

*Cherokee
Banking
Company
and Subsidiary*

Consolidated Financial Statements
December 31, 2009 and 2008
(with Independent
Accountants' Report thereon)





Porter Keadle Moore, LLP

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors and Shareholders
Cherokee Banking Company
Canton, Georgia

We have audited the accompanying consolidated balance sheets of Cherokee Banking Company and Subsidiary as of December 31, 2009 and 2008, and the related consolidated statements of operations, comprehensive loss, changes in shareholders' equity, and cash flows for the years then ended. 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 auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 Cherokee Banking Company and Subsidiary as of December 31, 2009 and 2008 and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Porter Keadle Moore, LLP

Atlanta, Georgia
April 29, 2010

Certified Public Accountants

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Consolidated Balance Sheets

December 31, 2009 and 2008

	<u>Assets</u>	<u>2009</u>	<u>2008</u>
Cash and due from banks, including reserve requirements of \$972,000 in 2009		\$ 19,820,881	4,948,716
Interest-bearing deposits at other financial institutions		5,449,000	597,000
Investment securities available-for-sale		19,250,253	19,416,766
Other investments		1,358,800	1,400,350
Loans, net		139,075,784	158,195,692
Premises and equipment, net		5,957,274	6,243,733
Bank owned life insurance		3,791,140	3,591,530
Other real estate		3,053,489	1,176,052
Accrued interest receivable and other assets		<u>3,030,162</u>	<u>2,920,853</u>
		\$ <u>200,786,783</u>	<u>198,490,692</u>
<u>Liabilities and Shareholders' Equity</u>			
Deposits:			
Demand		\$ 20,194,145	19,965,922
Money market and NOW accounts		38,484, 856	36,752,621
Savings		13,089,898	14,880,020
Time		61,985,198	48,858,536
Time over \$100,000		<u>35,480,101</u>	<u>47,180,696</u>
Total deposits		169,234,198	167,637,795
Federal funds purchased		-	256,000
Federal Home Loan Bank borrowings		12,000,000	12,000,000
Junior subordinated debentures		3,093,000	3,093,000
Accrued interest payable and other liabilities		<u>1,671,673</u>	<u>2,124,838</u>
Total liabilities		<u>185,998,871</u>	<u>185,111,633</u>
Commitments			
Shareholders' equity:			
Preferred stock, no par value; 2,000,000 shares authorized; no shares issued and outstanding		-	-
Common stock, no par value; 10,000,000 shares authorized; 2,131,639 and 1,106,393 shares issued and outstanding, respectively		16,113,149	12,227,650
(Accumulated deficit) retained earnings		(1,327,698)	905,010
Accumulated other comprehensive income		<u>2,461</u>	<u>246,399</u>
Total shareholders' equity		<u>14,787,912</u>	<u>13,379,059</u>
		\$ <u>200,786,783</u>	<u>198,490,692</u>

See accompanying notes to consolidated financial statements.

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Consolidated Statements of Operations

For the Years Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Interest and dividend income:		
Interest and fees on loans	\$ 8,762,239	10,648,977
Interest and dividends on investment securities	585,993	568,549
Interest on federal funds sold	36,531	109,452
Interest on interest-bearing deposits at other financial institutions	<u>105,384</u>	<u>44,605</u>
Total interest and dividend income	<u>9,490,147</u>	<u>11,371,583</u>
Interest expense:		
Interest on deposits	3,847,900	4,770,417
Interest on borrowed funds	<u>566,634</u>	<u>472,596</u>
Total interest expense	<u>4,414,534</u>	<u>5,243,013</u>
Net interest income	5,075,613	6,128,570
Provision for loan losses	<u>3,280,606</u>	<u>2,792,397</u>
Net interest income after provision for loan losses	<u>1,795,007</u>	<u>3,336,173</u>
Other income:		
Service charges on deposit accounts	723,269	774,345
Mortgage origination fees	72,563	31,275
Gain on sale of investment securities available-for-sale	409,727	1,437
Other income	<u>416,326</u>	<u>407,902</u>
Total other income	<u>1,621,885</u>	<u>1,214,959</u>
Other expenses:		
Salaries and employee benefits	2,804,607	3,361,330
Occupancy and equipment	689,395	727,682
Loss on sales and write downs of other real estate	498,510	328,370
Loss on write down of other investments	49,350	-
Other real estate	162,181	115,565
Other operating	<u>2,894,330</u>	<u>2,228,081</u>
Total other expenses	<u>7,098,373</u>	<u>6,761,028</u>
Loss before income taxes	(3,681,481)	(2,209,896)
Income tax benefit	<u>1,448,773</u>	<u>907,929</u>
Net loss	\$ <u>(2,232,708)</u>	<u>(1,301,967)</u>
Basic loss per common share	\$ <u>(1.64)</u>	<u>(1.18)</u>
Diluted loss per common share	\$ <u>(1.64)</u>	<u>(1.18)</u>
Weighted average common shares outstanding:		
Basic	1,362,529	1,105,372
Diluted	1,362,529	1,105,372

See accompanying notes to consolidated financial statements.

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Consolidated Statements of Comprehensive Loss

For the Years Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Net loss	\$ <u>(2,232,708)</u>	<u>(1,301,967)</u>
Other comprehensive (loss) income, net of tax:		
Unrealized holding gains on investment securities available- for-sale, net of income taxes of \$6,186 and \$235,954	10,093	384,978
Reclassification adjustment for gains on sale of investment securities available-for-sale included in net loss, net of income taxes of \$155,696 and \$546	<u>(254,031)</u>	<u>(891)</u>
Other comprehensive (loss) income	<u>(243,938)</u>	<u>384,087</u>
Comprehensive loss	\$ <u>(2,476,646)</u>	<u>(917,880)</u>

See accompanying notes to consolidated financial statements.

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Consolidated Statements of Changes in Shareholders' Equity

For the Years Ended December 31, 2009 and 2008

	<u>Common Stock</u>		(Accumulated Deficit)	Accumulated Other	Total
	<u>Shares</u>	<u>Amount</u>	<u>Retained Earnings</u>	<u>Comprehensive</u>	<u>Shareholders'</u>
				<u>(Loss) Income</u>	<u>Equity</u>
Balance, December 31, 2007	1,105,070	\$ 12,137,237	2,368,241	(137,688)	14,367,790
Net loss	-	-	(1,301,967)	-	(1,301,967)
Cashless exercise of stock options	1,323	-	-	-	-
Adoption of EITF 06-4, net of tax	-	-	(161,264)	-	(161,264)
Stock compensation expense	-	90,413	-	-	90,413
Change in unrealized holding gain/loss on investment securities available-for-sale, net of tax	<u>-</u>	<u>-</u>	<u>-</u>	<u>384,087</u>	<u>384,087</u>
Balance, December 31, 2008	1,106,393	12,227,650	905,010	246,399	13,379,059
Net loss	-	-	(2,232,708)	-	(2,232,708)
Issuance of common stock, net of stock issuance costs of \$272,606	1,025,246	3,828,378	-	-	3,828,378
Stock compensation expense	-	57,121	-	-	57,121
Change in unrealized holding gain/loss on investment securities available-for-sale, net of tax	<u>-</u>	<u>-</u>	<u>-</u>	<u>(243,938)</u>	<u>(243,938)</u>
Balance, December 31, 2009	<u>2,131,639</u>	<u>\$ 16,113,149</u>	<u>(1,327,698)</u>	<u>2,461</u>	<u>14,787,912</u>

See accompanying notes to consolidated financial statements.

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Consolidated Statements of Cash Flows

For the Years Ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Cash flows from operating activities:		
Net loss	\$ (2,232,708)	(1,301,967)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation, amortization and accretion	549,698	385,000
Provision for loan losses	3,280,606	2,792,397
Deferred income tax benefit	(368,809)	(807,746)
Stock compensation expense	57,121	90,413
Gain on sale of investment securities available-for-sale	(409,727)	(1,437)
Loss on write down of other investments	49,350	-
Loss on sales and write downs of other real estate	498,510	328,370
Income from bank owned life insurance	(199,610)	(130,176)
Change in:		
Accrued interest receivable and other assets	(109,309)	80,937
Accrued interest payable and other liabilities	<u>65,153</u>	<u>224,180</u>
Net cash provided by operating activities	<u>1,180,275</u>	<u>1,659,971</u>
Cash flows from investing activities:		
Proceeds from sales of investment securities available-for-sale	19,960,349	1,998,546
Proceeds from calls, maturities and paydowns of investment securities available-for-sale	4,802,456	13,585,838
Purchases of investment securities available-for-sale	(24,786,366)	(17,413,814)
Change in interest-bearing deposits	(4,852,000)	393,000
Purchases of other investments	(7,800)	(536,200)
Net change in loans	12,193,979	(2,369,658)
Purchase of premises and equipment	(56,885)	(35,560)
Purchase of bank owned life insurance	-	(86,000)
Proceeds from sales of other real estate	<u>1,269,376</u>	<u>405,326</u>
Net cash provided by (used in) investing activities	<u>8,523,109</u>	<u>(4,058,522)</u>
Cash flows from financing activities:		
Net change in deposits	1,596,403	(3,991,008)
Proceeds from Federal Home Loan Bank borrowings	-	12,000,000
Net change in federal funds purchased	(256,000)	(5,044,000)
Proceeds from the sale of common stock	4,100,984	-
Stock offering expense	<u>(272,606)</u>	<u>-</u>
Net cash provided by financing activities	<u>5,168,781</u>	<u>2,964,992</u>
Net change in cash and cash equivalents	14,872,165	566,441
Cash and cash equivalents at beginning of year	<u>4,948,716</u>	<u>4,382,275</u>
Cash and cash equivalents at end of year	\$ <u>19,820,881</u>	<u>4,948,716</u>
Supplemental disclosures of noncash investing and financing activities:		
Change in accumulated other comprehensive income, net of tax	\$ (243,938)	384,087
Loans transferred to other real estate	\$ 3,645,323	1,246,055
Change related to the adoption of EITF 06-4, net of tax	\$ -	161,264
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	\$ 4,585,323	5,330,542
Cash received during the year for income tax refunds	\$ 474,909	-

See accompanying notes to consolidated financial statements.

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements

(1) Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of Cherokee Banking Company (the "Company") and its wholly owned subsidiary, Cherokee Bank, N.A. (the "Bank"). All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company was incorporated for the purpose of becoming a bank holding company. The Bank commenced business on July 26, 1999 upon receipt of its banking charter from the Office of the Comptroller of the Currency (the "OCC"). The Bank is primarily regulated by the OCC and undergoes periodic examinations by this regulatory agency. The Company is regulated by the Federal Reserve and also is subject to periodic examinations. The Bank provides a full range of commercial and consumer banking services throughout the city of Canton and the Cherokee County area in Georgia.

The accounting principles followed by the Company and the Bank, and the methods of applying these principles, conform with accounting principles generally accepted in the United States of America ("GAAP") and with general practices in the banking industry. In preparing financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts in the financial statements. Actual results could differ significantly from these estimates. Material estimates common to the banking industry that are particularly susceptible to significant change in the near term include, but are not limited to, the determination of the allowance for loan losses, the valuation of real estate acquired in connection with or in lieu of foreclosure on loans, and valuation allowances associated with the realization of deferred tax assets, which are based on future taxable income.

Subsequent Events

Management has evaluated subsequent events for potential recognition or disclosure in the financial statements through April 29, 2010, the date on which the financial statements were available to be issued

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and amounts due from banks. Deposits in the amount of \$1,300,000 held at the Federal Home Loan Bank ("FHLB") are pledged as security for FHLB advances and possible future advances.

Investment Securities

The Company classifies its securities in one of three categories: trading, available-for-sale, or held-to-maturity. Trading securities are bought and held principally for the purpose of selling them in the near term. Held-to-maturity securities are those securities for which the Company has the ability and intent to hold until maturity. All securities not included in trading or held-to-maturity are classified as available-for-sale. At December 31, 2009 and 2008, all investment securities were classified as available-for-sale.

Trading and available-for-sale securities are recorded at fair value. Held-to-maturity securities are recorded at cost, adjusted for the amortization or accretion of premiums or discounts. Unrealized holding gains and losses on trading securities are recognized in earnings. Unrealized holding gains and losses, net of the related tax effect, on securities available-for-sale are excluded from earnings and are reported as a separate component of shareholders' equity until realized. Transfers of securities between categories are recorded at fair value at the date of transfer.

Management evaluates investment securities for other-than-temporary impairment on an annual basis. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in the fair value. A decline in the market value of any investment below cost that is deemed other-than-temporary is charged to earnings for the decline in value deemed to be credit related and a new cost basis in the security is established. The decline in value attributed to non-credit related factors is recognized in other comprehensive income

Premiums and discounts are amortized or accreted over the life of the related securities as adjustments to the yield. Realized gains and losses for securities classified as available-for-sale and held-to-maturity are included in earnings and are derived using the specific identification method for determining the cost of securities sold.

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, continued

(1) Summary of Significant Accounting Policies, continued

Other Investments

Other investments include FHLB stock, Federal Reserve Bank stock and other equity securities. The stock and other equity securities do not have a readily determinable fair value and are carried at cost. During 2009, the Company recorded a loss of \$49,350 on its investment in the common stock of Silverton Financial Services, Inc. after the OCC closed its banking subsidiary, Silverton Bank, N.A. At December 31, 2009, other investments included only FHLB and Federal Reserve Bank stock. These investments are carried at cost.

Loans and Allowance for Loan Losses

Interest on loans is calculated by using the simple interest method on daily balances of the principal amount outstanding.

Nonrefundable loan fees and certain direct loan origination costs are accounted for over the life of the related loan as an adjustment to the yield.

A loan is considered impaired when, based on current information and events, it is probable that all amounts due according to contractual terms of the loan agreement will not be collected. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, at the loan's observable market price, or at the fair value of the collateral of the loan if the loan is collateral dependent. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts, the borrower's financial condition is such that collection of interest is doubtful.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely. The allowance represents an amount which, in management's judgment, will be adequate to absorb probable losses on existing loans that may become uncollectible.

Management's judgment in determining the adequacy of the allowance is based on evaluations of the collectibility of loans. These evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, current economic conditions that may affect the borrower's ability to pay, overall portfolio quality and review of specific problem loans. In determining the adequacy of the allowance for loan losses, management uses a loan grading system that rates loans in nine different categories. Grades are assigned allocations of loss based on historical loss experience, as well as current economic conditions. The combination of these results is compared quarterly to the recorded allowance for loan losses and material differences are adjusted by increasing or decreasing the provision for loan losses. Management uses an external independent loan reviewer to challenge and corroborate its loan gradings and provide additional analysis, including peer group comparisons, in determining the adequacy of the allowance for loan losses and necessary provisions to the allowance.

Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance based on judgments different than those of management.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is provided using the straight-line method over the estimated useful lives of the assets. Costs incurred for maintenance and repairs are expensed currently.

Depreciation expense is computed over the following estimated useful lives:

Land improvements	15 years
Buildings and improvements	10 - 40 years
Furniture and equipment	3 - 10 years

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, continued

(1) Summary of Significant Accounting Policies, continued

Other Real Estate

Other real estate represents properties acquired through or in lieu of loan foreclosure and is initially recorded at fair value less estimated costs to sell. Any write-down to fair value at the time of transfer to other real estate is charged to the allowance for loan losses. Costs of improvements are capitalized, whereas costs relating to holding other real estate and subsequent adjustments to the value are expensed.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

In the event the future tax consequences of differences between the financial reporting bases and the tax bases of the assets and liabilities results in deferred tax assets, an evaluation of the probability of being able to realize the future benefits indicated by such asset is required. A valuation allowance is provided for the portion of the deferred tax asset when it is more likely than not that some portion or all of the deferred tax asset will not be realized. In assessing the realizability of the deferred tax assets, management considers the scheduled reversals of deferred tax liabilities, projected future taxable income, and tax planning strategies.

Management currently evaluates income tax positions judged to be uncertain. A loss contingency reserve is accrued if it is probable that the tax position will be challenged, it is probable that the future resolution of the challenge will confirm that a loss has been incurred, and the amount of such loss can be reasonably estimated.

Loss Per Share

Basic loss per share is based on the weighted average number of common shares outstanding during the period while the effects of potential shares outstanding during the year are included in diluted earnings per share. No presentation for the years ended December 31, 2009 and 2008 is presented below because inclusion of potential common shares in the diluted loss per share calculation for the periods then ended would be anti-dilutive.

Stock-Based Compensation Plans

The Company sponsors stock-based compensation plans, which are described more fully in Note 10. The Company accounts for these plans using a fair value based method of accounting whereby compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option-pricing model. Expected volatility is based on the historical volatility of the Company's stock. The Company uses historical data to estimate expected term and option forfeitures within the valuation model. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. There were no options granted during 2009 or 2008.

At December 31, 2009, unrecognized compensation expense associated with unvested options granted was approximately \$171,000. The expense will be recognized over the remainder of the vesting period, which approximates three years.

Comprehensive Income

GAAP generally requires that recognized revenues, expenses, gains and losses be included in net earnings. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the consolidated balance sheets, such items, along with net loss, are components of comprehensive income. The Company presents comprehensive income in a separate consolidated statement of comprehensive income.

Recent Accounting Pronouncements

Accounting standards that have been issued or proposed by the Financial Accounting Standards Board and other standard setting entities that do not require adoption until a future date are not expected to have a material impact on the Company's consolidated financial statements upon adoption.

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, continued

(2) Investment Securities

At December 31, 2009 and 2008, investment securities available-for-sale consisted of the following:

		<u>Amortized</u> <u>Cost</u>	<u>Gross</u> <u>Unrealized</u> <u>Gains</u>	<u>Gross</u> <u>Unrealized</u> <u>Losses</u>	<u>Estimated</u> <u>Fair</u> <u>Value</u>
December 31, 2009:					
Mortgage-backed securities	\$	<u>19,246,283</u>	<u>112,879</u>	<u>108,909</u>	<u>19,250,253</u>
December 31, 2008:					
Mortgage-backed securities	\$	<u>19,019,349</u>	<u>430,747</u>	<u>33,330</u>	<u>19,416,766</u>

The investment securities with unrealized losses as of December 31, 2009 were in a continuous unrealized loss position for less than twelve months. At December 31, 2009, unrealized losses in the investment portfolio related to debt securities. The unrealized losses on the debt securities arose due to changing interest rates and market conditions and are considered to be temporary because of acceptable investment grades where the repayment sources of principal and interest are largely backed by the U.S. Government sponsored corporations. Because the Bank has the intent and ability to hold these investments until maturity or a recovery of fair value, management does not consider these investments to be other than temporarily impaired.

Unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of December 31, 2008 are summarized as follows:

	<u>2008</u>					
	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair</u> <u>Value</u>	<u>Unrealized</u> <u>Losses</u>	<u>Fair</u> <u>Value</u>	<u>Unrealized</u> <u>Losses</u>	<u>Fair</u> <u>Value</u>	<u>Unrealized</u> <u>Losses</u>
Mortgage-backed securities	\$ <u>376,593</u>	<u>6,595</u>	<u>1,068,499</u>	<u>26,735</u>	<u>1,445,092</u>	<u>33,330</u>

Maturities of mortgage-backed securities differ from contractual maturities because borrowers have the right to call or repay obligations with or without call or prepayment penalties. Therefore, mortgage-backed securities are not presented by contractual maturity.

Proceeds from sales of securities available-for-sale during 2009 were \$19,960,349. Gross gains of \$409,727 and no losses were recognized on those sales. Proceeds from sales of securities available-for-sale during 2008 were \$1,998,546. Gross gains were \$6,795 and gross losses on sales of securities available-for-sale were \$5,358.

At December 31, 2009 and 2008, securities with a carrying value of approximately \$15,600,000 and \$3,079,000, respectively, were pledged to secure FHLB advances, lines of credit for overnight borrowings, public deposits and for other purposes required or permitted by law.

(3) Loans

Major classifications of loans at December 31, 2009 and 2008 are presented below:

	<u>2009</u>	<u>2008</u>
Commercial, financial and agricultural	\$ 70,590,151	82,293,337
Real estate – mortgage	38,749,083	32,033,575
Real estate – construction	29,471,063	43,915,908
Consumer	<u>4,241,009</u>	<u>3,922,206</u>
	143,051,306	162,165,026
Less allowance for loan losses	<u>3,975,522</u>	<u>3,969,334</u>
	\$ <u>139,075,784</u>	<u>158,195,692</u>

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, continued

(3) Loans, continued

The Bank grants loans and extensions of credit to individuals and a variety of businesses and corporations located in its general trade area of Cherokee County, Georgia and adjoining counties. Although the Bank has a diversified loan portfolio, a substantial portion of the loan portfolio is collateralized by improved and unimproved real estate and is dependent upon the real estate market.

Activity in the allowance for loan losses is summarized as follows for the years ended December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Balance, beginning of year	\$ 3,969,334	2,412,979
Provisions charged to operations	3,280,606	2,792,397
Loan charge-offs	(3,337,984)	(1,238,397)
Loan recoveries	<u>63,566</u>	<u>2,355</u>
Balance, end of year	\$ <u>3,975,522</u>	<u>3,969,334</u>

Information relating to impaired loans in 2009 and 2008 is summarized as follows:

	<u>2009</u>	<u>2008</u>
Impaired loans without a valuation allowance	\$ 7,513,947	9,775,915
Impaired loans with a valuation allowance	<u>3,205,291</u>	<u>1,031,283</u>
Total impaired loans	\$ <u>10,719,238</u>	<u>10,807,198</u>
Valuation allowance related to impaired loans	\$ 325,056	98,404
Average investment in impaired loans	\$ 9,788,329	6,851,974

Interest income recognized for cash payments received on impaired loans was approximately \$194,000 and \$409,000 for the years ended December 31, 2009 and 2008, respectively. Loans past due greater than 90 days and still accruing as of December 31, 2009 and 2008 were considered immaterial.

(4) Premises and Equipment

Major classifications of premises and equipment as of December 31, 2009 and 2008 are summarized as follows:

	<u>2009</u>	<u>2008</u>
Land and land improvements	\$ 1,413,630	1,413,630
Buildings and improvements	5,026,634	5,026,634
Furniture and equipment	<u>2,173,289</u>	<u>2,116,404</u>
	8,613,553	8,556,668
Less accumulated depreciation	<u>2,656,279</u>	<u>2,312,935</u>
	\$ <u>5,957,274</u>	<u>6,243,733</u>

Depreciation expense amounted to approximately \$343,000 and \$373,000 for the years ended December 31, 2009 and 2008, respectively.

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, continued

(5) Deposits

At December 31, 2009, contractual maturities of time deposits are summarized as follows:

2010		\$	79,938,453
2011			10,287,149
2012			4,098,406
2013			1,621,566
2014			<u>1,519,725</u>
		\$	<u>97,465,299</u>

At December 31, 2009 and 2008, the Bank held approximately \$6,891,000 and \$28,531,000, respectively, in certificates of deposit obtained through the efforts of third party brokers. The weighted average cost of these deposits for 2009 and 2008 was 3.60% and 3.64%, respectively.

(6) Junior Subordinated Debentures

On November 10, 2005, the Company issued through a wholly owned Delaware statutory trust, Cherokee Statutory Trust I, ("Trust I"), \$3,000,000 of preferred beneficial interest in the Company's unsecured junior subordinated debentures (trust preferred securities) that qualify as Tier I capital under Federal Reserve Board guidelines within certain limitations. The Company owns all of the common securities of Trust I. The proceeds from the issuance of the common securities and the trust preferred securities were used by Trust I to purchase \$3,093,000 of junior subordinated debentures of the Company, which carry a fixed rate of interest of 6.48% for the first five years and convert to a floating rate of interest adjusted every three months to the 3-Month London Interbank Offered Rate ("3-Month LIBOR") plus 150 basis points. The debentures and related accrued interest represent the sole assets of Trust I.

The trust preferred securities accrue and pay distributions quarterly, at a fixed rate of interest of 6.48% for the first five years and convert to a floating rate of interest adjusted every three months to the 3-Month LIBOR plus 150 basis points. The Company has entered into contractual arrangements which, taken collectively, fully and unconditionally guarantee payment of accrued and unpaid distributions required to be paid on the trust preferred securities, the redemption price with respect to any trust preferred securities called for redemption by Trust I, and payments due upon a voluntary or involuntary dissolution, winding up or liquidation of Trust I.

During the second quarter of 2009, the Company exercised its right under the trust preferred securities agreement for Trust I to defer, for up to 20 consecutive quarters, the interest payments on its junior subordinated debentures in order to maintain liquidity and conserve capital. During the extension period, interest will continue to accrue on the debentures, and interest on accrued interest will accrue at an annual rate equal to the interest rate in effect for the extension period, compounded quarterly from the date the interest would have been payable were it not for the extension period. Pursuant to the terms of the debenture, the Company is prohibited from paying dividends on its common stock while it is deferring interest payments. In accordance with the debenture agreement, the Company provided the Trustee with the proper notice of its election to suspend interest payments beginning in June 2009.

The Trust Preferred Securities are mandatorily redeemable upon maturity of the debentures on November 10, 2035, or upon earlier redemption as provided in the indenture. The Company has the right to redeem the debentures purchased by the Trust in whole or in part, on or after November 10, 2010. As specified in the indenture, if the debentures are redeemed prior to maturity, the redemption price will be the unpaid principal amount, plus any accrued unpaid interest.

(7) Federal Home Loan Bank Borrowings

At December 31, 2009 and 2008, the Bank had fixed rate advances outstanding from the FHLB of Atlanta amounting to \$12,000,000. The following advances require quarterly interest payments:

<u>Balance</u>	<u>Current Interest Rate</u>	<u>Maturity Date</u>	<u>Repricing Feature</u>	<u>Conversion Option Frequency</u>	<u>Next Option Date</u>
\$ 7,000,000	2.18%	March 18, 2013	Fixed convertible to variable (1)	Quarterly	March 18, 2010
<u>5,000,000</u>	3.92%	June 29, 2015	Fixed convertible to variable (1)	Quarterly	June 29, 2012
<u>\$ 12,000,000</u>					

(1) If the FHLB exercises its option to convert, the Bank may prepay the advance with no penalty.

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, continued

(7) Federal Home Loan Bank Borrowings, continued

The FHLB borrowings are secured by the Bank's stock in the FHLB, investment securities, a portion of the Bank's deposit account at the FHLB, and certain first mortgage loans. As of December 31, 2009, the Bank had a blanket lien with the FHLB and had pledged approximately \$56,924,000 in loans, as collateral for the FHLB borrowings.

(8) Income Taxes

The components of income tax benefit (expense) for the years ended December 31, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Current	\$ 1,079,964	100,183
Deferred	464,578	807,746
Change in valuation allowance	<u>(95,769)</u>	<u>807,746</u>
	\$ <u>1,448,773</u>	<u>907,929</u>

The differences between income tax benefit and the amount computed by applying the statutory federal income tax rate to net loss before taxes for the years ended December 31, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Pretax loss at statutory rate	\$ 1,251,704	751,365
Add (deduct):		
State tax benefit, net of federal benefit	186,000	73,684
Increase in cash surrender value of life insurance	38,505	44,137
Tax exempt interest	9,775	-
Increase in valuation allowance	<u>(95,769)</u>	<u>-</u>
Other	<u>58,558</u>	<u>38,743</u>
	\$ <u>1,448,773</u>	<u>907,929</u>

The following summarizes the components of the net deferred tax asset, which is included in other assets, at December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Deferred income tax assets:		
Allowance for loan losses	\$ 1,161,372	1,343,207
Other real estate	344,204	130,612
Deferred compensation	700,274	467,941
State credits and loss carryforwards	225,530	61,114
Other	75,315	48,696
Valuation allowance	<u>(95,769)</u>	<u>-</u>
Total deferred income tax assets	<u>2,506,695</u>	<u>2,051,570</u>
Deferred income tax liabilities:		
Premises and equipment	107,067	116,520
Unrealized gain on available-for-sale securities	<u>1,509</u>	<u>151,018</u>
Total deferred income tax liabilities	<u>108,576</u>	<u>267,538</u>
Net deferred income tax asset	\$ <u>2,302,350</u>	<u>1,784,032</u>

At December 31, 2009, the Company recorded a valuation allowance for certain state tax credit carryforwards that may expire unused in the future. At December 31, 2009, the Company has net operating loss carryforwards totaling approximately \$3,277,000 for state purposes that will begin to expire in 2029 unless previously utilized.

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, continued

(9) Commitments

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets. The contractual amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

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. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. Since many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include unimproved and improved real estate, certificates of deposit, or personal property.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to businesses within the Bank's trade area. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds real estate and assignments of deposit accounts as collateral supporting those commitments for which collateral is deemed necessary. The extent of collateral held for these commitments at December 31, 2009 and 2008 varies.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. In most cases, the Bank requires collateral to support financial instruments with credit risk.

	<u>2009</u>	<u>2008</u>
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	\$ 9,454,000	15,340,000
Standby letters of credit	\$ 140,000	178,000

The Bank also had available secured lines of credit for overnight borrowing in the amount of \$7,700,000 at December 31, 2009. At December 31, 2008, the Bank had available \$11,900,000 of unsecured lines of credit for overnight borrowings. The Bank had \$256,000 outstanding on the lines at December 31, 2008. The Bank had no overnight borrowings as of December 31, 2009.

(10) Employee and Director Benefit Plans

Defined Contribution Plan

The Company sponsors a defined contribution profit-sharing plan that is qualified pursuant to section 401(k) of the Internal Revenue Code. The plan allows eligible employees to defer a portion of their income by making contributions into the plan on a pretax basis. The plan provides a matching contribution based on a percentage of the amount contributed by the employee. The plan also provides that the Board of Directors may make discretionary profit-sharing contributions to the plan. During the years ended December 31, 2009 and 2008, the Company contributed approximately \$16,000 and \$78,000, respectively, to this plan under its matching provisions.

Stock Option Plan and Warrants

The Company sponsors an employee stock option plan for the benefit of key officers and employees. A total of 141,060 shares were reserved for possible issuance under the plan. The options generally vest over a five-year period and expire after ten years.

In connection with the Company's formation and initial offering, warrants for 201,905 shares were issued to the organizers. The warrants allow each holder to purchase one additional share of common stock for each share purchased in connection with the initial offering and were issued as of the date of issuance of the common stock sold in the offering. The warrants will be exercisable for a period of ten years following issuance, but generally no later than three months after ceasing to serve as a director, at the initial offering price of \$10 per share.

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, continued

(10) Employee and Director Benefit Plans, continued

A summary of activity in the directors' warrants and stock option plans for the years ended December 31, 2009 and 2008 are presented below:

	2009		2008	
	<u>Number</u>	Weighted Average Exercise <u>Price</u>	<u>Number</u>	Weighted Average Exercise <u>Price</u>
Outstanding, beginning of year	335,887	\$ 11.59	343,037	\$ 11.65
Forfeited	(37,820)	\$ 9.84	(4,800)	\$ 14.88
Exercised	-	-	(2,350)	\$ 12.11
Expired	(201,905)	\$ 9.09	-	\$ -
Outstanding, end of year	<u>96,162</u>	<u>\$ 17.53</u>	<u>335,887</u>	<u>\$ 11.59</u>
Exercisable, end of year	<u>76,602</u>	<u>\$ 15.74</u>	<u>302,893</u>	<u>\$ 10.38</u>

As of December 31, 2009, the weighted average remaining contractual term of the options outstanding and exercisable was approximately five years.

Post Retirement Benefits

The Company has adopted a defined contribution post retirement benefit plan to provide retirement benefits to certain of the Company's executive officers and directors and to provide death benefits for their designated beneficiaries. Under this plan, single-premium, split-dollar, whole-life insurance contracts totaling approximately \$2,288,000 have been purchased on certain executive officers and directors. For the years ended December 31, 2009 and 2008, the Company incurred expenses of approximately \$226,000 and \$191,000, respectively, in connection with this plan. Additionally, as of January 1, 2008, the Company recorded a cumulative effect adjustment to retained earnings in the amount of \$161,264 to recognize the liability related to its endorsement split-dollar life insurance policies that provide benefits to certain executive officers that extend to postretirement periods.

(11) Shareholders' Equity

During 2009, the Company raised capital through a private placement offering of its common stock. The Company sold 1,025,246 shares of its common stock for \$4 per share resulting in net proceeds of \$3,828,378.

Shares of preferred stock may be issued from time to time in one or more series as established by resolution of the Board of Directors of the Company, up to a maximum of 2,000,000 shares. Each resolution shall include the number of shares issued, preferences, special rights and limitations as determined by the Board.

(12) Related Party Transactions

The Bank conducts transactions with its directors and executive officers, including companies in which they have a beneficial interest, in the normal course of business. It is the Bank's policy to comply with federal regulations that require that loan and deposit transactions with directors and executive officers be made on substantially the same terms as those prevailing at the time made for comparable loans and deposits to other persons. As of December 31, 2009 and 2008, there were approximately \$4,215,000 and \$3,462,000, respectively, of related party deposits. Following is a summary of related party loans:

Balance at December 31, 2008	\$ 6,111,208
New Loans/Advances	1,066,115
Less: Repayments	(1,712,007)
Balance at December 31, 2009	<u>\$ 5,465,316</u>

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, continued

(13) Regulatory Matters

On April 29, 2009, the Board of Directors executed a Consent Order with the OCC. The Consent Order requires the Bank to undertake certain actions within designated time frames, and to operate in compliance with the provisions thereof during its term. The Board of Directors and management of the Bank have implemented these provisions and have determined that they are substantially in compliance with the stipulations of the Consent Order. The material provisions of the Consent Order require the Bank to maintain ratios of Total capital to risk weighted assets and Tier 1 capital to average assets of 12.0% and 8.0%, respectively; appoint a compliance committee; develop a three year strategic plan; develop a three year capital plan; implement a written commercial real estate concentration risk management program; implement a loan portfolio management system to ensure the timely identification of problem loans and leases; implement an effective criticized assets monitoring and management system; and develop a liquidity plan that is sufficient to sustain the Bank's operations and to withstand any anticipated or extraordinary demand against its funding base. Additionally, management has been notified by the Federal Reserve Bank that it must obtain written approval before 1) incurring any indebtedness; 2) distributing any interest, principal or other sums on subordinate debentures or trust preferred securities; 3) declaring or paying any dividends; 4) redeeming any corporate stock; or 5) making any other payment representing a reduction in its capital, except for the payment of normal and routine operating expenses.

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the financial statements. Under certain adequacy guidelines and the regulatory framework for prompt corrective action, specific capital guidelines that involve quantitative measures of the assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices must be met. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of Total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I Capital (as defined) to average assets (as defined). Pursuant to the Consent Order, the Bank is required to maintain elevated ratios of Total capital to risk weighted assets and Tier I capital to average assets of 12.0% and 8.0%, respectively. As of December 31, 2009, the Bank met the Total capital to risk weighted assets requirement. As of December 31, 2009, the Bank's Tier I capital to average assets was 7.94%. As of December 31, 2008, the Bank met all capital adequacy requirements to which it was subject.

As of December 31, 2009, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as adequately capitalized under the regulatory framework for prompt corrective action. The Bank met the threshold for being considered well capitalized under the regulatory framework for prompt corrective action; however, the Consent Order states that the Bank will not be considered above adequately capitalized while under the Consent Order. As of December 31, 2008, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. The Bank's actual capital amounts and ratios are also presented in the table below (amounts in thousands).

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
					Amount	Ratio
December 31, 2009:						
Total Capital to Risk Weighted Assets	\$ 18,416	12.45%	\$ 11,854	8.0%	\$ 14,817	10.0%
Tier I Capital to Risk Weighted Assets	\$ 16,540	11.18%	\$ 5,927	4.0%	\$ 8,890	6.0%
Tier I Capital to Average Assets	\$ 16,540	7.94%	\$ 8,316	4.0%	\$ 10,395	5.0%
December 31, 2008:						
Total Capital to Risk Weighted Assets	\$ 17,400	10.37%	\$ 13,424	8.0%	\$ 16,780	10.0%
Tier I Capital to Risk Weighted Assets	\$ 15,299	9.12%	\$ 6,712	4.0%	\$ 10,068	6.0%
Tier I Capital to Average Assets	\$ 15,299	7.47%	\$ 8,188	4.0%	\$ 10,235	5.0%

Dividends paid by the Bank are the primary source of funds available to the Company. Banking regulations limit the amount of dividends that may be paid without prior approval of the regulatory authorities. At December 31, 2009, the Bank cannot pay a dividend without prior approval.

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, continued

(14) Fair Value Measurements and Disclosures

The Company utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis such as impaired loan and other real estate. These nonrecurring fair value adjustments typically involve application of the lower of cost or market accounting or write-downs of individual assets. Additionally, the Company is required to disclose, but not record, the fair value of other financial instruments.

Fair Value Hierarchy

The Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 – Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 – Valuation is based upon quoted 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 at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

Following is a description of valuation methodologies used for assets and liabilities which are either recorded or disclosed at fair value. The Company does not record any liabilities at fair value.

Cash and Cash Equivalents

For disclosure purposes, the carrying amount of cash on hand and due from banks is a reasonable estimate of fair value.

Interest-Bearing Deposits in Banks

For disclosure purposes, the carrying value of interest-bearing deposits in banks is a reasonable estimate of fair value.

Investment Securities Available-for-Sale

Investment Securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange and U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter market funds. Level 2 securities include mortgage-backed securities issued by government sponsored enterprises and municipal bonds. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Other Investments

For disclosure purposes, the carrying value of other investments is a reasonable estimate of fair value.

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, continued

(14) Fair Value Measurements and Disclosures, continued

Loans

The fair value of fixed-rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings. For variable rate loans, the carrying amount is a reasonable estimate of fair value.

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment using one of three methods, including collateral value, market value of similar debt, and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2009 and 2008, the majority of the impaired loans were evaluated based on the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3.

Other Real Estate

Other real estate properties are adjusted to fair value upon transfer of the loans to other real estate. Subsequently, other real estate assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the other real estate as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market prices, the Company records the other real estate asset as nonrecurring Level 3.

Bank Owned Life Insurance

For disclosure purposes, the carrying value of bank owned life insurance is a reasonable estimate of fair value.

Deposits

For disclosure purposes, the fair value of demand deposits, NOW and money market accounts, and savings accounts is the amount payable on demand at the reporting date. The fair value of fixed maturity certificates of deposit is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities.

Federal Funds Purchased

For disclosure purposes, the carrying amount of federal funds purchased is a reasonable estimate of fair value.

Federal Home Loan Bank Borrowings

For disclosure purposes, the fair value of the FHLB fixed rate borrowings are estimated using discounted cash flows, based on the current incremental borrowing rates for similar types of borrowing arrangements.

Junior Subordinated Debentures

For disclosure purposes, the fair value of the fixed rate junior subordinated debentures is estimated using a discounted cash flow analysis that applies interest rates currently being offered on similar instruments.

Commitments to Extend Credit and Standby Letters of Credit

Because commitments to extend credit and standby letters of credit are generally short-term and at variable rates, the contract value and estimated fair value associated with these instruments are immaterial.

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, continued

(14) Fair Value Measurements and Disclosures, continued

Assets Recorded at Fair Value on a Recurring Basis

The table below presents the recorded amount of assets measured at fair value on a recurring basis as of December 31, 2009 and 2008 (amounts in thousands).

Balance at December 31, 2009					
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investment securities available-for-sale	\$	-	19,250	-	19,250

Balance at December 31, 2008					
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investment securities available-for-sale	\$	-	19,417	-	19,417

Assets Recorded at Fair Value on a Nonrecurring Basis

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis are included in the table below as of December 31, 2009 and 2008 (amounts in thousands).

Balance at December 31, 2009					
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Impaired loans	\$	-	7,767	2,627	10,394
Other real estate	\$	-	1,090	1,963	3,053

Balance at December 31, 2008					
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Impaired loans	\$	-	10,709	-	10,709
Other real estate	\$	-	1,176	-	1,176

The carrying amount and estimated fair values of the Company's financial instruments at December 31, 2009 and 2008 are as follows (amounts in thousands):

		<u>2009</u>		<u>2008</u>	
		<u>Carrying Amount</u>	<u>Estimated Fair Value</u>	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>
Assets:					
Cash and cash equivalents	\$	19,821	19,821	4,949	4,949
Interest-bearing deposits		5,449	5,449	597	597
Investment securities available-for-sale		19,250	19,250	19,417	19,417
Other investments		1,359	1,359	1,400	1,400
Loans, net		139,076	138,661	158,196	157,328
Cash surrender value of life insurance		3,791	3,791	3,592	3,592
Liabilities:					
Deposits	\$	169,234	169,708	167,638	167,273
Federal funds purchased		-	-	256	256
Federal Home Loan Bank borrowings		12,000	10,772	12,000	11,400
Junior subordinated debentures		3,093	3,217	3,093	3,253

CHEROKEE BANKING COMPANY AND SUBSIDIARY

Notes to Consolidated Financial Statements, continued

(14) Fair Value Measurements and Disclosures, continued

Limitations

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

Fair value estimates are based on existing on and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets and liabilities that are not considered financial instruments include deferred income taxes and premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.