SECURITY FEDERAL CORP
Form 10-Q
May 12, 2016
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 MARCH 31, 2016
( ) 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 NORTHWEST, 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	May 12, 2016	2,945,474

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

	March 31, 2016 Unaudited	December 31, 2015 Audited
ASSETS:		
Cash and Cash Equivalents	$8,392,324	$8,381,951
Certificates of Deposit with Other Banks	3,445,005	3,445,005
Investment and Mortgage-Backed Securities:		
Available For Sale	388,651,412	375,513,870
Held To Maturity (Fair Value of $29,986,883 and $29,681,280 at March 31, 2016 and December 31, 2015, Respectively)	29,946,584	29,873,098
Total Investment and Mortgage-Backed Securities:	418,597,996	405,386,968
Loans Receivable, Net:		
Held For Sale	1,171,189	2,462,559
Held For Investment: (Net of Allowance of $8,273,304 and $8,275,133 at March 31, 2016 and December 31, 2015, Respectively)	330,709,360	328,110,170
Total Loans Receivable, Net	331,880,549	330,572,729
Accrued Interest Receivable:		
Loans	961,515	886,968
Mortgage-Backed Securities	648,121	614,925
Investment Securities	1,431,631	1,523,200
Total Accrued Interest Receivable	3,041,267	3,025,093
Premises and Equipment, Net	20,293,834	20,116,918
Federal Home Loan Bank ("FHLB") Stock, at Cost	2,055,500	2,214,800
Other Real Estate Owned ("OREO")	2,582,056	4,361,411
Bank Owned Life Insurance	16,705,045	16,573,045
Goodwill	1,199,754	1,199,754
Other Assets	2,831,465	4,449,956
Total Assets	$811,024,795	$799,727,630
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Liabilities:		
Deposit Accounts	$661,231,739	$652,096,545
Advances From FHLB	30,890,000	34,640,000
Other Borrowings	8,707,151	6,411,977
Junior Subordinated Debentures	5,155,000	5,155,000
Advance Payments By Borrowers For Taxes and Insurance	421,233	256,730
Senior Convertible Debentures	6,084,000	6,084,000
Other Liabilities	5,239,643	4,115,956
Total Liabilities	717,728,766	708,760,208
Shareholders' Equity:		
Serial Preferred Stock, $.01 Par Value; Authorized 200,000 Shares; Issued and Outstanding Shares, 22,000	22,000,000	22,000,000
Common Stock, $.01 Par Value; Authorized 5,000,000 Shares; Issued and Outstanding Shares, 3,146,407 and 2,945,474, Respectively	31,464	31,464
Additional Paid-In Capital	12,030,824	12,028,832
Treasury Stock, at Cost (200,933 Shares)	(4,330,712)	(4,330,712)

Unvested Restricted Stock	(25,358)	(25,358)
Accumulated Other Comprehensive Income	5,217,871	4,262,361
Retained Earnings	58,371,940	57,000,835
Total Shareholders' Equity	93,296,029	90,967,422
Total Liabilities and Shareholders' Equity	$811,024,795	$799,727,630

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income (Unaudited)

	Three Months Ended March 31,	
	2016	2015
Interest Income:		
Loans	$4,642,108	$4,537,195
Mortgage-Backed Securities	1,254,401	1,424,353
Investment Securities	1,084,399	985,106
Other	4,510	2,550
Total Interest Income	6,985,418	6,949,204
Interest Expense:		
NOW and Money Market Accounts	103,115	118,429
Statement Savings Accounts	7,890	7,120
Certificate Accounts	408,732	479,159
FHLB Advances and Other Borrowed Money	248,659	421,755
Senior Convertible Debentures	121,680	121,680
Junior Subordinated Debentures	29,103	25,078
Total Interest Expense	919,179	1,173,221
Net Interest Income	6,066,239	5,775,983
Provision For Loan Losses	—	100,000
Net Interest Income After Provision For Loan Losses	6,066,239	5,675,983
Non-Interest Income:		
Gain on Sale of Investment Securities	258,068	1,486,939
Gain on Sale of Loans	208,966	154,019
Service Fees on Deposit Accounts	240,345	257,516
Commissions From Insurance Agency	169,847	130,112
Trust Income	162,000	148,800
Bank Owned Life Insurance Income	132,000	87,000
Check Card Fee Income	238,142	231,301
Grant Income	265,496	—
Other	152,876	155,320
Total Non-Interest Income	1,827,740	2,651,007
Non-Interest Expense:		
Compensation and Employee Benefits	3,330,798	2,987,031
Occupancy	496,718	490,658
Advertising	129,977	96,161
Depreciation and Maintenance of Equipment	476,374	417,245
Federal Deposit Insurance Corporation ("FDIC") Insurance Premiums	133,047	160,221
Net Cost of Operation of OREO	(675,926)	196,624
Prepayment Penalties on FHLB Advances	247,506	787,851
Other	1,397,450	1,118,804
Total Non-Interest Expense	5,535,944	6,254,595
Income Before Income Taxes	2,358,035	2,072,395
Provision For Income Taxes	641,292	567,768
Net Income	1,716,743	1,504,627
Preferred Stock Dividends	110,000	110,000
Net Income Available To Common Shareholders	$1,606,743	$1,394,627
Net Income Per Common Share (Basic)	$0.55	$0.47

Net Income Per Common Share (Diluted)	$0.52	$0.45
Cash Dividend Per Share On Common Stock	$0.08	$0.08
Weighted Average Shares Outstanding (Basic)	2,944,001	2,944,001
Weighted Average Shares Outstanding (Diluted)	3,248,443	3,248,230

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Unaudited)

	Three Months Ended March 31,	
	2016	2015
Net Income	$1,716,743	$1,504,627
Other Comprehensive Income		
Unrealized Gains on Securities:		
Unrealized Holding Gains on Securities Available For Sale, Net of Taxes of $707,595 and $735,658 at March 31, 2016 and 2015, Respectively	1,155,744	1,201,187
Reclassification Adjustment for Gains Included in Net Income, Net of Taxes of $98,066 and $565,037 at March 31, 2016 and 2015, Respectively	(160,002)	(921,902)
Amortization of Unrealized Gains on Available For Sale Securities Transfer to Held To Maturity, Net of Taxes of $(24,616) at March 31, 2016	(40,232)	—
Other Comprehensive Income	955,510	279,285
Comprehensive Income	$2,672,253	$1,783,912

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

5

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
For the Three Months Ended March 31, 2016 and 2015

	Preferred Stock	Common Stock	Unvested Restricted Stock	Additional Paid – In Capital	Treasury Stock	Accumulated Other Comprehensive Income	Retained Earnings	Total
Balance at December 31, 2015	$22,000,000	$31,464	(25,358)	$12,028,832	$(4,330,712)	$4,262,361	$57,000,835	$90,967,422
Net Income	—	—		—	—	—	1,716,743	1,716,743
Other Comprehensive Income, Net of Tax	—	—		—	—	955,510	—	955,510
Stock Option Compensation Expense	—	—		1,992	—	—	—	1,992
Cash Dividends on Preferred Stock	—	—		—	—	—	(110,000)	(110,000)
Cash Dividends on Common Stock	—	—		—	—	—	(235,638)	(235,638)
Balance at March 31, 2016	$22,000,000	$31,464	$(25,358)	$12,030,824	$(4,330,712)	$5,217,871	$58,371,940	$93,296,029

	Preferred Stock	Common Stock	Unvested Restricted Stock	Additional Paid – In Capital	Treasury Stock	Accumulated Other Comprehensive Income	Retained Earnings	Total
Balance at December 31, 2014	$22,000,000	$31,449	$—	$11,990,813	$(4,330,712)	$5,476,375	$52,267,460	$87,435,385
Net Income	—	—	—	—	—	—	1,504,627	1,504,627
Other Comprehensive Income, Net of Tax	—	—	—	—	—	279,285	—	279,285
Common Stock Issuance	—	15	(25,358)	25,343				—
Stock Option Compensation Expense	—	—	—	3,169	—	—	—	3,169
Cash Dividends on Preferred Stock	—	—	—	—	—	—	(110,000)	(110,000)

Cash Dividends on Common Stock	—	—	—	—	—	—	(235,638)	(235,638)
Balance at March 31, 2015	$22,000,000	$31,464	$(25,358)	$12,019,325	$(4,330,712)	$5,755,660	$53,426,449	$88,876,828

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

6

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

	Three Months Ended March 31, 2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	$1,716,743	$1,504,627
Adjustments To Reconcile Net Income To Net Cash Provided By Operating Activities:		
Depreciation Expense	343,740	309,913
Stock Option Compensation Expense	1,992	3,169
Discount Accretion and Premium Amortization	1,330,301	1,252,401
Provisions for Losses on Loans	—	100,000
Income From Bank Owned Life Insurance	(132,000)	(87,000)
Gain on Sales of Loans	(208,966)	(154,019)
Gain on Sales of Mortgage-Backed Securities	—	(358,141)
Gain on Sales of Investment Securities	(258,068)	(1,128,798)
Gain on Sale of OREO	(755,496)	(57,040)
Write Down on OREO	40,000	124,400
Amortization of Deferred Fees on Loans	29,269	4,737
Proceeds From Sale of Loans Held For Sale	7,852,627	5,860,686
Origination of Loans Held For Sale	(6,352,291)	(5,720,512)
(Increase) Decrease in Accrued Interest Receivable:		
Loans	(74,547)	(58,089)
Mortgage-Backed Securities	(33,196)	6,640
Investment Securities	91,569	77,870
Increase in Advance Payments By Borrowers	164,503	147,815
Other, Net	2,092,417	796,189
Net Cash Provided By Operating Activities	5,848,597	2,624,848
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of Mortgage-Backed Securities Available For Sale	(17,654,734)	(15,625,415)
Principal Repayments on Mortgage-Backed Securities Available For Sale	5,860,554	7,421,481
Proceeds From Sale of Mortgage-Backed Securities Available For Sale	—	7,266,721
Purchase of Mortgage-Backed Securities Held To Maturity	(1,507,125)	—
Principal Repayments on Mortgage-Backed Securities Held To Maturity	1,303,075	—
Purchase of Investment Securities Available For Sale	(10,273,607)	(41,533,216)
Principal Repayments on Investment Securities Available For Sale	4,406,607	—
Maturities of Investment Securities Available For Sale	2,001,279	9,257,293
Proceeds From Sale of Investment Securities Available For Sale	3,185,961	29,095,492
Purchase of FHLB Stock	(1,355,400)	(868,800)
Redemption of FHLB Stock	1,514,700	1,817,300
(Increase) Decrease in Loans Receivable	(2,628,459)	4,137,337
Proceeds From Sale of OREO	2,494,851	263,340
Purchase and Improvement of Premises and Equipment	(520,656)	(684,789)
Net Cash Provided By (Used In) Investing Activities	(13,172,954)	546,744

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited), Continued

	Three Months Ended March 31,	
	2016	2015
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase in Deposit Accounts	$9,135,194	$12,326,393
Proceeds from FHLB Advances	78,030,000	86,670,000
Repayment of FHLB Advances	(81,780,000)	(105,370,000)
Proceeds from Other Borrowings, Net	2,295,174	1,816,809
Dividends To Preferred Stock Shareholders	(110,000)	(110,000)
Dividends To Common Stock Shareholders	(235,638)	(235,638)
Net Cash Provided By (Used In) Financing Activities	7,334,730	(4,902,436)
Net Increase (Decrease) in Cash and Cash Equivalents	10,373	(1,730,844)
Cash and Cash Equivalents at Beginning of Period	8,381,951	10,192,702
Cash and Cash Equivalents at End of Period	$8,392,324	$8,461,858
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash Paid During the Period For:		
Interest	$830,171	$1,201,870
Income Taxes	$19,242	$10,388
Supplemental Schedule of Non Cash Transactions:		
Transfers From Loans Receivable to OREO	$—	$3,587,840

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 ("U.S. GAAP"); 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 consolidated financial statements appearing in Security Federal Corporation's (the "Company") 2015 Annual Report to Shareholders which was filed as an exhibit to our Annual Report on Form 10-K for the year ended December 31, 2015 ("2015 10-K") when reviewing interim financial statements.

2. Principles of Consolidation

The accompanying unaudited 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, and home insurance. SFINS has a wholly owned subsidiary, Collier Jennings Financial Corporation, which has as subsidiaries Security Federal Auto Insurance, The Auto Insurance Store Inc., and Security Federal Premium Pay Plans Inc. 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, 2015 included in our 2015 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. Due to 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.

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 regulatory agencies, including the Board of Governors of the Federal Reserve System ("Federal Reserve"), the FDIC and the South Carolina Board of Financial Institutions, that may require adjustments to be made to the allowance based upon the information that is available at the time of their examination.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

3. Critical Accounting Policies, Continued

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 March 31,	
	2016	2015

Earnings Available To Common Shareholders:		
Net Income	$1,716,743	$1,504,627
Preferred Stock Dividends	110,000	110,000
Net Income Available To Common Shareholders	$1,606,743	$1,394,627

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

4. Earnings Per Common Share, Continued

The following table is a summary of the Company's basic and diluted earnings per share for the periods indicated.

	For the Three Months Ended March 31,					
	2016			2015		
	Income	Shares	Per Share Amounts	Income	Shares	Per Share Amounts
Basic EPS	$1,606,743	2,944,001	$0.55	$1,394,627	2,944,001	$0.47
Effect of Dilutive Securities:						
Senior Convertible Debentures	75,442	304,200	(0.02)	75,442	304,200	(0.02)
Unvested Restricted Stock	—	242	(0.01)	—	29	—
Diluted EPS	$1,682,185	3,248,443	$0.52	$1,470,069	3,248,230	$0.45

5. Stock-Based Compensation

Certain officers and directors of the Company participate in incentive and non-qualified stock option plans. 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 March 31,			
	2016		2015	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Balance, Beginning of Period	29,500	$23.55	47,500	$22.41
Options Granted	—	—	—	—
Options Exercised	—	—	—	—
Options Forfeited	(3,500)	23.91	(18,000)	20.55
Balance, End Of Period	26,000	$23.50	29,500	$23.55
Options Exercisable	20,600	$23.51	18,900	$23.58
Options Available For Grant	50,000		50,000	

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

5. Stock-Based Compensation, Continued

At March 31, 2016, the Company had the following options outstanding:

Grant Date	Outstanding Options	Option Price	Expiration Date
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 March 31, 2016 or 2015 had an exercise price below the average market price during the three month periods ended March 31, 2016 or 2015. Therefore, these options were not deemed to be dilutive to EPS in those periods.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

6. 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 at the dates indicated are as follows:

	March 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
FHLB Securities	$2,000,000	$—	$4,890	$1,995,110
Federal Home Loan Mortgage Corporation ("FHLMC") & Federal National Mortgage Association ("FNMA") Bonds	1,997,016	18,605	—	2,015,621
Small Business Administration (“SBA”) Bonds	109,797,838	1,692,290	174,456	111,315,672
Tax Exempt Municipal Bonds	74,181,255	3,009,287	209,164	76,981,378
Taxable Municipal Bonds	1,016,098	3,952	—	1,020,050
Mortgage-Backed Securities	191,429,724	4,020,969	432,754	195,017,939
Equity Securities	250,438	55,204	—	305,642
	$380,672,369	$8,800,307	$821,264	$388,651,412

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
FHLB Securities	$2,000,000	$—	$67,912	$1,932,088
Federal Farm Credit Bank ("FFCB") Securities	2,000,000	—	12,064	1,987,936
FNMA Bonds	997,564	6,767	—	1,004,331
SBA Bonds	110,195,113	1,415,464	193,795	111,416,782
Tax Exempt Municipal Bonds	73,499,636	2,770,115	204,132	76,065,619
Mortgage-Backed Securities	180,197,347	3,281,116	681,251	182,797,212
Equity Securities	250,438	59,464	—	309,902
	$369,140,098	$7,532,926	$1,159,154	$375,513,870

The FHLB, FFCB, FHLMC and FNMA are government sponsored enterprises ("GSEs") and the securities and bonds issued by 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 Government National Mortgage Association ("GNMA") mortgage-backed securities, which are also backed by the full faith and credit of the United States government. At March 31, 2016 the Bank held an amortized cost and fair value of $113.5 million and $115.6 million, respectively, in GNMA mortgage-backed securities, which are included in mortgage-backed securities in the table above, compared to an amortized cost and fair value of $116.8 million and $118.5 million, respectively, at December 31, 2015.

Also included in mortgage-backed securities in the tables above and below are private label collateralized mortgage obligation ("CMO") securities. These securities are issued by non-governmental real estate mortgage investment conduits, which are not backed by the full faith and credit of the United States government. At March 31, 2016 the

Bank held an amortized cost and fair value of $14.7 million and $14.5 million, respectively, in private label CMO mortgage-backed securities, which are included in mortgage-backed securities in the table above, compared to an amortized cost and fair value of $3.8 million at December 31, 2015.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

6. 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 March 31, 2016 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. Since mortgage-backed securities are not due at a single maturity date, they are disclosed separately, rather than allocated over the the maturity groupings below.

Investment Securities	Amortized Cost	Fair Value
Less Than One Year	$447,262	$453,157
One – Five Years	16,871,672	17,216,800
Over Five – Ten Years	54,832,074	55,875,165
More Than Ten Years	117,091,637	120,088,351
Mortgage-Backed Securities	191,429,724	195,017,939
	$380,672,369	$388,651,412

At March 31, 2016 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 $79.2 million and $76.8 million, respectively, compared to an amortized cost and fair value of $81.0 million and $83.2 million, respectively at December 31, 2015.

The Bank received $3.2 million and $36.4 million, respectively, in gross proceeds from sales of available for sale securities during the three months ended March 31, 2016 and 2015. As a result, the Bank recognized gross gains of $258,000 and $1.5 million, respectively, and gross losses of $0 and $47,000, respectively, for the three months ended March 31, 2016 and 2015.

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.

	March 31, 2016					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
FHLB Securities	$—	$—	$1,995,110	$4,890	$1,995,110	$4,890
FFCB Securities	—	—	—	—	—	—
SBA Bonds	16,475,245	89,541	9,238,724	84,915	25,713,969	174,456
Tax Exempt Municipal Bonds	11,246,437	126,569	3,997,850	82,595	15,244,287	209,164
Mortgage-Backed Securities	38,690,737	334,990	8,060,303	97,764	46,751,040	432,754
	$66,412,419	$551,100	$23,291,987	$270,164	$89,704,406	$821,264

	December 31, 2015					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

FHLB Securities	$—	$—	$1,932,088	$67,912	$1,932,088	$67,912
FFCB Securities	1,987,936	12,064	—	—	1,987,936	12,064
SBA Bonds	25,090,453	119,533	7,982,777	74,262	33,073,230	193,795
Tax Exempt Municipal Bonds	13,668,473	175,020	709,800	29,112	14,378,273	204,132
Mortgage-Backed Securities	63,273,417	648,862	1,706,086	32,389	64,979,503	681,251
	$104,020,279	$955,479	$12,330,751	$203,675	$116,351,030	$1,159,154

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

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

Securities classified as available for sale are recorded at fair market value. At March 31, 2016, 32.9% of the unrealized losses, or 17 individual securities, were in a continuous loss position for 12 months or more. At December 31, 2015, 17.6% of the unrealized losses, or nine individual securities, were 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 a portion may be recognized in other comprehensive income. The fair value of investments on which OTTI is recognized then becomes the new cost basis of the investment. There was no OTTI recognized during the three months ended March 31, 2016.

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

The amortized cost, gross unrealized gains, gross unrealized losses, and fair values of held to maturity securities at the dates indicated are as follows:

	March 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Mortgage-Backed Securities (1)	$29,946,584	$ 125,776	$ 85,477	$29,986,883
Total Held To Maturity	$29,946,584	$ 125,776	$ 85,477	$29,986,883

(1) COMPRISED OF GSEs OR GNMA MORTGAGE-BACKED SECURITIES

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Mortgage-Backed Securities (1)	$29,873,098	$ 22,600	$ 214,418	$29,681,280
Total Held To Maturity	$29,873,098	$ 22,600	$ 214,418	$29,681,280

(1) COMPRISED OF GSEs OR GNMA MORTGAGE-BACKED SECURITIES

Other than the mortgage-backed securities included in the tables above, there were no other investment securities classified as held to maturity at March 31, 2016 and December 31, 2015.

At March 31, 2016, the Bank held GNMA mortgage-backed securities classified as held to maturity that had both an amortized cost and fair value of $19.3 million. The Company has not invested in any private label mortgage-backed securities classified as held to maturity.

At March 31, 2016, both the amortized cost and fair value of mortgage-backed securities held to maturity pledged as collateral for certain deposit accounts, FHLB advances and other borrowings was $24.7 million.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

7. Investment and Mortgage-Backed Securities, Held to Maturity, Continued

The following tables show gross unrealized losses, fair value and length of time that individual held to maturity securities were in a continuous unrealized loss position at March 31, 2016 and December 31, 2015.

	March 31, 2016					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-Backed Securities (1)	$11,964,145	$ 85,477	$ —	$ —	$11,964,145	$ 85,477
	$11,964,145	$ 85,477	$ —	$ —	$11,964,145	$ 85,477

(1) COMPRISED OF GSEs OR GNMA MORTGAGE-BACKED SECURITIES

	December 31, 2015					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-Backed Securities (1)	$25,484,972	$214,418	$ —	$ —	$25,484,972	$214,418
	$25,484,972	$214,418	$ —	$ —	$25,484,972	$214,418

(1) COMPRISED OF GSEs OR GNMA MORTGAGE-BACKED SECURITIES

The Company’s held to maturity portfolio is recorded at amortized cost. The Company has the ability and intent to hold these securities to maturity.

8. Loans Receivable, Net

Loans receivable, net, consisted of the following at the dates shown below:

	March 31, 2016	December 31, 2015
Residential Real Estate Loans	$76,642,289	$76,373,071
Consumer Loans	50,524,091	50,380,289
Commercial Business Loans	12,764,075	12,514,133
Commercial Real Estate Loans	201,166,921	200,083,125
Total Loans Held For Investment	341,097,376	339,350,618
Loans Held For Sale	1,171,189	2,462,559
Total Loans Receivable, Gross	342,268,565	341,813,177
Less:		
Allowance For Loan Losses	8,273,304	8,275,133
Loans In Process	2,015,710	2,902,849
Deferred Loan Fees	99,002	62,466
	10,388,016	11,240,448
Total Loans Receivable, Net	$331,880,549	$330,572,729

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

8. Loans Receivable, Net, Continued

Changes in the allowance for loan losses for the three months ended March 31, 2016 and 2015 are summarized as follows:

	Three Months Ended March 31,	
	2016	2015
Balance at Beginning of Period	$8,275,133	$8,357,496
Provision for Loan Losses	—	100,000
Charge Offs	(165,629)	(619,014)
Recoveries	163,800	80,435
Total Allowance for Loan Losses	$8,273,304	$7,918,917

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 to have the least amount of risk in terms of determining the allowance for loan losses. Loans that are graded as substandard are considered to have the most risk. 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 caution and special mention categories fall in between the pass and substandard grades and consist of loans that do not currently expose the Company to sufficient risk to warrant adverse classification but possess weaknesses.

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

	Credit Quality Measures				
March 31, 2016	Pass	Caution	Special Mention	Substandard	Total Loans
Residential Real Estate	$68,644,501	$726,630	$705,465	$6,565,693	$76,642,289
Consumer	46,694,470	2,340,199	80,733	1,408,689	50,524,091
Commercial Business	11,269,150	1,018,999	96,610	379,316	12,764,075
Commercial Real Estate	134,046,088	40,633,981	16,810,815	9,676,037	201,166,921
Total	$260,654,209	$44,719,809	$17,693,623	$18,029,735	$341,097,376

	Credit Quality Measures				
December 31, 2015	Pass	Caution	Special Mention	Substandard	Total Loans
Residential Real Estate	$67,605,311	$1,264,415	$607,336	$6,896,009	$76,373,071
Consumer	46,344,056	2,510,519	81,617	1,444,097	50,380,289
Commercial Business	10,519,123	1,465,136	102,046	427,828	12,514,133
Commercial Real Estate	129,242,390	43,863,659	17,304,431	9,672,645	200,083,125

Total	$253,710,880	$49,103,729	$18,095,430	$18,440,579	$339,350,618

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

8. Loans Receivable, Net, Continued

The following table presents an age analysis of past due balances by loan category at March 31, 2016:

	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	$421,074	$—	$3,074,983	$3,496,057	$73,146,232	$76,642,289
Consumer	810,449	—	534,872	1,345,321	49,178,770	50,524,091
Commercial Business	401,173	—	153,401	554,574	12,209,501	12,764,075
Commercial Real Estate	3,819,182	666,448	3,921,155	8,406,785	192,760,136	201,166,921
Total	$5,451,878	$666,448	$7,684,411	$13,802,737	$327,294,639	$341,097,376

The following table presents an age analysis of past due balances by loan category at December 31, 2015:

	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	$—	$1,144,381	$3,306,675	$4,451,056	$71,922,015	$76,373,071
Consumer	710,881	282,314	575,866	1,569,061	48,811,228	50,380,289
Commercial Business	101,201	—	178,076	279,277	12,234,856	12,514,133
Commercial Real Estate	3,309,287	929,819	2,973,135	7,212,241	192,870,884	200,083,125
Total	$4,121,369	$2,356,514	$7,033,752	$13,511,635	$325,838,983	$339,350,618

At March 31, 2016 and December 31, 2015, 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 loan category at March 31, 2016 compared to December 31, 2015:

	At March 31, 2016		At December 31, 2015		$	%
	Amount	Percent (1)	Amount	Percent (1)	Increase (Decrease)	Increase (Decrease)
Non-accrual Loans:						
Residential Real Estate	$3,074,983	0.91%	$3,306,675	0.98%	$(231,692)	(7.0)%
Commercial Business	153,401	0.05	178,076	0.05	(24,675)	(13.9)
Commercial Real Estate	3,921,155	1.16	2,973,135	0.88	948,020	31.9
Consumer	534,872	0.16	575,866	0.17	(40,994)	(7.1)
Total Non-accrual Loans	$7,684,411	2.28%	$7,033,752	2.08%	$650,659	9.3%

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

18

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

8. Loans Receivable, Net, Continued

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

	For the Three Months Ended March 31, 2016				
	Residential Real Estate	Consumer	Commercial Business	Commercial Real Estate	Total
Beginning Balance	$1,323,183	$1,063,153	$ 773,948	$5,114,849	$8,275,133
Provision	76,520	48,967	29,198	(154,685)	—
Charge-Offs	—	(94,429)	—	(71,200)	(165,629)
Recoveries	—	24,839	—	138,961	163,800
Ending Balance	$1,399,703	$1,042,530	$ 803,146	$5,027,925	$8,273,304

	For the Three Months Ended March 31, 2015				
	Residential Real Estate	Consumer	Commercial Business	Commercial Real Estate	Total
Beginning Balance	$1,392,065	$886,716	$ 159,353	$5,919,362	$8,357,496
Provision	7,370	330,931	345,077	(583,378)	100,000
Charge-Offs	(45,000)	(120,618)	(10,947)	(442,449)	(619,014)
Recoveries	—	44,768	3,320	32,347	80,435
Ending Balance	$1,354,435	$1,141,797	$496,803	$4,925,882	$7,918,917

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

March 31, 2016	Allowance For Loan Losses Individually Evaluated For Impairment	Collectively Evaluated For Impairment	Total
Residential Real Estate	$—	$1,399,703	$1,399,703
Consumer	2,300	1,040,230	1,042,530
Commercial Business	—	803,146	803,146
Commercial Real Estate	154,300	4,873,625	5,027,925
Total	$156,600	$8,116,704	$8,273,304

December 31, 2015	Allowance For Loan Losses Individually Evaluated For Impairment	Collectively Evaluated For Impairment	Total
Residential Real Estate	$—	$1,323,183	$1,323,183
Consumer	32,300	1,030,853	1,063,153
Commercial Business	—	773,948	773,948

Commercial Real Estate	49,300	5,065,549	5,114,849
Total	$81,600	$8,193,533	$8,275,133

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

8. Loans Receivable, Net, Continued

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

	Loans Receivable		
March 31, 2016	Individually Evaluated For Impairment	Collectively Evaluated For Impairment	Total
Residential Real Estate	$2,690,748	$73,951,541	$76,642,289
Consumer	353,775	50,170,316	50,524,091
Commercial Business	153,401	12,610,674	12,764,075
Commercial Real Estate	7,232,851	193,934,070	201,166,921
Total	$10,430,775	$330,666,601	$341,097,376

	Loans Receivable		
December 31, 2015	Individually Evaluated For Impairment	Collectively Evaluated For Impairment	Total
Residential Real Estate	$2,922,105	$73,450,966	$76,373,071
Consumer	372,382	50,007,907	50,380,289
Commercial Business	162,201	12,351,932	12,514,133
Commercial Real Estate	9,190,640	190,892,485	200,083,125
Total	$12,647,328	$326,703,290	$339,350,618

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 the 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 $12.5 million for three months ended March 31, 2016 compared to $18.0 million for the three months ended March 31, 2015.

20

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

8. Loans Receivable, Net, Continued

The following tables are a summary of information related to impaired loans at March 31, 2016 and December 31, 2015 and for the three months ended March 31, 2016 and 2015.

	At March 31, 2016			At December 31, 2015		
Impaired Loans	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With No Related Allowance Recorded:						
Residential Real Estate	$2,690,748	$2,787,248	$—	$2,922,105	$3,033,735	$ —
Consumer	291,087	334,817	—	120,889	129,188	—
Commercial Business	153,401	353,401	—	162,201	362,201	—
Commercial Real Estate	6,460,078	8,515,619	—	8,620,301	10,969,642	—
With An Allowance Recorded:						
Residential Real Estate	—	—	—	—	—	—
Consumer	62,689	62,689	2,300	251,493	256,923	32,300
Commercial Business	—	—	—	—	—	—
Commercial Real Estate	772,772	779,572	154,300	570,339	577,139	49,300
Total						
Residential Real Estate	2,690,748	2,787,248	—	2,922,105	3,033,735	—
Consumer	353,776	397,506	2,300	372,382	386,111	32,300
Commercial Business	153,401	353,401	—	162,201	362,201	—
Commercial Real Estate	7,232,850	9,295,191	154,300	9,190,640	11,546,781	49,300
Total	$10,430,775	$12,833,346	$156,600	$12,647,328	$15,328,828	$ 81,600

	For the Three Months Ended March 31,			
	2016		2015	
Impaired Loans	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With No Related Allowance Recorded:				
Residential Real Estate	$2,813,696	$ 447	$2,924,360	$ 828
Consumer	299,998	—	152,271	272
Commercial Business	158,601	—	235,173	—
Commercial Real Estate	8,432,619	91,860	13,217,496	75,944
With An Allowance Recorded:				
Residential Real Estate	—	—	—	—
Consumer	63,061	1,555	312,418	1,200
Commercial Business	—	—	—	—
Commercial Real Estate	775,514	1,424	1,140,637	17,128
Total				
Residential Real Estate	2,813,696	447	2,924,360	828
Consumer	363,059	1,555	464,689	1,472
Commercial Business	158,601	—	235,173	—
Commercial Real Estate	9,208,133	93,284	14,358,133	93,072

Total	$12,543,489	$ 95,286	$17,982,355	$ 95,372

21

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

8. 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 March 31, 2016 and December 31, 2015 were $5.3 million and $6.7 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 loan 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 March 31, 2016			For the Three Months Ended March 31, 2015		
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	—	—	—	3	840,292	840,292
Total	—	$ —	$ —	3	$ 840,292	$ 840,292

During the three months ended March 31, 2016, the Bank did not modify any loans that were considered to be TDRs. During the three months ended March 31, 2015, the Bank modified three commercial real estate loans that were considered to be TDRs. The Bank lowered the interest rate on one loan to allow the customer to begin making monthly principal and interest payments and changed the monthly payment to interest only for an agreed upon period for the other two loans.

At March 31, 2016, six previously restructured loans were in default, including two which had been restructured in the last 12 months. At March 31, 2015, there were no loans in default that had been restructured within the last 12 months.

The Bank considers any loan 30 days or more past due to be in default.

Our policy with respect to accrual of interest on loans restructured as 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 probable. 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 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. In addition to this payment history, the borrower must demonstrate an ability to continue making payments on the loan prior to restoration of accrual status.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

9. Regulatory Matters

As a state-chartered, federally insured commercial bank, the Bank is subject to the capital requirements established by the FDIC. Under the FDIC’s capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank’s assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank’s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.
Effective January 1, 2015 (with some changes transitioned into full effectiveness over two to four years), the Bank became subject to new capital adequacy requirements. The capital adequacy requirements are quantitative measures established by regulation that require the Bank to maintain minimum amounts and ratios of capital.
The Bank is now subject to new capital requirements adopted by the FDIC, which create a new required ratio for common equity Tier 1 ("CET1") capital, increases the leverage and Tier 1 capital ratios, changes the risk-weightings of certain assets for purposes of the risk-based capital ratios, creates an additional capital conservation buffer over the required capital ratios and changes what qualifies as capital for purpose of meeting these various capital requirements. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by bank regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. The Bank is required to maintain additional levels of Tier 1 common equity over the minimum risk-based capital levels before it may pay dividends, repurchase shares or pay discretionary bonuses.
The new minimum requirements are a ratio of CET1 capital to total risk-weighted assets (the "CET1 risk-based ratio") of 4.5%, a Tier 1 capital ratio of 6.0%, a total capital ratio of 8.0%, and a leverage ratio of 4.0%. In addition to the minimum CET1, Tier 1 and total capital ratios, the Bank will have to maintain a capital conservation buffer consisting of additional CET1 capital equal to 2.5% of risk-weighted assets above the required minimum levels in order to avoid limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses based on percentages of eligible retained income that could be utilized for such actions. This new capital conservation buffer requirement is to be phased in beginning in January 2016 at 0.625% of risk-weighted assets and increasing each year until fully implemented in January 2019.
In addition to the capital requirements, there are a number of changes in what constitutes regulatory capital, subject to transition periods. These changes include the phasing-out of certain instruments as qualifying capital. Mortgage servicing rights and deferred tax assets over designated percentages of CET1 will be deducted from capital, subject to a four-year transition period. CET1 will consist of Tier 1 capital less all capital components that are not considered common equity. In addition, Tier 1 capital will include accumulated other comprehensive income (loss), which includes all unrealized gains and losses on available for sale debt and equity securities, subject to a four-year transition period. Because of the Bank's asset size, it was not considered an advanced approaches banking organization and elected in the first quarter of calendar year 2015 to take the one-time option of deciding to permanently opt-out of the inclusion of unrealized gains and losses on available for sale debt and equity securities in its capital calculations. The new requirements also include changes in the risk-weighting of assets to better reflect credit risk and other risk exposure. These include a 150% risk weight (up from 100%) for certain high volatility commercial real estate acquisition, development and construction loans and for non-residential mortgage loans that are 90 days or more past due or otherwise on non-accrual status; a 20% (up from 0%) credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable; and a 250% risk weight (up from 100%) for mortgage servicing rights and deferred tax assets that are not deducted from capital.

Under the new standards, in order to be considered well-capitalized, the Bank must have a CET1 risk-based capital ratio of 6.5% (new), a Tier 1 risk-based capital ratio of 8.0% (increased from 6.0%), a total risk-based capital ratio of 10.0% (unchanged) and a Tier 1 leverage capital ratio of 5.0% (unchanged).

Bank holding companies are subject to capital adequacy requirements of the Federal Reserve under the Bank Holding Company Act of 1956, as amended, and the regulations of the Federal Reserve. For a bank holding company with less than $1.0 billion in assets, the capital guidelines apply on a bank only basis and the Federal Reserve expects the holding company's subsidiary banks to be well-capitalized under the prompt corrective action regulations. If Security Federal Corporation was subject to regulatory guidelines for bank holding companies with $1.0 billion or more in assets, at March 31, 2016, it would have exceeded all regulatory capital requirements.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

9. Regulatory Matters, Continued

The Company and the Bank's regulatory capital amounts and ratios were as follows at the dates indicated below:

	Actual		For Capital Adequacy		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in Thousands)					
March 31, 2016						
SECURITY FEDERAL CORP.						
Tier 1 Risk-Based Core Capital (To Risk Weighted Assets)	$86,503	21.9%	$23,719	6.0%	N/A	N/A
Total Risk-Based Capital (To Risk Weighted Assets)	96,856	24.5%	31,626	8.0%	N/A	N/A
Common Equity Tier 1 Capital (To Risk Weighted Assets)	64,877	16.4%	17,789	4.5%	N/A	N/A
Tier 1 Leverage (Core) Capital (To Adjusted Tangible Assets)	86,503	10.8%	31,952	4.0%	N/A	N/A
SECURITY FEDERAL BANK						
Tier 1 Risk-Based Core Capital (To Risk Weighted Assets)	$88,043	22.3%	$23,702	6.0%	$31,602	8.0 %
Total Risk-Based Capital (To Risk Weighted Assets)	93,022	23.6%	31,602	8.0%	39,503	10.0%
Common Equity Tier 1 Capital (To Risk Weighted Assets)	88,043	22.3%	17,776	4.5%	25,677	6.5 %
Tier 1 Leverage (Core) Capital (To Adjusted Tangible Assets)	88,043	11.0%	31,942	4.0%	39,927	5.0 %
December 31, 2015						
SECURITY FEDERAL CORP.						
Tier 1 Risk-Based Core Capital (To Risk Weighted Assets)	$84,672	21.7%	$23,429	6.0%	N/A	N/A
Total Risk-Based Capital (To Risk Weighted Assets)	95,429	24.4%	31,239	8.0%	N/A	N/A
Common Equity Tier 1 Capital (To Risk Weighted Assets)	63,504	16.3%	17,572	4.5%	N/A	N/A
Tier 1 Leverage (Core) Capital (To Adjusted Tangible Assets)	84,672	10.6%	31,811	4.0%	N/A	N/A
SECURITY FEDERAL BANK						
Tier 1 Risk-Based Core Capital	$87,728	22.5%	$23,440	6.0%	$31,254	8.0 %

(To Risk Weighted Assets)						
Total Risk-Based Capital (To Risk Weighted Assets)	92,653	23.7 %	31,254	8.0 %	39,067	10.0 %
Common Equity Tier 1 Capital (To Risk Weighted Assets)	87,728	22.5 %	17,580	4.5 %	25,394	6.5 %
Tier 1 Leverage (Core) Capital (To Adjusted Tangible Assets)	87,728	11.0 %	31,801	4.0 %	39,751	5.0 %

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

10. 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 March 31, 2016, the Company's investment portfolio was comprised of government and agency bonds, mortgage-backed securities issued by government agencies or GSEs, private label CMO mortgage-backed securities, municipal securities, and two equity investments. Fair value measurement is based upon prices obtained from third party pricing services that 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 institutional 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 a commitment 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 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.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

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

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 March 31, 2016, 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. At March 31, 2016 and December 31, 2015, the recorded investment in impaired loans was $10.4 million and $12.6 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 were as follows at March 31, 2016:

Assets:	Quoted Market Price In Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
FHLB Securities	$ —	$1,995,110	$ —
FHLMC and FNMA Bonds	—	2,015,621	—
SBA Bonds	—	111,315,672	—
Tax Exempt Municipal Bonds	—	76,981,378	—
Taxable Municipal Bonds	—	1,020,050	—
Mortgage-Backed Securities	—	195,017,939	—
Equity Securities	—	305,642	—
Total	$ —	$388,651,412	$ —

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

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

Assets measured at fair value on a recurring basis were as follows at December 31, 2015:

Assets:	Quoted Market Price In Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
FHLB Securities	$ —	$1,932,088	$ —
FFCB Securities	—	1,987,936	—
FNMA Bonds	—	1,004,331	—
SBA Bonds	—	111,416,782	—
Tax Exempt Municipal Bonds	—	76,065,619	—
Mortgage-Backed Securities	—	182,797,212	—
Equity Securities	—	309,902	—
Total	$ —	$375,513,870	$ —

There were no liabilities measured at fair value on a recurring basis as of March 31, 2016 and December 31, 2015.

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 March 31, 2016 and December 31, 2015, aggregated by the level in the fair value hierarchy within which those measurements fall.

Assets:	Level 1	Level 2	Level 3	Balance at March 31, 2016
Mortgage Loans Held For Sale	$ —	$1,171,189	$—	$1,171,189
Collateral Dependent Impaired Loans (1)	—	—	10,274,175	10,274,175
Foreclosed Assets	—	—	2,582,056	2,582,056
Total	$ —	$1,171,189	$12,856,231	$14,027,420

(1) IMPAIRED LOANS ARE REPORTED NET OF SPECIFIC RESERVES OF $156,600

Assets:	Level 1	Level 2	Level 3	Balance at December 31, 2015
Mortgage Loans Held For Sale	$ —	$2,462,559	$—	$2,462,559
Collateral Dependent Impaired Loans (1)	—	—	12,565,728	12,565,728
Foreclosed Assets	—	—	4,361,411	4,361,411
Total	$ —	$2,462,559	$16,927,139	$19,389,698

(1) IMPAIRED LOANS ARE REPORTED NET OF SPECIFIC RESERVES OF $81,600

There were no liabilities measured at fair value on a nonrecurring basis as of March 31, 2016 and December 31, 2015.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

10. 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 at March 31, 2016, the significant unobservable inputs used in the fair value measurements were as follows:

	Fair Value	Valuation Technique	Significant Unobservable Inputs	Range
Collateral Dependent Impaired Loans	$10,274,175	Appraised Value	Discount Rates/ Discounts to Appraised Values	0% - 16%
Foreclosed Assets	2,582,056	Appraised Value/Comparable Sales	Discount Rates/ Discounts to Appraised Values	16% - 100%

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 Receivable, Net—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

10. 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 at March 31, 2016 and December 31, 2015 presented in accordance with the applicable accounting guidance.

	March 31, 2016				
	Carrying	Fair Value			
(In Thousands)	Amount	Total	Level 1	Level 2	Level 3
Financial Assets:					
Cash and Cash Equivalents	$8,392	$8,392	$8,392	$ —	$ —
Certificates of Deposits with Other Banks	3,445	3,445	—	3,445	—
Investment and Mortgage-Backed Securities	418,598	418,638	—	418,638	—
Loans Receivable, Net	331,881	332,763	—	—	332,763
FHLB Stock	2,056	2,056	2,056	—	—
Financial Liabilities:					
Deposits:					
Checking, Savings and Money Market Accounts	$424,381	$424,381	$424,381	$ —	$ —
Certificate Accounts	236,851	236,836	—	236,836	—
Advances From FHLB	30,890	31,628	—	31,628	—
Other Borrowed Money	8,707	8,707	8,707	—	—
Senior Convertible Debentures	6,084	6,084	—	6,084	—
Junior Subordinated Debentures	5,155	5,155	—	5,155	—

	December 31, 2015				
	Carrying	Fair Value			
(In Thousands)	Amount	Total	Level 1	Level 2	Level 3
Financial Assets:					
Cash and Cash Equivalents	$8,382	$8,382	$8,382	$ —	$ —
Certificates of Deposits With Other Banks	3,445	3,445	—	3,445	—
Investment and Mortgage-Backed Securities	405,387	405,196	—	405,196	—
Loans Receivable, Net	330,573	327,460	—	—	327,460
FHLB Stock	2,215	2,215	2,215	—	—
Financial Liabilities:					
Deposits:					
Checking, Savings and Money Market Accounts	$415,975	$415,975	$415,975	$ —	$ —
Certificate Accounts	236,122	235,476	—	235,476	—
Advances From FHLB	34,640	35,676	—	35,676	—
Other Borrowed Money	6,412	6,412	6,412	—	—
Senior Convertible Debentures	6,084	6,084	—	6,084	—
Junior Subordinated Debentures	5,155	5,155	—	5,155	—

At March 31, 2016, the Bank had $49.0 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

10. 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.

11. 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 the Investments-Equity Method and Joint Ventures topic of the ASC to address accounting for investments in qualified affordable housing projects. If certain conditions are met, the amendments permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects by amortizing the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizing the net investment performance in the income statement as a component of income tax expense (benefit). If those conditions are not met, the investment should be accounted for as an equity method investment or a cost method investment in accordance with existing accounting guidance. The amendments were effective for the Company for interim and annual reporting periods beginning after December 15, 2014 and were applied retrospectively for all periods presented. The amendments did not have a material effect on the Company's financial statements.

In May 2014 and August 2015, 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, 2017. 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 consolidated 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 were effective for the Company on January 1, 2015. These amendments did not have a material effect on the Company's consolidated financial statements.

In June 2014, the FASB issued guidance which clarifies that performance targets associated with stock compensation should be treated as a performance condition and should not be reflected in the grant date fair value of the stock award. The amendments were effective for the Company on January 1, 2016. These amendments did not have a material effect on the Company's consolidated financial statements.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

11. Accounting and Reporting Changes, Continued

In February 2015, the FASB issued guidance which amends the consolidation requirements and significantly changes the consolidation analysis required under U.S. GAAP. Although the amendments are expected to result in the deconsolidation of many entities, the Company will need to reevaluate all its previous consolidation conclusions. The amendments were effective for the Company on January 1, 2016. These amendments did not have a material effect on the Company's consolidated financial statements.
In January 2016, the FASB amended the Financial Instruments topic of the ASC to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments will be effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company will apply the guidance by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values will be applied prospectively to equity investments that exist as of the date of adoption of the amendments. The Company does not expect these amendments to have a material effect on its consolidated financial statements.

In February 2016, the FASB amended the Leases topic of the ASC to revise certain aspects of recognition, measurement, presentation, and disclosure of leasing transactions. The amendments will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company is currently evaluating the effect that implementation of the new standard will have on its financial position, results of operations, and cash flows.

In March 2016, the FASB amended the Revenue from Contracts with Customers topic of the ASC to clarify the implementation guidance on principal versus agent considerations and address how an entity should assess whether it is the principal or the agent in contracts that include three or more parties. The amendments will be effective for the Company for reporting periods beginning after December 15, 2017. The Company does not expect these amendments to have a material effect on its consolidated financial statements.

In March 2016, the FASB issued guidance to simplify several aspects of the accounting for share-based payment award transactions including the income tax consequences, the classification of awards as either equity or liabilities, and the classification on the statement of cash flows. Additionally, the guidance simplifies two areas specific to entities other than public business entities allowing them apply a practical expedient to estimate the expected term for all awards with performance or service conditions that have certain characteristics and also allowing them to make a one-time election to switch from measuring all liability-classified awards at fair value to measuring them at intrinsic value. The amendments will be effective for the Company for annual periods beginning after December 15, 2016 and interim periods within those annual periods. The Company does not expect these amendments to have a material effect on its consolidated 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.

12. 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

Certain matters discussed in this Quarterly Report on Form 10-Q may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to our financial condition, results of operations, plans, objectives, future performance or business. Forward-looking statements are not statements of historical fact, are based on certain assumptions and are generally identified by use of the words "believes," "expects," "anticipates," "estimates," "forecasts," "intends," "plans," "targets," "potentially," "probably," "projects," "outlook" or similar expressions or future or conditional verbs such as "may," "will," "should," "would" and "could." Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, assumptions and statements about, among other things, expectations of the business environment in which we operate, projections of future performance or financial items, perceived opportunities in the market, potential future credit experience, and statements regarding our mission and vision. These forward-looking statements are based upon current management expectations and may, therefore, involve risk and uncertainties. Our actual results, performance, or achievements may differ materially from those suggested, expressed, or implied by forward-looking statements as a result of a wide variety or range of factors, including, but not limited to:

- 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 affected 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 allowance for loan losses;
- 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 Board of Governors of the Federal Reserve System ("Federal Reserve") and our bank subsidiary by the Federal Deposit Insurance Corporation ("FDIC") and the South Carolina State 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, or impose additional requirements or restrictions on us, any of which could adversely affect our liquidity and earnings;
- legislative or regulatory changes that adversely affect our business, including the effect of the Dodd-Frank Wall Street Reform and Consumer Protection Act; changes in regulatory policies and principles, or the interpretation of regulatory capital requirements or other rules, including as a result of Basel III; and any changes in rules affecting our ability to comply with the requirements of the U. S. Department of Treasury Community Development Capital Initiative;
- 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 the 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 manage loan delinquency rates;

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

- increased competitive pressures among financial services companies;
- changes in consumer spending, borrowing and savings habits;
- 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 stock and preferred stock;
- adverse changes in the securities markets;
- 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; 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 2015 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 on Form 10-Q and in other public reports and 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 2016 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 March 31, 2016 and December 31, 2015

Assets
Total assets increased $11.3 million or 1.4% to $811.0 million at March 31, 2016 from $799.7 million at December 31, 2015. The increase was primarily due to an increase in investments and net loans receivable, offset by decreases in OREO and other assets. The increases and decreases in total assets were primarily concentrated in the following asset categories:

			Increase (Decrease)	
	March 31, 2016	December 31, 2015	Amount	Percent
Investment and Mortgage-Backed Securities – Available For Sale	$388,651,412	$375,513,870	$13,137,542	3.5%
Investment and Mortgage-Backed Securities – Held To Maturity	29,946,584	29,873,098	73,486	0.2
Loans Receivable, Net	331,880,549	330,572,729	1,307,820	0.4
OREO	2,582,056	4,361,411	(1,779,355)	(40.8)
FHLB Stock	2,055,500	2,214,800	(159,300)	(7.2)
Bank Owned Life Insurance	16,705,045	16,573,045	132,000	0.8
Other Assets	2,831,465	4,449,956	(1,618,491)	(36.4)

Investment and mortgage-backed securities available for sale increased $13.1 million or 3.5% to $388.7 million at March 31, 2016 from $375.5 million at December 31, 2015. Investment and mortgage-backed securities held to maturity increased $73,000 or 0.2% to $29.9 million at March 31, 2016. The Bank purchased 20 investment and mortgage backed securities classified as available for sale and one mortgage-backed security classified as held to maturity during the first quarter of 2016.

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

Loans receivable, net, increased $1.3 million or 0.4% to $331.9 million at March 31, 2016 from $330.6 million at December 31, 2015 as a result of increased loan originations in all four loan categories offset by a decrease in loans held for sale. Residential real estate loans increased $269,000 or 0.4% to $76.6 million at March 31, 2016 from $76.4 million at December 31, 2015. Consumer loans increased $144,000 or 0.3% to $50.5 million at March 31, 2016 from $50.4 million at December 31, 2015. Commercial real estate loans increased $1.1 million or 0.5% to $201.2 million at March 31, 2016 from $200.1 million at December 31, 2015. Commercial business loans increased $250,000 or 2.0% to $12.8 million at March 31, 2016 from $12.5 million at December 31, 2015. Loans held for sale were $1.2 million at March 31, 2016, a decrease of $1.3 million or 52.4% from $2.5 million at December 31, 2015.

OREO decreased $1.8 million or 40.8% to $2.6 million at March 31, 2016 from $4.4 million at December 31, 2015. The decrease was due to OREO sales of $1.7 million and writedowns of $40,000 during the quarter ended March 31, 2016. There were no additions to OREO during the quarter ended March 31, 2016. At March 31, 2016, the OREO balance consisted of the following real estate properties: five single-family residences and 29 lots within residential subdivisions located throughout our market areas in South Carolina and Georgia; six parcels of commercial land in South Carolina; two commercial buildings in South Carolina; and eight lots within a subdivision and adjacent 22.96 acres of land in Aiken, South Carolina.

FHLB stock decreased $159,000 or 7.2% to $2.1 million at March 31, 2016 compared to $2.2 million at December 31, 2015 as a result of stock redemptions by the FHLB of Atlanta. The Bank, as a member of the FHLB of Atlanta, is required to acquire and hold shares of capital stock in the FHLB of Atlanta in an amount equal to a membership component, which is 0.09% of total assets, plus a transaction component, which is 4.25% of outstanding advances (borrowings) from the FHLB of Atlanta. As the Bank's total advances have decreased, so has it’s required investment in FHLB stock.

Other assets decreased $1.6 million or 36.4% to $2.8 million at March 31, 2016 compared to $4.4 million at December 31, 2015 primarily as a result of a decrease in net deferred taxes, which was 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:

	March 31, 2016		December 31, 2015		Balance Increase (Decrease)	
	Balance	Weighted Rate	Balance	Weighted Rate	Amount	Percent
Demand Accounts:						
Checking	$155,621,563	0.02%	$155,765,968	0.03%	$(144,405)	(0.09)%
Money Market	235,351,208	0.16	229,016,993	0.16%	6,334,215	2.77
Statement Savings Accounts	33,408,467	0.10	31,191,828	0.10%	2,216,639	7.11
Total	$424,381,238	0.11%	$415,974,789	0.11%	$8,406,449	2.02%
Certificate Accounts:						
0.00 – 0.99%	$172,674,864		$175,755,511		$(3,080,647)	(1.75)%
1.00 – 1.99%	59,882,440		51,479,431		8,403,009	16.32

2.00 – 2.99%	4,293,197		8,886,814		(4,593,617)	(51.69)
Total	236,850,501	0.72%	236,121,756	0.69%	728,745	0.31%
Total Deposits	$661,231,739	0.33%	$652,096,545	0.32%	$9,135,194	1.40%

Included in the certificate accounts above were $45.9 million and $42.5 million in brokered deposits at March 31, 2016 and December 31, 2015, respectively, with a weighted average interest rate of 1.03% and 0.94%, respectively.

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

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

	March 31, 2016		December 31, 2015		Increase (Decrease)	
Fiscal Year Due:	Balance	Rate	Balance	Rate	Balance	Percent
2016	$5,000,000	4.03%	$16,740,000	1.51%	$(11,740,000)	(70.13)%
2017	15,890,000	2.54	12,900,000	4.38	2,990,000	23.18
2018	5,000,000	3.39	5,000,000	3.39	—	—
Thereafter	5,000,000	1.11	—	—	5,000,000	100.00
Total Advances	$30,890,000	2.68%	$34,640,000	3.87%	$(3,750,000)	(10.83)%

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 $72.0 million and $70.1 million, respectively, at March 31, 2016 and $77.8 million and $74.7 million, respectively, at December 31, 2015. Advances are subject to prepayment penalties. During the quarter ended March 31, 2016, the Bank prepaid one FHLB advance with a balance of $5.0 million and incurred $248,000 in prepayment penalties.

The following table shows callable FHLB advances at March 31, 2016. 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, re-borrow funds on different terms, or convert the advance to a three-month floating rate advance tied to LIBOR.

As of March 31, 2016

Borrow Date	Maturity Date	Amount	Interest Rate	Type	Call Dates
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

Other Borrowings – The Bank had $8.7 million in other borrowings (non-FHLB advances) at March 31, 2016, an increase of $2.3 million or 35.8% from $6.4 million at December 31, 2015. 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 March 31, 2016 and December 31, 2015, 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 $13.6 million and $13.9 million, respectively, at March 31, 2016 and $14.3 million and $14.6 million, respectively, at December 31, 2015.

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. The Capital Securities accrue and pay distributions at a floating rate of three month LIBOR plus 170 basis points annually which was equal to 2.33% at March 31, 2016. The distribution rate payable on the Capital Securities is cumulative and payable quarterly in arrears. 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 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.

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

Equity – Shareholders' equity increased $2.3 million or 2.6% to $93.3 million at March 31, 2016 from $91.0 million at December 31, 2015. Accumulated other comprehensive income, net of tax, comprised entirely of unrealized gains on securities available for sale, net of tax, increased $956,000 or 22.4% to $5.2 million at March 31, 2016 from $4.3 million at December 31, 2015. The Company's net income available for common shareholders was $1.6 million for the three months ended March 31, 2016, after payment of $110,000 in preferred stock dividends. The Board of Directors of the Company declared common stock dividends totaling $236,000 during the three months ended March 31, 2016. Book value per common share was $24.21 at March 31, 2016 compared to $23.41 at December 31, 2015.

Results of Operations for the Three Month Periods Ended March 31, 2016 and 2015

Net Income Available to Common Shareholders - Net income available to common shareholders increased $212,000 or 15.2% to $1.6 million or $0.52 per diluted common share for the three months ended March 31, 2016 compared to $1.4 million or $0.45 per diluted common share for the three months ended March 31, 2015. The increase in net income was primarily the result of an increase in net interest income combined with a decrease in non-interest expense and a decrease in non-interest income.

Net Interest Income - The net interest margin on a tax equivalent basis increased 27 basis points to 3.36% for the three months ended March 31, 2016 from 3.09% for the comparable period in 2015 as the average yield earned on interest-earning assets increased and the average cost of interest-bearing liabilities declined. Net interest income increased $290,000 or 5.0% to $6.1 million during the three months ended March 31, 2016, compared to $5.8 million during the same period in 2015. During the three months ended March 31, 2016, average interest earning assets decreased $19.1 million or 2.5% to $743.8 million compared to $763.0 million for the same period in 2015, while average interest-bearing liabilities decreased $20.7 million or 3.1% to $649.5 million compared to $670.3 million for the same period in 2015.

Interest Income - Total interest income increased $36,000 or 0.5% to $7.0 million for the three months ended March 31, 2016 from $6.9 million for the same period in 2015. Total tax equivalent interest income increased $87,000 or 1.2% to $7.2 million during the three months ended March 31, 2016 from $7.1 million for the same period in 2015. This increase was primarily the result of an increase in the tax equivalent interest income from investment securities, which increased $150,000 or 13.5% to $1.3 million for the three months ended March 31, 2016 from $1.1 million for the same period in 2015. The increase in tax equivalent interest income was a result of an increase of 25 basis points in the yield combined with a $5.5 million increase in the average balance of the investment securities portfolio. Total interest income on loans increased $105,000 or 2.3% to $4.6 million during the three months ended March 31, 2016 from $4.5 million during the comparable period in 2015. The increase was the result of an increase of 18 basis points in the loan yield to 5.56% for the quarter ended March 31, 2016 from 5.38% for the same period in 2015. Interest income from mortgage-backed securities decreased $170,000 or 11.9% to $1.3 million for the quarter ended March 31, 2016 from $1.4 million for the same period in 2015. The decrease is a result of a 10 basis point decrease in the portfolio yield combined with a $19.0 million or 8.1% decrease in the average balance of mortgage-backed securities.

The following table compares detailed average balances, associated yields, and the resulting changes in interest income for the three months ended March 31, 2016 and 2015:

Three Months Ended March 31,		Increase
2016	2015	(Decrease)

	Average Balance	Yield(1)	Average Balance	Yield(1)	In Interest Income
Loans Receivable, Net	$333,870,832	5.56%	$337,268,397	5.38%	$ 104,913
Mortgage-Backed Securities	215,023,420	2.33	234,037,658	2.43	(169,952)
Investment Securities[2]	191,045,846	2.64	185,573,875	2.39	99,293
Overnight Time and Certificates of Deposit	3,898,237	0.46	6,082,263	0.17	1,960
Total Interest-Earning Assets	$743,838,335	3.85%	$762,962,193	3.71%	$ 36,214

[1] Annualized

[2] Tax equivalent basis recognizes the income tax savings when comparing taxable and tax-exempt assets and was calculated using an effective tax rate of 34%. The tax equivalent adjustment relates to the tax exempt municipal bonds and was $174,733 and $124,081 for the quarters ended March 31, 2016 and 2015, respectively.

36

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

Interest Expense - Total interest expense decreased $254,000 or 21.7% to $919,000 during the three months ended March 31, 2016 compared to $1.2 million for the same period last year. The decrease in total interest expense was attributable to decreases in interest rates paid and a $20.7 million or 3.1% decrease in the average balance of interest-bearing liabilities. Interest expense on deposits decreased $85,000 or 14.1% to $520,000 during the three months ended March 31, 2016 compared to $605,000 for the same period in 2015. The decrease was attributable to a five basis point decrease in the cost of deposit accounts combined with a $15.2 million or 2.5% decrease in average interest-bearing deposits to $592.2 million for the quarter ended March 31, 2016 when compared to $607.5 million for the quarter ended March 31, 2015. The largest decrease was in certificate accounts, which decreased $20.1 million or 7.9% to an average balance of $235.3 million during the three months ended March 31, 2016 compared to $255.4 million for the same period in 2015. 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 $173,000 or 41.0% to $249,000 during the three months ended March 31, 2016 from $422,000 for the same period in 2015. The average balance of FHLB advances and other borrowed money decreased $5.5 million or 10.6% to $46.0 million during the three months ended March 31, 2016 from $51.5 million for the same period last year. During the quarter ended March 31, 2016 the Bank prepaid one FHLB advance with a balance of $5.0 million and a 4.4% rate in order to reduce interest expense in future periods and improve net interest spread. The following table compares detailed average balances, cost of funds, and the resulting changes in interest expense for the three months ended March 31, 2016 and 2015.

	Three Months Ended March 31,				Increase
	2016		2015		(Decrease)
	Average Balance	Yield(1)	Average Balance	Yield(1)	In Interest Expense
Now and Money Market Accounts	$325,249,730	0.13%	$323,136,179	0.15%	$(15,314)
Statement Savings Accounts	31,700,352	0.10	28,913,643	0.10	770
Certificate Accounts	235,297,624	0.69	255,441,004	0.75	(70,427)
FHLB Advances and Other Borrowings	46,043,648	2.16	51,521,204	3.27	(173,096)
Junior Subordinated Debentures	5,155,000	2.26	5,155,000	1.95	4,025
Senior Convertible Debentures	6,084,000	8.00	6,084,000	8.00	—
Total Interest-Bearing Liabilities	$649,530,354	0.57%	$670,251,030	0.70%	$(254,042)

(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 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 loan portfolio based on historical trends and the risk inherent in each loan category. Currently, management applies a four year historical loss ratio to each loan category to estimate the inherent loss in these pooled loans.

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 underlying the loan.

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

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

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.

Annualized net charge-offs were $7,000 or 0% of gross loans during the quarter ended March 31, 2016 compared to $2.2 million or 0.64% of gross loans for the same three month period in 2015. There was no provision for loan losses for the quarter ended March 31, 2016 compared to a provision of $100,000 for the quarter ended March 31, 2015. The following table details selected activity associated with the allowance for loan losses for the quarters ended March 31, 2016 and 2015:

	Three Months Ended March 31,	
	2016	2015
Beginning Balance	$8,275,133	$8,357,496
Provision	—	100,000
Charge-offs	(165,629)	(619,014)
Recoveries	163,800	80,435
Ending Balance	$8,273,304	$7,918,917
Allowance For Loan Losses as a % of Gross Loans Receivable, Held For Investment at the end of the period	2.4%	2.3%
Allowance For Loan Losses as a % of Impaired Loans at the end of the period	79.3%	50.4%
Impaired Loans	$10,430,775	$15,698,201
Gross Loans Receivable, Held For Investment (1)	$338,982,664	$338,098,500
Total Loans Receivable, Net	$331,880,549	$332,058,427

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

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 $823,000 or 31.1% to $1.8 million for the quarter ended March 31, 2016, compared to $2.7 million for the quarter ended March 31, 2015. The following table provides a detailed analysis of the changes in the components of non-interest income:

	Three Months Ended March 31,		Increase (Decrease)	
	2016	2015	Amounts	Percent
Gain on Sale of Investment Securities	$258,068	$1,486,939	$(1,228,871)	(82.6)%
Gain on Sale of Loans	208,966	154,019	54,947	35.7
Service Fees on Deposit Accounts	240,345	257,516	(17,171)	(6.7)
Commissions from Insurance Agency	169,847	130,112	39,735	30.5
Bank Owned Life Insurance Income	132,000	87,000	45,000	51.7

Trust Income	162,000	148,800	13,200	8.9
Check Card Fee Income	238,142	231,301	6,841	3.0
Grant Income	265,496	—	265,496	100.0
Other	152,876	155,320	(2,444)	(1.6)
Total Non-Interest Income	$1,827,740	$2,651,007	$(823,267)	(31.1)%

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

Gain on sale of investment securities was $258,000 during the quarter ended March 31, 2016, a decrease of $1.2 million or 82.6% compared to $1.5 million for the same period last year. The decrease was due to a decrease in the number of investment securities sold. The Bank sold four securities during the first quarter of 2016 compared to 32 during the same period in 2015.

Gain on sale of loans increased $55,000 or 35.7% to $209,000 for the quarter ended March 31, 2016 from $154,000 during the same period in 2015.

Income from the cash value of bank owned life insurance (BOLI) increased $45,000 or 51.7% to $132,000 during the quarter ended March 31, 2016 from $87,000 for the same period in 2015. The Company did not receive any life insurance proceeds during the first quarter of 2016 or 2015. All BOLI income recognized during both quarters was related to accrued interest credited to the cash surrender value underlying the BOLI policies.

The Bank received $265,000 in grant income during the quarter ended March 31, 2016, compared to no grant income during the same period in 2015. The grant was awarded by the Bank Enterprise Award Program in recognition of the Bank’s investments in distressed communities and its continued commitment to community development. The amount of the award increases as the Bank’s investment in these distressed communities increases.

Non-Interest Expense - For the quarter ended March 31, 2016, non-interest expense decreased $719,000 or 11.5% to $5.5 million compared to $6.3 million for the same period in 2015. The decrease was primarily due to a $755,000 net gain on the sale of OREO, which was recorded as an offset to the cost of operating OREO during the quarter ended March 31, 2016. The following table provides a detailed analysis of the changes in the components of non-interest expense:

	Three Months Ended March 31,		Increase (Decrease)	
	2016	2015	Amounts	Percent
Compensation and Employee Benefits	$3,330,798	$2,987,031	$343,767	11.5%
Occupancy	496,718	490,658	6,060	1.2
Advertising	129,977	96,161	33,816	35.2
Depreciation and Maintenance of Equipment	476,374	417,245	59,129	14.2
FDIC Insurance Premiums	133,047	160,221	(27,174)	(17.0)
Net Cost of Operating OREO	(675,926)	196,624	(872,550)	(443.8)
Prepayment Penalties on FHLB Advances	247,506	787,851	(540,345)	(68.6)
Other	1,397,450	1,118,804	278,646	24.9
Total Non-Interest Expense	$5,535,944	$6,254,595	$(718,651)	(11.5)%

Compensation and employee benefits expenses increased $344,000, or 11.5% to $3.3 million for the quarter ended March 31, 2016 compared to $3.0 million during the same period in 2015 due to general cost of living increases.

The Company incurred a prepayment penalty of $248,000 for paying down one FHLB advance during the three months ended March 31, 2016 compared to a prepayment penalty of $788,000 during the three months ended March 31, 2015. The Company elected to prepay these higher rate advances in order to reduce interest expense in future periods and improve net interest spread.

Other expenses increased $279,000, or 24.9% to $1.4 million for the quarter ended March 31, 2016 compared to $1.1 million for the same period in the prior year. Other expenses include legal, professional, and consulting expenses, supplies and other miscellaneous expenses.

Provision For Income Taxes – The provision for income taxes increased $74,000 or 13.0% to $641,000 for the three months ended March 31, 2016 from $568,000 for the same period one year ago. Income before taxes was $2.4 million and $2.1 million for the three months ended March 31, 2016 and 2015, respectively. The Company’s combined federal and state effective income tax rate for the current quarter was 27.2% compared to 27.4% for the same quarter one year ago.

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 three months ended March 31, 2016 loan disbursements exceeded loan repayments resulting in a $1.3 million or 0.4% increase in total net loans receivable. During the same three month period, deposits increased $9.1 million and FHLB advances decreased $3.8 million. The Bank had $209.0 million in additional borrowing capacity at the FHLB at the end of the period. At March 31, 2016, the Bank had $137.1 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 March 31, 2016, the Bank exceeded all regulatory capital requirements with Common Equity Tier 1 Capital (CET1), Tier 1 leverage-based capital, Tier 1 risk-based capital, and total risk-based capital ratios of 22.3%, 11.0%, 22.3%, and 23.6%, respectively. To be categorized as “well capitalized” under the prompt corrective action provisions the Bank must maintain minimum CET1, total risk based capital, Tier 1 risk based capital and Tier 1 leverage capital ratios of 6.5%, 10.0%, 8.0% and 5.0%, respectively.

The Company also exceeded all regulatory capital requirements with CET1, Tier 1 leverage-based capital, Tier 1 risk-based capital and total risk-based capital ratios of 16.4%, 10.8%, 21.9%, and 24.5%, respectively, at March 31, 2016.

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 March 31, 2016.

(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	$ 17	$ 101	$ 5,061	$5,179	$43,314	$48,493
Standby Letters of Credit	—	—	530	530	1,340	531
Total	$ 17	$ 101	$ 5,591	$5,709	$43,315	$49,024

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. Net portfolio value is defined as the net present value of assets, liabilities, and off-balance sheet contracts.

For the three months ended March 31, 2016, 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 3.28%.

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 March 31, 2016 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 March 31, 2016 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.

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

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, 2015.

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

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 Certificate for the Series B Preferred Shares (2)
4.3	Form of Indenture with respect to the Company's 8.0% Convertible Senior Debentures Due 2029 (5)
4.4	Specimen Convertible Senior Debenture Due 2029 (5)
4.5	Letter Agreement (including Securities Exchange Agreement B Standard Terms, attached as Exhibit A) dated September 29, 2010 between the Company and the United States Department of the Treasury (2)
4.6	Letter Agreement (including Securities Purchase Agreement B Standard Terms, attached as Exhibit A) dated September 29, 2010 between the Company and the United States Department of the Treasury (2)
10.1	1993 Salary Continuation Agreements (6)
10.2	Amendment One to 1993 Salary Continuation Agreements (7)
10.3	Form of 2006 Salary Continuation Agreement (8)
10.4	Form of Security Federal Split Dollar Agreement (8)
10.5	1999 Stock Option Plan (9)
10.6	2002 Stock Option Plan (10)

10.7 2006 Stock Option Plan (11)
10.8 2008 Equity Incentive Plan (12)

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

10.9	Form of incentive stock option agreement and non-qualified stock option agreement pursuant to the 2006 Stock Option Plan (11)
10.10	2004 Employee Stock Purchase Plan (13)
10.11	Incentive Compensation Plan (6)
10.12	Form of Compensation Modification Agreement (14)
14	Code of Ethics (15)
25	Subsidiaries of Registrant
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 March 31, 2016, formatted in Extensible Business Reporting Language (XBRL): (a) Consolidated Balance Sheets; (b) Consolidated Statements of Income; (c) Consolidated Statements of Comprehensive Income; (d) Consolidated Statements of Changes in Shareholders’ Equity; (e) Consolidated Statements of Cash Flows; and (f) Notes to Consolidated Financial Statements

---

(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 January 16, 2015.
(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) 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.
(6) Filed on June 28, 1993, as an exhibit to the Company’s Annual Report on Form 10-KSB and incorporated herein by reference.
(7) 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.
(8) 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.
(9) Filed on March 2, 2000, as an exhibit to the Company's Registration Statement on Form S-8 and incorporated herein by reference
(10) Filed on January 3, 2003, as an exhibit to the Company's Registration Statement on Form S-8 and incorporated herein by reference.
(11) 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.
(12) Filed on November 12, 2008, as an exhibit to the Company's Registration Statement on Form S-8 and incorporated herein by reference.
(13) Filed on June 18, 2004, as an exhibit to the Company’s Proxy Statement and incorporated herein by reference.
(14) Incorporated by reference to the Company’s Current Report on Form 8-K filed on December 23, 2008.
(15) Filed on June 29, 2006, as an exhibit to the Company’s Annual Report on Form 10-K and incorporated herein by reference.

44

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES
Notes To Consolidated Financial Statements

Signatures

Pursuant to the requirements 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:	May 12, 2016	By:	/s/J. Chris Verenes
			J. Chris Verenes
			Chief Executive Officer
			Duly Authorized Representative
Date:	May 12, 2016	By:	/s/Jessica T. Cummins
			Jessica T. Cummins
			Chief Financial Officer
			Duly Authorized Representative

SECURITY FEDERAL CORPORATION AND SUBSIDIARIES

EXHIBIT INDEX

31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
31.2	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
32	Certification of the 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 March 31, 2016, formatted in Extensible Business Reporting Language (XBRL): (a) Consolidated Balance Sheets; (b) Consolidated Statements of Income; (c) Consolidated Statements of Comprehensive Income; (d) Consolidated Statements of Changes in Shareholders' Equity; (e) Consolidated Statements of Cash Flows; and (f) Notes to Consolidated Financial Statements