

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

FORM 10-K

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

For the fiscal year ended December 31, 2009

OR

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

For the transition period from _____ to _____

Commission File Number 1-5735

Provident Community Bancshares, Inc.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation
or organization)

57-1001177
(I.R.S. Employer
Identification No.)

2700 Celanese Road, Rock Hill, South Carolina
(Address of principal executive offices)

29732
(Zip Code)

Registrant's telephone number, including area code: (803) 325-9400

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

Title of Class
Common stock, par value \$0.01 per share

Name of each exchange on which registered
The NASDAQ Stock Market LLC

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

None

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

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

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

Yes No

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

(Check one): Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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

The aggregate market value of the voting stock held by non-affiliates, computed by reference to the price at which the voting stock was last sold on June 30, 2009, which is the last day of the registrant's second fiscal quarter, was approximately \$5,189,154 (1,572,471 shares at \$3.30 per share). Solely for this calculation it is assumed that directors and executive officers are affiliates of the registrant.

As of March 9, 2010, there were 1,790,599 shares of the registrant's common stock issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Proxy Statement for the 2010 Annual Meeting of Shareholders (Part III).

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SIGNATURES

PART I

Item 1. Business

General

Provident Community Bancshares, Inc. (“Provident Community Bancshares”) is the bank holding company for Provident Community Bank, N.A. (the “Bank”). Provident Community Bancshares has no material assets or liabilities other than its investment in the Bank. Provident Community Bancshares’ business activity primarily consists of directing the activities of the Bank. Accordingly, the information set forth in this report, including financial statements and related data, relates primarily to the Bank. Provident Community Bancshares and the Bank are collectively referred to as the “Corporation” herein.

The Bank’s operations are conducted through its main office in Rock Hill, South Carolina and eight full-service banking centers, all of which are located in the upstate area of South Carolina. The Bank is regulated by the Office of the Comptroller of the Currency (the “OCC”), is a member of the Federal Home Loan Bank of Atlanta (the “FHLB”) and its deposits are insured up to applicable limits by the Federal Deposit Insurance Corporation (the “FDIC”). Provident Community Bancshares is subject to regulation by the Federal Reserve Board (the “FRB”).

The business of the Bank primarily consists of attracting deposits from the general public and originating loans to consumers and businesses. The Bank also maintains a portfolio of investment securities. The principal sources of funds for the Bank’s lending activities include deposits received from the general public, interest and principal repayments on loans and, to a lesser extent, borrowings from the FHLB and other parties. The Bank’s primary source of income is interest earned on loans and investments. The Bank’s principal expense is interest paid on deposit accounts and borrowings and expenses incurred in operating the Bank.

Forward-Looking Statement

This annual report contains certain “forward-looking statements” within the meaning of the federal securities laws. These forward-looking statements are generally identified by use of the words “believe,” “expect,” “intend,” “anticipate,” “estimate,” “project” or similar expressions. These forward-looking statements include, but are not limited to, estimates and expectations of future performance with respect to the financial condition and results of operations of the Corporation and other factors. These forward-looking statements are not guarantees of future performance and are subject to various factors that could cause actual results to differ materially from these forward-looking statements. These factors include, but are not limited to: changes in general economic and market conditions and the legal and regulatory environment in which the Corporation operates; the development of an interest rate environment that adversely affects the Corporation’s interest rate spread or other income anticipated from the Corporation’s operations; changes in consumer spending, borrowing and savings habits; adverse changes in the securities markets; changes in accounting policies and practices; and increased competitive pressures among financial services companies. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. The Corporation does not undertake—and specifically disclaims any obligation—to publicly release the results of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

Competition

The Bank faces competition in both the attraction of deposit accounts and in the origination of mortgage, commercial and consumer loans. Its most direct competition for savings deposits historically has been derived from other commercial banks and thrift institutions located in and around Union, Laurens, Fairfield, Greenville and York Counties, South Carolina. As of June 30, 2009, according to information presented on the Federal Deposit Insurance Corporation’s website, the Bank held 39.78% of the deposits in Union County, which was the second largest share of deposits out of five financial institutions in the county. Additionally, the Bank held 27.78% of the deposits in Fairfield County, which was the second largest out of three financial institutions in the county, 6.87% of the deposits in Laurens County, which was the fifth largest share of deposits out of nine financial institutions in the

county and 3.30% of the deposits in York County, which was the tenth largest out of 17 financial institutions in that county. The Corporation held 0.24% of the deposits in Greenville County, which was 27th out of 35 financial institutions in the county. The Bank competes with super-regional banks, such as BB&T and SunTrust, and large regional banks, such as First-Citizens Bank and Trust Company of South Carolina and Carolina First Bank. These competitors have substantially greater resources and lending limits than does the Bank and offer services that the Bank does not provide. The Bank faces additional significant competition for investor funds from money market instruments and mutual funds. It competes for savings by offering depositors a variety of savings accounts, convenient office locations and other services.

The Bank competes for loans principally through the interest rates and loan fees it charges and the efficiency and quality of the services it provides borrowers, real estate brokers and home builders. The Bank's competition for real estate loans comes principally from other commercial banks, thrift institutions and mortgage banking companies.

Competition has increased and is likely to continue to increase as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. Technological advances, for example, have lowered barriers to market entry, allowed banks to expand their geographic reach by providing services over the Internet and made it possible for non-depository institutions to offer products and services that traditionally have been provided by banks. The Gramm-Leach-Bliley Act, which permits affiliation among banks, securities firms and insurance companies, also has changed and may continue to change the competitive environment in which the Bank conducts business.

Lending Activities

General. Set forth below is selected data relating to the composition of the Bank's loan portfolio on the dates indicated (dollars in thousands).

	At December 31,									
	2009		2008		2007		2006		2005	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Real estate loans:										
Residential	\$ 16,877	6.74%	\$ 20,235	7.26%	\$ 24,989	9.74%	\$29,482	12.71%	\$ 36,560	18.99%
Commercial	110,901	44.28	110,589	39.68	76,864	29.97	62,450	26.93	45,665	23.71
Construction loans	<u>2,923</u>	<u>1.17</u>	<u>5,867</u>	<u>2.11</u>	<u>4,764</u>	<u>1.86</u>	<u>5,787</u>	<u>2.50</u>	<u>4,842</u>	<u>2.51</u>
Total real estate loans	130,701	52.19	136,691	49.05	106,617	41.57	97,719	42.14	87,067	45.21
Consumer and installment loans	52,287	20.88	57,002	20.45	51,846	20.21	46,136	19.90	39,876	20.71
Commercial loans	<u>73,525</u>	<u>29.36</u>	<u>94,012</u>	<u>33.74</u>	<u>104,261</u>	<u>40.65</u>	<u>93,562</u>	<u>40.35</u>	<u>70,668</u>	<u>36.70</u>
Total loans	<u>256,513</u>	<u>102.43</u>	<u>287,705</u>	<u>103.24</u>	<u>262,724</u>	<u>102.43</u>	<u>237,417</u>	<u>102.39</u>	<u>197,611</u>	<u>102.62</u>
Less:										
Undisbursed loans in process	(320)	(0.13)	(1,926)	(0.69)	(2,379)	(0.93)	(2,238)	(0.97)	(1,980)	(1.03)
Loan discount unamortized	(309)	(0.12)	(383)	(0.14)	(476)	(0.18)	(607)	(0.26)	(764)	(0.40)
Allowance for loan losses	(5,579)	(2.23)	(6,778)	(2.43)	(3,344)	(1.30)	(2,754)	(1.19)	(2,394)	(1.24)
Deferred loan fees	<u>115</u>	<u>0.05</u>	<u>47</u>	<u>0.02</u>	<u>(38)</u>	<u>(0.02)</u>	<u>68</u>	<u>0.03</u>	<u>104</u>	<u>0.05</u>
Net loans receivable	<u>\$250,420</u>	<u>100.00%</u>	<u>\$278,665</u>	<u>100.00%</u>	<u>\$256,487</u>	<u>100.00%</u>	<u>\$231,886</u>	<u>100.00%</u>	<u>\$192,577</u>	<u>100.00%</u>

The following table sets forth, at December 31, 2009, certain information regarding the dollar amount of principal repayments for loans becoming due during the periods indicated (in thousands). Demand loans (loans having no stated schedule of repayments and no stated maturity) and overdrafts are reported as due in one year or less.

	Due Within One Year	Due After 1 Year Through 5 Years	Due After 5 Years	Total
Real estate loans:				
Residential loans.....	\$ 39	\$ 1,322	\$ 15,516	\$ 16,877
Commercial loans.....	26,829	58,788	25,284	110,901
Construction loans (1).....	2,923	--	--	2,923
Consumer and installment loans.....	7,157	21,307	23,823	52,287
Commercial loans.....	<u>42,590</u>	<u>20,313</u>	<u>10,622</u>	<u>73,525</u>
Total	<u>\$ 79,538</u>	<u>\$101,730</u>	<u>\$ 75,245</u>	<u>\$ 256,513</u>

(1) Includes construction/permanent loans.

The actual average life of mortgage loans is substantially less than their contractual term because of loan repayments and because of enforcement of due-on-sale clauses that give the Bank the right to declare a loan immediately due and payable if, among other things, the borrower sells the real property subject to the mortgage and the loan is not repaid. The average life of mortgage loans tends to increase, however, when current mortgage loan rates substantially exceed rates on existing mortgage loans.

The following table sets forth, at December 31, 2009, the dollar amount of loans due after December 31, 2010 which have fixed rates of interest and which have adjustable rates of interest (in thousands).

	Fixed	Adjustable	Total
Real estate loans:			
Residential loans.....	\$ 10,635	\$ 6,203	\$ 16,838
Commercial loans.....	60,875	23,197	84,072
Consumer and installment loans.....	20,612	24,518	45,130
Commercial loans.....	<u>17,612</u>	<u>13,323</u>	<u>30,935</u>
Total	<u>\$ 109,734</u>	<u>\$ 67,241</u>	<u>\$ 176,975</u>

Real Estate Loans. The Bank originates residential mortgage loans to enable borrowers to purchase existing single family homes or to construct new homes. At December 31, 2009, \$16.9 million, or 6.7% of the Corporation's net loan portfolio consisted of loans secured by residential real estate (net of undisbursed principal, excluding construction loans).

Office of the Comptroller of the Currency regulations limit the amount that national banks may lend in relationship to the appraised value of the real estate securing the loan, as determined by an appraisal at the time of loan origination. Federal banking regulations permit a maximum loan-to-value ratio of 100% for one-to four-family dwellings and 85% for all other real estate loans. The Bank's lending policies, however, limit the maximum loan-to-value ratio on one-to four-family real estate mortgage loans to 80% of the lesser of the appraised value or the purchase price. Any single-family loan made in excess of an 80% loan-to-value ratio and any commercial real estate loan in excess of a 75% loan-to-value ratio is required to have private mortgage insurance or additional collateral. In the past, the Bank has originated some commercial real estate loans in excess of a 75% loan-to-value ratio without private mortgage insurance or additional collateral.

The loan-to-value ratio, maturity and other provisions of the loans made by the Bank generally have reflected a policy of making less than the maximum loan permissible under applicable regulations, market conditions, and underwriting standards established by the Bank. Mortgage loans made by the Bank generally are long-term loans (15-30 years), amortized on a monthly basis, with principal and interest due each month. In the Bank's experience, real estate loans remain outstanding for significantly shorter periods than their contractual terms. Borrowers may refinance or prepay loans, at their option, with no prepayment penalty.

The Bank offers a full complement of mortgage lending products with both fixed and adjustable rates. Due to the nature of the Bank's marketplace, only a small percentage of residential loans are adjustable-rate mortgage loans ("ARMs"). The Bank offers ARMs tied to U.S. Treasury Bills with a maximum interest rate adjustment of 2% annually and 6% over the life of the loan. At December 31, 2009, the Bank had approximately \$6.2 million of ARMs, or 2.4% of the Bank's total loans receivable. At December 31, 2009, \$10.7 million, or 4.2%, of the Bank's loan portfolio consisted of long-term, fixed-rate residential real estate loans.

Net interest income depends to a large extent on how successful the Bank is in "matching" interest-earning assets and interest-bearing liabilities. The Corporation has taken steps to reduce its exposure to rising interest rates. For a discussion of these steps, see "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Commercial real estate loans constituted approximately \$110.9 million, or 44.3%, of the Bank's net loan portfolio at December 31, 2009. Commercial real estate loans consist of permanent loans secured by multi-family loans, generally apartment houses, as well as commercial and industrial properties, including office buildings, warehouses, shopping centers, hotels, motels and other special purpose properties. Commercial real estate loans are originated and purchased for inclusion in the Bank's portfolio. These loans generally have 20 to 30-year amortization schedules and are callable or have balloon payments after five years. Typically, the loan documents provide for adjustment of the interest rate every one to three years. Fixed-rate loans secured by multi-family residential and commercial properties have terms ranging from 20 to 25 years.

Loans secured by multi-family and commercial real estate properties may involve greater risk than single-family residential loans. Such loans generally are substantially larger than single-family residential loans. Further, the payment experience on loans secured by commercial properties typically depends on the successful operation of the properties, and thus may be subject to a greater extent to adverse conditions in the real estate market or in the economy generally. Our largest commercial real estate loan relationship was a \$5.4 million loan secured by commercial real estate including land and buildings located in Greenville, South Carolina. This loan was performing according to its original terms at December 31, 2009.

Construction Loans. The Bank engages in construction lending that primarily is secured by single family residential real estate and, to a much lesser extent, commercial real estate. The Bank grants construction loans to individuals with a takeout for permanent financing from one of our correspondent mortgage lenders or another financial institution, and to approved builders on both presold and unsold properties.

Construction loans to individuals are originated for a term of one year or less or are originated to convert to permanent loans at the end of the construction period. Construction loans are originated to builders for a term not to exceed 12 months. Generally, draw inspections are handled by the appraiser who initially appraised the property; however, in some instances the draw inspections are performed by a new appraisal firm.

Construction financing affords the Bank the opportunity to achieve higher interest rates and fees with shorter terms to maturity than do single-family permanent mortgage loans. However, construction loans generally are considered to involve a higher degree of risk than single-family permanent mortgage lending due to: (1) the concentration of principal among relatively few borrowers and development projects; (2) the increased difficulty at the time the loan is made of estimating the building costs and the selling price of the property to be built; (3) the increased difficulty and costs of monitoring the loan; (4) the higher degree of sensitivity to increases in market rates of interest; and (5) the increased difficulty of working out loan problems.

At December 31, 2009, the Bank had approximately \$2.9 million outstanding in construction loans, including approximately \$320,000 in undisbursed proceeds. Substantially all of these loans were secured by one- to four-family residences.

Consumer Loans. The Bank's consumer loan portfolio primarily consists of automobile loans on new and used vehicles, mobile home loans, boat loans, second mortgage loans, loans secured by savings accounts and unsecured loans. The Bank makes consumer loans to serve the needs of its customers and as a way to improve the interest-rate sensitivity of the Bank's loan portfolio.

Consumer loans tend to bear higher rates of interest and have shorter terms to maturity than residential mortgage loans. However, consumer loans historically have tended to have a higher rate of default than residential mortgage loans. Additionally, consumer loans entail greater risk than do residential mortgage loans, particularly in the case of loans that are unsecured or secured by rapidly depreciating assets such as automobiles. In these cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be affected adversely by job loss, divorce, illness or personal bankruptcy.

Commercial Loans. Commercial business loans are made primarily in our market area to small businesses through our branch network. Each county location of the branch network has an experienced commercial lender that is responsible for the generation of this product. In selective cases, we will enter into a loan participation within our market area to purchase a portion of a commercial loan that meets the Bank's underwriting criteria. We offer secured commercial loans with maturities of up to 20 years. The term for repayment will normally be limited to the lesser of the expected useful life of the asset being financed or a fixed amount of time, generally less than seven years. These loans have adjustable rates of interest indexed to the prime rate as reported in *The Wall Street Journal*. When making commercial loans, we consider the financial statements of the borrower, the borrower's payment history of both corporate and personal debt, the debt service capabilities of the borrower, the projected cash flows of the business, the viability of the industry in which the customer operates and the value of the collateral. A commercial loan generally is secured by a variety of collateral, primarily accounts receivable, inventory and equipment, and generally are supported by personal guarantees. Depending on the collateral used to secure the loans, commercial loans are made in amounts of up to 80% of the value of the collateral securing the loan. Our largest commercial loan relationship was a \$3.5 million loan secured by petroleum assets located in Winnsboro, South Carolina. This loan was performing according to its original terms at December 31, 2009.

Unlike residential mortgage loans, which are generally made on the basis of the borrower's ability to make repayment from his or her employment or other income, and which are secured by real property whose value tends to be more easily ascertainable, commercial loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flows of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. Further, any collateral securing such loans may depreciate over time, may be difficult to appraise and may fluctuate in value.

Loan Solicitation and Processing. Loan originations come from walk-in customers, sales and solicitations from loan officers and loan participations. The Bank utilizes various officers and loan committees for the approval of real estate loans. The Board of Directors has appointed a Board Loan Committee comprised of two members elected annually from the Board of Directors and four senior executive officers of the Bank. A quorum of three members, including at least one Board member, is required for any action. This Committee has the authority to approve all secured and unsecured loan requests with the exception of a single loan request exceeding \$3.0 million, which requires approval of the entire Board of Directors.

Loan Originations, Purchases and Sales. During 2001, we phased out broker loan purchases and originations and reduced our mortgage lending operations to provide an increased capital allocation for consumer and commercial lending. Consequently, the Bank did not securitize any loans in either the 2009 or 2008 fiscal years. The Bank does not have any current plans to sell a large volume of loans, other than fixed-rate mortgage loans it originates through its retail branch network. The Bank purchases participation interests in loans originated by other institutions. The Bank had total purchases of participation interests of \$3.4 million in 2009. These participation interests are primarily on commercial properties and carry either a fixed or adjustable interest rate. The Bank performs its own underwriting analysis on each of its participation interests before purchasing such loans and therefore believes there is no greater risk of default on these obligations. However, in a purchased participation loan, the Bank does not service the loan and thus is subject to the policies and practices of the lead lender with regard to monitoring delinquencies, pursuing collections and instituting foreclosure proceedings. The Bank is permitted to review all of the documentation relating to any loan in which the Bank participates, including any annual financial statements provided by a borrower. Additionally, the Bank receives periodic updates on the loan from the lead lender.

The following table sets forth the Bank's loan origination activity for the periods indicated (in thousands):

	Year Ended December 31,		
	2009	2008	2007
Loans originated:			
Real estate loans:			
Residential loans.....	\$ 2,324	\$ 3,504	\$ 5,338
Construction loans.....	-	1,556	-
Commercial loans.....	<u>11,515</u>	<u>33,725</u>	<u>14,414</u>
Total mortgage loans originated	<u>13,839</u>	<u>38,785</u>	<u>19,752</u>
Consumer and installment loans	5,419	20,769	17,924
Commercial loans	<u>11,484</u>	<u>30,055</u>	<u>45,449</u>
Total loans originated.....	<u>\$30,742</u>	<u>\$89,609</u>	<u>\$83,125</u>
Loan participations purchased.....	\$ 3,400	\$13,550	\$27,636
Loan participations sold	\$ -	\$ 1,000	\$ 2,000

Asset Quality. We maintain loan quality monitoring policies and systems that require detailed monthly and quarterly analyses of delinquencies, non-performing loans, real estate owned and other repossessed assets. Reports of such loans and assets by various categories are reviewed by management and the Board of Directors. The majority of our loans are originated in upstate South Carolina.

We closely monitor trends in problem assets which include non-accrual loans, renegotiated loans, and real estate and other assets acquired in the settlement of loans. Renegotiated loans, or troubled debt restructurings, are those loans where the borrower is experiencing financial difficulties and we have agreed to concessions of the terms such as changes in the interest rate charged and/or other concessions.

Problem Assets. The Bank determines a loan to be delinquent when payments have not been made according to contractual terms, typically evidenced by nonpayment of a monthly installment by the due date. The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent. Subsequent payments are either applied to the outstanding principal balance or recorded as interest income, depending on the assessment of the ultimate collectability of the loan. See Notes 1 and 3 of Notes to Consolidated Financial Statements.

A loan is impaired when it is probable, based on current information, the Bank will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. Management has determined that, generally, a failure to make a payment within a 90-day period constitutes a minimum delay or shortfall and generally does not constitute an impaired loan. However, management reviews each past due loan on a loan-by-loan basis and may determine a loan to be impaired before the loan becoming over 90 days past due, depending upon the circumstances of that particular loan. A loan is classified as non-accrual at the time management believes that the collection of interest is improbable, generally when a loan becomes 90 days past due.

The Bank's policy for charge-off of impaired loans is on a loan-by-loan basis. At the time management believes the collection of interest and principal is remote, the loan is charged off. It is our policy to evaluate impaired loans based on the fair value of the collateral. Interest income from impaired loans is recorded using the cash method.

Real estate acquired as a result of foreclosure or by deed in lieu of foreclosure is classified as real estate owned. When such property is acquired it is recorded at the lower of the unpaid principal balance of the related loan or its fair market value less selling costs. Any subsequent write-down of the property is charged to income.

The Bank adjusts balances on real estate acquired in settlement of loans to the lower of cost or market based on appraised value when the property is received in settlement. These values reflect current market conditions and sales experience. See Notes 1 and 3 of Notes to Consolidated Financial Statements.

The following table illustrates trends in problem assets and other asset quality indicators for the periods indicated (dollars in thousands).

	At December 31,				
	2009	2008	2007	2006	2005
Non-accrual loans	\$20,869	\$16,001	\$2,972	\$1,295	\$1,246
Troubled debt restructurings	3,320	316	102	113	127
Accruing loans which are contractually past due 90 days or more	-	-	-	-	-
Real estate owned, net	<u>5,917</u>	<u>667</u>	<u>856</u>	<u>148</u>	<u>224</u>
Total	<u>\$30,106</u>	<u>\$16,984</u>	<u>\$3,930</u>	<u>\$ 1,556</u>	<u>\$1,597</u>
As a percent of loans receivable and real estate acquired in settlement of loans	<u>11.74%</u>	<u>5.88%</u>	<u>1.49%</u>	<u>0.62%</u>	<u>0.76%</u>
As a percent of total assets	<u>6.59%</u>	<u>3.91%</u>	<u>0.96%</u>	<u>0.40%</u>	<u>0.43%</u>
Allowance for loan losses as a percent of problem assets	<u>18.53%</u>	<u>39.91%</u>	<u>85.09%</u>	<u>176.99%</u>	<u>149.91%</u>

The following table sets forth information with respect to the Bank's non-performing assets for the periods indicated (dollars in thousands).

	At December 31,				
	2009	2008	2007	2006	2005
Real estate	\$ 649	\$ 389	\$ 356	\$ 459	\$ 461
Commercial	19,045	13,345	2,445	631	436
Consumer	<u>1,175</u>	<u>2,267</u>	<u>171</u>	<u>205</u>	<u>349</u>
Total	<u>20,869</u>	<u>16,001</u>	<u>2,972</u>	<u>1,295</u>	<u>1,246</u>
Accruing loans which are contractually past due 90 days or more	-	-	-	-	-
Real estate owned, net	<u>5,917</u>	<u>667</u>	<u>856</u>	<u>148</u>	<u>224</u>
Total non-performing assets	<u>\$26,786</u>	<u>\$16,668</u>	<u>\$3,828</u>	<u>\$ 1,443</u>	<u>\$1,470</u>
Percentage of non-performing assets to loans receivable, net	<u>10.69%</u>	<u>5.98%</u>	<u>1.49%</u>	<u>0.62%</u>	<u>0.76%</u>

Non-performing assets increased \$10.1 million from \$16.7 million at December 31, 2008 to \$26.8 million at December 31, 2009. The majority of this increase relates primarily to four commercial real estate relationships totaling \$9.7 million that have been affected by the downturn in the residential housing market. Slow housing conditions have affected these borrowers's ability to sell the completed projects in a timely manner. These loans are primarily supported by commercial real estate and are currently being carried at management's best estimate of net realizable value, although no assurance can be given that no further losses will be incurred on these loans until the collateral has been acquired and liquidated or other arrangements can be made.

In addition to non-accrual loans of \$20.9 million at December 31, 2009, management has identified approximately \$17.8 million in potential problem loans that could move to non-accrual status in future periods. Potential problem loans are loans where know information about possible credit problems of the borrowers causes management to have concerns as to the ability of such borrowers to comply with the present repayment terms and may result in disclosure of such loans as non-accrual in future periods. Management is actively working a plan of action to mitigate any loss exposure and will continue to monitor their respective cash flow positions.

Troubled debt restructurings increased \$3.0 million from \$316,000 at December 31, 2008 to \$3.3 million at December 31, 2009. The majority of this increase relates primarily to two commercial real estate relationships totaling \$2.5 million that have been affected by the downturn in the commercial real estate market.

Real estate acquired through foreclosure increased \$5.2 million to \$5.9 million at December 31, 2009 from \$667,000 at December 31, 2008, as a result of foreclosure on commercial real estate properties. Approximately 88%, or \$4,800,000, of the increase was due to the foreclosure of two commercial real estate projects where the collateral values are supported by residential housing and undeveloped land. The properties are being actively marketed and maintained with the primary objective of liquidating the collateral at a level which most accurately approximates fair market value and allows recovery of as much of the unpaid balance as possible upon the sale of the properties in a reasonable period of time. The carrying value of these assets are believed to be representative of their fair market value, although there can be no assurance that the ultimate proceeds from the sale of these assets will be equal to or greater than the carrying values.

Interest income that would have been recorded for the year ended December 31, 2009 had non-accruing loans been current in accordance with their original terms amounted to approximately \$1.3 million. There was no interest included in interest income on such loans for the year ended December 31, 2009. Other than disclosed in the table above, there are no other loans at December 31, 2009 that management has serious doubts about the ability of borrowers to comply with present loan payment terms.

Allowance for Loan Losses. In originating loans, we recognize that losses will be experienced and that the risk of loss will vary with, among other things, the type of loan being made, the creditworthiness of the borrower over the term of the loan, general economic conditions and, in the case of a secured loan, the quality of the security for the loan. To cover losses inherent in the portfolio of performing loans, the Bank maintains an allowance for loan losses. Management's periodic evaluation of the adequacy of the allowance is based on a number of factors, including management's evaluation of the collectability of the loan portfolio, the composition and size of the portfolio, credit concentrations, trends in historical loss experience and economic conditions. Upon completion of the qualitative adjustments, the allowance is allocated to the components of the portfolio based on the adjusted factors. The amount of the allowance is based on the estimated value of the collateral securing the loan and other analysis pertinent to each situation.

The unallocated component of the allowance exists to mitigate the imprecision inherent in management's estimates of expected credit losses and includes its determination of the amounts necessary for concentrations, economic uncertainties and other subjective factors that may not have been fully considered in the allocated allowance. The relationship of the unallocated component to the total allowance may fluctuate from period to period. As of December 31, 2009, management has allocated the allowance to specific loan categories and, as a result, there was not an unallocated component of the allowance.

The Bank increases its allowance for loan losses by charging provisions for loan losses against income. The allowance for loan losses is maintained at an amount management considers adequate to absorb losses inherent in the portfolio. Although management believes that it uses the best information available to make such determinations, future adjustments to the allowance for loan losses may be necessary and results of operations could be affected significantly and adversely if circumstances substantially differ from the assumptions used in making the determinations.

The provision for loan loss calculation includes a segmentation of loan categories subdivided by residential mortgage, commercial and consumer loans. Each category is rated for all loans including performing groups. The weights assigned to each performing group are developed from previous loan loss experience and as the loss

experience changes, the category weight is adjusted accordingly. In addition, as the amount of loans in each category increases and decreases, the provision for loan loss calculation adjusts accordingly.

While we believe that we have established the existing allowance for loan losses in accordance with generally accepted accounting principles, there can be no assurance that regulators, in reviewing our loan portfolio, will not request the Bank to increase significantly the allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that a substantial increase will not be necessary should the quality of any loans deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses may affect adversely the Corporation's financial condition and results of operations. See Notes 1 and 3 of Notes to Consolidated Financial Statements for information concerning the provision and allowance for loan losses.

The following table sets forth an analysis of the Bank's allowance for loan losses for the periods indicated (dollars in thousands):

	For the Year Ended				
	December 31,				
	2009	2008	2007	2006	2005
Balance at beginning of year	<u>\$6,778</u>	<u>\$3,344</u>	<u>\$2,754</u>	<u>\$2,394</u>	<u>\$2,026</u>
Loans charged off:					
Real estate.....	(123)	(28)	-	(25)	(75)
Commercial	(8,460)	(783)	(668)	(141)	(302)
Consumer.....	<u>(1,533)</u>	<u>(65)</u>	<u>(45)</u>	<u>(74)</u>	<u>(195)</u>
Total charge-offs.....	<u>(10,116)</u>	<u>(876)</u>	<u>(713)</u>	<u>(240)</u>	<u>(572)</u>
Recoveries:					
Real estate.....	16	23	13	44	35
Commercial	203	45	218	66	26
Consumer.....	<u>3</u>	<u>32</u>	<u>6</u>	<u>20</u>	<u>10</u>
Total recoveries	<u>222</u>	<u>100</u>	<u>237</u>	<u>130</u>	<u>71</u>
Net charge-offs	<u>(9,894)</u>	<u>(776)</u>	<u>(476)</u>	<u>(110)</u>	<u>(501)</u>
Provision for loan losses (1)	<u>8,695</u>	<u>4,210</u>	<u>1,066</u>	<u>470</u>	<u>869</u>
Balance at end of year	<u>\$5,579</u>	<u>\$6,778</u>	<u>\$3,344</u>	<u>\$2,754</u>	<u>\$2,394</u>
Balance as a percent of loans.....	<u>2.18%</u>	<u>2.36%</u>	<u>1.28%</u>	<u>1.17%</u>	<u>1.23%</u>
Ratio of net charge-offs to average gross loans outstanding during the period.....	<u>3.64%</u>	<u>0.28%</u>	<u>0.20%</u>	<u>0.05%</u>	<u>0.27%</u>

(1) See "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a discussion of the factors responsible for changes in the provision for loan losses between the periods.

National credit conditions have resulted in historically high credit cost levels from the extraordinarily low cost levels over the past couple of years. The markets in which we operate are not immune from these conditions and have impacted our delinquencies, non-accrual loans, and charge-offs. The increasing trends in non-performing assets we have experienced over the past two fiscal years has warranted the increase in the provision for loan losses and charge-offs to \$8.7 million for 2009 compared to \$4.2 million for the year ending December 31, 2008.

The Corporation experienced bad debt charge-offs, net of recoveries, of approximately \$9.9 million for fiscal 2009 compared to \$776,000 for fiscal 2008. The increase in bad debt charge-offs over the previous year relates primarily to additional write-downs required in the disposition of commercial real estate and consumer loans as a result of declining collateral values.

The following table sets forth the breakdown of the allowance for loan losses by loan category and the percentage of loans in each category to total loans for the periods indicated. Management believes that the allowance can be allocated by category only on an approximate basis. The allocation of the allowance to each category is not necessarily indicative of further losses and does not restrict the use of the allowance to absorb losses in any category (dollars in thousands):

	At December 31,									
	2009		2008		2007		2006		2005	
	Amount	% of Loans in Each Category to Total Loans	Amount	% of Loans in Each Category to Total Loans	Amount	% of Loans in Each Category to Total Loans	Amount	% of Loans in Each Category to Total Loans	Amount	% of Loans in Each Category to Total Loans
Real estate	\$2,842	50.95%	\$3,068	47.51%	\$1,297	40.58%	\$ 993	41.16%	\$ 975	44.06%
Commercial	1,599	28.66	2,110	32.68	1,268	39.68	956	39.41	447	20.18
Consumer	1,138	20.39	1,280	19.81	630	19.74	471	19.43	792	35.76
Unallocated	--	N/A	320	N/A	149	N/A	334	N/A	180	N/A
Total allowance for loan losses....	<u>\$5,579</u>	<u>100.00%</u>	<u>\$6,778</u>	<u>100.00%</u>	<u>\$3,344</u>	<u>100.00%</u>	<u>\$2,754</u>	<u>100.00%</u>	<u>\$2,394</u>	<u>100.00%</u>

Asset Classification. The Office of the Comptroller of the Currency requires national banks to classify problem assets. Problem assets are classified as “substandard” or “impaired,” depending on the presence of certain characteristics. Assets that currently do not expose the insured institution to sufficient risk to warrant classification in the above-mentioned categories but possess weaknesses are designated “special mention.” An asset is considered “substandard” if it is inadequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. “Substandard” assets include those characterized by the “distinct possibility” that the institution will sustain some loss if the deficiencies are not corrected. Assets classified as “impaired” have all of the weaknesses inherent in those classified as “substandard” with the added characteristic that the weaknesses present make “collection or liquidation in full,” on the basis of currently existing facts, conditions, and values, “highly questionable and improbable.”

When an institution classifies problem assets as either special mention or substandard, it is required to establish general allowances for loan losses in an amount deemed prudent by management. General allowances represent loss allowances that have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When an institution classifies problem assets or a portion of assets as impaired, it is required either to establish a specific allowance for losses equal to 100% of the amount of the asset or a portion thereof so classified or to charge-off such amount. An institution’s determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the Comptroller of the Currency who can order the establishment of additional general or specific loss allowances. The Corporation considers all non-accrual loans to be impaired. Therefore, at December 31, 2009, loans classified as impaired totaled \$20.9 million.

Investment Activities

The following table sets forth the Corporation's investment and mortgage-backed securities portfolio at the dates indicated (dollars in thousands):

	At December 31,					
	2009		2008		2007	
	Carrying Value	Percent of Portfolio	Carrying Value	Percent of Portfolio	Carrying Value	Percent of Portfolio
Available for sale:						
Investment securities:						
U.S. Agency obligations.....	\$ 4	0.01%	\$ 6	0.01%	\$ 488	0.45%
Government Sponsored Enterprises.....	78,471	53.08	28,230	28.11	40,665	37.63
Municipal securities.....	6,042	4.09	6,358	6.33	9,601	8.88
Trust Preferred securities.....	5,912	4.00	8,392	8.36	12,093	11.20
Total investment securities.....	90,429	61.18	42,986	42.81	62,847	58.16
Mortgage-backed and related securities.....	57,387	38.82	57,432	57.19	45,214	41.84
Total.....	\$147,816	100.00%	\$100,418	100.00%	\$108,061	100.00%
	At December 31,					
	2009		2008		2007	
	Carrying Value	Percent of Portfolio	Carrying Value	Percent of Portfolio	Carrying Value	Percent of Portfolio
Held to maturity:						
Municipal securities.....	\$3,934	100.00%	\$2,430	100.00%	\$3,126	100.00%

The Corporation increased its level of investment securities over the previous year with funds from significant deposit growth above what was needed to fund loan growth.

The Corporation purchases mortgage-backed securities, both fixed-rate and adjustable-rate, from Freddie Mac, Fannie Mae and Ginnie Mae with maturities from five to thirty years. The Corporation maintained its level of mortgage-backed securities and increased its level of government sponsored enterprises securities that have the potential to increase to a higher rate depending on the interest rate environment.

The Corporation in previous years purchased mortgage derivative securities in the form of collateralized mortgage obligations ("CMOs") issued by financial corporations. The amortized cost of the CMOs at December 31, 2009 was approximately \$597,000 with a fair value of \$480,000.

The Corporation has in the past purchased trust preferred corporate securities, both fixed-rate and adjustable-rate, with maturities up to thirty years. Trust preferred securities are issued by financial institutions through a pooled trust preferred and single issue capital offerings. Because of the current trading dislocations in the debt markets, the traditional methods of market quotes have become unreliable. Accounting standards permit the use of reasonable management judgment regarding the probability of collecting all projected cash flows generated by the financial instrument. An other than temporary investment charge of \$3.8 million was recorded for 2009 that was related to these trust preferred securities. The other than temporary impairment charge was due to write-downs recorded on trust preferred securities as a result of projected shortfalls of interest and principal payments in the cash flow analysis of the securities. The total amortized cost of the trust preferred securities at December 31, 2009 was approximately \$8.6 million with a fair value of \$5.9 million. See Note 2 of Notes to Consolidated Financial Statements for more information regarding investment and mortgage-backed securities.

Management reviews securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

To determine which individual securities are at risk for other-than-temporary impairment, the Corporation considers various characteristics of each security including but not limited to the credit rating, the duration and amount of the unrealized loss, and any credit enhancements. The relative importance of this information varies based on the facts and circumstances surrounding each security, as well as the economic environment at the time of the assessment. As a result of this review, the Corporation identifies individual securities believed to be at risk for other-than-temporary impairment. These securities are evaluated by estimating projected cash flows based on the structure of the security and certain assumptions, such as prepayments, default rates, and loss severity to determine whether the Corporation expects to receive all of the contractual cash flows as scheduled. The Corporation recognizes an other-than-temporary impairment credit loss when the present value of the investment security's cash flows expected to be collected are less than the amortized cost basis.

The following table sets forth at amortized cost (held to maturity) and market value (available for sale) the maturities and weighted average yields* of the Corporation's investment and mortgage-backed securities portfolio at December 31, 2009 (dollars in thousands):

	Amount Due or Repricing within:									
	One Year or Less		Over One to Five Years		Over Five to Ten Years		Over Ten Years		Total	
	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield	Carrying Value	Weighted Average Yield
Available for Sale:										
Investment securities:										
U.S. Agency obligations.....	\$ --	-- %	\$ 4	8.07%	\$ --	-- %	\$ --	-- %	\$ 4	8.07%
Government sponsored enterprises (1)	--	--	--	--	17,859	3.50	60,612	4.15	78,471	4.00
Municipal securities	727	4.80	352	4.57	728	4.84	4,235	4.84	6,042	4.82
Trust Preferred securities	<u>4,663</u>	<u>4.59</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>1,249</u>	<u>7.00</u>	<u>5,912</u>	<u>5.10</u>
Total investment securities	5,390	4.61	356	4.61	18,587	3.55	66,096	4.24	90,429	4.13
Mortgage-backed and related securities	<u>2,145</u>	<u>2.34</u>	<u>336</u>	<u>2.91</u>	<u>--</u>	<u>--</u>	<u>54,906</u>	<u>4.61</u>	<u>57,387</u>	<u>4.52</u>
Total available for sale	<u>\$7,535</u>	3.97	<u>\$692</u>	3.78	<u>\$18,587</u>	3.55	<u>\$121,002</u>	4.41	<u>\$147,816</u>	4.28
Held to Maturity:										
Municipal securities	\$ --	-- %	\$ --	-- %	\$ --	-- %	\$ 3,934	4.25 %	\$ 3,934	4.25 %

(1)The following GSE issuers exceed 10% of shareholders' equity at 12/31/09.

Issuer	Book Value	Market Value
Fannie Mae (FNMA)	\$51,404	\$51,174
Federal Home Loan Bank (FHLB)	7,050	6,804
Freddie Mac (FHLMC)	<u>17,709</u>	<u>17,471</u>
	<u>\$76,163</u>	<u>\$75,449</u>

*The weighted average yield is based upon the cost value and the total income received of the instrument. The weighted average yield on tax-exempt securities is not presented on a tax-equivalent basis.

At December 31, 2009, approximately \$2.4 million of mortgage-backed securities were adjustable-rate securities.

Deposits and Borrowings

General deposits are the major source of our funds for lending and other investment purposes. In addition to deposits, we derive funds from principal repayments and interest payments on loans and investment and mortgage-backed securities. Principal repayments and interest payments are a relatively stable source of funds, although principal prepayments tend to slow when interest rates increase. Deposit inflows and outflows may be influenced significantly by general market interest rates and money market conditions. During 2009, the Bank experienced a net increase in deposits of approximately \$25.9 million due to various deposit promotion programs with continued emphasis on increasing core deposits. The Bank used the excess funds from the deposit growth to purchase agency and mortgage-backed securities.

Deposits. Local deposits are, and traditionally have been, the primary source of the Bank's funds for use in lending and for other general business purposes. We offer a number of deposit accounts including NOW accounts, money market savings accounts, passbook and statement savings accounts, individual retirement accounts and certificate of deposit accounts. Deposit accounts vary as to terms regarding withdrawal provisions, deposit provisions and interest rates.

We adjust the interest rates offered on our deposit accounts as necessary so as to remain competitive with other financial institutions in Union, Laurens, York, Greenville and Fairfield Counties in South Carolina.

The following table sets forth the time deposits of the Bank classified by rates as of the dates indicated (in thousands):

	At December 31,		
	2009	2008	2007
Up to 2.0%	\$ 79,098	\$ 13,254	\$ 228
2.01% to 4.0%	76,850	107,641	31,805
4.01% to 6.0%	14,875	66,143	129,536
6.01% to 8.0%	<u>28</u>	<u>28</u>	<u>26</u>
Total time deposits	<u>\$170,851</u>	<u>\$187,066</u>	<u>\$161,595</u>

The following table sets forth the maturities of time deposits at December 31, 2009 (in thousands):

	Amount
Within three months	\$ 47,709
After three months but within six months	48,860
After six months but within one year	23,117
After one year but within three years	50,814
After three years but within five years	<u>351</u>
Total	<u>\$170,851</u>

Certificates of deposit with maturities of less than one year decreased to \$119.7 million at December 31, 2009 from \$141.9 million at December 31, 2008. Historically, we have been able to retain a significant amount of deposits as they mature. In addition, we believe that we can adjust the offering rates of savings certificates to retain deposits in changing interest rate environments.

The following table indicates the amount of the Bank's jumbo certificates of deposit by time remaining until maturity as of December 31, 2009 (in thousands). Jumbo certificates of deposit are certificates in amounts of \$100,000 or more.

<u>Maturity Period</u>	<u>Amount</u>
Three months or less	\$19,044
Over three through six months.....	19,508
Over six months through twelve months	11,227
Over twelve months	<u>18,431</u>
Total jumbo certificates.....	<u>\$68,210</u>

See Note 7 of Notes to Consolidated Financial Statements for additional information about deposit accounts.

Borrowings. The Corporation utilizes advances from the FHLB agreements and other borrowings (treasury, tax and loan deposits, security repurchase agreements and trust preferred capital obligations) to supplement its supply of lendable funds for granting loans, making investments and meeting deposit withdrawal requirements. See "Regulation and Supervision — Federal Home Loan Bank System."

The following tables set forth certain information regarding borrowings by the Bank at the dates and for the periods indicated (dollars in thousands):

	<u>At December 31,</u>		
	<u>2009</u>	<u>2008</u>	<u>2007</u>
Balance outstanding at end of period:			
FHLB advances	\$64,500	\$69,500	\$69,500
Floating rate junior subordinated deferrable interest debentures	12,372	12,372	12,372
Securities sold under agreement to repurchase	18,520	19,005	24,131
Weighted average rate paid on:			
FHLB advances.....	4.23%	4.16%	4.55%
Floating rate junior subordinated deferrable interest debentures	3.77%	5.07%	6.68%
Securities sold under agreement to repurchase	1.52%	1.70%	4.00%

	At or For the Year Ended December 31,		
	2009	2008	2007
Maximum amount of borrowings outstanding at any month end:			
FHLB advances	\$69,500	\$77,500	\$85,250
Floating rate junior subordinated deferrable interest debentures.....	12,372	12,372	12,372
Securities sold under agreement to repurchase	20,411	23,389	39,175
Approximate average borrowings outstanding:			
FHLB advances	\$65,862	70,107	66,893
Floating rate junior subordinated deferrable interest debentures.....	12,372	12,372	12,372
Securities sold under agreement to repurchase	18,134	21,588	28,560
Approximate weighted average rate paid on:			
FHLB advances	4.23%	4.23%	4.77%
Floating rate junior subordinated deferrable interest debentures.....	4.28%	5.83%	7.25%
Securities sold under agreement to repurchase	1.56%	2.53%	4.44%

At December 31, 2009, the Corporation had unused short-term secured lines of credit to purchase federal funds from unrelated banks totaling \$4.0 million. These lines of credit are available on a one-to-ten day basis for general purposes of the Corporation. All of the lenders have reserved the right to withdraw these lines at their option. At December 31, 2009, the Bank had unused secured lines of credit for longer term advances totaling \$54.0 million.

Subsidiary Activities

Under OCC regulations, the Bank generally may invest in operating subsidiaries, which may engage in activities permissible for the Bank itself. The Bank currently holds Provident Financial Services, Inc. as a non-active subsidiary.

Provident Community Bancshares maintains two subsidiaries other than the Bank. In fiscal year 2006, Provident Community Bancshares Capital Trust I and Capital Trust II were established as capital trusts under Delaware law to issue trust preferred securities. Provident Community Bancshares Capital Trust I issued trust preferred securities on July 21, 2006 while Capital Trust II issued trust preferred securities on December 15, 2006.

Employees

The Corporation has 71 full-time employees and 8 part-time employees. None of the employees are represented by a collective bargaining unit. We believe that relations with our employees are excellent.

REGULATION AND SUPERVISION

General

Provident Community Bancshares, which is a bank holding company, is required to file certain reports with the Federal Reserve Board and otherwise comply with the Bank Holding Company Act of 1956, as amended (“BHCA”) and the rules and regulations promulgated thereunder.

The Bank, as a national bank, is subject to extensive regulation, examination and supervision by the Office of the Comptroller of the Currency, as its primary regulator, and the Federal Deposit Insurance Corporation, as the deposit insurer. The Bank's deposit accounts are insured up to applicable limits by the Deposit Insurance Fund managed by the FDIC. The Bank must file reports with the OCC and the FDIC concerning its activities and financial condition in addition to obtaining regulatory approvals prior to entering into certain transactions such as mergers with, or acquisitions of, other institutions. The OCC and/or the FDIC conduct periodic examinations to test the Bank's safety and soundness and compliance with various regulatory requirements. Many aspects of the Bank's operations are regulated by federal law including allowable activities, reserves against deposits, branching, mergers and investments. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulatory requirements and policies, whether by the OCC, the FDIC, or Congress, could have a material adverse impact on Provident Community Bancshares or the Bank and their operations.

Certain regulatory requirements applicable to the Bank and Provident Community Bancshares are referred to below or elsewhere herein. This description of statutory provisions and regulations applicable to national banks and their holding companies does not purport to be a complete description of such statutes and regulations and their effects on the Bank and Provident Community Bancshares.

Holding Company Regulation

Federal Regulation. As a bank holding company, Provident Community Bancshares is subject to examination, regulation and periodic reporting under the BHCA, as administered by the FRB. Provident Community Bancshares is required to obtain the prior approval of the FRB to acquire all, or substantially all, of the assets of any bank or bank holding company or merge with another bank holding company. Prior FRB approval is also required for Provident Community Bancshares to acquire direct or indirect ownership or control of any voting securities of any bank or bank holding company if, after giving effect to such acquisition, Provident Community Bancshares would, directly or indirectly, own or control more than 5% of any class of voting shares of the bank or bank holding company. In evaluating such transactions, the FRB considers such matters as the financial and managerial resources of and future prospects of the companies and banks involved, competitive factors and the convenience and needs of the communities to be served. Bank holding companies have authority under the BHCA to acquire additional banks in any state, subject to certain restrictions such as deposit concentration limits. In addition to the approval of the FRB, before any bank acquisition can be completed, prior approval may also be required from other agencies having supervisory jurisdiction over the banks to be acquired.

A bank holding company generally is prohibited from engaging in, or acquiring direct or indirect control of more than 5% of the voting securities of any company conducting non-banking activities. One of the principal exceptions to this prohibition is for activities found by the FRB to be so closely related to banking or managing or controlling banks to be a proper incident thereto. Some of the principal activities that the FRB has determined by regulation to be closely related to banking are: (1) making or servicing loans; (2) performing certain data processing services; (3) providing discount brokerage services; (4) acting as fiduciary, investment or financial advisor; (5) finance leasing personal or real property; (6) making investments in corporations or projects designed primarily to promote community welfare; and (7) acquiring a savings association, provided that the savings association only engages in activities permitted by bank holding companies.

The Gramm-Leach-Bliley Act of 1999 authorizes a bank holding company that meets specified conditions, including being "well-capitalized" and "well managed," to opt to become a "financial holding company" and thereby engage in a broader array of financial activities than previously permitted. Such activities may include insurance underwriting and investment banking. The Gramm-Leach-Bliley Act also authorizes banks to engage through "financial subsidiaries" in certain of the activities permitted for financial holding companies. Financial subsidiaries are generally treated as affiliates for purposes of restrictions on a bank's transactions with affiliates.

The FRB has adopted capital adequacy guidelines for bank holding companies (on a consolidated basis) substantially similar to those of the OCC for the Bank. See “Capital Requirements.” Provident Community Bancshares’ total and Tier 1 capital exceed these requirements as of December 31, 2009.

Bank holding companies are generally required to give the FRB prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of their consolidated net worth. The FRB may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe and unsound practice, or would violate any law, regulation, FRB order or directive, or any condition imposed by, or written agreement with, the FRB. There is an exception to this approval requirement for well-capitalized bank holding companies that meet certain other conditions.

The FRB has issued a policy statement regarding the payment of dividends by bank holding companies. In general, the FRB’s policies provide that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the Bank holding company appears consistent with the organization’s capital needs, asset quality, and overall financial condition. The FRB’s policies also require that a bank holding company serve as a source of financial strength to its subsidiary banks by standing ready to use available resources to provide adequate capital funds to those banks during periods of financial stress or adversity and by maintaining the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks where necessary. Furthermore, the FRB has authority to prohibit a bank holding company from paying a capital distribution where a subsidiary bank is undercapitalized. These regulatory policies could affect the ability of Provident Community Bancshares to pay dividends or otherwise engage in capital distributions.

The FRB has general authority to enforce the BHCA as to Provident Community Bancshares and may require a bank holding company to cease any activity or terminate control of any subsidiary engaged in an activity that the FRB believes constitutes a serious risk to the safety, soundness or stability of its bank subsidiaries.

Provident Community Bancshares and its subsidiaries will be affected by the monetary and fiscal policies of various agencies of the United States Government, including the Federal Reserve System. In view of changing conditions in the national economy and money markets, it is impossible for the management of Provident Community Bancshares accurately to predict future changes in monetary policy or the effect of such changes on the business or financial condition of Provident Community Bancshares or the Bank.

Acquisition of Provident Community Bancshares

Federal Regulation. Federal law requires that a notice be submitted to the FRB if any person (including a company), or group acting in concert, seeks to acquire 10% or more of Provident Community Bancshares’ outstanding voting stock, unless the FRB has found that the acquisition will not result in a change in control of Provident Community Bancshares. The FRB has 60 days from the filing of a complete notice to act, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the anti-trust effects of the acquisition.

Under the BHCA, any company would be required to obtain prior approval from the FRB before it may obtain “control” of Provident Community Bancshares within the meaning of the BHCA. “Control” generally is defined to mean the ownership or power to vote 25% or more of any class of voting securities of Provident Community Bancshares or the ability to control in any manner the election of a majority of Provident Community Bancshares’ directors. An existing bank holding company would be required to obtain the FRB’s prior approval under the BHCA before acquiring more than 5% of Provident Community Bancshares’ voting stock. See “Holding Company Regulation.”

Federal Banking Regulations

Capital Requirements. The OCC’s capital regulations require national banks to meet two minimum capital standards: a 4% Tier 1 capital to total adjusted assets ratio for most banks (3% for national banks with the highest examination rating) (the “leverage” ratio) and an 8% risk-based capital ratio. In addition, the prompt corrective

action standards discussed below also establish, in effect, a minimum 2% tangible capital to total assets standard, a 4% leverage ratio (3% for institutions receiving the highest rating on the financial institution examination rating system) and, together with the risk-based capital standard itself, a 4% Tier 1 capital to risk-based assets standard. "Tier 1 capital" is generally defined as common stockholders' equity (including retained earnings), certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries, less intangibles (other than certain mortgage servicing rights and credit card relationships), a percentage of certain non-financial equity investments and certain other specified items.

The risk-based capital standard requires the maintenance of Tier 1 and total capital (which is defined as Tier 1 capital plus Tier 2 capital) to risk-weighted assets of at least 4% and 8%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet activities, are multiplied by a risk-weight factor of 0% to 100%, as assigned by the OCC capital regulation based on the risks that the agency believes are inherent in the type of asset. The regulators have recently added a market risk adjustment to cover a bank's trading account, foreign exchange and commodity positions. Tier 2 capital may include cumulative preferred stock, long-term perpetual preferred stock, mandatory convertible securities, subordinated debt and intermediate preferred stock, the allowance for loan and lease losses limited to a maximum of 1.25% of risk-weighted assets, and up to 45% of unrealized gains on available-for-sale equity securities with readily determinable fair market values. Overall, the amount of Tier 2 capital included as part of total capital cannot exceed 100% of Tier 1 capital.

The FRB has adopted capital adequacy guidelines for bank holding companies (on a consolidated basis) substantially similar to those of the OCC for the Bank. Provident Community Bancshares' total and Tier 1 capital exceed these requirements.

Both the OCC and the FRB have the discretion to establish higher capital requirements on a case-by-case basis where deemed appropriate in the circumstances of a particular bank or bank holding company.

At December 31, 2009, the Bank met each of its capital requirements.

Prompt Corrective Regulatory Action. Under the prompt corrective action regulations, the OCC is required to take certain supervisory actions against undercapitalized institutions under its jurisdiction, the severity of which depends upon the institution's degree of undercapitalization. Generally, an institution that has a ratio of total capital to risk-weighted assets of less than 8%, a ratio of Tier 1 (core) capital to risk-weighted assets of less than 4% or a ratio of core capital to total assets of less than 4% (3% or less for institutions with the highest examination rating) is considered to be "undercapitalized." An institution that has a total risk-based capital ratio less than 6%, a Tier 1 capital ratio of less than 3% or a leverage ratio that is less than 3% is considered to be "significantly undercapitalized" and an institution that has a tangible capital to assets ratio equal to or less than 2% is deemed to be "critically undercapitalized." Subject to a narrow exception, the OCC is required to appoint a receiver or conservator within specified time frames for an institution that is "critically undercapitalized." The regulation also provides that a capital restoration plan must be filed with the OCC within 45 days of the date an institution receives notice that it is "undercapitalized," "significantly undercapitalized" or "critically undercapitalized." Compliance with the plan must be guaranteed by any parent holding company in the amount of the lesser of 5% of the bank's total assets or the amount necessary to achieve compliance with applicable capital regulations. In addition, numerous mandatory supervisory actions become immediately applicable to an undercapitalized institution, including, but not limited to, increased monitoring by regulators and restrictions on growth, capital distributions and expansion. The OCC could also take any one of a number of discretionary supervisory actions, including the issuance of a capital directive and the replacement of senior executive officers and directors.

Insurance of Deposit Accounts. The Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund of the FDIC. The Deposit Insurance Fund is the successor to the Bank Insurance Fund and the Savings Association Insurance Fund, which were merged in 2006.

Under the FDIC's risk-based assessment system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other factors, with less risky institutions paying lower assessments. An institution's assessment rate depends upon the category to which it is assigned. For 2008, assessments ranged from five to forty-three basis points of assessable deposits. Due to losses

incurred by the Deposit Insurance Fund in 2008 from failed institutions, and anticipated future losses, the FDIC has adopted, pursuant to a Restoration Plan to replenish the fund, an across the board seven basis point increase in the assessment range for the first quarter of 2009. The FDIC has proposed further refinements to its risk-based assessment that would be effective April 1, 2009 and would effectively make the range eight to 77^{1/2} basis points. The FDIC may adjust the scale uniformly from one quarter to the next, except that no adjustment can deviate more than three basis points from the base scale without notice and comment rulemaking. No institution may pay a dividend if in default of the federal deposit insurance assessment.

The FDIC imposed on all insured institutions a special emergency assessment of five basis points of total assets minus tier 1 capital, as of June 30, 2009 (capped at ten basis points of an institution's deposit assessment base), to cover losses to the Deposit Insurance Fund. That special assessment was collected on September 30, 2009. The FDIC provided for similar assessments during the final two quarters of 2009, if deemed necessary. However, in lieu of further special assessments, the FDIC required insured institutions to prepay estimated quarterly risk-based assessments for the fourth quarter of 2009 through the fourth quarter of 2012. The estimated assessments, which include an assumed annual assessment base increase of 5%, were recorded as a prepaid expense asset as of December 30, 2009. As of December 31, 2009, and each quarter thereafter, a charge to earnings will be recorded for each regular assessment with an offsetting credit to the prepaid asset.

Due to the recent difficult economic conditions, deposit insurance per account owner has been raised to \$250,000 for all types of accounts until January 1, 2014. In addition, the FDIC adopted an optional Temporary Liquidity Guarantee Program by which, for a fee, noninterest bearing transaction accounts received unlimited insurance coverage until December 31, 2009, subsequently extended until June 30, 2010. Certain senior unsecured debt issued by institutions and their holding companies during specified time periods could also be guaranteed by the FDIC through June 30, 2012. The Bank made the business decision to participate in the unlimited noninterest bearing transaction account coverage and the Bank and Provident Community Bancshares opted to participate in the unsecured debt guarantee program.

Federal law also provides for the possibility that the FDIC may pay dividends to insured institutions once the Deposit Insurance fund reserve ratio equals or exceeds 1.35% of estimated insured deposits.

In addition to the assessment for deposit insurance, institutions are required to make payments on bonds issued in the late 1980s by the Financing Corporation to recapitalize a predecessor deposit insurance fund. This payment is established quarterly and during the calendar year ending December 31, 2009 averaged 1.06 basis points of assessable deposits.

The Federal Deposit Insurance Corporation has authority to increase insurance assessments. A significant increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operations of the Bank. Management cannot predict what insurance assessment rates will be in the future.

Insurance of deposits may be terminated by the Federal Deposit Insurance Corporation upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the Federal Deposit Insurance Corporation or the Office of Thrift Supervision. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

Loans to One Borrower. National banks are subject to limits on the amount that they may lend to single borrowers. Generally, banks may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of its capital and surplus (including Tier 1 capital, Tier 2 capital and the amount of the allowance for loan and lease losses not included in Tier 2 capital). An additional amount may be lent, equal to 10% of capital and surplus, if such loan is secured by readily-marketable collateral, which is defined to include certain financial instruments and bullion. At December 31, 2009, the Bank's limit on loans to one borrower was \$5.5 million and the Bank's largest aggregate outstanding balance of loans to one borrower was \$5.4 million.

Limitation on Capital Distributions. National banks may not pay dividends out of their permanent capital and may not, without OCC approval, pay dividends in excess of the total of the bank's retained net income for the

year combined with retained net income for the prior two years less any transfers to surplus and capital distributions. A national bank may not pay a dividend that would cause it to fall below any applicable regulatory capital standard.

Branching. National banks are authorized to establish branches within the state in which they are headquartered to the extent state law allows branching by state banks. Federal law also provides for interstate branching for national banks. Interstate branching by merger was authorized as of June 1, 1997 unless the state in which the bank is to branch has enacted a law opting out of interstate branching or expedites the effective date by passing legislation. *De novo* interstate branching is permitted to the extent the state into which the bank is to branch has enacted a law authorizing out-of-state banks to establish *de novo* branches.

Transactions with Related Parties. The authority of a depository institution to engage in transactions with related parties or “affiliates” (*e.g.*, any company that controls or is under common control with an institution, including, in this case, Provident Community Bancshares) is limited by Sections 23A and 23B of the Federal Reserve Act (“FRA”). Section 23A limits the aggregate amount of covered transactions with any individual affiliate to 10% of the capital and surplus of the depository institution. The aggregate amount of covered transactions with all affiliates is limited to 20% of the depository institution’s capital and surplus. Certain transactions with affiliates are required to be secured by collateral in an amount and of a type described in Section 23A and the purchase of low quality assets from affiliates is generally prohibited. Section 23B generally provides that certain transactions with affiliates, including loans and asset purchases, must be on terms and under circumstances, including credit standards, that are substantially the same or at least as favorable to the institution as those prevailing at the time for comparable transactions with non-affiliated companies.

The authority of the Bank to extend credit to executive officers, directors and 10% or greater shareholders (“insiders”), as well as entities such persons control, is governed by Sections 22(g) and 22(h) of the FRA and Regulation O thereunder. Among other things, such loans are required to be made on terms substantially the same as those offered to unaffiliated individuals and are not to involve more than the normal risk of repayment. There is an exception to this requirement for loans made pursuant to a benefit or compensation program that is widely available to all employees of the institution and does not give preference to insiders over other employees. Regulation O also places individual and aggregate limits on the amount of loans that institutions may make to insiders based, in part, on the institution’s capital position and requires certain board approval procedures to be followed. Extensions of credit to executive officers are subject to additional restrictions.

Enforcement. The OCC has primary enforcement responsibility over national banks and has the authority to bring actions against such banks and all institution-affiliated parties, including directors, officers, stockholders, and any attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an insured institution. Formal enforcement action may range from the issuance of a capital directive or cease and desist order to removal of officers and/or directors to institution of receivership or conservatorship. Civil penalties cover a wide range of violations and can amount to \$25,000 per day, or even \$1.0 million per day in especially egregious cases. The FDIC has the authority to recommend to the OCC that it take enforcement action with respect to a national bank. If action is not taken by the agency, the FDIC has authority to take such action under certain circumstances. Federal law also establishes criminal penalties for certain violations. The FRB has generally similar enforcement authority with respect to Provident Community Bancshares. Neither Provident Community Bancshares nor the Bank are under any enforcement action.

Assessments. National banks are required to pay assessments to the OCC to fund the agency’s operations. The general assessments, paid on a semi-annual basis, are computed based upon the national bank’s (including consolidated subsidiaries) total balance sheet assets and financial condition. The OCC assessments paid by the Bank for 2009 totaled \$118,000.

Standards for Safety and Soundness. The federal banking agencies have adopted Interagency Guidelines Prescribing Standards for Safety and Soundness (“Guidelines”) and a final rule to implement safety and soundness standards required under federal law. The Guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. The standards address internal controls and information systems; internal audit system; credit

underwriting; loan documentation; interest rate risk exposure; asset quality and growth; earnings; and compensation, fees and benefits. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the Guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard. The final rule establishes deadlines for the submission and review of such safety and soundness compliance plans when such plans are required.

Community Reinvestment Act. The Community Reinvestment Act, (“CRA”), as implemented by OCC regulations, provides that a national bank has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution’s discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires the OCC, in connection with its examination of a bank, to assess the institution’s record of meeting the credit needs of its community and to take such record into account in its evaluation of certain corporate applications by such institution, such as mergers and branching. The Bank’s most recent rating was “satisfactory.”

USA Patriot Act. The USA Patriot Act of 2001 (the “Patriot Act”), designed to deny terrorists and others the ability to obtain anonymous access to the United States financial system, has significant implications for depository institutions, brokers, dealers and other businesses involved in the transfer of money. The Patriot Act mandated that financial institutions to implement additional policies and procedures with respect to, or additional measures designed to address matters such as: money laundering, suspicious activities and currency transaction reporting.

Federal Reserve System

The FRB regulations require savings institutions to maintain non-interest earning reserves against their transaction accounts (primarily NOW and regular checking accounts). For 2009, the regulations generally provided that reserves be maintained against aggregate transaction accounts as follows: for accounts aggregating \$44.4 million or less (subject to adjustment by the FRB) the reserve requirement was 3%; and for accounts aggregating greater than \$44.4 million, a reserve requirement of 10% (subject to adjustment by the FRB between 8% and 14%) was applied against that portion of total transaction accounts in excess of \$44.4 million. The first \$10.3 million of otherwise reservable balances (subject to adjustments by the FRB) were exempted from the reserve requirements. These amounts are adjusted annually and, for 2010, require a 3% ratio for up to \$55.2 million and an exemption of \$10.7 million. The Bank complies with the foregoing requirements.

Federal Home Loan Bank System

The Bank is a member of the Federal Home Loan Bank System, which consists of 12 regional Federal Home Loan Banks. The Federal Home Loan Bank provides a central credit facility primarily for member institutions. The Bank, as a member of the Federal Home Loan Bank of Atlanta, is required to acquire and hold shares of capital stock in the Federal Home Loan Bank of Atlanta. The Bank was in compliance with this requirement with an investment in Federal Home Loan Bank stock at December 31, 2009 of \$3.9 million.

The Federal Home Loan Banks are required to provide funds for the resolution of insolvent thrifts in the late 1980s and to contribute funds for affordable housing programs. These requirements could reduce the amount of dividends that the Federal Home Loan Banks pay to their members and could also result in the Federal Home Loan Banks imposing a higher rate of interest on advances to their members. If dividends were reduced, or interest on future Federal Home Loan Bank advances increased, the Bank’s net interest income would likely also be reduced.

Regulatory Restructuring Legislation

The Obama Administration has proposed, and the House of Representatives and Senate are currently considering, legislation that would restructure the regulation of depository institutions. Proposals range from the merger of the Office of Thrift Supervision with the Office of the Comptroller of the Currency to the creation of an independent federal agency that would assume the regulatory responsibilities of the Office of Thrift Supervision,

FDIC, OCC and the FRB. Also proposed is the creation of a new federal agency to administer and enforce consumer and fair lending laws, a function that is now performed by the depository institution regulators. The federal preemption of state laws currently accorded federally chartered depository institutions would be reduced under certain proposals as well.

Enactment of any of these proposals may revise the regulatory structure imposed on the Bank, which could result in more stringent regulation. At this time, management has no way of predicting the contents of any final legislation, or whether any legislation will be enacted at all.

Item 1A. Risk Factors

An investment in shares of our common stock involves various risks. Before deciding to invest in our common stock, you should carefully consider the risks described below in conjunction with the other information in this annual report, including the items included as exhibits. Our business, financial condition and results of operations could be harmed by any of the following risks or by other risks that have not been identified or that we may believe are immaterial or unlikely. The value or market price of our common stock could decline due to any of these risks, and you may lose all or part of your investment. The risks discussed below also include forward-looking statements, and our actual results may differ substantially from those discussed in these forward-looking statements.

Our provision for loan losses increased substantially during the past fiscal year and we may be required to make further increases in our provision for loan losses and to charge-off additional loans in the future, each of which could adversely affect our results of operations.

For the year ended December 31, 2009, we recorded a provision for loan losses of \$8.7 million. We also recorded net loan charge-offs of \$9.9 million. We are experiencing increasing loan delinquencies and credit losses. The deterioration in the general economy and our market area has become a significant contributing factor to the increased levels of loan delinquencies and non-performing assets. General economic conditions, decreased home prices, slower sales and excess inventory in the housing market have caused the increase in delinquencies.

At December 31, 2009, our non-performing loans totaled \$20.9 million, representing 8.1% of total loans. Total loans that we have classified as impaired, substandard or special mention including our non-performing loans totaled \$51.4 million, representing 20.0% of total loans. If these loans do not perform according to their terms and the collateral is insufficient to pay any remaining loan balance, we may experience loan losses, which could have a material effect on our operating results. Like all financial institutions, we maintain an allowance for loan losses to provide for loans in our portfolio that may not be repaid in their entirety. We believe that our allowance for loan losses is maintained at a level adequate to absorb probable losses inherent in our loan portfolio as of the corresponding balance sheet date. However, our allowance for loan losses may not be sufficient to cover actual loan losses, and future provisions for loan losses could materially adversely affect our operating results.

In evaluating the adequacy of our allowance for loan losses, we consider numerous quantitative factors, including our historical charge-off experience, growth of our loan portfolio, changes in the composition of our loan portfolio and the volume of delinquent and classified loans. In addition, we use information about specific borrower situations, including their financial position and estimated collateral values, to estimate the risk and amount of loss for those borrowers. Finally, we also consider many qualitative factors, including general and economic business conditions, current general market collateral valuations, trends apparent in any of the factors we take into account and other matters, which are by nature more subjective and fluid. Our estimates of the risk of loss and amount of loss on any loan are complicated by the significant uncertainties surrounding our borrowers' abilities to successfully execute their business models through changing economic environments, competitive challenges and other factors. Because of the degree of uncertainty and susceptibility of these factors to change, our actual losses may vary from our current estimates.

At December 31, 2009, our allowance for loan losses as a percentage of total loans was 2.2%. Our regulators, as an integral part of their examination process, periodically review our allowance for loan losses and may require us to increase our allowance for loan losses by recognizing additional provisions for loan losses

charged to expense, or to decrease our allowance for loan losses by recognizing loan charge-offs, net of recoveries. Any such additional provisions for loan losses or charge-offs, as required by these regulatory agencies, could have a material adverse effect on our financial condition and results of operations.

Further economic downturns may adversely affect our investment securities portfolio and profitability.

At December 31, 2009, the cost basis of our available for sale investment portfolio was \$149.3 million, including \$597,000 of collateralized mortgage obligations (“CMOs”) and \$8.6 million of collateralized debt obligations (“CDOs”) secured by trust preferred securities issued by various financial institutions. These CMOs are secured by first lien residential jumbo mortgage loans geographically dispersed across the United States with a significant amount of the CMOs secured by properties located in California.

At December 31, 2009, the fair value of these securities was \$147.8 million. Under U.S. generally accepted accounting principles, declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses. The amount of the impairment related to other non-credit related factors is recognized in other comprehensive income.

For the year ended December 31, 2009, we recognized a \$3.8 million OTTI charge on CDOs of which the entire amount was identified as credit related. These OTTI charges were determined by, among other things, a constant default rate, prepayments and loss severity of the security.

We closely monitor these and our other investment securities for changes in credit risk. The valuation of our investment securities and the determination of any OTTI with respect to such securities are highly complex and involve a comprehensive process, including quantitative modeling significant judgment. The valuation of our investment securities will also continue to be influenced by external markets and other factors, including implementation of Securities and Exchange Commission and Financial Accounting Standards Board guidance on fair value accounting, and default rates of specific CMOs and CDOs, rating agency actions, and the prices at which observable market transactions occur. The current market environment significantly limits our ability to mitigate our exposure to valuation changes in our CMO and CDO securities by selling them. Accordingly, if market conditions do not improve or deteriorate further and we determine our holdings of these or other investment securities have additional OTTI, our future earnings and shareholders’ equity could be materially adversely affected.

We may need to raise additional capital in the future, but that capital may not be available when it is needed.

We are required by federal regulatory authorities to maintain adequate levels of capital to support our operations. While we currently have sufficient capital resources to satisfy our capital requirements, we may at some point, however, need to raise additional capital to augment our balance sheet if our asset quality continues to weaken. If we raise capital through the issuance of additional shares of our common stock or other securities, it would dilute the ownership interests of existing shareholders and may dilute the per share book value of our common stock. New investors may also have rights, preferences and privileges senior to our current shareholders which may adversely impact our current shareholders.

Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside of our control, and on our financial performance. Accordingly, we may not be able to raise additional capital, if needed, on terms acceptable to us. If we cannot raise additional capital when needed, we may become subject to additional regulatory restrictions or have to shrink our balance sheet.

Our increased emphasis on commercial lending may expose us to increased lending risks.

At December 31, 2009, 44.3% of our loan portfolio consisted of commercial real estate loans and 29.4% of our loan portfolio consisted of commercial business loans. We have increased our emphasis on these types of loans since we converted to a national bank charter in July 2003. These types of loans generally expose a lender to greater risk of non-payment and loss than one- to four-family residential mortgage loans because repayment of the

loans often depends on the successful operation of the property and the income stream of the borrowers. Such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to one- to four-family residential mortgage loans. Commercial business loans expose us to additional risks since they typically are made on the basis of the borrower's ability to make repayments from the cash flow of the borrower's business and are secured by non-real estate collateral that may depreciate over time. In addition, since such loans generally entail greater risk than one- to four-family residential mortgage loans, we may need to increase our allowance for loan losses in the future to account for the likely increase in probable incurred credit losses associated with the growth of such loans. Also, many of our commercial borrowers have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan.

The unseasoned nature of a significant portion of our commercial loan portfolio may result in errors in judging its collectability, which may lead to additional loan charge-offs and provisions for loan losses, which would hurt our profits.

Our commercial loan portfolio, which includes loans secured by commercial real estate as well as business assets, has increased from \$116.3 million, or 58.9% of total loans, at December 31, 2005 to \$184.4 million, or 71.9% of total loans, at December 31, 2009. A large portion of our commercial loan portfolio is unseasoned and does not provide us with a significant payment history pattern with which to judge future collectability. These loans have also not been subjected to unfavorable economic conditions. As a result, it is difficult to predict the future performance of this part of our loan portfolio. These loans may have delinquency or charge-off levels above our historical experience, which could adversely affect our future performance. Further, commercial loans generally have larger balances and involve a greater risk than one- to four-family residential mortgage loans. Accordingly, if we make any errors in judgment in the collectability of our commercial loans, any resulting charge-offs may be larger on a per loan basis than those incurred with our residential mortgage loan portfolio.

If the value of real estate in northwestern South Carolina were to continue to decline, a significant portion of our loan portfolio could become under-collateralized, which could have a material adverse effect on us.

Northwestern South Carolina has experienced declines in home prices over the last two years. A further decline in local economic conditions or real estate values could adversely affect the value of the real estate collateral securing our loans. A continued decline in property values would diminish our ability to recover on defaulted loans by selling the real estate collateral, making it more likely that we would suffer losses on defaulted loans. Additionally, a decrease in asset quality could require additions to our allowance for loan losses through increased provisions for loan losses, which would hurt our profits. Also, a decline in local economic conditions may have a greater effect on our earnings and capital than on the earnings and capital of larger financial institutions whose real estate loan portfolios are more geographically diverse. Real estate values are affected by various factors in addition to local economic conditions, including, among other things, changes in general or regional economic conditions, governmental rules or policies and natural disasters.

Our business is subject to the success of the local economy in which we operate.

Since the latter half of 2007, depressed economic conditions have existed throughout the United States, including our market area. Our market area has experienced home price declines increased foreclosures and increased unemployment rates. Continued deterioration of economic conditions in our market area could reduce our growth rate, affect the ability of our customers to repay their loans and generally affect our financial condition and results of operations. Conditions such as inflation, recession, unemployment, high interest rates, short money supply, scarce natural resources, international disorders, terrorism and other factors beyond our control may adversely affect our profitability. We are less able than a larger institution to spread the risks of unfavorable local economic conditions across a large number of diversified economies. Any sustained period of increased payment delinquencies, foreclosures or losses caused by adverse market or economic conditions in the State of South Carolina could adversely affect the value of our assets, revenues, results of operations and financial condition. Moreover, we cannot give any assurance we will benefit from any market growth or favorable economic conditions in our primary market areas if they do occur.

The building of market share through our branching strategy could cause our expenses to increase faster than revenues.

We opened a banking center in Simpsonville in March 2006 and a second banking center in Rock Hill in October 2006. There are considerable costs involved in opening branches and new branches generally require a period of time to generate sufficient revenues to offset their costs, especially in areas in which we do not have an established presence. Accordingly, any new branch can be expected to negatively impact our earnings for some period of time until the branch reaches certain economies of scale.

Our market area limits our growth potential.

Some of our offices are located in areas that have experienced population and economic decline. Thus, our ability to originate loans and grow deposits in these areas may be limited. To counter this, we have attempted to expand our operations into communities that are experiencing population growth and economic expansion. This was the impetus for the opening of our banking centers in Rock Hill in York County and Simpsonville in Greenville County and the relocation of our main office to Rock Hill. However, we can provide no assurance that we will be able to successfully enter new markets with similar growth potential. If we are unable to do so, our ability to grow our business and our earnings will be restricted.

Recent negative developments in the financial industry and the domestic and international credit markets may adversely affect our operations and our stock price.

As a result of the general economic downturn and uncertainty in the financial markets, commercial as well as consumer loan portfolio performances have deteriorated at many institutions and the competition for deposits and quality loans has increased significantly. In addition, the values of real estate collateral supporting many commercial loans and home mortgages have declined and may continue to decline. Bank and bank holding company stock prices have been negatively affected, as has the ability of banks and bank holding companies to raise capital or borrow in the debt markets compared to recent years. As a result, there is a potential for new federal or state laws and regulations regarding lending and funding practices and liquidity standards, and bank regulatory agencies are expected to be very aggressive in responding to concerns and trends identified in examinations, including the expected issuance of many formal enforcement orders. Negative developments in the financial industry and the domestic and international credit markets, and the impact of new legislation in response to those developments, may negatively impact our operations by restricting our business operations, including our ability to originate or sell loans, and adversely impact our financial performance or our stock price.

Increased and/or special FDIC assessments will hurt our earnings.

Beginning in late 2008, the economic environment caused higher levels of bank failures, which dramatically increased FDIC resolution costs and led to a significant reduction in the Deposit Insurance Fund. As a result, the FDIC has significantly increased the initial base assessment rates paid by financial institutions for deposit insurance. These increases in the base assessment rate have increased our deposit insurance costs and negatively impacted our earnings. In addition, in May 2009, the FDIC imposed a special assessment on all insured institutions due to recent bank and savings association failures. Our special assessment, which was reflected in earnings for the quarter ended June 30, 2009, was \$211,000.

In lieu of imposing an additional special assessment, the FDIC adopted a rule requiring that all institutions prepay their assessments for the fourth quarter of 2009 and all of 2010, 2011 and 2012. This prepayment was due on December 30, 2009. Under the rule, the assessment rate for the fourth quarter of 2009 and for 2010 is based on each institution's total base assessment rate for the third quarter of 2009, modified to assume that the assessment rate in effect on September 30, 2009 had been in effect for the entire third quarter, and the assessment rate for 2011 and 2012 will be equal to the modified third quarter assessment rate plus an additional three basis points. In addition, each institution's base assessment rate for each period will be calculated using its third quarter assessment base, adjusted quarterly for an estimated 5% annual growth rate in the assessment base through the end of 2012. Under this rule, we made a payment of approximately \$2.0 million to the FDIC on December 30, 2009 as a

prepaid assessment and will amortize the expense over the three year assessment period.

The limitations on dividends and repurchases imposed through our participation in the Capital Purchase Program may make our common stock less attractive of an investment.

On March 6, 2009, the United States Department of the Treasury (the “Treasury”) purchased shares of our preferred stock as part of the Troubled Asset Relief Program (“TARP”) Capital Purchase Program. As part of this transaction, we agreed to not increase the dividend paid on our common stock and to not repurchase shares of our common stock for a period of three years. These capital management devices contribute to the attractiveness of our common stock and limitations and prohibitions on such activities may make our common stock less attractive to investors.

The limitations on executive compensation imposed through our participation in the Capital Purchase Program may restrict our ability to attract, retain and motivate key employees, which could adversely affect our operations.

As part of our participation in the TARP Capital Purchase Program, we agreed to be bound by certain executive compensation restrictions, including limitations on severance payments and the clawback of any bonus and incentive compensation that were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria. The American Recovery and Reinvestment Act of 2009 provides more stringent limitations on severance pay and the payment of bonuses to certain officers and highly compensated employees. To the extent that any of these compensation restrictions do not permit us to provide a comprehensive compensation package to our key employees that is competitive in our market area, we have difficulty in attracting, retaining and motivating our key employees, which could have an adverse effect on our results of operations.

The exercise of the warrant by Treasury will dilute existing shareholders’ ownership interest and may make it more difficult for us to take certain actions that may be in the best interests of shareholders.

In addition to the issuance of preferred shares, we also granted the Treasury a warrant to purchase 179,110 shares of common at a price of \$7.77 per share. If the Treasury exercises the entire warrant, it would result in a significant dilution to the ownership interest of our existing stockholders and dilute the earnings per share value of our common stock. Further, if the Treasury exercises the entire warrant, it will become the largest shareholder of the Company. The Treasury has agreed that it will not exercise voting power with regard to the shares that it acquires by exercising the warrant. However, Treasury’s abstention from voting may make it more difficult for us to obtain shareholder approval for those matters that require a majority of total shares outstanding, such as a business combination involving the Company.

The terms governing the issuance of the preferred stock to Treasury may be changed, the effect of which may have an adverse effect on our operations.

The Securities Purchase Agreement that we entered into with the Treasury provides that the Treasury may unilaterally amend any provision of the agreement to the extent required to comply with any changes in applicable federal statutes that may occur in the future. The American Recovery and Reinvestment Act of 2009 placed more stringent limits on executive compensation for participants in the TARP Capital Purchase Program and established a requirement that compensation paid to executives be presented to shareholders for a “non-binding” vote. Further changes in the terms of the transaction may occur in the future. Such changes may place further restrictions on our business or results of operations, which may adversely affect the market price of our common stock.

Our inability to raise capital at attractive rates may restrict our ability to redeem the preferred stock we issued, which may lead to a greater cost of that investment.

The terms of the preferred stock issued to the Treasury provide that the shares pay a dividend at a rate of 5% per year for the first five years after which time the rate will increase to 9% per year. It is our current goal to repay the Treasury before the date of the increase in the dividend rate on the preferred stock. However, our ability to repay the Treasury will depend on our ability to raise capital, which will depend on conditions in the capital

markets at that time, which are outside of our control. We can give no assurance that we will be able to raise additional capital or that such capital will be available on terms more attractive to us than the Treasury's investment.

Strong competition within our market area could hurt our profits and slow growth.

We face intense competition both in making loans and attracting deposits. This competition has made it more difficult for us to make new loans and has occasionally forced us to offer higher deposit rates. Price competition for loans and deposits might result in us earning less on our loans and paying more on our deposits, which reduces net interest income. According to the Federal Deposit Insurance Corporation, as of June 30, 2009, we held 2.46% of the deposits in Fairfield, Greenville, Laurens, Union and York Counties, in South Carolina, which was the 11th largest market share of deposits out of the 39 financial institutions that held deposits in these counties. Some of the institutions with which we compete have substantially greater resources and lending limits than we have and may offer services that we do not provide. We expect competition to increase in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. Our profitability depends upon our continued ability to compete successfully in our market area.

Changes in interest rates could reduce our net interest income and earnings.

Our net interest income is the interest we earn on loans and investment less the interest we pay on our deposits and borrowings. Our net interest margin is the difference between the yield we earn on our assets and the interest rate we pay for deposits and our other sources of funding. Changes in interest rates—up or down—could adversely affect our net interest margin and, as a result, our net interest income. Although the yield we earn on our assets and our funding costs tend to move in the same direction in response to changes in interest rates, one can rise or fall faster than the other, causing our net interest margin to expand or contract. Our liabilities tend to be shorter in duration than our assets, so they may adjust faster in response to changes in interest rates. As a result, when interest rates rise, our funding costs may rise faster than the yield we earn on our assets, causing our net interest margin to contract until the yield catches up. Changes in the slope of the “yield curve”—or the spread between short-term and long-term interest rates—could also reduce our net interest margin. Normally, the yield curve is upward sloping, meaning short-term rates are lower than long-term rates. Because our liabilities tend to be shorter in duration than our assets, when the yield curve flattens or even inverts, we could experience pressure on our net interest margin as our cost of funds increases relative to the yield we can earn on our assets.

The trading history of our common stock is characterized by low trading volume. Our common stock may be subject to sudden decreases.

Although our common stock trades on Nasdaq Capital Market, it has not been regularly traded. We cannot predict whether a more active trading market in our common stock will occur or how liquid that market might become. A public trading market having the desired characteristics of depth, liquidity and orderliness depends upon the presence in the marketplace of willing buyers and sellers of our common stock at any given time, which presence is dependent upon the individual decisions of investors, over which we have no control.

The market price of our common stock may be highly volatile and subject to wide fluctuations in response to numerous factors, including, but not limited to, the factors discussed in other risk factors and the following:

- actual or anticipated fluctuations in our operating results;
- changes in interest rates;
- changes in the legal or regulatory environment in which we operate;
- press releases, announcements or publicity relating to us or our competitors or relating to trends in our industry;

- changes in expectations as to our future financial performance, including financial estimates or recommendations by securities analysts and investors;
- future sales of our common stock;
- changes in economic conditions in our marketplace, general conditions in the U.S. economy, financial markets or the banking industry; and
- other developments affecting our competitors or us.

These factors may adversely affect the trading price of our common stock, regardless of our actual operating performance, and could prevent you from selling your common stock at or above the price you desire. In addition, the stock markets, from time to time, experience extreme price and volume fluctuations that may be unrelated or disproportionate to the operating performance of companies. These broad fluctuations may adversely affect the market price of our common stock, regardless of our trading performance.

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

The Bank is subject to extensive regulation, supervision and examination by the Office of the Comptroller of the Currency, its chartering authority and federal regulator, and by the Federal Deposit Insurance Corporation, as insurer of its deposits. Provident Community Bancshares is subject to regulation and supervision by the Federal Reserve Board. Such regulation and supervision govern the activities in which an institution and its holding company may engage, and are intended primarily for the protection of the insurance fund and for the depositors and borrowers of the Bank. The regulation and supervision by the Office of the Comptroller of the Currency, the Federal Reserve Board and the Federal Deposit Insurance Corporation are not intended to protect the interests of investors in Provident Community Bancshares common stock. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on our operations, the classification of our assets and determination of the level of our allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on our operations.

Provisions of our certificate of incorporation, bylaws and Delaware law, as well as federal banking regulations, could delay or prevent a takeover of us by a third party.

Provisions in our certificate of incorporation and bylaws and the corporate law of the State of Delaware could delay, defer or prevent a third party from acquiring us, despite the possible benefit to our shareholders, or otherwise adversely affect the price of our common stock. These provisions include: supermajority voting requirements for certain business combinations; the election of directors to staggered terms of three years; and advance notice requirements for nominations for election to our board of directors and for proposing matters that shareholders may act on at shareholder meetings. In addition, we are subject to Delaware laws, including one that prohibits us from engaging in a business combination with any interested shareholder for a period of three years from the date the person became an interested shareholder unless certain conditions are met. These provisions may discourage potential takeover attempts, discourage bids for our common stock at a premium over market price or adversely affect the market price of, and the voting and other rights of the holders of, our common stock. These provisions could also discourage proxy contests and make it more difficult for you and other shareholders to elect directors other than the candidates nominated by our Board.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Corporation owns two banking offices and an operations center in Union, South Carolina, one banking office in Winnsboro, South Carolina, two banking offices in Rock Hill, South Carolina and a banking office in each of Laurens, Jonesville and Simpsonville, South Carolina. The net book value of the Corporation's investment in premises and equipment totaled approximately \$5.4 million at December 31, 2009. See Note 5 of Notes to Consolidated Financial Statements. All property is in good condition and meets the operating needs of the Corporation.

Item 3. Legal Proceedings

Neither Provident Community Bancshares nor the Bank is engaged in any legal proceedings of a material nature at the present time. From time to time, the Bank is involved in routine legal proceedings occurring in the ordinary course of business wherein it enforces the Bank's security interest in mortgage loans the Bank has made.

Item 4. Submission of Matters to a Vote of Security Holders

Reserved

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Common Stock Information

Provident Community Bancshares, Inc.'s common stock is listed on the Nasdaq Capital Market under the symbol PCBS. As of March 1, 2010, there were 674 shareholders of record and 1,790,599 shares of common stock issued and outstanding.

The following table contains the range of high and low sales prices of Provident Community Bancshares' common stock as reported by the Nasdaq Global Market (prior to December 9, 2009) and by the Nasdaq Capital Market (beginning December 9, 2009) and per share dividend as declared during each quarter of the last two calendar years.

2009	High	Low	Dividend
Fourth Quarter	\$ 3.25	\$ 1.99	\$ -
Third Quarter	\$ 4.00	\$ 2.60	\$ -
Second Quarter	\$ 5.00	\$ 2.00	\$0.03
First Quarter	\$10.00	\$ 1.50	\$0.03
2008	High	Low	Dividend
Fourth Quarter	\$10.00	\$ 7.25	\$0.115
Third Quarter	\$11.77	\$ 6.44	\$0.115
Second Quarter	\$17.75	\$ 9.75	\$0.115
First Quarter	\$19.19	\$17.25	\$0.115

Provident Community Bancshares is subject to the requirements of Delaware law, which generally limits dividends to an amount equal to the excess of the net assets of Provident Community Bancshares (the amount by which total assets exceed total liabilities) over its statutory capital or, if there is no excess, to its net profits for the current year and the immediately preceding fiscal year. See Note 13 to the Consolidated Financial Statements for information regarding certain limitations imposed on the Bank's ability to pay cash dividends to the holding company.

As part of the Company's participation in the Capital Purchase Program of the U.S. Department of Treasury's Troubled Asset Relief Program, prior to the earlier of March 6, 2012 or the date on which the preferred stock issued in that transaction has been redeemed in full or the Treasury has transferred its shares to non-affiliates, the Company cannot increase its quarterly cash dividend above \$0.03 per share, without prior approval by the Treasury.

Purchases of Equity Securities By Issuer

In May 2005, the Corporation implemented a share repurchase program under which the Corporation may repurchase up to 5% of the outstanding shares or 98,000 shares. In August 2006, the program was expanded by an additional 5% or 92,000 shares. As of December 31, 2009, 37,120 shares remained available for repurchase under the plan. However, as part of the Company's participation in the Capital Purchase Program of the U.S. Department of Treasury's Troubled Asset Relief Program, prior to the earlier of March 6, 2012 or the date on which the preferred stock issued in that transaction has been redeemed in full or the Treasury has transferred its shares to non-affiliates, the Company cannot increase repurchase any shares of its common stock, without the prior approval of the Treasury. The Company did not repurchase any shares of its common stock in the fourth quarter of 2009.

Item 6. Selected Financial Data

	Years Ended December 31,				
	2009	2008	2007	2006	2005
Operations Data:					
Interest income	\$ 20,899	\$ 22,785	\$26,009	\$23,491	\$19,213
Interest expense	<u>(11,593)</u>	<u>(13,206)</u>	<u>(15,214)</u>	<u>(12,967)</u>	<u>(8,970)</u>
Net interest income	9,306	9,579	10,795	10,524	10,243
Provision for loan losses.....	<u>(8,695)</u>	<u>(4,210)</u>	<u>(1,066)</u>	<u>(470)</u>	<u>(869)</u>
Net interest income after provision					
for loan losses	611	5,369	9,729	10,054	9,374
Other income	34	3,684	3,162	2,876	2,543
Other expense	<u>(12,047)</u>	<u>(10,046)</u>	<u>(10,167)</u>	<u>(9,178)</u>	<u>(8,537)</u>
(Loss) income before income taxes	(11,402)	(993)	2,724	3,752	3,380
Income tax (benefit) expense.....	<u>(4,011)</u>	<u>(596)</u>	<u>(534)</u>	<u>(949)</u>	<u>(914)</u>
Net (loss) income.....	(7,391)	(397)	2,190	2,803	2,466
Preferred stock dividends and accretion.....	<u>382</u>	<u>=</u>	<u>=</u>	<u>=</u>	<u>=</u>
(Loss) income available to common shares...	<u><u>\$(7,773)</u></u>	<u><u>\$(397)</u></u>	<u><u>\$2,190</u></u>	<u><u>\$2,803</u></u>	<u><u>\$2,466</u></u>
Net (loss) income per common share					
(Basic).....	(\$4.34)	(\$0.22)	\$1.21	\$1.50	\$1.29
Net (loss) income per common share					
(Diluted)	(\$4.34)	(\$0.22)	\$1.19	\$1.48	\$1.26
Dividends paid per common stock	\$0.06	\$0.46	\$0.455	\$0.43	\$0.40
Weighted average number of					
common shares outstanding (Basic)	1,789,743	1,784,412	1,810,916	1,865,951	1,914,357
Weighted average number of common shares					
outstanding (Diluted).....	1,789,743	1,784,412	1,846,980	1,893,203	1,962,920

	At December 31,				
	2009	2008	2007	2006	2005
Financial Condition:	<i>(Dollars In Thousands)</i>				
Assets	\$457,003	\$434,218	\$407,641	\$387,630	\$371,042
Cash and due from banks	15,631	21,370	11,890	9,124	8,380
Securities	151,750	102,848	111,187	122,185	146,283
Loans (net)	250,420	278,665	256,487	231,886	192,577
Deposits.....	332,762	306,821	270,399	248,440	234,988
Advances from Federal Home Loan Bank					
Bank and other borrowings.....	64,500	69,500	69,500	70,000	75,715
Securities sold under agreement to repurchase	18,520	19,005	24,131	28,533	24,615
Floating rate junior subordinated deferrable interest debentures	12,372	12,372	12,372	12,372	8,247
Shareholders' equity.....	26,121	23,924	27,313	25,967	25,333

	Years Ended December 31,				
	2009	2008	2007	2006	2005
Other Selected Data:					
Average interest rate spread	2.13%	2.37%	2.70%	2.81%	2.87%
Net interest margin.....	2.20	2.51	2.91	3.01	3.02
Return on average assets	(1.61)	(0.10)	0.55	0.75	0.68
Return on average shareholders' equity ...	(28.89)	(1.46)	8.25	11.19	9.68
Operating expense to average assets	2.25	2.33	2.42	2.28	2.17
Ratio of average shareholders' equity to average assets.....	5.62	6.60	6.63	6.68	7.01

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Critical Accounting Policies

The Corporation has adopted various accounting policies that govern the application of accounting principles generally accepted in the United States of America in the preparation of financial statements. The significant accounting policies of the Corporation are described in the footnotes to the consolidated financial statements.

Certain accounting policies involve significant judgments and assumptions by management that could have a material impact on the carrying value of certain assets and liabilities. Management considers such accounting policies to be critical accounting policies. The judgments and assumptions used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and assumptions made by management, actual results could differ from these judgments and estimates, which could have a material impact on the carrying values of assets and liabilities and the results of operations of the Corporation.

The Corporation believes the allowance for loan losses is a critical accounting policy that requires significant judgments and estimates used in the preparation of consolidated financial statements. Management reviews the level of the allowance on a monthly basis and establishes the provision for loan losses based on the size and composition of the loan portfolio, overall portfolio quality, delinquency levels, a review of specific problem loans, loss experience, economic conditions, and other factors related to the collectability of the loan portfolio. A portion of the allowance is established by segregating the loans by residential mortgage, commercial and consumer loans and assigning allocation percentages based on historical loss experience and delinquency trends. The applied allocation percentages are reevaluated at least annually to ensure their relevance in the current economic

environment. Accordingly, increases in the size of the loan portfolio and the increased emphasis on commercial real estate and commercial business loans, which carry a higher degree of risk of default and, thus, a higher allocation percentage, increases the allowance. Additionally, a portion of the allowance is established based on the level of specific classified assets.

Although the Corporation believes that it uses the best information available to establish the allowance for loan losses, future additions to the allowance may be necessary based on estimates that are susceptible to change as a result of changes in economic conditions and other factors. In addition, the Office of the Comptroller of the Currency, as an integral part of its examination process, will periodically review the Corporation's allowance for loan losses. Such agency may require the Corporation to recognize adjustments to the allowance based on its judgments about information available to it at the time of its examination. See Notes 1 and 4 of the Notes to the Consolidated Financial Statements included in this annual report for a detailed description of the Corporation's estimation process and methodology related to allowance for loans losses.

Average Balances, Interest and Average Yields/Cost

The following table sets forth certain information for the periods indicated regarding: (1) average balances of assets and liabilities; (2) the total dollar amounts of interest income from average interest-earning assets and interest expense on average interest-bearing liabilities; and (3) average yields and costs. Such yields and costs for the periods indicated are derived by dividing income or expense by the average monthly balance of assets or liabilities, respectively, for the periods presented.

	Years Ended December 31,								
	2009			2008			2007		
	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost
	(Dollars in thousands)								
Interest-earning assets:									
Loans receivable, net (1)	\$274,662	\$14,230	5.18%	\$275,238	\$17,230	6.26%	\$240,192	\$19,048	7.93%
Mortgage-backed securities	73,619	3,616	4.91	50,255	2,710	5.39	30,059	1,492	4.96
Investment securities:									
Taxable	53,507	2,573	4.81	41,147	2,319	5.64	83,833	4,708	5.62
Nontaxable.....	9,285	430	4.63	9,991	471	4.71	12,906	603	4.67
Total investment securities.....	62,792	3,003	4.78	51,138	2,790	5.46	96,739	5,311	5.49
Deposits and federal funds sold	12,185	50	0.41	4,364	55	1.26	3,413	158	4.63
Total interest-earning assets.....	423,258	20,899	4.94	380,995	22,785	5.98	370,403	26,009	7.02
Non-interest-earning assets	36,941			31,509			29,752		
Total assets	<u>\$460,199</u>			<u>\$412,504</u>			<u>\$400,155</u>		
Interest-bearing liabilities:									
Savings accounts	13,508	69	0.51	12,888	83	0.64	14,486	111	0.77
Negotiable order of withdrawal accounts (2).....	117,381	2,385	2.03	83,966	2,147	2.55	74,326	2,426	3.26
Certificate accounts	185,452	5,541	2.99	164,077	6,729	4.10	155,490	7,295	4.69
FHLB advances and other borrowings	96,368	3,598	3.73	104,496	4,247	4.06	107,823	5,382	4.99
Total interest-bearing liabilities	412,709	11,593	2.81	365,427	13,206	3.61	352,125	15,214	4.32
Noninterest-bearing sources:									
Non-interest-bearing deposits	18,659			16,807			18,288		
Non-interest-bearing liabilities	3,249			3,026			3,007		
Total liabilities.....	434,617			385,260			373,420		
Shareholders' equity.....	25,582			27,244			26,735		
Total liabilities and shareholders' Equity	<u>\$460,199</u>			<u>\$412,504</u>			<u>\$400,155</u>		
Net interest income.....		<u>\$9,306</u>			<u>\$9,579</u>			<u>\$10,795</u>	
Interest rate spread (3).....			2.13%			2.37%			2.70%
Impact of noninterest-bearing sources			0.07			0.14			0.21
Net interest margin (4)			2.20%			2.51%			2.91%
Ratio of average interest-earning assets to average interest-bearing liabilities	1.03x			1.04x			1.05x		

- (1) Average loans receivable includes non-accruing loans. Interest income does not include interest on loans 90 days or more past due.
- (2) Average costs include the affects of non-interest bearing deposits.
- (3) Represents difference between weighted average yield on all interest-earning assets and weighted average rate on all interest-bearing liabilities.
- (4) Represents net interest income before provision for loan losses as a percentage of average interest-earning assets.

Rate/Volume Analysis

The following table sets forth certain information regarding changes in interest income and interest expense of the Corporation for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (1) changes in volume (changes in volume multiplied by prior rate) and (2) changes in rate (changes in rate multiplied by prior volume). The net change attributable to the combined impact of rate and volume has been allocated to rate and volume variances consistently on a proportionate basis.

	Years Ended December 31, 2009 vs. 2008		
	<u>Volume</u>	<u>Rate</u>	<u>Total</u>
	<u>(Dollars in Thousands)</u>		
Change in interest income:			
Loans.....	\$ (36)	\$(2,964)	\$(3,000)
Mortgage-backed securities	1,260	(354)	906
Investment securities (1)	<u>998</u>	<u>(790)</u>	<u>208</u>
Total interest income.....	<u>2,222</u>	<u>(4,108)</u>	<u>(1,886)</u>
Change in interest expense:			
Deposits	1,847	(2,811)	(964)
Borrowings and other.....	<u>(330)</u>	<u>(319)</u>	<u>(649)</u>
Total interest expense	<u>1,517</u>	<u>(3,130)</u>	<u>(1,613)</u>
Change in net interest income....	<u>\$ 705</u>	<u>\$ (978)</u>	<u>\$ (273)</u>

(1) Includes fed funds and overnight deposits.

Results of Operations

Comparison of Years Ended December 31, 2009 and December 31, 2008

The Corporation recorded a net loss to common shareholders for year ended December 31, 2009 of approximately \$7.8 million compared to net loss of approximately \$397,000 for the year ended December 31, 2008. Net loss to common shareholders per share was (\$4.34) per share (basic and diluted) for the year ended December 31, 2009 compared to (\$0.22) per share (basic and diluted) for the year ended December 31, 2008. Net interest income before the loan loss provision for the year ended December 31, 2009 decreased \$273,000, or 2.8%, to \$9.3 million compared to \$9.6 million for the previous year. The decrease was due primarily to a compression of the net interest margin caused by declining interest rates. The increase in the net loss was due primarily to an increase in the provision for loan losses due to an increase in non-performing loans, classified loans and charge-offs, a decrease in non-interest income due to an other than temporary impairment charge and an increase in non-interest expense due to goodwill impairment charges.

Interest Income. Total interest income decreased \$1.9 million, or 8.3%, from \$22.8 million for the year ended December 31, 2008 to \$20.9 million for the year ended December 31, 2009. Interest income on loans decreased \$3.0 million, or 17.4%, from \$17.2 million for 2008 to \$14.2 million for 2009 due primarily to declining market rates. Interest income on deposits, federal funds sold and investment securities increased \$1.1 million, or 20.1%, from \$5.6 million for 2008 to \$6.7 million for 2009. The increase was due primarily to higher average balances, partially offset by lower investment yields due to declining market interest rates.

Interest Expense. Interest expense decreased 12.2% to \$11.6 million for 2009 from \$13.2 million for 2008. Interest expense decreased \$964,000 for deposits and decreased \$649,000 for other borrowings and floating rate junior subordinated deferrable interest debentures. Interest expense for deposits decreased due primarily to lower market interest rates and a shift in the composition of the deposit portfolio from certificates of deposits to transaction accounts, offset by higher average balances. Interest expense on other borrowings decreased due to lower market interest rates and lower average balances.

Provision for Loan Loss. We have developed policies and procedures for evaluating the overall quality of our credit portfolio and the timely identification of potential problem credits. The Board of Directors reviews and approves the appropriate level for our allowance for loan losses quarterly based upon management's recommendations, the results of the internal monitoring and reporting system, quarterly external independent loan reviews and the analysis of economic conditions in our local markets. Additions to the allowance for loan losses, which are expensed as the provision for loan losses on our income statement, are periodically made to maintain the allowance at an appropriate level based on our analysis of the potential risk in the loan portfolio. Loan losses, which include write downs and charge offs are charged directly to the allowance while recoveries are credited against the allowance. The amount of the provision is a function of the size and composition of loans outstanding, the level of non-performing loans, historical loan loss experience, the amount of loan losses actually charged against the reserve during the given period, and current and anticipated economic conditions.

Our allowance for loan losses is based upon judgments and assumption of risk elements in the portfolio, future economic conditions and other factors affecting borrowers. The process includes identification and analysis of loss potential in various portfolio segments utilizing a credit risk grading process and specific reviews and evaluations of significant problem credits. In addition, we monitor overall portfolio quality through observable trends in delinquencies, charge-offs, and general and economic conditions in the market area. The adequacy of the allowance for loan losses and the effectiveness of our monitoring and analysis system are also reviewed periodically by the banking regulators, which may require that we increase the allowance for loan losses. Risks are inherent in making all loans, including risks with respect to the period of time over which loans may be repaid, risks resulting from changes in economic and industry conditions, risks inherent in dealing with individual borrowers, and, in the case of a collateralized loan, risks resulting from uncertainties about the future value of the collateral.

Our judgment about the adequacy of the allowance is based upon a number of assumptions about future events, which we believe to be reasonable, but which may not prove to be accurate. Thus, charge-offs in future periods could exceed the allowance for loan losses, or substantial additional increases in the allowance for loan losses could be required. Additions to the allowance for loan losses would result in a decrease of our net income and our capital. Based on present information, we believe the allowance for loan losses is adequate at December 31, 2009 to meet presently known and inherent risks in the loan portfolio. See "Item 1-Business Lending Activities-Allowance for Loan Losses" for more information on the determination of the allowance for loan losses.

The provision for loan losses increased from \$4.2 million for 2008 to \$8.7 million for 2009 primarily due to: (1) an increase in non-performing and classified assets and (2) an increase in charge-offs. The allowance for loan losses decreased \$1.2 million to \$5.6 million as of December 31, 2009 compared to \$6.8 million as of December 31, 2008 due primarily to the significant increase in loans charged off of \$8.9 million for 2009 compared to 2008. Non-performing assets increased \$10.1 million from \$16.7 million at December 31, 2008 to \$26.8 million at December 31, 2009. The majority of this increase relates primarily to acquisition and development real estate relationships that have been affected by the downturn in the residential housing market. Slow housing conditions have affected these borrowers's ability to sell the completed projects in a timely manner. Management continues to evaluate and assess all non-performing assets on a regular basis as part of its well-established loan monitoring and review process. At December 31, 2009, criticized and classified loans, including non-performing loans, totaled \$51.4 million, compared to \$40.9 million at September 30, 2009 and \$32.6 million at December 31, 2008. The majority of this increase relates primarily to commercial real estate relationships that have been affected by the current economic downturn. Management has sought to provide an amount estimated to be necessary to maintain an allowance for loan losses that is adequate to cover the level of loss that management believed to be inherent in the portfolio as a whole, taking into account the Corporation's experience, economic conditions and information about borrowers available at the time of the analysis. However, if expectations regarding economic conditions in the Corporation's market areas is worse

than currently anticipated, especially its effect on real estate related activities and real property values, further additions in provisions for loan losses could be needed in the future.

The Corporation experienced loan charge-offs, net of recoveries, of approximately \$9.9 million for 2009 compared to \$776,000 for 2008. The loan charge-offs for 2009 related primarily to write-downs required in the disposition of commercial loans. The allowance for loan losses to total loans at December 31, 2009 was 2.18% compared to 2.36% at December 31, 2008. The allowance for loan losses to non-performing loans at December 31, 2009 was 26.7% compared to 40.6% at December 31, 2008.

Our non-performing loans totaled \$20.9 million at December 31, 2009 compared to \$16.0 million at December 30, 2008. Nonperforming loans totaled \$21.0 million at June 30, 2009 and \$16.6 million at March 31, 2009. While management uses the best information available to establish the allowance for loan losses, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the valuations. Such adjustments would be made in the relevant period and may be material to the financial statements.

Non-Interest Income
(Dollars in thousands)

	Year ended December 31				
	2009		2008		2007
	Amount	% Change	Amount	% Change	Amount
Net gain on sale of investments	\$ 775	55.62%	\$ 498	758.62%	\$ 58
Fees for financial services	2,932	(4.95)	3,085	2.42	3,012
Other-than-temporary-impairment write-down on securities	(3,756)	100.00	--	--	--
Other fees, net	<u>83</u>	<u>(17.82)</u>	<u>101</u>	<u>12.22</u>	<u>90</u>
Total non-interest income	<u>\$ 34</u>	<u>(99.08)</u>	<u>\$ 3,684</u>	<u>16.51</u>	<u>\$ 3,162</u>

The decrease in non-interest income was due primarily to an other-than-temporary impairment charge of \$3.8 million from write-downs recorded on pooled trust preferred securities as a result of projected shortfalls of interest and principal payments in the cash flow analysis of the securities. Fees for financial services decreased primarily due to lower fees from a reduction in loan volumes along with lower fees generated from third party investment brokerage and financing receivables programs as a result of lower product volumes. Gains on sale of investments were \$775,000 for 2009 as the Corporation sold \$40.0 million in investment securities to improve yield.

Non-Interest Expense
(Dollars in thousands)

	Year ended December 31				
	2009		2008		2007
	Amount	% Change	Amount	% Change	Amount
Compensation and employee benefits	\$ 4,512	(8.77)%	\$ 4,946	(0.08)%	\$ 4,950
Occupancy and equipment.....	2,685	8.44	2,476	(2.06)	2,528
Deposit insurance premiums	871	771.00	100	233.33	30
Professional services	371	3.34	359	(22.13)	461
Advertising and public relations.....	85	(61.54)	221	(11.60)	250
Loan operations	555	198.38	186	24.00	150
Telephone	192	1.05	190	0.00	190
Items processing	338	30.50	259	17.19	221
Intangible amortization.....	324	(22.12)	416	(13.33)	480
Impairment of intangible assets	1,349	100.00	--	--	--
Other.....	<u>765</u>	<u>(14.33)</u>	<u>893</u>	<u>(1.54)</u>	<u>907</u>
Total non-interest expense	<u>\$ 12,047</u>	<u>19.92</u>	<u>\$ 10,046</u>	<u>(1.19)</u>	<u>\$ 10,167</u>

Compensation and employee benefits decreased 8.8%, or \$434,000, compared to the year ended December 31, 2008 due primarily to reductions in accrued incentive compensation expense and reductions in employee pension benefit costs. Occupancy and equipment expenses increased 8.4%, or \$209,000, due primarily to additional expense from outsourcing the staffing function for information technology and higher ATM expense due to increased fees and usage. Deposit insurance premiums expense increased \$771,000, or 771.0%, to \$871,000 for 2009 from \$100,000 for 2008, due to higher FDIC premium assessments as a result of a one-time assessment credit under the Federal Insurance Reform Act becoming fully utilized in 2008, a special assessment that was charged to all federally insured banks and higher balances of deposits and higher assessment rates. Professional services expense increased 3.3%, or \$12,000, due primarily to higher legal and consultant expenses. Advertising and public relations expense decreased 61.5%, or \$136,000, from the year ended December 31, 2008 to the year ended December 31, 2009 due primarily to lower product and promotion expenses. Loan operations costs increased \$369,000, or 198.4%, to \$555,000 for the year ended December 31, 2009 from \$186,000 for the year ended December 31, 2008, due to higher disposition costs associated with foreclosed real estate properties. Intangible amortization expense decreased \$92,000, or 22.1%, to \$324,000 for the year ended December 31, 2009 from \$416,000 for 2008, due to deposit premiums related to branch acquisitions becoming fully amortized. Impairment of intangible assets was \$1.3 million for the year ended December 31, 2009 due to the charge-off of all remaining goodwill and deposit premium amortization related to a previous acquisition as a result of the decrease in the Corporation's market capitalization. Items processing expense increased \$79,000, or 30.5%, to \$338,000 for the year ended December 31, 2009 from \$259,000 for the year ended December 31, 2008 due to an increase in transaction accounts. Other operating expense decreased 14.3%, or \$128,000, for the year ended December 31, 2009 compared to the year ended December 31, 2008 due primarily to lower loan expense due to reduced loan volumes and reductions in courier expense as a result of the installation of branch capture collection systems.

Goodwill is reviewed for potential impairment at least annually at the reporting unit level. The Corporation performs its impairment testing in the fourth quarter of each year and more frequently if circumstances exist that indicate a probable reduction in the fair value below carrying value. An impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. Other intangible assets are evaluated for impairment if events and circumstances indicate a possible impairment. Such evaluation of other intangible assets is based on undiscounted cash flow projections. Impairment charges of \$192,000 were recorded related to a deposit premium impairment.

In performing the first step ("Step 1") of the goodwill impairment testing and measurement process to identify possible impairment, the estimated fair value was developed using a market valuation approach that utilizes the current stock price as the primary indicator of fair market value. The results of this Step 1 process indicated that the estimated fair value was less than book value, thus requiring the Corporation to perform the second step ("Step 2") of the goodwill impairment test. Based on the Step 2 analysis, it was determined that the implied fair value of goodwill was \$0 as of December 31, 2009, which resulted in a goodwill impairment charge of \$1,157,000 for the year ended December 31, 2008 that was recorded as a component of noninterest expense on the consolidated statement of operations.

The primary factor in the determination of goodwill impairment in 2009 was the Corporation's relatively low stock price and resulting market valuation. The Corporation's stock price has been trading below its book value throughout 2009. Management attributes its relatively low stock price to both financial services industry-wide and Corporation specific factors primarily related to credit quality issues. The goodwill impairment charge is non-cash expense, and since goodwill is a non interest earning asset, this charge will not impact the Corporation's future operating performance.

Income Tax Expense. Due to the net loss that the Corporation recorded for the year ended December 31, 2009, the net income tax benefit was \$4.0 million compared to a net income tax benefit of \$596,000 for the year ended December 31, 2008.

Financial Condition, Liquidity and Capital Resources

Financial Condition

Assets. At December 31, 2009, the Corporation's assets totaled \$457.0 million, an increase of \$22.8 million, or 5.3%, as compared to \$434.2 million at December 31, 2008. Cash and cash equivalents decreased \$5.7 million to \$15.6 million from \$21.4 million at December 31, 2008. The decrease was due primarily to a decrease in overnight deposits as those funds were used to purchase investment securities. Investment and mortgage-backed securities increased \$48.9 million to \$151.8 million from \$102.8 million at December 31, 2008 due to the purchase of agency and mortgage-backed securities that were funded primarily with deposit growth.

Total loans, net, decreased \$28.3 million, or 10.1%, to \$250.4 million at December 31, 2009 from \$278.7 million at December 31, 2008. The decrease was due to a significant reduction in loan demand as a result of economic conditions currently present in South Carolina. Consumer loans decreased \$4.7 million, or 8.3%, during 2009, commercial loans decreased \$20.2 million, or 9.9%, and residential mortgage loans decreased \$6.3 million or 24.1%.

Real estate acquired through foreclosure increased \$5.2 million to \$5.9 million at December 31, 2009 from \$667,000 at December 31, 2008, as a result of foreclosure on commercial real estate properties. Approximately 88%, or \$4.8 million of the increase was due to the foreclosure of two commercial real estate projects where the collateral values are supported by residential housing and undeveloped land. The properties are being actively marketed and maintained with the primary objective of liquidating the collateral at a level which most accurately approximates fair market value and allows recovery of as much of the unpaid balance as possible. The carrying value of these assets are believed to be representative of their fair market value, although there can be no assurance that the ultimate proceeds from the sale of these assets will be equal to or greater than the carrying values.

Intangible assets decreased \$2.8 million to \$0 at December 31, 2009 compared to \$2.8 million at December 31, 2008 as a result of the charge-off of goodwill and deposit premiums related to a previous acquisition that resulted from the significant decrease in the Corporation's market capitalization. Other assets increased \$5.7 million, or 98.3%, to \$11.5 million at December 31, 2009 from \$5.8 million at December 31, 2008 due primarily to an increase in deferred income taxes as a result of the \$7.4 million net loss in 2009 compared to the \$397,000 net loss for 2008. In addition, other assets include a prepaid expense for \$2.2 million where the FDIC required all banks to prepay their assessment premiums for a three year period.

Liabilities. Total liabilities increased \$20.6 million, or 5.0%, to \$430.9 million at December 31, 2009 from \$410.3 million at December 31, 2008. Total deposits increased \$25.9 million, or 8.4%, from \$306.8 million at December 31, 2008 to \$332.8 million at December 31, 2009. Time deposits decreased \$16.5 million, or 8.7%, from \$187.1 million at December 31, 2008 to \$170.8 million at December 31, 2009 while transaction deposit accounts increased \$42.2 million, or 35.2%, from \$119.8 million at December 31, 2008 to \$161.9 million at December 31, 2009. The increase in transaction accounts was due primarily to a special account promotion. The Corporation continues to target lower cost demand deposit accounts versus traditional higher cost certificates of deposits. The increase in deposits was utilized to fund the growth in investment securities and to pay down borrowings for the year.

Shareholders' Equity. On March 13, 2009, the Corporation sold \$9.3 million in preferred shares and warrants to purchase 178,880 shares of common stock, \$0.01 par value, at an exercise price of \$7.77 per share to the United States Department of Treasury pursuant to the federal government's Troubled Asset Relief Program Capital Purchase Program. Shareholders' equity increased \$2.2 million, or 9.2%, to \$26.1 million at December 31, 2009 from \$23.9 million at December 31, 2008 due to a net loss of \$7.4 million, common stock dividend payments of \$0.06 per share at a cost of \$107,000 and preferred stock dividend payments of \$310,000 offset by the preferred stock issuance and a \$724,000 decrease in unrealized losses on securities available for sale. At December 31, 2009, all of the Bank's capital ratios continued to be sufficient to classify it as a well-capitalized institution by regulatory measures.

Liquidity

Liquidity is the ability to meet demand for loan disbursements, deposit withdrawals, repayment of debt, payment of interest on deposits and other operating expenses. The primary sources of liquidity are deposits, loan sales and repayments, borrowings, maturities, prepayment and sales of securities and interest payments.

While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit outflows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition. The primary investing activities of the Corporation are the origination of commercial and consumer loans and the purchase of investment and mortgage-backed securities. These activities are funded primarily by principal and interest payments on loans and investment securities, deposit growth, securities sold under agreements to repurchase, and the utilization of FHLB advances. During 2009, the Corporation originated \$30.7 million in loans and purchased \$3.4 million in loan participations. At December 31, 2009, the Corporation's holdings of investment and mortgage-backed securities totaled \$151.7 million, \$147.8 million of which was available for sale. Approximately \$94.6 million and \$80.6 million of investment securities at December 31, 2009 and December 31, 2008, respectively, were pledged as collateral to secure deposits of the State of South Carolina, and Union, Laurens and York counties along with additional borrowings and repurchase agreements.

During 2009, total deposits increased \$25.9 million. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by the Corporation and its local competitors and other factors. The Corporation closely monitors its liquidity position on a daily basis. Certificates of deposit, which are scheduled to mature in one year or less from December 31, 2009, totaled \$119.7 million. The Corporation relies primarily on competitive rates, customer service, and long-standing relationships with customers to retain deposits. From time to time, the Corporation will also offer competitive special products to its customers to increase retention and to attract new deposits. Based upon the Corporation's experience with deposit retention and current retention strategies, management believes that, although it is not possible to predict future terms and conditions upon renewal, a significant portion of such deposits will remain with the Corporation. If the Corporation requires funds beyond its ability to generate them internally, additional external sources of funds are available through FHLB advances, lines of credit and wholesale deposits. At December 31, 2009, the Corporation had outstanding \$64.5 million of FHLB borrowings and \$18.5 million of securities sold under agreements to repurchase. At December 31, 2009, the Corporation had unused short-term secured lines of credit to purchase federal funds from unrelated banks totaling \$4.0 million and the ability to borrow an additional \$54.0 million from secured borrowing lines. Lines of credit are available on a one-to-ten day basis for general purposes of the Corporation. All of the lenders have reserved the right to withdraw these lines at their option.

See Note 17 to the Consolidated Financial Statements for further information about commitments and contingencies.

Parent Company Liquidity

Provident Community Bancshares, Inc. is a separate legal entity from the Bank and must provide for its own liquidity. In addition to its operating expenses, Provident Community Bancshares is responsible for paying any dividends declared to its shareholders and paying the obligations on its outstanding debentures and preferred stock. The Corporation paid cash dividends per common shareholder of \$0.06 per share for 2009 compared to \$0.46 per share for 2008. The payment of cash dividends for common shares was suspended after the first quarter of 2009 in order to retain capital and it is unknown at this time when or if the program will resume. Provident Community Bancshares' primary sources of income are proceeds that it retained from its offering of preferred stock and dividends received from the Bank. The amount of dividends that the Bank may declare and pay to Provident Community Bancshares in any calendar year, without the receipt of prior approval from the Office of the Comptroller of the Currency cannot exceed retained net income for that year combined with retained net income for two years less any transfers to surplus and capital distributions. At December 31, 2009, Provident Community Bancshares, Inc. had liquid assets of \$1.6 million.

Capital Resources

At December 31, 2009, the Bank exceeded the OCC's and the FRB's capital requirements. See Note 19 to the Consolidated Financial Statements for further discussion of these capital requirements.

Off-Balance Sheet Arrangements

In the normal course of operations, the Corporation engages in a variety of financial transactions that, in accordance with generally accepted accounting principles are not recorded in its financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customer's requests for funding and take the form of legally binding agreements to lend money to customers at predetermined interest rates for a specified period of time. Outstanding loan commitments (including commitments to fund credit lines) totaled \$40.1 million at December 31, 2009. Management of the Corporation anticipates that it will have sufficient funds available to meet its current loan commitments. Each customer's credit worthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on the credit evaluation of the borrower. Collateral varies but may include accounts receivable, inventory, property, plant and equipment, commercial and residential real estate. The credit risk on these commitments is managed by subjecting each customer to normal underwriting and risk management processes.

At December 31, 2009, the undisbursed portion of construction loans was \$320,000 and the unused portion of credit lines was \$38.3 million. Funding for these commitments is expected to be provided from deposits, loan and mortgage-backed securities principal repayments, maturing investments and income generated from operations.

For the year ended December 31, 2009, the Corporation did not engage in any off-balance sheet transactions reasonably likely to have a material effect on its financial condition, results of operation and cash flows.

Impact of Inflation and Changing Prices

The financial statements and related data presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America, which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation. Unlike industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. However, non-interest expenses do reflect general levels of inflation.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not applicable as issuer is a smaller reporting company.

Item 8. Financial Statements and Supplementary Data

Management's Report on Internal Control Over Financial Reporting

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The internal control process has been designed under our supervision to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external reporting purposes in accordance with accounting principles generally accepted in the United States of America.

Management conducted an assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2009, utilizing the framework established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has determined that the Company's internal control over financial reporting as of December 31, 2009 is effective.

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that accurately and fairly reflect, in reasonable detail, transactions and dispositions of assets; and provide reasonable assurances that: (1) transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States; (2) receipts and expenditures are being made only in accordance with authorizations of management and the directors of the Company; and (3) unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the Company's financial statements are prevented or timely detected.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.



REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
Provident Community Bancshares, Inc.
Rock Hill, South Carolina

We have audited the accompanying consolidated balance sheets of Provident Community Bancshares, Inc. and Subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income (loss), stockholders' equity and comprehensive income (loss), and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Provident Community Bancshares, Inc. and Subsidiaries as of December 31, 2009 and 2008, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

We were not engaged to examine management's assertion about the effectiveness of Provident Community Bancshares, Inc. and Subsidiaries' internal control over financial reporting as of December 31, 2009 included in the accompanying Management's Report on Internal Control over Financial Reporting, and accordingly, we do not express an opinion thereon.

Elliott Davis, LLC

Elliott Davis, LLC
Columbia, South Carolina
March 3, 2010

Elliott Davis LLC, 1901 Main Street Suite 1650, P.O. Box 2227, Columbia, SC 29202-2227
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PROVIDENT COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	As of December 31,	
	2009	2008
	<i>(In Thousands)</i>	
<u>Assets</u>		
Cash and due from banks	\$ 10,344	\$ 8,424
Federal Funds sold.....	5,287	12,946
Investments and mortgage-backed securities		
Held to maturity (fair value of \$3,976,000 and \$2,310,000 at December 31, 2009 and 2008)	3,934	2,430
Available for sale.....	<u>147,816</u>	<u>100,418</u>
Total investments and mortgage-backed securities	<u>151,750</u>	<u>102,848</u>
Loans, net of allowance for loan losses of \$5,579,000 in 2009 and \$6,778,000 in 2008.....	250,420	278,665
Real estate acquired through foreclosure.....	5,917	667
Federal Home Loan Bank stock, at cost.....	3,947	3,929
Federal Reserve Bank stock, at cost.....	832	599
Office properties and equipment, net	5,447	5,837
Accrued interest receivable	2,238	2,087
Intangible assets.....	-	2,845
Cash surrender value of life insurance	9,332	9,577
Other assets.....	<u>11,489</u>	<u>5,794</u>
Total assets	<u>\$457,003</u>	<u>\$434,218</u>
<u>Liabilities</u>		
Deposits.....	\$332,762	\$306,821
Advances from the Federal Home Loan Bank	64,500	69,500
Securities sold under agreements to repurchase	18,520	19,005
Floating rate junior subordinated deferrable interest debentures	12,372	12,372
Accrued interest payable	581	701
Other liabilities.....	<u>2,147</u>	<u>1,895</u>
Total liabilities.....	<u>430,882</u>	<u>410,294</u>
Commitments and contingencies – Notes 13 and 17		
<u>Shareholders' equity</u>		
Serial preferred stock, no par value, authorized – 500,000 shares, issued and outstanding – 9,266 shares at December 31, 2009 and none at December 31, 2008.....	9,245	-
Common stock – \$0.01 par value, authorized – 5,000,000 shares issued and outstanding – 1,790,599 shares at December 31, 2009 and 1,787,092 shares at December 31, 2008.....	20	20
Common stock warrants	25	-
Additional paid-in capital	12,919	12,903
Accumulated other comprehensive loss	(972)	(1,696)
Retained earnings, substantially restricted	11,184	18,997
Treasury stock, at cost	<u>(6,300)</u>	<u>(6,300)</u>
Total shareholders' equity	<u>26,121</u>	<u>23,924</u>
Total liabilities and shareholders' equity.....	<u>\$457,003</u>	<u>\$434,218</u>

See Notes to Consolidated Financial Statements.

PROVIDENT COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (LOSS)

	Years Ended December 31,	
	2009	2008
	<i>(In Thousands, Except Share Data)</i>	
Interest Income:		
Loans	\$ 14,230	\$ 17,230
Deposits and federal funds sold	50	55
Securities available for sale:		
State and municipal (non taxable)	286	352
Other investments (taxable)	6,116	4,842
Securities held to maturity and FHLB/FRB stock dividends	<u>217</u>	<u>306</u>
Total interest income	<u>20,899</u>	<u>22,785</u>
Interest Expense:		
Deposit accounts	7,995	8,959
Floating rate junior subordinated deferrable Interest debentures	530	721
Advances from the FHLB and other borrowings.....	<u>3,068</u>	<u>3,526</u>
Total interest expense	<u>11,593</u>	<u>13,206</u>
Net Interest Income	9,306	9,579
Provision for loan losses	<u>8,695</u>	<u>4,210</u>
Net interest income after provision for loan losses	<u>611</u>	<u>5,369</u>
Non-Interest income:		
Fees for financial services	2,932	3,085
Other fees, net.....	83	101
Other-than-temporary-impairment write-down on securities	(3,756)	--
Net gain on sale of investments	<u>775</u>	<u>498</u>
Total non-interest income	<u>34</u>	<u>3,684</u>
Non-Interest Expense:		
Compensation and employee benefits	4,512	4,946
Occupancy and equipment.....	2,685	2,476
Deposit insurance premiums.....	871	100
Professional services.....	371	359
Advertising and public relations	85	221
Loan operations	555	186
Telephone	192	190
Items processing	338	259
Intangible amortization	324	416
Impairment of intangible assets	1,349	--
Other	<u>765</u>	<u>893</u>
Total non-interest expense.....	<u>12,047</u>	<u>10,046</u>
Loss before income taxes	(11,402)	(993)
Benefit for income taxes.....	<u>(4,011)</u>	<u>(596)</u>
Net loss	\$(7,391)	\$(397)
Accretion of preferred stock to redemption value and preferred dividends	<u>382</u>	<u>—</u>
Net to common shareholders	<u>\$(7,773)</u>	<u>\$(397)</u>
Net loss per common share (basic).....	<u>\$(4.34)</u>	<u>\$(0.22)</u>
Net loss per common share (diluted).....	<u>\$(4.34)</u>	<u>\$(0.22)</u>
Cash dividends per common share	<u>\$0.06</u>	<u>\$0.46</u>
Weighted average number of common shares outstanding (basic).....	<u>1,789,743</u>	<u>1,784,412</u>
Weighted average number of common shares outstanding (diluted).....	<u>1,789,743</u>	<u>1,784,412</u>

See Notes to Consolidated Financial Statements.

PROVIDENT COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)
TWELVE MONTHS ENDED DECEMBER 31, 2009 AND 2008

	Preferred Stock		Common Stock		Warrants	Additional Paid-In Capital	Retained Earnings, Substantially Restricted	Accumulated Other Comprehensive Income (loss)	Treasury Stock At Cost	Total Shareholder's Equity
	Shares	Amount	Shares	Amount						
	<i>(Dollars in Thousands, Except Share Data)</i>									
Balance at December 31, 2007.....			<u>1,794,866</u>	<u>\$20</u>		<u>\$12,781</u>	<u>\$20,276</u>	<u>\$191</u>	<u>(\$5,955)</u>	<u>\$27,313</u>
Net Income (loss).....	--	--	--	--	--	--	(397)	--	--	(397)
Other comprehensive loss, net of tax on unrealized holding gains arising during period.....	--	--	--	--	--	--	--	(2,173)	--	(2,173)
Less reclassification adjustment for gains included in net income.....	--	--	--	--	--	--	--	286	--	<u>286</u>
Comprehensive loss.....	--	--	--	--	--	--	--	--	--	(2,284)
Stock option activity, net.....	--	--	1,424	--	--	2	--	--	--	2
Dividend plan contributions.....	--	--	10,508	--	--	120	--	--	--	120
Cumulative effect of change in accounting principal.....	--	--	--	--	--	--	(60)	--	--	(60)
Share repurchase program.....	--	--	(19,706)	--	--	--	--	--	(345)	(345)
Cash dividend (\$0.46 per share).....	--	--	--	--	--	--	(822)	--	--	(822)
Balance at December 31, 2008.....	<u>--</u>	<u>--</u>	<u>1,787,092</u>	<u>\$20</u>	<u>--</u>	<u>\$12,903</u>	<u>\$18,997</u>	<u>\$(1,696)</u>	<u>\$(6,300)</u>	<u>\$23,924</u>
Net Income (loss).....	--	--	--	--	--	--	(7,391)	--	--	(7,391)
Other comprehensive loss, net of tax on unrealized holding gains arising during period.....	--	--	--	--	--	--	--	2,572	--	2,572
Less reclassification adjustment for gains and other than temporary investment charge in net loss.....	--	--	--	--	--	--	--	(1,848)	--	(1,848)
Comprehensive loss.....	--	--	--	--	--	--	--	--	--	(6,667)
Dividend plan contributions.....	--	--	3,507	--	--	16	--	--	--	16
Issuance of preferred stock, net.....	9,266	9,240	--	--	--	--	--	--	--	9,240
Issuance of common stock warrants.....	--	--	--	--	25	--	--	--	--	25
Accretion of preferred stock to redemption value.....	--	5	--	--	--	--	(5)	--	--	-
Preferred stock dividend.....	--	--	--	--	--	--	(310)	--	--	(310)
Cash dividend (\$0.06 per share).....	--	--	--	--	--	--	(107)	--	--	(107)
Balance at December 31, 2009.....	<u>9,266</u>	<u>\$9,245</u>	<u>1,790,599</u>	<u>\$20</u>	<u>\$25</u>	<u>\$12,919</u>	<u>\$11,184</u>	<u>\$(972)</u>	<u>\$(6,300)</u>	<u>\$26,121</u>

See Notes to Consolidated Financial Statements.

PROVIDENT COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended	
	December 31,	
	2009	2008
	<i>(In Thousands)</i>	
Operating activities:		
Net loss	\$(7,391)	\$(397)
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Provision for loan losses.....	8,695	4,210
Amortization expense.....	324	523
Depreciation expense.....	534	652
Recognition of deferred income, net of costs	(325)	(515)
Deferral of fee income, net of costs.....	255	435
Other than temporary impairment charge on AFS securities.....	3,756	–
Impairment of intangible assets	1,349	–
Gain on investments	(775)	(498)
(Increase) decrease in accrued interest receivable.....	(151)	538
Loss on sale of assets acquired from foreclosed loans	(2)	(28)
Increase in bank owned life insurance.....	(400)	(402)
Increase in other assets	(4,523)	(594)
Decrease in accrued interest payable.....	(120)	(41)
Increase (decrease) in other liabilities	<u>253</u>	<u>(1,290)</u>
Net cash provided by operating activities.....	<u>1,479</u>	<u>2,593</u>
Investing activities:		
Purchase of investment and mortgage-backed securities:		
Available for sale	(161,315)	(74,450)
Held to maturity	(1,504)	–
Proceeds from maturity of investment and mortgage-backed securities:		
Available for sale	41,736	34,650
Held to maturity	250	696
Proceeds from sale of investment and mortgage-backed securities:		
Available for sale	39,987	37,040
Principal repayments on mortgage-backed securities		
Available for sale	29,618	7,394
Net decrease (increase) in loans.....	14,372	(28,063)
Purchase of FHLB/FRB stock.....	(251)	(103)
Proceeds from redemption of life insurance	644	–
Proceeds from sales of foreclosed assets, net of costs and improvements	69	875
Purchase of office properties and equipment	(144)	(1,344)
Net cash used in investing activities	<u>(36,538)</u>	<u>(23,305)</u>
Financing activities:		
Proceeds from the exercise of stock options.....	–	2
Proceeds from dividend reinvestment plan	16	120
Proceeds from the issuance of preferred stock, net.....	9,240	–
Proceeds from the issuance of warrants	25	–
Dividends paid in cash	(107)	(821)
Dividends paid on preferred stock	(310)	–
Split dollar post retirement liability recapitalization	–	(60)
Repayment of term borrowings, net.....	(5,485)	(5,126)
Share repurchase program.....	–	(345)
Increase in deposit accounts.....	<u>25,941</u>	<u>36,422</u>
Net cash provided by financing activities	<u>29,320</u>	<u>30,192</u>
Net increase (decrease) in cash and due from banks.....	(5,739)	9,480
Cash and cash equivalents at beginning of period	<u>21,370</u>	<u>11,890</u>
Cash and cash equivalents at end of period	<u>\$15,631</u>	<u>\$21,370</u>

See Notes to Consolidated Financial Statements

PROVIDENT COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Organization - Provident Community Bancshares, Inc. (“Provident Community Bancshares”) is the bank holding company for Provident Community Bank, N.A., a national bank (the “Bank”). Provident Community Bancshares and the Bank are collectively referred to as the Corporation in this annual report. The Bank, founded in 1934, offers a complete array of financial products and services through nine full-service banking centers in five counties in South Carolina, including checking, savings, time deposits, individual retirement accounts (IRAs), investment services, and secured and unsecured consumer loans. The Bank originates and services home loans and provides financing for small businesses and affordable housing.

Estimates - The accounting and reporting policies of the Corporation conform to accounting principles generally accepted in the United States of America and to general practice within the banking industry. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of commitments and contingencies. Actual results could differ from those estimates. The following summarizes the more significant policies.

Basis of Consolidation - The accompanying consolidated financial statements include the accounts of Provident Community Bancshares and the Bank. All inter-company amounts and balances have been eliminated in consolidation.

Disclosure Regarding Segments - The Corporation reports as one operating segment, as the chief operating decision-maker reviews the results of operations of the Corporation as a single enterprise.

Advertising - Advertising, promotional, and other business development costs are generally expensed as incurred. External costs incurred in producing media advertising are expensed the first time the advertising takes place. External costs relating to direct mailing costs are expensed in the period in which the direct mailings are sent.

Cash and cash equivalents - Cash and cash equivalents include cash on hand and amounts due from depository institutions, federal funds sold and short term, interest-earning deposits. From time to time, the Corporation’s cash deposits with other financial institutions may exceed the FDIC insurance limits.

Investments and Mortgage-backed Securities - The Corporation accounts for investment securities in accordance with FASB ASC Topic 320: Investments in Debt and Equity Securities. In accordance with FASB ASC Topic 320, debt securities that the Corporation has the positive intent and ability to hold to maturity are classified as “held to maturity” securities and reported at amortized cost. Debt and equity securities that are bought and held principally for the purpose of selling in the near term are classified as “trading” securities and reported at fair value, with unrealized gains and losses included in earnings. Debt and equity securities not classified as either held to maturity or trading securities are classified as “available for sale” securities and reported at fair value with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders’ equity. No securities have been classified as trading securities.

Purchases and sales of securities are accounted for on a settlement date basis. Premiums and discounts on debt securities are amortized or accreted as adjustments to income over the estimated life of the security using a method approximating the level yield method. Gains or losses on the sale of securities are based on the specific identification method. The fair value of securities is based on quoted market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

1. Summary of Significant Accounting Policies (continued)

Loans - Loans are stated at the principal balance outstanding. Mortgage loans consist principally of conventional one-to four-family residential loans and interim and permanent financing of non-residential loans that are secured by real estate. Commercial loans are made primarily on the strength of the borrower's general credit standing, the ability to generate repayment from income sources and the collateral securing such loans. Consumer loans generally consist of home equity loans, automobile and other personal loans. In many lending transactions, collateral is taken to provide an additional measure of security. Generally, the cash flows or earning power of the borrower represents the primary source of repayment, and collateral liquidation serves as a secondary source of repayment. The Corporation determines the need for collateral on a case-by-case or product-by-product basis. Factors considered include the current and prospective credit worthiness of the customer, terms of the instrument and economic conditions.

The Corporation generally originates single-family residential loans within its primary lending area. The Corporation's underwriting policies require such loans to be 80% loan to value based upon appraised values unless private mortgage insurance is obtained. These loans are secured by the underlying properties. Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are stated at the amount of unpaid principal, reduced by unearned discount and fees and an allowance for loan losses. Unearned interest on loans is amortized to income over the life of the loan, using the interest method. For all other loans, interest is accrued daily on the outstanding balances.

Loan origination and commitment fees and certain direct loan origination costs are deferred and the net amount amortized as an adjustment of the related loan's yield. The Corporation is generally amortizing these amounts over the contractual life. Commitment fees and costs are generally based upon a percentage of customer's unused line of credit and are recognized over the commitment period when the likelihood of exercise is remote. If the commitment is subsequently exercised during the commitment period, the remaining unamortized commitment fee at the time of exercise is recognized over the life of the loan as an adjustment of the yield.

For impaired loans, accrual of interest is discontinued on a loan when management believes, after considering collection efforts and other factors that the borrower's financial condition is such that collection of interest is doubtful. Cash collections on impaired loans are credited to the loan receivable balance, and no interest income is recognized on those loans until the principal balance has been collected.

The Corporation determines a loan to be delinquent when payments have not been made according to contractual terms, typically evidenced by nonpayment of a monthly installment by the due date. The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent.

All interest accrued but not collected for loans that are placed on non-accrual status or charged off are reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loans on non-accrual status as well as real estate acquired through foreclosure or deed taken in lieu of foreclosure are considered non-performing assets.

Allowance for Loan Losses - The Corporation maintains an allowance for loan losses. The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that collectability of the principal is unlikely. Subsequent recoveries, if any, are credited to the allowance.

1. Summary of Significant Accounting Policies (continued)

The allowance is an amount that management believes will be adequate to absorb estimated losses relating to specifically identified loans, as well as probable credit losses inherent in the balance of the loan portfolio, based on an evaluation of the collectability of existing loans and prior loss experience. This evaluation also takes into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay. The allowance for loan loss calculation includes a segmentation of loan categories by residential mortgage, commercial and consumer loans. Each category is rated for all loans. The weights assigned to each performing group are developed from previous loan loss experience and as the loss experience changes, the category weight is adjusted accordingly. As the loan categories increase and decrease in balance, the provision for loan loss calculation will adjust accordingly. The evaluation also includes a component for expected losses on groups of loans that are related to future events or expected changes in economic conditions. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses, and may require the Corporation to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as either impaired, substandard or special mention. For such loans that are also accounted for as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Recovery of the carrying value of loans is dependent to some extent on the future economic environment and operating and other conditions that may be beyond the Corporation's control. Unanticipated future adverse changes in such conditions could result in material adjustments to allowances (and future results of operation).

Accounting for Impaired Loans - Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical matter, at the loan's observable market value or fair value of the collateral if the loan is collateral dependent. If the resulting value of the impaired loan is less than the recorded balance, the impairment must be recognized by creating a valuation allowance for the difference and recognizing a corresponding bad debt expense. The risk characteristics used to aggregate loans are collateral type, borrower's financial condition and geographic location.

The Corporation generally determines a loan to be impaired at the time management believes that it is probable that the principal and interest may be uncollectible. Management has determined that, generally, a failure to make a payment within a 90-day period constitutes a minimum delay or shortfall and does not generally constitute an impaired loan. However, management reviews each past due loan and may determine a loan to be impaired prior to the loan becoming over 90 days past due, depending upon the circumstances of that particular loan. The Corporation's policy for charge-off of impaired loans is on a loan-by-loan basis. The Corporation's policy is to evaluate impaired loans based on the fair value of the collateral. Interest income from impaired loans is recorded using the cash method. At December 31, 2009, impaired loans totaled \$20.9 million and the Corporation had recognized no interest income from impaired loans. The average balance in impaired loans was \$20.0 million for 2009.

Office Properties and Equipment - Office properties and equipment are presented at cost less accumulated depreciation. Depreciation is provided on the straight-line basis over the estimated useful lives of the assets. Estimated useful lives are twenty to thirty nine years for buildings and improvements and generally five to ten years for furniture, fixtures and equipment.

The cost of maintenance and repairs is charged to expense as incurred, and improvements and other expenditures, which materially increase property lives, are capitalized. The costs and accumulated depreciation

1. Summary of Significant Accounting Policies (continued)

applicable to office properties and equipment retired or otherwise disposed of are eliminated from the related accounts, and any resulting gains or losses are credited or charged to income.

Securities Sold Under Agreements to Repurchase - The Corporation enters into sales of securities under agreements to repurchase. Fixed-coupon reverse repurchase agreements are treated as financings, with the obligations to repurchase securities sold being reflected as a liability and the securities underlying the agreements remaining as an asset. The securities are delivered by appropriate entry by the Corporation's safekeeping agent to the counterparties' accounts. The dealers may have sold, loaned or otherwise disposed of such securities to other parties in the normal course of their operations, and have agreed to resell to the Corporation substantially identical securities at the maturities of the agreements.

Federal Home Loan Bank Stock - The Bank, as a member institution of Federal Home Loan Bank of Atlanta ("FHLB"), is required to own capital stock in the FHLB based generally upon the Bank's balances of residential mortgage loans and FHLB advances. No ready market exists for this stock and it has no quoted market value. However, redemption of this stock historically has been at par value. The Bank carries this investment at its original cost.

Federal Reserve Bank Stock - The Bank, as a member institution of Federal Reserve Bank of Richmond ("FRB"), is required to own capital stock in the FRB based upon the Bank's capital and surplus. No ready market exists for this stock and it has no quoted market value. However, redemption of this stock historically has been at par value. The Bank carries this investment at its original cost.

Real Estate Acquired Through Foreclosure - Real estate acquired through foreclosure is stated at the lower of cost or estimated fair value less estimated costs to sell. Any accrued interest on the related loan at the date of acquisition is charged to operations. Costs relating to the development and improvement of property are capitalized to the extent that such costs do not exceed the estimated fair value less selling costs of the property, whereas those relating to holding the property are charged to expense. Real estate acquired through foreclosure is included in other assets on the balance sheet.

Intangible Assets - Intangible assets consist of core deposit premiums resulting from Provident Community Bank's branch acquisitions in 1997 and 1999 and the excess of cost over the fair value of net assets resulting from the acquisition of South Carolina Community Bancshares, Inc. in 1999.

Goodwill and identified intangible assets with indefinite lives related to acquisitions are not subject to amortization. Core deposit intangible assets are amortized over their estimated useful lives using methods that reflect the pattern in which the economic benefits are utilized.

The Corporation's unamortized goodwill and other intangible assets are reviewed annually to determine whether there have been any events or circumstances to indicate that the recorded amount is not recoverable from projected undiscounted net operating cash flows. If the projected undiscounted net operating cash flows are less than the carrying amount, a loss is recognized to reduce the carrying amount to fair value, and when appropriate, the amortization period is also reduced. Based on the impairment analysis performed, due to the Corporation's current market capitalization, all goodwill and deposit premiums were charged off in 2009.

Interest Income - Interest on loans is accrued and credited to income monthly based on the principal balance outstanding and the contractual rate on the loan. The Corporation places loans on non-accrual status when they become greater than 90 days delinquent or when in the opinion of management, full collection of principal or interest is unlikely. All interest that was accrued prior to the loan being placed on non-accrual status is automatically reversed after the 90 day delinquency period. The loans are returned to accrual status when full collection of principal and interest appears likely.

Income Taxes - Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax

1. Summary of Significant Accounting Policies (continued)

purposes. A valuation allowance is established for deferred tax assets that may not be realized. Also, on a prospective basis, the exception from the requirement to record deferred taxes on tax basis bad debt reserves in excess of the base year amounts is eliminated. The tax basis bad debt reserve that arose prior to the fiscal year 1988 (the base year amount) is frozen, and the book reserves at that date and all subsequent changes in book and tax basis reserves are included in the determination of deferred taxes.

Per-Share Data - Basic earnings per share is computed by dividing net income by the weighted-average number of shares outstanding for the period. Diluted earnings per share is similar to the computation of basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. The dilutive effect of options outstanding under Provident Community Bancshares's stock option plan is reflected in diluted earnings per share by the application of the treasury stock method. There were no common stock equivalents included in the diluted earnings per share calculation at December 31, 2009 or 2008.

Fair Values of Financial Instruments - The following methods and assumptions were used by the Corporation in estimating fair values of financial instruments as disclosed herein:

Cash and cash equivalents - The carrying amounts of cash and due from banks approximate their fair value.

Available for sale and held to maturity securities - Fair values for securities are based on quoted market prices. The carrying values of restricted equity securities approximate fair values. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions.

Loans - The Corporation is predominantly an asset based lender with real estate serving as collateral on a substantial majority of loans. The Corporation does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and the related impairment is charged against the allowance or a specific allowance is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Loans which are deemed to be impaired are primarily valued at the fair values of the underlying real estate collateral. Such fair values are obtained using collateral net liquidation value, market value of similar debt, enterprise value, and discounted cash flows. Those impaired loans not requiring a specific allowance represent loans for which the fair value of the expected repayment or collateral meet or exceed the recorded investment in such loans. The Corporation considers all non-accrual loans and troubled debt restructurings to be impaired.

Cash surrender value of life insurance - The carrying amounts of cash surrender values of life insurance approximate their fair value.

Deposit liabilities - The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate, fixed-term money-market accounts and certificates of deposit (CDs) approximate their fair values at the reporting date. Fair values for fixed-rate CDs are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Advances from the FHLB and other borrowings - The fair values of the Corporation's borrowings are estimated using discounted cash flow analysis based on the Corporation's current incremental borrowing rates for similar types of borrowing arrangements.

Securities sold under agreements to repurchase - The fair values of the Corporation's repurchase agreements are estimated using discounted cash flow analysis based on the Corporation's current incremental borrowing rates for similar types of borrowing arrangements.

1. Summary of Significant Accounting Policies (continued)

Accrued interest - The carrying amounts of accrued interest approximate their fair values.

Floating rate junior subordinated deferrable interest debentures - The fair values of the Corporation's floating rate debentures are estimated using discounted cash flow analysis based on the Corporation's current incremental borrowing rates for similar types of borrowing arrangements.

Off-balance-sheet instruments - Fair values for off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counter parties' credit standings.

Risks and Uncertainties - In the normal course of its business, the Corporation encounters two significant types of risk: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Corporation is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different speeds, or on different bases, than its interest-earning assets.

Credit risk is the risk of default on the Corporation's loan portfolio that results from the borrowers' inability or unwillingness to make contractually required payments. Credit risk also applies to investment securities and mortgage-backed securities should the issuer of the security be unable to make principal and interest payments. Market risk reflects changes in the value of collateral underlying loans receivable, the valuation of real estate held by the Corporation and the valuation of investment securities.

The Corporation is subject to the regulations of various government agencies. These regulations can and do change significantly from period to period. The Corporation also undergoes periodic examinations by the regulatory agencies, which may subject it to further changes with respect to asset valuations, amounts of required loss allowances and operating restrictions resulting from the regulators' judgments based on information available to them at the time of their examination.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the dates of the balance sheets and revenues and expenses for the periods covered. Actual results could differ from those estimates and assumptions.

Reclassifications - Certain amounts in prior years' financial statements have been reclassified to conform with current year classifications. These reclassifications had no effect on previously reported net income or shareholders' equity.

Stock-Based Compensation - The Corporation accounts for the compensation costs for its stock option plan under the fair value recognition provisions of Financial Accounting Standards Board FASB ASC 123(R), "Accounting for Stock-Based Compensation", (ASC 718-10-10).

There were no stock options granted in 2009 or 2008.

2. Investment and Mortgage-backed Securities

Held to Maturity - Securities classified as held to maturity consisted of the following (in thousands):

	As of December 31, 2009			Fair Value
	Amortized Cost	Gross Unrealized Gains	Losses	
Municipal Securities.....	<u>\$3,934</u>	<u>\$52</u>	<u>(\$10)</u>	<u>\$3,976</u>

2. **Investment and Mortgage-backed Securities (continued)**

Available for Sale - Securities classified as available for sale consisted of the following (in thousands):

	As of December 31, 2009			Fair Value
	Amortized Cost	Gross Unrealized Gains	Losses	
Investment Securities:				
U.S. Agency Obligations.....	\$ 4	\$ --	\$ --	\$ 4
Government Sponsored Enterprises ...	79,162	217	(908)	78,471
Municipal Securities.....	5,781	261	--	6,042
Trust Preferred Securities.....	8,570	--	(2,658)	5,912
Total Investment Securities	<u>93,517</u>	<u>478</u>	<u>(3,566)</u>	<u>90,429</u>
Mortgage-backed Securities:				
Fannie Mae.....	35,561	1,162	--	36,723
Ginnie Mae.....	16,569	461	--	17,030
Freddie Mac.....	3,068	86	--	3,154
Collateralized Mortgage Obligations .	597	--	(117)	480
Total Mortgage-backed Securities.....	<u>55,795</u>	<u>1,709</u>	<u>(117)</u>	<u>57,387</u>
Total available for sale	<u>\$149,312</u>	<u>\$ 2,187</u>	<u>\$(3,683)</u>	<u>\$147,816</u>

Held to Maturity - Securities classified as held to maturity consisted of the following (in thousands):

	As of December 31, 2008			Fair Value
	Amortized Cost	Gross Unrealized Gains	Losses	
Municipal Securities.....	<u>\$2,430</u>	<u>\$ --</u>	<u>\$(120)</u>	<u>\$2,310</u>

Available for Sale - Securities classified as available for sale consisted of the following (in thousands):

	As of December 31, 2008			Fair Value
	Amortized Cost	Gross Unrealized Gains	Losses	
Investment Securities:				
U.S. Agency Obligations.....	\$ 6	\$ --	\$ --	\$ 6
Government Sponsored Enterprises ...	27,901	331	(2)	28,230
Municipal Securities.....	6,135	223	--	6,358
Trust Preferred Securities.....	12,325	--	(3,933)	8,392
Total Investment Securities	<u>46,367</u>	<u>554</u>	<u>(3,935)</u>	<u>42,986</u>
Mortgage-backed Securities:				
Fannie Mae.....	31,989	452	(56)	32,385
Ginnie Mae.....	21,311	567	--	21,878
Freddie Mac	2,551	33	(10)	2,574
Collateralized Mortgage Obligations .	809	--	(214)	595
Total Mortgage-backed Securities.....	<u>56,660</u>	<u>1,052</u>	<u>(280)</u>	<u>57,432</u>
Total available for sale	<u>\$103,027</u>	<u>\$1,606</u>	<u>\$(4,215)</u>	<u>\$100,418</u>

2. Investment and Mortgage-backed Securities (continued)

The following table shows gross unrealized losses and fair value, aggregated by investment category, and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2009 (in thousands).

	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
<u>Held to Maturity</u>						
Municipal Securities.....	\$494	\$9	\$833	\$1	\$1,326	\$10
Total	<u>\$494</u>	<u>\$9</u>	<u>\$833</u>	<u>\$1</u>	<u>\$1,326</u>	<u>\$10</u>
<u>Securities Available for Sale</u>						
U.S. Agency Obligations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Government Sponsored Enterprises.....	41,040	908	-	-	41,040	908
Municipal Securities.....	-	-	-	-	-	-
Trust Preferred Securities.....	-	-	5,912	2,658	5,912	2,658
Mortgage-backed Securities	--	--	<u>532</u>	<u>117</u>	<u>532</u>	<u>117</u>
Total	<u>\$41,040</u>	<u>\$908</u>	<u>\$6,444</u>	<u>\$2,775</u>	<u>\$47,484</u>	<u>\$3,683</u>

The following table shows gross unrealized losses and fair value, aggregated by investment category, and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2008 (in thousands).

	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
<u>Held to Maturity</u>						
Municipal Securities.....	\$1,525	\$70	\$784	\$50	\$2,309	\$120
Total	<u>\$1,525</u>	<u>\$70</u>	<u>\$784</u>	<u>\$50</u>	<u>\$2,309</u>	<u>\$120</u>
<u>Securities Available for Sale</u>						
U.S. Agency Obligations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Government Sponsored Enterprises.....	3,000	2	-	-	3,000	2
Municipal Securities.....	-	-	-	-	-	-
Trust Preferred Securities.....	-	-	8,392	3,933	8,392	3,933
Mortgage-backed Securities	<u>126</u>	<u>3</u>	<u>8,629</u>	<u>277</u>	<u>8,755</u>	<u>280</u>
Total	<u>\$3,126</u>	<u>\$5</u>	<u>\$17,021</u>	<u>\$4,210</u>	<u>\$20,147</u>	<u>\$4,215</u>

2. Investment and Mortgage-backed Securities (continued)

Management reviews securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

To determine which individual securities are at risk for other-than-temporary impairment, the Corporation considers various characteristics of each security including but not limited to the credit rating, the duration and amount of the unrealized loss, and any credit enhancements. The relative importance of this information varies based on the facts and circumstances surrounding each security, as well as the economic environment at the time of the assessment. As a result of this review, the Corporation identifies individual securities believed to be at risk for other-than-temporary impairment. These securities are evaluated by estimating projected cash flows based on the structure of the security and certain assumptions, such as prepayments, default rates, and loss severity to determine whether the Corporation expects to receive all of the contractual cash flows as scheduled. The Corporation recognizes an other-than-temporary impairment credit loss when the present value of the investment security's cash flows expected to be collected are less than the amortized cost basis.

To determine impairment charges for the Corporation's collateralized debt obligations ("CDO"), we performed discounted cash flow valuations through a static default model test. The default model used assumed a 3.6% rate, which is three times the historic default rates, a 0% recovery on all banks in deferral of interest payments and a 0% prepayment rate. Cash flow valuations with a premium mark up of 300 basis points were also used to determine the fair market values of the Corporation's collateralized debt obligations. Valuation documentation for the cash flow analysis is provided by an independent third party and is reviewed each quarter by the Corporation's external auditor.

The following table presents the Corporation's investments by category and the related unrealized gains or losses, net of tax, recognized in other comprehensive losses, credit losses recognized in and credit ratings for each classification of security. Trust preferred securities are divided into pooled and single issue securities. All trust preferred pooled securities are in the mezzanine tranche. Private label trust preferred securities are \$2.0 million each and are evaluated each quarter based on the financial stability of the institution. Agency MBS and agency securities are government guaranteed and therefore, their risk is relatively low. These securities have no credit rating included in the table below.

Amounts in the following table are in millions.

Security Classification	Amortized Cost	Fair Value	OCI	OTTI	AAA	AA	A	Baa1	Ba3	Not Rated	Below Investment Grade
Single issuer trust preferred securities	\$ 4.0	\$ 2.8	\$(0.8)	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --	\$2.8	\$ --
Pooled trust preferred securities	4.6	3.1	(0.9)	(3.8)	--	--	--	--	0.8	--	2.3
Agency MBS	55.2	56.9	1.1	--	--	--	--	--	--	--	--
Private label CMO	0.6	0.5	(0.1)	--	0.5	--	--	--	--	--	--
Treasury/Agency	79.1	78.5	(0.5)	--	--	--	--	--	--	--	--
Municipals/AFS	5.8	6.0	0.2	--	2.4	0.9	1.1	1.1	--	0.5	--
Municipals/HTM	<u>3.9</u>	<u>4.0</u>	<u>--</u>	<u>--</u>	<u>2.5</u>	<u>0.5</u>	<u>1.0</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>
Total	<u>\$153.2</u>	<u>\$151.8</u>	<u>\$(1.0)</u>	<u>\$(3.8)</u>	<u>\$5.4</u>	<u>\$1.4</u>	<u>\$2.1</u>	<u>\$1.1</u>	<u>\$0.8</u>	<u>\$3.3</u>	<u>\$ 2.3</u>

For the year ended December, 31, 2009, the Corporation experienced a credit-related other-than-temporary impairment of \$3.8 million on the CDO portfolio. All of these securities are in the Corporation's available for sale portfolio. This was charged to earnings in non-interest income as "Other-than-temporary-impairment write-down on securities". The total securities impacted by credit-related other-than-temporary impairment have a current carrying value of \$3.1 million and represent approximately 2.1% of available for sale securities. These securities will have a

2. Investment and Mortgage-backed Securities (continued)

negligible impact on the Corporation's liquidity. We do not intend to sell the remaining debt securities and more likely than not, we will not be required to sell the debt securities before their anticipated recovery.

Proceeds, gross gains and gross losses realized from the sales of available for sale securities were as follows for the periods ended (in thousands):

	<u>Years Ended December 31,</u>	
	<u>2009</u>	<u>2008</u>
Proceeds.....	\$39,987	\$37,040
Gross gains	775	498
Gross losses	—	—
Net gain (loss) on investment transactions	\$775	\$498

The maturities of securities at December 31, 2009 are as follows (in thousands):

	<u>Held to Maturity</u>		<u>Available for Sale</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in one year or less	\$ --	\$ --	\$ 727	\$ 728
Due after one year through five years	--	--	424	429
Due after five years through ten years.....	--	--	18,784	18,626
Due after ten years.....	<u>3,934</u>	<u>3,976</u>	<u>129,377</u>	<u>128,033</u>
Total investment and mortgage-backed securities	<u>\$ 3,934</u>	<u>\$ 3,976</u>	<u>\$149,312</u>	<u>\$147,816</u>

The mortgage-backed securities held at December 31, 2009 mature between one and thirty years. The actual lives of those securities may be significantly shorter as a result of principal payments and prepayments. All mortgage-backed securities are U.S. Government securities issued through Fannie Mae, Ginnie Mae, or Freddie Mac.

At December 31, 2009 and 2008, \$94.6 million and \$80.6 million, respectively, of securities recorded at book value were pledged as collateral for certain deposits and borrowings.

At December 31, 2009, approximately \$2.4 million of mortgage-backed securities were adjustable rate securities. The adjustment periods range from monthly to annually and rates are adjusted based on the movement of a variety of indices.

Investments in collateralized mortgage obligations ("CMOs") had a fair market value of \$480,000 at December 31, 2009. These are private label CMO securities that were issued by a large regional bank. Therefore, the fair market value is determined by the current available broker supplied price as an estimate of the amount the Corporation could expect to receive in the open market. These securities are not actively traded as a result of the economic crisis.

3. Federal Home Loan Bank Capital Stock

Provident Community Bank, as a member institution of Federal Home Loan Bank of Atlanta ("FHLB"), is required to own capital stock in the FHLB of Atlanta based generally upon a membership-based requirement and an activity-based requirement related to the level of advances that the Corporation borrows from the FHLB. No ready market exists for this stock and it has no quoted market value. However, redemption of this stock historically has been at par value. The carrying value (which approximates fair value) of this stock was \$3.9 million at December 31, 2009 and \$3.9 million at December 31, 2008.

In evaluating other-than-temporary impairment of the FHLB stock, the Corporation considered the most recent financial results of the FHLB, the resumption of paying dividends on common stock, its ability to repurchase

3. Federal Home Loan Bank Capital Stock (continued)

the stock at par value throughout the year in a timely manner based on the level of advances that the Corporation maintains, and the baseline credit assessment rating given by Moody's Investors Service of AAA. The Corporation believes that the resumption of the common stock dividend and the investment grade rating of AAA indicate that there is no impairment in the investment in the FHLB stock as of December 31, 2009.

4. Loans, Net

Loans receivable consisted of the following (in thousands):

	As of December 31,	
	2009	2008
Mortgage loans:		
Fixed-rate residential.....	\$ 10,675	\$ 12,847
Adjustable-rate residential	6,202	7,388
Commercial real estate	110,901	110,589
Construction	<u>2,923</u>	<u>5,867</u>
Total mortgage loans	<u>130,701</u>	<u>136,691</u>
Commercial loans:		
Commercial non-real estate.....	34,429	27,946
Commercial lines of credit	<u>39,096</u>	<u>66,066</u>
Total commercial loans	<u>73,525</u>	<u>94,012</u>
Consumer loans:		
Home equity	17,395	17,371
Consumer and installment	34,578	39,301
Consumer lines of credit	<u>314</u>	<u>330</u>
Total consumer loans.....	<u>52,287</u>	<u>57,002</u>
Total loans	<u>256,513</u>	<u>287,705</u>
Less:		
Undisbursed portion of interim construction loans	(320)	(1,926)
Unamortized loan discount	(309)	(383)
Allowance for loan losses	(5,579)	(6,778)
Net deferred loan origination costs	<u>115</u>	<u>47</u>
Total, net.....	<u>\$250,420</u>	<u>\$278,665</u>
Weighted-average interest rate of loans	4.87%	5.47%

Under OCC regulations, the Bank may not make loans to one borrower in excess of 15% of unimpaired capital. This limitation does not apply to loans made before August 9, 1989. At December 31, 2009, the Bank had loans outstanding to one borrower ranging up to \$5.4 million.

Adjustable-rate residential real estate loans (approximately \$6.2 million and \$7.4 million at December 31, 2009 and 2008, respectively) are subject to rate adjustments annually and generally are adjusted based on movement of the Federal Home Loan Bank National Monthly Median Cost of Funds rate or the Constant Maturity Treasury index. The maximum loan rates can be adjusted is 200 basis points in any one year with a lifetime cap of 600 basis points.

Non-refundable deferred origination fees and cost and discount points collected at loan closing, net of commitment fees paid, are deferred and recognized at the time of sale of the mortgage loans. Gain or loss on sales of mortgage loans is recognized based upon the difference between the selling price and the carrying amount of the mortgage loans sold. Other fees earned during the loan origination process are also included in net gain or loss on sales of mortgage loans.

Until 2002, the Bank originated both fixed rate and adjustable rate mortgage loans with terms generally ranging from fifteen to thirty years and generally sold the loans while retaining servicing on loans originated. The Bank discontinued the origination of loans held for sale in 2002. The underlying value of loans serviced for others was \$10.6 million and \$13.0 million at December 31, 2009 and 2008, respectively.

Loans that management identifies as impaired generally will be non-performing loans. At December 31, 2009 and 2008, loans which are accounted for on a non-accrual basis or contractually past due ninety days or more

4. Loans, net (continued)

totaled approximately \$20.9 million and \$16.0 million, respectively. The amount the Corporation will ultimately realize from these loans could differ materially from their carrying value because of future developments affecting the underlying collateral or the borrower's ability to repay the loans. During the years ended December 31, 2009 and 2008, the Corporation recognized no interest income on loans past due 90 days or more, whereas, under the original terms of these loans, the Corporation would have recognized additional interest income of approximately \$1.4 million and \$715,000, respectively.

Information about impaired loans as of and for the years ended December 31, 2009 and 2008, is as follows:

	Years Ended December 31,	
	2009	2008
Loans receivable for which there is a related allowance for credit losses determined in accordance with ASC 310-10/Statement No. 114	\$1,829	\$7,774
Other impaired loans	<u>19,040</u>	<u>8,227</u>
Total impaired loans	<u>\$20,869</u>	<u>\$16,001</u>
Average monthly balance of impaired loans	<u>\$20,006</u>	<u>\$ 7,588</u>
Specific allowance for credit losses.....	\$ 675	\$ 3,536

Specific reserves of \$6.4 million were charged against impaired loans as partial charge-offs for the year ended December 31, 2009.

The changes in allowance for loan losses consisted of the following (in thousands):

	Years Ended December 31,	
	2009	2008
Balance at beginning of Period.....	\$6,778	\$3,344
Provision for loan losses.....	8,695	4,210
Net charge-offs	<u>(9,894)</u>	<u>(776)</u>
Balance at end of period	<u>\$5,579</u>	<u>\$6,778</u>

Renegotiated loans, or troubled debt restructurings, are those loans where the borrower is experiencing financial difficulties and we have agreed to concessions of the terms such as changes in the interest rate charged and/or other concessions. Troubled debt restructurings increased \$3.0 million from \$316,000 at December 31, 2008 to \$3.3 million at December 31, 2009. The majority of this increase relates primarily to two commercial real estate relationships totaling \$2.5 million that have been affected by the downturn in the commercial real estate market.

Directors and officers of the Corporation are customers of the Corporation in the ordinary course of business. Loans to directors and officers have terms consistent with those offered to other customers. Loans to officers and directors of the Corporation are summarized as follows (in thousands):

	Years Ended December 31,	
	2009	2008
Balance at beginning of period.....	\$ 539	\$349
Loans originated during the period	1,719	219
Loan repayments during the period.....	<u>(78)</u>	<u>(29)</u>
Balance at the end of period	<u>\$2,180</u>	<u>\$539</u>

5. Office Properties and Equipment

Office properties and equipment consisted of the following (in thousands):

	As of December 31,	
	2009	2008
Land	\$1,656	\$1,656
Building and improvements	5,269	5,146
Office furniture, fixtures and equipment.....	<u>2,057</u>	<u>2,989</u>
Total	8,982	9,791
Less accumulated depreciation.....	<u>(3,535)</u>	<u>(3,954)</u>
Office properties and equipment, net	<u>\$5,447</u>	<u>\$5,837</u>

Depreciation expense was \$534,000 and \$652,000 for the years ended December 31, 2009 and 2008, respectively.

6. Intangible Assets

Intangible assets consisted of the following (in thousands):

	Years Ended December 31,	
	2009	2008
Core Deposit Premium		
Balance at beginning of year.....	\$516	\$932
Amortization.....	(324)	(416)
Charge-off of remaining deposit premium	<u>(192)</u>	--
Balance at end of year	-	516
Goodwill		
Balance at beginning of year.....	2,329	2,329
Reclassification of goodwill.....	(1,172)	--
Charge-off of remaining goodwill	<u>(1,157)</u>	--
Balance at end of year	-	<u>2,329</u>
Total	<u>\$-</u>	<u>\$2,845</u>

A reclassification of goodwill occurred due to an adjustment to the goodwill valuation that was offset against deferred income taxes. This adjustment resulted from our review of prior income tax returns and the discovery of a misclassification from our business combination in 1999.

Goodwill is reviewed for potential impairment at least annually at the reporting unit level. The Corporation performs its impairment testing in the fourth quarter of each year and more frequently if circumstances exist that indicate a probable reduction in the fair value below carrying value. An impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. Other intangible assets are evaluated for impairment if events and circumstances indicate a possible impairment. Such evaluation of other intangible assets is based on undiscounted cash flow projections. Impairment charges of \$192,000 were recorded related to a deposit premium impairment.

In performing the first step ("Step 1") of the goodwill impairment testing and measurement process to identify possible impairment, the estimated fair value was developed using a market valuation approach that utilizes the current stock price as the primary indicator of fair market value. The results of this Step 1 process indicated that the estimated fair value was less than book value, thus requiring the Corporation to perform the second step ("Step 2") of the goodwill impairment test. Based on the Step 2 analysis, it was determined that the implied fair value of goodwill was \$0 as of December 31, 2009, which resulted in a goodwill impairment charge of \$1,157,000 for the year ended December 31, 2008 that was recorded as a component of noninterest expense on the consolidated statement of operations.

The primary factor in the determination of goodwill impairment in 2009 was the Corporation's relatively low stock price and resulting market valuation. The Corporation's stock price has been trading below its book value throughout 2009. Management attributes its relatively low stock price to both financial services industry-wide and Corporation specific factors primarily related to credit quality issues. The goodwill impairment charge is non-cash

6. Intangible Assets (continued)

expense, and since goodwill is a non interest earning asset, this charge will not impact the Corporation's future operating performance.

7. Deposit Accounts

Deposit accounts at December 31 were as follows (in thousands):

<u>Account Type</u>	<u>2009</u>			<u>2008</u>		
	<u>Rate</u>	<u>Balance</u>	<u>%</u>	<u>Rate</u>	<u>Balance</u>	<u>%</u>
NOW accounts:						
Commercial non-interest-bearing..	–%	\$ 18,015	5.42%	–%	\$ 17,002	5.54%
Non-commercial	2.30	98,274	29.53	2.06	68,033	22.18
Money market.....	1.57	32,239	9.69	2.17	22,313	7.27
Savings	0.51	<u>13,383</u>	<u>4.02</u>	0.57	<u>12,407</u>	<u>4.04</u>
Total demand and time deposits	1.74	<u>161,911</u>	<u>48.66</u>	1.92	<u>119,755</u>	<u>39.03</u>
Time deposits:						
Up to 3.00%		135,064	40.59		41,720	13.60
3.01% - 4.00%		20,885	6.27		79,176	25.80
4.01% - 5.00%		13,744	4.13		58,962	19.22
5.01% - 6.00%		1,130	0.34		7,180	2.34
6.01% - 7.00%		<u>28</u>	<u>0.01</u>		<u>28</u>	<u>0.01</u>
Total time deposits.....	2.27	<u>170,851</u>	<u>51.34</u>	3.56	<u>187,066</u>	<u>60.97</u>
Total deposit accounts	2.02%	<u>\$332,762</u>	<u>100.00%</u>	2.91%	<u>\$306,821</u>	<u>100.00%</u>

As of December 31, 2009 and 2008, total deposit accounts include approximately \$2.0 million and \$2.0 million, respectively, of deposits from the Corporation's officers, directors, employees or parties related to them.

At December 31, 2009 and 2008, time deposit accounts with balances of \$100,000 and over totaled approximately \$68.2 million and \$74.9 million, respectively.

Time deposits by maturity were as follows (in thousands):

<u>Maturity Date</u>	<u>As of December 31,</u>	
	<u>2009</u>	<u>2008</u>
Within 1 year.....	\$119,737	\$141,904
After 1 but within 2 years.....	48,695	40,462
After 2 but within 3 years.....	2,069	2,354
After 3 but within 4 years.....	287	1,854
Thereafter	<u>63</u>	<u>492</u>
Total time deposits	<u>\$170,851</u>	<u>\$187,066</u>

Interest expense on deposits consisted of the following (in thousands):

<u>Account Type</u>	<u>Years Ended December 31,</u>	
	<u>2009</u>	<u>2008</u>
NOW accounts and money market		
deposit accounts.....	\$2,385	\$2,147
Passbook and statement savings		
Accounts.....	69	83
Certificate accounts	5,572	6,758
Early withdrawal penalties	<u>(31)</u>	<u>(29)</u>
Total	<u>\$7,995</u>	<u>\$8,959</u>

8. Advances from the Federal Home Loan Bank

At December 31, 2009 and 2008, the Bank had \$64.5 million and \$69.5 million, respectively, of advances outstanding from the FHLB. The maturity of the advances from the FHLB is as follows (in thousands):

	As of December 31,			
	2009	Weighted Average Rate	2008	Weighted Average Rate
Contractual Maturity:				
Within one year – fixed rate	\$5,000	4.93	\$5,000	2.93%
After one but within three years – fixed rate	--	--	5,000	4.93
After one but within three years – adjustable rate	22,000	4.58	22,000	4.58
Greater than five years – adjustable rate	<u>37,500</u>	3.89	<u>37,500</u>	3.89
Total advances	<u>\$64,500</u>	<u>4.20%</u>	<u>\$69,500</u>	<u>4.11%</u>

The Bank pledges as collateral to the advances their FHLB stock, investment securities and has entered into a blanket collateral agreement with the FHLB whereby the Bank maintains, free of other encumbrances, qualifying loans (as defined) with unpaid principal balances equal to, when discounted at 50% to 80% of the unpaid principal balances, 100% of total advances. The amount of qualifying loans was \$52.8 million and \$48.5 million, respectively, at December 31, 2009 and 2008. In addition to qualifying loans, the Corporation also pledges investment securities. The amount of investment securities pledged for advances was \$46.5 million and \$36.1 million, respectively, at December 31, 2009 and 2008. Advances are subject to prepayment penalties and to calls at the option of the FHLB of Atlanta. The advances callable in fiscal 2010 are \$59.5 million with a weighted average rate of 4.15%. During fiscal years 2009 and 2008, the FHLB did not exercise any of the call provisions related to the advances.

9. Securities Sold Under Agreements to Repurchase

The Company had \$18,520,000 and \$19,005,000 borrowed under agreements to repurchase at December 31, 2009 and 2008, respectively. The amortized cost of the securities underlying the agreements to repurchase at December 31, 2009 was \$19,142,000 and \$22,188,000 at December 31, 2008. The maximum amount outstanding at any month end during 2009 was \$20,411,000 and \$23,389,000 for 2008. The average amount of outstanding agreements for 2009 was \$18,134,000 and \$21,588,000 for 2008 and the approximate weighted average interest rate was 1.56% in 2009 and 2.53% in 2008.

10. Floating Rate Junior Subordinated Deferrable Interest Debentures

On July 18, 2006, the Corporation sponsored the creation of Provident Community Bancshares Capital Trust I (“Capital Trust I”). The Corporation is the owner of all of the common securities of Capital Trust I. On July 21, 2006, Capital Trust I issued \$4,000,000 in the form of floating/fixed rate capital securities through a pooled trust preferred securities offering. The proceeds from this issuance, along with the Corporation’s \$124,000 capital contribution for Capital Trust I’s common securities, were used to acquire \$4,124,000 aggregate principal amount of the Corporation’s floating rate junior subordinated deferrable interest debentures due October 1, 2036 (the “Debentures”), which constitute the sole asset of Capital Trust I. The interest rate on the Debentures and the capital securities will be equal to 7.393% for the first five years. Thereafter, the interest rate is variable and adjustable quarterly at 1.74% over the three-month LIBOR. The Corporation has, through the Trust Agreement establishing Capital Trust I, the Guarantee Agreement, the notes and the related Debenture, taken together, fully irrevocably and unconditionally guaranteed all of the Capital Trust I obligations under the capital securities. The stated maturity of the Debentures is October 1, 2036. In addition, the Debentures are subject to redemption at par at the option of the Corporation, subject to prior regulatory approval, in whole or in part on any interest payment date after October 1, 2011. The Debentures are also subject to redemption prior to October 1, 2011 at up to 103.7% of par after the occurrence of certain events that would either have a negative tax effect on Capital Trust I or the Corporation or would result in Capital Trust I being treated as an investment company that is required to be registered under the Investment Company Act of 1940. The Corporation has the right, at one or more times, to defer interest payments on the Debentures for up to twenty consecutive quarterly periods. The Corporation paid \$305,000 and \$305,000 in interest for the years ended December 31, 2009 and 2008, respectively, for the Capital Trust I debentures.

10. Floating Rate Junior Subordinated Deferrable Interest Debentures (continued)

On November 28, 2006, the Corporation sponsored the creation of Provident Community Bancshares Capital Trust (“Capital Trust II”). The Corporation is the owner of all of the common securities of the Trust. On December 15, 2006, the Trust issued \$8,000,000 in the form of floating rate capital securities through a pooled trust preferred securities offering. The proceeds of Capital Trust II were utilized for the redemption of Union Financial Bancshares Statutory Trust (the “Trust”) issued on December 18, 2001. The proceeds from this issuance, along with the Corporation’s \$247,000 capital contribution for the Trust’s common securities, were used to acquire \$8,247,000 aggregate principal amount of the Corporation’s floating rate junior subordinated deferrable interest debentures due March 1, 2037 (the “Debentures”), which constitute the sole asset of the Trust. The interest rate on the Debentures and the capital securities is variable and adjustable quarterly at 1.74% over the three-month LIBOR, with a rate at December 31, 2008 of 3.92%. The Corporation has, through the Trust agreement establishing the Trust, the Guarantee Agreement, the notes and the related Debenture, taken together, fully irrevocably and unconditionally guaranteed all of the Trust’s obligations under the capital securities. The stated maturity of the Debentures is March 1, 2037. In addition, the Debentures are subject to redemption at par at the option of the Corporation, subject to prior regulatory approval, in whole or in part on any interest payment date after March 1, 2012. The Debentures are also subject to redemption prior to March 1, 2012 at 103.5% of par after the occurrence of certain events that would either have a negative tax effect on the Trust or the Corporation or would result in the Trust being treated as an investment company that is required to be registered under the Investment Company Act of 1940. The Corporation has the right, at one or more times, to defer interest payments on the Debentures for up to twenty consecutive quarterly periods. The Corporation paid \$225,000 and \$416,000 in interest to the Capital Trust II in 2009 and 2008, respectively.

11. Income Taxes

Income tax expense is summarized as follows (in thousands):

	<u>Years Ended December 31,</u>	
	<u>2009</u>	<u>2008</u>
Current.....	\$(1,057)	\$ 744
Deferred.....	<u>(2,954)</u>	<u>(1,340)</u>
Total income tax benefit.....	<u>\$(4,011)</u>	<u>\$(596)</u>

The provision for income taxes differed from amounts computed by applying the statutory federal rate of 34% to income before income taxes as follows (in thousands):

	<u>Years Ended December 31,</u>	
	<u>2009</u>	<u>2008</u>
Tax at federal income tax rate	\$(3,877)	\$(337)
Increase (decrease) resulting from:		
State income taxes, net of federal		
benefit.....	--	12
Interest on municipal bonds	(146)	(160)
Non-taxable life insurance income.....	(136)	(136)
Impairment of goodwill.....	393	--
Other, net.....	<u>(245)</u>	<u>25</u>
Total.....	<u>\$(4,011)</u>	<u>\$(596)</u>

The Corporation had analyzed the tax positions taken or expected to be taken in its tax returns and concluded it has no liability related to uncertain tax positions in accordance with FIN 48.

11. Income Taxes (continued)

The tax effects of significant items comprising the Corporation's deferred taxes as of December 31, 2009 and 2008 are as follows (in thousands):

	<u>December 31,</u>	
	<u>2009</u>	<u>2008</u>
Deferred tax assets:		
Book reserves in excess of tax basis bad debt reserves	\$1,516	\$2,305
Deferred compensation	527	453
Net operating loss.....	1,630	-
Other-than-temporary-impairment	1,277	-
SFAS No. 115 mark-to-market adjustment.....	553	913
Charitable contribution limitation	6	-
Other real estate owned.....	355	106
Core deposit intangible	232	131
Loan discount amortization.....	105	-
Other.....	<u>535</u>	<u>165</u>
Total deferred tax asset	<u>6,736</u>	<u>4,073</u>
Deferred tax liabilities:		
Difference between book and tax property basis	80	97
Difference between book and tax Federal Home Loan Bank stock	85	85
Deferred loan fees	41	17
Partnership pass-through differences	51	-
Prepaid expenses	<u>81</u>	<u>70</u>
Total deferred tax liability.....	<u>338</u>	<u>269</u>
Net deferred tax asset	<u>\$6,398</u>	<u>\$3,804</u>

The deferred tax assets of \$6.4 million and \$3.8 million at December 31, 2009 and 2008 are included in other assets in the balance sheet.

Deferred tax assets or liabilities are initially recognized for differences between the financial statement carrying amount and the tax basis of asset and liabilities which will result in future deductible or taxable amounts and operating loss and tax credit carry-forwards. A valuation allowance is then established, as applicable, to reduce the deferred tax asset to the level at which it is "more likely than not" that the tax benefits will be realized. Realization of tax benefits of deductible temporary differences and operating loss or credit carry-forwards depends on having sufficient taxable income of an appropriate character within the carry-back and carry-forward periods. Sources of taxable income that may allow for the realization of tax benefits include (1) taxable income in the current year or prior years that is available through carry-back, (2) future taxable income that will result from the reversal of existing taxable temporary differences, and (3) taxable income generated by future operations. There is no valuation allowance for deferred tax assets as of December 31, 2009 and 2008. It is management's belief that realization of the deferred tax asset is more likely than not.

Retained earnings at December 31, 2009 includes approximately \$1.6 million representing pre-1988 tax bad debt base year reserve amounts for which no deferred income tax liability has been provided since these reserves are not expected to reverse until indefinite future periods and may never reverse. Circumstances that would require an accrual of a portion or all of this unrecorded tax liability are failure to meet the definition of a bank, dividend payments in excess of current year or accumulated tax earnings and profits, or other distributions in dissolutions, liquidations or redemption of the Bank's stock.

12. Employee Benefits

The Corporation has a contributory profit-sharing plan which is available to all eligible employees. Annual employer contributions to the plan consist of an amount which matches participant contributions up to a maximum of 5% of a participant's compensation and a discretionary amount determined annually by the Corporation's Board of Directors. The annual contributions to the plan will be 5% of a participant's compensation. Employer expensed contributions to the plans were \$150,000 and \$147,500 for the years ended December 31, 2009 and 2008, respectively.

13. Financial Instruments with Off Balance Sheet Risk

The Corporation 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 and to reduce its own exposure to fluctuations in interest rates. These financial instruments are commitments to extend credit. They involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheets. The contract or notional amounts of those instruments reflect the extent of involvements the Corporation has in particular classes of financial instruments.

The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. The Corporation uses the same credit policies in making commitments and conditional obligations as they do for on-balance-sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Corporation upon extension of credit, is based on management's credit evaluation of the counter-party. Collateral held varies but may include accounts receivable, inventory, property, plant, and equipment and income-producing commercial properties.

The Corporation had loan commitments as follows (in thousands):

	<u>As of December 31,</u>	
	<u>2009</u>	<u>2008</u>
Fixed/variable interest rate commitments to fund residential credit.....	\$ 1,519	\$ 4,539
Commitments to fund commercial and construction loans	320	1,926
Unused portion of credit lines (principally variable-rate consumer lines secured by real estate)	<u>38,292</u>	<u>49,380</u>
Total.....	<u>\$40,131</u>	<u>\$55,845</u>

The Corporation has no additional financial instruments with off-balance sheet risk.

The Corporation did not incur any losses on its commitments in the years ended December 31, 2009 and 2008.

14. Fair Value of Financial Instruments

The estimated fair values of the Corporation's financial instruments were as follows at December 31, 2009 (in thousands):

	December 31, 2009	
	Carrying Amount	Fair Value
<u>Financial assets</u>		
Cash and due from banks	\$15,631	\$15,631
Securities available for sale	147,816	147,816
Securities held to maturity	3,934	3,976
Federal Home Loan Bank stock, at cost	3,947	3,947
Federal Reserve Bank stock, at cost	832	832
Loans, net	250,420	250,455
Accrued interest receivable	2,238	2,238
Cash surrender value of life insurance	9,332	9,332
<u>Financial liabilities</u>		
Deposits	\$332,762	\$323,113
Advances from FHLB and other borrowings	64,500	67,457
Securities sold under agreement to repurchase	18,520	18,544
Floating rate junior subordinated deferrable interest debentures	12,372	10,758
Accrued interest payable	581	581
<u>Off-balance-sheet assets (liabilities)</u>		
Commitments to extend credit	(\$40,131)	(\$0)

The estimated fair values of the Corporation's financial instruments were as follows at December 31, 2008 (in thousands):

	December 31, 2008	
	Carrying Amount	Fair Value
<u>Financial assets</u>		
Cash and due from banks	\$21,370	\$21,370
Securities available for sale	100,418	100,418
Securities held to maturity	2,430	2,310
Federal Home Loan Bank stock, at cost	3,929	3,929
Federal Reserve Bank stock, at cost	599	599
Loans, net	278,665	286,004
Accrued interest receivable	2,087	2,087
Cash surrender value of life insurance	9,577	9,577
<u>Financial liabilities</u>		
Deposits	\$306,821	\$315,542
Advances from FHLB and other borrowings	69,500	70,394
Securities sold under agreement to repurchase	19,005	19,232
Floating rate junior subordinated deferrable interest debentures	12,372	11,636
Accrued interest payable	701	701
<u>Off-balance-sheet assets (liabilities)</u>		
Commitments to extend credit	(\$55,845)	(\$0)

The Corporation utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Effective January 1, 2008, the Corporation adopted FASB 157 (ASC 820-10-15) Fair Value Measurements which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. This standard requires disclosures about the fair value of assets and

14. Fair Value of Financial Instruments (continued)

liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans).

Fair Value Hierarchy

ASC 820-10-15 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820-10-15 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1** Valuation is based upon quoted prices in active markets for identical assets or liabilities.
- Level 2** Valuation is based upon quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3** Valuation is based upon quoted prices for similar assets or liabilities; quoted prices in markets that are not active; and model-based techniques whose value is determined using pricing models, discounted cash flow methodologies and similar techniques.

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

Investment Securities Available for Sale

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

Loans

The Corporation is predominantly an asset based lender with real estate serving as collateral on a substantial majority of loans. The Corporation does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and the related impairment is charged against the allowance or a specific allowance is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Loans which are deemed to be impaired are primarily valued at the fair values of the underlying real estate collateral. Such fair values are obtained using collateral net liquidation value, market value of similar debt, enterprise value, and discounted cash flows. Those impaired loans not requiring a specific allowance represent loans for which the fair value of the expected repayment or collateral meet or exceed the recorded investment in such loans. The Corporation considers all non-accrual loans and troubled debt restructurings to be impaired. Therefore, at December 31, 2009, loans classified as impaired totaled \$20.9 million. Based on recommendations from our primary bank regulator, specific reserves of \$6.4 million were charged off against the outstanding loans at December 31, 2009. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is not observable market price, the Corporation records the impaired loans as nonrecurring Level 3.

14. Fair Value of Financial Instruments (continued)

Real Estate Acquired Through Foreclosure

Other real estate owned (“OREO”) is adjusted to fair value upon transfer of the loans to OREO. Subsequently, OREO is 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 Corporation records the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation records the OREO as nonrecurring Level 3.

Goodwill and Other Intangible Assets

Goodwill and other intangible assets are subject to impairment testing. Goodwill and other intangible assets measured at fair value on a nonrecurring basis relate to intangible assets (deposit premium intangible) that were acquired in connection with acquisitions and were valued at their fair market values at the time of acquisition. As such, the Corporation classifies goodwill and other intangible assets subjected to nonrecurring value adjustments as Level 3. The Corporation evaluated its goodwill and intangibles in 2009 and determined the entire amounts to be impaired. Therefore, the Corporation did not have any goodwill or other intangible assets at December 31, 2009.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

Assets measured at fair value on a recurring basis at December 31, 2009 are as follows:

	<u>Total</u>	<u>(Level 1)</u>	<u>(Level 2)</u>	<u>(Level 3)</u>
Available for Sale Securities	\$147,816,000	\$78,474,000	\$66,232,000	\$3,110,000

Assets and liabilities measured at fair value on a recurring basis at December 31, 2008 are as follows:

	<u>Total</u>	<u>(Level 1)</u>	<u>(Level 2)</u>	<u>(Level 3)</u>
Available for Sale Securities	\$100,418,000	\$28,236,000	\$67,337,000	\$4,845,000

The following is a reconciliation of the beginning and ending balances for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period ended December 31, 2009.

	Fair Value Measurements Using Significant <u>Unobservable Inputs (Level 3)</u>
	Investment Securities
	<u>Available-for-Sale</u>
Beginning balance at December 31, 2008	\$4,845,000
Transfers in of Level 3	--
Gain/(Loss) for the year	(1,735,000)
Purchases, sales, issuances and settlements, net	--
Ending balance at December 31, 2009	<u>\$3,110,000</u>

14. Fair Value of Financial Instruments (continued)

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

The Corporation may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period.

Assets and liabilities measured at fair value on a nonrecurring basis at December 31, 2009 are as follows:

	<u>Total</u>	<u>(Level 1)</u>	<u>(Level 2)</u>	<u>(Level 3)</u>
Non performing loans	\$20,869,000	\$--	\$20,869,000	\$--
Other real estate owned	<u>5,917,000</u>	<u>--</u>	<u>5,917,000</u>	<u>--</u>
Total assets at fair value	<u>\$26,786,000</u>	<u>\$--</u>	<u>\$26,786,000</u>	<u>\$--</u>

Assets and liabilities measured at fair value on a nonrecurring basis at December 31, 2008 are as follows:

	<u>Total</u>	<u>(Level 1)</u>	<u>(Level 2)</u>	<u>(Level 3)</u>
Non performing loans	\$16,001,000	\$--	\$16,001,000	\$--
Other real estate owned	667,000	--	667,000	--
Goodwill and intangible assets	<u>2,845,000</u>	<u>--</u>	<u>2,845,000</u>	<u>--</u>
Total assets at fair value	<u>\$19,513,000</u>	<u>\$--</u>	<u>\$19,513,000</u>	<u>\$--</u>

15. Preferred Stock

On March 13, 2009, as part of the United States Department of the Treasury's Capital Purchase Program, the Corporation issued 9,266 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A, \$1,000 per share liquidation preference, and a warrant to purchase up to 178,880 shares of the Corporation's common stock for a period of ten years at an exercise price of \$7.77 per share, in exchange for \$9,266,000 in cash from the United States Department of the Treasury. The proceeds, net of issuance costs consisting primarily of legal fees, were allocated between the preferred stock and the warrant on a pro rata basis, based upon the estimated market values of the preferred stock and the warrant. As a result, \$25,000 of the proceeds was allocated to the warrant. The amount allocated to the warrant is considered a discount on the preferred stock and will be amortized using the level yield method over a five-year period through a charge to retained earnings. Such amortization will not reduce net income, but will reduce income available to common shareholders. Fair market value of the preferred stock was determined by using a discounted cash flow model that assumed a market dividend yield for similar preferred stock.

The preferred stock pays cumulative dividends of 5% per year for the first five years and 9% per year thereafter. The Corporation may redeem the preferred stock at its liquidation preference plus accrued and unpaid dividends at any time with the prior regulatory approval. The securities purchase agreement between the Corporation and the United States Department of the Treasury limits, for three years, the rate of dividend payments on the Corporation's common stock to the amount of its last quarterly cash dividend before participation in the program of \$0.03 per share unless an increase is approved by the Department of the Treasury, limits the Corporation's ability to repurchase its common stock for three years and subjects the Corporation to certain executive compensation limitations included in the Emergency Economic Stabilization Act of 2008, as amended by the American Recovery and Reinvestment Act of 2009. The Corporation plans to remain in the program for the initial three-year period and evaluate alternative sources of capital after that point.

16. Real Estate Acquired in Settlement of Loans

Real estate acquired in settlement of loans through foreclosure is summarized as follows:

	Years Ended December 31,	
	2009	2008
Balance at beginning of period.....	\$667	\$856
Foreclosures added during the period...	5,890	163
Provision charged as a write-down.....	<u>(640)</u>	<u>(352)</u>
Balance at the end of period	<u>\$5,917</u>	<u>\$667</u>

Net real estate operations expense was \$787,000 and \$409,000 for the years ended December 31, 2009 and 2008, respectively.

17. Supplemental Cash Flow Disclosures

	Years Ended December 31,	
	2009	2008
Cash paid for:		
Income taxes.....	\$ --	\$ 680
Interest.....	11,713	13,247
Non-cash transactions:		
Loans foreclosed	5,890	163
Unrealized gain (loss) on securities available for sale.....	(\$1,495)	(\$2,609)

18. Commitments and Contingencies

Lease commitments - The Corporation leases certain Bank facilities under rental agreements that have expiration dates between 2018 and 2025. Future minimum rental payments due under these leases are as follows:

<u>Years Ended</u>	
2010	\$ 469,464
2011	469,464
2012	469,464
2013	469,464
2014	469,464
Thereafter	2,370,192

Total rent expense for the years ended December 31, 2009 and 2008 was \$484,000 and \$446,000, respectively.

Lines of credit - At December 31, 2009, the Corporation had unused short-term secured lines of credit to purchase federal funds from unrelated banks totaling \$4.0 million and the ability to borrow an additional \$54.0 million from secured borrowing lines. Lines of credit are available on a one-to-ten day basis for general purposes of the Corporation. All of the lenders have reserved the right to withdraw these lines at their option.

Concentrations of Credit Risk - Financial instruments, which potentially subject the Corporation to concentrations of credit risk, consist principally of loans receivable, investment securities, federal funds sold and amounts due from banks.

The Corporation makes loans to individuals and small businesses for various personal and commercial purposes primarily in the Piedmont region of South Carolina and North Carolina. The Corporation's loan portfolio is not concentrated in loans to any single borrower or a relatively small number of borrowers. Additionally, management is not aware of any concentrations of loans to classes of borrowers or industries that would be similarly affected by economic conditions. Management has identified a concentration of a type of lending that it is monitoring. Commercial non-mortgage loans totaled \$73.5 million at December 31, 2009 representing 281% of total equity and 29% of loans receivable. At December 31, 2008, this concentration totaled \$94.0 million representing

18. Commitments and Contingencies (continued)

392% of total equity and 34% of net loans receivable. Commercial loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business and are generally secured by a variety of collateral types, primarily accounts receivable, inventory and equipment.

In addition to monitoring potential concentrations of loans to particular borrowers or groups of borrowers, industries, geographic regions and loan types, management monitors exposure to credit risk from other lending practices such as loans that subject borrowers to substantial payment increases (e.g. principal deferral periods, loans with initial interest-only periods, etc.) and loans with high loan-to-value ratios. Management has determined that the Corporation has a concentration of loans that exceed one of the regulatory guidelines for loan-to-value ratios. This particular guideline states that the total amount by which commercial, agricultural, and multifamily and other non-residential properties exceed the regulatory maximum loan-to-value ratio limits should not exceed 30% of a bank's total risk-based capital. The excess over regulatory guidelines for these types of loans totaled \$19.9 million at December 31, 2009 representing 52% of the Bank's total risk-based capital. These amounts exceeded regulatory guidelines by \$7.2 million and 18.6%, respectively.

Additionally, there are industry practices that could subject the Corporation to increased credit risk should economic conditions change over the course of a loan's life. For example, the Corporation makes variable rate loans and fixed rate principal-amortizing loans with maturities prior to the loan being fully paid (i.e. balloon payment loans). These loans are underwritten and monitored to manage the associated risks. Therefore, management believes that these particular practices do not subject the Corporation to unusual credit risk.

The Corporation's investment portfolio consists principally of obligations of the United States, its agencies or its corporations and general obligation municipal securities. In the opinion of management, there is no concentration of credit risk in its investment portfolio.

The Corporation places its deposits and correspondent accounts with and sells its federal funds to high quality institutions. Management believes credit risk associated with correspondent accounts is not significant.

Litigation - The Corporation is involved in legal actions in the normal course of business. In the opinion of management, based on the advice of its general counsel, the resolution of these matters will not have a material adverse impact on future results of operations or the financial position of the Corporation.

Potential Impact of Changes in Interest Rates - The Corporation's profitability depends to a large extent on its net interest income, which is the difference between interest income from loans and investments and interest expense on deposits and borrowings. Like most financial institutions, the Corporation's interest income and interest expense are significantly affected by changes in market interest rates and other economic factors beyond its control. Management seeks to manage the relationships between interest-sensitive assets and liabilities in order to protect against wide interest rate fluctuations.

The Corporation has more interest-rate sensitive assets than liabilities. Thus, it enjoys an increasing net interest rate spread during periods of rising interest rates. The Corporation experiences a shrinking net interest spread in a falling interest rate environment.

19. Stock Option Plans

At December 31, 2009, the Corporation had the following stock options outstanding.

<u>Grant Date</u>	<u>Shares Granted</u>	<u>Average Exercise Price Per Share</u>	<u>Average Intrinsic Value(1)</u>	<u>Expiration Date</u>	<u>Earliest Date Exercisable</u>
October, 2000	1,700	\$ 8.75	\$ –	October, 2010	October, 2000
January, 2001	15,840	9.06	–	January, 2011	January, 2001
January, 2002	13,573	10.36	–	January 2012	January, 2002
April, 2002	750	13.00	–	April, 2012	April, 2002
December, 2003	36,500	16.75	–	December, 2013	December, 2003
January, 2005	1,000	16.60	–	January, 2015	January, 2005
March, 2005	<u>21,500</u>	17.26	–	March, 2015	March, 2005
Total shares granted	<u>90,863</u>		<u>\$ –</u>		

(1) The aggregate intrinsic value of a stock option in the table above represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on December 31, 2009. This amount changes based on changes in the market value of the Corporation's stock.

At December 31, 2009, the Corporation had the following options exercisable:

<u>Fiscal Year</u>	<u>Range of exercise price</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Number Options Exercisable</u>	<u>Average Exercise Price</u>
2000	\$ 8.75	0.8 years	1,700	\$ 8.75
2001	9.06	2 years	15,840	9.06
2002	10.36-13.00	2.6 years	13,573	10.50
2003	16.75	4 years	750	16.75
2005	16.60	5 years	36,500	16.60
2005	17.26	4.9 years	1,000	17.26
			<u>21,500</u>	
	<u>\$8.75-\$17.26</u>	<u>3.8 years</u>	<u>90,863</u>	<u>\$14.44</u>

Options for the two previous fiscal years were forfeited and exercised as follows:

	<u>Stock options</u>	<u>Weighted average exercise</u>
Outstanding at December 31, 2007.....	<u>110,693</u>	<u>\$14.59</u>
Granted	–	–
Forfeited	(9,036)	15.64
Exercised	<u>(7,544)</u>	<u>15.57</u>
Outstanding at December 31, 2008.....	<u>94,113</u>	<u>\$14.44</u>
Granted	–	–
Forfeited	(3,250)	16.02
Exercised	–	–
Outstanding at December 31, 2009.....	<u>90,863</u>	<u>\$14.44</u>

The intrinsic value of options exercised for the years ended December 31, 2009 and 2008 was \$0 and \$24,108, respectively.

20. Liquidation Account, Dividend Restrictions and Regulatory Matters

On August 7, 1987, the Bank completed its conversion from a federally chartered mutual savings and loan association to a federally chartered stock savings and loan association. A special liquidation account was established by the Bank for the pre-conversion retained earnings of approximately \$3,718,000. The liquidation account is maintained for the benefit of depositors who held a savings or demand account as of the March 31, 1986 eligibility or the June 30, 1987 supplemental eligibility record dates who continue to maintain their deposits at the

20. Liquidation Account, Dividend Restrictions and Regulatory Matters (continued)

Bank after the conversion. In the event of a future liquidation (and only in such an event), each eligible and supplemental eligible account holder who continues to maintain his or her deposit account will be entitled to receive a distribution from the liquidation account. The total amount of the liquidation account will be decreased in an amount proportionately corresponding to decreases in the deposit account balances of eligible and supplemental eligible account holders on each subsequent annual determination date. Except for payment of dividends by the Bank to Provident Community Bancshares and repurchase of the Bank's stock, the existence of the liquidation account will not restrict the use or application of such net worth.

The Bank is prohibited from declaring cash dividends on its common stock or repurchasing its common stock if the effect thereof would cause its net worth to be reduced below either the amount required for the liquidation account or the minimum regulatory capital requirement. In addition, the Bank is also prohibited from declaring cash dividends and repurchasing its own stock without prior regulatory approval if the total amount of all dividends and stock repurchases (including any proposed dividends and stock repurchases) for the applicable calendar year exceeds its current year's net income plus its retained net income for the preceding two years. Under current OCC regulations the Bank is limited in the amount it may loan to affiliates, including the Corporation. Loans to a single affiliate may not exceed 10%, and the aggregate of loans to all affiliates may not exceed 20% of bank capital and surplus.

The Bank and the Corporation are subject to various regulatory capital requirements administered by banking regulators. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Corporation's financial statements.

Under 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.

Quantitative measures established by regulations to ensure capital adequacy require the Bank and the Corporation to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets (as defined in the regulations). Management believes, as of December 31, 2009, that the Bank and the Corporation meet the capital adequacy requirements to which they are subject.

As of December 31, 2009 and 2008, the Bank was "well capitalized" under the regulatory framework for prompt corrective action based on its capital ratio calculations. In order to be "well capitalized", the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since December 31, 2009 that management believes have changed the Bank's classification.

Under present regulations of the OCC, the Bank must have core capital (leverage requirement) equal to 4.0% of assets, of which 1.5% must be tangible capital, excluding intangible assets. The Bank must also maintain risk-based regulatory capital as a percent of risk weighted assets at least equal to 8.0%. In measuring compliance with capital standards, certain adjustments must be made to capital and total assets.

20. Liquidation Account, Dividend Restrictions and Regulatory Matters (continued)

The following tables present the total risk-based, Tier 1 risk-based and Tier 1 leverage requirements for the Corporation and the Bank (in thousands).

	December 31, 2009					
	Actual		Regulatory Minimum		"Well Capitalized"	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Leverage ratio						
Corporation	\$31,511	6.91%	\$18,234	4.00%	\$ n/a	n/a%
Bank	32,924	7.17	18,364	4.00	22,955	5.00
Tier 1 capital ratio						
Corporation	31,511	10.38	12,140	4.00	n/a	n/a
Bank	32,924	10.86	12,125	4.00	18,188	6.00
Total risk-based capital ratio ...						
Corporation	38,259	12.61	24,279	8.00	n/a	n/a
Bank	36,703	12.11	24,251	8.00	30,314	10.00

	December 31, 2008					
	Actual		Regulatory Minimum		"Well Capitalized"	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Leverage ratio						
Corporation	\$31,710	7.46%	\$16,786	4.00%	\$ n/a	n/a%
Bank	33,698	8.04	16,772	4.00	20,965	5.00
Tier 1 capital ratio						
Corporation	31,710	10.02	12,494	4.00	n/a	n/a
Bank	33,698	10.80	12,480	4.00	18,720	6.00
Total risk-based capital ratio ...						
Corporation	38,710	12.39	24,989	8.00	n/a	n/a
Bank	37,634	12.06	24,961	8.00	31,201	10.00

Under current Federal Reserve guidelines, the Corporation includes trust preferred securities in Tier 1 capital.

The Bank is required to maintain reserves, in the form of cash and balances with the Federal Reserve Bank, against its deposit liabilities. The amounts of such reserves totaled \$4.8 million at December 31, 2009 and \$2.5 million at December 31, 2008.

21. Recently Issued Accounting Standards

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

In June 2009, the Financial Accounting Standards Board ("FASB") issued guidance which restructured generally accepted accounting principles ("GAAP") and simplified access to all authoritative literature by providing a single source of authoritative nongovernmental GAAP. The guidance is presented in a topically organized structure referred to as the FASB Accounting Standards Codification ("ASC"). The new structure is effective for interim or annual periods ending after September 15, 2009. All existing accounting standards have been superseded and all other accounting literature not included is considered nonauthoritative.

The FASB issued new accounting guidance on accounting for transfers of financial assets in June 2009. The guidance limits the circumstances in which a financial asset should be derecognized when the transferor has not transferred the entire financial asset by taking into consideration the transferor's continuing involvement. The standard requires that a transferor recognize and initially measure at fair value all assets obtained (including a transferor's beneficial interest) and liabilities incurred as a result of a transfer of financial assets accounted for as a sale. The concept of a qualifying special-purpose entity is no longer applicable. The standard is effective for the

21. Recently Issued Accounting Standards (continued)

first annual reporting period that begins after November 15, 2009, for interim periods within the first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Corporation does not expect the guidance to have any impact on the Corporation's financial statements. The ASC was amended in December, 2009, to include this guidance.

Guidance was issued in June 2009 requiring a company to analyze whether its interest in a variable interest entity ("VIE") gives it a controlling financial interest that should be included in consolidated financial statements. A company must assess whether it has an implicit financial responsibility to ensure that the VIE operates as designed when determining whether it has the power to direct the activities of the VIE that significantly impact its economic performance, making it the primary beneficiary. Ongoing reassessments of whether a company is the primary beneficiary are also required by the standard. This guidance amends the criteria to qualify as a primary beneficiary as well as how to determine the existence of a VIE. The standard also eliminates certain exceptions that were previously available. This guidance is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. Comparative disclosures will be required for periods after the effective date. The Corporation does not expect the guidance to have any impact on the Corporation's financial position. An update was issued in December, 2009, to include this guidance in the ASC.

In January, 2010, an amendment was issued to clarify the scope of subsidiaries for consolidation purposes. The amendment provides that the decrease in ownership guidance should apply to (1) a subsidiary or group of assets that is a business or nonprofit activity, (2) a subsidiary that is a business or nonprofit activity that is transferred to an equity method investee or joint venture, and (3) an exchange of a group of assets that constitutes a business or nonprofit activity for a noncontrolling interest in an entity. The guidance does not apply to a decrease in ownership in transactions related to sales of in substance real estate or conveyances of oil and gas mineral rights. The update is effective for the interim or annual reporting periods ending on or after December 15, 2009 and had no impact on the Corporation's financial statements.

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

**22. Provident Community Bancshares, Inc. Financial Information
(Parent Corporation Only)**

Condensed financial information for Provident Community Bancshares is presented as follows (in thousands):

	As of December 31,	
	2009	2008
<u>Condensed Balance Sheets</u>		
Assets:		
Cash and due from banks	\$ 1,638	\$ 1,173
Investment in subsidiary	36,565	34,849
Other	<u>380</u>	<u>379</u>
Total assets	<u>\$38,583</u>	<u>\$36,401</u>
Liabilities and Shareholders' Equity:		
Accrued interest payable	\$ 90	\$ 105
Floating rate junior subordinated deferrable interest debentures	12,372	12,372
Shareholders' equity	<u>26,121</u>	<u>23,924</u>
Total liabilities and shareholders' equity	<u>\$38,583</u>	<u>\$36,401</u>
	Years Ended December 31,	
	2009	2008
<u>Condensed Statements of Income(Loss)</u>		
Equity in undistributed earnings (losses) of subsidiary	\$(6,774)	\$ 412
Interest expense	(530)	(721)
Other expense, net	<u>(87)</u>	<u>(88)</u>
Net loss	<u>\$(7,391)</u>	<u>\$(397)</u>
<u>Condensed Statements of Cash Flows</u>		
Operating Activities:		
Net loss	\$(7,391)	\$(397)
Adjustments to reconcile net loss to net cash used in operating activities:		
Equity in undistributed earnings (losses) of subsidiary	6,774	(412)
Increase (decrease) in other assets and liabilities, net	<u>(16)</u>	<u>(10)</u>
Net cash used in operating activities	<u>(633)</u>	<u>(819)</u>
Investing Activities:		
Capital contribution to subsidiary	<u>(7,766)</u>	--
Net cash used in investing activities	<u>(7,766)</u>	--
Financing Activities:		
Dividends received from subsidiary	--	2,900
Dividend reinvestment plan contributions	16	120
Issuance of preferred stock	9,240	--
Issuance of common stock warrants	25	--
Preferred stock dividends paid	(310)	--
Cash dividends paid	(107)	(821)
Share repurchase program	--	(345)
Proceeds from the exercise of stock options	<u>--</u>	<u>2</u>
Net cash provided by financing activities	<u>8,864</u>	<u>1,856</u>
Net increase in cash and due from banks	465	1,037
Cash and due from banks at beginning of period	<u>1,173</u>	<u>136</u>
Cash and due from banks at end of period	<u>\$1,638</u>	<u>\$1,173</u>

23. Quarterly Financial Data (unaudited)

The tables set forth below summarize selected financial data regarding results of operations for the periods indicated (in thousands, except common share data).

For the year ended December 31, 2009

	<u>First quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth quarter</u>	<u>Total</u>
Interest income	\$5,138	\$5,344	\$5,352	\$5,065	\$20,899
Interest expense	<u>3,027</u>	<u>3,003</u>	<u>2,898</u>	<u>2,665</u>	<u>11,593</u>
Net interest income	2,111	2,341	2,454	2,400	9,306
Provision for loan losses	2,700	925	1,425	3,645	8,695
Non-interest income	480	270	413	(1,129)	34
Non-interest expense	2,516	2,617	2,480	4,434	12,047
Provision (benefit) for income taxes	(930)	(364)	(402)	(2,315)	(4,011)
Preferred stock dividends and accretion	<u>25</u>	<u>118</u>	<u>119</u>	<u>120</u>	<u>382</u>
(Loss) income available to common shareholders	<u>\$(1,720)</u>	<u>\$(685)</u>	<u>\$(755)</u>	<u>\$(4,613)</u>	<u>\$(7,773)</u>
Net loss income per common share—Basic	<u>\$(0.95)</u>	<u>\$(0.32)</u>	<u>\$(0.42)</u>	<u>\$(2.65)</u>	<u>\$(4.34)</u>
Net loss income per common share—Diluted	<u>\$(0.95)</u>	<u>\$(0.32)</u>	<u>\$(0.42)</u>	<u>\$(2.65)</u>	<u>\$(4.34)</u>

For the year ended December 31, 2008

	<u>First quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth quarter</u>	<u>Total</u>
Interest income	\$6,175	\$5,700	\$5,533	\$5,377	\$22,785
Interest expense	<u>3,673</u>	<u>3,236</u>	<u>3,137</u>	<u>3,160</u>	<u>13,206</u>
Net interest income	2,502	2,464	2,396	2,217	9,579
Provision for loan losses	310	365	615	2,920	4,210
Non-interest income	885	850	1,062	887	3,684
Non-interest expense	2,522	2,550	2,456	2,518	10,046
Provision (benefit) for income taxes	<u>134</u>	<u>83</u>	<u>81</u>	<u>(894)</u>	<u>(596)</u>
Net income (loss)	<u>\$421</u>	<u>\$316</u>	<u>\$306</u>	<u>\$(1,440)</u>	<u>\$(397)</u>
Net income (loss) per common share—Basic	<u>\$0.24</u>	<u>\$0.18</u>	<u>\$0.17</u>	<u>\$(0.81)</u>	<u>\$(0.22)</u>
Net income (loss) per common share—Diluted	<u>\$0.23</u>	<u>\$0.18</u>	<u>\$0.17</u>	<u>\$(0.81)</u>	<u>\$(0.22)</u>

24. Subsequent Events

The Corporation has evaluated events and transactions through the filing date for potential recognition or disclosure in the consolidated financial statements and has determined there are no subsequent events to disclose.

Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A(T). Controls and Procedures

(a) Disclosure Controls and Procedures

The Company's management, including the Company's principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the "Exchange Act"). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or

submits under the Exchange Act with the Securities and Exchange Commission (the “SEC”) (1) is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and (2) is accumulated and communicated to the Company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

(b) Internal Controls Over Financial Reporting

Management’s annual report on internal control over financial reporting is incorporated herein by reference to the Company’s audited Consolidated Financial Statements in this Annual Report on Form 10-K.

This annual report does not include an attestation report of the Company’s registered public accounting firm regarding internal control over financial reporting. Management’s report was not subject to attestation by the Company’s registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management’s report in this annual report.

(c) Changes to Internal Control Over Financial Reporting

Except as indicated herein, there were no changes in the Company’s internal control over financial reporting during the three months ended December 31, 2009 that have materially affected, or are reasonable likely to materially affect, the Company’s internal control over financial reporting.

(See Item 8. Financial Statements and Supplementary Data for additional information regarding management’s report on internal control over financial reporting.)

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Directors

For information concerning the Board of Directors of Provident Community Bancshares, the information contained under the section captioned “Items to be Voted on By Shareholders — Item 1 — Election of Directors” in the Proxy Statement is incorporated herein by reference.

Compliance with Section 16(a) of the Exchange Act

Reference is made to the cover page of this Form 10-K and to the section captioned “Other Information Relating to Directors and Executive Officers — Section 16(a) Beneficial Ownership Reporting Compliance” for information regarding compliance with section 16(a) of the Exchange Act.

Code of Ethics

For information concerning the Corporation’s code of ethics, the information contained under the section captioned “Corporate Governance — Code of Ethics and Business Conduct” in the Proxy Statement is incorporated herein by reference. A copy of the code of ethics is available, in the Investor Relations Section of our website at www.providentonline.com.

Executive Officers of the Registrant

Certain executive officers of the Bank also serve as executive officers of Provident Community Bancshares. The day-to-day management duties of the executive officers of Provident Community Bancshares and the Bank relate primarily to their duties as to the Bank. The executive officers of Provident Community Bancshares currently are as follows:

<u>Name</u>	<u>Age(1)</u>	<u>Position as of December 31, 2009</u>
Dwight V. Neese	59	President, Chief Executive Officer and Director
Richard H. Flake	61	Executive Vice President – Chief Financial Officer
Lud W. Vaughn	59	Executive Vice President – Chief Operating Officer

(1) At December 31, 2009.

Dwight V. Neese was appointed as President and Chief Executive Officer of the Bank effective September 5, 1995.

Richard H. Flake joined the Company in September 1995.

Lud W. Vaughn joined the Company in April 2003. Prior to joining the Company, Mr. Vaughn was Senior Vice President for Bank of America in Rock Hill, South Carolina.

Corporate Governance

Information concerning the audit committee and the audit committee financial expert and other corporate governance matters is incorporated herein by reference to the section titled “Corporate Governance — Committees of the Board of Directors” and “— Audit Committee” in the Proxy Statement.

Item 11. Executive Compensation

The information contained under the sections captioned “Executive Compensation” and “Corporate Governance-Director Compensation” in the Proxy Statement is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

(a) Security Ownership of Certain Beneficial Owners

Information required by this item is incorporated herein by reference to the section captioned “Stock Ownership” in the Proxy Statement.

(b) Security Ownership of Management

Information required by this item is incorporated herein by reference to the section captioned “Stock Ownership” in the Proxy Statement.

(c) Management of Provident Community Bancshares knows of no arrangements, including any pledge by any person of securities of Provident Community Bancshares, the operation of which may at a subsequent date result in a change in control of the registrant.

(d) Equity Compensation Plan Information

The following table sets forth information about the Company common stock that may be issued upon the exercise of stock options, warrants and rights under all of the Company's equity compensation plans as of December 31, 2009.

Plan category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	90,863	\$14.39	157,373
Equity compensation plans not approved by security holders			
Total	90,863	\$14.39	157,273

Item 13. Certain Relationships and Related Transactions, and Director Independence

Transactions with Related Persons

The information required by this item is incorporated herein by reference to the sections captioned "Other Information Relating to Director and Executive Officers—Policies and Procedures for Approval of Related Person Transactions" and "—Transactions with Related Persons" in the Proxy Statement.

Director Independence

Information concerning director independence is incorporated herein by reference to the section titled "Corporate Governance—Director Independence" in the Proxy Statement.

Item 14. Principal Accountant Fees and Services

The information required by this Item is incorporated herein by reference to the section captioned "Items to be Voted On By Stockholders—Item 3—Ratification of the Appointment of the Independent Registered Public Accounting Firm" in the Proxy Statement.

PART IV

Item 15. Exhibits

Exhibit No.	Description	Incorporated by Reference to
3(a)	Amended and Restated Certificate of Incorporation	Form 10-Q for the quarterly period ended June 30, 2006, as filed on August 9, 2006
3(b)	Bylaws	Form 10-K for the year ended December 31, 2008, as filed on March 26, 2009
4(a)	Certificate of Designations establishing Fixed Rate Cumulative Perpetual Preferred Stock, Series A, of Provident Community Bancshares	Form 8-K as filed on March 3, 2009
4(b)	Form of stock certificate for Fixed Rate Cumulative Perpetual Preferred Stock, Series A	Form 8-K as filed on March 3, 2009
4(c)	Warrant to purchase 179,100 Share of Common Stock of Provident Community Bancshares, Inc.	Form 8-K as filed on March 3, 2009
10(a)	Employment Agreement with Dwight V. Neese	Form 10-KSB for the year ended September 30, 2003, as filed on December 19, 2003
10(b)	Employment Agreement with Richard H. Flake	Form 10-KSB for the year ended September 30, 2003, as filed on December 19, 2003
10(c)	(Form of First Amendment to the Employment Agreement by and between Provident Community Bancshares, Inc., Provident Community Bank and each of Dwight V. Neese and Richard R. Flake	Form 10-K for the year ended December 31, 2008, as filed on March 26, 2009
10(d)	Provident Community Bancshares, Inc. 1995 Stock Option Plan	Definitive Proxy Statement as filed on December 22, 1995
10(e)	Provident Community Bancshares, Inc. 2001 Stock Option Plan	Definitive Proxy Statement as filed on December 22, 2000
10(f)	Provident Community Bancshares, Inc. 2006 Stock Option Plan	Definitive Proxy Statement as filed on March 20, 2006
10(g)	Amended and Restated Change in Control Agreement by and among Lud W. Vaughn, Provident Community Bank, N.A. and Provident Community Bancshares, Inc.	Form 10-Q for the quarterly period ended June 30, 2007, as filed on August 13, 2007
10(h)	Form of First Amendment to the Amended and Restated Change in Control Agreement by and between Provident Community Bancshares, Inc., Provident Community Bank and Lud W. Vaughn	Form 10-K for the year ended December 31, 2008, as filed on March 26, 2009
10(i)	Supplemental Executive Retirement Plan, by and between Dwight V. Neese and Provident Community Bank	Form 10-Q for the quarterly period ended March 31, 2007, as filed on May 14, 2007
10(j)	Supplemental Executive Retirement Plan #2, by and between Dwight V. Neese and Provident Community Bank	Form 10-Q for the quarterly period ended March 31, 2007, as filed on May 14, 2007
10(k)	Supplemental Executive Retirement Plan, by and between Richard H. Flake and Provident Community Bank	Form 10-Q for the quarterly period ended March 31, 2007, as filed on May 14, 2007
10(l)	Supplemental Executive Retirement Plan #2, by and between Richard H. Flake and Provident Community Bank	Form 10-Q for the quarterly period ended March 31, 2007, as filed on May 14, 2007
10(m)	Supplemental Executive Retirement Plan, by and between Lud W. Vaughn and Provident Community Bank	Form 10-Q for the quarterly period ended June 30, 2007, as filed on August 13, 2007

10(n)	Form of Second Amendment to the Employment Agreement by and between Provident Community Bancshares, Inc., (formerly Union Financial Bancshares, Inc.) Provident Community Bank and each of Dwight V. Neese and Richard R. Flake	Form 10-K for the year ended December 31, 2008, as filed on March 26, 2009
10(o)	Form of First Amendment to the Amended and Restated Change in Control Agreement by and between Provident Community Bancshares, Inc., (formerly Union Financial Bancshares, Inc.) Provident Community Bank and Lud W. Vaughn	Form 10-K for the year ended December 31, 2008, as filed on March 26, 2009
21	Subsidiaries of the Registrant	
23	Consent of Independent Auditor	
31(a)	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	
31(b)	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer	
32	Section 1350 Certifications	
99(a)	Principal Executive Officer Certification Regarding TARP	
99(b)	Principal Financial Officer Certification Regarding TARP	

SIGNATURES

In accordance with the requirements of Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PROVIDENT COMMUNITY BANCSHARES, INC.

Date: March 16, 2010

By: /s/ Dwight V. Neese
Dwight V. Neese
President and Chief Executive Officer

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ Dwight V. Neese
Dwight V. Neese
(Principal Executive Officer)

By: /s/ Russell H. Smart
Russell H. Smart
Director

Date: March 16, 2010

Date: March 16, 2010

By: /s/ Richard H. Flake
Richard H. Flake
(Principal Financial and
Accounting Officer)

By: /s/ Phillip C. Wilkins
Phillip C. Wilkins
Director

Date: March 16, 2010

Date: March 16, 2010

By: /s/ Robert H. Breakfield
Robert H. Breakfield
Director

Date: March 16, 2010

By: /s/ William M. Graham
William M. Graham
Director

Date: March 16, 2010

By: /s/ Carl L. Mason
Carl L. Mason
Director

Date: March 16, 2010