which was collateralized entirely by investment securities (included in the $27.3 million discussed above). Due to the Bank's financial condition, the FHLB discounts the value of the collateral pledged for advances at rates higher than those used for banks with stronger credit. Accordingly, the amount of required collateral is elevated compared to some of our peers. The Bank intends to supplement its loan collateral with investment securities as needed to secure the FHLB borrowings, or prepay advances to reduce the amount of collateral required to secure the debt. Unpledged securities available for collateral amounted to $26.9 million as of December 31, 2013. In the event the Bank prepays additional advances prior to maturity, it must do so at fair value.

NOTE 13. COMMITMENTS AND CONTINGENCIES

In the ordinary course of business, the Company has various outstanding commitments and contingent liabilities that are not reflected in the accompanying consolidated financial statements.

The principal commitments as of December 31, 2013 and 2012 are as follows:

	2013		2012	
		(Dollars in Thousands)		
Undisbursed portion of loans closed	$	3,090	$	3,029
Unused lines of credit and commitments to fund loans		47,803		44,349

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 13. COMMITMENTS AND CONTINGENCIES (continued)

As of December 31, 2013, the undisbursed portion of loans closed was primarily unfunded SBA loans with variable rates ranging from 5.75% to 6.00% and , and the unused lines of credit and commitments to fund loans were made up of both fixed rate and variable rate commitments. The fixed rate commitments totaled $25.1 million and had interest rates that ranged from 3.45% to 18.00%; variable rate commitments totaled $22.7 million and had interest rates that ranged from 3.00% to 14.75%. As of December 31, 2012, the undisbursed portion of loans closed was unfunded SBA loans with fixed and variable rates ranging from 5.75% to 6.75%, and the unused lines of credit and commitments to fund loans were made up of both fixed rate and variable rate commitments. The fixed rate commitments totaled $23.8 million and had interest rates that ranged from 3.50% to 18.00%; variable rate commitments totaled $20.5 million and had interest rates that ranged from 3.00% to 18.00%.

As of December 31, 2013 and 2012, the Company had fully secured outstanding standby letters of credit commitments totaling $27,000 and $27,000, respectively.

Since certain commitments to make loans, provide lines of credit, and to fund loans in process expire without being used, the amount does not necessarily represent future cash commitments. In addition, commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. The exposure to credit loss in the event of nonperformance by the other party to these financial instruments is represented by the contractual amount of these instruments. The Company follows the same credit policies to make such commitments as is followed for those loans recorded on the consolidated balance sheet.

The Company does not have any employment agreements with its officers, therefore, the Company has not accrued for any liability related to such agreements.

Other than its borrowing capacity with the FHLB, the Company did not maintain a line of credit with any financial institutions as of December 31, 2013. As of December 31, 2012, the Company maintained borrowing capacity with the FHLB and a line of credit with one other financial institution for $3.5 million, for which no balance was outstanding.

The Company has operating leases in place for two business locations and certain ordinary office equipment. Lease payments in total over the next 5 years are approximately $0.9 million.

NOTE 14. INCOME TAXES

Income tax expense (benefit) for the years ending December 31, 2013, 2012 and 2011 was as follows:

	2013	2012	2011
	(Dollars in Thousands)		
Current federal	$	$ 150	$ (521)
Current state			

Deferred federal		11,664		(2,321)		(2,978)
Deferred state		2,356		(146)		(886)
Increase (decrease) in valuation allowance federal		(11,664)		2,321		2,978
Increase (decrease) in valuation allowance state		(2,356)		146		983
Income tax expense (benefit)	$		$	150	$	(424)

The 2011 income tax benefit was the result of the Company filing an amended federal income tax return for the 2008 tax year. However, the Company recorded income tax expense of $0.2 million for the year ended December 31, 2012 as a result of an Internal Revenue Service examination of the 2008 tax return. The recorded expense was due to the disallowance of certain bad debt expense deductions for which the Company had originally received a credit of $0.4 million, as compared to no credit for the same period in the prior year.

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 14. INCOME TAXES (continued)

The effective tax rate differs from the statutory federal income tax rate for the years ending December 31, 2013, 2012 and 2011 as follows:

	2013		2012		2011	
	(Dollars in Thousands)					
Income taxes at current statutory rate of 34%	$	(3,878)	$	(2,216)	$	(3,642)
Increase (decrease) from:						
State income tax, net of Federal tax effect		(414)		(146)		(523)
Tax-exempt income		(12)		(12)		(12)
Increase in cash surrender value of bank owned life insurance		(129)		(151)		(229)
Taxable proceeds from bank owned life insurance surrender						701
Stock option expense		1		6		24
Change related to Internal Revenue Code § 382 net operating loss carryover limitations		18,479		-		-
Change in federal valuation allowance		(11,664)		2,321		2,978
Change in state valuation allowance		(2,356)		146		983
Change related to amended returns				150		(521)
Other, net		(27)		52		(183)
Income tax expense (benefit)	$		$	150	$	(424)
Effective tax rate		0.0 %		0.0 %		0.0 %

Deferred tax assets and liabilities as of December 31, 2013 and 2012 were due to the following:

	2013		2012	
	(Dollars in Thousands)			
Deferred tax assets:				
Allowance for portfolio loan losses	$	2,609	$	4,101
Depreciation				
Net unrealized loss on securities available-for-sale		2,840		
Deferred compensation arrangements		559		490
Other real estate owned		1,413		834
Net operating loss carryover		7,879		20,843
Deferred loan fees		647		744
Interest income on non-accrual loans		3		24
Accrued expenses		375		323
Acquired customer intangibles		344		421

Alternative minimum tax carryover	527	527
Donation carryover	66	66
Other	244	173
Total deferred tax assets	17,506	28,546
Valuation allowance federal	(15,237)	(24,098)
Valuation allowance state	(1,553)	(3,615)
Total deferred tax assets, net of valuation allowance	716	833
Deferred tax liability:		
Net unrealized gain on securities available-for-sale		(258)
Depreciation	(170)	(127)
Deferred loan costs	(49)	(29)
Prepaid expenses	(317)	(256)
Other	(180)	(163)
Total deferred tax liability	(716)	(833)
Net deferred tax asset	$	$

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 14. INCOME TAXES (continued)

The Company considers at each reporting period all available evidence, both positive and negative, to determine whether, based on the weight of that evidence, a valuation allowance is needed to reduce its deferred tax asset to an amount that is more likely than not to be realized. A determination of the need for a valuation allowance for the deferred tax assets is dependent upon management's evaluation of both positive and negative evidence. Positive evidence includes the probability of achieving forecasted future taxable income, applicable tax strategies and assessments of the current and future economic and business conditions. Negative evidence includes the Company's cumulative losses and expiring tax credit carryovers.

Under the rules of Internal Revenue Code § 382 (IRC § 382), a change in the ownership of the Company occurred during the first quarter of 2013. During the second quarter of 2013, the Company became aware of the change in ownership based on applicable filings made by stockholders with the Securities and Exchange Commission. In accordance with IRC § 382, the Company determined the gross amount of net operating loss carryover that it could utilize was limited to approximately $325,000 per year. The Company also determined it was in a net unrealized built-in loss position (NUBIL) at the time of the ownership change. Due to the Company's NUBIL position recognition of certain losses during the next one to five years will have an adverse effect on the utilization of the existing net operating losses, as the recognized losses will be applied to the annual limitation before the net operating losses are applied. As a result of the limitation, the Company wrote off approximately $46.3 million of federal net operating loss carryover and $72.3 million of state net operating loss carryover, all of which had been previously reserved for with a valuation allowance

As of December 31, 2013 and 2012, the Company evaluated the expected realization of its federal and state deferred tax assets which, prior to a valuation allowance, totaled $17.5 million and $28.5 million, respectively, and were primarily comprised of future tax benefits associated with the allowance for portfolio loan losses and net operating loss carryover. The deferred tax asset in 2013 was also comprised of future tax benefits associated with the net unrealized loss on securities available-for-sale. Based on this evaluation it was concluded that a valuation allowance continues to be required for the federal deferred tax asset. The realization of the deferred tax asset is dependent upon generating taxable income. The Company also continues to maintain a valuation allowance for the state deferred tax asset. If the valuation allowance is reduced or eliminated, future tax benefits will be recognized as a reduction to income tax expense which will have a positive non-cash impact on our net income and stockholders' equity.

The Company has a federal net operating loss carryover of $20.9 million which begins to expire in 2019. There is a valuation allowance of $7.1 million on this carryover. The Company has a state net operating loss carryover of $7.1 million which begins to expire in 2018. The Company maintains a valuation allowance of $0.8 million on this carryover.

NOTE 15. LOSS PER COMMON SHARE

Basic loss per common share is computed by dividing net loss by the weighted average number of common shares outstanding for the period. The basic weighted average common shares and common stock equivalents are computed using the treasury stock method. The basic weighted average common shares outstanding for the period is adjusted for average unallocated employee stock ownership plan shares, average director's deferred compensation shares and average unearned restricted stock awards. Diluted loss per common share is computed by dividing net loss by the weighted average number of common shares outstanding for the period increased for the dilutive effect of unvested stock options and stock awards. The dilutive effect of the unvested stock options and stock awards is calculated under the treasury stock method utilizing the average market value of the Company's stock for the period.

Due to reported losses in each period there was no dilutive effect of stock options or stock awards, and therefore, were not considered in computing diluted weighted average common shares outstanding for the years ended December 31, 2013, 2012 and 2011, respectively.

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 15. LOSS PER COMMON SHARE (continued)

The following table summarizes the basic and diluted loss per common share computation for the years ended December 31, 2013, 2012 and 2011:

	2013	2012	2011
	(Dollars in Thousands, Except Share Information)		
Basic:			
Net Loss	$ (11,406)	$ (6,667)	$ (10,287)
Weighted average common shares outstanding	3,652,311	2,628,969	2,629,001
Less: average unallocated employee stock ownership plan shares	(86,201)	(91,004)	(89,432)
Less: average director's deferred compensation shares	(37,336)	(39,926)	(46,684)
Less: average unvested restricted stock awards	(682)	(1,073)	(2,594)
Weighted average common shares outstanding, as adjusted	3,528,093	2,496,966	2,490,291
Basic loss per common share	$ (3.23)	$ (2.67)	$ (4.13)
Diluted:			
Net Loss	$ (11,406)	$ (6,667)	$ (10,287)
Weighted average common shares outstanding, as adjusted (from above)	3,528,093	2,496,966	2,490,291
Add: dilutive effects of assumed exercise of stock options			
Add: dilutive effects of full vesting of stock awards			
Weighted average dilutive shares outstanding	3,528,093	2,496,966	2,490,291
Diluted loss per common share	$ (3.23)	$ (2.67)	$ (4.13)

NOTE 16. EMPLOYEE BENEFITS

Defined Contribution Plan

Company employees, meeting certain age and length of service requirements, may participate in a 401(k) plan sponsored by the Company. Plan participants may contribute between 1% and 75% of gross income, subject to an Internal Revenue Service maximum amount, with a company match equal to 50% of the first 6% of the compensation contributed. For the years ended December 31, 2013, 2012 and 2011, the total plan expense was $101,000, $57,000, and $149,000, respectively. The Company re-instituted its matching program in April 2010, which had been suspended beginning in first quarter of 2009.

Supplemental Executive Retirement Plan and Director Retirement Plan

Under the terms of the executive and senior officer supplemental executive retirement plan (SERP) and the Director Retirement Plan, each participant will receive a monthly benefit payment beginning on a date defined by each plan.

Under the executive and senior officer SERPs, benefit payments begin the first month after the retirement date while under the Director Retirement Plan benefit payments began on the first month following 100% vesting. Benefit payments are due over a period of ten (10) to twenty (20) years after retirement and are based on the amount of each participant's appreciation benefit plus accrued interest on unpaid balances.

Payment of vested appreciation benefits is contingent upon certain events and requires OCC approval as a result of the Consent Order between the Company and the OCC (see Note 19). Additionally, due to the Consent Order payments for appreciation benefits that vest following an executive being involuntarily terminated or occurring after the executive severs employment are subject to approval by the FDIC and the OCC.

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 16. EMPLOYEE BENEFITS (continued)

Vesting in the appreciation benefit for the executive SERPs and Director Retirement Plan is contingent upon the occurrence of defined events. For the executive SERPs, these events include the successful completion of the second step conversion, two consecutive quarters of positive income before the expense of participant vesting by the Company, the participant's death or disability, a change-of control of the Company, or involuntary termination of employment. For the Director Retirement Plan, the event is the successful completion of the second step conversion. The vested appreciation benefit is payable over 15 years for executive SERPs and 10 years for the Director Retirement Plan. The vested but unpaid appreciation benefits of the executive SERPs and Director Retirement Plan are credited for interest at a rate of 3-month LIBOR plus 275 basis points. Under the terms of the senior officer SERP the appreciation benefit is established upon completion of the second step conversion and becomes payable to the participant over 20 years following separation from service due to retirement from the Company, which may be no earlier than age 55. In the event of a death of a participant with 5 or more years of service a lump sum payment is due to the participant's beneficiary. The participant forfeits their appreciation benefit if the employee leaves the Company prior to retirement. The unpaid appreciation benefit for each participant is credited for interest at a rate of 3-month LIBOR plus 275 basis points.

On February 3, 2011, the Company completed the second-step conversion thus triggering certain vesting for each of the plans. Under the terms of the agreements the executive SERPs vested 15% of the appreciation benefit and the Director Retirement Plan vested 100% in the appreciation benefit. The executive SERPs and Director Retirement Plan were partially funded through the creation of a rabbi trust (the Trust). The Trust purchased 34,009 shares of Company stock at $10.00 per share during the second step conversion and has recorded the purchase as common stock held by benefits plans in stockholders’ equity. Benefits paid by the Trust may be paid in cash or stock and the assets of the Trust are considered general assets of the Company. Changes in the fair-value of Company stock are recorded as adjustments to the benefits accrued for each participant. Under the terms of the agreement the senior officer SERP vested 100% in the appreciation benefit at the date of the second-step conversion.

The Company recorded expense of $163,000 for SERP and Director Retirement Plans in 2013, including increases in the market value of Company stock held in the Trust and interest on unpaid appreciation benefits, net of reversal of benefits accrued for senior officer SERP participants who severed their employment. The Company recorded expense of $(37,000) for SERP and Director Retirement Plans in 2012, including reversal of benefits accrued for senior officer SERP participants who severed their employment and reductions in the market value of Company stock held in the Trust, net of interest on unpaid appreciation benefits. The Company recorded expense of $822,000 for SERP and Director Retirement Plans in 2011, including interest on unpaid appreciation benefits and net of reversal of benefits accrued for senior officer SERP participants who severed their employment.

Below is the amount of accrued liability and unvested appreciation benefit under the SERP and Director Retirement Plan as of December 31, 2013 and 2012:

	2013	2012
	(Dollars in Thousands)	
Accrued liability:		

Executive and senior officer SERP	$	565	$	391
Director retirement plan	$	163	$	176
Unvested appreciation benefit:				
Executive and senior officer SERP	$	1,873	$	2,019
Director retirement plan	$		$	

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 16. EMPLOYEE BENEFITS (continued)

Deferred Director Fee Plan

A deferred director fee compensation plan covers all non-employee directors. Under the plan directors may defer director fees. These fees are expensed as earned and the plan accumulates the fees plus earnings. At December 31, 2013 and 2012, the liability for the plan was $205,000 and $189,000, respectively.

Split Dollar Life Insurance Agreements

The Company has Split Dollar Life insurance agreements with certain executive officers to provide life insurance benefits in addition to that available to all employees. The expense related to this benefit for the years ended December 31, 2013, 2012 and 2011 was $(60,000), $(88,000), and $34,000, respectively. The Company recorded a credit to expense in 2013 and 2012 due to the departures of executives who surrendered the benefit under the terms of the agreement. There was no related liability for Split Dollar Life insurance benefits at December 31, 2013. The related liability for Split Dollar Life insurance benefits was $60,000 at December 31, 2012.

Consulting Agreement with Director

Effective April 1, 2011, the Company entered into a consulting agreement with a member of the Board of Directors which provides for total consulting fees of $250,000. The fee is earned at a rate of $83,333 per year over three years. In addition, the director is entitled to an incentive bonus of $500,000 if the Company reverses (and fully realizes as capital) by December 31, 2014, the entire valuation reserve established by the Company with respect to its net deferred federal and state income tax asset of $20.7 million as of December 31, 2010, and the accounting treatment with respect to the valuation reserve has been agreed to by the Company’s independent accounting firm as being in accordance with generally accepted accounting principles.

NOTE 17. EMPLOYEE STOCK OWNERSHIP PLAN

The Company established the ESOP described below following Atlantic Coast Federal Corporation’s first step conversion in 2004. Upon completion of the second step conversion on February 3, 2011 (see Note 1), all unallocated shares in the plan were exchanged for Atlantic Coast Financial Corporation shares at a rate of 0.1960 shares of Atlantic Coast Financial Corporation for each share of Atlantic Coast Federal Corporation. As part of the conversion, the Company loaned $0.7 million to the trust for the ESOP enabling it to purchase 68,434 shares of common stock in the stock offering for allocation under such plan. The Company’s loan to the ESOP was combined with the remaining debt from the original note, described below, and modified to be payable over 20 years. Further, the Plan was modified such that unearned shares held by the plan will be allocated over the same term as the debt.

In connection with its minority stock offering in 2004, the Company established an ESOP for the benefit of its employees with an effective date of January 1, 2004. The ESOP purchased 465,520 shares of common stock from the minority stock offering with proceeds from a ten-year note in the amount of $4.7 million from the Company. The Company's Board of Directors determines the amount of contribution to the ESOP annually but is required to make contributions sufficient to service the ESOP's debt. Shares are released for allocation to employees as the ESOP debt is repaid. Eligible employees receive an allocation of released shares at the end of the calendar year on a relative compensation basis. An employee becomes eligible on January 1st or July 1st immediately following the date they complete one year of service. Company dividends on allocated shares will be paid to employee accounts. Dividends on unallocated shares held by the ESOP will be applied to the ESOP note payable.

Contributions to the ESOP were $89,000, $86,000 and $90,000 for the years ended 2013, 2012 and 2011. Contributions did not include dividends on unearned shares in 2013, 2012 and 2011.

Compensation expense for shares committed to be released under the Company's ESOP was $20,000, $11,000 and $29,000 for the years ended 2013, 2012 and 2011, respectively.

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 17. EMPLOYEE STOCK OWNERSHIP PLAN (continued)

Shares held by the ESOP as of December 31, 2013 and 2012 were as follows:

	2013	2012
Allocated to eligible employees	4,790	4,790
Unearned	81,437	86,227
Total ESOP shares	86,227	91,017
	(Dollars in Thousands)	
Fair value of unearned shares	$ 353	$ 173

NOTE 18. STOCK-BASED COMPENSATION

The Company established the stock-based compensation plans described below following Atlantic Coast Federal Corporation's first step conversion in 2004. Upon completion of the second step conversion on February 3, 2011 (see Note 1), all unallocated or unvested shares in the plans were exchanged for Atlantic Coast Financial Corporation shares at a rate of 0.1960 shares of Atlantic Coast Financial Corporation for each share of Atlantic Coast Federal Corporation. In 2005 the Company's stockholders approved the establishment of both the Atlantic Coast Federal Corporation 2005 Recognition and Retention Plan (the Recognition Plan), and the Atlantic Coast Federal Corporation 2005 Stock Option Plan (the Stock Option Plan). The compensation cost that has been charged against income for the Recognition Plan for the years ended December 31, 2013, 2012 and 2011 was $3,000, $22,000 and $106,000, respectively. The compensation cost that has been charged against income for the Stock Option Plan for the years ended December 31, 2013, 2012 and 2011 was $24,000, $36,000 and $60,000, respectively.

The Recognition Plan

The Recognition Plan permits the Company's Board of Directors to award up to 55,888 shares of its common stock to directors and key employees designated by the board. As of December 31, 2013 substantially all shares had been awarded. Under the terms of the Recognition Plan, awarded shares are restricted as to transferability and may not be sold, assigned, or transferred prior to vesting. Awarded shares vest at a rate of 20% of the initially awarded amount per year, beginning on the first anniversary date of the award, and are contingent upon continuous service by the recipient through the vesting date; accelerated vesting occurs if there is a change in control of the Company or death or disability of the participant. The second step conversion completed February 3, 2011 (see Note 1) was not considered a change in control. Any awarded shares which are forfeited are returned to the Company and can be re-awarded to another recipient. The Recognition Plan became effective on July 1, 2005 and remains in effect for the earlier of 10 years from the effective date, or the date on which all shares of common stock available for award have vested.

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 18. STOCK-BASED COMPENSATION (continued)

There were no common stock share awards during the years ended December 31, 2013 and 2012. A summary of the status of the shares of the Recognition Plan at December 31, 2013 and 2012 is presented below:

	Shares	Weighted-Average Grant-Date Fair Value	
Non-vested at December 31, 2011	1,393	$	29.49
Granted			
Vested	(571)		57.87
Forfeited			
Non-vested at December 31, 2012	822		14.95
Granted			
Vested	(274)		14.95
Forfeited			
Non-vested at December 31, 2013	548	$	14.95

There was $5,000 and $8,000 of total unrecognized compensation expense related to non-vested shares awarded under the Recognition Plan at December 31, 2013 and 2012, respectively. The expense is expected to be recognized over a weighted-average period of 1.5 years. The total fair value of shares vested during the years ended December 31, 2013 and 2012 was $4,000 and $33,000, respectively.

<u>The Stock Option Plan</u>

The Stock Option Plan permits the Company's Board of Directors to grant options to purchase up to 139,720 shares of its common stock to the Company's directors and key employees. Under the terms of the Stock Option Plan, granted stock options have a contractual term of 10 years from the date of grant, with an exercise price equal to the market price of the Company's common stock on the date of grant. Key employees are eligible to receive incentive stock options or non-qualified stock options, while outside directors are eligible for non-statutory stock options only.

The Stock Option Plan also permits the Company's Board of Directors to issue key employees, simultaneous with the issuance of stock options, an equal number of Limited Stock Appreciation Rights (Limited SAR). The Limited SARs are exercisable only upon a change of control and, if exercised, reduce one-for-one the recipient's related stock option grants. Under the terms of the Stock Option Plan, granted stock options vest at a rate of 20% of the initially granted amount per year, beginning on the first anniversary date of the grant, and are contingent upon continuous service by the recipient through the vesting date. Accelerated vesting occurs if there is a change in control of the Company or death or disability of the participant. The second step conversion completed February 3, 2011 (see Note 1) was not considered a change in control. The Stock Option Plan became effective on July 28, 2005 and terminates upon the earlier of 10 years after the effective date, or the date on which the exercise of Options or related rights equaling the maximum number of shares occurs. There were 53,688 stock options remaining to be awarded as of December 31, 2013.

There were no incentive stock option awards during the years ended December 31, 2013 and 2012. There were 25,000 of incentive stock option awards during the year ended December 31, 2011.

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 18. STOCK-BASED COMPENSATION (continued)

A summary of the option activity under the Stock Option Plan as of December 31, 2013 and 2012, and changes for the year then ended is presented below:

	Shares	Weighted-Average Exercise Price		Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (in Thousands)
Outstanding at December 31, 2011	131,947	$	46.83		
Granted					
Exercised					
Forfeited	(14,225)		63.95		
Outstanding at December 31, 2012	117,722	$	44.98	5.2	$
Vested or expected to vest	89,139	$	44.98	5.2	$
Exercisable at year end	81,340	$	65.10	3.9	$
Outstanding at December 31, 2012	117,722	$	44.98		
Granted					
Exercised					
Forfeited	(33,967)		30.18		
Outstanding at December 31, 2013	83,755	$	50.98	3.6	$
Vested or expected to vest	61,979	$	50.98	3.6	$
Exercisable at year end	74,035	$	57.67	3.2	$

The fair value of each option award is estimated on the date of grant using the Black Scholes option-pricing model based on certain assumptions. Due to the somewhat limited daily trading volume of shares of our Company stock, the volatility of the SNL thrift index was used in lieu of the historical volatility of our Company stock. The risk free rate for periods within the contractual term of the option is based on the U.S. Treasury yield curve in effect at the date of the grant. The expected life of the options is estimated based on historical employee behavior and represents the period of time that options are expected to remain outstanding. These weighted assumptions for awards granted during the years ended December 31, 2013, 2012 and 2011 are summarized in the following table:

	2013		2012		2011	
Intrinsic value of options exercised	$		$		$	
Cash received from options exercised	$		$		$	
Tax benefit realized from options exercised	$		$		$	
Risk-free interest rate		n/a		n/a	1.45	%

Volatility of Company’s stock	n/a	n/a		23.90	%
Expected dividend yield	n/a	n/a		0.00	%
Expected life of options	n/a	n/a		6 years	
Weighted average fair value of options granted	n/a	n/a	$	1.33	

There was $35,000 and $60,000 of total unrecognized compensation cost related to non-vested stock options granted under the Plan as of December 31, 2013 and 2012, respectively. The cost is expected to be recognized over a weighted-average period of 2.0 years.

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 19. REGULATORY SUPERVISION

On August 10, 2012 the Board of Directors of the Bank agreed to the Order with its primary regulator, the OCC. The Order does not affect Atlantic Coast Bank's ability to continue to conduct its banking business with customers in a normal fashion. Banking products and services, hours of operation, internet banking, ATM usage, and FDIC deposit insurance coverage are unaffected. The Order provided, among other things, that:

the Order replaces and therefore terminates the Supervisory Agreement entered into between the Bank and the OTS on December 10, 2010;

within 10 days of the date of the Order, the Board of Directors had to establish a compliance committee that will be responsible for monitoring and coordinating Atlantic Coast Bank's adherence to the provisions of the Order;

within 90 days of the date of the Order, the Board of Directors had to develop and submit to the OCC for receipt of supervisory non-objection of at least a two-year strategic plan to achieve objectives for Atlantic Coast Bank's risk profile, earnings performance, growth, balance sheet mix, off-balance sheet activities, liability structure, capital and liquidity adequacy and updating such plan each year by January 31 beginning on January 31, 2014;

until such time as the OCC provides written supervisory non-objection of Atlantic Coast Bank's strategic plan, Atlantic Coast Bank will not significantly deviate from products, services, asset composition and size, funding sources, structures, operations, policies, procedures and markets of Atlantic Coast Bank that existed prior to the Order without receipt of prior non-objection from the OCC;

by December 31, 2012, Atlantic Coast Bank needed to achieve and maintain a total risk based capital ratio of 13.00% of risk weighted assets and Tier 1 capital ratio of 9.00% of adjusted total assets;

within 60 days of the date of the Order, the Board of Directors needed to develop and implement an effective internal capital planning process to assess Atlantic Coast Bank's capital adequacy in relation to its overall risks and to ensure maintenance of appropriate capital levels, which should be no less than total risk based capital ratio of 13.00% of risk weighted assets and Tier 1 capital ratio of 9.00% of adjusted total assets;

Atlantic Coast Bank may not accept, renew or roll over any brokered deposit unless it has applied for and been granted a waiver of this prohibition by the FDIC;

within 90 days of the date of the Order, the Board of Directors had to forward to the OCC for receipt of written supervisory non-objection a written capital plan for Atlantic Coast Bank covering at least a two year period that achieves and maintains total risk based capital ratio of 13.00% of risk weighted assets and Tier 1 capital of 9.00% ratio of adjusted total assets in addition to certain other requirements;

Atlantic Coast Bank may declare or pay a dividend or make a capital distribution only when it is in compliance with its approved capital plan and would remain in compliance with its approved capital plan after payment of such dividends or capital distribution and receives prior written approval of the OCC;

following receipt of written no supervisory objection of its capital plan, the Board of Directors will monitor Atlantic Coast Bank's performance against the capital plan and shall review and update the plan annually no later than January 31 of each year, beginning with January 31, 2014;

ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 19. REGULATORY SUPERVISION (continued)

if Atlantic Coast Bank fails to achieve and maintain the required capital ratios by December 31, 2012, fails to submit a capital plan within 90 days of the date of the Order or fails to implement a written capital plan for which the OCC has provided a written determination of no supervisory objection, then, at the sole discretion of the OCC, Atlantic Coast Bank may be deemed undercapitalized for purposes of the Order;

within 30 days of the date of the Order, the Board of Directors had to revise and maintain a comprehensive liquidity risk management program which assesses on an ongoing basis, Atlantic Coast Bank's current and projected funding needs, and that ensures that sufficient funds or access to funds exist to meet those needs;

within 60 days of the date of the Order, the Board of Directors had to revise its problem asset reduction plan (PARP), the design of which will be to eliminate the basis of criticism of those assets criticized as "doubtful," "substandard" or "special mention" during the OCC's most recent report of examination as well as any subsequent examination or review by the OCC and any other internal or external loan reviews;

within 60 days of the date of the Order, the Board of Directors had to revise its written concentration management program for identifying, monitoring, and controlling risks associated with asset and liability concentrations, including off-balance sheet concentrations;

Atlantic Coast Bank's concentration management program will include a contingency plan to reduce or mitigate concentrations deemed imprudent for Atlantic Coast Bank's earnings, capital, or in the event of adverse market conditions, including strategies to reduce the current concentrations to Board of Directors established limits and a restriction on purchasing BOLI until such time as the BOLI exposure has been reduced below regulatory guidelines of 25.00% of total capital; and the Board of Directors was to immediately take all necessary steps to ensure that Atlantic Coast Bank's management corrects each violation of law, rule or regulation cited in the OCC's most recent report of examination and within 60 days of the date of the Order, the Board of Directors had to adopt, implement, and thereafter ensure Bank adherence to specific procedures to prevent future violations and Atlantic Coast Bank's adherence to general procedures addressing compliance management of internal controls and employee education regarding laws, rules and regulations.

The Bank believes it has accomplished all requirements under the Order to date. Even though the Bank has achieved the minimum capital ratios, the OCC may continue to enforce the Order, or portions thereof, for some period of time to monitor the Company's continued compliance with the Order.

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 19. REGULATORY SUPERVISION (continued)

The Bank's actual and required capital levels and ratios were as follows:

	Actual		Required to be Well-Capitalized Under Prompt Corrective Action		Required Capital Levels Under the Consent Order	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in Millions)					
December 31, 2013						
Total capital (to risk weighted assets)	$ 77.0	20.47 %	$ 37.6	10.00 %	$ 48.9	13.00 %
Tier 1 (core) capital (to risk weighted assets)	72.3	19.22 %	22.6	6.00 %	n/a	n/a
Tier 1 (core) capital (to adjusted total assets)	72.3	9.73 %	37.1	5.00 %	66.9	9.00 %
December 31, 2012						
Total capital (to risk weighted assets)	$ 45.6	9.78 %	$ 46.6	10.00 %	$ 60.6	13.00 %
Tier 1 (core) capital (to risk weighted assets)	39.7	8.52 %	28.0	6.00 %	n/a	n/a
Tier 1 (core) capital (to adjusted total assets)	39.7	5.13 %	38.7	5.00 %	69.6	9.00 %

As a result of entering into the Order to achieve and maintain specific capital levels, the Bank's capital classification under the PCA rules as of December 31, 2013 was well-capitalized.

The Company remains subject to the Supervisory Agreement with the Federal Reserve Board which was entered into on December 10, 2010 and provides, among other things, that: (1) the Company must comply with regulatory prior notification requirements with respect to changes in directors and senior executive officers; (2) the Company cannot declare or pay dividends or make any other capital distributions without prior written Federal Reserve Board approval; (3) the Company will not be permitted to enter into, renew, extend or revise any contractual arrangement relating to compensation or benefits for any senior executive officers or directors, unless it provides 30 days prior written notice of the proposed transaction to the Federal Reserve Board; (4) the Company may not make any golden parachute payment or prohibited indemnification payment without Federal Reserve Board prior written approval; (5) the Company may not incur, issue, renew or rollover any debt or debt securities, increase any current lines of credit, guarantee the debt of any entity, or otherwise incur any additional debt without the prior written non-objection of the Federal Reserve Board.

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 20. PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION

CONDENSED BALANCE SHEETS
December 31, 2013 and 2012

	2013	2012
	(Dollars in Thousands)	
Cash and cash equivalents at subsidiary	$ 1,311	$ 268
Investment in subsidiary	64,756	40,417
Note receivable from ESOP	2,039	2,128
Other assets	70	223
Total assets	$ 68,176	$ 43,036
Accrued expenses and other liabilities	$ 2,651	$ 2,776
Total stockholders' equity	65,525	40,260
Total liabilities and stockholders' equity	$ 68,176	$ 43,036

CONDENSED STATEMENTS OF OPERATIONS
Years ended December 31, 2013, 2012 and 2011

	2013	2012	2011
	(Dollars in Thousands)		
Net interest income	$ 68	$ 56	$ 37
Noninterest income and expense:			
Loss on sale of securities available-for-sale			(158)
Other-than-temporary-impairment loss			(186)
Other	454	454	454
Equity in net loss of subsidiary	(11,415)	(6,356)	(8,946)
Noninterest expense	(513)	(821)	(1,488)
Total noninterest income and expense	(11,474)	(6,723)	(10,324)
Net loss	$ (11,406)	$ (6,667)	$ (10,287)

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ATLANTIC COAST FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Years Ended December 31, 2013, 2012 and 2011

NOTE 20. PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION (continued)

CONDENSED STATEMENTS OF CASH FLOWS
Years ended December 31, 2013, 2012 and 2011

	2013		2012		2011	
	(Dollars in Thousands)					
Cash flows from operating activities:						
Net loss	$	(11,406)	$	(6,667)	$	(10,287)
Adjustments to reconcile net loss to net cash from (used in) operating activities:						
Loss on sale of securities available-for-sale						158
Other-than-temporary-impairment loss on securities available-for-sale						186
Share-based compensation expense		27		58		166
Amortization of premium on securities available-for-sale						(6)
Net change in other assets		84		(4)		1,279
Net change in accrued expenses and other liabilities		(36)		(193)		(809)
Equity in undistributed loss of subsidiary		11,415		6,356		8,946
Net cash from (used in) operating activities		84		(450)		(367)
Cash flows from investing activities:						
Proceeds from maturities and payments of securities available-for-sale						188
Proceeds from sale of securities available-for-sale						561
Expenditures on premises and equipment		1		1		
Payment received on ESOP loan		89		86		90
Contribution to subsidiary		(44,000)				(9,350)
Net cash from (used in) investing activities		(43,910)		87		(8,511)
Cash flows from financing activities:						
Repayment of other borrowings						(5,000)
Proceeds from sale of common stock in public offering		44,869				
Proceeds from sale of common stock in second-step conversion and offering						14,428
SERP distributions				(21)		(55)
Shares purchased for and distributions from Rabbi Trust				14		(119)
Loan to ESOP						(684)
Repayment to subsidiary				(1,495)		
Net cash from (used in) financing activities		44,869		(1,502)		8,570

Net increase (decrease) in cash and cash equivalents	1,043	(1,865)	(308)
Cash and cash equivalents, beginning of period	268	2,133	2,441
Cash and cash equivalents, end of period	$ 1,311	$ 268	$ 2,133

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures. Based on their evaluation as of the end of the period covered by this Annual Report on Form 10-K, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934 (the Exchange Act)) are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

(b) Management's report on internal control over financial reporting. The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

The Company's internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2013. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control Integrated Framework* (1992). Based on that assessment and those criteria, management concluded the Company maintained effective internal control over financial reporting as of December 31, 2013.

This annual report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's independent registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

(c) Changes in internal controls. There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(d)) that occurred during the quarter ended December 31, 2013, that have materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

Not applicable.

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PART III.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item is included under the captions “Proposal I - Election of Directors,” “Directors,” “Executive Officers who are not Directors,” “Code of Ethics,” “Meetings and Committees of the Board of Directors - Audit Committee,” and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's Proxy Statement for the 2014 annual meeting of stockholders, which is expected to be filed within 120 days after the end of our 2013 fiscal year, and is incorporated herein by reference

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is included under the caption “Executive Compensation,” and “Director Compensation” in the Company's Proxy Statement for the 2014 annual meeting of stockholders, which is expected to be filed within 120 days after the end of our 2013 fiscal year, and is incorporated herein by reference

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item is included under the caption “Voting Securities and Principal Holders Thereof,” and “Proposal I - Election of Directors,” in the Company's Proxy Statement for the 2014 annual meeting of stockholders, which is expected to be filed within 120 days after the end of our 2013 fiscal year, and *Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchase of Equity Securities* of this Annual Report on Form 10-K on page 60, each of which is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item is included under the caption “Board Independence,” and “Transactions with Certain Related Persons” in the Company's Proxy Statement for the 2014 annual meeting of stockholders, which is expected to be filed within 120 days after the end of our 2013 fiscal year, and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is included under the caption “Proposal II - Ratification of the Appointment of the Independent Registered Public Accounting Firm” in the Company's Proxy Statement for the 2014 annual meeting of stockholders, which is expected to be filed within 120 days after the end of our 2013 fiscal year, and is incorporated herein by reference.

PART IV.

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as a part of this report

1. Consolidated financial statements.

The consolidated financial statements are set forth under Item 8. Financial Statements and Supplementary Data of this report on Form 10-K.

2. Financial statement schedules.

The following information is filed as part of this Form 10-K and should be read in conjunction with the consolidated financial statements contained in Item 8. Financial Statements and Supplementary Data of this report on Form 10-K:
Report of Independent Registered Public Accounting Firm

All other schedules have been omitted because they were not applicable or because the required information has been included in the consolidated financial statements or notes thereto.

Exhibits

1.1	Underwriting Agreement [1]
2.1	Agreement and Plan of Merger by and among Atlantic Coast Financial Corporation, Atlantic Coast Bank, Bond Street Holdings, Inc. and Florida Community Bank, N.A., dated February 25, 2013 [2]
2.2	Amendment Number 1 to the Agreement and Plan of Merger by and among Atlantic Coast Financial Corporation, Atlantic Coast Bank, Bond Street Holdings, Inc. and Florida Community Bank, N.A., dated April 22, 2013 [3]
3.1	Amended and Restated Articles of Incorporation of Atlantic Coast Financial Corporation [4]
3.2	Bylaws of Atlantic Coast Financial Corporation [5]
4	Form of Common Stock Certificate of Atlantic Coast Financial Corporation [6]
10.1	Employee Stock Ownership Plan [7]
10.2	Form of Employment Agreement with Thomas B. Wagers, Sr. [8]
10.3	Amended and Restated 2005 Director Retirement Plan [9]
10.4	Atlantic Coast Financial Corporation 2005 Stock Option Plan [10]
10.5	Atlantic Coast Financial Corporation 2005 Recognition and Retention Plan [11]
10.6	Split Dollar Life Insurance Agreement with Thomas B. Wagers, Sr. [12]
10.7	Atlantic Coast Federal Corporation 2008 Executive Deferred Compensation Plan [13]
10.8	Fourth Amended and Restated Supplemental Executive Retirement Agreement with Thomas B. Wagers, Sr. [14]
10.9	Supplemental Executive Retirement Agreement with Phillip S. Buddenbohm[15]
10.10	Consulting Agreement with Jay S. Sidhu [16]
10.11	Non-compete and Non-solicitation Agreement with Thomas B. Wagers, Sr. [17]
10.12	Non-compete and Non-solicitation Agreement with Phillip S. Buddenbohm[18]
10.13	Atlantic Coast Federal Corporation Employee Stock Purchase Plan [19]
10.14	Atlantic Coast Federal Corporation Director Stock Purchase Plan [20]
10.15	Atlantic Coast Federal Corporation Amended and Restated 2005 Director Deferred Fee Plan [21]
10.16	Atlantic Coast Federal Corporation Amended and Restated 2007 Director Deferred Compensation Plan for Equity [22]
10.17	Atlantic Coast Bank Director Emeritus Plan [23]
10.18	Atlantic Coast Bank 2005 Amended and Restated Director Retirement Plan [24]
10.19	Consent Order with the Office of the Comptroller of the Currency [25]
10.20	Supervisory Agreement, dated as of December 10, 2010, by and between Atlantic Coast Financial Corporation, as successor to Atlantic Coast Federal, MHC, and the Federal Reserve Board, as successor

	to the Office of Thrift Supervision [26]
21	Subsidiaries of Registrant
23.1	Consent of McGladrey LLP
31.1	Certification of Chief Executive Officer of Atlantic Coast Financial Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer of Atlantic Coast Financial Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.	Certification of Chief Executive Officer and Chief Financial Officer of Atlantic Coast Financial Corporation pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document *
101.SCH	XBRL Taxonomy Extension Schema Document *
101.CAL	XBRL Taxonomy Calculation Linkbase Document *
101 DEF	XBRL Taxonomy Extension Definition Linkbase Document *
101 LAB	XBRL Taxonomy Label Linkbase Document *
101.PRE	XBRL Taxonomy Presentation Linkbase Document *

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1 Incorporated by reference to Exhibit 1.1 of Atlantic Coast Financial Corporation's Form S-1, filed with the Securities and Exchange Commission on November 21, 2013.

2 Incorporated by reference to Exhibit 2.1 of Atlantic Coast Financial Corporation's Current Report on Form 8-K, filed with the Securities and Exchange Commission on February 26, 2013.

3 Incorporated by reference to Exhibit 2.2 of Atlantic Coast Financial Corporation's Form 8-K Current Report, originally filed with the Securities and Exchange Commission on April 23, 2013.

4 Incorporated by reference to Exhibit 3.1 of the registrant's Registration Statement on Form S-1, and any amendments thereto, originally filed with the Securities and Exchange Commission on June 18, 2010 (Registration No. 333-167632).

5 Incorporated by reference to Exhibit 3.2 of the registrant's Registration Statement on Form S-1, and any amendments thereto, originally filed with the Securities and Exchange Commission on June 18, 2010 (Registration No. 333-167632).

6 Incorporated by reference to Exhibit 4 of the registrant's Registration Statement on Form S-1, and any amendments thereto, originally filed with the Securities and Exchange Commission on June 18, 2010 (Registration No. 333-167632).

7 Incorporated by reference to Exhibit 10.1 of the registrant's Registration Statement on Form S-1, and any amendments thereto, originally filed with the Securities and Exchange Commission on June 18, 2010 (Registration No. 333-167632).

8 Incorporated by reference to Exhibit 10.25 of the registrant's Amendment No. 3 to the Form S-1 Registration Statement, originally filed with the Securities and Exchange Commission on October 29, 2010 (Registration No. 333-167632).

9 Incorporated by reference to Exhibit 10.23 of the registrant's Registration Statement on Form S-1, and any amendments thereto, originally filed with the Securities and Exchange Commission on June 18, 2010 (Registration No. 333-167632).

10 Incorporated by reference to Appendix C to the Definitive Proxy Statement originally filed by Atlantic Coast Federal Corporation with the Securities and Exchange Commission on April 7, 2005.

11 Incorporated by reference to Atlantic Coast Federal Corporation's Form 8-K Current Report, originally filed with the Securities and Exchange Commission on November 9, 2006.

12 Incorporated by reference to Exhibit 10.4 to Atlantic Coast Federal Corporation's Form 8-K Current Report, originally filed with the Securities and Exchange Commission on January 7, 2010.

13 Incorporated by reference to Atlantic Coast Federal Corporation's Form 8-K Current Report originally filed with the Securities and Exchange Commission on February 12, 2008.

14 Incorporated by reference to Exhibit 10.12 of Atlantic Coast Financial Corporation's Form 10-K Annual Report originally filed with the Securities and Exchange Commission on March 28, 2012.

15 Incorporated by reference to Exhibit 10.9 of Atlantic Coast Financial Corporation's Form 10-K Annual Report originally filed with the Securities and Exchange Commission on April 1, 2013.

16 Incorporated by reference to Exhibit 10.1 of the registrant's Form 8-K current Report, originally filed with the Securities and Exchange Commission on May 18, 2011.

17

Incorporated by reference to Exhibit 10.9 of Atlantic Coast Federal Corporation's Form 8-K current Report originally filed with the Securities and Exchange Commission on May 14, 2010.

18 Incorporated by reference to Exhibit 10.12 of Atlantic Coast Financial Corporation's Form 10-K Annual Report originally filed with the Securities and Exchange Commission on April 1, 2013.

19 Incorporated by reference to Appendix A to the Definitive Proxy Statement originally filed by Atlantic Coast Federal Corporation with the Securities and Exchange Commission on April 7, 2010.

20 Incorporated by reference to Appendix B to the Definitive Proxy Statement originally filed by Atlantic Coast Federal Corporation with the Securities and Exchange Commission on April 7, 2010.

21 Incorporated by reference to Exhibit 10.6 of Atlantic Coast Federal Corporation's Form 10-K Annual Report originally filed with the Securities and Exchange Commission on March 31, 2009.

22 Incorporated by reference to Exhibit 10.15 of Atlantic Coast Federal Corporation's Form 10-K Annual Report originally filed with the Securities and Exchange Commission on March 31, 2009.

23 Incorporated by reference to Exhibit 10.14 of Atlantic Coast Federal Corporation's Form 10-K Annual Report originally filed with the Securities and Exchange Commission on March 31, 2009.

24 Incorporated by reference to Exhibit 10.23 of the registrant's Registration Statement on Form S-1, and any amendments thereto, originally filed with the Securities and Exchange Commission on June 18, 2010 (Registration No. 333-167632).

25 Incorporated by reference to Exhibit 10.1 of Atlantic Coast Financial Corporation's Form 8-K Current Report, originally filed with the Securities and Exchange Commission on August 14, 2012.

26 Incorporated by reference to Exhibit 10.2 of Atlantic Coast Federal Corporation's Form 8-K originally filed with the Securities and Exchange Commission on December 16, 2010.

* These documents formatted in XBRL (Extensible Business Reporting Language) have been attached as Exhibit 101 to this report.

SIGNATURES

Pursuant to the requirements of the Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ATLANTIC COAST FINANCIAL CORPORATION

Date: March 14, 2014	By:	/s/ John K. Stephens, Jr.
		John K. Stephens, Jr. President and Chief Executive Officer (Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacity and on the dates indicated.

By: /s/ John K. Stephens, Jr.
John K. Stephens, Jr.
President and Chief Executive Officer
(Principal Executive Officer)
Director

Date: March 14, 2014

By: /s/ James D. Hogan
James D. Hogan
Executive Vice President and
Chief Financial Officer
(Principal Financial and Accounting Officer)
Director
Date: March 14, 2014

By: /s/ Dave Bhasin
Dave Bhasin
Director
Date: March 14, 2014

By: /s/ Kevin G. Champagne
Kevin G. Champagne
Director
Date: March 14, 2014

By: /s/ Bhanu Choudhrie
Bhanu Choudhrie
Director
Date: March 14, 2014

By: /s/ John J. Dolan
John J. Dolan
Director
Date: March 14, 2014

By: /s/ W. Eric Palmer
W. Eric Palmer
Director
Date: March 14, 2014

By: /s/ Jay S. Sidhu
Jay S. Sidhu
Director
Date: March 14, 2014

By: /s/ H. Dennis Woods
H. Dennis Woods
Director
Date: March 14, 2014