

Live Oak Bancshares, Inc.
Form 10-K
March 14, 2016

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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, 2015

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____.

Commission file number: 001-37497

LIVE OAK BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

North Carolina

(State or other jurisdiction of incorporation or organization)

26-4596286

(I.R.S. Employer Identification No.)

1741 Tiburon Drive,

Wilmington, NC

(Address of principal executive offices)

28403

(Zip Code)

Registrant's telephone number, including area code: (910) 790-5867

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

Title of each class

Voting Common Stock, no par value per share

Name of each exchange on which registered

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90

days. YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES 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 10-K 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 definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer (Do not check if smaller reporting company)

Smaller Reporting Company

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

As of June 30, 2015, the last business day of the registrant's most recently completed second fiscal quarter, there was no established public market for the registrant's common stock and, therefore, the registrant cannot calculate the aggregate market value of its voting and non-voting common stock held by non-affiliates as of such date. The aggregate market value of the voting and non-voting common stock held by non-affiliates computed by reference to the price at which the common equity was last sold as of December 31, 2015, was approximately \$240,482,084. Common stock held by each officer and director and by each person known to the registrant who owned 10% or more of the outstanding voting and non-voting common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

As of March 11, 2016, there were 29,454,897 shares of the registrant's voting common stock outstanding and 4,723,530 shares of the registrant's non-voting common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's definitive proxy statement for the 2016 Annual Meeting of Shareholders, which the registrant plans to file subsequent to the date hereof, are incorporated by reference into Part III.

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Important Note Regarding Forward-Looking Statements

This Annual Report on Form 10-K (this "Report") contains statements that management believes are forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995. These statements generally relate to the Company's financial condition, results of operations, plans, objectives, future performance or business. They usually can be identified by the use of forward-looking terminology, such as "believes," "expects," or "are expected to," "plans," "projects," "goals," "estimates," "may," "should," "could," "would," "intends to," "outlook" or "anticipates," or v and similar words, or by discussions of strategies that involve risks and uncertainties. You should not place undue reliance on these statements, as they are subject to risks and uncertainties, including but not limited to, those described in this Report on Form 10-K. When considering these forward-looking statements, you should keep in mind these risks and uncertainties, as well as any cautionary statements management may make. Moreover, you should treat these statements as speaking only as of the date they are made and based only on information actually known to the Company at the time. Management undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. Forward-looking statements contained in this Report are based on current expectations, estimates and projections about the Company's business, management's beliefs and assumptions made by management. These statements are not guarantees of the Company's future performance and involve certain risks, uncertainties and assumptions, which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in the forward-looking statements. These risks, uncertainties and assumptions include, without limitation:

- deterioration in the financial condition of borrowers resulting in significant increases in the Company's loan losses and provisions for those losses and other adverse impacts to results of operations and financial condition;
- changes in SBA rules, regulations and loan products, including specifically the Section 7(a) program, changes in SBA standard operating procedures or changes to the Bank's status as an SBA Preferred Lender;
- changes in interest rates that affect the level and composition of deposits, loan demand and the values of loan collateral, securities, and interest sensitive assets and liabilities;
- the failure of assumptions underlying the establishment of reserves for possible loan losses;
- changes in loan underwriting, credit review or loss reserve policies associated with economic conditions, examination conclusions, or regulatory developments;
- a reduction in or the termination of the Company's ability to use the technology-based platform that is critical to the success of its business model, including a failure in or a breach of its operational or security systems or those of its third party service providers;
- changes in financial market conditions, either internationally, nationally or locally in areas in which the Company conducts operations, including reductions in rates of business formation and growth, demand for our products and services, commercial and residential real estate development and prices, premiums paid in the secondary market for the sale of loans, and valuation of servicing rights;
- changes in accounting principles, policies, and guidelines applicable to bank holding companies and banking;
- fluctuations in markets for equity, fixed-income, commercial paper and other securities, which could affect availability, market liquidity levels, and pricing;
- the effects of competition from other commercial banks, non-bank lenders, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and mutual funds, and other financial institutions operating in the Company's market area and elsewhere, including institutions operating regionally, nationally and internationally, together with such competitors offering banking products and services by mail, telephone and the Internet;
- the Company's ability to attract and retain key personnel;
- governmental monetary and fiscal policies as well as other legislative and regulatory changes, including with respect to SBA lending programs;
- changes in political and economic conditions, including continuing political and economic effects of the global economic downturn and other major developments;
-

the impact of heightened regulatory scrutiny of financial products and services, primarily led by the Consumer Financial Protection Bureau;
the Company's ability to comply with any requirements imposed on it by regulators, and the potential negative consequences that may result;

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operational, compliance and other factors, including conditions in local areas in which the Company conducts business such as inclement weather or a reduction in the availability of services or products for which loan proceeds will be used, that could prevent or delay closing and funding loans before they can be sold in the secondary market; the effect of any mergers, acquisitions or other transactions, to which the Company may from time to time be a party, including management's ability to successfully integrate any businesses acquired; other risk factors listed from time to time in reports that the Company files with the SEC, including those described under "Risk Factors" in this Report; and the success at managing the risks involved in the foregoing.

Except as otherwise disclosed, forward-looking statements do not reflect: (i) the effect of any acquisitions, divestitures or similar transactions that have not been previously disclosed; (ii) any changes in laws, regulations or regulatory interpretations; or (iii) any change in current dividend or repurchase strategies, in each case after the date as of which such statements are made. All forward-looking statements speak only as of the date on which such statements are made, and the Company undertakes no obligation to update any statement, to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events.

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PART I

Item 1. BUSINESS

General

Live Oak Bancshares, Inc. (“LOB” and, collectively with its subsidiaries including Live Oak Banking Company, the “Company,” also referred to as “Our” and “We”), headquartered in Wilmington, North Carolina, is the bank holding company for Live Oak Banking Company (the “Bank” or “Live Oak Bank”). The Bank is a commercial bank incorporated under the laws of North Carolina in December 2008 and is an established national online platform for small business lending. The Company provides select small businesses across the United States an efficient means to access capital. LOB completed its initial public offering (“IPO”) in July 2015.

The Company

The Company predominately originates loans partially guaranteed by the U.S. Small Business Administration (the “SBA”), to small businesses and professionals with what the Company believes are lower risk characteristics. Industries, or “verticals,” on which the Company focuses its lending efforts are carefully selected. Within each vertical the Company retains individuals who possess extensive industry-specific experience. Additionally, the Company’s domain experts are engaged and active in each of the industries served.

In addition to focusing on industry verticals, the Company emphasizes developing detailed knowledge of the customers’ businesses. This knowledge is developed, in part, through regular visits to customers’ operations, wherever they are located. These regular visits are designed to foster both for the Company and for the customer a deep and personalized experience throughout the loan relationship. The Company services customers efficiently throughout the loan process and monitors their performance by means of the technology-based platform, which eliminates the need to maintain traditional branch locations and therefore eliminates a significant component of traditional overhead expense associated with banking franchises. The Company has developed and continues to refine a technology-based platform to facilitate providing financial services to the small business community on a national scale and has leveraged this technology to optimize the Company’s loan origination process, customer experience, reporting metrics, and servicing activity.

For additional information on the Company’s business, financial performance and results of operations, see “Overview” and “Executive Summary” in Part II Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations of this Report. For information on the Company’s financial information about geographic areas, see Part II Item 8 of this Report.

LOB’s voting common stock trades on the NASDAQ Global Select Market (“Nasdaq”) under the symbol “LOB.” As of January 31, 2016, there were 277 holders of record of LOB’s voting common stock. The Company’s principal executive office is located at 1741 Tiburon Drive, Wilmington, North Carolina 28403, telephone number (910) 790-5867. The Company maintains a website at www.liveoakbank.com. Documents available on the website include: (i) the Company’s Code of Conduct; and (ii) charters for the Audit & Risk, Compensation, and Nominating and Governance Committees of the Board of Directors. These documents also are available in print to any shareholder who requests a copy.

In addition, available free of charge through the Company’s website is the Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, current reports on Form 8-K and amendments to those reports as soon as reasonably practicable after electronically filing or furnishing such material to the U.S. Securities and Exchange Commission (“SEC”). These filings are also accessible on the SEC’s website at www.sec.gov. You may read and copy any material LOB files with the SEC at the SEC’s Public Reference Room at 100 F Street, NE, Washington, DC 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

The Company also will provide without charge a copy of this Report to any shareholder by mail. Requests should be sent to Live Oak Bancshares, Inc., Attention: Corporate Secretary, 1741 Tiburon Drive, Wilmington, NC 28403.

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Competition

Commercial banking in the United States is extremely competitive. The Company competes with national banking organizations including the largest commercial banks headquartered in the country, all of which have small business lending divisions. The Company also competes with other federally and state chartered financial institutions such as community banks and credit unions, finance and business development companies, peer-to-peer and marketplace lenders and other non-bank lenders. Most of the Company's competitors have higher legal lending limits and are also able to provide more services and make greater use of media advertising.

Despite the intense level of competition among small business lenders, the Company believes that it occupies a category of lender distinct from competitors, having both the benefit of deposit funding and the ability to grow quality assets. One of the Company's principal advantages is the technology-based platform it uses, which management believes has accelerated the Company's ability to issue proposals, complete credit due diligence and finalize commitments. The Company believes that its personnel also provides a competitive advantage, not only because they are industry participants with relevant experience in the Company's identified verticals but also because many have made meaningful equity investments in LOB, fostering a sense of ownership.

The Bank licenses the nCino bank operating system on a nonexclusive basis. As a result, this technology is available to other lenders. However, management believes that the Bank's ability to actively develop and improve upon the existing platform with in-house developers gives the Bank a competitive advantage over competitors who also may use this platform.

Employees

As of December 31, 2015, the Company had 327 full-time employees and 39 part-time employees. None of these employees are covered by a collective bargaining agreement, and management considers relations with employees to be good.

Subsidiaries

In addition to the Bank, the Company holds the following wholly owned subsidiaries: Live Oak Grove, LLC, opened in September 2015 for the purpose of providing Company employees and business visitors an on-site restaurant location; Government Loan Solutions, Inc. ("GLS"), a management and technology consulting firm that specializes in the settlement, accounting, and securitization processes for government guaranteed loans, including loans originated under the SBA 7(a) loan program and USDA-guaranteed loans; and 504 Fund Advisors, LLC ("504FA"), formed to serve as the investment advisor to the 504 Fund, a closed-end mutual fund organized to invest in SBA section 504 loans. Until it was dissolved at the end of December 2015, the Company also owned Independence Aviation, LLC, which was formed for the purpose of purchasing and operating aircraft used for business purposes of the Company.

SUPERVISION AND REGULATION

Federal Bank Holding Company Regulation and Structure

As a registered bank holding company, LOB is subject to regulation under the Bank Holding Company Act, or BHCA, and to the supervision, examination and reporting requirements of the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The Bank is a North Carolina-chartered commercial bank and is subject to regulation, supervision and examination by the FDIC and the North Carolina Commissioner of Banks, or NCCOB. The BHCA requires every bank holding company to obtain the prior approval of the Federal Reserve before:

- it may acquire direct or indirect ownership or control of any voting shares of any bank if, after the acquisition, the bank holding company will directly or indirectly own or control more than 5% of the voting shares of the bank;
- it or any of its subsidiaries, other than a bank, may acquire all or substantially all of the assets of any bank; or
- it may merge or consolidate with any other bank holding company.

The BHCA further provides that the Federal Reserve may not approve any transaction that would result in a monopoly or that would substantially lessen competition in the banking business, unless the public interest in meeting the needs of the communities to be served outweighs the anti-competitive effects. The Federal Reserve is also required to consider the financial and managerial resources and future prospects of the bank holding companies and banks involved and the convenience and needs of the communities to be served. Consideration of financial resources generally focuses on capital adequacy, and consideration of convenience and needs issues focuses, in part, on the

performance under the Community Reinvestment Act of 1977, both of which are discussed elsewhere in more detail.

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Subject to various exceptions, the BHCA and the Change in Bank Control Act, together with related regulations, require Federal Reserve approval prior to any person or company acquiring “control” of a bank holding company. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of a bank holding company. Control is also presumed to exist, although rebuttable, if a person or company acquires 10% or more, but less than 25%, of any class of voting securities and either:

• the bank holding company has registered securities under Section 12 of the Securities Exchange Act of 1934, as amended, or the Exchange Act; or

• no other person owns a greater percentage of that class of voting securities immediately after the transaction.

LOB's common stock is registered under Section 12 of the Exchange Act. The regulations provide a procedure for challenging rebuttable presumptions of control.

The BHCA generally prohibits a bank holding company from retaining direct or indirect ownership or control of any voting shares of any company which is not a bank or bank holding company or engaging in activities other than banking, managing or controlling banks or other permissible subsidiaries and acquiring or retaining direct or indirect control of any company engaged in any activities other than activities closely related to banking or managing or controlling banks. In determining whether a particular activity is permissible, the Federal Reserve considers whether performing the activity can be expected to produce benefits to the public that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices. The Federal Reserve has the power to order a bank holding company or its subsidiaries to terminate any activity or control of any subsidiary when the continuation of the activity or control constitutes a serious risk to the financial safety, soundness or stability of any bank subsidiary of that bank holding company.

Under the BHCA, a bank holding company may file an election with the Federal Reserve to be treated as a financial holding company and engage in an expanded list of financial activities. The election must be accompanied by a certification that all of the company's insured depository institution subsidiaries are “well capitalized” and “well managed.” Additionally, the Community Reinvestment Act of 1977 rating of each subsidiary bank must be satisfactory or better. If, after becoming a financial holding company and undertaking activities not permissible for a bank holding company, the company fails to continue to meet any of the prerequisites for financial holding company status, the company must enter into an agreement with the Federal Reserve to comply with all applicable capital and management requirements. If the company does not return to compliance within 180 days, the Federal Reserve may order the company to divest its subsidiary banks or the company may discontinue or divest investments in companies engaged in activities permissible only for a bank holding company that has elected to be treated as a financial holding company. LOB has not filed an election to become a financial holding company.

Under Federal Reserve policy and as has been recently codified by the Dodd-Frank Act, the Company is expected to act as a source of financial strength for Live Oak Bank and to commit resources to support Live Oak Bank. This support may be required at times when LOB might not be inclined to provide it or it might not be in LOB's best interests or the best interests of its shareholders. In addition, any capital loans made by the Company to Live Oak Bank will be repaid only after Live Oak Bank's deposits and various other obligations are repaid in full.

Live Oak Bank is also subject to numerous state and federal statutes and regulations that affect its business, activities and operations and is supervised and examined by state and federal bank regulatory agencies. The FDIC and the NCCOB regularly examine the operations of Live Oak Bank and are given the authority to approve or disapprove mergers, consolidations, the establishment of branches and similar corporate actions. These agencies also have the power to prevent the continuance or development of unsafe or unsound banking practices or other violations of law.

Bank Merger Act

Section 18(c) of the Federal Deposit Insurance Act, popularly known as the “Bank Merger Act,” requires the prior written approval of appropriate federal bank regulatory agencies before any bank may (i) merge or consolidate with, (ii) purchase or otherwise acquire the assets of, or (iii) assume the deposit liabilities of, another bank if the resulting institution is to be a state nonmember bank.

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The Bank Merger Act prohibits the applicable federal bank regulatory agency from approving any proposed merger transaction that would result in a monopoly, or would further a combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States. Similarly, the Bank Merger Act prohibits the applicable federal bank regulatory agency from approving a proposed merger transaction whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade. An exception may be made in the case of a merger transaction whose effect would be to substantially lessen competition, tend to create a monopoly, or otherwise restrain trade, if the applicable federal bank regulatory agency finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

In every proposed merger transaction, the applicable federal bank regulatory agency must also consider the financial and managerial resources and future prospects of the existing and proposed institutions, the convenience and needs of the community to be served, and the effectiveness of each insured depository institution involved in the proposed merger transaction in combating money-laundering activities, including in overseas branches.

State Law

Live Oak Bank is subject to extensive supervision and regulation by the NCCOB. The NCCOB oversees state laws that set specific requirements for bank capital and that regulate deposits in, and loans and investments by, banks, including the amounts, types, and in some cases, rates. The NCCOB supervises and performs periodic examinations of North Carolina-chartered banks to assure compliance with state banking statutes and regulations, and banks are required to make regular reports to the NCCOB describing in detail their resources, assets, liabilities, and financial condition. Among other things, the NCCOB regulates mergers and consolidations of state-chartered banks, capital requirements for banks, loans to officers and directors, record keeping, types and amounts of loans and investments, and the establishment of branches.

The NCCOB has extensive enforcement authority over North Carolina banks. Such authority includes the ability to issue cease and desist orders and to seek civil money penalties. The NCCOB may also take possession of a North Carolina bank in various circumstances, including for a violation of its charter or of applicable laws, operating in an unsafe and unsound manner, or as a result of an impairment of its capital, and may appoint a receiver.

On October 1, 2012, the North Carolina Banking Law Modernization Act became effective and many of the state banking laws to which Live Oak Bank is subject were amended. Under the revised banking laws, the NCCOB continues to enforce specific requirements for bank capital, the payment of dividends, loans to officers and directors, record keeping, and types and amounts of loans and investments made by commercial banks.

The Company is also required to maintain registration as a bank holding company with the NCCOB. Subject to certain exceptions, the Company may not acquire control over another bank or bank holding company or consummate a merger or other combination transaction with another company without the prior approval of the NCCOB. The NCCOB also has authority to assert civil money penalties against a holding company if the NCCOB determines such holding company to be in violation of any banking laws and the holding company fails to comply with an NCCOB order to cease and desist from such violations of law.

Payment of Dividends and Other Restrictions

The Company is a legal entity separate and distinct from the Bank. While there are various legal and regulatory limitations under federal and state law on the extent to which banks can pay dividends or otherwise supply funds to holding companies, the principal source of cash revenues for the Company is dividends from the Bank. The relevant federal and state regulatory agencies have authority to prohibit a state bank or bank holding company, which would include the Bank and the Company, from engaging in what, in the opinion of such regulatory body, constitutes an unsafe or unsound practice in conducting its business. The payment of dividends could, depending upon the financial condition of a bank, be deemed to constitute an unsafe or unsound practice in conducting its business.

North Carolina commercial banks, such as Live Oak Bank, are subject to legal limitations on the amounts of dividends they are permitted to pay. Specifically, an insured depository institution, such as Live Oak Bank, is prohibited from making capital distributions, including the payment of dividends, if, after making such distribution, the institution

would become “undercapitalized” (as such term is defined in the applicable law and regulations).

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The Federal Reserve has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve's view that a bank holding company should pay cash dividends only to the extent that the holding company's net income for the past four quarters is sufficient to cover both the cash dividends and a rate of earning retention that is consistent with the holding company's capital needs, asset quality and overall financial condition. The Federal Reserve also indicated that it would be inappropriate for a holding company experiencing serious financial problems to borrow funds to pay dividends. Furthermore, under the prompt corrective action regulations adopted by the Federal Reserve, the Federal Reserve may prohibit a bank holding company from paying any dividends if any of the holding company's bank subsidiaries are classified as undercapitalized.

A bank holding company is required to give the Federal Reserve prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of its consolidated net worth. The Federal Reserve may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe or unsound practice or would violate any law, regulation, Federal Reserve order or any condition imposed by, or written agreement with, the Federal Reserve.

Capital Adequacy

The Company must comply with the Federal Reserve's established capital adequacy standards, and Live Oak Bank is required to comply with the capital adequacy standards established by the FDIC. The Federal Reserve has promulgated two basic measures of capital adequacy for bank holding companies: a risk-based measure and a leverage measure. A bank holding company must satisfy all applicable capital standards to be considered in compliance.

The risk-based capital standards are designed to make regulatory capital requirements more sensitive to differences in risk profile among banks and bank holding companies, account for off-balance-sheet exposure and minimize disincentives for holding liquid assets.

Assets and off-balance-sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance-sheet items. Under revised capital standards that apply to us and the Bank as of January 1, 2015, the minimum risk-based capital ratios are a common equity Tier 1 capital to risk-weighted assets ratio of 4.5%, a Tier 1 capital to risk-weighted assets ratio of 6%, and a total capital to risk-weighted assets ratio of 8%. In addition, to avoid restrictions on capital distributions and discretionary bonus payments, the Company and the Bank are required to meet a capital conservation buffer of common equity Tier 1 capital in addition to the minimum common equity Tier 1 capital ratio. The capital conservation buffer will be phased in beginning January 1, 2016 until January 1, 2019, at which point it will be set at 2.5% common equity Tier 1 capital to risk-weighted assets, which sits "on top" of the 4.5% minimum common equity Tier 1 to risk-weighted assets ratio. Common equity Tier 1 capital is predominantly comprised of retained earnings and common stock instruments (that meet strict delineated criteria), net of treasury stock, and after making necessary capital deductions and adjustments. Tier 1 capital is comprised of common equity Tier 1 capital plus Additional Tier 1 capital, which consists of noncumulative perpetual preferred stock and similar instruments meeting specified eligibility criteria and "TARP" preferred stock and other instruments issued under the Emergency Economic Stabilization Act of 2008. Total capital is comprised of Tier 1 capital plus Tier 2 capital, which consists of subordinated debt with a minimum original maturity of at least five years and a limited amount of loan loss reserves. At December 31, 2015, the Company's risk-based capital ratios, as calculated under the revised capital standards applicable as of January 1, 2015, were 23.22% common equity Tier 1 capital to risk weighted assets, 23.22% Tier 1 capital to risk weighted assets, and 24.12% total capital to risk weighted assets.

In addition, the Federal Reserve has established minimum leverage ratio guidelines for bank holding companies. These guidelines provide for a minimum ratio of Tier 1 capital to average total on-balance sheet assets, less goodwill and certain other intangible assets, of 4% for bank holding companies. The Company's ratio at December 31, 2015 was 18.36% compared to 13.38% at December 31, 2014. The guidelines also provide that bank holding companies experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Furthermore, the Federal Reserve has indicated that it will consider a "tangible Tier 1 Capital leverage ratio" and other indications of capital

strength in evaluating proposals for expansion or new activities.

Failure to meet capital guidelines could subject a bank to a variety of enforcement remedies, including issuance of a capital directive, the termination of deposit insurance by the FDIC, a prohibition on taking brokered deposits and certain other restrictions on its business. As described below, the FDIC can impose substantial additional restrictions upon FDIC-insured depository institutions that fail to meet applicable capital requirements.

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The Federal Deposit Insurance Act, or FDI Act, requires the federal regulatory agencies to take “prompt corrective action” if a depository institution does not meet minimum capital requirements. The FDI Act establishes five capital tiers: “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized” and “critically undercapitalized.” A depository institution’s capital tier will depend upon how its capital levels compare to various relevant capital measures and certain other factors, as established by regulation.

The federal bank regulatory agencies have adopted regulations establishing relevant capital measures and relevant capital levels applicable to FDIC-insured banks. The relevant capital measures are the Total Risk-Based Capital ratio, Tier 1 Risk-Based Capital ratio, Common Equity Tier 1 Capital ratio and the leverage ratio. As of January 1, 2015, an FDIC-insured bank was:

“well capitalized” if it has a Total Risk-Based Capital ratio of 10% or greater, a Tier 1 Risk-Based Capital ratio of 8% or greater, a Common Equity Tier 1 Capital ratio of 6.5% or greater and a leverage ratio of 5% or greater and is not subject to any order or written directive by the appropriate regulatory authority to meet and maintain a specific capital level for any capital measure;

“adequately capitalized” if it has a Total Risk-Based Capital ratio of 8% or greater, a Tier 1 Risk-Based Capital ratio of 6% or greater, a Common Equity Tier 1 Capital ratio of 4.5% or greater and a leverage ratio of 4% or greater and is not “well capitalized”;

“undercapitalized” if it has a Total Risk-Based Capital ratio of less than 8%, a Tier 1 Risk-Based Capital ratio of less than 6%, a Common Equity Tier 1 Capital ratio of less than 4% or a leverage ratio of less than 4%;

“significantly undercapitalized” if it has a Total Risk-Based Capital ratio of less than 6%, a Tier 1 Risk-Based Capital ratio of less than 4%, a Common Equity Tier 1 Capital ratio of less than 3% or a leverage ratio of less than 3%; and

“critically undercapitalized” if its tangible equity is equal to or less than 2% of average quarterly tangible assets.

An institution may be downgraded to, or deemed to be in, a capital category that is lower than is indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. As of December 31, 2015, Live Oak Bank had capital levels that qualify as “well capitalized” under the regulations applicable as of January 1, 2015.

The FDI Act generally prohibits an FDIC-insured bank from making a capital distribution (including payment of a dividend) or paying any management fee to its holding company if the bank is or would thereafter be “undercapitalized.”

“Undercapitalized” banks are subject to growth limitations and are required to submit a capital restoration plan. The federal regulators may not accept a capital plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the bank’s capital. In addition, for a capital restoration plan to be acceptable, the bank’s parent holding company must guarantee that the institution will comply with such capital restoration plan until the institution has been adequately capitalized on average during each of four consecutive calendar quarters. The aggregate liability of the parent holding company under such guaranty is limited to the lesser of: (i) an amount equal to 5% of the bank’s total assets at the time it became “undercapitalized”; and (ii) the amount which is necessary (or would have been necessary) to bring the institution into compliance with all capital standards applicable with respect to such institution as of the time it fails to comply with the plan. If a bank fails to submit an acceptable plan, it is treated as if it is “significantly undercapitalized.”

“Significantly undercapitalized” insured banks may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become “adequately capitalized,” requirements to reduce total assets and the cessation of receipt of deposits from correspondent banks. “Critically undercapitalized” institutions are subject to the appointment of a receiver or conservator. A bank that is not “well capitalized” is also subject to certain limitations relating to brokered deposits.

The regulatory capital framework under which the Company and Live Oak Bank operate has recently changed in significant respects as a result of the Dodd-Frank Act, which was enacted in July 2010, and other regulations, including the separate regulatory capital requirements put forth by the Basel Committee on Banking Supervision, commonly known “Basel III.”

In July 2013, the Federal Reserve, FDIC and Office of the Comptroller of the Currency approved final rules that establish an integrated regulatory capital framework that addresses shortcomings in certain capital requirements. The

rules implement in the United States the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain changes required by the Dodd-Frank Act. These rule began to apply to the Company effective January 1, 2015.

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The major provisions of the rule applicable to the Company are:

The rule implements higher minimum capital requirements, includes a new common equity Tier 1 capital requirement, and establishes criteria that instruments must meet in order to be considered Common Equity Tier 1 capital, additional Tier 1 capital, or Tier 2 capital. These enhancements are intended to both improve the quality and increase the quantity of capital required to be held by banking organizations. The minimum capital to risk-weighted assets (“RWA”) requirements under the rule are a common equity Tier 1 capital ratio of 4.5% and a Tier 1 capital ratio of 6.0%, which is an increase from 4.0%, and a total capital ratio that remains at 8.0%. The minimum leverage ratio (Tier 1 capital to total assets) is 4.0%. The rule maintains the general structure of the current prompt corrective action, or PCA, framework while incorporating these increased minimum requirements.

The rule implements changes to the definition of capital. Among the most important changes are stricter eligibility criteria for regulatory capital instruments that would disallow the inclusion of instruments such as trust preferred securities in Tier 1 capital going forward, and new constraints on the inclusion of minority interests, mortgage-servicing assets (“MSAs”), deferred tax assets (“DTAs”), and certain investments in the capital of unconsolidated financial institutions. In addition, the rule requires that certain regulatory capital deductions be made from common equity Tier 1 capital.

Under the rule, in order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold a capital conservation buffer composed of common equity Tier 1 capital above its minimum risk-based capital requirements. The buffer is measured relative to RWA. Phase-in of the capital conservation buffer requirements began on January 1, 2016. A banking organization with a buffer greater than 2.5% would not be subject to limits on capital distributions or discretionary bonus payments; however, a banking organization with a buffer of less than 2.5% would be subject to increasingly stringent limitations as the buffer approaches zero. The rule also prohibits a banking organization from making distributions or discretionary bonus payments during any quarter if its eligible retained income is negative in that quarter and its capital conservation buffer ratio was less than 2.5% at the beginning of the quarter. When the rule is fully phased in, the minimum capital requirements plus the capital conservation buffer will exceed the PCA well-capitalized thresholds.

The rule also increases the risk weights for past-due loans, certain commercial real estate loans, and some equity exposures, and makes selected other changes in risk weights and credit conversion factors.

On July 9, 2013, the FDIC confirmed that it would join in the Basel III standards and, on September 10, 2013, issued an “interim final rule” applicable to the Bank that is identical in substance to the final rules issued by the Federal Reserve described above. The Bank was required to comply with the interim final rule beginning on January 1, 2015. Compliance by LOB and the Bank with these capital requirements affects their respective operations by increasing the amount of capital required to conduct operations.

Acquisitions

The Company must comply with numerous laws related to any potential acquisition activity. Under the BHCA, a bank holding company may not directly or indirectly acquire ownership or control of more than 5% of the voting shares or substantially all of the assets of any bank or merge or consolidate with another bank holding company without the prior approval of the Federal Reserve. The acquisition of non-banking companies is also regulated by the Federal Reserve. Current federal law authorizes interstate acquisitions of banks and bank holding companies without geographic limitation. Furthermore, a bank headquartered in one state is authorized to merge with a bank headquartered in another state, as long as neither of the states has opted out of such interstate merger authority prior to such date, and subject to any state requirement that the target bank shall have been in existence and operating for a minimum period of time, not to exceed five years, and to certain deposit market-share limitations. After a bank has established branches in a state through an interstate merger transaction, the bank may establish and acquire additional branches at any location in the state where a bank headquartered in that state could have established or acquired branches under applicable federal or state law. Additionally, since passage of the Dodd-Frank Act, a bank is now permitted to open a de novo branch in any state if that state would permit a bank organized in that state to open a branch.

Restrictions on Affiliate Transactions

Sections 23A and 23B of the Federal Reserve Act establish parameters for a bank to conduct “covered transactions” with its affiliates, with the objective of limiting risk to the insured bank. Generally, Sections 23A and 23B (i) limit the extent to which the bank or its subsidiaries may engage in “covered transactions” with any one affiliate to an amount equal to 10% of such bank’s capital stock and surplus, and limit the aggregate of all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus and (ii) require that all such transactions be on terms substantially the same, or at least as favorable, to the bank or subsidiary as those that would be provided to a non-affiliate. The term “covered transaction” includes the making of loans to the affiliate, purchase of assets from the affiliate, issuance of a guaranty on behalf of the affiliate and several other types of transactions.

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The Dodd-Frank Act imposes new restrictions on transactions between affiliates by amending these two sections of the Federal Reserve Act. Under the Dodd-Frank Act, restrictions on transactions with affiliates are enhanced by (i) including among “covered transactions” transactions between bank and affiliate-advised investment funds; (ii) including among “covered transactions” transactions between a bank and an affiliate with respect to securities repurchase agreements and derivatives transactions; (iii) adopting stricter collateral rules; and (iv) imposing tighter restrictions on transactions between banks and their financial subsidiaries.

FDIC Insurance Assessments

The assessment rate paid by each DIF member institution is based on its relative risks of default as measured by regulatory capital ratios and other factors. Specifically, the assessment rate is based on the institution’s capitalization risk category and supervisory subgroup category. An institution’s capitalization risk category is based on the FDIC’s determination of whether the institution is well capitalized, adequately capitalized or less than adequately capitalized. Live Oak Bank’s insurance assessments during 2015 and 2014 were \$514 thousand and \$251 thousand, respectively. An institution’s supervisory subgroup category is based on the FDIC’s assessment of the financial condition of the institution and the probability that FDIC intervention or other corrective action will be required. The FDIC may terminate insurance of deposits upon a finding that an institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

The Dodd-Frank Act expanded the base for FDIC insurance assessments, requiring that assessments be based on the average consolidated total assets less tangible equity capital of a financial institution. On February 7, 2011, the FDIC approved a final rule to implement the foregoing provision of the Dodd-Frank Act. Among other things, the final rule revised the assessment rate schedule to provide initial base assessment rates ranging from 5 to 35 basis points, subject to adjustments which could increase or decrease the total base assessment rates. The FDIC has three possible adjustments to an institution’s initial base assessment rate: (1) a decrease of up to five basis points (or 50% of the initial base assessment rate) for long-term unsecured debt, including senior unsecured debt (other than debt guaranteed under the Temporary Liquidity Guarantee Program) and subordinated debt; (2) an increase for holding long-term unsecured or subordinated debt issued by other insured depository institutions known as the Depository Institution Debt Adjustment; and (3) for institutions not well rated and well capitalized, an increase not to exceed 10 basis points for brokered deposits in excess of 10 percent of domestic deposits.

The law also gives the FDIC enhanced discretion to set assessment rate levels.

The FDIC also collects a deposit-based assessment from insured financial institutions on behalf of the Financing Corporation, or the FICO. The funds from these assessments are used to service debt issued by FICO in its capacity as a financial vehicle for the Federal Savings & Loan Insurance Corporation. The FICO assessment rate is set quarterly and in 2015 ranged from .150 basis points in the first quarter to .145 basis points in the fourth quarter per \$100 of assessable deposits. These assessments will continue until the debt matures in 2017 through 2019.

Community Reinvestment Act

The Community Reinvestment Act requires federal bank regulatory agencies to encourage financial institutions to meet the credit needs of low and moderate-income borrowers in their local communities. An institution’s size and business strategy determines the type of examination that it will receive. Large, retail-oriented institutions are examined using a performance-based lending, investment and service test. Small institutions are examined using a streamlined approach. All institutions may opt to be evaluated under a strategic plan formulated with community input and pre-approved by the bank regulatory agency.

The Community Reinvestment Act regulations provide for certain disclosure obligations. Each institution must post a notice advising the public of its right to comment to the institution and its regulator on the institution’s Community Reinvestment Act performance and to review the institution’s Community Reinvestment Act public file. Each lending institution must maintain for public inspection a file that includes a listing of branch locations and services, a summary of lending activity, a map of its communities and any written comments from the public on its performance in meeting community credit needs. The Community Reinvestment Act requires public disclosure of the regulators’ written Community Reinvestment Act evaluations of financial institutions. This promotes enforcement of Community

Reinvestment Act requirements by providing the public with the status of a particular institution's community reinvestment record.

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The Gramm-Leach-Bliley Act made various changes to the Community Reinvestment Act. Among other changes, Community Reinvestment Act agreements with private parties must be disclosed and annual Community Reinvestment Act reports relating to such agreements must be made available to a bank's primary federal regulator. A bank holding company will not be permitted to become a financial holding company and no new activities authorized under the Gramm-Leach-Bliley Act may be commenced by a holding company or by a bank financial subsidiary if any of its bank subsidiaries received less than a satisfactory Community Reinvestment Act rating in its latest Community Reinvestment Act examination. Live Oak Bank operates under an approved CRA strategic plan and received an "Outstanding" rating in its last CRA examination, which was conducted as of April 15, 2013.

The Volcker Rule

Under provisions of the Dodd-Frank Act referred to as the "Volcker Rule," certain limitations are placed on the ability of insured depository institutions and their affiliates to engage in sponsoring, investing in and transacting with certain investment funds, including hedge funds and private equity funds. The Volcker Rule also places restrictions on proprietary trading, which could impact certain hedging activities. The Volcker Rule became fully effective in July 2015, and banking entities currently have until July 2016 to divest certain legacy investments in covered funds. The Volcker Rule is not expected to have a material impact on the Company's operations.

Additional Legislative and Regulatory Matters

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, or the USA PATRIOT Act, requires each financial institution: (i) to establish an anti-money laundering program; (ii) to establish due diligence policies, procedures and controls with respect to its private banking accounts involving foreign individuals and certain foreign banks; and (iii) to avoid establishing, maintaining, administering or managing correspondent accounts in the United States for, or on behalf of, foreign banks that do not have a physical presence in any country. The USA PATRIOT Act also requires the Secretary of the Treasury to prescribe by regulation minimum standards that financial institutions must follow to verify the identity of customers, both foreign and domestic, when a customer opens an account. In addition, the USA PATRIOT Act contains a provision encouraging cooperation among financial institutions, regulatory authorities and law enforcement authorities with respect to individuals, entities and organizations engaged in, or reasonably suspected of engaging in, terrorist acts or money laundering activities.

Sarbanes-Oxley mandates for public companies, such as the Company, a variety of reforms intended to address corporate and accounting fraud and provides for the establishment of the PCAOB, which enforces auditing, quality control and independence standards for firms that audit SEC-reporting companies. Sarbanes-Oxley imposes higher standards for auditor independence and restricts the provision of consulting services by auditing firms to companies they audit and requires that certain audit partners be rotated periodically. It also requires chief executive officers and chief financial officers, or their equivalents, to certify the accuracy of periodic reports filed with the SEC, subject to civil and criminal penalties if they knowingly or willfully violate this certification requirement, and increases the oversight and authority of audit committees of publicly traded companies.

Fiscal and Monetary Policy

Banking is a business which depends on interest rate differentials for success. In general, the difference between the interest paid by a bank on its deposits and its other borrowings, and the interest received by a bank on its loans and securities holdings, constitutes a significant portion of a bank's earnings. Thus, the Company's earnings and growth will be subject to the influence of economic conditions generally, both domestic and foreign, and also to the monetary and fiscal policies of the United States and its agencies, particularly the Federal Reserve. The Federal Reserve regulates the supply of money through various means, including open market dealings in United States government securities, the discount rate at which banks may borrow from the Federal Reserve and the reserve requirements on deposits. The nature and timing of any changes in such policies and their effect on the Company's business and results of operations cannot be predicted.

Current and future legislation and the policies established by federal and state regulatory authorities will affect the Company's future operations. Banking legislation and regulations may limit the Company's growth and the return to its investors by restricting certain of its activities.

In addition, capital requirements could be changed and have the effect of restricting the activities of the Company or requiring additional capital to be maintained. The Company cannot predict with certainty what changes, if any, will be made to existing federal and state legislation and regulations or the effect that such changes may have on the Company's business and results of operations.

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Real Estate Lending Evaluations

The federal regulators have adopted uniform standards for evaluations of loans secured by real estate or made to finance improvements to real estate. Banks are required to establish and maintain written internal real estate lending policies consistent with safe and sound banking practices and appropriate to the size of the institution and the nature and scope of its operations. The regulations establish loan to value ratio limitations on real estate loans. Live Oak Bank's respective loan policies establish limits on loan to value ratios that are equal to or less than those established in such regulations.

Commercial Real Estate Concentrations

Lending operations of commercial banks may be subject to enhanced scrutiny by federal banking regulators based on a bank's concentration of commercial real estate, or CRE, loans. On December 6, 2006, the federal banking regulators issued final guidance to remind financial institutions of the risk posed by commercial real estate, or CRE, lending concentrations. CRE loans generally include land development, construction loans, and loans secured by multifamily property, and nonfarm, nonresidential real property where the primary source of repayment is derived from rental income associated with the property. The guidance prescribes the following guidelines for bank examiners to help identify institutions that are potentially exposed to significant CRE risk and may warrant greater supervisory scrutiny: total reported loans for construction, land development and other land, or C&D, represent 100% or more of the institution's total capital; or total CRE loans represent 300% or more of the institution's total capital, and the outstanding balance of the institution's CRE loan portfolio has increased over 50% or more during the prior 36 months.

As of December 31, 2015, the Bank's C&D concentration as a percentage of bank capital totaled 228.3% and the Bank's CRE concentration, net of owner-occupied loans, as a percentage of capital totaled 46.9%.

Limitations on Incentive Compensation

In October 2009, the Federal Reserve issued proposed guidance designed to help ensure that incentive compensation policies at banking organizations do not encourage excessive risk-taking or undermine the safety and soundness of the organization. In connection with the proposed guidance, the Federal Reserve announced that it would review incentive compensation arrangements of bank holding companies such as the Company as part of the regular, risk-focused supervisory process.

In June 2010, the Federal Reserve issued the incentive compensation guidance in final form and was joined by the FDIC, and the Office of the Comptroller of the Currency. The final guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide employees incentives that appropriately balance risk and reward and, thus, do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors. Any deficiencies in compensation practices that are identified may be incorporated into the organization's supervisory ratings, which can affect its ability to make acquisitions or perform other actions. The guidance provides that enforcement actions may be taken against a banking organization if its incentive compensation arrangements or related risk-management control or governance processes pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

Economic Environment

The policies of regulatory authorities, including the monetary policy of the Federal Reserve, have a significant effect on the operating results of bank holding companies and their subsidiaries. Among the means available to the Federal Reserve to affect the money supply are open market operations in U.S. government securities, changes in the discount rate on member bank borrowings and changes in reserve requirements against member bank deposits. These means are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits, and their use may affect interest rates charged on loans or paid on deposits. The Federal Reserve's monetary policies have materially affected the operating results of commercial banks in the past and are expected to continue to do so in

the future. The nature of future monetary policies and the effect of these policies on the Company's business and earnings cannot be predicted.

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Evolving Legislation and Regulatory Action

In 2009, many emergency government programs enacted in 2008 in response to the financial crisis and the recession slowed or wound down, and global regulatory and legislative focus has generally moved to a second phase of broader regulatory reform and a restructuring of the entire financial regulatory system. The Dodd-Frank Act was signed into law in 2010 and implements many new changes in the way financial and banking operations are regulated in the United States, including through the creation of a new resolution authority, mandating higher capital and liquidity requirements, requiring banks to pay increased fees to regulatory agencies and numerous other provisions intended to strengthen the financial services sector. Pursuant to the Dodd-Frank Act the Financial Stability Oversight Council, or the FSO, was created and is charged with overseeing and coordinating the efforts of the primary U.S. financial regulatory agencies (including the Federal Reserve, the FDIC and the SEC) in establishing regulations to address systemic financial stability concerns. Under the Dodd-Frank Act, the Consumer Financial Protection Bureau, or the CFPB, was also created as a new consumer financial services regulator. The CFPB is authorized to prevent unfair, deceptive and abusive practices and ensure that consumers have access to markets for consumer financial products and services and that such markets are fair, transparent and competitive.

New laws or regulations or changes to existing laws and regulations, including changes in interpretation or enforcement, could materially adversely affect the Company's financial condition or results of operations. Many aspects of the Dodd-Frank Act are subject to further rulemaking and will take effect over several years. As a result, the overall financial impact on the Company and Live Oak Bank cannot be anticipated at this time.

Small Business Lending Fund

The Small Business Jobs Act of 2010 created the Small Business Lending Fund to invest capital into community banking organizations. Through the fund, the U.S. Department of the Treasury (the "U.S. Treasury") invested in financial institutions through the purchase of senior preferred stock or indebtedness. The U.S. Treasury could invest up to 5% of risk-weighted assets for financial institutions with \$1 billion of total assets or less as of December 31, 2009, or up to 3% of risk-weighted assets for financial institutions with more than \$1 billion, but less than \$10 billion, in total assets on that date. In April 2011, the Company elected to participate in the program and issued \$6.8 million in senior securities to the U.S. Treasury ("SBLF Securities"). In December 2015, the Company redeemed the SBLF Securities by repaying \$6.8 million to the U.S. Treasury, which amount was equal to the funding along with accrued but unpaid interest.

Federal and State Taxation

The Company and its subsidiaries file a consolidated federal income tax return and separate state income tax returns in North Carolina. All the returns are filed on a calendar year basis. Consolidated income tax returns have the effect of eliminating intercompany income and expense, including dividends, from the computation of consolidated taxable income for the taxable year in which the items occur. In accordance with an income tax sharing agreement, income tax charges or credits are allocated among Live Oak and its subsidiaries on the basis of their respective taxable income or taxable loss that is included in the consolidated income tax return.

Banks and bank holding companies are subject to federal and state income taxes in essentially the same manner as other corporations. Taxable income is generally calculated under applicable sections of the Internal Revenue Code of 1986, as amended (the "Code"), with some modifications required by state law. Although Live Oak's federal income tax liability is determined under provisions of the Code, which is applicable to all taxpayers, Sections 581 through 597 of the Code apply specifically to financial institutions.

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Item 1A. RISK FACTORS

An investment in LOB common stock involves certain risks. The following discussion highlights the risks that management believes are material for the Company, but do not necessarily include all the risks that we may face. Additional risks and uncertainties that are not currently known or that management does not currently deem material could also have a material adverse impact on our business, results of our operations and financial condition. You should carefully consider the risk factors and uncertainties described below and elsewhere in this Report in evaluating an investment in LOB's common stock.

Risks Related to Our Business

The Company may experience increased delinquencies and credit losses, which could have a material adverse effect on its capital, financial condition, and results of operations.

Like other lenders, we face the risk that our customers will not repay their loans. A customer's failure to repay us is usually preceded by missed monthly payments. In some instances, however, a customer may declare bankruptcy prior to missing payments, and, following a borrower filing bankruptcy, a lender's recovery of the credit extended is often limited. Since many of our loans are secured by collateral, we may attempt to seize the collateral if and when a customer defaults on a loan. However, the value of the collateral might not equal the amount of the unpaid loan, and we may be unsuccessful in recovering the remaining balance from our customer. The resolution of nonperforming assets, including the initiation of foreclosure proceedings, requires significant commitments of time from management, which can be detrimental to the performance of their other responsibilities, and which expose us to additional legal costs. Elevated levels of loan delinquencies and bankruptcies in our market areas, generally, and among our customers specifically, can be precursors of future charge-offs and may require us to increase our allowance for loan and lease losses, or ALLL. Higher charge-off rates, delays in the foreclosure process or in obtaining judgments against defaulting borrowers or an increase in our ALLL may negatively impact our overall financial performance, may increase our cost of funds, and could materially adversely affect our business, results of operations and financial condition.

SBA lending is an important part of our business. Our SBA lending program is dependent upon the federal government, and we face specific risks associated with originating SBA loans.

Our SBA lending program is dependent upon the federal government. As an SBA Preferred Lender, we enable our clients to obtain SBA loans without being subject to the potentially lengthy SBA approval process necessary for lenders that are not SBA Preferred Lenders. The SBA periodically reviews the lending operations of participating lenders to assess, among other things, whether the lender exhibits prudent risk management. When weaknesses are identified, the SBA may request corrective actions or impose enforcement actions, including revocation of the lender's Preferred Lender status. If we lose our status as a Preferred Lender, we may lose some or all of our customers to lenders who are SBA Preferred Lenders, and as a result we could experience a material adverse effect to our financial results. Any changes to the SBA program, including changes to the level of guarantee provided by the federal government on SBA loans, may also have a material adverse effect on our business.

We generally sell the guaranteed portion of our SBA 7(a) loans in the secondary market. These sales have resulted in premium income for us at the time of sale and created a stream of future servicing income. We may not be able to continue originating these loans or selling them in the secondary market. Furthermore, even if we are able to continue originating and selling SBA 7(a) loans in the secondary market, we might not continue to realize premiums upon the sale of the guaranteed portion of these loans. When we sell the guaranteed portion of our SBA 7(a) loans, we incur credit risk on the non-guaranteed portion of the loans, and if a customer defaults on the non-guaranteed portion of a loan, we share any loss and recovery related to the loan pro-rata with the SBA. If the SBA establishes that a loss on an SBA guaranteed loan is attributable to significant technical deficiencies in the manner in which the loan was originated, funded or serviced by us, the SBA may seek recovery of the principal loss related to the deficiency from us, which could materially adversely affect our business, results of operations and financial condition.

The laws, regulations and standard operating procedures that are applicable to SBA loan products may change in the future. We cannot predict the effects of these changes on our business and profitability. Because government regulation greatly affects the business and financial results of all commercial banks and bank holding companies and

especially our organization, changes in the laws, regulations and procedures applicable to SBA loans could adversely affect our ability to operate profitably.

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We are dependent upon the use of intellectual property owned by third parties, and any change in our ability to use, or the terms upon which we may use, this intellectual property could have a material adverse effect on our business. The technology-based platform that is pivotal to our success is dependent on the use of the nCino Bank Operating System and Salesforce.com, Inc.'s Force.com cloud computing infrastructure platform. We rely on a non-exclusive license to use nCino's platform. Because our license is non-exclusive, the nCino Bank Operating System is available to other lenders and nothing would prevent our competitors from developing, licensing or using similar technology. Our license currently expires on November 15, 2018. Notwithstanding the term of our agreement, our license may be terminated if we are in material breach of the license and do not cure the breach within 30 days. In addition, nCino relies on a license to use the Salesforce.com platform, and if nCino were unable to maintain its rights under that license, our ability to rely on the nCino license could be adversely affected. We can offer no assurance that we will be able to renew or maintain our license to use the nCino Bank Operating System on terms that are acceptable. Termination of either of these licenses or the reduction or elimination of our licensed rights may result in our having to negotiate new licenses with less favorable terms, or the inability to obtain access to such licensed technology at all. If we were to lose access to this technology, or were only able to access the technology on less favorable terms, we would not be able to offer our customers the technology-based platform services they seek from us and our business would be materially and adversely affected.

A failure in or breach of our operational or security systems, or those of our third party service providers, including as a result of cyber-attacks, could disrupt our business, result in unintentional disclosure or misuse of confidential or proprietary information, damage our reputation, increase our costs and cause losses.

As a financial institution, our operations rely heavily on the secure data processing, storage and transmission of confidential and other information on our computer systems and networks. Any failure, interruption or breach in security or operational integrity of these systems could result in failures or disruptions in our online banking system, customer relationship management, general ledger, deposit and loan servicing and other systems. The security and integrity of our systems and the technology we use could be threatened by a variety of interruptions or information security breaches, including those caused by computer hacking, cyber-attacks, electronic fraudulent activity or attempted theft of financial assets. We may fail to promptly identify or adequately address any such failures, interruptions or security breaches if they do occur. While we have certain protective policies and procedures in place, the nature and sophistication of the threats continue to evolve. We may be required to expend significant additional resources in the future to modify and enhance our protective measures.

The nature of our business may make it an attractive target and potentially vulnerable to cyber-attacks, computer viruses, physical or electronic break-ins or similar disruptions. The technology-based platform we use processes sensitive data from our borrowers and investors. While we have taken steps to protect confidential information that we have access to, our security measures and the security measures employed by the owners of the technology in the platform that we use could be breached. Any accidental or willful security breaches or other unauthorized access to our systems could cause confidential customer, borrower, employee, vendor, partner or investor information to be stolen and used for criminal purposes. Security breaches or unauthorized access to confidential information could also expose us to liability related to the loss of the information, time-consuming and expensive litigation, and negative publicity. If security measures are breached because of third-party action, employee error, malfeasance or otherwise, or if design flaws in the technology-based platform that we use are exposed and exploited, our relationships with customers, borrowers employees, vendors, partners and investors could be severely damaged, and we could incur significant liability.

Because techniques used to sabotage or obtain unauthorized access to systems change frequently and generally are not recognized until they are launched against a target, we and our collaborators may be unable to anticipate these techniques or to implement adequate preventative measures. In addition, federal regulators and many federal and state laws and regulations require companies to notify individuals of data security breaches involving their personal data. These mandatory disclosures regarding a security breach are costly to implement and often lead to widespread negative publicity, which may cause customers, borrowers, employees, vendors, partners or investors to lose confidence in the effectiveness of our data security measures. Any security breach, whether actual or perceived, would

harm our reputation, we could lose customers, borrowers, employees, vendors, partners, or investors, and our business and operations could be adversely affected.

Additionally, we face the risk of operational disruption, failure, termination or capacity constraints of any of the third parties that facilitate our business activities, including exchanges, clearing agents, clearing houses or other financial intermediaries. Such parties could also be the source of an attack on, or breach of, our operational systems. Any failures, interruptions or security breaches in our information systems could damage our reputation, result in a loss of customer business, result in a violation of privacy or other laws, or expose us to civil litigation, regulatory fines or losses not covered by insurance.

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Our business is dependent on the successful and uninterrupted functioning of our information technology and telecommunications systems and third-party providers. The failure of these systems, or the termination of a third-party software license or service agreement on which any of these systems is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. If significant, sustained or repeated, a system failure or service denial could compromise our ability to operate effectively, damage our reputation, result in a loss of customer business, and/or subject us to additional regulatory scrutiny and possible financial liability, any of which could materially adversely affect our business, financial condition, results of operations and prospects, as well as the value of our common stock.

A return of recessionary conditions could result in increases in our level of nonperforming loans and/or reduce demand for our products and services, which could have a material adverse effect on our results of operations. Like all financial institutions, we are subject to certain risks resulting from a weakened economy, such as increased charge-offs and levels of past-due loans and nonperforming assets. Although the U.S. economy has emerged from the severe recession that occurred from 2007 to 2009, economic growth has been slow and uneven, and unemployment levels remain elevated in many areas of the country. In addition, recovery by many businesses has been impaired by lower consumer spending. A return of prolonged deteriorating economic conditions could adversely affect the ability of our customers to repay their loans, the value of our investments, and our ongoing operations, costs and profitability. These events may cause us to incur losses and may materially adversely affect our business, results of operations and financial condition.

Our loan portfolio mix, which includes owner-occupied commercial real estate loans, could result in increased credit risk in a challenging economy.

Our loan portfolio is concentrated in owner-occupied commercial real estate and owner-occupied commercial business loans. These types of loans generally are viewed as carrying more risk of default than residential real estate loans or certain other types of loans or investments. In fact, the FDIC has issued pronouncements alerting banks of its concern about heavy loan concentrations in certain types of commercial real estate loans, including acquisition, construction and development loans, and heavy loan concentrations in certain geographic segments. Because a portion of our loan portfolio is composed of these types of higher-risk loans, we face an increased risk of nonperforming loans that could result in a loss of earnings from these loans, an increase in the provision for loan losses, or an increase in loan charge-offs, any of which could have a material adverse impact on our business, results of operations and financial condition.

The current economic environment and any deterioration or downturn in the economies or real estate values in the markets we serve could have a material adverse effect on both borrowers' ability to repay their loans and the value of the real property securing those loans. Our ability to recover on defaulted loans would then be diminished, and we would be more likely to suffer losses on defaulted loans. Any of these developments could materially adversely affect our business, financial condition, results of operations and prospects.

The fair value of our investment securities can fluctuate due to factors outside of our control.

As of December 31, 2015, the fair value of our investment securities portfolio was approximately \$53.8 million. Factors beyond our control can significantly influence the fair value of securities in our portfolio and can cause potential adverse changes to the fair value of these securities. These factors include, but are not limited to, rating agency actions in respect of the securities, defaults by the issuer or with respect to the underlying securities, monetary tapering actions by the Federal Reserve, and changes in market interest rates and continued instability in the capital markets. Any of these factors, among others, could cause other-than-temporary impairments and realized or unrealized losses in future periods and declines in other comprehensive income, which could materially and adversely affect our business, results of operations, financial condition and prospects, as well as the value of our common stock. The process for determining whether impairment of a security is other-than-temporary usually requires complex, subjective judgments about the future financial performance and liquidity of the issuer and any collateral underlying the security in order to assess the probability of receiving all contractual principal and interest payments on the security. Our inability to accurately predict the future performance of an issuer or to efficiently respond to changing

market conditions could result in a decline in the value of our investment securities portfolio, which could have a material and adverse effect on our business, results of operations and financial condition.

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Our allowance for loan losses may prove to be insufficient to cover actual loan losses, which could have a material adverse effect on our financial condition and results of operations.

Our future success depends to a significant extent upon the quality of our assets, particularly loans. In originating loans, there is a substantial likelihood that we will experience credit losses. The risk of loss will vary with, among other things, general economic conditions, including the current economic environment and real estate market, the type of loan, the creditworthiness of the borrower over the term of the loan, and, in the case of a collateralized loan, the quality of the collateral for the loan.

Our loan customers may not repay their loans according to the terms of these loans, and the collateral securing the payment of these loans may be insufficient to assure repayment. As a result, we may experience significant loan losses, which could have a material adverse effect on our operating results. Our management makes various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. We maintain an allowance for loan losses in an attempt to cover any loan losses that may occur. In determining the size of the allowance, we rely on an analysis of our loan portfolio based on historical loss experience, volume and types of loans, trends in classification, volume and trends in delinquencies and non-accruals, national and local economic conditions, and other pertinent information.

If our assumptions are wrong, our current allowance may not be sufficient to cover future loan losses, and we may need to make adjustments to allow for different economic conditions or adverse developments in our loan portfolio. Material additions to our allowance in the form of provisions for loan losses would materially decrease our net income. We expect our allowance to continue to fluctuate; however, given current and future market conditions, our allowance may not be adequate to cover future loan losses.

In addition, federal and state regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize further loan charge-offs, based on judgments different than those of our management. Any increase in our allowance for loan losses or loan charge-offs as required by these regulators could have a negative effect on our operating results and could materially adversely affect our business, results of operations and financial condition.

The valuation of our servicing rights is based on estimates and subject to fluctuation based on market conditions and other factors that are beyond our control.

The fair value of our servicing rights is estimated based upon projections of expected future cash flows generated by the loans we service, historical prepayment rates, future prepayment estimates, portfolio characteristics, interest rates based on interest rate yield curves, volatility, market demand for servicing rights and other factors. While this evaluation process uses historical and other objective information, the valuation of our servicing rights is ultimately an estimate based on our experience, judgment and expectations regarding our servicing portfolio and the broader market. This is an inherently uncertain process and the value of our servicing rights may be adversely impacted by factors that are beyond our control, which may in turn have a material adverse effect on our business, results of operations and financial condition.

The recognition of gains on the sale of loans reflects certain assumptions.

Gains on the sale of loans comprise a significant component of our revenue. Noncash gains recognized in the years ended December 31, 2015, 2014 and 2013 were \$6.1 million, \$3.5 million and \$3.3 million respectively. The determination of these noncash gains is based on assumptions regarding the value of unguaranteed loans retained, servicing rights retained and deferred fees and costs. The value of retained unguaranteed loans and servicing rights are determined by our wholly owned subsidiary, GLS, which applies market derived factors such as prepayment rates, current market conditions and recent loan sales to arrive at valuations. Deferred fees and costs are determined using internal analysis of the cost to originate loans. Significant errors in assumptions used to compute gains on sale of loans could result in material revenue misstatements, which may have a material adverse effect on our business, results of operations and profitability. In addition, while we believe that the valuations provided by GLS are at arm's length, reflect fair value and are subject to validation by an independent third party on an annual basis, if such valuations are not reflective of fair market value then our business, results of operations and financial condition may be materially

and adversely affected.

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We anticipate that going forward we will experience increasing growth in our held-for-sale and held-for-investment loan portfolios due to our increasing construction portfolio or strategic business decisions.

Our revenue model has historically been driven by selling loans that we originate, or a portion of the loans, in the secondary market when fully funded. The growth of our construction portfolio will result in a decrease in the volume of loans sold relative to production in any period, which, in turn, decreases our revenue relative to production in any period. In addition, we anticipate growth in our loans held for investment due to our origination of loans that we choose not to sell or for which there is no secondary market or due to other strategic choices, including the pursuit of potential opportunities in conventional lending outside of SBA or other government guarantee programs. Growth in our held-for-sale and our held-for-investment loan portfolios exposes us to increased interest rate and credit risks.

We are subject to liquidity risk in our operations.

Liquidity risk is the possibility of being unable, at a reasonable cost and within acceptable risk tolerances, to pay obligations as they come due, to capitalize on growth opportunities as they arise, or to pay regular dividends because of an inability to liquidate assets or obtain adequate funding on a timely basis. Liquidity is required to fund various obligations, including credit obligations to borrowers, loan originations, withdrawals by depositors, repayment of debt, dividends to shareholders, operating expenses, and capital expenditures. Our liquidity is derived primarily from the sale of loans in the secondary market, retail deposit growth and retention, principal and interest payments on loans and investment securities, net cash provided from operations, and access to other funding sources. Historically, we have relied on brokered and Internet funds as a large portion of our deposit base. Our access to funding sources in amounts adequate to finance our activities or at a reasonable cost could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could adversely affect our access to liquidity sources include a decrease in the level of our business activity due to a market downturn, our lack of access to a traditional branch banking network designed to generate core deposits and adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as a severe disruption in the financial markets or negative views and expectations about the prospects for the financial services industry as a whole. Our access to borrowed funds could become limited in the future, and we may be required to pay above market rates for additional borrowed funds, if we are able to obtain them at all, which may adversely affect our business, results of operations and financial condition.

The amount of other real estate owned, or OREO, may increase significantly, resulting in additional losses, and costs and expenses that will negatively affect our operations.

In connection with our banking business, we take title to real estate collateral from time to time through foreclosure or otherwise in connection with efforts to collect debts previously contracted. Such real estate is referred to as other real estate owned, or OREO. As the amount of OREO increases, our losses, and the costs and expenses to maintain the real estate, likewise increase. The amount of OREO we hold may increase due to various economic conditions or other factors. Any additional increase in losses and maintenance costs and other expenses due to OREO may have a material adverse effect on our business, results of operations and financial condition. Such effects may be particularly pronounced in a market of reduced real estate values and excess inventory, which may make the disposition of OREO properties more difficult, increase maintenance costs and other expenses, and reduce our ultimate realization from any OREO sales. In addition, at the time of acquisition of the OREO we are required to reflect its fair market value in our financial statements. If the OREO declines in value subsequent to its acquisition, we are required to recognize a loss. As a result, declines in the value of our OREO will have a negative effect on our business, results of operations and financial condition. As of December 31, 2015, we had six OREO properties with an aggregate carrying value of \$2.7 million. For more information about amounts held in OREO, see Note 9 to our audited consolidated financial statements as of and for the year ended December 31, 2015 filed with this Report.

We are subject to environmental liability risk associated with our lending activities.

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur

substantial expenses and may materially reduce the affected property's value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our business, results of operations and financial condition.

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Our use of appraisals in deciding whether to make a loan secured by real property or how to value the loan in the future may not accurately reflect the net value of the collateral that we can realize.

In considering whether to make a loan secured by real property, we generally require an appraisal of the property. However, an appraisal is only an estimate of the value of the property at the time the appraisal is made, and, as real estate values may experience changes in value in relatively short periods of time, especially given heightened economic uncertainty, this estimate might not accurately describe the net value of the real property collateral after the loan has been closed. If the appraisal does not reflect the amount that may be obtained upon any sale or foreclosure of the property, we may not realize an amount equal to the indebtedness secured by the property. In addition, we rely on appraisals and other valuation techniques to establish the value of our OREO and to determine certain loan impairments. If any of these valuations are inaccurate, our consolidated financial statements may not reflect the correct value of OREO, and our ALLL may not reflect accurate loan impairments. The valuation of the properties securing the loans in our portfolio may negatively impact the continuing value of those loans and could materially adversely affect our business, results of operations and financial condition.

We could be subject to losses, regulatory action or reputational harm due to fraudulent and negligent acts on the part of loan applicants, our borrowers, our employees and vendors.

In deciding whether to extend credit or enter into other transactions with customers and counterparties, we may rely on information furnished by or on behalf of customers and counterparties, including financial statements, property appraisals, title information, employment and income documentation, account information and other financial information. We may also rely on representations of clients and counterparties as to the accuracy and completeness of such information and, with respect to financial statements, on reports of independent auditors. Any such misrepresentation or incorrect or incomplete information may not be detected prior to funding a loan or during our ongoing monitoring of outstanding loans. In addition, one or more of our employees or vendors could cause a significant operational breakdown or failure, either as a result of human error or where an individual purposefully sabotages or fraudulently manipulates our loan documentation, operations or systems. Any of these developments could have a material adverse effect on our business, results of operations and financial condition.

We may fail to realize all of the anticipated benefits, including estimated cost savings, of potential future acquisitions. In the future, we may encounter difficulties in obtaining required regulatory approvals for, or face unexpected contingent liabilities from, businesses we may acquire. Integration of an acquired business can be complex and costly, sometimes including combining relevant accounting and data processing systems and management controls, as well as managing relevant relationships with employees, customers, suppliers and other business partners. Integration efforts could divert management attention and resources, which could adversely affect our business, results of operations and financial condition. Additionally, given continued market volatility and uncertainty, we may also experience increased credit costs or need to take additional markdowns and allowances for loan losses on assets and loans we may acquire. These increased credit costs, markdowns and allowances could materially adversely affect our financial condition and results of operations, as well as the value of our common stock.

Implementation of our growth strategy depends, in part, on our ability to successfully identify acquisition opportunities and strategic partners that will complement our operating philosophy, and also on the successful integration of their operations with our own. To successfully acquire target companies or establish complementary lines of business, we must be able to correctly identify profitable or growing markets, as well as attract the necessary relationships and high caliber personnel to make these new business lines profitable. In addition, we may not be able to identify suitable opportunities for further growth and expansion. As consolidation of the financial services industry continues, the competition for suitable acquisition candidates may increase. We will compete with other financial services companies for acquisition opportunities, and many of these competitors have greater financial resources than we do and may be able to pay more for an acquisition than we are able or willing to pay. If we are unable to effectively implement our growth strategies, our business, results of operations and financial condition may be materially and adversely affected.

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Changes in the interest rate environment could reduce our net interest income, which could reduce our profitability. As a financial institution, our earnings depend in part on our net interest income, which is the difference between the interest income that we earn on interest-earning assets, such as investment securities and loans, and the interest expense that we pay on interest-bearing liabilities, such as deposits and borrowings. Additionally, changes in interest rates affect the premiums we may receive in connection with the sale of SBA 7(a) loans in the secondary market, pre-payment speeds of loans for which we own servicing rights, our ability to fund our operations with customer deposits, and the fair value of securities in our investment portfolio. Therefore, any change in general market interest rates, including changes in federal fiscal and monetary policies, affects us more than non-financial companies and can have a significant effect on our net interest income and results of operations. Our assets and liabilities may react differently to changes in overall market rates or conditions because there may be mismatches between the repricing or maturity characteristics of the assets and liabilities. As a result, an increase or decrease in market interest rates could have material adverse effects on our net interest margin, noninterest income and results of operations. Further, since we began originating loans in May 2007 we have operated in a period of low market interest rates. In a rising interest rate environment, potential borrowers could seek to defer loans as they wait for interest rates to settle, and borrowers of variable rate loans may be subject to increased interest rates, which could result in a greater rate of default. Rising interest rates may also present additional challenges to our business that we have not anticipated.

We face strong competition from a diverse group of competitors.

The banking business is highly competitive, and we experience strong competition from many other financial institutions, including some of the largest commercial banks headquartered in the country, as well as other federally and state chartered financial institutions such as community banks and credit unions, finance and business development companies, consumer finance companies, peer-to-peer and marketplace lenders, securities brokerage firms, insurance companies, money market and mutual funds and other non-bank lenders.

We compete with these institutions both in attracting deposits and in making loans, primarily on the basis of the interest rates we pay and yield on these products. Many of our competitors are well-established, much larger financial institutions. While we believe we can successfully compete with these other lenders in our industry verticals, we may face a competitive disadvantage as a result of our smaller size. Furthermore, nothing would prevent our competitors from developing or licensing a technology-based platform similar to the technology-based platform we currently use in our business. In addition, many of our non-bank competitors have fewer regulatory constraints and may have lower cost structures. We expect competition to continue to intensify due to financial institution consolidation, legislative, regulatory and technological changes, and the emergence of alternative banking sources.

Our ability to compete successfully will depend on a number of factors, including, among other things:

- our ability to build and maintain long-term customer relationships while ensuring high ethical standards and safe and sound banking practices;
- the scope, relevance and pricing of products and services that we offer;
- customer satisfaction with our products and services;
- industry and general economic trends; and
- our ability to keep pace with technological advances and to invest in new technology.

Increased competition could require us to increase the rates we pay on deposits or lower the rates we offer on loans, which could reduce our profitability. Our failure to compete effectively in our primary markets could cause us to lose market share and could have a material adverse effect on our business, results of operations and financial condition.

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Prior to August 3, 2014, we were taxed as an S corporation under the Internal Revenue Code, and claims of taxing authorities related to our prior status as an S corporation could harm us.

We voluntarily terminated our S corporation status effective as of August 3, 2014, and we are now treated as a C corporation under the income tax provisions of the Internal Revenue Code of 1986, as amended, which is applicable to most corporations and imposes income tax on the corporation as an entity that is separate and distinct from its shareholders. If the open tax years in which we were an S corporation are audited by the Internal Revenue Service, and we are determined not to have qualified for, or to have violated, our S corporation status, we will be obligated to pay back taxes, interest and penalties, and we do not have the right to reclaim tax distributions that we have made to our shareholders during those periods. These amounts could include federal, state and any local taxes on all of our taxable income while we were an S corporation. Any such claims could result in additional costs to us and could have a material adverse effect on our business, results of operations and financial condition.

Our loan portfolio may be affected by deterioration in real estate markets, including declines in the performance of loans.

Deterioration in real estate markets could result in declining prices and excess inventories. As a result, developers may experience financial deterioration and banking institutions may experience declines in the performance of construction, development and commercial loans. We make credit and reserve decisions based on the current conditions of borrowers or projects combined with our expectations for the future. If conditions are worse than forecast, we could experience higher charge-offs and delinquencies than is provided in the allowance for loan losses, which could materially adversely affect our business, results of operations and financial condition.

A prolonged U.S. government shutdown or default by the U.S. on government obligations would harm our results of operations.

Our results of operations, including revenue, non-interest income, expenses and net interest income, would be adversely affected in the event of widespread financial and business disruption on account of a default by the United States on U.S. government obligations or a prolonged failure to maintain significant U.S. government operations, particularly those pertaining to the SBA or the FDIC. Any such failure to maintain such U.S. government operations would impede our ability to originate SBA loans or our ability to sell such loans in the secondary market, which would materially adversely affect our business, results of operations and financial condition.

Deterioration in the fiscal position of the U.S. federal government and downgrades in U.S. Treasury and federal agency securities could adversely affect us and our subsidiary's banking operations.

The long-term outlook for the fiscal position of the U.S. federal government is uncertain, as illustrated by the 2011 downgrade by certain rating agencies of the credit rating of the U.S. government and federal agencies. In addition to causing economic and financial market disruptions, any future downgrade, failure to raise the U.S. statutory debt limit, or deterioration in the fiscal outlook of the U.S. federal government, could, among other things, materially adversely affect the market value of the U.S. government and federal agency securities that we hold, the availability of those securities as collateral for borrowing, and our ability to access capital markets on favorable terms. In particular, it could increase interest rates and disrupt payment systems, money markets, and long-term or short-term fixed income markets, adversely affecting the cost and availability of funding, which could negatively affect our profitability. Also, the adverse consequences could extend to those to whom we extend credit and could adversely affect their ability to repay their loans. Any of these developments could materially adversely affect our business, results of operations and financial condition.

Deterioration in the commercial soundness of our counterparties could adversely affect us.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships, and we routinely execute transactions with counterparties in the financial industry. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, could create another market-wide liquidity crisis similar to that experienced in late 2008 and early 2009 and could lead to losses or defaults by us or by other institutions. The deterioration or failure of our counterparties would have a material adverse effect on our business, results of operations and financial condition.

We have different lending risks than larger, more diversified banks.

Our ability to diversify our economic risks is limited. We lend primarily to small businesses in selected industries, which may expose us to greater lending risks than those of banks lending to larger, better-capitalized businesses with longer operating histories.

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Small businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities and may have limited operating histories. If economic conditions negatively impact the verticals in which we operate, our business, results of operations and financial condition may be adversely affected.

We attempt to manage our credit exposure through careful monitoring of loan applicants and through loan approval and review procedures. We have established an evaluation process designed to determine the adequacy of our allowance for loan losses. While this evaluation process uses historical and other objective information, the classification of loans and the establishment of loan losses is an estimate based on experience, judgment and expectations regarding our borrowers, and the economies in which we and our borrowers operate, as well as the judgment of our regulators. This is an inherently uncertain process, and our loan loss reserves may not be sufficient to absorb future loan losses or prevent a material adverse effect on our business, results of operations and financial condition.

We rely heavily on our management team, and the unexpected loss of any of those personnel could adversely affect our operations; we depend on our ability to attract and retain key personnel.

We are a customer-focused and relationship-driven organization. We expect our future growth to be driven in a large part by the relationships maintained with our customers by our chief executive officer, president, and other senior officers. The unexpected loss of any of our key employees could have an adverse effect on our business, results of operations and financial condition. The implementation of our business strategy will also require us to continue to attract, hire, motivate and retain skilled personnel to develop new customer relationships as well as new financial products and services. We are not party to non-compete or non-solicitation agreements with any of our officers or employees. The market for qualified employees in the businesses in which we operate is competitive, and we may not be successful in attracting, hiring or retaining key personnel. Our inability to attract, hire or retain key personnel could have a material adverse effect on our business, results of operations and financial condition.

Our risk management framework may not be effective in mitigating risks and/or losses to us.

We have implemented a risk management framework to manage our risk exposure. This framework is comprised of various processes, systems and strategies, and is designed to manage the types of risk to which we are subject, including, among others, credit, market, liquidity, interest rate and compliance risks. Our framework also includes financial and other modeling methodologies which involve management assumptions and judgment. Our risk management framework may not be effective under all circumstances and it may fail to adequately mitigate risk or loss to us. If our framework is not effective, we could suffer unexpected losses and be subject to potentially adverse regulatory consequences, and our business, results of operations and financial condition could be materially and adversely affected.

Hurricanes or other adverse weather events could disrupt our operations, which could have an adverse effect on our business or results of operations.

North Carolina's coastal region is affected, from time to time, by adverse weather events, particularly hurricanes. We cannot predict whether, or to what extent, damage caused by future hurricanes or other weather events will affect our operations. Weather events could cause a disruption in our day-to-day business activities and could have a material adverse effect on our business, results of operations and financial condition.

Outbreaks of avian disease, such as avian influenza, or the perception that outbreaks may occur, could have a material adverse effect on lending operations in our Poultry Agriculture vertical.

Pandemic events beyond our control, such as an outbreak of avian disease, or "bird flu," could have a material adverse effect on the performance of our portfolio of loans in our Poultry Agriculture vertical and on the demand for new loans in this vertical. An outbreak of disease could result in governmental restrictions on the import and export of fresh and frozen chicken or other poultry products to or from our customers. This could result in the cancellation of orders and the curtailment of farming operations by our customers and could create adverse publicity that may have a material adverse effect on the performance of our existing loans and future business prospects in our Poultry Agriculture vertical. In addition, consumer fears about avian disease have, in the past, depressed demand for fresh poultry, which may adversely impact the demand for future loans and the performance of existing loans in our Poultry Agriculture vertical.

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If we fail to maintain an effective system of internal control over financial reporting, we may not be able to accurately report our financial results. As a result, current and potential shareholders could lose confidence in our financial reporting which would harm our business and the trading price of our securities.

If we identify material weaknesses in our internal control over financial reporting or are otherwise required to restate our financial statements, we could be required to implement expensive and time-consuming remedial measures and could lose investor confidence in the accuracy and completeness of our financial reports. We may also face regulatory enforcement or other actions, including the potential delisting of our securities from NASDAQ. This could have a material adverse effect on our business, financial condition and results of operations, and could subject us to litigation. Changes in accounting standards and management's selection of accounting methods, including assumptions and estimates, could materially impact our financial statements.

From time to time the SEC and the Financial Accounting Standards Board, or FASB, update accounting principles generally accepted in the United States ("GAAP") that govern the preparation of our financial statements. These changes can be hard to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in changes to previously reported financial results, or a cumulative charge to retained earnings. In addition, management is required to use certain assumptions and estimates in preparing our financial statements, including determining the fair value of certain assets and liabilities, among other items. If the assumptions or estimates are incorrect, we may experience unexpected material adverse consequences that could negatively affect our business, results of operations and financial condition.

Our business reputation is important and any damage to it could have a material adverse effect on our business.

Our reputation is very important to sustain our business, as we rely on our relationships with our current, former and potential customers and shareholders, and the industries that we serve. Any damage to our reputation, whether arising from legal, regulatory, supervisory or enforcement actions, matters affecting our financial reporting or compliance with SEC and exchange listing requirements, negative publicity, the conduct of our business or otherwise could have a material adverse effect on our business, results of operations and financial condition.

Insiders have substantial control over us, and this control may limit our shareholders' ability to influence corporate matters and may delay or prevent a third party from acquiring control over us.

As of January 31, 2016, our directors and executive officers and their related entities currently beneficially own, in the aggregate, approximately 29.8% of our outstanding common stock. The significant concentration of stock ownership may adversely affect the trading price of our common stock due to investors' perception that conflicts of interest may exist or arise. In addition, these shareholders will be able to exercise influence over all matters requiring shareholder approval, including the election of directors and approval of corporate transactions, such as a merger or other sale of our company or its assets. This concentration of ownership could limit your ability to influence corporate matters and may have the effect of delaying or preventing a change in control, including a merger, consolidation or other business combination involving us, or discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control, even if that change in control would benefit our other shareholders. For information regarding the ownership of our outstanding stock by our executive officers and directors and related entities, see "Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters" in this Report.

Risks Related to Our Regulatory Environment

We are subject to extensive regulation that could limit or restrict our activities.

We operate in a highly regulated industry and are subject to examination, supervision, and comprehensive regulation by various federal and state regulatory agencies. Our compliance with these regulations is costly and restricts certain of our activities, including the declaration and payment of cash dividends to shareholders, mergers and acquisitions, investments, loans and interest rates charged, interest rates paid on deposits, and locations of offices. We are also subject to capitalization guidelines established by our regulators, which require us to maintain adequate capital to support our growth and operations. Should we fail to comply with these regulatory requirements, federal and state regulators could impose additional restrictions on the activities of the Company and the Bank, which could materially and adversely affect our business, results of operations and financial condition.

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The laws and regulations applicable to the banking industry have recently changed and may continue to change, and we cannot predict the effects of these changes on our business and profitability. Because government regulation greatly affects the business and financial results of all commercial banks and bank holding companies, our cost of compliance could adversely affect our business, results of operations and financial condition.

The Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, was enacted on July 21, 2010. The provisions of the Dodd-Frank Act, and its implementing regulations may materially and adversely affect our business, results of operations and financial condition. Some or all of the changes, including the new rulemaking authority granted to the Consumer Financial Protection Bureau, or the CFPB, may result in greater liability, reporting requirements, assessment fees, operational restrictions, capital requirements, and other regulatory burdens applicable to us while many of our non-bank competitors may remain free from such burdens. The changes arising out of the Dodd-Frank Act could adversely affect our ability to attract and maintain depositors, to offer competitive products and services, to attract and retain key personnel and to expand our business.

Congress may consider additional proposals to change substantially the financial institution regulatory system and to expand or contract the powers of banking institutions and bank holding companies. Such legislation may change existing banking statutes and regulations, as well as our current operating environment significantly. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand our permissible activities, or affect the competitive balance among banks, savings associations, credit unions, other financial institutions and non-bank lenders. We cannot predict whether new legislation will be enacted and, if enacted, the effect that it, or any regulations, would have on our business, results of operations or financial condition.

Our financial condition and results of operations are affected by credit policies of monetary authorities, particularly the Federal Reserve. Actions by monetary and fiscal authorities, including the Federal Reserve, could have an adverse effect on our deposit levels, loan demand, or business and earnings, as well as the value of our common stock.

We may be required to raise additional capital in the future, including to comply with new increased minimum capital thresholds established by our regulators as part of their implementation of Basel III, but that capital may not be available when it is needed and could be dilutive to our existing shareholders, which could adversely affect our financial condition and results of operations.

In July 2013, the Federal Reserve, FDIC and Office of the Comptroller of the Currency approved final rules that establish an integrated regulatory capital framework that addresses perceived shortcomings in certain capital requirements. The rules implement in the United States the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain changes required by the Dodd-Frank Act.

The major provisions of the rule applicable to the Company are:

The rule implements higher minimum capital requirements, includes a new common equity Tier 1 capital requirement, and establishes criteria that instruments must meet in order to be considered Common Equity Tier 1 capital, additional Tier 1 capital, or Tier 2 capital. These enhancements are intended to both improve the quality and increase the quantity of capital required to be held by banking organizations. The minimum capital to risk-weighted assets (“RWA”) requirements under the rule are a common equity Tier 1 capital ratio of 4.5% and a Tier 1 capital ratio of 6.0%, which is an increase from 4.0%, and a total capital ratio that remains at 8.0%. The minimum leverage ratio (Tier 1 capital to total assets) is 4.0%. The rule maintains the general structure of the current prompt corrective action, or PCA, framework while incorporating these increased minimum requirements.

The rule implements changes to the definition of capital. Among the most important changes are stricter eligibility criteria for regulatory capital instruments that would disallow the inclusion of instruments such as trust preferred securities in Tier 1 capital going forward, and new constraints on the inclusion of minority interests, mortgage-servicing assets (“MSAs”), deferred tax assets (“DTAs”), and certain investments in the capital of unconsolidated financial institutions. In addition, the rule requires that certain regulatory capital deductions be made from common equity Tier 1 capital.

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Under the rule, in order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold a capital conservation buffer composed of common equity Tier 1 capital above its minimum risk-based capital requirements. The buffer is measured relative to RWA. Phase-in of the capital conservation buffer requirements began on January 1, 2016. A banking organization with a buffer greater than 2.5% would not be subject to limits on capital distributions or discretionary bonus payments; however, a banking organization with a buffer of less than 2.5% would be subject to increasingly stringent limitations as the buffer approaches zero. The rule also prohibits a banking organization from making distributions or discretionary bonus payments during any quarter if its eligible retained income is negative in that quarter and its capital conservation buffer ratio was less than 2.5% at the beginning of the quarter. When the rule is fully phased in, the minimum capital requirements plus the capital conservation buffer will exceed the PCA well-capitalized thresholds.

The rule also increases the risk weights for past-due loans, certain commercial real estate loans, and some equity exposures, and makes selected other changes in risk weights and credit conversion factors.

Compliance by LOB and the Bank with these capital requirements affects their respective operations by increasing the amount of capital required to conduct operations. In order to support the operations at the Bank, we may need to raise capital in the future. Our ability to raise capital will depend in part on conditions in the capital markets at that time, which are outside our control. Accordingly, we may be unable to raise capital on terms acceptable to us if at all. If we cannot raise capital when needed, our ability to operate or further expand our operations could be materially impaired. In addition, if we decide to raise equity capital under such conditions, the interests of our shareholders could be diluted.

Our deposit operations are subject to extensive regulation, and we expect additional regulatory requirements to be implemented in the future.

We are subject to significant anti-money laundering, “know your customer” and other regulations under applicable law, including the Bank Secrecy Act and the USA Patriot Act, and we could become subject in the future to additional regulatory requirements beyond those that are currently adopted, proposed or contemplated. We expect that federal and state bank regulators will increase their oversight, inspection and investigatory role over our deposit operations and the financial services industry generally. Furthermore, we intend to increase our deposit product offerings and grow our customer deposit portfolio in the future and, as a result, we are, and will continue to be, subject to heightened compliance and operating costs that could adversely affect our business, results of operations and financial condition. In addition, legal and regulatory proceedings and other contingencies will arise from time to time that may have an adverse effect on our business practices and results of operations.

The FDIC Deposit Insurance assessments that we are required to pay may continue to materially increase in the future, which would have an adverse effect on our earnings.

As a member institution of the FDIC, we are assessed a quarterly deposit insurance premium. Failed banks nationwide have significantly depleted the insurance fund and reduced the ratio of reserves to insured deposits. As a result, we may be required to pay significantly higher premiums or additional special assessments that could adversely affect our business, results of operations and financial condition.

On October 19, 2010, the FDIC adopted a Deposit Insurance Fund, or DIF, Restoration Plan, which requires the DIF to attain a 1.35% reserve ratio by September 30, 2020. The Dodd-Frank Act directs the FDIC to “offset the effect” of the increased reserve ratio for insured depository institutions with total consolidated assets of less than \$10 billion. In addition, the FDIC modified the method by which assessments are determined and, effective April 1, 2011, adjusted assessment rates, which will range from 2.5 to 45 basis points (annualized), subject to adjustments for unsecured debt and, in the case of small institutions outside the lowest risk category and certain large and highly complex institutions, brokered deposits. Further increased FDIC assessment premiums, due to our risk classification, emergency assessments, or implementation of the modified DIF reserve ratio, could have a material adverse effect on our business, results of operations and financial condition.

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Risks Related to our Common Stock

The low trading volume in our common stock may adversely affect your ability to resell shares at prices that you find attractive or at all.

Our common stock is listed for quotation on the Nasdaq Global Select Market under the ticker symbol “LOB”. The average daily trading volume for our common stock is less than that of larger financial institutions. From July 24, 2015, to February 29, 2016, the average daily trading volume for our common stock was approximately 97,585 shares. Due to its relatively low trading volume, sales of our common stock may place significant downward pressure on the market price of our common stock. Furthermore, it may be difficult for holders to resell their shares at prices they find attractive, or at all.

We are an “emerging growth company,” and the reduced reporting requirements applicable to emerging growth companies may make our common stock less attractive to investors.

We are an “emerging growth company,” as defined in the federal securities laws. For as long as we continue to be an emerging growth company, we may take advantage of exemptions from various reporting requirements that are applicable to other public companies that are not emerging growth companies, including reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and shareholder approval of any golden parachute payments not previously approved. We could be an emerging growth company for up to five years, although we could lose that status sooner if our gross revenues exceed \$1.0 billion, if we issue more than \$1.0 billion in non-convertible debt in a three-year period, or if the market value of our common stock held by non-affiliates exceeds \$700 million as of any June 30 before that time, in which case we would no longer be an emerging growth company as of the following December 31. We cannot predict if investors will find our common stock less attractive because we may rely on these exemptions, or if we choose to rely on additional exemptions in the future. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock price may be more volatile.

Securities analysts may not initiate or continue coverage on our common stock.

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

Future sales of shares of our common stock by existing shareholders could depress the market price of our common stock.

LOB had 34,176,256 shares of common stock outstanding at January 31, 2016, none of which remain subject to post-IPO lock-up agreements. In addition, as of January 31, 2016, there were outstanding options to purchase 3,543,531 shares of our common stock that, if exercised, will result in these additional shares becoming available for sale. A large portion of these shares and options are held by a small number of persons. Sales by these shareholders or option holders of a substantial number of shares could significantly reduce the market price of our common stock.

Our ability to pay cash dividends on our securities is limited and we may be unable to pay future dividends.

We may not declare or pay dividends on our securities, including our common stock, in the future. Any future determination relating to dividend policy will be made at the discretion of our board of directors and will depend on a number of factors, including our future earnings, capital requirements, financial condition, future prospects, regulatory restrictions, and other factors that our board of directors may deem relevant. The holders of our capital stock are entitled to receive dividends when, and if, declared by our board of directors out of funds legally available for that purpose. As part of our consideration to pay cash dividends, we intend to retain adequate funds from future earnings to support the development and growth of our business. In addition, our ability to pay dividends is restricted by federal policies and regulations. It is the current policy of the Federal Reserve that bank holding companies should pay cash

dividends on capital stock only out of net income available over the past year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. Further, our principal source of funds to pay dividends is cash dividends that we receive from the Bank, which, in turn, will be highly dependent upon the Bank's historical and projected results of operations, liquidity, cash flows and financial condition, as well as various legal and regulatory prohibitions and other restrictions on the ability of the Bank to pay dividends, extend credit or otherwise transfer funds to LOB.

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Additional issuances of common stock or securities convertible into common stock may dilute holders of our common stock.

LOB may, in the future, determine that it is advisable, or LOB may encounter circumstances where it is determined that it is necessary, to issue additional shares of common stock, securities convertible into, exchangeable for or that represent an interest in common stock, or common stock-equivalent securities to fund strategic initiatives or other business needs or to build additional capital. Our board of directors is authorized to cause us to issue additional shares of common stock from time to time for adequate consideration without any additional action on the part of our shareholders. The market price of our common stock could decline as a result of other offerings, as well as other sales of a large block of common stock or the perception that such sales could occur.

LOB is subject to extensive regulation, and ownership of its common stock may have regulatory implications for holders thereof.

LOB is subject to extensive federal and state banking laws, including the Bank Holding Company Act of 1956, as amended, or BHCA, and federal and state banking regulations, that will impact the rights and obligations of owners of its common stock, including, for example, its ability to declare and pay dividends on its common stock. Shares of LOB's common stock are voting securities for purposes of the BHCA and any bank holding company or foreign bank that is subject to the BHCA may need approval to acquire or retain more than 5% of the then outstanding shares of LOB's common stock, and any holder (or group of holders deemed to be acting in concert) may need regulatory approval to acquire or retain 10% or more of the shares of LOB's common stock. A holder or group of holders may also be deemed to control LOB if they own 25% or more of our total equity. Under certain limited circumstances, a holder or group of holders acting in concert may exceed the 25% percent threshold and not be deemed to control us until they own 33% percent or more of our total equity. The amount of total equity owned by a holder or group of holders acting in concert is calculated by aggregating all shares held by the holder or group, whether as a combination of voting or non-voting shares or through other positions treated as equity for regulatory or accounting purposes and meeting certain other conditions. Holders of LOB common stock should consult their own counsel with regard to regulatory implications.

Holders should not expect us to redeem or repurchase outstanding shares of LOB common stock.

LOB's common stock is a perpetual equity security. This means that it has no maturity or mandatory redemption date and will not be redeemable at the option of the holders. Any decision LOB may make at any time to propose the repurchase or redemption of shares of its common stock will depend upon, among other things, our evaluation of the Company's capital position, the composition of our shareholders' equity, general market conditions at that time and other factors we deem relevant. LOB's ability to redeem shares of its common stock is subject to regulatory restrictions and limitations, including those of the Federal Reserve Board.

Offerings of debt, which would rank senior to LOB's common stock upon liquidation, may adversely affect the market price of LOB common stock.

The Company may attempt to increase its capital resources or, if regulatory capital ratios fall below the required minimums, The Company could be forced to raise additional capital by making additional offerings of debt or equity securities, senior or subordinated notes, preferred stock and common stock. Upon liquidation, holders of the Company's debt securities and lenders with respect to other borrowings will receive distributions of available assets prior to the holders of LOB common stock.

Anti-takeover provisions could adversely affect LOB shareholders.

In some cases, shareholders would receive a premium for their shares if LOB were acquired by another company. However, state and federal law and LOB's articles of incorporation and bylaws make it difficult for anyone to acquire the Company without approval of the LOB board of directors. For example, LOB's articles of incorporation require a supermajority vote of two-thirds of our outstanding common stock in order to effect a sale or merger of the company in certain circumstances. Consequently, a takeover attempt may prove difficult, and shareholders may not realize the highest possible price for their securities.

Shares of LOB common stock are not insured deposits and may lose value.

Shares of LOB common stock are not savings accounts, deposits or other obligations of any depository institution and are not insured or guaranteed by the FDIC or any other governmental agency or instrumentality, any other deposit insurance fund or by any other public or private entity. An investment in our common stock is inherently risky for the reasons described in this “Risk Factors” section. As a result, if you acquire shares of our common stock, you may lose some or all of your investment.

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Item 1B. UNRESOLVED STAFF COMMENTS

There were no unresolved comments received from the SEC regarding LOB's periodic or current reports.

Item 2. PROPERTIES

The following table sets forth the location of the Company's main office, as well as additional offices and certain information relating to the facilities.

Office	Address	Year Opened	Approximate Square Footage	Owned or Leased
Main Office	1741 Tiburon Dr	2013	36,000	Owned
Satellite Wilmington Office	2605 Irongate Dr Ste. 100	2013	10,632	Leased
Atlanta Loan Production Office	3060 Peachtree Rd Ste. 1220	2010	4,455	Leased
Fayetteville, AR Office	2027 E Millennium Pl Ste 2	2014	1,575	Leased
Gainesville, GA Office	500 Jesse Jewell Pkwy Ste. 200	2014	843	Leased
Santa Rosa, CA Office	100 B Street Ste. 100	2015	2,386	Leased
Houston, TX Relationship Office	16801 Greenspoint Park Dr Ste. 395	2015	3,387	Leased

The Company believes that its properties are maintained in good operating condition and are suitable and adequate for its operational needs.

Item 3. LEGAL PROCEEDINGS

In the ordinary course of operations, LOB and the Bank are at times involved in legal proceedings. In the opinion of management, as of December 31, 2015 there are no material pending legal proceedings to which LOB, or any of its subsidiaries, is a party, or of which any of their property is the subject.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

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

Market Information

From July 23, 2015 through December 31, 2015, the Company's voting common stock was listed for trading on the NASDAQ Global Select Market under the symbol "LOB." Quotations of the sales volume and the closing sales prices of the voting common stock of the Company are listed daily in the NASDAQ Global Select Market's listings. As of December 31, 2015, there were 34,172,899 shares outstanding (comprised of 29,449,369 voting common shares and 4,723,530 non-voting common shares) and 270 holders of record (comprised of 265 holders of record for voting common shares and 5 holders of record for non-voting common shares) for the Company's common stock. The Company's non-voting common stock is not listed for trading on any exchange.

The following table sets forth the quarterly high and low closing prices for the Company's voting common stock as reported by the NASDAQ Global Select Market and the dividends declared per share of common stock for each quarter since the initial public offering:

	Closing Price		Cash Dividends Declared
	High	Low	
2015			
Third Quarter (beginning July 23, 2015)	\$20.65	\$18.62	\$0.01
Fourth Quarter	\$19.34	\$12.88	\$0.01

Dividend Policy

On September 9, 2015 the Company declared its first quarterly cash dividend of \$0.01 per share since completing its IPO. Since declaring this dividend, the Company has declared a dividend to stockholders in each subsequent quarter, with the most recent declared in February 2016.

The timing and amount of cash dividends paid depends on the Company's earnings, capital requirements, financial condition and other relevant factors. Although the Company has begun paying quarterly cash dividends to its stockholders, stockholders are not entitled to receive dividends. Downturns in domestic and global economies and other factors could cause the Company's board of directors to consider, among other things, the elimination of or reduction in the amount and/or frequency of cash dividends paid on the Company's common stock. See "Supervision and Regulation" under Item 1 of this Report for more information on restrictions on the Company's ability to declare and pay dividends. The Company can offer no assurance that the board of directors will continue to declare or pay cash dividends in any future period.

Recent Sales of Unregistered Securities

None.

Securities Authorized for Issuance under Equity Compensation Plans

See item 12 of this report for disclosure regarding securities authorized for issuance and equity compensation plans required by Item 201(d) of Regulation S-K.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

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Item 6. SELECTED FINANCIAL DATA

The tables below set forth selected consolidated financial data as of the dates or for the periods indicated. This data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 and the Consolidated Financial Statements and Notes in Item 8 of this Report.

(dollars in thousands, except per share data)

	As of and for the Year Ended December 31,				
	2015	2014	2013	2012	2011
Income Statement Data					
Net interest income	\$25,589	\$14,713	\$10,779	\$8,097	\$6,007
Provision for (recovery of) loan loss	3,806	2,793	(858)	2,110	2,855
Noninterest income	84,328	60,042	56,477	42,430	32,127
Noninterest expense	71,715	54,526	40,172	33,619	20,967
Income, before income taxes	34,396	17,436	27,942	14,798	14,312
Income tax expense	13,795	7,388	—	—	—
Net income	20,601	10,048	27,942	14,798	14,312
Net income attributable to noncontrolling interest	24	—	120	1,297	—
Net income to common shareholders	20,625	10,048	28,062	16,095	14,312
Net income (net of tax effect) (1)	20,625	10,723	17,258	9,899	8,802
Period End Balances					
Assets	1,052,622	673,315	430,355	342,468	266,157
Loans held for sale	480,619	295,180	159,438	145,183	111,877
Loans held for investment	279,969	203,936	141,349	92,669	85,721
Allowance for loan losses	7,415	4,407	2,723	5,108	4,617
Deposits	804,788	522,080	356,620	286,674	222,163
Borrowings	28,375	47,949	12,325	12,205	8,659
Shareholder's equity	199,488	91,814	48,390	31,760	27,583
Per Common Share Data					
Net income per share - basic	0.66	0.42	1.38	0.83	0.82
Net income per share - diluted	0.65	0.41	1.37	0.80	0.70
Net income per share (net of tax effect) - basic (1)	0.66	0.45	0.85	0.51	0.50
Net income per share (net of tax effect) - diluted (1)	0.65	0.44	0.84	0.49	0.43
Operating net income per share (Non-GAAP) - basic	0.54	0.57	0.48	0.51	0.50
Operating net income per share (Non-GAAP) - diluted	0.53	0.56	0.48	0.49	0.42
Dividends declared	0.10	2.18	0.48	0.59	0.55
Book value	5.84	3.21	2.38	1.57	1.46
Tangible book value	5.84	3.20	2.36	1.57	1.46

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	As of and for the Year Ended December 31,					
	2015	2014	2013	2012	2011	
Performance Ratios						
Return on average assets	2.26	% 1.77	% 6.53	% 5.01	% 5.75	%
Return on average equity	14.52	14.11	62.82	51.67	61.64	
Return on average assets (net of tax effect) (1)	2.26	1.89	4.02	3.08	3.54	
Return on average equity (net of tax effect) (1)	14.52	15.05	38.63	31.78	37.91	
Net interest margin	3.26	3.04	2.95	2.83	2.81	
Efficiency ratio	65.25	72.87	59.74	66.54	54.98	
Noninterest income to total revenue	76.72	80.34	83.97	83.97	84.25	
Average equity to average assets	15.53	12.56	10.40	9.69	9.33	
Dividend payout ratio (inclusive of tax distributions)	15.15	447.33	10.65	33.56	20.70	
Dividend payout ratio (net of tax effect) (1)	15.15	419.17	17.32	54.57	33.66	
Selected Loan Metrics						
Loans originated	\$ 1,158,640	\$ 848,090	\$ 498,752	\$ 413,763	\$ 306,637	
Guaranteed loans sold	640,886	433,912	339,342	276,676	238,442	
Average net gain on sale of loans	105.14	115.18	112.64	121.21	94.83	
Held for sale guaranteed loans (note amount) (3)	497,875	326,723	144,228	121,666	97,089	
Annual increase in held for sale guaranteed loans (note amount)	171,152	182,495	22,562	24,577	N/A	
Estimated net gain to be recognized on annual increase in guaranteed loans held for sale (2)	17,995	21,020	2,541	2,979	N/A	
Asset Quality Ratios						
Allowance for loan losses to loans held for investment	2.65	% 2.16	% 1.93	% 5.51	% 5.39	%
Net charge-offs to average loans held for investment	0.37	1.21	3.47	4.92	1.96	
Nonperforming loans	\$ 12,367	\$ 18,692	\$ 8,697	\$ 8,593	\$ 9,871	
Foreclosed assets	2,666	1,084	773	1,518	—	
Nonperforming loans (unguaranteed exposure)	2,037	3,137	1,714	3,531	3,081	
Foreclosed assets (unguaranteed exposure)	373	371	341	232	—	
Nonperforming loans not guaranteed by the SBA and foreclosed assets	2,410	3,508	2,055	3,763	3,081	
Nonperforming loans not guaranteed by the SBA and foreclosed assets to total assets	0.23	% 0.52	% 0.48	% 1.10	% 1.16	%
Capital and Liquidity Ratios						
Common equity tier 1 capital (to risk-weighted assets)	23.22	% N/A	N/A	N/A	N/A	
Total capital (to risk-weighted assets)	24.12	19.63	% 15.95	% 17.91	% 18.40	%

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Tier 1 risk-based capital (to risk-weighted assets)	23.22	17.41	15.09	16.65	17.13
Tier 1 leverage capital (to average assets)	18.36	13.38	10.39	10.63	11.84

Net income (net of tax effect), earnings per share (net of tax effect) on a basic and diluted basis, return on average assets (net of tax effect), and return on average equity (net of tax effect) for each year shown was determined by calculating a provision for income taxes using an assumed annual effective income tax rate of 38.5% for the years (1) ended December 31, 2014, 2013, 2012 and 2011, and adjusting our historical net income for each period presented to give effect to the pro forma provision for federal and state income taxes for such year. For the year ended December 31, 2014 the Company also excluded the initial deferred tax liability recorded as a result of the change in tax status on August 3, 2014 due to the conversion from an S corporation to a C corporation.

(2) The estimated revenue from the sale of the annual increase in guaranteed loans is based on the average net gain of loans for that year.

(3) Includes the entire note amount, including undisbursed funds for multi-advance loans.

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

Overview

The following presents management's discussion and analysis for the more significant factors that affected the Company's financial condition as of December 31, 2015 and 2014 and results of operations for each of the years in the three-year period ended December 31, 2015. This discussion should be read in conjunction with the financial statements and related notes included elsewhere in this Annual Report on Form 10-K. Results of operations for the periods included in this review are not necessarily indicative of results to be obtained during any future period. Dollar amounts in tables are stated in thousands, except for per share amounts.

Nature of Operations

Live Oak Bancshares, Inc. ("LOB" and, collectively with its subsidiaries including Live Oak Banking Company, the "Company") is a bank holding company headquartered in Wilmington, North Carolina incorporated under the laws of North Carolina in December 2008. The Company conducts business operations primarily through its commercial bank subsidiary, Live Oak Banking Company (the "Bank"). The Bank was established in May 2008 as a North Carolina-chartered commercial bank. The Bank specializes in providing lending services to small businesses nationwide in targeted industries. The Bank identifies and seeks to grow within selected industry sectors, or verticals, by leveraging expertise within those industries. A significant portion of the loans originated by the Bank are guaranteed by the Small Business Administration ("SBA") under the 7(a) program. In 2010, the Bank formed Live Oak Number One, Inc., a wholly-owned subsidiary, to hold properties foreclosed on by the Bank.

In addition to the Bank, the Company owns Live Oak Grove, LLC, opened in September 2015 for the purpose of providing Company employees and business visitors an on-site restaurant location, Government Loan Solutions, Inc. ("GLS"), a management and technology consulting firm that specializes in the settlement, accounting, and securitization processes for government guaranteed loans, including loans originated under the SBA 7(a) loan program and USDA-guaranteed loans, and 504 Fund Advisors, LLC ("504FA"), which was formed to serve as the investment advisor to the 504 Fund, a closed-end mutual fund organized to invest in SBA section 504 loans.

The Company generates revenue primarily from the sale of SBA-guaranteed loans and net interest income. Income from the sale of loans is comprised of loan servicing revenue and revaluation and net gains on sales of loans. Offsetting these revenues are the cost of funding sources, provision for loan losses, any costs related to foreclosed assets and other operating costs such as salaries and employee benefits, travel, professional services, advertising and marketing and tax expense.

Conversion from S Corporation to C Corporation

Effective August 3, 2014, the Company terminated its status as an "electing small business corporation," or S corporation, under Subchapter S of the Internal Revenue Code of 1986, or the Code, and became a C corporation under the Code for income tax purposes. As a result of the conversion to a C corporation, the Company recorded a net deferred tax liability of \$3.3 million on the balance sheet. Upon recognition of the deferred tax liability the Company also recorded an offsetting adjustment to income tax expense of \$3.3 million, which decreased after-tax earnings and shareholders' equity by the same amount.

Executive Summary

Following is a summary of the Company's financial highlights and events for 2015:

During 2015, the Company entered into four new verticals bringing the total of industries served at year-end to eleven. It also developed and began providing loans in a pilot program through eLending. eLending is a highly efficient technology-based platform for smaller, less complex business loans of up to \$350,000. The initiative was publicly launched in February 2016.

• Loan production increased to \$1.16 billion for 2015, a 36.6% increase over 2014.

• Guaranteed loan sales increased by \$207.0 million, or 47.7%, to \$640.9 million in 2015.

• Loans held for investment increased by \$76.0 million, or 37.3%, to \$280.0 million at the end of 2015.

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Asset quality continued to improve as nonperforming unguaranteed loans declined by \$1.1 million, or 35.1%, to \$2.0 million at the end of 2015 from \$3.1 million at the end of 2014.

Core recurring revenues consisting of net interest income, servicing revenue and gains on sale of loans increased to \$109.1 million, a 40.7% increase over 2014.

Adjusted pre-tax net income, which excludes non-recurring income and expenses, improved \$8.5 million over 2014, or 38.5% to \$30.6 million. Reported net income on a comparable basis increased by 105.3% over 2014 to \$20.6 million.

Return on average assets increased to 2.26% for 2015 from 1.77% for 2014.

On July 23, 2015, the Company closed on its initial public offering issuing 5,500,000 shares of voting common stock, no par value, at \$17.00 per share, in exchange for total proceeds of \$87.2 million, net of issue costs. Consequently, total shareholders' equity rose significantly to \$199.5 million at December 31, 2015 from \$91.8 million on December 31, 2014.

Business Outlook

Below is a discussion of management's current expectations regarding company performance over the near-term based on market conditions, the regulatory environment and business strategies as of the time the Company filed this Report. Actual outcomes and results may differ materially from what is expressed or forecasted in these forward-looking statements. See "Important Note Regarding Forward-Looking Statements" in this Report for more information on forward-looking statements.

The Company's results for 2015 demonstrated strong underlying financial performance and solid growth momentum. Management continues to focus not only on building out existing verticals but incrementally adding new verticals to the loan portfolio. The Company expects to originate approximately \$1.35 billion in loans in 2016, with approximately 40% of those loans fully funded at closing. Management anticipates that the Company's held-for-sale and held-for-investment loan portfolios will continue to grow as a result of growth in the construction portfolio as well as strategic business decisions, including the pursuit of potential opportunities in conventional lending outside of SBA or other government guarantee programs. Noninterest expenses are expected to increase as a result of investments to support this expected growth in loan production as well as other infrastructure costs.

Non-GAAP Financial Measures

Statements included in this management's discussion and analysis include non-GAAP financial measures and should be read along with the accompanying tables which provide a reconciliation of non-GAAP financial measures to GAAP financial measures. The reconciliation of non-GAAP measures is presented at the conclusion of this Item 7 section.

Management believes that non-GAAP financial measures provide additional useful information that allows readers to evaluate the ongoing performance of the Company without regard to transactional activities. Non-GAAP financial measures should not be considered as an alternative to any measure of performance or financial condition as promulgated under GAAP, and investors should consider the Company's performance and financial condition as reported under GAAP and all other relevant information when assessing the performance or financial condition of the Company. Non-GAAP financial measures have limitations as analytical tools, and investors should not consider them in isolation or as a substitute for analysis of the Company's results or financial condition as reported under GAAP.

Results of Operations

Years ended December 31, 2015 vs. 2014

The Company reported net income available to common shareholders totaling \$20.6 million, or \$0.65 per diluted share, for 2015 compared to \$10.0 million, or \$0.41 per diluted share, for 2014. This increase in net income is primarily attributable to the following items:

An increase in net interest income of \$10.9 million, or 73.9%, arising primarily from higher levels of loans held for sale related to originations in newer verticals that require a lengthier period of loan advances before being sold; and

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An increase in noninterest income of \$24.3 million, or 40.4%, predominately composed of \$17.4 million, or 34.8%, growth in net gains on sale of loans, the absence of \$2.2 million in one-time losses in 2014 on investments in non-consolidated affiliates and a one-time gain of \$3.8 million related to the sale of an investment in nCino, Inc., a former subsidiary of the Company (“nCino”), partially offset by a \$770 thousand, or 7.2%, decrease in loan servicing revenue and revaluation arising from increased negative servicing asset valuation adjustments of \$4.0 million in 2015. Further offsetting the above items which contributed to increased levels of net income was an increase in noninterest expense of \$17.2 million, or 31.5%. The increased level of noninterest expense was principally driven by costs underlying increased loan production and the build out of new initiatives of the Company, including increases to salaries and benefits of \$11.2 million, or 38.3%, and to travel expense of \$2.0 million, or 36.9%. Also partially offsetting the contributors to increased levels of net income was an increase to income tax expense of \$6.4 million, or 86.7%, arising from the Company’s status as a C Corporation commencing on August 3, 2014, and growing profitability.

Years ended December 31, 2014 vs. 2013

For the year ended December 31, 2014, the Company reported net income of \$10.0 million, or \$0.41 per diluted share, a decrease of \$18.1 million, or 64.2%, compared to net income of \$28.1 million for the year ended December 31, 2013. The net income decrease resulted primarily from an increase in non-operating expenses incurred in 2014 and the impact of the conversion to a C corporation in August 2014, offset by a moderate increase in noninterest income. The recognition of a one-time gain in January 2013 in connection with the deconsolidation of the previously consolidated subsidiary, nCino, in the amount of \$12.2 million resulted in marginal growth in noninterest income of \$3.6 million in 2014. Offsetting this one-time gain in fiscal year 2013 were losses recognized for equity method investments of \$2.8 million, principally related to allocated losses from nCino of \$1.8 million subsequent to its deconsolidation. In June 2014, the Company divested its ownership in nCino to its shareholders in the form of a dividend with a subsequent cost method investment in nCino of \$6.1 million in August of 2014. For the year ended December 31, 2014, noninterest expense totaled \$54.5 million, an increase of 35.6% compared to the year ended December 31, 2013. Net income, excluding non-recurring expenses related to a stock grant to key employees, recognition of a deferred tax liability upon conversion from an S corporation to a C corporation, expenses related to the exploration of capital raising alternatives and C corporation income tax expense for the last five months of 2014, net of an effective tax rate of 38.5% for the full year, totaled approximately \$13.6 million in 2014. Adjusted for significant non-recurring income and expenses for fiscal years 2013 and 2014, noninterest income increased \$15.8 million, or 35.6%, while noninterest expense increased \$9.7 million, or 24.1%, in fiscal year 2014 compared to fiscal year 2013. Other than the reasons for the increase in net income before adjustment for non-recurring income and expenses, additional primary drivers of the increase in net income excluding non-recurring items was the exclusion of the deconsolidation gain of \$12.2 million from 2013 income along with the exclusion of 2014 expenses related to the foregone initial public offering of \$1.7 million and \$3.0 million in stock grant expense. After-tax net income adjusted for non-recurring income and expenses for the year ended December 31, 2014 increased \$3.8 million, or 39.4%, compared to the year ended December 31, 2013. For more information and a reconciliation of net income adjusted for non-recurring income and expense see “Non-GAAP Measures.”

For the year ended December 31, 2014, revenue generated from core banking operations of net interest income, loan servicing revenue, and net gain on sale of loans increased \$3.9 million, \$2.6 million, and \$11.8 million, respectively, compared to the corresponding amounts for the year ended December 31, 2013. The net gain on sale of loans was positively impacted by an increase in the volume of guaranteed loans sold of \$94.6 million, as well as by an increase in the revenue recognized for each loan sold. Gross revenue recognized for loan sales increased from an average \$113 thousand per million for fiscal year 2013 to an average of \$115 thousand per million for fiscal year 2014, due to changes in market rates. For the same period, the net loss resulting from the revaluation of servicing rights totaled \$2.2 million, a decrease of \$146 thousand compared to the year ended December 31, 2013, as a result of amortization of the serviced portfolio, changes in prepayment speeds, and prevailing market conditions. As the current market improves or deteriorates, the value of the existing servicing asset responds accordingly. Noninterest expense increased

approximately \$14.4 million, or 35.7%, compared to the year ended December 31, 2013, primarily as the result of increasing personnel and infrastructure to support growth in the loan portfolio. For the year ended December 31, 2014, the allowance for loan loss provision expense increased \$3.7 million, or 425.5%, compared to the year ended December 31, 2013, due to a change in the methodology in the reserve for impaired loans and a \$62.6 million increase in total loans held for investment.

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Net Interest Income and Margin

Net interest income represents the difference between the income that the Company earns on interest-earning assets and the cost of interest-bearing liabilities. The Company's net interest income depends upon the volume of interest-earning assets and interest-bearing liabilities and the interest rates that the Company earns or pays on them. Net interest income is affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as "volume changes." It is also affected by changes in yields earned on interest-earning assets and rates paid on interest-bearing deposits and other borrowed funds, referred to as "rate changes." As a bank without a branch network, the Bank gathers deposits over the Internet and in the community in which it is headquartered. Due to the nature of a branchless bank and the relatively low overhead required for deposit gathering, the rates the Bank offers are generally above the industry average.

Years ended December 31, 2015 vs. 2014

For 2015, net interest income increased \$10.9 million, or 73.9%, to \$25.6 million compared to \$14.7 million in 2014 due to favorable volume and interest rate factors. Average interest earning assets rose by \$301.0 million, or 62.2%, to \$784.7 million for 2015 compared to \$483.7 million for 2014, while the yield on average interest earning assets increased by fourteen basis points to 4.39%. The cost of funds on interest bearing liabilities for 2015 decreased slightly by four basis points to 1.19%, and the average balance in interest bearing liabilities increased by \$269.5 million, or 56.9% during the same period. As indicated in the rate/volume table below, the slight decrease in rate and increased volume in interest bearing liabilities was outpaced by the effects of the increased volume and rate of interest earning assets, resulting in increased interest income of \$13.9 million and increased interest expense of \$3.0 million for 2015. The volume of interest bearing liabilities was also mitigated by \$87.2 million in capital raised in the July 2015 initial public offering. For 2015 compared to 2014, net interest margin increased from 3.04% to 3.26% due to the aforementioned effects.

Years ended December 31, 2014 vs. 2013

For the year ended December 31, 2014, net interest income increased \$3.9 million, or 36.5%, to \$14.7 million compared to the year ended December 31, 2013. This increase was due to growth in average interest earning assets combined with higher asset yields and a relatively stable cost of funds. Average interest earning assets increased by \$117.7 million, or 32.2%, from fiscal year 2013 to 2014, while the related yield on average interest earning assets increased by seven basis points to 4.25%, or an equivalent of \$5.3 million. As a strategic initiative to develop market share as a de novo bank, the Bank offered loans at highly competitive market rates in the development phase of our business. As the business evolved, the Bank began pricing loans commensurate with premium market rates and the added value that accompanies each loan from the Bank's business advisory group, or BAG. The Bank formed the BAG in 2010 to enhance borrower experience by focusing specifically on the needs of borrowers within each vertical. The BAG provides complementary advisory service to customers, such as receivables and inventory review, in conjunction with periodic financial health reviews which deepens existing relationships. While the corresponding cost of funds on interest bearing liabilities for fiscal year 2014 declined slightly by two basis points to 1.23%, the average balance in interest bearing liabilities increased by \$111.7 million or 30.8%. As indicated in the below rate volume table, the slight drop in the cost of funds was outpaced by the effects of the increased volume of interest bearing liabilities resulting in increased interest expense for fiscal year 2014 of \$1.3 million. For the year ended December 31, 2014 compared to the year ended December 31, 2013, net interest margin increased from 2.95% to 3.04% due to the aforementioned affects. As a bank without a branch network, the Bank gathers deposits over the Internet and in the community in which it is headquartered. Due to the nature of a branchless bank and low overhead required for deposit gathering, the rates the Bank is able to offer are generally above the industry average. The Bank began, on a limited basis, publicly promoting its deposit products in fiscal year 2012, which accounts for the increase in interest bearing liabilities.

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Average Balances and Yields. The following table presents information regarding average balances for assets and liabilities, the total dollar amounts of interest income and dividends from average interest-earning assets, the total dollar amount of interest expense on average interest-bearing liabilities, and the resulting average yields and costs. The yields and costs for the periods indicated are derived by dividing the income or expense by the average balances for assets or liabilities, respectively, for the periods presented. Loan fees are included in interest income on loans.

	2015		2014		2013					
	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate	
Interest earning assets:										
Interest earning balances in other banks	\$84,782	\$300	0.35 %	\$56,053	\$163	0.29 %	\$58,319	\$126	0.22 %	
Investment securities	50,431	811	1.61	29,634	455	1.53	17,543	391	2.23	
Loans held for sale	435,508	22,590	5.19	306,026	15,464	5.05	232,632	11,813	5.08	
Loans held for investment	213,974	10,750	5.02	91,964	4,483	4.87	54,468	2,666	4.89	
Subsidiary note receivable	—	—	—	—	—	—	3,039	304	10.00	
Total interest earning assets	784,695	34,451	4.39	483,677	20,565	4.25	366,001	15,300	4.18	
Less: Allowance for loan losses	(5,254)			(3,228)			(5,146)			
Non-interest earning assets	135,151			86,853			68,779			
Total assets	\$914,592			\$567,302			\$429,634			
Interest bearing liabilities:										
Money market accounts	\$354,033	\$2,601	0.73 %	\$215,745	\$2,270	1.05 %	\$186,265	\$2,401	1.29 %	
Certificates of deposit	343,625	4,778	1.39	231,675	2,461	1.06	163,686	1,546	0.94	
Total deposits	697,658	7,379	1.06	447,420	4,731	1.06	349,951	3,947	1.13	
Small business lending fund	6,222	94	1.51	6,800	102	1.50	6,800	102	1.50	
Notes payable to investors	—	—	—	2,717	272	10.00	3,623	362	9.99	
Other borrowings	39,515	1,389	3.52	16,983	747	4.40	1,826	110	6.02	
Total interest bearing liabilities	743,395	8,862	1.19	473,920	5,852	1.23	362,200	4,521	1.25	
Non-interest bearing deposits	15,131			11,492			15,732			
Non-interest bearing liabilities	14,004			8,264			4,350			
Redeemable equity	—			2,391			2,681			
Shareholders' equity	142,044			71,235			44,671			

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Noncontrolling interest	18	—	—	
Total liabilities and shareholders' equity	\$914,592	\$567,302	\$429,634	
Net interest income and interest rate spread	\$25,589	3.20 %	\$14,713 3.02 %	\$10,779 2.93 %
Net interest margin		3.26	3.04	2.95
Ratio of average interest-earning assets to average interest-bearing liabilities		105.56 %	102.06 %	101.05 %

(1)Average loan balances include non-accruing loans.

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Rate/Volume Analysis. The following table sets forth the effects of changing rates and volumes on net interest income. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by current volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The total column represents the sum of the prior columns. For purposes of this table, changes attributable to changes in both rate and volume that cannot be segregated have been allocated proportionally based on the changes due to rate and the changes due to volume.

	2015 vs. 2014			2014 vs. 2013		
	Increase (Decrease) Due to Rate	Volume	Total	Increase (Decrease) Due to Rate	Volume	Total
Interest income:						
Interest earning balances in other banks	\$44	\$93	\$137	\$43	\$(6)	\$37
Investment securities	29	327	356	(164)	) 228	64
Loans held for sale	496	6,630	7,126	(67)	) 3,718	3,651
Loans held for investment	228	6,039	6,267	(15)	) 1,832	1,817
Subsidiary note receivable	—	—	—	(152)	) (152)	(304)
Total interest income	797	13,089	13,886	(355)	) 5,620	5,265
Interest expense:						
Money market accounts	(904)	) 1,235	331	(476)	) 345	(131)
Certificates of deposit	944	1,373	2,317	233	682	915
Small business lending fund	1	(9)	(8)) —	—	—
Notes payable to investors	(136)	) (136)	(272)	) 1	(91)	(90)
Other borrowings	(250)	) 892	642	(153)	) 790	637
Total interest expense	(345)	) 3,355	3,010	(395)	) 1,726	1,331
Net interest income	\$1,142	\$9,734	\$10,876	\$40	\$3,894	\$3,934

Provision for Loan Losses. The provision for loan losses represents the amount necessary to be charged against the current period's earnings to maintain the allowance for loan losses at a level that is appropriate in relation to the estimated losses inherent in the loan portfolio. A number of factors are considered in determining the required level of loan loss reserves and the provision required to achieve the appropriate reserve level, including loan growth, credit risk rating trends, nonperforming loan levels, delinquencies, loan portfolio concentrations and economic and market trends.

Losses inherent in loan relationships are mitigated by the portion of the loan that is guaranteed by the SBA. A typical SBA 7(a) loan carries a 75% guarantee, which reduces the risk profile of these loans. The Company believes that its focus on compliance with regulations and guidance from the SBA are key factors to managing this risk.

Years ended December 31, 2015 vs. 2014

For 2015, the provision for loan losses was \$3.8 million, an increase of \$1.0 million, or 36.3%, compared to the same period in 2014. Much of the loan growth for 2015 occurred within new lending verticals with higher assumed loss factors due to the Company's lack of historical loss experience in those industries.

Net charge-offs were \$798 thousand for 2015, compared to net charge-offs of \$1.1 million for 2014. In addition, at December 31, 2015, nonperforming loans not guaranteed by the SBA totaled \$2.0 million, which was 0.7% of the held-for-investment loan portfolio compared to \$3.1 million, or 1.5%, of loans held for investment at December 31, 2014.

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Years ended December 31, 2014 vs. 2013

For the year ended December 31, 2014, the provision for loan losses was \$2.8 million, an increase of \$3.7 million, or 425.5%, compared to the same period in 2013. The higher provision for loan losses in 2014 was primarily the result of an increase in reserves on impaired loans of \$1.1 million, coupled with loan loss provisions totaling approximately \$1.7 million in response to substantial loan growth and increases in qualitative reserves, partially mitigated by declining loss ratios. Much of the loan growth occurred within new lending verticals with higher loss factors due to the Company's lack of historical experience in those industries. Net loan charge-offs were \$1.1 million for the fiscal year ended December 31, 2014, compared to \$1.9 million for fiscal year 2013, equating to 0.28% and 0.66% of average loans for the respective periods. In addition, at December 31, 2014, nonperforming loans not guaranteed by the SBA totaled \$3.1 million, which was 1.5% of the held-for-investment loan portfolio compared to \$1.7 million, or 1.2%, of loans held for investment at December 31, 2013.

Noninterest Income

Noninterest income principally represents income from the sale of SBA-guaranteed loans. This income is comprised of loan servicing revenue and revaluation and net gains on sales of loans. Revenue from the sale of loans depends upon volume and rates of underlying loans as well as cost and availability of funds in the secondary markets prevailing in the period between loan funding and closing of sale. In addition, the loan servicing revaluation is significantly impacted by changes in market rates and other underlying assumptions such as prepayment speeds and default rates. Other less common elements of noninterest income include nonrecurring gains and losses on investments.

The following table shows the components of noninterest income and the dollar and percentage changes for the periods presented.

	Years Ended December 31,			2014/2015 Increase (Decrease)		2013/2014 Increase (Decrease)		
	2015	2014	2013	Amount	Percent	Amount	Percent	
Noninterest income - excluding nCino, LLC:								
Loan servicing revenue	\$ 16,081	\$ 12,823	\$ 10,273	\$ 3,258	25.41	% \$ 2,550	24.82	%
Loan servicing revaluation	(6,229)	(2,201)	(2,347)	(4,028)	(183.01)	146	6.22	
Net gains on sales of loans	67,385	49,977	38,225	17,408	34.83	11,752	30.74	
Gain on deconsolidation of subsidiary	—	—	12,212	—	—	(12,212)	(100.00)	
Equity in loss of non-consolidated affiliates	(26)	(2,221)	(2,756)	2,195	98.83	535	19.41	
Gain of sale of investment in non-consolidated affiliate	3,782	—	—	3,782	100.00	—	—	
Gain (loss) on sale of securities available-for-sale	13	(74)	11	87	117.57	(85)	(772.73)	
Construction supervision fee income	1,623	361	116	1,262	349.58	245	211.21	
Other noninterest income	1,699	1,377	578	322	23.38	799	138.24	
Subtotal	\$ 84,328	\$ 60,042	\$ 56,312	\$ 24,286	40.45	% \$ 3,730	6.62	%
Noninterest income - nCino, LLC:								
Software professional services	\$—	\$—	\$ 103	\$—	—	% \$(103)	(100.00)	%
Software subscription fee	—	—	56	—	—	(56)	(100.00)	
Sales of support contracts	—	—	6	—	—	(6)	(100.00)	
Subtotal	\$—	\$—	\$ 165	\$—	—	% \$(165)	(100.00)	%

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Total noninterest income	\$84,328	\$60,042	\$56,477	\$24,286	40.45	%	\$3,565	6.31	%
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Years ended December 31, 2015 vs. 2014

For 2015, noninterest income increased by \$24.3 million, or 40.4%, compared to 2014. Increases in the serviced loan portfolio and the volume of loans sold in the secondary market, the core components of the Company's business, contributed \$20.7 million to noninterest income growth, including \$3.3 million of increased servicing revenue and \$17.4 million of increased net gains on sale of loans. Other factors contributing to the increase in noninterest income were a \$3.8 million one-time gain arising in the first quarter of 2015 related to the sale of the investment in nCino combined with an increase of \$2.2 million due to minimal equity method investments in non-consolidated affiliates during 2015 compared to \$2.2 million in losses on such investments in 2014, and an increase of \$1.3 million in fees earned for monitoring higher levels of multi-advance loans in 2015. Offsetting increases in noninterest income were larger downward adjustments in the valuation of servicing rights of \$4.0 million during 2015 compared to the same period in 2014.

The tables below reflect loan production, sales of guaranteed loans and the aggregate balance in guaranteed loans sold. These components are key drivers of the Company's recurring noninterest income.

	Three months ended December 31,		Three months ended September 30,		Three months ended June 30,		Three months ended March 31,	
	2015	2014	2015	2014	2015	2014	2015	2014
Amount of loans originated	\$330,798	\$264,379	\$302,962	\$259,925	\$276,822	\$188,489	\$248,058	\$135,297
SBA-guaranteed portions of loans sold	219,328	125,757	147,377	114,871	137,134	105,698	137,047	87,586
Outstanding balance of guaranteed loans sold ⁽¹⁾	1,779,989	1,302,828	1,608,197	1,218,805	1,504,115	1,137,685	1,403,968	1,057,048

	Years ended December 31,				
	2015	2014	2013	2012	2011
Amount of loans originated	\$1,158,640	\$848,090	\$498,752	\$413,763	\$306,637
SBA-guaranteed portions of loans sold	640,886	433,912	339,342	276,676	238,442
Outstanding balance of guaranteed loans sold ⁽¹⁾	1,779,989	1,302,828	1,005,764	767,721	550,622

(1) This represents the outstanding principal balance of guaranteed loans serviced, as of the last day of the applicable period, which have been sold into the secondary market.

Changes in various components of noninterest income are discussed in more detail below.

Loan Servicing Revenue: While portions of the loans that the Bank originates are sold and generate premium revenue, servicing rights for all loans that the Bank originates, including loans sold, are retained by the Bank. In exchange for continuing to service loans that are sold, the Bank receives fee income represented in loan servicing revenue equivalent to one percent of the outstanding balance of the loans sold. In addition, the cost of servicing sold loans is approximately 0.40% of the balance of the loans sold, which is included in the loan servicing revaluation computations. Unrecognized servicing revenue is reflected in a servicing asset recorded on the balance sheet.

Revenues associated with the servicing of loans are recognized over the expected life of the loan through the income statement, and the servicing asset is reduced as this revenue is recognized. For the year ended December 31, 2015, loan servicing revenue increased \$3.3 million, or 25.4%, compared to the year ended December 31, 2014, as a result of an increase in the average outstanding balance of guaranteed loans sold. At December 31, 2015, the outstanding balance of guaranteed loans sold in the secondary market was \$1.78 billion, with a weighted average servicing fee rate of 1.07%. At December 31, 2014, the outstanding balance of guaranteed loans sold was \$1.30 billion, with a weighted average servicing fee rate of 1.11%. Prior to January 2010, the Company sold loans for servicing in excess of 1.0%. As loans sold for servicing fee rates in excess of 1.0% prior to fiscal year 2010 amortize, the Company expects that the weighted average servicing fee rate will approach and stabilize at approximately 1.0%.

Loan Servicing Revaluation: The Company revalues its serviced loan portfolio at least quarterly. The revaluation considers the amortization of the portfolio, current market conditions for loan sale premiums, and current prepayment speeds. For the year ended December 31, 2015, there was a net negative loan servicing revaluation of \$6.2 million. The decline in service valuation for 2015 was due to amortization of the loan portfolio and a decline in the premium market.

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In consideration of the sensitivity of servicing rights as discussed above and in Note 4 to the accompanying audited financial statements, the following table is provided as of December 31, 2015 reflecting the effect on fair value due to changes in yield curve rates.

Change in Yield Curve Assumption	Increase (Decrease) in Value
+300 basis point	\$(4,314)
+200 basis point	(2,974)
+100 basis point	(1,539)
- 100 basis point	1,655

Net Gains on Sale of Loans: For the year ended December 31, 2015, net gains on sales of loans increased \$17.4 million, or 34.8%, compared to 2014. This increase was primarily due to a higher volume of guaranteed loans sold. For 2015, the volume of guaranteed loans sold increased \$207.0 million, or 47.7%, from \$433.9 million in 2014 to \$640.9 million in 2015. The premiums paid in the secondary market had a negative impact on the net gains on sale of loans. The average net gain on sale for 2015 was somewhat lower at \$105 thousand of revenue for each \$1 million in loans sold, compared to \$115 thousand of revenue for each \$1 million sold for 2014.

Years ended December 31, 2014 vs. 2013

For the year ended December 31, 2014, noninterest income increased by \$3.6 million, or 6.3%, compared to the year ended December 31, 2013. Increases in loan production, the core component of business, as well as the volume of loans sold in the secondary market, contributed \$14.3 million to noninterest income growth, including \$2.5 million of increased servicing revenue and \$11.8 million of increased gains on sale of loans.

For the year ended December 31, 2014, net gains on sales of loans increased \$11.8 million, or 30.7%, compared to the year ended December 31, 2013. The increase was primarily due to an increase in the volume of guaranteed loans sold of \$94.6 million, or 27.9%, from \$339.3 million for the year ended December 31, 2013 to \$433.9 million for the year ended December 31, 2014. The increase was also the result of an improvement in the premium realized for loans sold in the secondary market from an average of \$113 thousand per \$1 million for the year ended December 31, 2013 to an average of \$115 thousand per \$1 million sold for the year ended December 31, 2014. Cash received for the loans sold during the year ended December 31, 2014 and 2013 was \$478 million and \$374 million, respectively.

While portions of the loans that the Bank originates are sold, generating premium revenue, servicing rights for all loans that the Bank originates are retained by the Bank. In exchange for continuing to service loans that are sold, the Bank receives fee income represented in loan servicing revenue equivalent to one percent of the loan balance. In addition, the cost of servicing sold loans is approximately 0.40% which is included in the loan servicing revaluation computations. Unrecognized servicing revenue is reflected in a servicing asset recorded on our balance sheet.

Revenues associated with the servicing of loans are recognized over the expected life of the loan as a reduction of the servicing asset. For the year ended December 31, 2014, loan servicing revenue increased \$2.5 million, or 24.8%, compared to the year ended December 31, 2013, as a result of an increase in the average outstanding balance of guaranteed loans sold due to an increase in the volume of loans sold throughout the year. At year end December 31, 2014, the outstanding balance of loans sold in the secondary market was \$1.30 billion, with a weighted average servicing fee rate of 1.11%. For the year ended December 31, 2013, the outstanding balance of loans sold was \$1.01 billion, with a weighted average servicing fee rate of 1.16%. Prior to January 2010, the Company sold loans for servicing in excess of 1.0%.

For the year ended December 31, 2014, the loan servicing revaluation adjustment increased by \$146 thousand, or 6.2%, over the year ended December 31, 2013. Much of this increase was associated with the continued growth in the loan portfolio serviced.

The growth of noninterest income from fiscal year 2013 to fiscal year 2014 was negatively impacted by the absence of a one-time gain of \$12.2 million in fiscal year 2013. For the year ended December 31, 2013, the gain on the deconsolidation of the Company's investment in nCino was \$12.2 million, which resulted from the combination of a gain of \$9.7 million related to the measurement of the retained investment in nCino at fair value and \$2.5 million related to the recovery of negative net assets in nCino at the date of deconsolidation.

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For the year ended December 31, 2014, the Company had one equity method investment: 504 Fund Advisors, LLC, or 504 FA, which totaled \$231 thousand. Losses attributable to 504 FA for the year ended December 31, 2014 totaled \$411 thousand compared to a partial-year net loss of \$108 thousand for the year ended December 31, 2013.

For the six months ended June 30, 2014, the Company carried ownership in nCino as an equity method investment. The Company's ownership of nCino was distributed pro rata to its shareholders at June 30, 2014. Losses attributable to nCino for the six months ended June 30, 2014, totaled \$1.8 million compared to a net loss of \$2.6 million for the year ended December 31, 2013.

On August 4, 2014, the Company acquired 9.0% ownership of nCino through the purchase of shares from an existing nCino shareholder. For the year ended December 31, 2014, the Company carried ownership of nCino as a cost method investment totaling \$6.1 million.

Noninterest Expense

Noninterest expense comprises all operating costs of the Company, such as travel, professional services, advertising and marketing expenses, exclusive of interest and income tax expense.

The following table shows the components of noninterest expense and the related dollar and percentage changes for the periods presented.

	Years Ended December 31,			2014/2015 Increase (Decrease)		2013/2014 Increase (Decrease)			
	2015	2014	2013	Amount	Percent	Amount	Percent		
Noninterest expense - excluding nCino, LLC:									
Salaries and employee benefits	\$40,323	\$29,165	\$20,417	\$11,158	38.26	% \$8,748	42.85	%	
Non-staff expenses:									
Travel expense	7,379	5,392	4,442	1,987	36.85	950	21.39		
Professional services expense	2,643	3,775	1,658	(1,132)	(29.99)	2,117	127.68		
Advertising and marketing expense	4,333	3,316	2,305	1,017	30.67	1,011	43.86		
Occupancy expense	3,475	1,851	1,775	1,624	87.74	76	4.28		
Data processing expense	3,583	2,660	1,748	923	34.70	912	52.17		
Equipment expense	2,119	1,566	1,131	553	35.31	435	38.46		
Other loan origination and maintenance expense	2,069	1,652	1,743	417	25.24	(91)	(5.22))	
Other expense	5,791	5,149	4,481	642	12.47	668	14.91		
Total non-staff expenses excluding nCino, LLC	31,392	25,361	19,283	6,031	23.78	6,078	31.52		
Total noninterest expense excluding nCino, LLC	71,715	54,526	39,700	17,189	31.52	14,826	37.35		
Noninterest expense - nCino, LLC:									
Salaries and employee benefits	—	—	349	—	—	(349)	(100.00))	
Non-staff expenses:									
Travel expense	—	—	16	—	—	(16)	(100.00))	
Professional services expense	—	—	56	—	—	(56)	(100.00))	
Advertising and marketing expense	—	—	11	—	—	(11)	(100.00))	
Occupancy expense	—	—	2	—	—	(2)	(100.00))	
Data processing expense	—	—	1	—	—	(1)	(100.00))	
Other expense	—	—	37	—	—	(37)	(100.00))	
Total noninterest expense of nCino, LLC	—	—	472	—	—	(472)	(100.00))	
Total noninterest expense	\$71,715	\$54,526	\$40,172	\$17,189	31.52	% \$14,354	35.73	%	

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Years ended December 31, 2015 vs. 2014

Total noninterest expense for 2015 increased \$17.2 million, or 31.5%, compared to 2014. The increase in noninterest expense was predominately impacted by increased personnel, travel and occupancy expenses. Changes in various components of noninterest expense are discussed below.

Salaries and employee benefits: Total personnel expense for 2015 increased by \$11.2 million, or 38.3%, compared to 2014. This increase primarily resulted from further investment in human capital to support the growing loan production from new and existing verticals as well as development of a new small loan platform. The increase during 2015 compared to 2014 would have been larger excluding the impact of \$3.0 million in non-recurring expenses in the first quarter of 2014 related to stock grants. Salaries and employee benefits expense included \$1.4 million and \$3.7 million of stock based compensation in 2015 and 2014, respectively. Expenses related to the employee stock purchase program, stock grants, stock options, stock option compensation and restricted stock expense are all considered stock based compensation.

Travel expense: For 2015, total travel expenses increased by \$2.0 million, or 36.9%, compared to 2014. Travel costs are a critical element of the Company's business strategy because the Company does not maintain branch locations across its national footprint. The increase in travel-related expenses was primarily driven by growing loan production (up \$310.6 million, or 36.6%, from 2014 to 2015). Travel costs also increased due to the Company's customer relationship management strategy via the Company's business advisory group, or BAG, as a result of servicing a \$2.73 billion loan portfolio as of December 31, 2015. Travel expense represented 10.3% and 9.9% of total noninterest expense for the years ended 2015 and 2014, respectively.

Professional service expense: The total cost of professional services decreased by \$1.1 million, or 30.0%, in 2015 compared to 2014. The decrease is primarily attributable to \$1.7 million in non-recurring expenses during 2014 arising from the exploration of various capital raising opportunities.

Advertising and marketing expense: Advertising and marketing costs increased \$1.0 million, or 30.7%, in 2015 compared to 2014. The primary driver of these increases was the cost of growing brand recognition in newer verticals via advertising and trade show presence.

Occupancy expense: Total occupancy costs increased \$1.6 million, or 87.7%, compared to 2014. The primary driver of the increase in occupancy expense was increased levels of personnel and supporting infrastructure to support loan production and portfolio service.

Data processing expense: For 2015, the total costs associated with data processing and development increased \$923 thousand, or 34.7%, compared to 2014. The increase was principally due to increased levels of activity in the core system from the substantial growth in loan originations, software and applications required to operate the Company's digital platform as well as the introduction of eLending and the expanded client portal.

Years ended December 31, 2014 vs. 2013

For the year ended December 31, 2014, the Company recognized \$54.5 million in total noninterest expense, an increase of \$14.4 million, or 35.7%, compared to the year ended December 31, 2013. Excluding nCino, total noninterest expense increased by \$14.8 million, or 37.4%, for the year ended December 31, 2014 compared to the year ended December 31, 2013. Changes in the primary drivers of this increase are discussed below.

Salaries and employee benefits: For the year ended December 31, 2014, total personnel expense increased by \$8.4 million, or 40.4%, compared to the year ended December 31, 2013. Excluding nCino, personnel expense increased by \$8.7 million, or 42.9%, from the year ended December 31, 2013 to \$29.2 million for the year ended December 31, 2014 and represented 53.5% of total noninterest expense for the year ended December 31, 2014. This increase primarily resulted from an increase in full-time equivalent employees from 141 at December 31, 2013 to 192 at December 31, 2014 to support loan production, balance sheet, and income growth. The increase in personnel expenses from 2013 to 2014 also included \$4.4 million of salary and employee benefits in restricted stock and stock grant related expenses.

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Travel expense: For the year ended December 31, 2014, total travel costs increased by \$934 thousand, or 21.0%, compared to the year ended December 31, 2013. Travel costs are a critical element of the Company's national footprint since the Company does not maintain brick and mortar locations. The increase in travel-related expenses is the result of growing loan production 70.0% from \$498.8 million for the year ended December 31, 2013 to \$848.1 million for the year ended December 31, 2014. Travel costs also increased due to the Company's relationship management via the BAG, one of the Company's primary differentiators, as a result of servicing a \$2.0 billion loan portfolio as of December 31, 2014, compared to a \$1.4 billion loan portfolio as of December 31, 2013. Travel expense was \$5.4 million for fiscal year 2014 and represented 9.9% of total noninterest expense. Exclusive of nCino, travel expense increased \$950 thousand, or 21.4%, from 2013 to 2014.

Professional service expense: For the year ended December 31, 2014, the total cost of professional services increased by \$2.1 million, or 120.2%, compared to the year ended December 31, 2013. The increase is primarily attributable to the expenses the Company incurred in 2014 in exploring various capital raising opportunities. Professional service expense related solely to nCino declined by \$56 thousand from fiscal year 2013 to 2014 as a result of the deconsolidation in January of 2013.

Advertising and Marketing expense: For the year ended December 31, 2014, the total costs of advertising and marketing totaled \$3.3 million, an increase of \$1.0 million, or 43.2%, compared to the year-ended December 31, 2013. The primary driver of the increase is growing brand recognition in newer verticals. Excluding nCino, advertising and marketing increased 43.9%.

Income Tax Expense

Income tax expense for 2015 and 2014, totaled \$13.8 million and \$7.4 million, respectively, an increase of \$6.4 million, or 86.7%. The Company transitioned from an S corporation to a C corporation effective August 3, 2014. Due to this change in taxable status, the Company recorded an initial \$3.3 million deferred tax liability in 2014 which is included in total 2014 tax expense. The Company has determined that had it been taxed as a C corporation and paid federal income taxes, the federal tax rates would have been approximately 38.5% during 2014 and 2013. On a pro forma basis, the Company's federal income tax expense would have been \$6.7 million and \$10.8 million for 2014 and 2013, respectively.

Discussion and Analysis of Financial Condition

December 31, 2015 vs. December 31, 2014

Total assets at December 31, 2015 were \$1.05 billion, an increase of \$379.3 million, or 56.3%, compared to total assets of \$673.3 million at December 31, 2014. This increase was due to higher levels of loan originations combined with longer retention times of loans held for sale, comprised largely of loans to newer verticals which require a lengthier period of loan advances prior to being sold.

Cash and cash equivalents were \$102.6 million at December 31, 2015, an increase of \$72.7 million, or 243.1%, compared to \$29.9 million at December 31, 2014. This increase was primarily a result of increases in the deposit portfolio and net proceeds of the initial public offering of \$87.2 million which closed in July 2015.

Total investment securities increased \$4.4 million during 2015, from \$49.3 million at December 31, 2014 to \$53.8 million at December 31, 2015, an increase of 9.0%. The portfolio is comprised of US government agency securities, residential mortgage-backed securities and a mutual fund.

Loans held for sale increased \$185.4 million, or 62.8%, during 2015, from \$295.2 million at December 31, 2014 to \$480.6 million at December 31, 2015. The increase was primarily the result of a higher volume of loan originations combined with the aforementioned lengthening of time to sell due to originations of multi-advance loans in newer verticals.

Loans held for investment increased \$76.0 million, or 37.3%, during 2015, from \$203.9 million at December 31, 2014 to \$280.0 million at December 31, 2015. The increase was primarily the result of higher loan originations.

Premises and equipment increased \$27.4 million, or 77.6%, during 2015, from \$35.3 million at December 31, 2014 to \$62.7 million at December 31, 2015. The increase was the result of the completion of construction on a second building on the Company's campus in Wilmington, NC.

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Servicing assets increased \$9.2 million, or 26.4%, during 2015 from \$35.0 million at December 31, 2014 to \$44.2 million at December 31, 2015. The increase in servicing assets is primarily the result of loan sales during 2015 significantly outpacing the combined impact of the existing serviced portfolio and \$6.2 million in negative valuation adjustments due to external market conditions (principally isolated to prepayment rates).

At December 31, 2015, the Company did not have any investments in non-consolidated subsidiaries. This is a decrease of \$6.3 million from December 31, 2014. During the first quarter of 2015, 100% of the cost method investment in nCino was sold for a gain of \$3.8 million and the Company's ownership in 504FA increased from 50% to 91.3%, resulting in it becoming a consolidated subsidiary with an 8.7% noncontrolling interest held by a third party investor. Transactions during the third quarter of 2015 increased the Company's ownership of 504FA to 92.4%. Foreclosed assets increased \$1.6 million, or 145.9%, to \$2.7 million at December 31, 2015, from \$1.1 million at December 31, 2014. Of this increase, \$2 thousand was associated with foreclosed assets relating to portions of loans not guaranteed by the SBA.

Other assets increased \$11.6 million, or 99.3%, during 2015. The increase in other assets is principally comprised of the following 2015 activity: pledged collateral on secured borrowings increased by \$4.4 million; accounts receivable increased by \$2.8 million related principally to SBA guarantees in the process of collection on defaulted loans; \$1.5 million related to a commitment to invest in the Five Points Mezzanine Fund III; and accrued interest receivable grew by \$2.5 million due to higher levels of loan production.

Total deposits were \$804.8 million at December 31, 2015, an increase of \$282.7 million, or 54.2%, from \$522.1 million at December 31, 2014. The increase in deposits was driven by execution of a deposit growth strategy to support the growth in loan origination.

At December 31, 2015, the Company did not carry a balance of short term borrowings. During 2015, the Company's outstanding \$6.1 million short term borrowing from an unaffiliated commercial bank at December 31, 2014 was paid in full. Long term borrowings decreased \$13.5 million, or 32.2%, from \$41.8 million at December 31, 2014 to \$28.4 million at December 31, 2015. This decrease in long term borrowings was principally driven by repayment of \$6.8 million in debt to the Small Business Lending Fund program, and an aggregate of \$7.0 million in debt owed by the Company's wholly owned subsidiary, Independence Aviation. In an effort to streamline operations, Independence Aviation's net assets were transferred to the Company and the Bank on December 31, 2015 effectively dissolving the subsidiary.

Shareholders' equity at December 31, 2015 was \$199.5 million as compared to \$91.8 million at December 31, 2014. The book value per share was \$5.84 at December 31, 2015 and average equity to average assets was 15.5% for 2015, compared to a book value per share of \$3.21 at December 31, 2014 and average equity to average assets of 12.6% for the year ended December 31, 2014. The change in shareholders' equity principally represents the proceeds of \$87.2 million, net of issue costs, from the initial public offering closed in July 2015, combined with net income to common shareholders for 2015 of \$20.6 million partially offset by \$1.5 million in dividends and \$1.3 million in stock compensation expense.

December 31, 2014 and 2013

Total assets at December 31, 2014 were \$673.3 million, an increase of \$243.0 million, or 56.5%, compared to total assets of \$430.4 million at December 31, 2013. This increase was principally comprised of higher levels of investment securities available-for-sale and certificates of deposit (\$39.9 million increase, or 205.0%), growing loan originations and increased levels of premises and equipment to house the growing workforce (\$10.2 million increase, or 40.9%). Funding this growth was net proceeds of \$74.6 million from the issuance of stock in a private placement on August 5, 2014 combined with growth in deposits of \$165.5 million, or 46.4%, and increased borrowings of \$35.6 million, or 289.0%.

Loans held for sale increased \$135.7 million, or 85.1%, during 2014, from \$159.4 million at December 31, 2013 to \$295.2 million at December 31, 2014. Loans held for investment increased \$62.6 million, or 44.3%, during 2014, from \$141.3 million at December 31, 2013 to \$203.9 million at December 31, 2014. The increase in loans held for sale and for investment was primarily the result of new loan originations. New loan originations totaled \$848.1 million in 2014.

Construction loans are eligible for sale in the secondary market when they fully fund. At December 31, 2014, undisbursed loan commitments related to construction loans amounted to \$240.8 million. If all construction loans on the books at December 31, 2014 were fully funded the Bank would have an additional \$311.4 million in guaranteed loans classified as available for sale. The noninterest revenue on these loans was not recognized until they were actually sold.

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Loans. As of December 31, 2015 and 2014, the cumulative total outstanding principal balance of guaranteed loans sold since May 2007 totaled \$1.78 billion and \$1.30 billion, respectively. The Company has historically sold a significant portion of loans it originates in the secondary market while the Company continues to service the loans sold in full. As of December 31, 2015 and 2014, combined loans held for investment and held for sale totaled \$760.6 million and \$499.1 million, respectively. Any loan or portion of a loan that the Company has the intent and ability to sell is carried as held for sale.

The average age of the held for sale portfolio as of December 31, 2015 was 14.4 months from origination date. Less than 10% of the current held for sale portfolio is older than two years. The majority of held for sale loans over one year old are comprised of construction loans. Construction loans typically have extended build out periods that inherently result in longer lead times between origination and the ultimate sale date. Approximately 29.2% of the held for sale portfolio is aged between one and two years. All loans classified as special mention (risk grade 5) or worse or being identified as impaired are excluded from the held for sale loan portfolio.

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As of December 31, 2015 and 2014, loans held for investment totaled \$280.0 million and \$203.9 million, respectively. The increase in loans held for investment is the result of continued growth in loan originations. The following table presents the balance and associated percentage of each category of loans held for investment within the loan portfolio at the five most recently completed fiscal year ends. The following held for investment loan tables do not include net deferred costs and discount on SBA 7(a) unguaranteed loans. The net impact on loans held for investment for net deferred costs and discount on SBA 7(a) unguaranteed loans is \$23 thousand, \$485 thousand, \$(757) thousand, \$(611) thousand, and \$(777) thousand as of December 31, 2015, 2014, 2013, 2012 and 2011, respectively.

	2015		2014		2013		2012		2011		
	Total Loans	% of Loans in Category of Total Loans	Total Loans	% of Loans in Category of Total Loans	Total Loans	% of Loans in Category of Total Loans	Total Loans	% of Loans in Category of Total Loans	Total Loans	% of Loans in Category of Total Loans	
Commercial & Industrial											
Agriculture	\$30	0.01	% \$—	—	% \$—	—	% \$—	—	% \$—	—	%
Death Care Management	4,832	1.73	3,603	1.77	1,782	1.25	283	0.30	—	—	
Healthcare	15,240	5.44	12,319	6.06	8,739	6.15	4,996	5.36	7,005	8.10	
Independent Pharmacies	41,588	14.86	34,079	16.75	24,026	16.91	12,192	13.07	10,963	12.67	
Registered Investment Advisors	18,358	6.56	9,660	4.75	2,817	1.98	—	—	—	—	
Veterinary Industry	21,579	7.71	20,902	10.27	19,978	14.06	15,719	16.85	15,809	18.28	
Other Industries	3,230	1.15	494	0.24	17	0.01	1,010	1.08	21	0.02	
Total	104,857	37.46	81,057	39.84	57,359	40.36	34,200	36.66	33,798	39.07	
Construction & Development											
Agriculture	11,351	4.05	3,910	1.92	—	—	—	—	—	—	
Death Care Management	769	0.27	92	0.05	989	0.70	315	0.34	—	—	
Healthcare	7,231	2.58	2,957	1.45	4,997	3.52	3,136	3.36	595	0.69	
Independent Pharmacies	101	0.04	215	0.11	101	0.07	637	0.69	255	0.29	
Registered Investment Advisors	378	0.13	—	—	—	—	—	—	—	—	
Veterinary Industry	3,834	1.37	2,207	1.08	4,199	2.95	4,163	4.46	1,139	1.32	
Other Industries	658	0.24	145	0.07	—	—	252	0.27	—	—	
Total	24,322	8.68	9,526	4.68	10,286	7.24	8,503	9.12	1,989	2.30	
Owner Occupied Commercial											

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Real Estate											
Agriculture	1,863	0.67	259	0.13	—	—	—	—	—	—	—
Death Care											
Management	20,327	7.26	18,879	9.28	11,668	8.21	3,703	3.97	—	—	—
Healthcare	37,684	13.46	26,173	12.86	11,129	7.83	6,207	6.65	4,996	5.78	—
Independent											
Pharmacies	7,298	2.61	4,750	2.33	3,490	2.46	3,008	3.22	1,329	1.54	—
Registered											
Investment	2,808	1.00	2,161	1.06	171	0.12	—	—	—	—	—
Advisors											
Veterinary											
Industry	59,999	21.43	57,934	28.48	47,896	33.70	35,554	38.12	43,518	50.31	—
Other											
Industries	4,752	1.70	1,464	0.72	107	0.08	2,105	2.26	868	1.00	—
Total	134,731	48.13	111,620	54.86	74,461	52.40	50,577	54.22	50,711	58.63	—
Commercial											
Land											
Agriculture	16,036	5.73	1,248	0.62	—	—	—	—	—	—	—
Total	16,036	5.73	1,248	0.62	—	—	—	—	—	—	—
Total Loans	\$279,946	100.00%	\$203,451	100.00%	\$142,106	100.00%	\$93,280	100.00%	\$86,498	100.00%	—

Regardless of the classification reflected above and discussed in more detail below, the loans the Bank originates are generally to small businesses where operating cash flow is the primary source of repayment, but may also include collateralization by real estate, inventory, accounts receivable, equipment and/or personal guarantees. When collateral includes real estate it is typically owner-occupied. These common attributes among most of the loans the Bank funds is a product of the Bank's specialization as a SBA lender.

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Commercial & Industrial. Increases in Commercial & Industrial, or C&I, loans from December 31, 2014 to December 31, 2015 occurred in all verticals, with most of the growth occurring in Registered Investment Advisors and Independent Pharmacies due to the Bank's marketing efforts and brand recognition in these industries. Overall, C&I loans increased \$23.8 million, or 29.4%, from December 31, 2014 to December 31, 2015. The Bank's growth in verticals such as Independent Pharmacies and Registered Investment Advisors resulted in higher growth rates in the C&I portfolio. Real estate collateral on C&I loans is often not part of the loan balance and is owner occupied. The premises for industries in C&I loans tend to have either a small real estate component or the business occupies a leasehold space. Terms for C&I loans are generally ten years.

Construction & Development. Construction and Development, or C&D, loans increased \$14.8 million, or 155.3%, from December 31, 2014 to December 31, 2015. The increase was primarily the result of increased industry emphasis on facility expansion principally in the Agriculture, Healthcare and Veterinary verticals increasing \$7.4 million, \$4.3 million and \$1.6 million, respectively. Terms for C&D loans are generally 20 to 25 years.

Owner Occupied Commercial Real Estate. Commercial Real Estate, or CRE, loans increased \$23.1 million, or 20.7%, from December 31, 2014 to December 31, 2015. All CRE verticals experienced growth in 2015, with the largest increases occurring in Healthcare, Independent Pharmacies, Veterinary and Agriculture verticals with year to year growth of \$11.5 million, \$2.5 million, \$2.1 million and \$1.6 million, respectively. Growth in CRE lending was largely attributed to ongoing facility expansion and acquisition activity during 2015.

Commercial Land. Commercial land loans increased \$14.8 million, or 1,184.9%, from December 31, 2014 to December 31, 2015. Commercial land loans are solely comprised of loans within the Agriculture vertical. The growth in commercial land loans was driven by the Bank's continued expansion into the poultry segment of the Agriculture vertical.

Loan Concentration

Loan concentrations may exist when there are borrowers engaged in similar activities or types of loans extended to a diverse group of borrowers that could cause those borrowers or portfolios to be similarly impacted by economic or other conditions. The breakdown of total held for sale loans by industry sector is presented in the following table. The following table does not include net deferred costs and discount on SBA 7(a) unguaranteed loans. The net impact on loans held for sale for net deferred costs and discount on SBA 7(a) unguaranteed loans is \$3.2 million, \$3.1 million, \$475 thousand, \$(625) thousand, and \$(183) thousand as of December 31, 2015, 2014, 2013, 2012 and 2011, respectively.

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	At December 31, 2015			At December 31, 2014			At December 31, 2013			At December 31, 2012	
	Concentration Risk Unguaranteed	Concentration Risk Guaranteed	Total	Concentration Risk Unguaranteed	Concentration Risk Guaranteed	Total	Concentration Risk Unguaranteed	Concentration Risk Guaranteed	Total	Concentration Risk Unguaranteed	Concentration Risk Guaranteed
Commercial & Industrial											
Agriculture	\$171	\$51	\$222	\$—	\$—	\$—	\$—	\$—	\$—	\$—	\$—
Death Care Management	3,483	556	4,039	2,312	2,855	5,167	1,166	2,740	3,906	279	548
Healthcare	13,728	2,046	15,774	5,250	4,979	10,229	3,404	2,866	6,270	4,804	5,498
Independent Pharmacies	29,903	2,833	32,736	24,513	6,696	31,209	13,272	8,058	21,330	14,353	8,727
Registered Investment Advisors	17,537	5,087	22,624	9,471	5,667	15,138	3,355	2,719	6,074	—	—
Veterinary Industry	12,894	2,838	15,732	9,301	5,744	15,045	9,800	3,202	13,002	12,797	8,325
Other Industries	8,774	6,624	15,398	1,500	963	2,463	1,026	131	1,157	50	142
Total	86,490	20,035	106,525	52,347	26,904	79,251	32,023	19,716	51,739	32,283	23,579
Construction & Development											
Agriculture	17,005	83,949	100,954	2,246	11,230	13,476	—	—	—	—	—
Death Care Management	1,698	5,778	7,476	36	179	215	1,374	5,235	6,609	126	1,455
Healthcare	11,469	54,374	65,843	1,764	8,695	10,459	6,493	26,427	32,920	1,510	12,520
Independent Pharmacies	152	760	912	—	—	—	151	158	309	675	3,166
Registered Investment Advisors	567	2,835	3,402	—	—	—	—	—	—	—	—
Veterinary Industry	3,900	19,360	23,260	1,677	8,385	10,062	4,177	13,110	17,287	3,650	21,250
Other Industries	1,590	4,934	6,524	16	79	95	—	—	—	—	—
Total	36,381	171,990	208,371	5,739	28,568	34,307	12,195	44,930	57,125	5,961	38,560
Owner Occupied Commercial Real Estate											
Agriculture	2,794	6,455	9,249	1,809	9,043	10,852	—	—	—	—	—
Death Care Management	17,808	1,971	19,779	15,572	4,744	20,316	12,015	3,528	15,543	3,273	449
Healthcare	34,749	10,974	45,723	24,668	33,787	58,455	6,173	1,822	7,995	5,987	107
Independent Pharmacies	5,661	2,325	7,986	5,082	3,155	8,237	3,528	—	3,528	1,661	658
Registered Investment Advisors	2,205	—	2,205	2,731	2,464	5,195	220	109	329	—	—

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Registered
Investment
Advisors

Veterinary
Industry

32,025	1,690	33,715	26,237	22,932	49,169	18,088	3,932	22,020	27,449	6,153	131,600
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Other
Industries

9,880	1,104	10,984	2,865	1,818	4,683	684	—	684	—	—	—
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Total

105,122	24,519	129,641	78,964	77,943	156,907	40,708	9,391	50,099	38,370	7,345	145,735
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Commercial
Land

Agriculture

24,382	8,529	32,911	5,472	16,121	21,593	—	—	—	—	—	—
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Total

24,382	8,529	32,911	5,472	16,121	21,593	—	—	—	—	—	—
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Total

\$252,375	\$225,073	\$477,448	\$142,522	\$149,536	\$292,058	\$84,926	\$74,037	\$158,963	\$76,614	69,145	\$1,045,800
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Whenever a loan held for sale exhibits credit quality issues (i.e., the loan is on nonaccrual, downgraded to special mention, risk grade 5, or greater) it is transferred to loans held for investment. Accordingly all loans experiencing charge-offs are classified as held for investment. For loans transferred from held for sale to held for investment during the twelve months ended December 31, 2015 and 2014 there have been \$0 and \$211 thousand in charge offs, respectively. For loans transferred from held for investment to held for sale during the twelve months ended December 31, 2015 and 2014 there have been \$8 thousand and \$15 thousand in charge offs, respectively. As of December 31, 2015 and 2014 there were no loans classified as held for sale which were identified as being impaired or on nonaccrual status.

The following table presents total held-for-investment loans by industry sector:

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	At December 31, 2015			At December 31, 2014			At December 31, 2013			At December 31, 2012		
	Unguaranteed	Guaranteed	Total	Unguaranteed	Guaranteed	Total	Unguaranteed	Guaranteed	Total	Unguaranteed	Guaranteed	Total
Commercial & Industrial												
Agriculture	\$30	\$—	\$30	\$—	\$—	\$—	\$—	\$—	\$—	\$—	\$—	\$—
Death Care Management	4,832	—	4,832	3,603	—	3,603	1,782	—	1,782	283	—	283
Healthcare	11,900	3,340	15,240	8,779	3,540	12,319	7,164	1,575	8,739	4,564	432	4,996
Independent Pharmacies	40,025	1,563	41,588	31,686	2,393	34,079	24,026	—	24,026	12,192	—	12,192
Registered Investment Advisors	18,358	—	18,358	9,660	—	9,660	2,817	—	2,817	—	—	—
Veterinary Industry	19,247	2,332	21,579	17,406	3,496	20,902	16,444	3,534	19,978	12,681	3,038	15,719
Other Industries	3,124	106	3,230	373	121	494	17	—	17	1,010	—	1,010
Total	97,516	7,341	104,857	71,507	9,550	81,057	52,250	5,109	57,359	30,730	3,470	34,200
Construction & Development												
Agriculture	11,233	118	11,351	3,910	—	3,910	—	—	—	—	—	—
Death Care Management	769	—	769	92	—	92	989	—	989	315	—	315
Healthcare	7,231	—	7,231	2,957	—	2,957	4,997	—	4,997	2,630	758	3,388
Independent Pharmacies	101	—	101	215	—	215	101	—	101	637	—	637
Registered Investment Advisors	378	—	378	—	—	—	—	—	—	—	—	—
Veterinary Industry	3,296	538	3,834	2,207	—	2,207	4,199	—	4,199	4,163	—	4,163
Other Industries	658	—	658	145	—	145	—	—	—	—	—	—
Total	23,666	656	24,322	9,526	—	9,526	10,286	—	10,286	7,745	758	8,503
Owner Occupied Commercial Real Estate												
Agriculture	1,863	—	1,863	259	—	259	—	—	—	—	—	—
Death Care Management	19,037	1,290	20,327	17,354	1,525	18,879	11,668	—	11,668	3,703	—	3,703
Healthcare	36,885	799	37,684	24,254	1,919	26,173	10,329	800	11,129	4,787	1,793	6,580
Independent Pharmacies	7,298	—	7,298	4,750	—	4,750	3,490	—	3,490	1,622	1,386	3,008
Registered Investment	2,808	—	2,808	2,161	—	2,161	171	—	171	—	—	—

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Advisors												
Veterinary Industry	52,911	7,088	59,999	49,903	8,031	57,934	41,387	6,509	47,896	30,953	4,601	3
Other Industries	4,752	—	4,752	1,177	287	1,464	107	—	107	1,732	—	1
Total	125,554	9,177	134,731	99,858	11,762	111,620	67,152	7,309	74,461	42,797	7,780	5
Commercial Land												
Agriculture	16,036	—	16,036	1,248	—	1,248	—	—	—	—	—	—
Total	16,036	—	16,036	1,248	—	1,248	—	—	—	—	—	—
Total	\$262,772	\$17,174	\$279,946	\$182,139	\$21,312	\$203,451	\$129,688	\$12,418	\$142,106	\$81,272	\$12,008	\$

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Loans held for investment generally consist of loans classified as special mention (Risk Grade 5) or worse, identified as impaired and the unguaranteed portion required to be retained by the SBA. At December 31, 2015, total guaranteed loans held for investment classified as special mention or worse was \$17.2 million with \$10.3 million on a non-accrual basis. Of total guaranteed loans held for investment at December 31, 2014, \$21.3 million was classified as special mention or worse with \$15.6 million on a non-accrual basis. Presently, the Company classifies the guaranteed portion of all performing loans as held for sale.

Loans to veterinarians represent \$85.4 million, or 30.5%, of the total held for investment balance. The Veterinary vertical was the original vertical and formed the basis of the Company's existing model. From inception in May 2007 through December 31, 2015, the Company originated \$1.24 billion of loans to small business professionals in the Veterinary vertical, with \$837.5 million in outstanding principal remaining in the servicing portfolio and \$85.4 million held for investment. Healthcare loans represent the next largest vertical at \$60.2 million, or 21.5%, of the total held for investment balance. From May 2007 through December 31, 2015, the Bank originated \$747.0 million to small business professionals in the Healthcare vertical with \$557.3 million in outstanding principal remaining in the servicing portfolio and \$187.5 million on book. Loans to Independent Pharmacies represent the third largest vertical at \$49.0 million, or 17.5%, of the total held for investment balance. From May 2007 through December 31, 2015, the Bank originated \$647.0 million to small business professionals in the Pharmacy vertical with \$482.4 million in outstanding principal remaining in the servicing portfolio and \$90.6 million on book.

The Company believes the risk associated with industry concentration is mitigated by the geographical diversity of the overall loan portfolio with loans originated in each of the fifty U.S. states and certain U.S. territories. Additionally, the Company has demonstrated the ability to expand lending activities into selected new verticals and intends to continue this expansion in the future. To the extent that the Company is successful in expanding into new verticals, the Company believes any risk related to concentration within any one industry will be further mitigated.

The maximum loan size under the SBA 7(a) program is \$5.0 million. The average loan size at origination for the Company's portfolio in its chosen industries in 2015 was \$1.1 million. At December 31, 2015, no single loan had an outstanding borrower principal balance greater than \$5.0 million. At December 31, 2015, the average outstanding balance per loan was approximately \$837 thousand. Total outstanding principal balance, including those serviced for others, equaled or exceeded \$3.0 million on 28 loans which cumulatively totaled \$102.1 million at December 31, 2015. Of this \$102.1 million in outstanding principal, \$10.2 million was held for investment. The outstanding principal balance of the full loan portfolio, including those serviced for others, totaled \$2.73 billion of which \$279.9 million was held for investment.

Loan Maturity

As of December 31, 2015, \$2.50 billion, or 91.6%, of the total outstanding principal loans, including those serviced for others, were variable rate loans that adjust at specified dates based on the prime lending rate or other variable indices. As of December 31, 2015, \$2.04 billion, or 74.5%, of total outstanding principal loans were variable rate loans that adjust on either a calendar monthly or calendar quarterly basis using the prime lending rate or other variable indices. At December 31, 2015, 92.1%, or \$697.7 million, of the combined held for sale and held for investment loan portfolio was comprised of variable rate loans. At December 31, 2015, \$4.0 million, or 1.4%, of the held for investment balance matures in less than five years. Loans maturing in greater than five years total \$276.0 million of the total \$279.9 million. The variable rate portion of the total held for investment loans is 92.1%, which reflects the Company's strategy to minimize interest rate risk through the use of variable rate products.

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	At December 31, 2015			
	Remaining Contractual Maturity of Total Held for Investment Loans			
	One Year or Less	After One Year and Through Five Years	After Five Years	Total
Fixed rate loans:				
Commercial & Industrial				
Death Care Management	\$—	\$—	\$908	\$908
Healthcare	—	—	896	896
Independent Pharmacies	—	—	2,161	2,161
Registered Investment Advisors	—	—	458	458
Veterinary Industry	—	—	1,215	1,215
Other Industries	—	—	284	284
Total	—	—	5,922	5,922
Construction & Development				
Agriculture	—	2	—	2
Death Care Management	—	—	129	129
Healthcare	—	—	896	896
Registered Investment Advisors	—	—	25	25
Veterinary Industry	—	—	275	275
Other Industries	—	—	136	136
Total	—	2	1,461	1,463
Owner Occupied Commercial Real Estate				
Death Care Management	—	—	4,108	4,108
Healthcare	—	—	4,755	4,755
Registered Investment Advisors	—	—	482	482
Veterinary Industry	—	—	3,533	3,533
Other Industries	—	—	778	778
Total	—	—	13,656	13,656
Commercial Land				
Agriculture	—	—	1,010	1,010
Total	—	—	1,010	1,010
Total fixed rate loans	—	2	22,049	22,051
Variable rate loans:				
Commercial & Industrial				
Agriculture	—	7	23	30
Death Care Management	—	22	3,902	3,924
Healthcare	5	677	13,662	14,344
Independent Pharmacies	—	1,237	38,190	39,427
Registered Investment Advisors	—	—	17,900	17,900
Veterinary Industry	—	1,734	18,630	20,364
Other Industries	—	—	2,946	2,946
Total	5	3,677	95,253	98,935
Construction & Development				
Agriculture	—	—	11,349	11,349
Death Care Management	—	—	640	640
Healthcare	—	—	6,335	6,335
Independent Pharmacies	—	—	101	101

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Registered Investment Advisors	—	—	353	353
Veterinary Industry	—	—	3,559	3,559
Other Industries	—	—	522	522
Total	—	—	22,859	22,859
Owner Occupied Commercial Real Estate				
Agriculture	—	—	1,863	1,863
Death Care Management	—	3	16,216	16,219
Healthcare	—	—	32,929	32,929
Independent Pharmacies	199	—	7,099	7,298
Registered Investment Advisors	—	—	2,326	2,326
Veterinary Industry	6	81	56,379	56,466
Other Industries	—	3	3,971	3,974
Total	205	87	120,783	121,075
Commercial Land				
Agriculture	—	—	15,026	15,026

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	At December 31, 2015			
	Remaining Contractual Maturity of Total Held for Investment Loans			
	One Year or Less	After One Year and Through Five Years	After Five Years	Total
Total	—	—	15,026	15,026
Total variable rate loans	210	3,764	253,921	257,895
Total	\$210	\$3,766	\$275,970	\$279,946

Asset Quality

Management considers asset quality to be of primary importance. A formal loan review function, independent of loan origination, is used to identify and monitor problem loans. This function reports directly to the Audit & Risk Committee of the Board of Directors.

Nonperforming Assets

The Bank places loans on nonaccrual status when they become 90 days past due as to principal or interest payments, or prior to that if management has determined based upon current information available to them that the timely collection of principal or interest is not probable. When a loan is placed on nonaccrual status, any interest previously accrued as income but not actually collected is reversed and recorded as a reduction of loan interest and fee income. Typically, collections of interest and principal received on a nonaccrual loan are applied to the outstanding principal as determined at the time of collection of the loan.

Troubled debt restructurings occur when, because of economic or legal reasons pertaining to the debtor's financial difficulties, debtors are granted concessions that would not otherwise be considered. Such concessions would include, but are not limited to, the transfer of assets or the issuance of equity interests by the debtor to satisfy all or part of the debt, modification of the terms of debt or the substitution or addition of debtor(s).

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The following table provides information with respect to nonperforming assets and troubled debt restructurings at the dates indicated.

	2015	2014	2013	2012	2011	
Nonaccrual loans:						
Total nonperforming loans (all on nonaccrual)	\$12,367	\$18,692	\$8,697	\$8,593	\$9,871	
Total accruing loans past due 90 days or more	—	—	—	—	—	
Foreclosed assets	2,666	1,084	773	1,518	—	
Total troubled debt restructurings	11,021	10,611	9,736	9,120	6,459	
Less nonaccrual troubled debt restructurings	(8,814)	(9,805)	(5,781)	(5,426)	(5,161)	
Total performing troubled debt restructurings	2,207	806	3,955	3,694	1,298	
Total nonperforming assets and troubled debt restructurings	\$17,240	\$20,582	\$13,425	\$13,805	\$11,169	
Total nonperforming loans to total loans held for investment	4.42	% 9.17	% 6.15	% 9.27	% 11.52	%
Total nonperforming loans to total assets	1.17	% 2.78	% 2.02	% 2.51	% 3.71	%
Total nonperforming assets and troubled debt restructurings to total assets	1.64	% 3.06	% 3.12	% 4.03	% 4.20	%

	2015	2014	2013	2012	2011	
Nonaccrual loans guaranteed by U.S. government:						
Total nonperforming loans guaranteed by the SBA (all on nonaccrual)	\$10,330	\$15,555	\$6,983	\$5,062	\$6,790	
Total accruing loans past due 90 days or more guaranteed by the SBA	—	—	—	—	—	
Foreclosed assets guaranteed by the SBA	2,293	713	432	1,286	—	
Total troubled debt restructurings guaranteed by the SBA	7,710	8,433	6,139	4,476	3,505	
Less nonaccrual troubled debt restructurings guaranteed by the SBA	(7,550)	(8,433)	(4,814)	(3,097)	(3,505)	
Total performing troubled debt restructurings guaranteed by SBA	160	—	1,325	1,379	—	
Total nonperforming assets and troubled debt restructurings guaranteed by the SBA	\$12,783	\$16,268	\$8,740	\$7,727	\$6,790	
Total nonperforming loans not guaranteed by the SBA to total held for investment loans	0.73	% 1.54	% 1.21	% 3.81	% 3.59	%
Total nonperforming loans not guaranteed by the SBA to total assets	0.19	% 0.47	% 0.40	% 1.03	% 1.16	%
Total nonperforming assets and troubled debt restructurings not guaranteed by the SBA to total assets	0.42	% 0.64	% 1.09	% 1.77	% 1.65	%

Total nonperforming assets and troubled debt restructurings at December 31, 2015 were \$17.2 million, which represented a \$3.3 million, or 16.2%, decrease from December 31, 2014. Total nonperforming assets at December 31, 2015 were composed of \$12.4 million in nonaccrual loans and \$2.7 million of foreclosed assets. Of the \$17.2 million of nonperforming assets, \$12.8 million carried an SBA guaranty, leaving an unguaranteed exposure of \$4.5 million in total nonperforming assets at December 31, 2015. The unguaranteed exposure in total nonperforming assets at December 31, 2014 was \$4.3 million. Unguaranteed exposure relating to nonperforming assets at December 31, 2015 increased by \$143 thousand, or 3.3%, compared to December 31, 2014.

As a percentage of the Bank's total capital, nonperforming loans represented 12.0% at December 31, 2015, compared to nonperforming loans of 30.0% of the Bank's total capital at December 31, 2014. Adjusting the ratio to include only

the unguaranteed portion of nonperforming loans as a percent of the Bank's total capital to reflect management's belief that the greater magnitude of risk resides in the unguaranteed portion of nonperforming loans, the ratios at December 31, 2015 and December 31, 2014 were 2.0% and 5.0%, respectively.

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As of December 31, 2015 and 2014, potential problem loans and impaired loans totaled \$41.0 million. Risk Grades 5 through 8 represent the spectrum of criticized and impaired loans. Loans in the Veterinary and Healthcare industries, our two largest verticals, comprise the largest portion of the total potential problem and impaired loans at 50.2% and 27.0%, respectively. As of December 31, 2014, potential problem and impaired loans were comprised of 56.2% and 21.3% in Veterinary and Healthcare Industry verticals, respectively. The majority of the impaired loans in the Veterinary Industry were originated prior to 2010. The Company believes that its underwriting and credit quality standards have improved as the business has matured. At December 31, 2015, the portion of criticized loans guaranteed by the SBA totaled \$17.2 million resulting in unguaranteed exposure risk of \$23.8 million, or 9.1% of total held for investment unguaranteed exposure. This compares to total criticized and impaired loans of \$41.0 million at December 31, 2014, of which \$21.3 million was guaranteed by the SBA.

The Bank does not classify loans that experience insignificant payment delays and payment shortfalls as impaired. The Bank considers an “insignificant period of time” from payment delays to be a period of 90 days or less. The Bank would consider a modification for a customer experiencing what is expected to be a short term event that has temporarily impacted cash flow. This could be due, among other reasons, to illness, weather, impact from a one-time expense, slower than expected start-up, construction issues or other short term issues. In all cases, credit will review the request to determine if the customer is stressed and how the event has impacted the ability of the customer to repay the loan long term. To date, the only types of short term modifications the Bank has given are payment deferral and interest only extensions. The Bank does not alter the rate or lengthen the amortization of the note due to insignificant payment delays. Short term modifications are not classified as troubled debt restructurings, or TDRs, because they do not meet the definition set by the applicable FDIC and accounting standards.

Management endeavors to be proactive in its approach to identify and resolve problem loans and is focused on working with the borrowers and guarantors of these loans to provide loan modifications when warranted. Management implements a proactive approach to identifying and classifying loans as criticized, Risk Grade 5. For example, at December 31, 2015 and 2014, Risk Grade 5 loans totaled \$17.5 million and \$9.8 million, respectively. The increase in Risk Grade 5 loans from December 31, 2014 to 2015 was principally confined to our three largest verticals; Veterinary (\$1.5 million or 19.6% of increase), Healthcare (\$3.6 million or 46.6% of increase) and Independent Pharmacies (\$1.8 million or 22.6% of increase). The underlying cause of the increase in Risk Grade 5 loans from December 31, 2014 to 2015 was ongoing maturity of larger existing verticals combined with \$3.6 million dollars in previously Risk Grade 6 credits being upgraded to Risk Grade 5 or better during the fourth quarter of 2015. This is indicative of the Bank’s proactive approach to servicing. Management embraces an approach to work closely with challenged credits to provide resources and support when deemed appropriate in an effort to bring these credits back to performing status. These subject upgraded credits represent businesses that have experienced stress in the past but have demonstrated significant financial and repayment improvements over multiple periods. As such, management deemed it appropriate to upgrade these credits. While the level of nonperforming assets fluctuates in response to changing economic and market conditions, the relative size and composition of the loan portfolio, and management’s degree of success in resolving problem assets, management believes that a proactive approach to early identification and intervention is critical to successfully managing a small business loan portfolio.

Interest income that would have been recorded for the years ended December 31, 2015, 2014 and 2013 had nonaccrual loans been current throughout the period amounted to \$0.8 million, \$0.4 million and \$0.2 million, respectively.

Allowance for Loan Losses

The allowance for loan losses (“ALL”), a material estimate which could change significantly in the near-term in the event of rapidly deteriorating credit quality, is established through a provision for loan losses charged to earnings to account for losses that are inherent in the loan portfolio and estimated to occur, and is maintained at a level that management considers appropriate to absorb losses in the loan portfolio. Loan losses are charged against the ALL when management believes that the collectability of the principal loan balance is unlikely. Subsequent recoveries, if any, are credited to the ALL when received.

Judgment in determining the adequacy of the ALL is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available and as situations and information change.

The ALL is evaluated on a quarterly basis by management and takes into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans and current economic conditions and trends that may affect borrowers' ability to repay.

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Estimated credit losses should meet the criteria for accrual of a loss contingency, i.e., a provision to the ALL, set forth in accounting principles generally accepted in the United States of America (“GAAP”). Methodology for determining the ALL is generally based on GAAP, the Interagency Policy Statement on the Allowance for Loan and Lease Losses and other regulatory and accounting pronouncements. The ALL is determined by the sum of three separate components: (i) the impaired loan component, which addresses specific reserves for impaired loans; (ii) the general reserve component, which addresses reserves for pools of homogeneous loans; and (iii) an unallocated reserve component (if any) based on management’s judgment and experience. The loan pools and impaired loans are mutually exclusive; any loan that is impaired should be excluded from its homogenous pool for purposes of that pool’s reserve calculation, regardless of the level of impairment.

The ALL of \$4.4 million at December 31, 2014 increased by \$3.0 million, or 68.3%, to \$7.4 million at December 31, 2015. The ALL, as a percentage of loans held for investment, amounted to 2.6% at December 31, 2015 and 2.2% at December 31, 2014. The majority of this increase was in general reserves and was attributed to growth in loans held for investment and expansion into new verticals with higher assumed loss factors due to the Company’s lack of experience in those industries. General reserves as a percentage of non-impaired loans amounted to 2.05% at December 31, 2015 as compared to 1.52% at December 31, 2014. Net charge-offs were \$798 thousand for the year ended December 31, 2015, compared to net charge-offs of \$1.1 million for the year ended December 31, 2014.

Total past due loans and loan charge-offs have declined as management continues to work to improve asset quality. Management believes the ALL of \$7.4 million at December 31, 2015 is appropriate in light of the risk inherent in the loan portfolio. Management’s judgments are based on numerous assumptions about current events that it believes to be reasonable, but which may or may not be valid. Thus, there can be no assurance that loan losses in future periods will not exceed the current ALL or that future increases in the ALL will not be required. No assurance can be given that management’s ongoing evaluation of the loan portfolio in light of changing economic conditions and other relevant circumstances will not require significant future additions to the ALL, thus adversely affecting the Company’s operating results. Additional information on the ALL is presented in Note 3 to the consolidated financial statements included with this report.

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The following table sets forth the breakdown of the allowance for loan losses by loan category at the dates indicated.

	2015				2014				2013			
	Allowance	Total Loans	% of Total Allowance	% of Loans in Category of Total Loans	Allowance	Total Loans	% of Total Allowance	% of Loans in Category of Total Loans	Allowance	Total Loans	% of Total Allowance	% of Loans in Category of Total Loans
Commercial & Industrial												
Agriculture	\$5	\$30	0.07	0.01	\$—	\$—	—	—	\$—	\$—	—	—
Death Care Management	31	4,832	0.42	1.72	2	3,603	0.05	1.77	2	1,782	0.07	1.25
Healthcare	684	15,240	9.22	5.44	875	12,319	9.85	6.06	334	8,739	12.27	6.15
Independent Pharmacies	724	41,588	9.76	14.86	336	34,079	6.62	16.75	132	24,024	4.85	16.91
Registered Investment Advisors	220	18,358	2.97	6.56	7	9,660	0.16	4.75	74	2,817	2.72	1.98
Veterinary Industry	555	21,579	7.48	7.71	114	20,902	2.59	10.27	304	19,978	1.16	14.06
Other Industries	547	3,230	7.38	1.15	35	494	0.79	0.24	16	17	0.59	0.01
Total	2,766	104,857	7.30	37.45	1,369	81,057	7.06	39.84	862	57,359	5.166	40.36
Construction & Development												
Agriculture	811	11,351	10.94	4.05	362	3,910	8.21	1.92	—	—	—	—
Death Care Management	9	769	0.12	0.27	1	92	0.02	0.05	10	989	0.37	0.70
Healthcare	152	7,231	2.05	2.58	145	2,957	3.29	1.45	242	4,997	8.89	3.52
Independent Pharmacies	1	101	0.01	0.04	4	215	0.09	0.11	2	101	0.07	0.07
Registered Investment Advisors	7	378	0.09	0.14	—	—	—	—	—	—	—	—