SECURITY FEDERAL CORP
Form 10-Q
August 13, 2014
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10 – Q
(Mark one)
(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2014
( ) 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: 0-16120
SECURITY FEDERAL CORPORATION
(Exact name of registrant as specified in its charter)

South Carolina	57-0858504
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

238 RICHLAND AVENUE, WEST, AIKEN, SOUTH CAROLINA 29801
(Address of principal executive office and Zip Code)
(803) 641-3000
(Registrant's telephone number, including area code)
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
YES X NO

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

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 filed [ ]	Accelerated filer [ ]
Non-accelerated filer [ ]	Smaller reporting company [X]

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

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

CLASS:	OUTSTANDING SHARES AT:	SHARES:
Common Stock, par value $0.01 per share	August 13, 2014	2,944,001

SCHEDULES OMITTED

All schedules other than those indicated above are omitted because of the absence of the conditions under which they are required or because the information is included in the consolidated financial statements and related notes.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

Part 1. Financial Information
Item 1. Financial Statements
Consolidated Balance Sheets

	June 30, 2014	December 31, 2013
ASSETS:		
Cash And Cash Equivalents	$12,531,186	$7,629,771
Certificates Of Deposit With Other Banks	2,095,000	2,100,395
Investment And Mortgage-Backed Securities:		
Available For Sale (Amortized Cost Of $428,932,644 And $430,241,854 At June 30, 2014 And December 31, 2013, Respectively)	436,810,833	431,003,452
Loans Receivable, Net:		
Held For Sale	1,384,240	1,234,158
Held For Investment (Net Of Allowance Of $9,112,157 and $10,241,970 At June 30, 2014 And December 31, 2013, Respectively)	345,221,173	357,682,507
Total Loans Receivable, Net	346,605,413	358,916,665
Accrued Interest Receivable:		
Loans	949,305	1,031,747
Mortgage-Backed Securities	725,498	732,100
Investment Securities	1,504,633	1,393,156
Total Accrued Interest Receivable	3,179,436	3,157,003
Premises And Equipment, Net	18,485,846	17,243,390
Federal Home Loan Bank ("FHLB") Stock, At Cost	4,573,120	5,016,600
Repossessed Assets Acquired In Settlement Of Loans	4,131,265	3,947,226
Bank Owned Life Insurance	11,000,045	11,474,305
Intangible Assets, Net	—	11,970
Goodwill	1,199,754	1,199,754
Other Assets	3,709,901	7,547,528
Total Assets	$844,321,799	$849,248,059
LIABILITIES AND SHAREHOLDERS’ EQUITY:		
Liabilities:		
Deposit Accounts	$658,423,773	$658,696,772
Advances From FHLB	75,152,312	87,740,058
Other Borrowings	9,358,367	8,002,739
Junior Subordinated Debentures	5,155,000	5,155,000
Advance Payments By Borrowers For Taxes And Insurance	496,259	255,364
Senior Convertible Debentures	6,084,000	6,084,000
Other Liabilities	5,150,311	5,324,046
Total Liabilities	759,820,022	771,257,979
Shareholders' Equity:		
Serial Preferred Stock, $.01 Par Value; Authorized 200,000 Shares; Issued And Outstanding, 22,000 Shares At June 30, 2014 And December 31, 2013, Respectively	22,000,000	22,000,000
Common Stock, $.01 Par Value; Authorized 5,000,000 Shares; Issued 3,144,934 Shares At June 30, 2014 And At December 31, 2013, Respectively	31,449	31,449
Additional Paid-In Capital	11,984,475	11,978,137
	(4,330,712)	(4,330,712)

Treasury Stock, At Cost (200,933 Shares At June 30, 2014 And December 31, 2013, Respectively)		
Accumulated Other Comprehensive Income	4,889,470	472,406
Retained Earnings	49,927,095	47,838,800
Total Shareholders' Equity	84,501,777	77,990,080
Total Liabilities And Shareholders' Equity	$844,321,799	$849,248,059

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

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SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Interest Income:				
Loans	$4,920,562	$5,524,185	$9,784,050	$11,109,071
Mortgage-Backed Securities	1,640,016	1,221,271	3,029,134	2,582,447
Investment Securities	1,073,905	932,545	2,011,206	1,688,416
Other	2,457	1,707	6,025	4,043
Total Interest Income	7,636,940	7,679,708	14,830,415	15,383,977
Interest Expense:				
NOW And Money Market Accounts	128,974	211,968	309,733	444,056
Statement Savings Accounts	6,589	9,724	12,716	20,788
Certificate Accounts	500,307	674,138	1,009,102	1,414,013
FHLB Advances And Other Borrowed Money	724,577	915,786	1,432,292	1,898,891
Senior Convertible Debentures	121,680	121,680	243,360	243,360
Junior Subordinated Debentures	25,187	25,787	50,202	51,597
Total Interest Expense	1,507,314	1,959,083	3,057,405	4,072,705
Net Interest Income	6,129,626	5,720,625	11,773,010	11,311,272
Provision For Loan Losses	100,000	900,000	200,000	2,045,381
Net Interest Income After Provision For Loan Losses	6,029,626	4,820,625	11,573,010	9,265,891
Non-Interest Income:				
Gain (Loss) On Sale Of Investment Securities	(39,485)	369,729	44,871	753,780
Gain On Sale Of Loans	218,288	210,840	346,530	395,628
Service Fees On Deposit Accounts	284,071	278,263	560,556	542,094
Commissions From Insurance Agency	109,229	104,649	200,863	244,962
Trust Income	141,000	135,000	246,000	270,000
Bank Owned Life Insurance Income	198,537	78,000	404,364	183,000
Check Card Fee Income	233,861	222,929	444,556	418,122
Community Development Financial Institution ("CDFI") Financial Award Income	17,750	220,071	299,710	636,071
Other	168,687	123,422	320,887	244,228
Total Non-Interest Income	1,331,938	1,742,903	2,868,337	3,687,885
Non-Interest Expense:				
Compensation And Employee Benefits	2,836,547	2,768,450	5,683,549	5,589,825
Occupancy	474,836	487,664	975,752	962,978
Advertising	142,863	70,088	243,259	177,731
Depreciation And Maintenance Of Equipment	393,270	369,760	810,776	808,932
Federal Deposit Insurance Corporation ("FDIC") Insurance Premiums	178,785	196,476	364,242	364,198
Amortization Of Intangibles	—	12,501	11,970	25,002
Net Cost Of Operation Of Other Real Estate Owned	254,474	341,392	523,570	737,761
Prepayment Penalties on FHLB Advances	—	85,089	—	238,342
Other	1,035,848	1,060,192	2,030,184	1,999,727
Total General And Administrative Expenses	5,316,623	5,391,612	10,643,302	10,904,496
Income Before Income Taxes	2,044,941	1,171,916	3,798,045	2,049,280
Provision For Income Taxes	568,125	293,354	1,018,709	499,349

Net Income	1,476,816	878,562	2,779,336	1,549,931
Preferred Stock Dividends	110,000	110,000	220,000	220,000
Net Income Available To Common Shareholders	$1,366,816	$768,562	$2,559,336	$1,329,931
Net Income Per Common Share (Basic)	$0.46	$0.26	$0.87	$0.45
Net Income Per Common Share (Diluted)	$0.44	$0.26	$0.83	$0.45
Cash Dividend Per Share On Common Stock	$0.08	$0.08	$0.16	$0.16
Weighted Average Shares Outstanding (Basic)	2,944,001	2,944,001	2,944,001	2,944,001
Weighted Average Shares Outstanding (Diluted)	3,248,201	2,944,001	3,248,201	2,944,001

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

	Three Months Ended June 30,	
	2014	2013
Net Income	$1,476,816	$878,562
Other Comprehensive Income (Loss)		
Unrealized Gains (Losses) On Securities:		
Unrealized Holding Gains (Losses) On Securities Available For Sale, Net Of Taxes Of $1,668,413 And $2,805,077 At June 30, 2014 And 2013, Respectively	2,697,666	(4,578,780)
Reclassification Adjustment For (Gains) Losses Included In Net Income, Net Of Taxes Of $(15,004) And $140,497 At June 30, 2014 And 2013, Respectively	24,481	(229,232)
Held To Maturity Transfer To Available For Sale, Net Of Taxes of $0 and $530,733 at June 30, 2014 and 2013, Respectively	—	865,933
Other Comprehensive Income (Loss)	2,722,147	(3,942,079)
Comprehensive Income (Loss)	$4,198,963	$(3,063,517)

	Six Months Ended June 30,	
	2014	2013
Net Income	$2,779,336	$1,549,931
Other Comprehensive Income (Loss)		
Unrealized Gains (Losses) On Securities:		
Unrealized Holding Gains (Losses) On Securities Available For Sale, Net Of Taxes Of $2,707,233 And $3,363,779 At June 30, 2014 And 2013, Respectively	4,444,884	(5,490,354)
Reclassification Adjustment For Gains Included In Net Income, Net Of Taxes Of $17,051 And $286,437 At June 30, 2014 And 2013, Respectively	(27,820)	(467,343)
Held To Maturity Transfer To Available For Sale, Net Of Taxes of $0 and $530,733 at June 30, 2014 and 2013, Respectively	—	865,933
Other Comprehensive Income (Loss)	4,417,064	(5,091,764)
Comprehensive Income (Loss)	$7,196,400	$(3,541,833)

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
For the Six Months Ended June 30, 2014 and 2013

	Preferred Stock	Warrants	Common Stock	Additional Paid – In Capital	Treasury Stock	Accumulated Other Comprehensive Income	Retained Earnings	Total
Balance at December 31, 2012	$22,000,000	$400,000	$31,449	$11,630,717	$(4,330,712)	$7,431,310	$45,429,720	$82,592,484
Net Income	—	—	—	—	—	—	1,549,931	1,549,931
Other Comprehensive Loss, Net Of Tax	—	—	—	—	—	(5,091,764)	—	(5,091,764)
Stock Option Compensation Expense	—	—	—	(8,919)	—	—	—	(8,919)
Cash Dividends On Preferred	—	—	—	—	—	—	(220,000)	(220,000)
Cash Dividends On Common	—	—	—	—	—	—	(471,041)	(471,041)
Balance at June 30, 2013	$22,000,000	$400,000	$31,449	$11,621,798	$(4,330,712)	$2,339,546	$46,288,610	$78,350,691

	Preferred Stock	Common Stock	Additional Paid – In Capital	Treasury Stock	Accumulated Other Comprehensive Income	Retained Earnings	Total
Balance at December 31, 2013	$22,000,000	$31,449	$11,978,137	$(4,330,712)	$472,406	$47,838,800	$77,990,080
Net Income	—	—	—	—	—	2,779,336	2,779,336
Other Comprehensive Income, Net Of Tax	—	—	—	—	4,417,064	—	4,417,064
Stock Option Compensation Expense	—	—	6,338	—	—	—	6,338
Cash Dividends On Preferred	—	—	—	—	—	(220,000)	(220,000)
Cash Dividends On Common	—	—	—	—	—	(471,041)	(471,041)
Balance at June 30, 2014	$22,000,000	$31,449	$11,984,475	$(4,330,712)	$4,889,470	$49,927,095	$84,501,777

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

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SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

	Six Months Ended June 30, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	$2,779,336	$1,549,931
Adjustments To Reconcile Net Income To Net Cash Provided By Operating Activities:		
Depreciation Expense	591,422	645,468
Amortization Of Intangible Assets	11,970	25,002
Stock Option Compensation (Benefit) Expense	6,338	(8,919)
Discount Accretion And Premium Amortization	2,688,258	3,848,810
Provisions For Losses On Loans	200,000	2,045,381
Income Accrued On Bank Owned Life Insurance	(150,000)	(183,000)
Gain On Sales Of Loans	(346,530)	(395,628)
Gain On Sales Of Mortgage-Backed Securities	(254,538)	(384,051)
(Gain) Loss On Sales Of Investment Securities	209,667	(369,729)
Gain On Sale Of Real Estate Owned	(64,723)	(991)
Write Down On Real Estate Owned	405,000	574,378
Amortization Of Deferred Fees On Loans	9,345	(3,335)
Proceeds From Sale Of Loans Held For Sale	12,328,927	17,376,516
Origination Of Loans Held For Sale	(12,132,479)	(15,685,061)
(Increase) Decrease In Accrued Interest Receivable:		
Loans	82,442	(26,295)
Mortgage-Backed Securities	6,602	96,245
Investment Securities	(111,477)	(273,802)
Increase In Advance Payments By Borrowers	240,895	304,934
Other, Net	969,761	1,736,408
Net Cash Provided By Operating Activities	7,470,216	10,872,262
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase Of Mortgage-Backed Securities Available For Sale	(38,071,908)	(48,748,823)
Principal Repayments On Mortgage-Backed Securities Available For Sale	15,842,466	31,690,621
Principal Repayments On Mortgage-Backed Securities Held To Maturity	—	942,806
Purchase Of Investment Securities Available For Sale	(18,395,226)	(39,548,282)
Maturities Of Investment Securities Available For Sale	11,985,537	8,692,353
Purchase of Investment Securities Held To Maturity	—	(1,000,000)
Maturities Of Investment Securities Held To Maturity	—	3,501,978
Proceeds From Sale of Investment Securities Available For Sale	13,953,153	10,875,010
Proceeds From Sale of Mortgage-Backed Securities Available For Sale	13,351,800	20,946,735
Proceeds From Redemption of Certificates Of Deposits With Other Banks	—	250,000
Purchase Of FHLB Stock	(3,671,300)	(2,165,206)
Redemption Of FHLB Stock	4,114,780	3,156,006
Proceeds From Bank Owned Life Insurance	624,260	—
Decrease In Loans Receivable	11,213,029	17,536,325
Proceeds From Sale Of Repossessed Assets	514,644	4,182,107
Purchase And Improvement Of Premises And Equipment	(1,833,878)	(419,894)
Proceeds From Sale of Premises and Equipment	—	1,250
Net Cash Provided By Investing Activities	9,627,357	9,892,986

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SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited) (Continued)	Six Months Ended June 30, 2014		2013	
CASH FLOWS FROM FINANCING ACTIVITIES:				
Decrease In Deposit Accounts	$(272,999	)	$(5,256,308	)
Proceeds From FHLB Advances	141,215,000		60,900,000	
Repayment Of FHLB Advances	(153,802,746	)	(74,608,520	)
Increase in Other Borrowings, Net	1,355,628		322,568	
Dividends To Preferred Stock Shareholders	(220,000	)	(220,000	)
Dividends To Common Stock Shareholders	(471,041	)	(471,041	)
Net Cash Used By Financing Activities	(12,196,158	)	(19,333,301	)
Net Increase In Cash And Cash Equivalents	4,901,415		1,431,947	
Cash And Cash Equivalents At Beginning Of Period	7,629,771		7,903,950	
Cash And Cash Equivalents At End Of Period	$12,531,186		$9,335,897	
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash Paid During The Period For:				
Interest	$3,089,937		$4,164,419	
Income Taxes	$180,350		$68,419	
Supplemental Schedule Of Non Cash Transactions:				
Transfers From Loans Receivable To Other Real Estate Owned	$1,038,960		$2,782,523	
Transfers From Investment Securities Held To Maturity To Available For Sale	$—		$49,907,323	
Transfers From Mortgage-Backed Securities Held To Maturity To Available For Sale	$—		$22,100,000	

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

1. Basis of Presentation

The accompanying unaudited consolidated financial statements were prepared in accordance with instructions for Form 10-Q and accounting principles generally accepted in the United States of America; therefore, they do not include all disclosures necessary for a complete presentation of financial condition, results of operations, and cash flows. Such statements are unaudited but, in the opinion of management, reflect all adjustments, which are of a normal recurring nature and necessary for a fair presentation of results for the selected interim periods. Users of financial information produced for interim periods are encouraged to refer to the footnotes contained in the audited financial statements appearing in Security Federal Corporation's (the "Company") 2013 Annual Report to Shareholders which was filed as an exhibit to our Annual Report on Form 10-K for the year ended December 31, 2013 ("2013 10-K") when reviewing interim financial statements. The Company changed its fiscal year from March 31 to December 31 effective January 17, 2013. The results of operations for the three and six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the entire fiscal year.

2. Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Security Federal Bank (the "Bank") and the Bank's wholly owned subsidiaries, Security Federal Insurance, Inc. ("SFINS") and Security Financial Services Corporation ("SFSC"). SFINS was formed during fiscal 2002 and began operating during the December 2001 quarter and is an insurance agency offering auto, business, health, and home insurance. SFINS has a wholly owned subsidiary, Collier Jennings Financial Corporation which has as subsidiaries Security Federal Insurance Technologies, Inc. and Security Federal Premium Pay Plans Inc. (the "Collier Jennings Companies"). Security Federal Premium Pay Plans Inc. has one wholly owned premium finance subsidiary and also has an ownership interest in four other premium finance subsidiaries. SFSC was formed in 1975 and is currently inactive.

The Company has a wholly owned subsidiary, Security Federal Statutory Trust (the "Trust"), which issued and sold fixed and floating rate capital securities of the Trust. However, under current accounting guidance, the Trust is not consolidated in the Company's financial statements. The Bank is primarily engaged in the business of accepting savings and demand deposits and originating mortgage loans and other loans to individuals and small businesses for various personal and commercial purposes.

3. Critical Accounting Policies

The Company has adopted various accounting policies, which govern the application of accounting principles generally accepted in the United States in the preparation of our financial statements. Our significant accounting policies are described in the footnotes to the audited consolidated financial statements at December 31, 2013 included in our 2013 Annual Report to Shareholders. Certain accounting policies involve significant judgments and assumptions by management, which have a material impact on the carrying value of certain assets and liabilities, and, as such, have a greater possibility of producing results that could be materially different than originally reported. We consider these accounting policies to be critical accounting policies. The judgments and assumptions we use are based on historical experience and other factors, which we believe to be reasonable under the circumstances. Because of the nature of the judgments and assumptions we make, actual results could differ from these judgments and estimates which could have a material impact on our carrying values of assets and liabilities and our results of operations.

The Company believes the allowance for loan losses is a critical accounting policy that requires the most significant judgments and estimates used in preparation of the consolidated financial statements. The impact of an unexpected and sudden large loss could deplete the allowance and potentially require increased provisions to replenish the allowance, which would negatively affect earnings. The Company provides for loan losses using the allowance method. Accordingly, all loan losses are charged to the related allowance and all recoveries are credited to the allowance for loan losses. Additions to the allowance for loan losses are provided by charges to operations based on various factors, which, in management’s judgment, deserve current recognition in estimating possible losses. Such factors considered by management include the fair value of the underlying collateral, stated guarantees by the borrower (if applicable), the borrower’s ability to repay from other economic resources, growth and composition of the loan portfolio, the relationship of the allowance for loan losses to the outstanding loans, loss experience, delinquency trends, and general economic conditions. Management evaluates the carrying value of the loans periodically and the allowance is adjusted accordingly.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

3. Critical Accounting Policies, Continued

While management uses the best information available to make evaluations, future adjustments may be necessary if economic conditions differ substantially from the assumptions used in making these evaluations. The allowance for loan losses is subject to periodic evaluations by our bank regulators, including the Board of Governors of the Federal Reserve System ("Federal Reserve"), the FDIC and the South Carolina Board of Financial Institutions, and may be subject to adjustments based upon the information that is available at the time of their examination. The Company values impaired loans at the loan’s fair value if it is probable that the Company will be unable to collect all amounts due according to the terms of the loan agreement at the present value of expected cash flows, the market price of the loan, if available, or the value of the underlying collateral. Expected cash flows are required to be discounted at the loan’s effective interest rate. When the ultimate collectibility of an impaired loan’s principal is in doubt, wholly or partially, all cash receipts are applied to principal. When this doubt does not exist, cash receipts are applied under the contractual terms of the loan agreement first to interest and then to principal. Once the recorded principal balance has been reduced to zero, future cash receipts are applied to interest income to the extent that any interest has been foregone. Further cash receipts are recorded as recoveries of any amounts previously charged off.

The Company uses assumptions and estimates in determining income taxes payable or refundable for the current year, deferred income tax liabilities and assets for events recognized differently in its financial statements and income tax returns, and income tax expense. Determining these amounts requires analysis of certain transactions and interpretation of tax laws and regulations. The Company exercises considerable judgment in evaluating the amount and timing of recognition of the resulting tax liabilities and assets. These judgments and estimates are reevaluated on a continual basis as regulatory and business factors change. No assurance can be given that either the tax returns submitted by us or the income tax reported on the Consolidated Financial Statements will not be adjusted by either adverse rulings by the United States Tax Court, changes in the tax code, or assessments made by the Internal Revenue Service.

4. Earnings Per Common Share

Accounting guidance specifies the computation, presentation and disclosure requirements for earnings per share (“EPS”) for entities with publicly held common stock or potential common stock such as options, warrants, convertible securities or contingent stock agreements if those securities trade in a public market. Basic EPS is computed by dividing net income by the weighted average number of common shares outstanding. Diluted EPS is similar to the computation of basic EPS except that the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive common shares had been issued. The dilutive effect of options outstanding under the Company’s stock option plan is reflected in diluted earnings per share by application of the treasury stock method.

Net income available to common shareholders represents consolidated net income adjusted for preferred dividends declared, accretions of discounts and amortization of premiums on preferred stock issuances and cumulative dividends related to the current dividend period that have not been declared as of period end.

The following table provides a reconciliation of net income to net income available to common shareholders for the periods presented:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2014	2013	2014	2013
Earnings Available To Common Shareholders:				
Net Income	$1,476,816	$878,562	$2,779,336	$1,549,931
Preferred Stock Dividends	110,000	110,000	220,000	220,000
Net Income Available To Common Shareholders	$1,366,816	$768,562	$2,559,336	$1,329,931

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

4. Earnings Per Common Share, Continued

The following table shows the effect of dilutive options and warrants on the Company's earnings per share for the periods indicated:

	For the Three Months Ended June 30, 2014			For the Six Months Ended June 30, 2014		
	Income	Shares	Per Share Amounts	Income	Shares	Per Share Amounts
Basic EPS	$1,366,816	2,944,001	$0.46	$2,559,336	2,944,001	$0.87
Effect of Dilutive Securities:						
Senior Convertible Debentures	75,422	304,200	(0.02)	150,883	304,200	(0.04)
Diluted EPS	$1,442,238	3,248,201	$0.44	$2,710,219	3,248,201	$0.83

There were no dilutive securities or options for the three and six months ended June 30, 2013, therefore no reconciliation is provided for these periods.

5. Stock-Based Compensation

Certain officers and directors of the Company participate in an incentive and non-qualified stock option plan. Options are granted at exercise prices not less than the fair value of the Company’s common stock on the date of the grant. The following is a summary of the activity under the Company’s stock option plans for the periods presented:

	Three Months Ended June 30, 2014		2013	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Balance, Beginning of Period	50,500	$22.49	68,400	$22.63
Options Granted	—	—	—	—
Options Exercised	—	—	—	—
Options Forfeited	(3,000)	23.83	—	—
Balance, End Of Period	47,500	$22.41	68,400	$22.63

	Six Months Ended June 30, 2014		2013	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Balance, Beginning of Period	61,500	$22.49	68,400	$22.63
Options Granted	—	—	—	—
Options Exercised	—	—	—	—
Options Forfeited	(14,000)	22.74	—	—

Balance, End Of Period	47,500	$22.41	68,400	$22.63
Options Exercisable	32,600		47,500	
Options Available For Grant	50,000		50,000	

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

5. Stock-Based Compensation, Continued

At June 30, 2014, the Company had the following options outstanding:

Grant Date	Outstanding Options	Option Price	Expiration Date
01/01/05	18,000	$20.55	12/31/14
01/01/06	3,500	$23.91	01/01/16
08/24/06	3,500	$23.03	08/24/16
05/24/07	2,000	$24.34	05/24/17
07/09/07	1,000	$24.61	07/09/17
10/01/07	2,000	$24.28	10/01/17
01/01/08	13,000	$23.49	01/01/18
05/19/08	2,500	$22.91	05/19/18
07/01/08	2,000	$22.91	07/01/18

None of the options outstanding at June 30, 2014 or 2013 had an exercise price below the average market price during the three or six month periods ended June 30, 2014 or 2013. Therefore, these options were not deemed to be dilutive to earnings per share in those periods.

6. Stock Warrants

In conjunction with its participation in the U.S. Department of the Treasury's ("U.S. Treasury") Capital Purchase Program, the Company sold a warrant to the U.S. Treasury to purchase 137,966 shares of the Company's common stock at $19.57 per share. The warrant had a 10-year term and was immediately exercisable upon issuance.

On July 31, 2013, the Company repurchased its outstanding warrant at a fair market value of $50,000 from the U.S. Treasury. As a result of the transaction the warrant was canceled which reduced warrants outstanding by $400,000 and increased additional paid in capital by $350,000.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

7. Investment and Mortgage-Backed Securities, Available For Sale

The amortized cost, gross unrealized gains, gross unrealized losses, and fair values of investment and mortgage-backed securities available for sale are as follows:

	June 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair value
FHLB Securities	$14,325,249	$100,255	$421,073	$14,004,431
Federal Farm Credit Bank ("FFCB") Securities	5,750,000	—	137,495	5,612,505
Fannie Mae ("FNMA") And Freddie Mac ("FHLMC") Bonds	996,457	791	—	997,248
Small Business Administration (“SBA”) Bonds	95,497,940	1,822,916	271,402	97,049,454
Tax Exempt Municipal Bonds	58,330,018	1,776,888	352,949	59,753,957
Mortgage-Backed Securities	253,775,042	6,812,674	1,499,478	259,088,238
Equity Securities	257,938	47,062	—	305,000
	$428,932,644	$10,560,586	$2,682,397	$436,810,833

	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair value
FHLB Securities	$13,538,723	$25,695	$893,968	$12,670,450
FFCB Securities	5,750,000	—	383,820	5,366,180
FNMA And FHLMC Bonds	1,993,473	—	18,543	1,974,930
SBA Bonds	99,228,708	1,914,720	319,443	100,823,985
Tax Exempt Municipal Bonds	63,590,959	410,151	2,685,988	61,315,122
Mortgage-Backed Securities	245,882,053	5,843,365	3,128,883	248,596,535
Equity Securities	257,938	—	1,688	256,250
	$430,241,854	$8,193,931	$7,432,333	$431,003,452

FHLB securities, FFCB securities and FNMA and FHLMC mortgage-backed securities are issued by government-sponsored enterprises (“GSEs”). GSEs are not backed by the full faith and credit of the United States government. SBA bonds are backed by the full faith and credit of the United States government. Included in the tables above and below in mortgage-backed securities are GNMA mortgage-backed securities, which are also backed by the full faith and credit of the United States government. At June 30, 2014 the Bank held an amortized cost and fair value of $172.6 million and $177.2 million, respectively, in GNMA mortgage-backed securities included in mortgage-backed securities listed above compared to an amortized cost and fair value of $170.4 million and $173.5 million, respectively, at December 31, 2013. All mortgage-backed securities above are either GSEs or GNMA mortgage-backed securities. The Company has not invested in any private label mortgage-backed securities.

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SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

7. Investment and Mortgage-Backed Securities, Available For Sale, Continued

The amortized cost and fair value of investment and mortgage-backed securities available for sale at June 30, 2014 are shown below by contractual maturity. Expected maturities will differ from contractual maturities because borrowers have the right to prepay obligations with or without call or prepayment penalties.

Investment Securities	Amortized Cost	Fair Value
Less Than One Year	$321,151	$328,913
One – Five Years	12,647,153	12,876,501
Over Five – Ten Years	72,912,189	73,784,671
More Than Ten Years	89,277,109	90,732,510
Mortgage-Backed Securities	253,775,042	259,088,238
	$428,932,644	$436,810,833

At June 30, 2014 the amortized cost and fair value of investment and mortgage-backed securities available for sale pledged as collateral for certain deposit accounts, FHLB advances and other borrowings were $129.0 million and $132.8 million, respectively, compared to an amortized cost and fair value of $118.3 million and $121.1 million, respectively at December 31, 2013.

The Bank received $13.4 million and $10.9 million in gross proceeds from sales of available for sale securities during the three months ended June 30, 2014 and 2013, respectively. As a result, the Bank recognized gross gains of $168,000 and $370,000 respectively, and gross losses of $207,000 and zero respectively, for the three months ended June 30. 2014 and 2013.

The Bank received $27.3 million and $31.8 million in gross proceeds from sales of available for sale securities during the six months ended June 30, 2014 and 2013, respectively. As a result, the Bank recognized gross gains of $477,000 and $754,000, respectively, and gross losses of $432,000 and zero, respectively, for the six months ended June 30, 2014 and 2013.

The following tables show gross unrealized losses and fair value, aggregated by investment category, and length of time that the individual available for sale securities have been in a continuous unrealized loss position at the dates indicated.

	June 30, 2014					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
FHLB Securities	$—	$—	$7,577,335	$421,073	$7,577,335	$421,073
FFCB Securities	4,634,994	115,006	977,511	22,489	5,612,505	137,495
SBA Bonds	15,275,676	132,635	7,622,202	138,767	22,897,878	271,402
Tax Exempt Municipal Bond	4,442,890	44,641	19,923,138	308,308	24,366,028	352,949
Mortgage-Backed Securities	39,386,204	1,187,371	22,734,106	312,107	62,120,310	1,499,478
	$63,739,764	$1,479,653	$58,834,292	$1,202,744	$122,574,056	$2,682,397

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SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

7. Investment and Mortgage-Backed Securities, Available For Sale, Continued

	December 31, 2013					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
FHLB Securities	$10,288,110	$651,608	$1,757,640	$242,360	$12,045,750	$893,968
FFCB Securities	4,435,070	314,930	931,110	68,890	5,366,180	383,820
FNMA Bonds	1,974,930	18,543	—	—	1,974,930	18,543
SBA Bonds	12,183,961	288,678	3,541,453	30,765	15,725,414	319,443
Tax Exempt Municipal Bond	39,848,206	2,556,014	2,008,272	129,974	41,856,478	2,685,988
Mortgage-Backed Securities	88,516,030	2,756,216	6,436,369	372,667	94,952,399	3,128,883
Equity Securities	—	—	101,250	1,688	101,250	1,688
	$157,246,307	$6,585,989	$14,776,094	$846,344	$172,022,401	$7,432,333

Securities classified as available for sale are recorded at fair market value. At both June 30, 2014 and December 31, 2013, 11.4% of the unrealized losses, representing 38 and 11 individual securities, respectively, consisted of securities in a continuous loss position for 12 months or more. The Company has the ability and intent to hold these securities until such time as the value recovers or the securities mature. The Company believes, based on industry analyst reports and credit ratings, that the deterioration in value is attributable to changes in market interest rates and is not in the credit quality of the issuer and therefore, these losses are not considered other-than-temporary. The Company reviews its investment securities portfolio at least quarterly and more frequently when economic conditions warrant, assessing whether there is any indication of other-than-temporary impairment (“OTTI”).

Factors considered in the review include estimated future cash flows, length of time and extent to which market value has been less than cost, the financial condition and near term prospects of the issuer, and our intent and ability to retain the security to allow for an anticipated recovery in market value.

If the review determines that there is OTTI, then an impairment loss is recognized in earnings equal to the entire difference between the investment’s cost and its fair value at the balance sheet date of the reporting period for which the assessment is made, or we may recognize a portion in other comprehensive income. The fair value of investments on which OTTI is recognized then becomes the new cost basis of the investment.

8. Investment and Mortgage-Backed Securities, Held to Maturity

On June 30, 2013, the Company transferred all of its investment and mortgage-backed securities classified as held to maturity to available for sale. Based on changes in the current rate environment, management elected this change in an effort to more effectively manage the investment portfolio, including subsequently selling some securities that were formerly classified as held to maturity. The amortized cost of the securities that were transferred totaled $72.0 million and the net unrealized gain related to these securities totaled $1.4 million on the date of the transfer. As a result of the transfer and subsequent sales, the Company believes it has tainted its held to maturity classification and judgment will be required in the future in determining when circumstances have changed such that management can assert with a great degree of credibility that it has the intent and ability to hold debt securities to maturity.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

9. Loans Receivable, Net

Loans receivable, net, consisted of the following as of the dates shown:

	June 30, 2014	December 31, 2013
Residential Real Estate Loans	$78,147,843	$83,004,482
Consumer Loans	50,497,661	52,205,901
Commercial Business	8,964,667	7,775,098
Commercial Real Estate	219,384,091	228,399,555
Total Loans Held For Investment	356,994,262	371,385,036
Loans Held For Sale	1,384,240	1,234,158
Total Loans Receivable, Gross	358,378,502	372,619,194
Less:		
Allowance For Loan Losses	9,112,157	10,241,970
Loans In Process	2,649,601	3,465,072
Deferred Loan Fees (Costs)	11,331	(4,513)
	11,773,089	13,702,529
Total Loans Receivable, Net	$346,605,413	$358,916,665

Changes in the allowance for loan losses for the three and six months ended June 30, 2014 and 2013 are summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Balance At Beginning Of Period	$9,845,755	$11,105,226	$10,241,970	$11,318,371
Provision For Loan Losses	100,000	900,000	200,000	2,045,381
Charge Offs	(1,016,477)	(1,081,851)	(1,794,052)	(2,467,311)
Recoveries	182,879	83,904	464,239	110,838
Total Allowance For Loan Losses	$9,112,157	$11,007,279	$9,112,157	$11,007,279

The Company uses a risk based approach based on the following credit quality measures when analyzing the loan portfolio: pass, caution, special mention, and substandard. These indicators are used to rate the credit quality of loans for the purposes of determining the Company's allowance for loan losses. Pass loans are loans that are performing and are deemed adequately protected by the net worth of the borrower or the underlying collateral value. These loans are considered the least risky in terms of determining the allowance for loan losses. Substandard loans are considered the most risky category. These loans typically have an identified weakness or weaknesses and are inadequately protected by the net worth of the borrower or collateral value. All loans 90 days or more past due are automatically classified in this category. The other two categories fall in between these two grades.

The following tables list the loan grades used by the Company as credit quality indicators and the balance in each category at the dates presented, excluding loans held for sale.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

9. Loans Receivable, Net, Continued

June 30, 2014	Credit Quality Measures				
	Pass	Caution	Special Mention	Substandard	Total Loans
Residential Real Estate	$68,998,207	$2,496,195	$397,203	$6,256,238	$78,147,843
Consumer	48,319,721	1,065,653	137,931	974,356	50,497,661
Commercial Business	8,023,461	244,286	119,067	577,853	8,964,667
Commercial Real Estate	130,972,537	35,222,429	36,515,818	16,673,307	219,384,091
Total	$256,313,926	$39,028,563	$37,170,019	$24,481,754	$356,994,262

December 31, 2013	Credit Quality Measures				
	Pass	Caution	Special Mention	Substandard	Total Loans
Residential Real Estate	$74,505,587	$890,902	$403,138	$7,204,855	$83,004,482
Consumer	50,370,640	843,799	143,649	847,813	52,205,901
Commercial Business	6,807,620	368,019	524,928	74,531	7,775,098
Commercial Real Estate	135,793,150	43,252,464	25,581,235	23,772,706	228,399,555
Total	$267,476,997	$45,355,184	$26,652,950	$31,899,905	$371,385,036

The following table presents an age analysis of past due balances by category at June 30, 2014:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans Receivable
Residential Real Estate	$—	$1,071,054	$4,403,170	$5,474,224	$72,673,619	$78,147,843
Consumer	497,092	129,718	699,496	1,326,306	49,171,355	50,497,661
Commercial Business	1,127,249	95,713	494,736	1,717,698	7,246,969	8,964,667
Commercial Real Estate	2,768,652	768,166	9,884,181	13,420,999	205,963,092	219,384,091
Total	$4,392,993	$2,064,651	$15,481,583	$21,939,227	$335,055,035	$356,994,262

The following table presents an age analysis of past due balances by category at December 31, 2013:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans Receivable
Residential Real Estate	$—	$1,363,132	$4,607,613	$5,970,745	$77,033,737	$83,004,482
Consumer	1,494,429	234,878	399,062	2,128,369	50,077,532	52,205,901
Commercial Business	115,186	—	33,055	148,241	7,626,857	7,775,098
Commercial Real Estate	5,103,522	2,046,666	4,972,667	12,122,855	216,276,700	228,399,555

Total	$6,713,137	$3,644,676	$10,012,397	$20,370,210	$351,014,826	$371,385,036

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

9. Loans Receivable, Net, Continued

At June 30, 2014 and December 31, 2013, the Company did not have any loans that were 90 days or more past due and still accruing interest. Our strategy is to work with our borrowers to reach acceptable payment plans while protecting our interests in the existing collateral. In the event an acceptable arrangement cannot be reached, we may have to acquire these properties through foreclosure or other means and subsequently sell, develop, or liquidate them.

The following table shows non-accrual loans by category at June 30, 2014 compared to December 31, 2013:

	At June 30, 2014		At December 31, 2013		$	%
	Amount	Percent [1]	Amount	Percent [1]	Increase (Decrease)	Increase (Decrease)
Non-accrual Loans:						
Residential Real Estate	$4,403,170	1.24 %	$4,607,613	1.25 %	$(204,443)	(4.4)%
Commercial Business	494,736	0.14	33,055	0.01	461,681	1,396.7
Commercial Real Estate	9,884,181	2.79	4,972,667	1.35	4,911,514	98.8
Consumer	699,496	0.20	399,062	0.11	300,434	75.3
Total Non- accrual Loans	$15,481,583	4.37 %	$10,012,397	2.72 %	$5,469,186	54.6 %

(1) PERCENT OF TOTAL LOANS HELD FOR INVESTMENT, NET OF DEFERRED FEES AND LOANS IN PROCESS.

The following tables show the activity in the allowance for loan losses by category for the periods indicated:

	For the Three Months Ended June 30, 2014				
	Residential Real Estate	Consumer	Commercial Business	Commercial Real Estate	Total
Beginning Balance	$1,668,156	$803,868	$369,381	$7,004,350	$9,845,755
Provision	(130,818)	29,492	142,959	58,367	100,000
Charge-Offs	(165,191)	(13,591)	(17,132)	(820,563)	(1,016,477)
Recoveries	135,134	13,977	1,370	32,398	182,879
Ending Balance	$1,507,281	$833,746	$496,578	$6,274,552	$9,112,157

	For the Six Months Ended June 30, 2014				
	Residential Real Estate	Consumer	Commercial Business	Commercial Real Estate	Total
Beginning Balance	$1,706,643	$847,777	$426,658	$7,260,892	$10,241,970
Provision	(87,312)	156,833	67,998	62,481	200,000
Charge-Offs	(247,663)	(208,040)	(17,132)	(1,321,217)	(1,794,052)
Recoveries	135,613	37,176	19,054	272,396	464,239
Ending Balance	$1,507,281	$833,746	$496,578	$6,274,552	$9,112,157

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SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

9. Loans Receivable, Net, Continued

For the Three Months Ended June 30, 2013

	Residential Real Estate	Consumer	Commercial Business	Commercial Real Estate	Total
Beginning Balance	$1,591,884	$908,393	$542,903	$8,062,046	$11,105,226
Provision	156,264	66,151	(57,981)	735,566	900,000
Charge-Offs	(82,277)	(96,499)	—	(903,075)	(1,081,851)
Recoveries	—	10,868	3,632	69,404	83,904
Ending Balance	$1,665,871	$888,913	$488,554	$7,963,941	$11,007,279

For the Six Months Ended June 30, 2013

	Residential Real Estate	Consumer	Commercial Business	Commercial Real Estate	Total
Beginning Balance	$1,521,559	$1,001,271	$618,919	$8,176,622	$11,318,371
Provision	255,835	(15,662)	(135,047)	1,940,255	2,045,381
Charge-Offs	(111,523)	(116,075)	(4,436)	(2,235,277)	(2,467,311)
Recoveries	—	19,379	9,118	82,341	110,838
Ending Balance	$1,665,871	$888,913	$488,554	$7,963,941	$11,007,279

The following tables present information related to impaired loans evaluated individually for impairment and collectively evaluated for impairment in the allowance for loan losses:

	Allowance For Loan Losses		
June 30, 2014	Individually Evaluated For Impairment	Collectively Evaluated For Impairment	Total
Residential Real Estate	$145,876	$1,361,405	$1,507,281
Consumer	2,600	831,146	833,746
Commercial Business	207,500	289,078	496,578
Commercial Real Estate	482,700	5,791,852	6,274,552
Total	$838,676	$8,273,481	$9,112,157

	Allowance For Loan Losses		
December 31, 2013	Individually Evaluated For Impairment	Collectively Evaluated For Impairment	Total
Residential Real Estate	$158,791	$1,547,852	$1,706,643
Consumer	103,109	744,668	847,777
Commercial Business	—	426,658	426,658
Commercial Real Estate	840,658	6,420,234	7,260,892
Total	$1,102,558	$9,139,412	$10,241,970

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

9. Loans Receivable, Net, Continued

The following tables present information related to impaired loans evaluated individually for impairment and collectively evaluated for impairment in loans receivable for the periods indicated:

	Loans Receivable		
June 30, 2014	Individually Evaluated For Impairment	Collectively Evaluated For Impairment	Total
Residential Real Estate	$4,734,446	$73,413,397	$78,147,843
Consumer	315,465	50,182,196	50,497,661
Commercial Business	494,736	8,469,931	8,964,667
Commercial Real Estate	22,543,381	196,840,710	219,384,091
Total	$28,088,028	$328,906,234	$356,994,262

	Loans Receivable		
December 31, 2013	Individually Evaluated For Impairment	Collectively Evaluated For Impairment	Total
Residential Real Estate	$4,838,236	$78,166,246	$83,004,482
Consumer	275,491	51,930,410	52,205,901
Commercial Business	19,775	7,755,323	7,775,098
Commercial Real Estate	26,221,312	202,178,243	228,399,555
Total	$31,354,814	$340,030,222	$371,385,036

Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired management measures impairment and records the loan at fair value. Fair value is estimated using one of the following methods: fair value of the collateral less estimated costs to sale, discounted cash flows, or market value of the loan based on similar debt. The fair value of the collateral less estimated costs to sell is the most frequently used method. Typically, the Company reviews the most recent appraisal and if it is over 24 months old will request a new third party appraisal. Depending on the particular circumstances surrounding the loan, including the location of the collateral, the date of the most recent appraisal and the value of the collateral relative to the recorded investment in the loan, management may order an independent appraisal immediately or, in some instances, may elect to perform an internal analysis. The average balance of impaired loans was $29.8 million for three months ended June 30, 2014 compared to $35.3 million for the three months ended June 30, 2013.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

9. Loans Receivable, Net, Continued

The following tables are a summary of information related to impaired loans as of June 30, 2014 and December 31, 2013 and for the three and six months ended June 30, 2014 and 2013.

	At			For the Three Months Ended June 30,			
	June 30, 2014			2014		2013	
Impaired Loans	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Invesment	Interest Income Recognized	Average Recorded Invesment	Interest Income Recognized
With No Related Allowance Recorded:							
Residential Real Estate	$4,138,338	$4,138,338	$—	$4,298,141	$14,139	$3,202,717	$3,890
Consumer Loans	247,748	247,748	—	249,210	—	300,998	2,875
Commercial Business	16,089	16,089	—	16,089	—	23,302	—
Commercial Real Estate	19,869,021	19,869,021	—	21,434,443	155,690	26,980,203	180,095
With An Allowance Recorded:							
Residential Real Estate	596,108	741,984	145,876	603,056	—	596,933	1,938
Consumer Loans	67,717	70,317	2,600	67,932	839	—	—
Commercial Business	478,647	686,147	207,500	483,561	—	—	—
Commercial Real Estate	2,674,360	3,157,060	482,700	2,636,348	8,384	4,191,700	26,979
Total							
Residential Real Estate	4,734,446	4,880,322	145,876	4,901,197	14,139	3,799,650	5,828
Consumer Loans	315,465	318,065	2,600	317,142	839	300,998	2,875
Commercial Business	494,736	702,236	207,500	499,650	—	23,302	—
Commercial Real Estate	22,543,381	23,026,081	482,700	24,070,791	164,074	31,171,903	207,074
Total	$28,088,028	$28,926,704	$838,676	$29,788,780	$179,052	$35,295,853	$215,777

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

9. Loans Receivable, Net, Continued

	For the Six Months Ended June 30,			
	2014		2013	
Impaired Loans	Average Recorded Invesment	Interest Income Recognized	Average Recorded Invesment	Interest Income Recognized
With No Related Allowance Recorded:				
Residential Real Estate	$4,351,870	$ 26,355	$3,236,129	$ 6,087
Consumer Loans	250,016	—	300,783	3,467
Commercial Business	16,089	—	24,819	—
Commercial Real Estate	21,817,619	268,199	27,549,900	506,537
With An Allowance Recorded:				
Residential Real Estate	620,314	—	596,933	9,548
Consumer Loans	68,212	2,086	—	—
Commercial Business	488,387	—	—	—
Commercial Real Estate	2,694,448	28,374	4,216,012	63,051
Total				
Residential Real Estate	4,972,184	26,355	3,833,062	15,635
Consumer Loans	318,228	2,086	300,783	3,467
Commercial Business	504,476	—	24,819	—
Commercial Real Estate	24,512,067	296,573	31,765,912	569,588
Total	$30,306,955	$ 325,014	$35,924,576	$588,690

	December 31, 2013		
Impaired Loans	Recorded Investment	Unpaid Principal Balance	Related Allowance
With No Related Allowance Recorded:			
Residential Real Estate	$3,936,316	$4,588,645	$—
Consumer Loans	106,197	106,198	—
Commercial Business	19,775	19,775	—
Commercial Real Estate	21,810,347	26,775,853	—
With An Allowance Recorded:			
Residential Real Estate	901,920	901,920	158,791
Consumer Loans	169,294	169,294	103,109
Commercial Business	—	—	—
Commercial Real Estate	4,410,965	4,954,058	840,658
Total			
Residential Real Estate	4,838,236	5,490,565	158,791
Consumer Loans	275,491	275,492	103,109
Commercial Business	19,775	19,775	—
Commercial Real Estate	26,221,312	31,729,911	840,658

Total	$31,354,814	$37,515,743	$1,102,558

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9. Loans Receivable, Net, Continued

In the course of resolving delinquent loans, the Bank may choose to restructure the contractual terms of certain loans. A troubled debt restructuring ("TDR") is a restructuring in which the Bank, for economic or legal reasons related to a borrower's financial difficulties, grants a concession to a borrower that it would not otherwise consider (Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 310-40). The concessions granted on TDRs generally include terms to reduce the interest rate, extend the term of the debt obligation, or modify the payment structure on the debt obligation. The Bank grants such concessions to reassess the borrower's financial status and develop a plan for repayment. TDRs included in impaired loans at June 30, 2014 and December 31, 2013 were $11.2 million and $12.4 million, respectively.

Loans on nonaccrual status at the date of modification are initially classified as nonaccrual TDRs. Loans on accruing status at the date of concession are initially classified as accruing TDRs if the note is reasonably assured of repayment and performance is expected in accordance with its modified terms. Such loans may be designated as nonaccrual loans subsequent to the concession date if reasonable doubt exists as to the collection of interest or principal under the restructuring agreement. Nonaccrual TDRs are returned to accruing status when there is economic substance to the restructuring, there is documented credit evaluation of the borrower's financial condition, the remaining balance is reasonably assured of repayment in accordance with its modified terms, and the borrower has demonstrated sustained repayment performance in accordance with the modified terms for a reasonable period of time (generally a minimum of six months).

The following table is a summary of loans restructured as TDRs during the periods indicated:

	For the Three Months Ended June 30, 2014			For the Three Months Ended June 30, 2013		
Troubled Debt Restructurings	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Residential Real Estate	—	$ —	$ —	—	$ —	$ —
Consumer Loans	—	—	—	—	—	—
Commercial Business	—	—	—	—	—	—
Commercial Real Estate	1	79,072	79,072	1	329,999	329,999
Total	1	$ 79,072	$ 79,072	1	$ 329,999	$ 329,999

	For the Six Months Ended June 30, 2014			For the Six Months Ended June 30, 2013		
Troubled Debt Restructurings	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Residential Real Estate	—	$ —	$ —	—	$ —	$ —
Consumer Loans	—	—	—	—	—	—
Commercial Business	—	—	—	—	—	—
Commercial Real Estate	1	79,072	79,072	4	1,651,023	1,651,023

Total	1	$ 79,072	$ 79,072	4	$ 1,651,023	$ 1,651,023

During the three and six months ended June 30, 2014, the Bank modified one loan that was considered to be a TDR by lowering the interest rate. During the three months ended June 30, 2013, the Bank modified one loan that was considered to be a TDR by lowering the interest rate. This modification enabled the customer to begin making monthly principal and interest payments.

During the six months ended June 30, 2014, five loans totaling $3.0 million that had previously been restructured were in default, four of the loans totaling $2.8 million went into default during the six month period. No loans that had been previously restructured within the last twelve months defaulted during the six months ended June 30, 2014. The Bank considers any loan 30 days or more past due to be in default.

9. Loans Receivable, Net, Continued

Our policy with respect to accrual of interest on loans restructured in a TDR follows relevant supervisory guidance. That is, if a borrower has demonstrated performance under the previous loan terms and shows capacity to perform under the restructured loan terms, continued accrual of interest at the restructured interest rate is likely. If a borrower was materially delinquent on payments prior to the restructuring but shows capacity to meet the restructured loan terms, the loan will likely continue as nonaccrual going forward. Lastly, if the borrower does not perform under the restructured terms, the loan is placed on nonaccrual status.

We will continue to closely monitor these loans and will cease accruing interest on them if management believes that the borrowers may not continue performing based on the restructured note terms. If, after previously being classified as a TDR, a loan is restructured a second time, then that loan is automatically placed on nonaccrual status. Our policy with respect to nonperforming loans requires the borrower to make a minimum of six consecutive payments in accordance with the loan terms before that loan can be placed back on accrual status. Further, the borrower must show capacity to continue performing into the future prior to restoration of accrual status.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
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10. Regulatory Matters

The Federal Reserve and bank regulatory agencies require bank holding companies and financial institutions to maintain capital at adequate levels based on a percentage of assets and off-balance sheet exposures, adjusted for risk weights ranging from 0% to 100%. Under the capital adequacy guidelines, regulatory capital is classified into two tiers. These guidelines require an institution to maintain a certain level of Tier 1 and Tier 2 capital to risk-weighted assets. Tier 1 capital consists of common shareholders' equity, excluding the unrealized gain or loss on securities available for sale, minus certain intangible assets. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, are multiplied by a risk-weight factor of 0% to 100% based on the risks believed to be inherent in the type of asset. Tier 2 capital consists of Tier 1 capital plus the general reserve for loan losses, subject to certain limitations. The Bank is required to maintain capital at a minimum level based on total average assets, which is known as the Tier 1 leverage ratio. Failure to meet minimum capital requirements can initiate certain mandatory and discretionary actions by regulators that could have a material adverse effect on the Company. As of June 30, 2014 and December 31, 2013, the Bank was categorized as "well capitalized" under the regulatory framework for prompt corrective action. The Company and the Bank's regulatory capital amounts and ratios are as follows as of the dates indicated:

	Actual			For Capital Adequacy			To Be Well Capitalized Under Prompt Corrective Action Provisions		
	Amount	Ratio		Amount	Ratio		Amount	Ratio	
	(Dollars in Thousands)								
June 30, 2014									
SECURITY FEDERAL CORP.									
Tier 1 Risk-Based Core Capital (To Risk Weighted Assets)	$73,494	19.2	%	$15,335	4.0	%	N/A	N/A	
Total Risk-Based Capital (To Risk Weighted Assets)	86,567	22.6	%	30,671	8.0	%	N/A	N/A	
Tier 1 Leverage (Core) Capital (To Adjusted Tangible Assets)	73,494	8.7	%	33,635	4.0	%	N/A	N/A	
SECURITY FEDERAL BANK									
Tier 1 Risk-Based Core Capital (To Risk Weighted Assets)	$83,486	21.8	%	$15,324	4.0	%	$22,986	6.0	%
Total Risk-Based Capital (To Risk Weighted Assets)	88,328	23.1	%	30,468	8.0	%	38,309	10.0	%
Tier 1 Leverage (Core) Capital (To Adjusted Tangible Assets)	83,486	9.9	%	33,624	4.0	%	42,031	5.0	%
December 31, 2013									
SECURITY FEDERAL CORP.									
Tier 1 Risk-Based Core Capital (To Risk Weighted Assets)	$70,598	17.8	%	$15,894	4.0	%	N/A	N/A	
Total Risk-Based Capital (To Risk Weighted Assets)	84,529	21.3	%	31,788	8.0	%	N/A	N/A	

Tier 1 Leverage (Core) Capital (To Adjusted Tangible Assets)	70,598	8.3	%	34,079	4.0	%	N/A	N/A		
SECURITY FEDERAL BANK										
Tier 1 Risk-Based Core Capital (To Risk Weighted Assets)	$81,624	20.6	%	$15,883	4.0	%	$23,825	6.0	%
Total Risk-Based Capital (To Risk Weighted Assets)	86,652	21.8	%	31,767	8.0	%	39,709	10.0	%
Tier 1 Leverage (Core) Capital (To Adjusted Tangible Assets)	81,624	9.6	%	34,069	4.0	%	42,586	5.0	%

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SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

11. Carrying Amounts and Fair Value of Financial Instruments

The Company has adopted accounting guidance which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value under generally accepted accounting principles. This guidance applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements; accordingly, the standard does not require any new fair value measurements of reported balances.

Accounting guidance emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, the guidance establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

Level 1	Valuation is based upon quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as U.S. Treasuries and money market funds.
Level 2	Valuation is based upon quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments, mortgage-backed securities, municipal bonds, corporate debt securities and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain derivative contracts.
Level 3	Valuation is generated from model-based techniques that use at least one significant assumption based on unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

The following is a description of the valuation methodologies used for assets and liabilities recorded at fair value.

Investment Securities Available for Sale

Investment securities available for sale are recorded at fair value on a recurring basis. At June 30, 2014, the Company's investment portfolio was comprised of government and agency bonds, mortgage-backed securities issued by government agencies or GSEs, municipal securities, and two equity investments. The portfolio did not contain any private label mortgage-backed securities. Fair value measurement is based upon prices obtained from third party pricing services who use independent pricing models which rely on a variety of factors including reported trades, broker/dealer quotes, benchmark yields, economic and industry events and other relevant market information. As such, these securities are classified as Level 2.

Mortgage Loans Held for Sale

The Company originates fixed rate residential loans on a servicing released basis in the secondary market. Loans closed but not yet settled with Freddie Mac or other investors, are carried in the Company’s loans held for sale portfolio. These loans are fixed rate residential loans that have been originated in the Company’s name and have closed. Virtually all of these loans have commitments to be purchased by investors and the majority of these loans were locked in by price with the investors on the same day or shortly thereafter that the loan was locked in with the Company’s customers. Therefore, these loans present very little market risk for the Company.

The Company usually delivers to, and receives funding from, the investor within 30 days. Commitments to sell these loans to the investor are considered derivative contracts and are sold to investors on a “best efforts" basis. The Company is not obligated to deliver a loan or pay a penalty if a loan is not delivered to the investor. As a result of the short-term nature of these derivative

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

11. Carrying Amounts and Fair Value of Financial Instruments, Continued

contracts, the fair value of the mortgage loans held for sale in most cases is the same as the value of the loan amount at its origination. These loans are classified as Level 2.

Impaired Loans

The Company does not record loans held for investment at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established as necessary. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment.

Fair value is estimated using one of the following methods: fair value of the collateral less estimated costs to sell, discounted cash flows, or market value of the loan based on similar debt. The fair value of the collateral less estimated costs to sell is the most frequently used method. Typically, the Company reviews the most recent appraisal and if it is over 24 months old will request a new third party appraisal. Depending on the particular circumstances surrounding the loan, including the location of the collateral, the date of the most recent appraisal and the value of the collateral relative to the recorded investment in the loan, management may order an independent appraisal immediately or, in some instances, may elect to perform an internal analysis. Specifically as an example, in situations where the collateral on a nonperforming commercial real estate loan is out of the Company’s primary market area, management would typically order an independent appraisal immediately, at the earlier of the date the loan becomes nonperforming or immediately following the determination that the loan is impaired. However, as a second example, on a nonperforming commercial real estate loan where management is familiar with the property and surrounding areas and where the original appraisal value far exceeds the recorded investment in the loan, management may perform an internal analysis whereby the previous appraisal value would be reviewed and adjusted for current conditions including recent sales of similar properties in the area and any other relevant economic trends. These valuations are reviewed at a minimum on a quarterly basis.

Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At June 30, 2014, most of the total impaired loans were evaluated based on the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. The Company records impaired loans as nonrecurring Level 3. As of June 30, 2014 and December 31, 2013, the recorded investment in impaired loans was $28.1 million and $31.4 million, respectively.

Foreclosed Assets

Foreclosed assets are adjusted to fair value upon transfer of the loans to foreclosed assets. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management’s estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset as nonrecurring Level 3. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the asset as nonrecurring Level 3. Assets measured at fair value on a recurring basis are as follows as of June 30, 2014:

Assets:	Quoted Market Price In Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
FHLB Securities	$—	$14,004,431	$—
FFCB Securities	—	5,612,505	—
FNMA And FHLMC Bonds	—	997,248	—
SBA Bonds	—	97,049,454	—
Tax Exempt Municipal Bonds	—	59,753,957	—
Mortgage-Backed Securities	—	259,088,238	—
Equity Securities	—	305,000	—
Total	$—	$436,810,833	$—

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SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

11. Carrying Amounts and Fair Value of Financial Instruments, Continued

Assets measured at fair value on a recurring basis are as follows as of December 31, 2013:

Assets:	Quoted Market Price In Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
FHLB Securities	$—	$12,670,450	$—
FFCB Securities	—	5,366,180	—
FNMA Bonds	—	1,974,930	—
SBA Bonds	—	100,823,985	—
Tax Exempt Municipal Bonds	—	61,315,122	—
Mortgage-Backed Securities	—	248,596,535	—
Equity Securities	—	256,250	—
Total	$—	$431,003,452	$—

There were no liabilities measured at fair value on a recurring basis as of June 30, 2014 or December 31, 2013.

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. The table below presents assets measured at fair value on a nonrecurring basis as of June 30, 2014 and December 31, 2013, aggregated by the level in the fair value hierarchy within which those measurements fall. There were no liabilities measured at fair value on a nonrecurring basis as of June 30, 2014 and December 31, 2013.

Assets:	Level 1	Level 2	Level 3	Balance At June 30, 2014
Mortgage Loans Held For Sale	$—	$1,384,240	$—	$1,384,240
Collateral Dependent Impaired Loans (1)	—	—	27,249,352	27,249,352
Foreclosed Assets	—	—	4,131,265	4,131,265
Total	$—	$1,384,240	$31,380,617	$32,764,857

(1) IMPAIRED LOANS ARE REPORTED NET OF SPECIFIC RESERVES OF $838,676

Assets:	Level 1	Level 2	Level 3	Balance At December 31, 2013
Mortgage Loans Held For Sale	$—	$1,234,158	$—	$1,234,158
Collateral Dependent Impaired Loans (1)	—	—	30,252,256	30,252,256
Foreclosed Assets	—	—	3,947,226	3,947,226
Total	$—	$1,234,158	$34,199,482	$35,433,640

(1) IMPAIRED LOANS ARE REPORTED NET OF SPECIFIC RESERVES OF $1,103,000

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

11. Carrying Amounts and Fair Value of Financial Instruments, Continued

For Level 3 assets and liabilities measured at fair value on a recurring or non-recurring basis as of June 30, 2014, the significant unobservable inputs used in the fair value measurements were as follows:

	Fair Value June 30, 2014	Valuation Technique	Significant Unobservable Inputs	Range
Collateral Dependent Impaired Loans	$27,249,352	Appraised Value	Discount Rates/ Discounts to Appraised Values	6% - 87%
Foreclosed Assets	4,131,265	Appraised Value/Comparable Sales	Discount Rates/ Discounts to Appraised Values	7% - 79%

For assets and liabilities that are not presented on the balance sheet at fair value, the following methods are used to determine the fair value:

Cash and cash equivalents—The carrying amount of these financial instruments approximates fair value. All mature within 90 days and do not present unanticipated credit concerns.

Certificates of deposit with other banks—Fair value is based on market prices for similar assets.

Investment securities held to maturity—Securities held to maturity are valued at quoted market prices or dealer quotes.

Loans—The fair value of loans are estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. As discount rates are based on current loan rates as well as management estimates, the fair values presented may not be indicative of the value negotiated in an actual sale.

FHLB Stock—The fair value approximates the carrying value.

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

FHLB Advances—Fair value is estimated based on discounted cash flows using current market rates for advances with similar terms.

Other Borrowed Money—The carrying value of these short term borrowings approximates fair value.

Senior Convertible Debentures— The fair value is estimated by discounting the future cash flows using the current rates at which similar debenture offerings with similar terms and maturities would be issued by similar institutions. As discount rates are based on current debenture rates as well as management estimates, the fair values presented may not be indicative of the value negotiated in an actual sale.

Junior Subordinated Debentures—The carrying value of junior subordinated debentures approximates fair value.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

11. Carrying Amounts and Fair Value of Financial Instruments, Continued

The following tables are a summary of the carrying value and estimated fair value of the Company's financial instruments as of June 30, 2014 and December 31, 2013 presented in accordance with the applicable accounting guidance.

	June 30, 2014				
(In Thousands)	Carrying Amount	Fair Value Total	Level 1	Level 2	Level 3
Financial Assets:					
Cash And Cash Equivalents	$12,531	$12,531	$12,531	$—	$—
Certificates Of Deposits With Other Banks	2,095	2,095	—	2,095	—
Investment And Mortgage-Backed Securities	436,811	436,811	—	436,811	—
Loans Receivable, Net	346,605	338,191	—	—	338,191
FHLB Stock	4,573	4,573	4,573	—	—
Financial Liabilities:					
Deposits:					
Checking, Savings, And Money Market Accounts	$403,774	$403,774	$403,774	$—	$—
Certificate Accounts	254,650	255,375	—	255,375	—
Advances From FHLB	75,152	79,123	—	79,123	—
Other Borrowed Money	9,358	9,358	9,358	—	—
Senior Convertible Debentures	6,084	6,084	—	6,084	—
Junior Subordinated Debentures	5,155	5,155	—	5,155	—

	December 31, 2013				
(In Thousands)	Carrying Amount	Fair Value Total	Level 1	Level 2	Level 3
Financial Assets:					
Cash And Cash Equivalents	$7,630	$7,630	$7,630	$—	$—
Certificates Of Deposits With Other Banks	2,100	2,100	—	2,100	—
Investment And Mortgage-Backed Securities	431,003	431,003	—	431,003	—
Loans Receivable, Net	358,917	356,623	—	—	356,623
FHLB Stock	5,017	5,017	5,017	—	—
Financial Liabilities:					
Deposits:					
Checking, Savings, And Money Market Accounts	$401,813	$401,813	$401,813	$—	$—
Certificate Accounts	256,884	257,883	—	257,883	—
Advances From FHLB	87,740	92,608	—	92,608	—
Other Borrowed Money	8,003	8,003	8,003	—	—

Senior Convertible Debentures	6,084	6,084	—	6,084	—
Junior Subordinated Debentures	5,155	5,155	—	5,155	—

At June 30, 2014, the Bank had $46.7 million of off-balance sheet financial commitments. These commitments are to originate loans and unused consumer lines of credit and credit card lines. Because these obligations are based on current market rates, if funded, the original principal is considered to be a reasonable estimate of fair value.

Fair value estimates are made on a specific date, based on relevant market data and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale the Bank's entire holdings of a particular financial instrument.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

11. Carrying Amounts and Fair Value of Financial Instruments, Continued

Because no active market exists for a significant portion of the Bank's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, current interest rates and prepayment trends, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in any of these assumptions used in calculating fair value would also significantly affect the estimates. Fair value estimates are based on existing on- and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. For example, the Bank has significant assets and liabilities that are not considered financial assets or liabilities including deposit franchise values, loan servicing portfolios, deferred tax liabilities, and premises and equipment.

In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates. The Company has used management's best estimate of fair value on the above assumptions. Thus, the fair values presented may not be the amounts, which could be realized, in an immediate sale or settlement of the instrument. In addition, any income taxes or other expenses that would be incurred in an actual sale or settlement are not taken into consideration in the fair value presented.

12. Accounting and Reporting Changes

The following is a summary of recent authoritative pronouncements that could affect accounting, reporting, and disclosure of financial information by the Company:

In January 2014, the FASB amended Receivables topic of the Accounting Standards Codification. The amendments are intended to resolve diversity in practice with respect to when a creditor should reclassify a collateralized consumer mortgage loan to other real estate owned (OREO). In addition, the amendments require a creditor to reclassify a collateralized consumer mortgage loan to OREO upon obtaining legal title to the real estate collateral, or the borrower voluntarily conveying all interest in the real estate property to the lender to satisfy the loan through a deed in lieu of foreclosure or similar legal agreement. The amendments will be effective for the Company for annual periods, and interim periods within those annual period beginning after December 15, 2014, with early implementation of the guidance permitted. In implementing this guidance, assets that are reclassified from real estate to loans are measured at the carrying value of the real estate at the date of adoption. Assets reclassified from loans to real estate are measured at the lower of the net amount of the loan receivable or the fair value of the real estate less costs to sell at the date of adoption. The Company will apply the amendments prospectively. The Company does not expect these amendments to have a material effect on its financial statements.

In May 2014, the FASB issued guidance to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance will be effective for the Company for reporting periods beginning after December 15, 2016. The Company will apply the guidance using a modified retrospective approach. The Company does not expect these amendments to have a material effect on its financial statements.

In June 2014, the FASB issued guidance which makes limited amendments to the guidance on accounting for certain repurchase agreements. The new guidance (1) requires entities to account for repurchase-to-maturity transactions as secured borrowings (rather than as sales with forward repurchase agreements), (2) eliminates accounting guidance on linked repurchase financing transactions, and (3) expands disclosure requirements related to certain transfers of financial assets that are accounted for as sales and certain transfers (specifically, repos, securities lending transactions, and repurchase-to-maturity transactions) accounted for as secured borrowings. The amendments will be effective for the Company for the first interim or annual period beginning after December 15, 2014. The Company will apply the guidance by making a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. The Company does not expect these amendments to have a material effect on its financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting authorities are not expected to have a material impact on the Company’s financial position, results of operations or cash flows.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

13. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date.

Management has reviewed all events occurring through the date the consolidated financial statements were available to be issued and no other subsequent events occurred requiring accrual or disclosure.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements and "Safe Harbor" statement under the Private Securities Litigation Reform Act of 1995

This report contains forward-looking statements, which can be identified by the use of words such as "believes," "intends," "expects," "anticipates," "estimates" or similar expressions. Forward-looking statements include, but are not limited to:

- statements of our goals, intentions and expectations;
- statements regarding our business plans, prospects, growth and operating strategies;
- statements regarding the quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

These forward-looking statements are subject to significant risks and uncertainties. Actual results may differ materially from those contemplated by the forward-looking statements due to, among others, the following factors:

- the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs and changes in our allowance for loan losses and provision for loan losses that may be impacted by deterioration in the housing and commercial real estate markets which may lead to increased losses and non-performing assets in our loan portfolio, and may result in our allowance for loan losses not being adequate to cover actual losses, and require us to materially increase our loan loss reserves;
- changes in general economic conditions, either nationally or in our market areas;
- changes in the levels of general interest rates, and the relative differences between short and long term interest rates, deposit interest rates, our net interest margin and funding sources;
- fluctuations in the demand for loans, the number of unsold homes, land and other properties and fluctuations in real estate values in our market areas;
- secondary market conditions for loans and our ability to sell loans in the secondary market;
- results of examinations of the Company by the Federal Reserve, and our bank subsidiary by the FDIC and the South Carolina Board of Financial Institutions or other regulatory authorities, including the possibility that any such regulatory authority may, among other things, require us to increase our reserve for loan losses, write-down assets, change our regulatory capital position or affect our ability to borrow funds or maintain or increase deposits, which could adversely affect our liquidity and earnings;
- legislative or regulatory changes that adversely affect our business including changes in regulatory policies and principles, or the interpretation of regulatory capital, including changes as a result of Basel III, or other rules, and any changes in rules applicable to institutions participating in the U.S. Department of Treasury Community Development Capital Initiative or other rules;
- our ability to attract and retain deposits;
- increases in premiums for deposit insurance;
- our ability to control operating costs and expenses;
- our ability to implement our business strategies
- the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation;
- difficulties in reducing risks associated with the loans on our balance sheet;
- staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our workforce and potential associated charges;
- computer systems on which we depend could fail or experience a security breach;
- our ability to retain key members of our senior management team;

- costs and effects of litigation, including settlements and judgments;
- our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we have acquired or we may in the future acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames and any goodwill charges related thereto;
- increased competitive pressures among financial services companies;
- changes in consumer spending, borrowing and savings habits;
- the impact of new legislation, including the Jumpstart Out Business Startups Act and Dodd-Frank Wall Street Reform and Consumer Protection Act and the implementing regulations;
- the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions;
- our ability to pay dividends on our common and preferred stock;
- adverse changes in the securities markets;

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- inability of key third-party providers to perform their obligations to us;
- changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the FASB, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods;
- Future legislative changes and our ability to continue to comply with the requirements of the U.S. Department of Treasury’s Community Development Capital Initiative; and
- other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products and services and the other risks described elsewhere in this document.

Some of these and other factors are discussed in the Company's 2013 Form 10-K under Item 1A, “Risk Factors.” Such developments could have an adverse impact on our financial position and our results of operations.

Any of the forward-looking statements that we make in this quarterly report and in other public statements we make may turn out to be inaccurate as a result of our beliefs and assumptions we make in connection with the factors set forth above or because of other unidentified and unpredictable factors. Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements and you should not rely on such statements. The Company undertakes no obligation to publish revised forward-looking statements to reflect the occurrence of unanticipated events or circumstances after the date hereof. These risks could cause our actual results for 2014 and beyond to differ materially from those expressed in any forward-looking statements by or on behalf of us, and could negatively affect the Company’s financial condition, liquidity and operating and stock price performance.

Financial Condition At June 30, 2014 and December 31, 2013

General – Total assets decreased $4,926,000 or 0.6% to $844.3 million at June 30, 2014 from $849.2 million at December 31, 2013. The primary reason for the decrease in total assets was a decrease of $12.3 million and $3.8 million in net loans receivable and other assets, respectively, offset partially by an increase of $5.8 million and $4.9 million in investment and mortgage- backed securities available for sale and cash and cash equivalents, respectively.

Assets – The increases and decreases in total assets were primarily concentrated in the following asset categories:

	June 30, 2014	December 31, 2013	Increase (Decrease) Amount	Percent
Cash And Cash Equivalents	$ 12,531,186	$ 7,629,771	$ 4,901,415	64.2%
Investment And Mortgage-Backed Securities – Available For Sale	436,810,833	431,003,452	5,807,381	1.3
Loans Receivable, Net	346,605,413	358,916,665	(12,311,252)	(3.4)
Premise And Equipment, Net	18,485,846	17,243,390	1,242,456	7.2
Bank Owned Life Insurance	11,000,045	11,474,305	(474,260)	(4.1)
Intangible Assets, Net	—	11,970	(11,970)	(100.0)
Other Assets	3,709,901	7,547,528	(3,837,627)	(50.8)

Cash and cash equivalents increased $4.9 million or 64.2% to $12.5 million at June 30, 2014 from $7.6 million at December 31, 2013. Investment and mortgage-backed securities available for sale increased $5.8 million or 1.3% to $436.8 million at June 30, 2014 from $431.0 million at December 31, 2013.

Loans receivable, net, decreased $12.3 million or 3.4% to $346.6 million at June 30, 2014 from $358.9 million at December 31, 2013. This decrease was a result of increased loan paydowns combined with lower loan demand from creditworthy borrowers. Residential real estate loans decreased $4.9 million or 5.9% to $78.1 million at June 30, 2014 from $83.0 million at December 31, 2013. Consumer loans decreased $1.7 million or 3.3% to $50.5 million at June 30, 2014 compared to $52.2 million at December 31, 2013. Commercial real estate loans decreased $9.0 million or 3.9% to $219.4 million at June 30, 2014 from $228.4 million at December 31, 2013.

Commercial business loans increased $1.2 million or 15.3% to $9.0 million at June 30, 2014 from $7.8 million at December 31, 2013. Loans held for sale increased $150,000 or 12.2% to $1.4 million at June 30, 2014 from $1.2 million at December 31, 2013.

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Premises and equipment, net increased $1.2 million or 7.2% to $18.5 million at June 30, 2014 from $17.2 million at December 31, 2013. The Bank purchased land for $1.3 million during the six months ended June 30, 2014 for a prospective future branch site in Columbia County, Georgia.

Bank owned life insurance decreased $474,000 or 4.1% to $11.0 million at June 30, 2014 compared to $11.5 million at December 31, 2013. The Company redeemed $624,000 in life insurance during the period. This was offset slightly by income from bank owned life insurance totaling $150,000.

Other assets decreased $3.8 million or 50.8% to $3.7 million at June 30, 2014 compared to $7.5 million at December 31, 2013 as a result of deferred taxes related to increased unrealized gains in the investment portfolio.

Liabilities
Deposit Accounts – The balances, weighted average rates and increases and decreases in deposit accounts were as follows:

	June 30, 2014		December 31, 2013		Balance Increase (Decrease)	
	Balance	Weighted Rate	Balance	Weighted Rate	Amount	Percent
Demand Accounts:						
Checking	$ 144,210,745	0.03%	$ 136,695,876	0.04%	$ 7,514,869	5.50%
Money Market	232,990,758	0.19	240,631,708	0.28	(7,640,950)	(3.18)
Statement Savings Accounts	26,572,138	0.10	24,485,648	0.10	2,086,490	8.52
Total	403,773,641	0.13	401,813,232	0.19	1,960,409	0.49
Certificate Accounts						
0.00 – 1.99%	228,739,893		226,750,180		1,989,713	0.88
2.00 – 2.99%	24,916,434		28,848,252		(3,931,818)	(13.63)
3.00 – 3.99%	993,805		1,285,108		(291,303)	(22.67)
4.00 – 4.99%	—		—		—	—
5.00 – 5.99%	—		—		—	—
Total	254,650,132	0.78	256,883,540	0.83	(2,233,408)	(0.87)
Total Deposits	$ 658,423,773	0.38%	$ 658,696,772	0.44%	$ (272,999)	(0.04)%

Included in the certificate accounts above were $29.6 million and $25.6 million in brokered deposits at June 30, 2014 and December 31, 2013, respectively, with a weighted average interest rate of 1.05% and 1.23%, respectively.

Advances From FHLB – FHLB advances are summarized by contractual year of maturity and weighted average interest rate in the table below:

	June 30, 2014		December 31, 2013		Balance Decrease	
Fiscal Year Due:	Balance	Rate	Balance	Rate	Balance	Percent
2014	$ 22,252,312	1.43%	$ 34,840,058	1.64%	$ (12,587,746)	(36.13)%
2015	15,000,000	4.01	15,000,000	4.01	—	—

2016	20,000,000	4.61	20,000,000	4.61	—	—
2017	12,900,000	4.38	12,900,000	4.38	—	—
2018	5,000,000	3.39	5,000,000	3.39	—	—
Thereafter	—	—	—	—	—	—
Total Advances	$ 75,152,312	3.43%	$ 87,740,058	3.23%	$ (12,587,746)	(14.35)%

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Advances are secured by a blanket collateral agreement with the FHLB pledging the Bank's portfolio of residential first mortgage loans and investment securities with an amortized cost and fair value of $106.8 million and $103.6 million at June 30, 2014, respectively, and $111.6 million and $102.7 million at December 31, 2013, respectively. Advances are subject to prepayment penalties.

The following table shows at June 30, 2014 FHLB advances that are callable as of the dates indicated. These advances are also included in the above table. All callable advances are callable at the option of the FHLB. If an advance is called, the Bank has the option to pay off the advance without penalty, reborrow funds on different terms, or convert the advance to a three-month floating rate advance tied to LIBOR.

As of June 30, 2014

Borrow Date	Maturity Date	Amount	Int. Rate	Type	Call Dates
11/23/05	11/23/15	$ 5,000,000	3.993 %	Multi-Call	5/23/08 and quarterly thereafter
07/11/06	07/11/16	5,000,000	4.800	Multi-Call	7/11/08 and quarterly thereafter
11/29/06	11/29/16	5,000,000	4.025	Multi-Call	5/29/08 and quarterly thereafter
05/24/07	05/24/17	7,900,000	4.375	Multi-Call	5/27/08 and quarterly thereafter
07/25/07	07/25/17	5,000,000	4.396	Multi-Call	7/25/08 and quarterly thereafter

Other Borrowings – The Bank had $9.4 million and $8.0 million in other borrowings (non-FHLB advances) at June 30, 2014 and December 31, 2013, respectively. These borrowings consist of short-term repurchase agreements with certain commercial demand deposit customers for sweep accounts. The repurchase agreements typically mature within one to three days and the interest rate paid on these borrowings floats monthly with money market type rates. At both June 30, 2014 and December 31, 2013, the interest rate paid on the repurchase agreements was 0.15%. The Bank had pledged as collateral for these repurchase agreements investment and mortgage-backed securities with amortized costs and fair values of $15.8 million and $16.3 million, respectively, at June 30, 2014 and $14.8 million and $15.4 million, respectively, at December 31, 2013.

Junior Subordinated Debentures – On September 21, 2006, Security Federal Statutory Trust (the "Trust"), issued and sold fixed and floating rate capital securities of the Trust (the "Capital Securities"). The Trust used the net proceeds from the sale of the Capital Securities to purchase a like amount of junior subordinated debentures (the "Debentures") of the Company which are reported on the Consolidated Balance Sheets as junior subordinated debentures, generating proceeds of $5.0 million. The Company used the proceeds for general corporate purposes, primarily to provide capital to the Bank. The Capital Securities qualify as Tier 1 capital under Federal Reserve guidelines. The Debentures are the sole assets of the Trust. The Company's obligations under the Debentures and related documents, taken together, constitute a full and unconditional guarantee by the Company of the obligations of the Trust.

The Capital Securities accrue and pay distributions annually at a rate per annum equal to 1.93% at June 30, 2014. Prior to September 2011, one-half of the Capital Securities issued in the transaction had a fixed rate of 6.88% and the remaining half had a floating rate of three-month LIBOR plus 170 basis points. After September 2011, the fixed rate was converted to the floating rate, with all of the Capital Securities having a floating rate of three month LIBOR plus 170 basis points. The distribution rate payable on the Capital Securities is cumulative and payable quarterly in arrears.

The Company has the right, subject to events of default, to defer payments of interest on the Capital Securities for a period not to exceed 20 consecutive quarterly periods, provided that no extension period may extend beyond the maturity date of December 15, 2036. The Company has no current intention to exercise its right to defer payments of interest on the Capital Securities.

The Capital Securities mature or are mandatorily redeemable upon maturity on December 15, 2036, or upon earlier optional redemption as provided in the indenture. The Company has the right to redeem the Capital Securities in whole or in part.

Convertible Debentures – Effective December 1, 2009, the Company issued $6.1 million in convertible senior debentures. The debentures will mature on December 1, 2029 and accrue interest at the rate of 8.0% per annum until maturity or earlier redemption or repayment. Interest on the debentures is payable on June 1 and December 1 of each year and commenced on June 1, 2010. The

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debentures are convertible into the Company’s common stock at a conversion price of $20 per share at the option of the holder at any time prior to maturity.

The debentures are redeemable, in whole or in part, at the option of the Company at any time on or after December 1, 2019, at a price equal to 100% of the principal amount of the debentures to be purchased plus any accrued and unpaid interest to, but excluding, the date of redemption. The debentures are unsecured general obligations of the Company ranking equal in right of payment to all of our present and future unsecured indebtedness that is not expressly subordinated.

Equity – Shareholders’ equity increased $6.5 million or 8.3% to $84.5 million at June 30, 2014 from $78.0 million at December 31, 2013. Accumulated other comprehensive income, net of tax, comprised primarily of unrealized gains on securities available for sale, net of tax, increased $4.4 million or 935.0% to $4.9 million at June 30, 2014 from $472,000 at December 31, 2013. The Company’s net income available for common shareholders was $2.6 million for the six months ended June 30, 2014, after payment of $220,000 in preferred stock dividends. The Board of Directors of the Company declared common stock dividends totaling $471,000 during the six months ended June 30, 2014. Book value per common share was $21.23 at June 30, 2014 and $19.02 at December 31, 2013.

Results of Operations for the Three Month Periods Ended June 30, 2014 and 2013

Net Income Available to Common Shareholders - Net income available to common shareholders increased $598,000 or 77.8% to $1.4 million or $0.44 per diluted common share for the three months ended June 30, 2014 compared to $769,000 or $0.26 per diluted common share for the three months ended June 30, 2013. The increase in net income available to common shareholders
was primarily the result of an increase in net interest income combined with a decrease in the provision for loan losses. These factors were offset slightly by a decrease in non-interest income.

Net Interest Income - The net interest margin on a tax equivalent basis increased 27 basis points to 3.15% for the three months ended June 30, 2014 from 2.88% for the comparable period in 2013 as the decline in the average cost of interest-bearing liabilities outpaced the decline in the average balance of interest-earning assets. Net interest income increased $409,000 or 7.2% to $6.1 million during the three months ended June 30, 2014, compared to $5.7 million for the same period in 2013. During the three months ended June 30, 2014, average interest earning assets decreased $20.9 million or 2.6% to $794.7 million from $815.6 million for the same period in 2013. Average interest-bearing liabilities decreased $33.9 million or 4.6% to $705.2 million for the three months ended June 30, 2014 from $734.1 million for the comparable period in 2013.

Interest Income - Total tax equivalent interest income decreased $68,000 or 0.9% to $7.8 million during the three months ended June 30, 2014 compared to the same period in 2013. This decrease was primarily the result of the decrease in interest-earning assets, particularly loans. Total interest income on loans decreased $604,000 or 10.9% to $4.9 million during the three months ended June 30, 2014 from $5.5 million during the comparable period in 2013 as a result of the average loan portfolio balance decreasing $26.9 million or 7.1% to $354.6 million combined with the yield on the loan portfolio decreasing 24 basis point to 5.55%. Interest income from mortgage-backed securities increased $419,000 or 34.3% to $1.6 million as a result of a 60 basis point increase in the portfolio yield combined with a $7.0 million increase in the average balance. Tax equivalent interest income from investment securities increased $116,000 or 10.8% to $1.2 million as a result of an increase of 26 basis points in the yield combined with an increase of $16.4 million in the average balance of the investment securities portfolio.

The following table compares detailed average balances, associated yields, and the resulting changes in interest income for the three months ended June 30, 2014 and 2013:

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	Three Months Ended June 30, 2014		2013		
	Average Balance	Yield[1]	Average Balance	Yield[1]	Increase (Decrease) In Interest And Dividend Income From 2013
Loans Receivable, Net	$ 354,583,836	5.55 %	$ 381,504,531	5.79 %	$ (603,623)
Mortgage-Backed Securities	256,386,601	2.56	249,395,337	1.96	418,745
Investment Securities[2]	181,028,201	2.64	181,332,991	2.38	116,227
Overnight Time And Certificates of Deposit	2,666,342	0.37	3,362,167	0.20	750
Total Interest-Earning Assets	$ 794,664,980	3.90 %	$ 815,595,026	3.84 %	$ (67,901)

(1) Annualized
(2) Tax equivalent basis is calculated using an effective tax rate of 34% and amounted to $119,706 and $144,839 for the quarters ended June 30, 2014 and 2013, respectively.

Interest Expense - Total interest expense decreased $452,000 or 23.1% to $1.5 million during the three months ended June 30, 2014 compared to $2.0 million for the same period in 2013. The decrease in total interest expense was attributable to decreases in interest rates paid and a $33.9 million decrease in the average balance of interest-bearing liabilities. Interest expense on deposits decreased $260,000 or 29.0% to $636,000 during the three months ended June 30, 2014 compared to $896,000 for the same period in 2013. The decrease was attributable to a 16 basis point decrease in the cost of deposit accounts combined with a $14.7 million decrease in average interest-bearing deposits to $607.2 million for the three months ended June 30, 2014 compared to $621.9 million for the three months ended June 30, 2013. The decrease was concentrated in the certificate accounts, which decreased $16.0 million or 5.8% to $258.9 million during the three months ended June 30, 2014 compared to $274.8 million for the same period in 2013. The Bank has been competing less aggressively for time deposits in its local area and focusing instead on core deposits, or non time deposits.

Interest expense on FHLB advances and other borrowings decreased $191,000 or 20.9% to $725,000 during the three months ended June 30, 2014 from $916,000 for the same period in 2013. The average balance of FHLB advances and other borrowed money decreased $19.2 million or 18.1% to $86.7 million during the three months ended June 30, 2014 from $105.9 million for the same period in 2013. The following table compares detailed average balances, cost of funds, and the resulting changes in interest expense for the three months ended June 30, 2014 and 2013.

	Three Months Ended June 30, 2014		2013		
	Average Balance	Yield[1]	Average Balance	Yield[1]	Decrease In Interest Expense From 2013
Now And Money Market Accounts	$ 321,842,988	0.16%	$ 322,708,180	0.26%	$ (82,994)
Statement Savings Accounts	26,478,968	0.10	24,356,240	0.16	(3,135)
Certificates Accounts	258,855,596	0.77	274,844,828	0.98	(173,831)
FHLB Advances And	86,734,189	3.34	105,920,679	3.46	(191,209)

Other Borrowed Money								
Junior Subordinated Debentures		5,155,000	1.95		5,155,000	2.00		(600)
Senior Convertible Debentures		6,084,000	8.00		6,084,000	8.00		—
Total Interest-Bearing Liabilities	$	705,150,741	0.86%	$	739,068,927	1.06%	$	(451,769)

(1) Annualized

Provision for Loan Losses - The amount of the provision is determined by management’s on-going monthly analysis of the loan portfolio and the adequacy of the allowance for loan losses. The Company has policies and procedures in place for evaluating and monitoring the overall credit quality of the loan portfolio and for timely identification of potential problem loans including internal

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and external loan reviews. The adequacy of the allowance for loan losses is reviewed monthly by the Asset Classification Committee and quarterly by the Board of Directors.

Management's monthly review of the adequacy of the allowance includes three main components. The first component is an analysis of loss potential in various homogeneous segments of the portfolio based on historical trends and the risk inherent in each category. Previously, management applied a five year historical loss ratio to each loan category to estimate the inherent loss in these pooled loans. However, as a result of the decline in economic conditions and the unprecedented increases in delinquencies and charge offs experienced by the industry, the Company no longer considers five year historical losses relevant indicators of future losses. Management began applying 12 to 24 month historical loss ratios to each loan category to more accurately project losses in the near future.

The second component of management's monthly analysis is the specific review and evaluation of significant problem credits identified through the Company's internal monitoring system. These loans are evaluated for impairment and recorded in accordance with accounting guidance. For each loan deemed impaired, management calculates a specific reserve for the amount in which the recorded investment in the loan exceeds the fair value. This estimate is based on a thorough analysis of the most probable source of repayment, which is typically liquidation of the collateral.

The third component is an analysis of changes in qualitative factors that may affect the portfolio, including but not limited to: relevant economic trends that could impact borrowers' ability to repay, industry trends, changes in the volume and composition of the portfolio, credit concentrations, or lending policies and the experience and ability of the staff and Board of Directors. Management also reviews and incorporates certain ratios such as percentage of classified loans, average historical loan losses by loan category, delinquency percentages, and the assignment of percentage targets of reserves in each loan category when evaluating the allowance.

Once the analysis is completed, the three components are combined and compared to the allowance amount. Based on this, charges are made to the provision as needed.

Net charge-offs were $834,000 or 0.23% of gross loans during the three months ended June 30, 2014 compared to $998,000 or 0.26% of gross loans for the same three month period in 2013. The provision for loan losses was $100,000 for the quarter ended June 30, 2014 compared to $900,000 for the same quarter in the prior year. The following table details selected activity associated with the allowance for loan losses for the three months ended June 30, 2014 and 2013:

	Three Months Ended June 30, 2014		Three Months Ended June 30, 2013	
Beginning Balance	$ 9,845,755		$ 11,105,226	
Provision	100,000		900,000	
Charge-offs	(1,016,477)		(1,081,851)	
Recoveries	182,879		83,904	
Ending Balance	$ 9,112,157		$ 11,007,279	
Allowance For Loan Losses As A Percentage Of Gross Loans Receivable, Held For Investment At The End Of The Period	2.6	%	2.9	%
Allowance For Loan Losses As A Percentage Of Impaired Loans At The End Of The Period	32.5	%	31.9	%

Impaired Loans	$ 28,088,028	$ 34,527,535
Gross Loans Receivable, Held For Investment And Held For Sale	$ 358,378,502	$ 387,126,732
Total Loans Receivable, Net	$ 346,605,413	$ 374,049,099

Our strategy is to work with our borrowers to reach acceptable payment plans while protecting our interests in the existing collateral. In the event an acceptable arrangement cannot be reached, we may need to acquire these properties through foreclosure or other means and subsequently sell, develop or liquidate them.

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Non-Interest Income - Non-interest income decreased $411,000 or 23.6% to $1.3 million for the three months ended June 30, 2014, compared to $1.7 million for the three months ended June 30, 2013. The following table provides a detailed analysis of the changes in the components of non-interest income:

	Three Months Ended June 30,		Increase (Decrease)	
	2014	2013	Amounts	Percent
Gain (Loss) On Sale Of Investments	$ (39,485)	$ 369,729	$ (409,214)	(110.7)%
Gain On Sale Of Loans	218,288	210,840	7,448	3.5
Service Fees On Deposit Accounts	284,071	278,263	5,808	2.1
Commissions From Insurance Agency	109,229	104,649	4,580	4.4
Income From Cash Value Of Life Insurance	198,537	78,000	120,537	154.5
Trust Income	141,000	135,000	6,000	4.4
Check Card Fee Income	233,861	222,929	10,932	4.9
CDFI Financial Award Income	17,750	220,071	(202,321)	(91.9)
Other	168,687	123,422	45,265	36.7
Total Non-Interest Income	$ 1,331,938	$ 1,742,903	$ (410,965)	(23.6)%

The loss on sale of investments was $39,000 during the quarter ended June 30, 2014, a decrease of $409,000 or 110.7% compared to a gain of $370,000 for the same period last year. The loss resulted from the sale of 12 investments during the quarter ended June 30, 2014 compared to seven investments during the same period in 2013. Management elected to sell a portion of the Bank's investments that were anticipated to perform poorly when rates rise. These investments were replaced with alternative investments that perform better in a rising rate environment.

Income from cash value of life insurance increased $121,000 or 154.5% to $199,000 during the quarter ended June 30, 2014 from $78,000 for the same period in 2013. The Company recognized $124,000 in death benefits in 2014 in addition to $75,000 in income related to changes in the cash surrender value of the bank owned life insurance.

CDFI financial award income decreased $202,000 or 91.9% during the three months ended June 30, 2014, compared to the same period in 2013.

General And Administrative Expenses –For the quarter ended June 30, 2014, non-interest expense decreased $75,000 or 1.4% to $5.3 million compared to $5.4 million for the same period in 2013. The decrease in non-interest expense was primarily a result of a decrease in the prepayment penalties on FHLB advances and net cost of operation of other real estate owned. The following table provides a detailed analysis of the changes in the components of general and administrative expenses:

	Three Months Ended June 30,		Increase (Decrease)	
	2014	2013	Amounts	Percent
Compensation And Employee Benefits	$ 2,836,547	$ 2,768,450	$ 68,097	2.5%
Occupancy	474,836	487,664	(12,828)	(2.6)
Advertising	142,863	70,088	72,775	103.8
Depreciation And Maintenance Of Equipment	393,270	369,760	23,510	6.4
FDIC Insurance Premiums	178,785	196,476	(17,691)	(9.0)
Amortization of Intangibles	—	12,501	(12,501)	(100.0)

Net Cost Of Operation Of Other Real Estate Owned	254,474	341,392	(86,918)	(25.5)
Prepayment Penalties on FHLB Advances	—	85,089	(85,089)	(100.0)
Other	1,035,848	1,060,192	(24,344)	(2.3)
Total General And Administrative Expenses	$ 5,316,623	$ 5,391,612	$ (74,989)	(1.4)%

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Compensation and employee benefits expenses increased $68,000, or 2.5% to $2.8 million for the three months ended June 30, 2014 compared to the same period last year. The Company recognized $100,000 in accrued bonuses during the three months ended June 30, 2014 related to a new incentive compensation plan offered to employees during the year. Occupancy expense decreased $13,000 or 2.6% to $475,000 for the three months ended June 30, 2014 compared to $488,000 for the three months ended June 30, 2013. Depreciation and maintenance of equipment increased $24,000 or 6.4% during the same period.

Net cost of operation of other real estate owned decreased $87,000 or 25.5% to $254,000 during the quarter ended June 30, 2014 from $341,000 during the quarter ended June 30, 2013. This amount includes all expenses associated with other real estate owned including write-down in value and gain or loss on sales incurred during the period. Other real estate owned was $4.1 million at June 30, 2014 compared to $4.8 million at June 30, 2013.

The Company incurred a prepayment penalty of $85,000 for paying down FHLB advances during the three months ended June 30, 2013. The Company elected to prepay these higher rate advances to lower cost of funds. The Company did not prepay any advances during the three months ended June 30, 2014.

Other expenses decreased $24,000, or 2.3% to $1.0 million for the three month period ended June 30, 2014 compared to $1.1 million for the same period in the prior year. Other expenses include legal, professional, and consulting expenses, stationary and office supplies and other miscellaneous expenses.

Provision For Income Taxes – The provision for income taxes increased $275,000 or 93.7% to $568,000 for the three months ended June 30, 2014 from $293,000 for the same period one year ago. Income before income taxes was $2.0 million and $1.2 million for the three months ended June 30, 2014 and 2013, respectively. The Company's combined federal and state effective income tax rate for the current quarter was 27.8% compared to 25.0% for the same quarter one year ago.

Results of Operations for the Six Month Periods Ended June 30, 2014 and 2013

Net Income Available to Common Shareholders - Net income available to common shareholders increased $1.2 million or 92.4% to $2.6 million for the six months ended June 30, 2014 compared to $1.3 million for the six months ended June 30, 2013. The increase in net income was primarily the result of an increase of $462,000 in net interest income combined with a decrease of $1.8 million in the provision for loan losses. These factors were offset slightly by a decrease of $820,000 in non-interest income.

Net Interest Income - The net interest margin increased 20 basis points to 3.03% for the six months ended June 30, 2014 from 2.83% for the comparable period in 2013. As a result, net interest income increased $462,000 or 4.1% to $11.8 million during the six months ended June 30, 2014, compared to $11.3 million for the same period in 2013. During the six months ended June 30, 2014, average interest earning assets decreased $21.3 million or 2.6% to $794.7 million while average interest-bearing liabilities decreased $34.2 million or 4.6% to $707.8 million from $742.1 million for the six months ended June 30, 2013.
Interest Income - Total interest income decreased $554,000 or 3.6% to $14.8 million during the six months ended June 30, 2014 from $15.4 million for the same period in 2013. This decrease is the result of the decrease in interest-earning assets. Total interest income on loans decreased $1.3 million or 11.9% to $9.8 million during the six months ended June 30, 2014 from $11.1 million for the same period in 2013 as a result of the average loan portfolio balance decreasing $31.4 million or 8.1% to $356.0 million from $387.4 million for the same period in 2013 and the yield on the loan portfolio decreasing 24 basis points to 5.50%. Interest income from mortgage-backed securities

increased $447,000 or 17.3% to $3.0 million as a result of a 32 basis point increase in the portfolio yield combined with a $5.1 million or 2.1% increase in the average balance. Tax equivalent interest income from investment securities increased $327,000 or 16.9% to $2.3 million as a result of an increase of 26 basis points in the yield combined with an increase of $8.0 million or 4.6% in the average balance of the investment securities portfolio.

The following table compares detailed average balances, associated yields, and the resulting changes in interest income for the six months ended June 30, 2014 and 2013:

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
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	Six Months Ended June 30, 2014			2013			
	Average Balance	Yield[1]		Average Balance	Yield[1]		Increase (Decrease) In Interest And Dividend Income From 2013
Loans Receivable, Net	$ 355,979,382	5.50	%	$ 387,353,900	5.74	%	$ (1,325,021)
Mortgage-Backed Securities	252,847,394	2.40		247,726,224	2.08		446,687
Investment Securities[2]	182,978,094	2.47		175,000,872	2.21		326,644
Overnight Time And Certificates of Deposit	2,884,270	0.42		5,871,124	0.14		1,982
Total Interest-Earning Assets	$ 794,689,140	3.79	%	$ 815,952,120	3.83	%	$ (549,708)

(1) Annualized

(2) Tax equivalent basis is calculated using an effective tax rate of 38% and was $247,238 and $243,384 for the six months ended June 30, 2014 and 2013, respectively.

Interest Expense - Total interest expense decreased $1.0 million or 24.9% to $3.1 million during the six months ended June 30, 2014 compared to $4.1 million for the same period last year. The decrease in total interest expense is attributable to decreases in interest rates paid and a $34.2 million decrease in the average balance of interest-bearing liabilities. Interest expense on deposits decreased $547,000 or 29.1% to $1.3 million during the six months ended June 30, 2014 compared to $1.9 million for the same period last year. The decrease was attributable to a 16 basis point decrease in the cost of deposit accounts combined with a $12.5 million decrease in average interest-bearing deposits to $609.2 million for the six month period ended June 30, 2014 when compared to $621.6 million for the six month period ended June 30, 2013. The decrease was concentrated in the certificate accounts, which decreased $18.9 million or 6.8% to $259.9 million during the six months ended June 30, 2014 compared to the same period in 2013. Interest expense on advances and other borrowings decreased $467,000 or 24.6% to $1.4 million during the six months ended June 30, 2014. The average balance of FHLB advances and other borrowed money decreased $21.8 million or 19.9% to $87.4 million during the six months ended June 30, 2014 from $109.2 million for the same period last year.

The following table compares detailed average balances, cost of funds, and the resulting changes in interest expense for the six months ended June 30, 2014 and 2013:

	Six Months Ended June 30, 2014		2013		
	Average Balance	Yield[1]	Average Balance	Yield[1]	Decrease In Interest Expense From 2013
Now And Money Market Accounts	$ 323,584,744	0.19%	$ 319,221,712	0.28%	$ (134,323)
Statement Savings Accounts	25,688,599	0.10	23,665,732	0.18	(8,072)
Certificates Accounts	259,885,905	0.78	278,736,209	1.01	(404,911)
FHLB Advances And Other Borrowed Money	87,431,287	3.28	109,187,416	3.48	(466,599)
Junior Subordinated Debentures	5,155,000	1.95	5,155,000	2.00	(1,395)

Senior Convertible Debentures	6,084,000	8.00	6,084,000	8.00	—
Total Interest-Bearing Liabilities	$ 707,829,535	0.86 %	$ 742,050,069	1.10 %	$ (1,015,300)

(1) Annualized

Provision for Loan Losses - The provision for loan losses was $200,000 for the six months ended June 30, 2014 compared to $2.0 million for the same period in the prior year. The decrease in the provision for loan losses is attributable to a decline in net charge offs. Net charge offs for the six months ended June 30, 2014 declined $1.1 million or 43.6% to $1.3 million from $2.4 million during the comparable period in 2013.

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The following table details selected activity associated with the allowance for loan losses for the six months ended June 30, 2014 and 2013:

	Six Months Ended June 30, 2014	2013
Beginning Balance	$ 10,241,970	$ 11,318,371
Provision	200,000	2,045,381
Charge-offs	(1,794,052)	(2,467,311)
Recoveries	464,239	110,838
Ending Balance	$ 9,112,157	$ 11,007,279

Our strategy is to work with our borrowers to reach acceptable payment plans while protecting our interests in the existing collateral. In the event an acceptable arrangement cannot be reached, we may need to acquire these properties through foreclosure or other means and subsequently sell, develop or liquidate them.

Non-Interest Income - Non-interest income decreased $820,000 or 22.2% to $2.9 million for the six months ended June 30, 2014, compared to $3.7 million for the six months ended June 30, 2013. The following table provides a detailed analysis of the changes in the components of non-interest income:

	Six Months Ended June 30,		Increase (Decrease)	
	2014	2013	Amounts	Percent
Gain On Sale Of Investments	$ 44,871	$ 753,780	$ (708,909)	(94.0)%
Gain On Sale Of Loans	346,530	395,628	(49,098)	(12.4)
Service Fees On Deposit Accounts	560,556	542,094	18,462	3.4
Income From Cash Value Of Life Insurance	404,364	183,000	221,364	121.0
Commissions From Insurance Agency	200,863	244,962	(44,099)	(18.0)
Trust Income	246,000	270,000	(24,000)	(8.9)
Check Card Fee Income	444,556	418,122	26,434	6.3
CDFI Financial Award Income	299,710	636,071	(336,361)	(52.9)
Other	320,887	244,228	76,659	31.4
Total Non-Interest Income	$ 2,868,337	$ 3,687,885	$ (819,548)	(22.2)%

Gain on sale of investments was $45,000 during the six months ended June 30, 2014 a decrease of $709,000 or 94.0% compared to $754,000 during the same period last year. The gain resulted from the sale of 21 investments during the period compared to 12 in the comparable period of 2013. Gain on sale of loans decreased $49,000 or 12.4% to $347,000 during the six months ended June 30, 2014 compared to $396,000 for the same period last year.

Income from the cash value of life insurance increased $221,000 or 121.0% to $404,000 for the six months ended June 30, 2014 compared to $183,000 for the same period in 2013. The Bank recognized $254,000 in death benefits in 2014 in addition to $150,000 in income related to changes in the cash surrender value of the bank owned life insurance policies.

CDFI financial award income decreased $336,000 or 52.9% during the six months ended June 30, 2014 compared to the same period in 2013. The Bank received a CDFA award in 2013 in recognition of its commitment to community development. The CDFA award totaled $1.5 million, of which $271,000 in income remains to be recognized as the microloans are funded.

General And Administrative Expenses – For the six months ended June 30, 2014, non-interest expense decreased $261,000 or 2.4% to $10.6 million compared to $10.9 million for the same period in 2013. The decrease in non-interest expense is primarily a result of a decrease in net cost of operation of other real estate owned and prepayment penalties on FHLB advances during the six months ended June 30, 2014 offset partially by an increase in compensation and employee benefits and advertising expenses. The following table provides a detailed analysis of the changes in the components of general and administrative expenses:

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
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	Six Months Ended June 30,		Increase (Decrease)	
	2014	2013	Amounts	Percent
Compensation And Employee Benefits	$ 5,683,549	$ 5,589,825	$ 93,724	1.7%
Occupancy	975,752	962,978	12,774	1.3
Advertising	243,259	177,731	65,528	36.9
Depreciation And Maintenance Of Equipment	810,776	808,932	1,844	0.2
FDIC Insurance Premiums	364,242	364,198	44	0.0
Amortization of Intangibles	11,970	25,002	(13,032)	(52.1)
Net Cost Of Operation Of Other Real Estate Owned	523,570	737,761	(214,191)	(29.0)
Prepayment Penalties On FHLB Advances	—	238,342	(238,342)	(100.0)
Other	2,030,184	1,999,727	30,457	1.5
Total General And Administrative Expenses	$ 10,643,302	$ 10,904,496	$ (261,194)	(2.4)%

Net cost of operation of other real estate owned decreased $214,000 or 29.0% to $524,000 for the six months ended June 30, 2014 from $738,000 during the six months ended June 30, 2013. Other real estate owned was $4.1 million at June 30, 2014 compared to $4.8 million at June 30, 2013.

The Company incurred a prepayment penalty of $238,000 for paying down FHLB advances during the six months ended June 30, 2013. As part of the Company's strategy, management elected to replace some higher rate advances with lower rate callable certificates of deposit. The Company did not prepay any FHLB advances during the six months ended June 30, 2014.

Compensation and employee benefits expenses were at $5.7 million for the six months ended June 30, 2014, increasing $94,000 or 1.7% from $5.6 million during the same period last year. The Company recognized $100,000 in accrued bonuses during the six months ended June 30, 2014 related to a new incentive compensation plan offered to employees during the year compared to none in 2013.

Provision For Income Taxes – The provision for income taxes increased $519,000 or 104.0% to $1.0 million for the six months ended June 30, 2014 from $499,000 for the same period one year ago. Income before income taxes was $3.8 million and $2.0 million for the six months ended June 30, 2014 and 2013, respectively. The Company’s combined federal and state effective income tax rate for the six months ended June 30, 2014 was 26.8% compared to 24.4% for the same period in 2013.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Management's Discussion and Analysis of Financial Condition and Results of Operations

Liquidity Commitments, Capital Resources, and Impact of Inflation and Changing Prices

Liquidity – The Company actively analyzes and manages the Bank’s liquidity with the objective of maintaining an adequate level of liquidity and to ensure the availability of sufficient cash flows to support loan growth, fund deposit withdrawals, fund operations, and satisfy other financial commitments. See the “Consolidated Statements of Cash Flows” contained in Item 1 – Financial Statements, herein.

The primary sources of funds are customer deposits, loan repayments, loan sales, maturing investment securities, and advances from the FHLB. The sources of funds, together with retained earnings and equity, are used to make loans, acquire investment securities and other assets, and fund continuing operations. While maturities and the scheduled amortization of loans are a predictable source of funds, deposit flows and mortgage repayments are greatly influenced by the level of interest rates, economic conditions, and competition. Management believes that the Company’s current liquidity position and its forecasted operating results are sufficient to fund all of its existing commitments.

During the six months ended June 30, 2014 loan repayments exceeded loan disbursements resulting in a $12.3 million or 3.4% decrease in total net loans receivable. During the six months ended June 30, 2014, deposits decreased $273,000 and FHLB advances decreased $12.6 million. The Bank had $179.4 million in additional borrowing capacity at the FHLB at the end of the period. At June 30, 2014, the Bank had $152.6 million of certificates of deposit maturing within one year. Based on previous experience, the Bank anticipates a significant portion of these certificates will be renewed on maturity.

At June 30, 2014, the Bank was categorized as “well capitalized” under the regulatory framework for prompt corrective action with total risk based, Tier 1 risk based and Tier 1 leverage ratios of 23.1%, 21.8% and 9.9%, respectively. To be categorized as “well capitalized” the Bank must maintain minimum total risk based, Tier 1 risk based and Tier 1 leverage ratios of 10%, 6% and 5%, respectively. There are no current conditions or events that management believes would change the Company’s or the Bank’s category.

Off-Balance Sheet Commitments – The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments generally include commitments to originate mortgage, commercial and consumer loans, and involve to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The Company’s maximum exposure to credit loss in the event of nonperformance by the borrower is represented by the contractual amount of those instruments. Since some commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company uses the same credit policies in making commitments as it does for on-balance sheet instruments. Collateral is not required to support commitments.

The following table sets forth the length of time until maturity for unused commitments to extend credit and standby letters of credit at June 30, 2014.

(Dollars in thousands)	Within One Month	After One Through Three Months	After Three Through Twelve Months	Within One Year	Greater Than One Year	Total
Unused Lines Of Credit	$43	$249	$10,562	$10,854	$34,453	$45,307
Standby Letters Of Credit	630	134	620	1,384	11	1,395
Total	$673	$383	$11,182	$12,238	$34,464	$46,702

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SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the risk of loss from adverse changes in market prices and rates. The Company’s market risk arises principally from interest rate risk inherent in its lending, investment, deposit and borrowing activities. Management actively monitors and manages its interest rate risk exposure. Although the Company manages other risks such as credit quality and liquidity risk in the normal course of business, management considers interest rate risk to be its most significant market risk that could potentially have the largest material effect on the Company’s financial condition and results of operations. Other types of market risks such as foreign currency exchange rate risk and commodity price do not arise in the normal course of the Company’s business activities.

The Company’s profitability is affected by fluctuations in the market interest rate. Management’s goal is to maintain a reasonable balance between exposure to interest rate fluctuations and earnings. A sudden and substantial increase or decrease in interest rates may adversely impact the Company’s earnings to the extent that the interest rates on interest-earning assets and interest-bearing liabilities do not change at the same rate, to the same extent or on the same basis. The Company monitors the impact of changes in interest rates on its net interest income using a test that measures the impact on net interest income and net portfolio value of an immediate change in interest rates in 100 basis point increments and by measuring the Bank’s interest sensitivity gap (“Gap”). Net portfolio value is defined as the net present value of assets, liabilities, and off-balance sheet contracts. Gap is the amount of interest sensitive assets repricing or maturing over the next twelve months compared to the amount of interest sensitive liabilities maturing or repricing in the same time period.

For the three and six months ended June 30, 2014, the Bank's interest rate spread, defined as the average yield on interest bearing assets less the average rate paid on interest bearing liabilities was 3.05% and 2.93% respectively.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures: An evaluation of the Company's disclosure controls and procedures (as defined in Rule 13a - 15(e) of the Securities Exchange Act of 1934 ("Act")) was carried out under the supervision and with the participation of the Company's Chief Executive Officer, Chief Financial Officer and several other members of the Company's senior management as of the end of the period covered by this quarterly report. The Company's Chief Executive Officer and Chief Financial Officer concluded that at June 30, 2014 the Company's disclosure controls and procedures were effective in ensuring that the information required to be disclosed by the Company in the reports it files or submits under the Act is (i) accumulated and communicated to the Company's management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner, and (ii) recorded, processed, summarized and reported within the time period specified in the Securities and Exchange Commission's rules and forms. There have been no significant changes in our internal controls over financial reporting during the quarter ended June 30, 2014 that have materially affected or are reasonably likely to affect our internal controls over financial reporting.

The Company does not expect that its disclosure controls and procedures will prevent all error and or fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any control procedure also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control procedure, misstatements due to error or fraud may occur and not be detected.

Part II: Other Information

Item 1 Legal Proceedings

The Company is not engaged in any legal proceedings of a material nature at the present time. From time to time, the Company is a party to legal proceedings in the ordinary course of business wherein it enforces its security interest in mortgage loans it has made.

Item 1A Risk Factors

There have been no material changes in the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

Item 2 Unregistered Sales of Equity Securities and Use Of Proceeds

None

Item 3 Defaults Upon Senior Securities

None

Item 4 Mine Safety Disclosures

Not applicable

Item 5 Other Information
None

Item 6 Exhibits

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SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

3.1	Articles of Incorporation, as amended (1)
3.2	Articles of Amendment, including Certificate of Designation relating to the Company's Fixed Rate Cumulative Perpetual Preferred Stock Series B (2)
3.3	Amended and Restated Bylaws (3)
4.1	Form of Stock Certificate of the Company and other instruments defining the rights of security holders, including indentures (4)
4.2	Form of Stock Certificate for the Series B Preferred Shares (2)
4.3	Warrant to purchase shares of the Company's common stock dated December 19, 2008 (5)
4.4	Form of Indenture with respect to the Company's 8.0% Convertible Senior Debentures Due 2029 (6)
4.5	Specimen Convertible Senior Debenture Due 2029 (6)
4.6	Letter Agreement dated September 29, 2010 between Security Federal Corporation and the United States Department of the Treasury, including the Exchange Agreement – Standard Terms, with respect to the exchange of the Series A Fixed Rate Cumulative Perpetual Preferred Stock for the Series B Fixed Rate Cumulative Perpetual Preferred Stock (2)
4.7	Letter Agreement dated September 29, 2010 between Security Federal Corporation and the United States Department of the Treasury, including the Securities Purchase Agreement – Standard Terms, with respect to the purchase of the Series B Fixed Rate Cumulative Perpetual Preferred Stock (2)
10.1	1993 Salary Continuation Agreements (7)
10.2	Amendment One to 1993 Salary Continuation Agreements (8)
10.3	Form of 2006 Salary Continuation Agreement (9)
10.4	1999 Stock Option Plan (10)
10.5	2002 Stock Option Plan (11)
10.6	2006 Stock Option Plan (12)
10.7	2008 Equity Incentive Plan (13)
10.8	Form of incentive stock option agreement and non-qualified stock option agreement pursuant to the 2006 Stock Option Plan (12)
10.9	2004 Employee Stock Purchase Plan (14)
10.10	Incentive Compensation Plan (7)
10.11	Form of Security Federal Bank Salary Continuation Agreement (9)
10.12	Form of Security Federal Split Dollar Agreement (9)
10.13	Form of Compensation Modification Agreement (5)
14	Code of Ethics (15)
25	Form T-1; Statement Eligibility of Trustee (6)
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act
101	The following materials from Security Federal Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2014, formatted in Extensible Business Reporting Language (XBRL): (a) Consolidated Balance Sheets; (b) Consolidated Statements of Income; (c) Consolidated Statements of Comprehensive Income (Loss); (d) Consolidated Statements of Changes in Shareholders'Equity; (e) Consolidated Statements of Cash Flows; and (f) Notes to Consolidated Financial Statements (16)

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(1) Filed on June 26, 1998, as an exhibit to the Company's Proxy Statement and incorporated herein by reference.
(2) Incorporated by reference to the Company's Current Report on Form 8-K filed on September 30, 2010.

(3) Incorporated by reference to the Company's Current Report on Form 8-K filed on December 19, 2011.

(4) Filed on August 12, 1987, as an exhibit to the Company's Registration Statement on Form 8-A and incorporated herein by reference.

(5) Incorporated by reference to the Company's Current Report on Form 8-K filed on December 23, 2008.

(6) Filed on July 13, 2009 as an exhibit to the Company's Registration Statement on Form S-1 (File No. 333-160553) and incorporated herein by reference.

(7) Filed on June 28, 1993, as an exhibit to the Company's Annual Report on Form 10-KSB and incorporated herein by reference.

(8) Filed as an exhibit to the Company's Quarterly Report on Form 10-QSB for the quarter ended September 30, 1993 and incorporated herein by reference.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

(9) Filed on May 24, 2006 as an exhibit to the Company’s Current Report on Form 8-K dated May 18, 2006 and incorporated herein by reference.
(10) Filed on March 2, 2000, as an exhibit to the Company's Registration Statement on Form S-8 and incorporated herein by reference
(11) Filed on January 3, 2003, as an exhibit to the Company's Registration Statement on Form S-8 and incorporated herein by reference.
(12) Filed on August 22, 2006, as an exhibit to the Company's Registration Statement on Form S-8 (Registration Statement No. 333-136813) and incorporated herein by reference.
(13) Filed on November 12, 2008, as an exhibit to the Company's Registration Statement on Form S-8 and incorporated herein by reference.
(14) Filed on June 18, 2004, as an exhibit to the Company’s Proxy Statement and incorporated herein by reference.
(15) Filed on June 29, 2006, as an exhibit to the Company’s Annual Report on Form 10-K and incorporated herein by reference.
(16) Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

Signatures

Pursuant to the requirement of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SECURITY FEDERAL CORPORATION

Date:	August 13, 2014	By:	/s/J. Chris Verenes J. Chris Verenes Chief Executive Officer Duly Authorized Representative
Date:	August 13, 2014	By:	/s/Jessica T. Cummins Jessica T. Cummins Chief Financial Officer Duly Authorized Representative

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

EXHIBIT INDEX

31.1	Certifications of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
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