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U.S. Securities and Exchange Commission

Washington, D.C. 20549

Form 10-K

x Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2008

¨ Transition Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ____________ to ____________

Commission file number 000-33227

Southern Community Financial Corporation

(Exact name of registrant as specified in its charter)

North Carolina	56-2270620
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
4605 Country Club Road Winston-Salem, North Carolina	27104
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (336) 768-8500

Securities Registered Pursuant to Section 12(b) of the Exchange Act:

Title of each class	Exchange on which registered
Common Stock, No Par Value	The NASDAQ Stock Market, LLC
7.95% Cumulative Trust Preferred Securities	The NASDAQ Stock Market, LLC
7.95% Junior Subordinated Debentures	The NASDAQ Stock Market, LLC
Guarantee with respect to 7.95% Cumulative Trust Preferred Securities	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 x

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “accelerated and large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer ¨ Accelerated filer x 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 x

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter, $99.7 million.

As of February 28, 2009, the registrant had outstanding 16,793,175 shares of Common Stock, no par value.

Documents Incorporated By Reference

Document	Where Incorporated
Proxy Statement for the Annual Meeting of Shareholders to be held May 26, 2009 to be mailed to shareholders within 120 days of December 31, 2008.	Part III

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PART I

Item 1. Business

Who We Are

Southern Community Financial Corporation ("we" or the "Company") is the holding company for Southern Community Bank and Trust (the "Bank"), a community bank with twenty-two banking offices operating in nine counties throughout North Carolina. The Bank commenced operations on November 18, 1996 and effective October 1, 2001 became a wholly-owned subsidiary of the newly formed holding company. Our banking offices are located in the Piedmont Triad area (including Winston-Salem (our headquarters), Greensboro, High Point and surrounding areas) Mooresville (the Charlotte area), Raleigh and Asheville.

At December 31, 2008, the Company had total assets of $1.8 billion, net loans of $1.3 billion, deposits of $1.2 billion and shareholders' equity of $187.7 million. The Company had net income available to common shareholders of $5.7 million, $7.6 million and $4.2 million and diluted earnings per common share of $0.33, $0.43 and $0.24 for the years ended December 31, 2008, 2007 and 2006, respectively.

The Company has been, and intends to remain, a community-focused financial institution offering a full range of financial services to individuals, businesses and nonprofit organizations in the communities we serve. Our banking services include checking and savings accounts; commercial, installment, mortgage and personal loans; trust and investment services; safe deposit boxes and other associated services to satisfy the needs of our customers.

In our twelve years of existence the Company has:

- Established a reputation for superior service to our customers and the communities in which we operate;
- Developed a full service financial institution operating in four of the fastest growing markets in North Carolina;
- Maintained third position in deposit market share in our home base of Forsyth County and fifth position in the Piedmont Triad;
- Maintained a strong credit culture. As of December 31, 2008, our nonperforming assets totaled $20.2 million or 1.12% of total assets and our allowance for loan losses amounted to $18.9 million or 1.43% of total loans and 131% of nonperforming loans; and
- Acquired The Community Bank, Pilot Mountain, North Carolina, in January 2004, raising our assets at that time to over $1.0 billion and increasing the number of banking offices.

The website for the Bank is www.smallenoughtocare.com. Our periodic reports on Forms 10-Q and 10-K are available on our website under "Investor Relations." The Company is registered as a financial holding company with the Federal Reserve System. The Company and the Bank are organized under the laws of North Carolina. The Federal Deposit Insurance Corporation insures the Bank's deposits up to applicable limits. The address of our principal executive office is 4605 Country Club Road, Winston-Salem, North Carolina 27104 and our telephone number is (336) 768-8500. Our common stock and one of our trust preferred security issues are traded on the NASDAQ Global Select Market System under the symbols "SCMF" and "SCMFO", respectively.

Our Market Area

The Company's primary market areas are the Piedmont Triad area of North Carolina, Mooresville (the Charlotte area) Asheville (Western Mountains of North Carolina) and Raleigh (in the Research Triangle region of the eastern Piedmont of North Carolina). The Piedmont Triad is a twelve county region located in north central North Carolina and is named for the three largest cities in the region, Winston-Salem (where our headquarters is located), Greensboro and High Point. The North Carolina State Data Center estimated that in July 2007, the region's estimated population was almost 1.6 million, approximately 20% of the state's population.

Winston-Salem is the largest city in Forsyth County and the fourth largest city in North Carolina in July 2007 according to the NC State Data Center. Greensboro is the largest city in Guilford County and the third largest city in North Carolina, while High Point is the second largest city in Guilford County and the ninth largest city in North Carolina according to the July 2007 estimates of the NC Data Center. The NC Data Center estimated the July 2007 population of Forsyth County to exceed 338 thousand and the population of Guilford County to exceed 460 thousand. The populations of Forsyth County and Guilford County are projected to grow to 427 thousand and 589 thousand, respectively, by 2030.

The Piedmont Triad is the economic hub of northwest North Carolina. In 2006, the US Department of Housing and Urban Development estimated that the 2005 median family income ranged from a low of $45,200 in the Mt. Airy micropolitan area to a high of $58,200 in the Winston-Salem metropolitan area. The Piedmont Triad has a very balanced and diversified economy and a work force that exceeded 827 thousand in July 2008, according to the NC Employment Security Commission. Approximately 99% of the work force is employed in nonagricultural wage and salary positions. According to the NC Employment Security Commission, the major employment sectors in 2006 were services (36%), manufacturing (18%), trade (11%), government (12%), financial (7%) and construction (6%). During 2008, NC Employment Security Commission statistics showed that the unemployment rate in the Piedmont Triad varied from a low of 5.3% to a high of 8.6% in December.

The Raleigh-Cary metropolitan statistical area is the fastest growing MSA in North Carolina with a 2008 population estimated by the Wake County Economic Development office of over one million. The NC Data Center estimated the July 2007 population of Wake County to exceed 832 thousand. The Wake County population is projected to more than double by 2030. The US Census Bureau estimated the area's 2004 median household income to be over $57,800. According to the NC Employment Security Commission, the labor force in the Research Triangle region exceeded 550 thousand in July 2008 and the unemployment rate during 2008 varied from a low of 4.0% to a high of 6.5% in December.

The Charlotte MSA is the second fastest growing MSA in North Carolina. The NC Data Center estimated the July 2007 population of Mecklenburg County to exceed 863 thousand. The Mecklenburg County population is projected to grow to over 1.3 million by 2030. According to the NC Employment Security Commission, the area's labor force exceeded 863 thousand in July 2008 and the unemployment rate during 2008 varied from a low of 5.2% to a high of 8.9% in December. Mooresville is located in the Lake Norman area, north of Charlotte.

Asheville is the largest city in Western North Carolina and the eleventh largest city in North Carolina, according to the July 2007 estimates of the NC Data Center, with an estimated population of over 76 thousand. In 2006, SRC, Inc. estimated the median family income in the area to be $40,700. The Western North Carolina region has a balanced and diversified economy. According to the US Bureau of Labor Statistics, the major employment sectors in 2008 were education and health services (16.9%), government (14.7%), retail (12.8%), leisure and hospitality (13.8%), manufacturing (11.2%), services (9.8%) and construction (6.7%). According to the NC Employment Security Commission, the Asheville MSA's labor force exceeded 212 thousand in July 2008 and the unemployment rate during 2008 varied from a low of 4.1% to a high of 6.7% in December.

The Bank serves our market areas through twenty-two full service banking offices. Our television and radio advertising has extended into our market areas for several years, providing the Bank name recognition. The Bank's customers may access various banking services through over one hundred ATMs owned or leased by the Bank, through debit cards, and through the Bank's automated telephone and Internet electronic banking products. These products allow the Bank's customers to apply for loans, access account information and conduct various transactions from their telephones and computers.

Business Strategy

The Company's primary objective is to become a vital, long-term player in our markets with a reputation for quality customer service provided by a financially sound organization. Our business strategy is to operate as a well capitalized institution that is strong in asset quality, profitable, independent, customer-oriented and connected to our community.

A commitment to customer service is at the foundation of our approach. Our commitment is to put our customers first and we believe it differentiates us from our competitors. Making good quality, profitable loans, which result in a long-standing relationship with our borrowers, will continue to be a cornerstone of our strategy. We intend to leverage the core relationships we build by providing a variety of services to our customers. With that focus, we target:

- Small and medium sized businesses, and the owners and managers of these entities;
- Professional and middle managers of locally based companies;
- Residential real estate developers; and
- Individual consumers.

We intend to grow our franchise through new and existing relationships developed by our employees and by expanding primarily to contiguous areas through branching and acquisitions which make strategic and economic sense.

We have also diversified our revenue in order to generate non-interest income. These efforts include expansion of mortgage banking, wealth management and investment in Small Business Investment Company (SBIC) activities through Salem Capital Partners. Southern Community Advisors, our wealth management group, offers investment advisory, brokerage, trust and insurance services. For more information on the Company's SBIC activities, see below under the heading "SUBSIDIARIES". For the year ended December 31, 2008 our non-interest income, excluding securities gains and losses, represented 19.2% of our total revenue. We believe that the profitability of these added businesses and services, not just the revenue generated, is critical to our long term success.

Key aspects of our strategy and mission include:

- To provide community-oriented banking services by delivering a broad range of financial services to our customers through responsive service and communication;
- To form a partnership with our customers whereby our decision making and product offerings are geared toward their best long-term interests;
- To be recognized in our community as a long-term player with employees, stockholders and directors committed to that effort; and
- To be progressive in our adoption of new technology so that we can provide our customers access to products and services that meet their needs for convenience and efficiency.

Our belief is that our way of doing business will build a profitable corporation and shareholder value. We want to consistently reward our shareholders for their investment and trust in us.

Subsidiaries

In addition to those financial services offered by the Bank, the Company has two subsidiaries, Southern Community Capital Trust II ("Trust II") and Southern Community Capital Trust III ("Trust III"), to issue trust preferred securities. Each subsidiary is described below.

In November 2003, Southern Community Capital Trust II publicly issued 3,450,000 shares of Trust Preferred Securities ("Trust II Securities"), generating gross total proceeds of $34.5 million. The Trust II Securities pay distributions at an annual rate of 7.95% and mature on December 31, 2033. The Trust II Securities began paying quarterly distributions on December 31, 2003. The Company has fully and unconditionally guaranteed the obligations of Trust II. The Trust II Securities are redeemable in whole or in part at any time after December 31, 2008. The proceeds from the Trust II Securities were utilized to purchase junior subordinated debentures from the Bank under the same terms and conditions as the Trust II Securities. We have the right to defer payment of interest on the debentures at any time and from time to time for a period not exceeding five years, provided that no deferral period extends beyond the stated maturities of the debentures. Such deferral of interest payments by the Company will result in a deferral of distribution payments on the related Trust II Securities. Should we defer the payment of interest on the debentures, the Company will be precluded from the payment of cash dividends to shareholders. The principal uses of the net proceeds from the sale of the debentures were to provide cash for the acquisition of The Community Bank, to increase our regulatory capital and to support the growth and operations of our subsidiary bank. The amount of proceeds qualifying for Tier 1 capital cannot comprise more than 25% of our core capital elements. Amounts in excess of that 25% limitation count as Tier 2 supplementary capital for regulatory capital purposes. At year end, the entire proceeds from the Trust II Securities qualified as Tier 1 capital of the Company for regulatory capital purposes. The amount that qualifies as Tier 1 capital will decrease during 2009 and subsequent years.

In June 2007, $10.0 million of trust preferred securities were placed through Southern Community Capital Trust III ("Trust III"), a newly formed subsidiary of the Company, as part of a pooled trust preferred security. The Trust issuer invested the total proceeds from the sale of the Trust Preferred Securities in Junior Subordinated Deferrable Interest Debentures (the "Junior Subordinated Debentures") issued by the Company. The terms of the trust preferred securities require payment of cumulative cash distributions quarterly at an annual rate, reset quarterly, equal to LIBOR plus 1.43%. During 2008, the Company entered into an interest rate swap derivative contract with a counterparty that shifted this debt service from a variable rate to a fixed rate of 4.7% per annum. The dividends paid to holders of the trust preferred securities, which are recorded as interest expense, are deductible for income tax purposes. The trust preferred securities are redeemable in 30 years with a five year call provision. The Company has fully and unconditionally guaranteed the trust preferred securities through the combined operation of the debentures and other related documents. The Company's obligation under the guarantee is unsecured and subordinate to senior and subordinated indebtedness of the Company. The principal use of the net proceeds from the sale of the debentures was to provide additional capital into the Company to fund its operations and continued expansion, and to maintain the Company's and the Bank's status as "well capitalized" under regulatory guidelines.

The Bank has interests in two unconsolidated entities (VCS Management LLC and SCP Advisor LLC) to house its investment in its SBIC activities. VCS Management, LLC was formed in March 2000 as the managing general partner of what is now known as Salem Capital Partners, L.P. ("SCP I"), a small business investment company (SBIC) licensed by the Small Business Administration. The Bank has invested $1.7 million in the partnership, which has a total of $9.2 million of invested capital from various private investors including the Bank. The partnership can also borrow funds on a non-recourse basis from the Small Business Administration to increase its funds available for investment. The partnership makes investments generally in the form of subordinated debt and earns revenue through interest received on its investments and potentially through gains realized from warrants that it receives in conjunction with its debt investments. The Bank shares in any earnings of the partnership through its investment in the partnership. During 2006, Salem Capital Partners II, L.P. ("SCP II") was formed and licensed by the Small Business Administration, with a purpose and operations similar to SCP I. Through December 31, 2008, the Bank has contributed $1.2 million of its $2.0 million capital commitment to SCP II. As of January 2009, SCP II has commitments for $35 million from various private investors, including the $2 million from the Bank. In connection with the formation of SCP II, a new entity, SCP Advisor LLC, was formed as the managing general partner of SCP I and II. The Bank owns 15% of SCP Advisor LLC. VCS Management, LLC is currently dormant and only receives the Bank's portion of any carried interest from SCP I. For the year ended December 31, 2008, the Company earned $60 thousand, or 0.1% of total revenue, from its SBIC activities, including income from the investments in SCP I and II and SBIC management fees. The revenue stream from SBIC activities has been irregular over the past two years due to the impact of economic conditions on certain portfolio companies during 2008 compared with substantial gains from the exit of certain portfolio investments during 2007.

Competition

The activities in which the Bank engages are highly competitive. Commercial banking in North Carolina is extremely competitive due to state laws which permit statewide branching. Consequently, many commercial banks have branches located in several communities. One of the largest regional commercial banks in North Carolina, a new community bank and one savings institution also have their headquarters in Winston-Salem. Currently, we operate branches in Buncombe, Forsyth, Guilford, Iredell, Rockingham, Stokes, Surry, Wake and Yadkin Counties, North Carolina. In June 2008, there were 717 branches operated by fifty-one banks and thirteen savings institutions in these nine counties with approximately $46.3 billion in deposits. On that date, deposits of the Bank were $1.2 billion for a 2.64% market share. The top three deposit market share leaders in this market area account for 60.6% of deposits. Many of these competing banks have capital resources and legal lending limits substantially in excess of those available to the Bank. Therefore, in our market area, the Bank has significant competition for deposits and loans from other depository institutions.

Other financial institutions such as credit unions, consumer finance companies, insurance companies, brokerage companies, small loan companies and other financial institutions with varying degrees of regulatory restrictions compete vigorously for a share of the financial services market. Credit unions have been permitted to expand their membership criteria and expand their loan services to include such traditional bank services as commercial lending. These entities pose an ever increasing challenge to our efforts to serve the markets traditionally served by banks. We expect competition to continue to be significant.

Employees

During 2008, all employees of Southern Community Financial Corporation were compensated by the Bank. At December 31, 2008, the Bank employed 337 full-time equivalent persons (including our executive officers). None of the employees are represented by any unions or similar groups, and we have not experienced any type of strike or labor dispute. We consider our relationship with our employees to be good and extremely important to our long-term success. The Board and management continually seek ways to enhance employee benefits and the well being of employees.

SUPERVISION AND REGULATION

Southern Community Financial Corporation is registered as a financial holding company with the Federal Reserve. The Bank is a North Carolina chartered banking corporation which is not a member of the Federal Reserve System. Banking is a complex, highly regulated industry. The primary goals of bank regulations are to maintain a safe and sound banking system and to facilitate the conduct of sound monetary policy. In furtherance of these goals, Congress has created several largely autonomous regulatory agencies and enacted numerous laws that govern banks, bank holding companies and the banking industry. The descriptions of and references to the statutes and regulations below are brief summaries and do not purport to be complete. The descriptions are qualified in their entirety by reference to the specific statutes and regulations discussed.

Southern Community Financial Corporation

Southern Community Financial Corporation is a bank holding company that has elected to be treated as a financial holding company. As a bank holding company under the Bank Holding Company Act of 1956, as amended, we are registered with and subject to regulation by the Federal Reserve. We are required to file annual and other reports with, and furnish information to, the Federal Reserve. The Federal Reserve may conduct periodic examinations of the Holding Company and may examine any of its subsidiaries, including the Bank.

The Bank Holding Company Act provides that a bank holding company must obtain the prior approval of the Federal Reserve for the acquisition of more than five percent of the voting stock or substantially all the assets of any bank or bank holding company. In addition, the Bank Holding Company Act restricts the extension of credit to any bank holding company by its subsidiary bank. The Bank Holding Company Act also provides that, with certain exceptions, a bank holding company may not engage in any activities other than those of banking or managing or controlling banks and other authorized subsidiaries or own or control more than five percent of the voting shares of any company that is not a bank. The Federal Reserve has deemed limited activities to be closely related to banking and therefore permissible for a bank holding company.

Subject to various limitations, federal banking law generally permits a bank holding company to elect to become a “financial holding company.” A financial holding company may affiliate with securities firms and insurance companies and engage in other activities that are “financial in nature.” Among the activities that are deemed “financial in nature” are, in addition to traditional lending activities, securities underwriting, dealing in or making a market in securities, sponsoring mutual funds and investment companies, insurance underwriting and agency activities, certain merchant banking activities as well as activities that the Federal Reserve considers to be closely related to banking.

A bank holding company may become a financial holding company if each of its subsidiary banks is “well capitalized” under the Federal Deposit Insurance Corporation Improvement Act prompt corrective action provisions, is well managed and has at least a satisfactory rating under the Community Reinvestment Act. In addition, the bank holding company must file a declaration with the Federal Reserve that the bank holding company wishes to become a financial holding company. A bank holding company that falls out of compliance with these requirements may be required to cease engaging in some of its activities. Southern Community Financial Corporation elected, and was authorized by the Federal Reserve, to be a financial holding company.

The Federal Reserve serves as the primary "umbrella" regulator of financial holding companies, with supervisory authority over each parent company and limited authority over its subsidiaries. Expanded financial activities of financial holding companies are generally regulated according to the type of such financial activity: banking activities by banking regulators, securities activities by securities regulators and insurance activities by insurance regulators. Federal law imposes certain restrictions and disclosure requirements regarding private information collected by financial institutions.

Enforcement Authority. We will be required to obtain the approval of the Federal Reserve prior to engaging in or, with certain exceptions, acquiring control of more than 5% of the voting shares of a company engaged in any new activity. Prior to granting such approval, the Federal Reserve must weigh the expected benefits of any such new activity to the public (such as greater convenience, increased competition, or gains in efficiency) against the risk of possible adverse effects of such activity (such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices). The Federal Reserve has cease-and-desist powers over bank holding companies and their nonbanking subsidiaries where their actions would constitute a serious threat to the safety, soundness or stability of a subsidiary bank. The Federal Reserve also has authority to regulate debt obligations (other than commercial paper) issued by bank holding companies. This authority includes the power to impose interest ceilings and reserve requirements on such debt obligations. A bank holding company and its subsidiaries are also prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property or furnishing of services.

Interstate Acquisitions. Federal banking law generally provides that a bank holding company may acquire or establish banks in any state of the United States, subject to certain aging and deposit concentration limits. In addition, North Carolina banking laws permit a bank holding company that owns stock of a bank located outside North Carolina to acquire a bank or bank holding company located in North Carolina. In any event, federal banking law will not permit a bank holding company to own or control banks in North Carolina if the acquisition would exceed 20% of the total deposits of all federally-insured deposits in North Carolina.

Capital Adequacy. The Federal Reserve has promulgated capital adequacy regulations for all bank holding companies with assets in excess of $150 million. The Federal Reserve's capital adequacy regulations are based upon a risk based capital determination, whereby a bank holding company's capital adequacy is determined in light of the risk, both on- and off-balance sheet, contained in the company's assets. Different categories of assets are assigned risk weightings and are counted at a percentage of their book value.

The regulations divide capital between Tier 1 capital (core capital) and Tier 2 capital. For a bank holding company, Tier 1 capital consists primarily of common stock, related surplus, noncumulative perpetual preferred stock, minority interests in consolidated subsidiaries and a limited amount of qualifying cumulative preferred securities. Goodwill and certain other intangibles are excluded from Tier 1 capital. Tier 2 capital consists of an amount equal to the allowance for loan and lease losses up to a maximum of 1.25% of risk weighted assets, limited other types of preferred stock not included in Tier 1 capital, hybrid capital instruments and term subordinated debt. Investments in and loans to unconsolidated banking and finance subsidiaries that constitute capital of those subsidiaries are excluded from capital. The sum of Tier 1 and Tier 2 capital constitutes qualifying total capital. The Tier 1 component must comprise at least 50% of qualifying total capital.

Every bank holding company has to achieve and maintain a minimum Tier 1 capital ratio of at least 4.0% and a minimum total capital ratio of at least 8.0%. In addition, banks and bank holding companies are required to maintain a minimum leverage ratio of Tier 1 capital to average total consolidated assets (leverage capital ratio) of at least 3.0% for the most highly-rated, financially sound banks and bank holding companies and a minimum leverage ratio of at least 4.0% for all other banks. The Federal Deposit Insurance Corporation and the Federal Reserve define Tier 1 capital for banks in the same manner for both the leverage ratio and the risk-based capital ratio. However, the Federal Reserve defines Tier 1 capital for bank holding companies in a slightly different manner. As of December 31, 2008, the Company's leverage capital ratio, Tier 1 risk-based capital ratio and total risk-based capital ratio were 10.57%, 12.46% and 13.80%, respectively.

The guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory level, without significant reliance on intangible assets. The guidelines also indicate that the Federal Reserve will continue to consider a “Tangible Tier 1 Leverage Ratio” in evaluating proposals for expansion or new activities. The Tangible Tier 1 Leverage Ratio is the ratio of Tier 1 capital, less intangibles not deducted from Tier 1 capital, to quarterly average total assets. As of December 31, 2008, the Federal Reserve had not advised us of any specific minimum Tangible Tier 1 Leverage Ratio applicable to us.

The Company’s trust preferred securities, which are accounted for as debt under generally accepted accounting principles, presently qualify as Tier 1 regulatory capital and are reported in Federal Reserve regulatory reports as minority interest in our consolidated subsidiaries. The Company’s trust preferred securities from Trust III also qualify as Tier I regulatory capital although they are part of a pooled transaction. The junior subordinated debentures related to Trust III do not qualify as Tier 1 regulatory capital. The Federal Reserve limits restricted core capital elements to twenty-five percent of all core capital elements.

Under the United States Treasury’s Capital Purchase Program (CPP), the Company issued $42.75 million in Cumulative Perpetual Preferred Stock, Series A, on December 5, 2008. In addition, the Company provided warrants to the Treasury to purchase 1,623,418 shares of the Company’s common stock at an exercise price of $3.95 per share. These warrants are immediately exercisable and expire ten years from the date of issuance. The preferred stock is non-voting, other than having class voting rights on certain matters, and pays cumulative dividends quarterly at a rate of 5% per annum for the first five years and 9% per annum thereafter. The preferred shares are redeemable at the option of the Company under certain circumstances during the first three years and thereafter without restriction.

Source of Strength for Subsidiaries. Bank holding companies are required to serve as a source of financial strength for their depository institution subsidiaries, and if their depository institution subsidiaries become undercapitalized, bank holding companies may be required to guarantee the subsidiaries’ compliance with capital restoration plans filed with their bank regulators, subject to certain limits.

Dividends. As a bank holding company that does not, as an entity, currently engage in separate business activities of a material nature, our ability to pay cash dividends depends upon the cash dividends we receive from our subsidiary bank. Our primary source of income is dividends paid by the Bank. We must pay all of our operating expenses from funds we receive from the Bank. North Carolina banking law requires that dividends be paid out of retained earnings and prohibits the payment of cash dividends if payment of the dividend would cause the Bank’s surplus to be less than 50% of its paid-in capital. Also, under federal banking law, no cash dividend may be paid if the Bank is undercapitalized or insolvent or if payment of the cash dividend would render the bank undercapitalized or insolvent and no cash dividend may be paid by the Bank if it is in default of any deposit insurance assessment due to the FDIC. Therefore, shareholders may receive dividends from us only to the extent that funds are available at the holding company or from our subsidiary bank. In addition, the Federal Reserve generally prohibits bank holding companies from paying dividends except out of operating earnings, and the prospective rate of earnings retention appears consistent with the bank holding company’s capital needs, asset quality and overall financial condition. The Federal Reserve may impose restrictions on the Company’s payment of cash dividends since we are required to maintain adequate regulatory capital of our own and are expected to serve as a source of financial strength and to commit resources to our subsidiary bank. As a condition of the issuance of Cumulative Perpetual Preferred Stock to the United States Treasury under its Capital Purchase Program, the Company must obtain the consent of the United States Treasury Department to increase the cash dividend on its common stock from the September 30, 2008 quarterly level of $0.04 per common share.

Change of Control. State and federal banking law restrict the amount of voting stock of the company that a person may acquire without the prior approval of banking regulators. The Bank Holding Company Act requires that a bank holding company obtain the approval of the Federal Reserve before it may merge with a bank holding company, acquire a subsidiary bank, acquire substantially all of the assets of any bank, or before it may acquire ownership or control of any voting shares of any bank or bank holding company if, after such acquisition, it would own or control, directly or indirectly, more than 5% of the voting shares of that bank or bank holding company. The overall effect of such laws is to make it more difficult to acquire us by tender offer or similar means than it might be to acquire control of another type of corporation. Consequently, our shareholders may be less likely to benefit from rapid increases in stock prices that often result from tender offers or similar efforts to acquire control of other types of companies.

The Bank

The Bank is subject to various requirements and restrictions under the laws of the United States and the State of North Carolina. As a North Carolina bank, our subsidiary bank is subject to regulation, supervision and regular examination by the North Carolina Banking Commission. The Bank is also subject to regulation, supervision and regular examination by the Federal Deposit Insurance Corporation. The North Carolina Banking Commission and the FDIC have the power to enforce compliance with applicable banking statutes and regulations. These requirements and restrictions include requirements to maintain reserves against deposits, restrictions on the nature and amount of loans that may be made and the interest that may be charged thereon and restrictions relating to investments and other activities of the Bank.

Transactions with Affiliates. The Bank may not engage in specified transactions (including, for example, loans) with its affiliates unless the terms and conditions of those transactions are substantially the same or at least as favorable to the Bank as those prevailing at the time for comparable transactions with or involving other nonaffiliated entities. In the absence of comparable transactions, any transaction between the Bank and its affiliates must be on terms and under circumstances, including credit standards, which in good faith would be offered or would apply to nonaffiliated companies. In addition, transactions referred to as "covered transactions" between the Bank and its affiliates may not exceed 10% of the Bank's capital and surplus per affiliate and an aggregate of 20% of its capital and surplus for covered transactions with all affiliates. Certain transactions with affiliates, such as loans, also must be secured by collateral of specific types and amounts. The Bank also is prohibited from purchasing low quality assets from an affiliate. Every company under common control with the Bank, including the Company and Southern Community Capital Trust II, is deemed to be an affiliate of the Bank.

Loans to Insiders. Federal law also constrains the types and amounts of loans that the Bank may make to its executive officers, directors and principal shareholders. Among other things, these loans are limited in amount, must be approved by the Bank's board of directors in advance, and must be on terms and conditions as favorable to the Bank as those available to an unrelated person.

Regulation of Lending Activities. Loans made by the Bank are also subject to numerous federal and state laws and regulations, including the Truth-In-Lending Act, Federal Consumer Credit Protection Act, the Equal Credit Opportunity Act, the Real Estate Settlement Procedures Act and adjustable rate mortgage disclosure requirements. Remedies to the borrower or consumer and penalties to the Bank are provided if the Bank fails to comply with these laws and regulations. The scope and requirements of these laws and regulations have expanded significantly in recent years.

Branch Banking. All banks located in North Carolina are authorized to branch statewide. Accordingly, a bank located anywhere in North Carolina has the ability, subject to regulatory approval, to establish branch facilities near any of our facilities and within our market area. If other banks were to establish branch facilities near our facilities, it is uncertain whether these branch facilities would have a material adverse effect on our business.

Federal law provides for nationwide interstate banking and branching, subject to certain aging and deposit concentration limits that may be imposed under applicable state laws. Applicable North Carolina statutes permit regulatory authorities to approve de novo branching in North Carolina by institutions located in states that would permit North Carolina institutions to branch on a de novo basis into those states. Federal regulations prohibit an out-of-state bank from using interstate branching authority primarily for the purpose of deposit production. These regulations include guidelines to ensure that interstate branches operated by an out-of-state bank in a host state are reasonably helping to meet the credit needs of the host state communities served by the out-of-state bank.

Reserve Requirements. Pursuant to regulations of the Federal Reserve, the bank must maintain average daily reserves against its transaction accounts. During 2008, no reserves were required to be maintained on the first \$9.3 million of transaction accounts, but reserves equal to 3.0% were required on the aggregate balances of those accounts between \$9.3 million and \$43.9 million, and additional reserves were required on aggregate balances in excess of \$43.9 million in an amount equal to 10.0% of the excess. These percentages are subject to annual adjustment by the Federal Reserve, which has advised that for 2009, no reserves will be required to be maintained on the first \$10.3 million of transaction accounts, but reserves equal to 3.0% will be required on the aggregate balances of those accounts between \$10.3 million and \$44.4 million, and additional reserves are required on aggregate balances in excess of \$44.4 million in an amount equal to 10.0% of the excess. Because required reserves must be maintained in the form of vault cash or in a non-interest-bearing account at a Federal Reserve Bank, the effect of the reserve requirement is to reduce the amount of the institution's interest-earning assets. As of December 31, 2008, the Bank met its reserve requirements.

Community Reinvestment. Under the Community Reinvestment Act ("CRA"), as implemented by regulations of the federal bank regulatory agencies, an insured 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 banks, nor does it limit a bank'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 federal bank regulatory agencies, in connection with their examination of insured banks, to assess the Bank's records of meeting the credit needs of their communities, using the ratings of "outstanding," "satisfactory," "needs to improve," or "substantial noncompliance," and to take that record into account in its evaluation of certain applications by those banks. All banks are required to make public disclosure of their CRA performance ratings. The Bank received a "satisfactory" rating in its most recent CRA examination.

Governmental Monetary Policies. The commercial banking business is affected not only by general economic conditions but also by the monetary policies of the Federal Reserve. Changes in the discount rate on member bank borrowings, control of borrowings, open market transactions in United States government securities, the imposition of and changes in reserve requirements against member banks and deposits and assets of foreign bank branches, and the imposition of and changes in reserve requirements against certain borrowings by banks and their affiliates are some of the monetary policies available to the Federal Reserve. Those monetary policies influence to a significant extent the overall growth of all bank loans, investments and deposits and the interest rates charged on loans or paid on time and savings deposits in order to mitigate recessionary and inflationary pressures. These techniques are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits, and their use may also affect interest rates charged on loans or paid for deposits.

The monetary policies of the Federal Reserve Board have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. In view of changing conditions in the national economy and money markets, as well as the effect of actions by monetary and fiscal authorities, no prediction can be made as to possible future changes in interest rates, deposit levels, loan demand or the business and earnings of the Bank.

Dividends. All dividends paid by the Bank are paid to the Company, the sole shareholder of the Bank. The general dividend policy of the Bank is to pay dividends at levels consistent with maintaining liquidity and preserving our applicable capital ratios and servicing obligations. The dividend policy of the Bank is subject to the discretion of the board of directors of the Bank and will depend upon such factors as future earnings, growth, financial condition, cash needs, capital adequacy, compliance with applicable statutory and regulatory requirements and general business conditions.

The ability of the Bank to pay dividends is restricted under applicable law and regulations. Under North Carolina banking law, dividends must be paid out of retained earnings and no cash dividends may be paid if payment of the dividend would cause the bank's surplus to be less than 50% of its paid-in capital. Also, under federal banking law, no cash dividend may be paid if the Bank is undercapitalized or insolvent or if payment of the cash dividend would render the Bank undercapitalized or insolvent and no cash dividend may be paid by the Bank if it is in default of any deposit insurance assessment due to the Federal Deposit Insurance Corporation.

The exact amount of future dividends paid to the Company by the Bank will be a function of the profitability of the Bank in general and applicable tax rates in effect from year to year. The Bank's ability to pay dividends in the future will directly depend on future profitability, which cannot be accurately estimated or assured. We expect that, for the foreseeable future, dividends will be paid by the Bank to the Company as needed to pay any separate expenses of Southern Community Financial Corporation and/or to make required payments on the Company's debt obligations, including the debentures which fund the interest payments on the Company's trust preferred securities and to pay cash dividends to the Company's shareholders.

Capital Adequacy. The capital adequacy regulations which apply to state banks, such as the Bank, are similar to the Federal Reserve requirements promulgated with respect to bank holding companies discussed above.

Changes in Management. Any depository institution that has been chartered less than two years, is not in compliance with the minimum capital requirements of its primary federal banking regulator, or is otherwise in a troubled condition must notify its primary federal banking regulator of the proposed addition of any person to the board of directors or the employment of any person as a senior executive officer of the institution at least 30 days before such addition or employment becomes effective. During this 30-day period, the applicable federal banking regulatory agency may disapprove of the addition of such director or employment of such officer. The Bank is not subject to any such requirements.

Enforcement Authority. The federal banking laws also contain civil and criminal penalties available for use by the appropriate regulatory agency against certain "institution-affiliated parties" primarily including management, employees and agents of a financial institution, as well as independent contractors such as attorneys and accountants and others who participate in the conduct of the financial institution's affairs and who caused or are likely to cause more than minimum financial loss to or a significant adverse affect on the institution, who knowingly or recklessly violate a law or regulation, breach a fiduciary duty or engage in unsafe or unsound practices. These practices can include the failure of an institution to timely file required reports or the submission of inaccurate reports. These laws authorize the appropriate banking agency to issue cease and desist orders that may, among other things, require affirmative action to correct any harm resulting from a violation or practice, including restitution, reimbursement, indemnification or guarantees against loss. A financial institution may also be ordered to restrict its growth, dispose of certain assets or take other action as determined by the primary federal banking agency to be appropriate.

Prompt Corrective Action. Banks are subject to restrictions on their activities depending on their level of capital. Federal "prompt corrective action" regulations divide banks into five different categories, depending on their level of capital. Under these regulations, a bank is deemed to be "well capitalized" if it has a total risk-based capital ratio of ten percent or more, a core capital ratio of six percent or more and a leverage ratio of five percent or more, and if the bank is not subject to an order or capital directive to meet and maintain a certain capital level. Under these regulations, a bank is deemed to be "adequately capitalized" if it has a total risk-based capital ratio of eight percent or more, a core capital ratio of four percent or more and a leverage ratio of four percent or more (unless it receives the highest composite rating at its most recent examination and is not experiencing or anticipating significant growth, in which instance it must maintain a leverage ratio of three percent or more). Under these regulations, a bank is deemed to be "undercapitalized" if it has a total risk-based capital ratio of less than eight percent, a core capital ratio of less than four percent or a leverage ratio of less than three percent. Under these regulations, a bank is deemed to be "significantly undercapitalized" if it has a risk-based capital ratio of less than six percent, a core capital ratio of less than three percent and a leverage ratio of less than three percent. Under such regulations, a bank is deemed to be "critically undercapitalized" if it has a leverage ratio of less than or equal to two percent. In addition, the applicable federal banking agency has the ability to downgrade a bank's classification (but not to "critically undercapitalized") based on other considerations even if the bank meets the capital guidelines.

If a state bank, such as the Bank, is classified as undercapitalized, the bank is required to submit a capital restoration plan to the FDIC. An undercapitalized bank is prohibited from increasing its assets, engaging in a new line of business, acquiring any interest in any company or insured depository institution, or opening or acquiring a new branch office, except under certain circumstances, including the acceptance by the FDIC of a capital restoration plan for the bank.

If a state bank were classified as undercapitalized, the FDIC may take certain actions to correct the capital position of the bank. If a state bank is classified as significantly undercapitalized, the FDIC would be required to take one or more prompt corrective actions. These actions would include, among other things, requiring sales of new securities to bolster capital, changes in management, limits on interest rates paid, prohibitions on transactions with affiliates, termination of certain risky activities and restrictions on compensation paid to executive officers. If a bank is classified as critically undercapitalized, the bank must be placed into conservatorship or receivership within 90 days, unless the Federal Deposit Insurance Corporation determines otherwise.

The capital classification of a bank affects the frequency of examinations of the bank and impacts the ability of the bank to engage in certain activities and affects the deposit insurance premiums paid by the bank. The FDIC is required to conduct a full-scope, on-site examination of every member bank on a periodic basis.

Banks also may be restricted in their ability to accept brokered deposits, depending on their capital classification. "Well capitalized" banks are permitted to accept brokered deposits, but all banks that are not well capitalized are not permitted to accept such deposits. The FDIC may, on a case-by-case basis, permit member banks that are adequately capitalized to accept brokered deposits if the FDIC determines that acceptance of such deposits would not constitute an unsafe or unsound banking practice with respect to the bank.

Deposit Insurance. In prior years the Bank's deposits were generally insured up to $100,000 per insured non-IRA non-transaction account and up to $250,000 per IRA account by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation. The Emergency Economic Stabilization Act signed October 3, 2008 temporarily raised the basic limit of FDIC deposit insurance from $100,000 to $250,000 with an expected return to the $100,000 limit on December 31, 2009. The Company is required to pay deposit insurance assessments set by the FDIC. The FDIC determines the Bank's deposit insurance assessment rates on the basis of four risk categories. During 2008, the Bank's assessment was determined by a formula that ranged from 0.05% to 0.07% at the lowest assessment category up to a maximum assessment of 0.43% of the Bank's average deposit base, with the exact assessment determined by the Bank's assets, its capital and the FDIC's supervisory opinion of its operations. The insurance assessment rate may change periodically. On October 7, 2008, the FDIC announced a proposed restoration plan that will increase the deposit insurance premiums for banks, while making adjustments to the formula that determines a bank's deposit insurance premiums. Under the proposal, the deposit insurance rates would be raised uniformly by seven basis points (annualized) beginning January 1, 2009. As amended in FDIC's DIF restoration plan approved on February 27, 2009, effective April 1, 2009, the formula will range from 0.07% to 0.24% at the lowest assessment category up to a maximum assessment of 0.78% of the Bank's average deposit base. In an effort to encourage banks to limit the FDIC's exposure, the 2009 insurance assessment rate formula will also:

- Reduce the assessment rate paid by a bank by up to 0.05% based on the amount of unsecured debt held by the institution;
- Increase a bank's assessment by up to 0.225% based on its risk profile if the bank has high levels of secured liabilities (if greater than 25% of domestic deposits), since those claims must be paid before depositors can make claims in the event of a failure; and
- Increase a bank's assessment by up to 0.10% if brokered deposits make up more than 10% of the institution's domestic deposits. For well-managed and well-capitalized institutions, this would only apply when accompanied by rapid asset growth.

On February 27, 2009, the FDIC also approved as a part of its restoration plan the imposition of a 20 basis point emergency special assessment on insured depository institutions as of June 30, 2009. The assessment will be collected on September 30, 2009. This final rule would also permit the FDIC to impose an emergency special assessment after June 30, 2009, of up to ten basis points if necessary to maintain public confidence in federal deposit insurance. Based on assessable deposit balances as of December 31, 2008, this special assessment, if implemented as approved, would equal approximately $2.5 million. This special assessment if implemented as proposed will have a significant impact on the results of operations of the Company for the quarter ending June 30, 2009 and the full year 2009. The FDIC has the authority to terminate deposit insurance.

On October 14, of 2008, the FDIC announced the creation of the Temporary Liquidity Guarantee Program (TLPG), which seeks to strengthen confidence and encourage liquidity in the banking system. The TLGP has two primary components that are available to financial institutions on a voluntary basis. The first component, the Debt Guarantee Program, is a guarantee of newly issued senior unsecured debt issued on or before June 30, 2009 and would provide protection until the earlier of the maturity date or June 30, 2012. Issuers electing to participate in this program would pay an annual cost of guarantee tiered from 50 basis points for terms of 180 days or less to 100 basis points for terms over one year. The second component, the Transaction Account Guarantee Program, provides unlimited deposit insurance above the existing deposit insurance limit for certain non-interest bearing transaction accounts through December 31, 2009. Beginning November 13, 2008, if an insured depository institution did not opt-out of the Transaction Account Guarantee Program, it would be assessed on a quarterly basis an annualized 10 basis point assessment on balances in noninterest-bearing transaction accounts that exceed the $250,000 deposit insurance limit. The Company elected to participate in the TLGP's enhanced deposit insurance program and the guarantee of unsecured debt. The enhancement to the deposit insurance protection and the demands on the insurance fund due to current weakness in the banking system will result in significantly increased deposit insurance cost for all banks during 2009.

Recent Legislation. The US Congress recently enacted the American Recovery and Reinvestment Act of 2009, which contains additional restrictions on executive compensation for institutions that participated in the United States Department of the Treasury's Capital Purchase Program. The Company holds investments pursuant to the Capital Purchase Program. Because the Treasury has not promulgated regulations in response to this bill's provisions, we cannot determine the full extent of the impact of these provisions on the Company's executive officers and other highly compensated employees. Therefore, the Company can not predict how the Treasury will enforce these provisions on the pre-existing contract rights of the Company's executive officers and highly compensated employees.

Our management cannot predict what other legislation might be enacted or what other regulations might be adopted or the effects thereof.

Item 1A. Risk Factors

An investment in our common stock involves risk. Shareholders should carefully consider the risks described below in conjunction with the other information in this Form 10-K and information incorporated by reference in this Form 10-K, including our consolidated financial statements and related notes. If any of the following risks or other risks which have not been identified or which we may believe are immaterial or unlikely, actually occur, our business, financial condition and results of operations could be harmed. This could cause the price of our stock to decline and shareholders could lose part or all of their investment. This Form 10-K contains forward-looking statements that involve risks and uncertainties, including statements about our future plans, objectives, intentions and expectations. Many factors, including those described below, could cause actual results to differ materially from those discussed in our forward-looking statements.

Risks Related to Holding Southern Community Common Stock

Our long term business strategy includes continuing prudent, disciplined growth strategy. Our financial condition and results of operations could be negatively affected if we fail to grow or fail to manage our growth effectively.

We intend to continue pursuing a prudent, disciplined growth strategy for our business. Our prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in significant growth stages of development. We cannot assure you we will be able to expand our market presence in our existing markets or successfully enter new markets or that any such expansion will not adversely affect our results of operations. Failure to manage our growth effectively could have a material adverse effect on our business, future prospects, financial condition or results of operations, and could adversely affect our ability to successfully implement our business strategy. Also, if our revenue growth declines, our operating results could be materially adversely affected. Our ability to successfully grow will depend on a variety of factors including the continued availability of desirable business opportunities, the competitive responses from other financial institutions in our market areas and our ability to manage our growth.

We may face risks with respect to future expansion.

In the past, we have sought to increase the size of our franchise by pursuing business development opportunities and we have grown rapidly since our incorporation. We have purchased another financial institution as a part of that strategy. We may acquire other financial institutions or parts of those entities in the future. Acquisitions and mergers involve a number of risks, including:

- the time and costs associated with identifying and evaluating potential acquisitions and merger partners;
- the accuracy of estimates and judgments used to evaluate credit, operations, management and market risks with respect to the target entity;
- the time and costs of evaluating new markets, hiring experienced local management and opening new offices and the time lags between these activities and the generation of sufficient assets and deposits to support the costs of the expansion;
- our ability to finance an acquisition and possible ownership and economic dilution to our current shareholders;
- the diversion of our management's attention to the negotiation of a transaction and the integration of the operations and personnel of the combining businesses;

- entry into new markets where we lack experience;
- the introduction of new products and services into our business;
- the incurrence and possible impairment of goodwill associated with an acquisition and possible adverse short-term effects on our results of operations; and
- the risk of loss of key employees and customers.

We may incur substantial costs to expand, and we can give no assurance such expansion will result in the levels of profits we seek. There can be no assurance integration efforts for any future mergers or acquisitions will be successful. Also, we may issue equity securities, including common stock and securities convertible into shares of our common stock in connection with future acquisitions, which could cause ownership and economic dilution to our current shareholders and to investors purchasing common stock in this offering. There is no assurance that, following any future mergers or acquisition, our integration efforts will be successful or our company, after giving effect to the acquisition, will achieve profits comparable to or better than our historical experience.

If the value of real estate in our core market areas were to decline materially, a significant portion of our loan portfolio could become under-collateralized, which could have a material adverse effect on us.

With most of our loans concentrated in the Piedmont Triad region of North Carolina, a decline in local economic conditions could adversely affect the values of our real estate collateral. Consequently, 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 geographically diverse. In addition to the financial strength and cash flow characteristics of the borrower in each case, the Bank often secures loans with real estate collateral. At December 31, 2008, approximately 66% of the Bank's loans had real estate as a primary or secondary component of collateral. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, our earnings and capital could be adversely affected.

Interest rate volatility could significantly harm our business.

Southern Community's results of operations are affected by the monetary and fiscal policies of the federal government and the regulatory policies of governmental authorities. A significant component of Southern Community's earnings is the net interest income of its subsidiary, Southern Community Bank and Trust. Net interest income is the difference between income from interest-earning assets, such as loans, and the expense of interest-bearing liabilities, such as deposits. We may not be able to effectively manage changes in what we charge as interest on our earning assets and the expense we must pay on interest-bearing liabilities, which may significantly reduce our earnings. The Federal Reserve has made significant changes in interest rates during the last few years. Since rates charged on loans often tend to react to market conditions faster than do rates paid on deposit accounts, these rate changes may have a negative impact on our earnings until we can make appropriate adjustments in our deposit rates. In addition, there are costs associated with our risk management techniques, and these costs could be material. Fluctuations in interest rates are not predictable or controllable and, therefore, there can be no assurances of our ability to continue to maintain a consistent positive spread between the interest earned on our earning assets and the interest paid on our interest-bearing liabilities.

Southern Community may have higher loan losses than it has allowed for.

Southern Community's loan losses could exceed the allowance for loan losses it has set aside. Southern Community's average loan size continues to increase and reliance on historic loss experience and other assumptions related to management's assessment of the adequacy of the Company's allowances for loan losses may not be warranted. Approximately 67% of our loan portfolio is composed of construction, commercial mortgage and commercial loans. Repayment of such loans is generally considered subject to greater credit risk than residential mortgage loans. Industry experience shows that a portion of loans will become delinquent and a portion of the loans will require partial or entire charge-off. Regardless of the underwriting criteria Southern Community utilizes, losses may be experienced as a result of various factors beyond its control, including, among other things, changes in market conditions affecting the value of its loan collateral and problems affecting the credit of its borrowers.

Our construction loans are subject to additional lending risks that could adversely affect earnings.

As of December 31, 2008, approximately 28% of our total loan portfolio was comprised of construction, acquisition and development loans. In the event of a continuing general economic slowdown, these loans may have additional risk due to the borrower's inability to repay on a timely basis. In addition to the normal repayment risk and potential decreases in real estate values, construction lending may pose additional risks that affect repayment and the value and marketability of real estate collateral, such as:

- developers, builders or owners may fail to complete or develop projects;
- developers, builders, or owners may experience a decline in liquidity and secondary sources of repayment;
- municipalities may place moratoriums on building, utility connections or required certifications;
- developers may fail to sell the improved real estate;
- there may be construction delays and cost overruns;
- Loans with rising variable rates may experience increases in the borrower's payments on the loan at a time when the borrower's income is under stress;
- collateral may prove insufficient; or
- permanent financing may not be obtained in a timely manner.

Any of these conditions could negatively affect collectability, our net income and our financial condition.

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

We intend to complete two facilities currently under construction. We are currently operating in a temporary facility in Asheville although we will be moving into our new permanent building in the second quarter of 2009. We also are operating in a temporary facility in Raleigh and plan to move into that permanent building during the third quarter of 2009. There are considerable costs involved in opening branches. New branches generally do not generate sufficient revenues to offset their costs until they have been in operation for at least a year or more. Accordingly, our new branches can be expected to negatively impact our earnings for some period of time until the branches reach certain economies of scale. Our expenses could be further increased if we encounter delays in the opening of any of our new branches. Finally, we have no assurance our new branches will be successful even after they have been established.

If Southern Community loses key employees with significant business contacts in its market area, its business may suffer.

Southern Community's success is dependent on the personal contacts of its officers and employees in its market area. If Southern Community lost key employees temporarily or permanently, its business could be hurt. Southern Community could be particularly hurt if its key employees went to work for competitors. Southern Community's future success depends on the continued contributions of its existing senior management personnel, particularly on the efforts of F. Scott Bauer and Jeff T. Clark, each of whom has significant local experience and contacts in its market area.

Government regulations may prevent or impair our ability to pay dividends, engage in acquisitions, or operate in other ways.

Current and future legislation and the policies established by federal and state regulatory authorities will affect Southern Community's operations. Southern Community is subject to supervision and periodic examination by the Federal Reserve Board and the North Carolina Commissioner of Banks. Southern Community's principal subsidiary, Southern Community Bank and Trust, as a state chartered commercial bank, also receives regulatory scrutiny from the North Carolina Commissioner of Banks and the FDIC. Banking regulations, designed primarily for the protection of depositors, may limit our growth and the return to you as an investor in Southern Community, by restricting its activities, such as:

- the payment of dividends to shareholders;
- possible transactions with or acquisitions by other institutions;

- desired investments;
- loans and interest rates;
- interest rates paid on deposits; and
- the possible expansion of branch offices.

Southern Community has elected to be regulated as a financial holding company to expand its opportunities to provide additional services, but it will have to comply with other federal laws and regulations and could face enforcement actions by regulatory agencies. Southern Community cannot predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that such changes may have on its business. The cost of compliance with regulatory requirements may adversely affect Southern Community's ability to operate profitably.

Our trading volume has been low compared with larger bank holding companies and the sale of substantial amounts of our common stock in the public market could depress the price of our common stock.

The average daily trading volume of our shares on the NASDAQ Global Select Market for the three months ended February 28, 2009 was approximately 12,430 shares. Lightly traded stock can be more volatile than stock trading in an active public market like that for the larger bank holding companies. We cannot predict the extent to which an active public market for our common stock will develop or be sustained. In recent years, the stock market has experienced a high level of price and volume volatility and market prices for the stock of many companies have experienced wide price fluctuations that have not necessarily been related to their operating performance. Therefore, our shareholders may not be able to sell their shares at the volumes, prices, or times that they desire. We cannot predict the effect, if any, that future sales of our common stock in the market, or availability of shares of our common stock for sale in the market, will have on the market price of our common stock. We therefore can give no assurance that sales of substantial amounts of our common stock in the market, or the potential for large amounts of sales in the market, would not cause the price of our common stock to decline or impair our ability to raise capital through sales of our common stock.

Southern Community faces strong competition in its market area, which may limit its asset growth and profitability.

The banking business in Southern Community's primary market area, which is currently concentrated in the Piedmont Triad area and surrounding areas in central North Carolina, is very competitive, and the level of competition facing it may increase further, which may limit its asset growth and profitability. Southern Community experiences competition in both lending and attracting funds from other banks and nonbank financial institutions located within our market area, some of which are significantly larger, well-established institutions. Nonbank competitors for deposits and deposit-type accounts include savings associations, credit unions, securities firms, money market funds, life insurance companies and the mutual funds industry. For loans, Southern Community encounters competition from other banks, savings associations, finance companies, mortgage bankers and brokers, insurance companies, small loan and credit card companies, credit unions, pension trusts and securities firms. We may face a competitive disadvantage as a result of our smaller size, lack of multi-state geographic diversification and inability to spread our marketing costs across a broader market.

Southern Community's Articles of Incorporation include anti-takeover provisions that may prevent shareholders from receiving a premium for their shares or effecting a transaction favored by a majority of shareholders.

Southern Community's Articles of Incorporation include certain anti-takeover provisions, such as being subject to the Shareholder Protection Act and Control Share Acquisition Act under North Carolina law and a provision allowing our Board of Directors to consider the social and economic effects of a proposed merger, which may have the effect of preventing shareholders from receiving a premium for their shares of common stock and discouraging a change of control of Southern Community by allowing minority shareholders to prevent a transaction favored by a majority of the shareholders. The primary purpose of these provisions is to encourage negotiations with our management by persons interested in acquiring control of our corporation. These provisions may also tend to perpetuate present management and make it difficult for shareholders owning less than a majority of the shares to be able to elect even a single director.

Holders of our trust preferred securities have rights that are senior to those of our common shareholders.

We have supported our continued growth through the issuance of trust preferred securities from special purpose trusts and accompanying junior subordinated debentures. At December 31, 2008, we had outstanding trust preferred securities and accompanying junior subordinated debentures totaling $44.5 million. Payments of the principal and interest on the trust preferred securities of this special purpose trust are conditionally guaranteed by us. Further, the accompanying junior subordinated debentures we issued to the special purpose trust are senior to our shares of common stock. As a result, we must make payments on the junior subordinated debentures before any dividends can be paid on our common stock and, in the event of our bankruptcy, dissolution or liquidation, the holders of the junior subordinated debentures must be satisfied before any distributions can be made on our common stock. We have the right to defer distributions on our junior subordinated debentures (and the related trust preferred securities) for up to five years, during which time no dividends may be paid on our common stock.

The common stock of Southern Community Financial Corporation is not FDIC insured.

The common stock of Southern Community is not a savings or deposit account or other obligation of any bank and is not insured by the Federal Deposit Insurance Corporation, the Bank Insurance Fund or any other governmental agency and is subject to investment risk, including the possible loss of principal.

Risks Related to an Investment in the Preferred Securities

If we do not make interest payments under the debentures, the trust will be unable to pay distributions and liquidation amounts. The guarantee would not apply because the guarantee covers payments only if the trust has funds available.

The trust will depend solely on our payments on the debentures to pay amounts due to holders of the preferred securities on the debentures. Without these payments, the trust will not have sufficient funds to pay distributions or the liquidation amount on the preferred securities. In that case, holders of the preferred securities will not be able to rely on the guarantee for payment of these amounts because the guarantee only applies if the trust has sufficient funds to make distributions or to pay the liquidation amount. Instead, holders of the preferred securities or the property trustee will have to institute a direct action against us to enforce the property trustee’s rights under the indenture relating to the debentures.

We must rely on dividends from our bank subsidiary to make interest payments on the debentures to the trust.

Our ability to make payments on the debentures when due will depend primarily on dividends received from our bank subsidiary because we are a holding company and substantially all of our assets are held by our bank subsidiary. The ability of our bank subsidiary to pay dividends is subject to legal restrictions and the Bank’s profitability, financial condition, capital expenditures and other cash flow requirements. We may also borrow additional funds, issue debt instruments, issue and sell shares of preferred stock, or engage in other types of financing activities, in order to increase our capital. Covenants contained in loan or financing agreements or other debt instruments could restrict or condition our payment of cash dividends based on various financial considerations or factors.

Regulatory authorities may limit dividends paid to us and thereby our ability to make interest payments on the debentures to the trust.

We cannot assure holders of the preferred securities that our bank subsidiary will be able to pay dividends in the future due to regulatory restrictions or that our regulators will not attempt to preclude us from making interest payments on the subordinated debentures. North Carolina banking law requires that cash dividends be paid by a bank only out of retained earnings and prohibits the payment of cash dividends if payment of the dividend would cause the bank’s surplus to be less than 50% of its paid-in capital. We may also be precluded from making interest payments on the subordinated debentures by our regulators in order to address any perceived deficiencies in liquidity or regulatory capital levels at the holding company level. Such regulatory action would require us to obtain consent from our regulators prior to paying dividends on our common stock or interest on the subordinated debentures. In the event our regulators withheld their consent to our payment of interest on the subordinated debentures, we would exercise our right to defer interest payments on the subordinated debentures, and the trust would not have funds available to make distributions on the preferred securities during such period.

Our obligation to make interest payments to the trust on the debentures is subordinated to existing liabilities or additional debt we may incur.

Our obligations under the debentures and the guarantee are unsecured and will rank junior in priority of payment to our existing liabilities and any future senior and subordinated indebtedness. However, our issuance of the debentures and the preferred securities does not limit our ability or the ability of our subsidiaries to incur additional indebtedness, guarantees or other liabilities. Also, because we are a holding company, the creditors of our bank subsidiary, including depositors, also will have priority over holders of the preferred securities in any distribution of our subsidiaries' assets in liquidation, reorganization or otherwise. Accordingly, the debentures and the guarantee will be effectively subordinated to all existing and future liabilities of our subsidiaries, and holders of the preferred securities should look only to our assets for payments on the preferred securities and the debentures.

We have the option to defer interest payments on the debentures for substantial periods.

As long as we are not in default under the indenture relating to the debentures, we may, at one or more times, defer interest payments on the debentures for up to 20 consecutive quarters. If we defer interest payments on the debentures, the trust will defer distributions on the preferred securities during any deferral period.

If we defer interest payments, holders of the preferred securities will still be required to recognize the deferred interest amounts as income.

During a deferral period, holders of the preferred securities will be required to recognize as income for federal income tax purposes the amount approximately equal to the interest that accrues on your proportionate share of the debentures, held by the trust in the tax year in which that interest accrues, even though holders of the preferred securities will not receive these amounts until a later date if they hold the preferred securities until the deferred interest is paid.

If holders of the preferred securities sell their preferred securities during a deferral period, they will forfeit the deferred interest amount and only have a capital loss.

Holders of the preferred securities will not receive the cash related to any accrued and unpaid interest from the trust if they sell the preferred securities before the end of any deferral period. During a deferral period, accrued but unpaid distributions will increase their tax basis in the preferred securities. If holders of the preferred securities sell the preferred securities during a deferral period, their increased tax basis will decrease the amount of any capital gain or increase the amount of any capital loss that they may have otherwise realized on the sale. A capital loss, except in certain limited circumstances, cannot be applied to offset ordinary income. As a result, deferral of distributions could result in ordinary income and a related tax liability for the holder, and a capital loss that may only be used to offset a capital gain.

Deferrals of interest payments may increase the volatility of the market price of the preferred securities.

If we defer interest payments, the market price of the preferred securities would likely be adversely affected. The preferred securities may trade at a price that does not fully reflect the value of accrued but unpaid interest on the debentures. If holders of the preferred securities sell the preferred securities during a deferral period, they may not receive the same return on investment as someone who continues to hold the preferred securities. Because of our right to defer interest payments, the market price of the preferred securities may be more volatile than the market prices of other securities without a deferral feature.

There are no financial covenants in the indenture and the trust agreement.

The indenture governing the debentures and the trust agreement governing the trust do not require us to maintain any financial ratios or specified levels of net worth, revenues, income, cash flow or liquidity. The instruments do not protect holders of the debentures or the preferred securities in the event we experience significant adverse changes in our financial condition or results of operations. In addition, neither the indenture nor the trust agreement limits our ability or the ability of any subsidiary to incur additional indebtedness. Therefore, holders of the preferred securities should not consider the provisions of these governing instruments as a significant factor in evaluating whether we will be able to comply with our obligations under the debentures or the guarantee.

We may redeem some or all of the debentures at any time after December 31, 2008 and reduce the period during which holders of the preferred securities will receive distributions.

We have the option to redeem any or all of the outstanding debentures after December 31, 2008 without the payment of any premium. Upon early redemption, holders of the preferred securities may be required to reinvest their principal at a time when they may not be able to earn a return that is as high as they were earning on the preferred securities.

We may redeem all of the debentures at any time upon the occurrence of certain events.

We may redeem all of the debentures before their stated maturity without payment of premium within 90 days after certain occurrences at any time during the life of the trust. These occurrences include adverse tax, investment company or bank regulatory developments. Upon early redemption, holders of the preferred securities may be required to reinvest their principal at a time when they may not be able to earn a return that is as high as they were earning on the preferred securities.

We can distribute the debentures to holders of the preferred securities, which may have adverse tax consequences for holders of the preferred securities and could also adversely affect the market price of the preferred securities.

The trustees may dissolve the trust before maturity of the debentures and distribute the debentures to holders of the preferred securities under the terms of the trust agreement. Under current interpretations of United States federal income tax laws supporting classification of the trust as a grantor trust for tax purposes, a distribution of the debentures to holders of the preferred securities upon the dissolution of the trust would not be a taxable event. Nevertheless, if the trust is classified for United States income tax purposes as an association taxable as a corporation at the time it is dissolved, the distribution of the debentures would be a taxable event to holders of the preferred securities. In addition, if there is a change in law, a distribution of the debentures upon the dissolution of the trust could be a taxable event to holders of the preferred securities. Also, the debentures that holders of the preferred securities may receive if the trust is liquidated may trade at a discount to the price that was paid to purchase the preferred securities.

Holders of the preferred securities must rely on the property trustee to enforce their rights if there is an event of default under the indenture.

Holders of the preferred securities may not be able to directly enforce their rights against us under the indenture if an event of default occurs. If an event of default occurs under the indenture, holders of the preferred securities must rely on the enforcement by the property trustee of its rights as holder of the debentures against us. The holders of a majority in liquidation amount of the preferred securities will have the right to direct the property trustee to enforce its rights. If the property trustee does not enforce its rights following an event of default and there is no request by the record holders of the debentures to do so, any record holder may, to the extent permitted by applicable law, take action directly against us to enforce the property trustee’s rights. If an event of default occurs that is attributable to our failure to pay interest or principal on the debentures, or if we default under the guarantee, holders of the preferred securities may proceed directly against us. Holders of the preferred securities will not be able to exercise directly any other remedies available to the holders of the debentures, unless the property trustee fails to do so.

Holders of preferred securities have limited voting rights to replace the property trustee and the Delaware trustee.

Holders of preferred securities only have voting rights that pertain primarily to certain amendments to the trust agreement. In general, only we can replace or remove any of the trustees. The holders of at least a majority in aggregate liquidation amount of the preferred securities may replace the property trustee and the Delaware trustee only if an event of default under the trust agreement occurs and is continuing.

The subordinated debentures and the preferred securities do not represent deposit accounts and are not insured.

The subordinated debentures and the preferred securities do not represent bank deposit accounts and they are not obligations issued or guaranteed by the Federal Deposit Insurance Corporation or by any other governmental agency.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

As of December 31, 2008, we operated out of twenty-two banking offices, six operations/administrative offices, and two lending offices. All banking offices have ATMs. A summary of our offices is as follows:

	Approximate Square Footage	Year Established or Acquired	Owned or Leased
Banking Offices:			
Asheville, North Carolina			
80 Peachtree Road	3,191	2006	Leased
Clemmons, North Carolina			
6290 Towncenter Drive	3,800	2004	Owned
Dobson, North Carolina			
201 West Kapp Street	2,800	1995(1)	Owned
Greensboro, North Carolina			
1505 Highwoods Blvd.	9,800	2005	Owned
High Point, North Carolina			
2541 Eastchester Drive	3,000	2003	Owned
Jonesville, North Carolina			
503 Winston Road	2,500	1995(1)	Owned
Kernersville, North Carolina			
1207 South Main Street	8,300	2002	Owned
King, North Carolina			
105 Post Office Street	4,000	2004(1)	Owned
Madison, North Carolina			
619 Ayersville Road	2,000	1990(1)	Owned
Mooresville, NC			
210 Knob Hill Road	8,800	2006	Owned
Mount Airy, North Carolina			
255 East Independence Blvd.	10,345	1999(1)	Owned
2010 Community Drive	3,500	1988(1)	Owned
Pilot Mountain, North Carolina			
616 South Key Street	8,300	1987(1)	Owned
Raleigh, North Carolina			
2626 Glenwood Avenue	1,501	2006	Leased
Sandy Ridge, North Carolina			
4928 Highway 704 West	1,250	1989(1)	Owned
Union Grove, North Carolina			
1439 W. Memorial Highway	2,300	1990(1)	Owned

	Approximate Square Footage	Year Established or Acquired	Owned or Leased
Banking Offices:			
Walnut Cove, North Carolina			
1072 North Main Street	1,700	1999(1)	Leased
Winston Salem, North Carolina			
4701 Country Club Road	4,300	1996	Leased
225 Hanes Mill Road	2,800	2001	Owned
3151 Peters Creek Parkway	2,500	1998	Leased
500 South Stratford Road (3)	5,980	2008	Owned
536 South Stratford Road (3)	2,400	1998	Leased
Yadkinville, North Carolina			
532 East Main Street	7,800	1998	Owned
Operations and Administrative Offices:			
Winston Salem, North Carolina			
465 Shepherd Street	47,114	2006	Owned
100 Cambridge Plaza (2)	7,028	2006	Owned
104 Cambridge Plaza (2)	7,028	2006	Owned
108 Cambridge Plaza (2)	7,028	2006	Owned
112 Cambridge Plaza (2)	7,988	2006	Owned
4605 Country Club Road - Corporate	27,000	2003	Owned
Lending Offices:			
Winston Salem, North Carolina			
4625 Country Club Road	3,200	1998	Owned
Raleigh, North Carolina			
3948 Browning Place	1,058	2007	Leased

(1) Acquired as part of The Community Bank acquisition.
(2) Approximately 75% of these properties are leased to tenants.
(3) Relocated banking office from 536 South Stratford Road to 500 South Stratford Road in April 2008. The underlying lease on 536 South Stratford Road will expire in December 2009.

In addition to the above locations, the Bank has four off site ATMs (located at 3484 Robinhood Road and 401 Deacon Boulevard both in Winston-Salem, 1466 River Ridge Road in Clemmons and at 4575 Yadkinville Road, Pfafftown, North Carolina) and approximately 100 outsourced ATM cash dispensing machines throughout North Carolina.

All of our properties, including land, buildings and improvements, furniture, equipment and vehicles, had a net book value at December 31, 2008 of $40.0 million. See further information presented in Note 6 to our consolidated financial statements, which are presented under Item 8 in this Form 10-K.

We are currently constructing two permanent buildings to replace our temporary facilities in Asheville and Raleigh, increasing their respective square footage to 9,800 for Asheville and 10,700 for Raleigh. We expect to occupy the Asheville banking office in the second quarter of 2009 and the Raleigh banking office during third quarter of 2009.

Additional banking offices may be opened at later dates if deemed appropriate by the Board of Directors and if regulatory approval can then be obtained. The Company may acquire property in which a director, directly or indirectly, has an interest. In such event, the acquisition of such facilities shall be approved by a majority of the Board of Directors, excluding any individual who may have such an interest in the property.

Item 3. Legal Proceedings

The Company is a party to legal proceedings arising in the normal conduct of business. Our management believes that this litigation is not material to the Company's financial position or results of its operations or the operations of the Bank.

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

There were no matters submitted to a vote of our security holders during the fourth quarter of our fiscal year ended December 31, 2008.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

Price Range of Common Stock and Dividends

Our common stock and preferred securities are listed on the NASDAQ Global Select Market under the symbols "SCMF" and "SCMFO", respectively. The following table sets forth the high and low sales prices per share of our common stock and our preferred securities ("SCMFO"), based on published financial sources, and our dividend payments for the last two years.

		Price				Declared Cash Dividend per share
		SCMF		SCMFO		
Year	Quarterly Period	High	Low	High	Low	
2007	First Quarter	$ 10.97	$ 10.04	$ 10.53	$ 10.11	$ 0.035
	Second Quarter	10.23	8.65	10.50	10.04	0.040
	Third Quarter	8.94	6.25	10.29	9.66	0.040
	Fourth Quarter	8.80	6.40	10.30	8.64	0.040
2008	First Quarter	$ 7.89	$ 6.26	$ 9.94	$ 8.00	$ 0.040
	Second Quarter	7.73	5.52	9.73	7.50	0.040
	Third Quarter	6.30	3.86	9.15	6.01	0.040
	Fourth Quarter	4.97	2.11	8.74	5.75	0.040

At February 28, 2009, there were approximately 7,207 holders of record of our common stock.

Holders of our common stock will be entitled to receive any cash dividends the Board of Directors may declare. The declaration and payment of future dividends to holders of our common stock will be at the discretion of our Board of Directors and will depend upon our earnings and financial condition, regulatory conditions and considerations and such other factors as our Board of Directors may deem relevant. As a holding company, Southern Community Financial Corporation is ultimately dependent upon its bank subsidiary to provide funding for its operating expenses, debt service (including the interest payments on the preferred securities issued by our remaining trust subsidiary), and dividends. Our primary sources of income are dividends paid by the Bank and interest income on loans and deposits with the bank subsidiary. The Company must pay all of its operating expenses from funds received from the Bank. Various banking laws applicable to our bank subsidiary limit the payment of dividends, management fees and other distributions by the Bank to the Company and may therefore limit the Company's ability to make dividend payments. Under North Carolina banking law, dividends must be paid out of retained earnings and no cash dividends may be paid if payment of the dividend would cause the Bank's surplus to be less than 50% of its paid-in capital. Under federal banking law, no cash dividend may be paid if the Bank is undercapitalized or insolvent or if payment of the cash dividend would render the Bank undercapitalized or insolvent, or if it is in default of any deposit insurance assessment due to the Federal Deposit Insurance Corporation. As a condition of the issuance of Cumulative Perpetual Preferred Stock to the United States Treasury under its Capital Purchase Program, the Company must obtain the consent of the United States Treasury Department to increase the cash dividend on its common stock from the September 30, 2008 quarterly level of $0.04 per common share.

In the future, any declaration and payment of cash dividends will be subject to the Board of Directors' evaluation of our operating results, financial condition, future growth plans, general business and economic conditions, tax and other relevant considerations. There is no assurance that, in the future, we will have funds available to pay cash dividends, or, even if funds are available, that we will pay dividends in any particular amount or at any particular time, or that we will pay dividends at all.

Share Repurchases

The Company announced a plan to repurchase up to 300,000 shares of its common stock in March 2005, to repurchase an additional 600,000 shares in September 2005 and to repurchase up to an additional 1 million shares in July 2006. Through December 31, 2008, the Company has repurchased 1,858,073 shares at an average price of $6.99 per share under the three plans, including 600,000 shares at an average price of $2.93 purchased during the fourth quarter of 2008. The Company received prior approval from the United States Department of the Treasury to repurchase the 600,000 shares in the fourth quarter 2008 as we had received preliminary approval to participate in the Capital Purchase Program; however, we had not yet consummated the transaction at the date of the repurchase. The table below sets forth information with respect to shares of common stock repurchased during the three months ended December 31, 2008.

As a condition of the issuance of its Cumulative Perpetual Preferred Stock to the United States Treasury under its Capital Purchase Program, the Company must obtain the consent of the United States Treasury Department to repurchase any of its common stock.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Maximum Number of Shares That May Yet Be Purchased Under the Programs
October 1, 2008 to October 31, 2008	None	-	-	641,927
November 1, 2008 to November 30, 2008	None	-	-	641,927
December 1, 2008 to December 31, 2008	600,000	$ 2.93	600,000	41,927

Item 6. Selected Financial Data

SELECTED CONSOLIDATED FINANCIAL INFORMATION AND OTHER DATA

The following tables set forth selected consolidated financial information and other data. The results for 2004 include the impact of the acquisition of The Community Bank which was effective January 12, 2004. The information set forth below does not purport to be complete and should be read in conjunction with our consolidated financial statements appearing elsewhere in this annual report.

	For the Years Ended December 31,				
	2008	2007	2006	2005	2004
	(Dollars in thousands, except per share data)				
Operating Data:					
Interest income	$ 96,742	$ 98,908	$ 85,520	$ 68,097	$ 54,656
Interest expense	49,282	55,141	44,798	31,128	20,175
Net interest income	47,460	43,767	40,722	36,969	34,481
Provision for loan losses	8,165	2,775	2,510	950	2,239
Net interest income after provision for loan losses	39,295	40,992	38,212	36,019	32,242
Non-interest income	11,282	11,331	3,678	7,134	7,949
Non-interest expense	42,089	40,900	35,802	31,319	27,520
Income before income taxes	8,488	11,423	6,088	11,834	12,671
Provision for income taxes	2,634	3,869	1,890	4,161	4,556
Net income	5,854	7,554	4,198	7,673	8,115
Effective dividend on preferred stock	185	-	-	-	-
Net income available to common shareholders	$ 5,669	$ 7,554	$ 4,198	$ 7,673	$ 8,115
Securities gains(losses) included in non-interest income	$ 98	$ -	$ (4,156)	$ (266)	$ -
Per Share Data:					
Net Income					
Basic	$ 0.33	$ 0.43	$ 0.24	$ 0.43	$ 0.47
Diluted	0.33	0.43	0.24	0.42	0.45
Cash dividends	0.160	0.155	0.135	0.120	0.110
Book value	8.77	8.18	7.83	7.66	7.68
Weighted average shares					
Basic	17,363,395	17,559,352	17,566,315	17,825,152	17,298,285
Diluted	17,398,318	17,624,399	17,757,436	18,133,859	18,033,333
Balance Sheet Data:					
Total assets	1,803,778	1,569,182	1,436,465	1,287,613	1,222,946
Loans	1,314,811	1,188,438	1,033,411	868,827	796,103
Allowance for loan losses	18,851	14,258	13,040	11,785	12,537
Deposits	1,233,112	1,045,237	1,024,582	941,949	845,501
Short-term borrowings	145,197	117,772	92,748	9,186	69,647
Long-term debt	228,016	254,633	172,549	192,551	163,494
Stockholders' equity	187,710	142,339	136,225	134,885	136,834
Capital Ratios:					
Total risk-based capital	13.80%	11.44%	11.40%	13.21%	13.81%
Tier 1 risk-based capital	12.46%	10.28%	10.20%	11.94%	11.78%
Leverage ratio	10.57%	8.96%	8.73%	9.60%	9.67%
Equity to assets ratio	10.41%	9.07%	9.48%	10.48%	11.20%

	2008	2007	2006	2005	2004
	For the Years Ended December 31, (Dollars in thousands, except per share data)				
Selected Performance Ratios:					
Return on average assets	0.34%	0.50%	0.31%	0.60%	0.69%
Return on average equity	4.02%	5.45%	3.11%	5.67%	6.21%
Net interest spread (1)	2.75%	2.81%	2.92%	2.86%	3.03%
Net interest margin (2)	2.99%	3.19%	3.30%	3.20%	3.26%
Non-interest income as a percentage of total revenue (3)	19.21%	20.57%	8.28%	16.18%	18.73%
Non-interest income as a percentage of average assets	0.65%	0.75%	0.27%	0.56%	0.68%
Non-interest expense to average assets	2.42%	2.70%	2.62%	2.44%	2.36%
Efficiency ratio (4)	71.65%	74.23%	80.64%	71.01%	64.86%
Dividend payout ratio	48.48%	36.05%	56.26%	27.91%	23.40%
Asset Quality Ratios:					
Nonperforming loans to period-end loans	1.10%	0.17%	0.26%	0.16%	0.27%
Allowance for loan losses to period-end loans	1.43%	1.20%	1.26%	1.36%	1.57%
Allowance for loan losses to nonperforming loans	1.31X	6.95X	4.95X	8.37X	5.77X
Nonperforming assets to total assets (5)	1.12%	0.18%	0.25%	0.13%	0.27%
Net loan charge-offs to average loans outstanding	0.28%	0.14%	0.13%	0.14%	0.19%
Other Data:					
Number of banking offices	22	22	21	19	18
Number of full-time equivalent employees	337	337	326	299	271

(1) Net interest spread is the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.

(2) Net interest margin is net interest income divided by average interest-earning assets.

(3) Total revenue consists of net interest income and non-interest income.

(4) Efficiency ratio is non-interest expense divided by the sum of net interest income and non-interest income.

(5) Nonperforming assets consist of nonaccrual loans, restructured loans and real estate owned, where applicable.

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

The following presents management's discussion and analysis of our financial condition and results of operations and should be read in conjunction with the financial statements and related notes included elsewhere in this annual report. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ significantly from those anticipated in these forward-looking statements as a result of various factors. The following discussion is intended to assist in understanding the financial condition and results of our operations.

CRITICAL ACCOUNTING POLICIES

The Company's accounting policies are in accordance with accounting principles generally accepted in the United States and with general practices within the banking industry. Management makes a number of estimates and assumptions relating to reported amounts of assets, liabilities, revenues and expenses in the preparation of the financial statements and disclosures. Estimates and assumptions that are most significant to the Company are related to the determination of the allowance for loan losses, goodwill and other intangible assets and income taxes.

Allowance for Loan Losses

The allowance for loan losses represents management's estimate of probable losses inherent in the loan portfolio. Determining the appropriate level of the allowance is one of the most critical and complex accounting estimates for any financial institution. Management's judgments include those involved in risk grading the loan portfolio, determining specific allowances for loans considered impaired, and evaluating the impact of current economic conditions on the levels of the allowance. Loans are considered impaired when it is probable that all amounts due will not be collected in accordance with the contractual terms of the loan agreement. While management believes that the allowance for loan losses is appropriate and adequate to cover probable losses inherent in the portfolio, future adjustments to the allowance may be necessary and results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. 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 increases will not be necessary should the quality of any loans deteriorate as a result of the factors discussed herein. Any material increase in the allowance for loan losses may adversely affect our financial condition and results of operations. For further discussion, see "Nonperforming Assets" and "Analysis of Allowance for Loan Losses" under "ASSET QUALITY."

Goodwill and Other Intangibles

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Other intangible assets represent purchased intangible assets that can be separately distinguished from goodwill. Goodwill impairment testing is performed annually or more frequently if events or circumstances indicate possible impairment. The evaluation of goodwill for impairment uses both the income and market approaches to value the Company. The income approach consists of discounting projected long-term future cash flows, which are derived from internal forecasts and economic expectations for the Company. The significant inputs to the income approach include the long-term target tangible equity to tangible assets ratio and the discount rate, which is determined utilizing the Company's cost of capital adjusted for a company-specific risk factor. The company-specific risk factor is used to address the uncertainty of growth estimates and earnings projections of management. Under the market approach, a value is calculated from an analysis of comparable acquisition transactions based on earnings, book value, assets and deposit premium multiples from the sale of similar financial institutions. Our goodwill testing for 2008, which was updated as of December 31, 2008, indicated that the goodwill booked at the time of the acquisition of The Community Bank continues to properly value the acquired company and has not been impaired. No impairment has been recorded as a result of goodwill testing performed during 2008 or 2007. Given the substantial decline in our common stock price and the economic outlook for our industry, the excess of the fair value over carrying value has narrowed compared with previous assessments. If our stock price continues to decline, if the Company does not produce anticipated cash flows, or if comparable banks begin selling at significantly lower prices than in the past, our goodwill may be impaired in the future.

Intangible assets with finite lives include core deposits and other intangibles. Intangible assets other than goodwill are subject to impairment testing at least annually or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Core deposit intangibles are amortized on the straight-line method over a period not to exceed 10 years. Note 7 contains additional information regarding goodwill and other intangible assets.

Income Taxes

Accrued taxes represent the estimated amount payable to or receivable from taxing jurisdictions, either currently or in the future, and are reported, on a net basis, as a component of "other assets" in the consolidated balance sheets. The calculation of the Company's income tax expense is complex and requires the use of many estimates and judgments in its determination.

Management's determination of the realization of the net deferred tax asset is based upon management's judgment of various future events and uncertainties, including the timing and amount of future income and the implementation of various tax plans to maximize realization of the deferred tax asset. Management believes that the Company will generate sufficient operating earnings to realize the deferred tax benefits.

From time to time, management bases the estimates of related tax liabilities on its belief that future events will validate management's current assumptions regarding the ultimate outcome of tax-related exposures. While the Company has obtained the opinion of advisors that the anticipated tax treatment of these transactions should prevail and has assessed the relative merits and risks of the appropriate tax treatment, examination of the Company's income tax returns, changes in tax law and regulatory guidance may impact the treatment of these transactions and resulting provisions for income taxes.

OVERVIEW

Southern Community's founders recognized an opportunity to fulfill the financial service needs of individuals and organizations left underserved by consolidation within the financial services industry. To fill a part of this void, the founders began in 1995 the process by which Southern Community Bank and Trust was created, and began operations on November 18, 1996. From inception, Southern Community has strived to serve the financial needs of small to medium-sized businesses, individuals, residential homebuilders and others in and around our markets in North Carolina. We offer a broad array of banking and other financial products; many of which are similar to those offered by our larger competitors, but we deliver them with an emphasis on superior customer service. We believe that our emphasis on quality customer service is the single most important factor among many that have fueled our growth to $1.8 billion in total assets in just over twelve years of operations.

The Company began operations in November 1996 with $11.0 million in capital, a single branch facility and thirteen employees. Through December 31, 2008, Southern Community Financial Corporation has grown to a total of twenty-two full-service banking offices with $1.2 billion in customer deposit accounts. In support of this growth, the Company has generated additional capital through issuing common stock and retaining operating earnings. At December 31, 2008, the Company had $187.7 million in total stockholders' equity. Through our banking subsidiary we offer traditional banking products as well as a full array of financial services. In October 2001, Southern Community Financial Corporation, a financial holding company, became the parent company of Southern Community Bank and Trust. On January 12, 2004 we acquired The Community Bank, a $240.0 million asset community bank with 10 banking offices in contiguous markets. The Company created Southern Community Advisors, our wealth management division, and has developed and acquired mortgage banking operations. While these operations are currently not significant to our results of operations, we intend to pursue growth in these businesses to enhance our non-interest income.

Real estate secured loans, including construction loans and loans secured by existing commercial and residential properties, comprise the majority of our loan portfolio, with the balance of our loans consisting of commercial and industrial loans and loans to individuals. We originate residential mortgages, at both fixed and variable rates, earning fees for loans originated and additional income for loans sold to others. It has been our strategy to recruit skilled banking professionals who are well trained and highly knowledgeable about our market area, enabling us to develop and maintain a loan portfolio of sound credit quality.

Management recognizes that our growth may expose the Company to increased operational and market risk, primarily with respect to managing overhead, funding costs and credit quality. The Company has developed critical functions such as Credit Administration, Training, Audit and Compliance to assist in managing and monitoring these and other risks. We are committed to creating and maintaining a solid and diversified financial services organization with a focus on customer service. It is management's firm belief that this foundation will continue building our loyal customer base while attracting new clients and providing opportunities for future growth. As bank consolidations continue to take place in our markets, Southern Community Financial Corporation is positioned to continue to benefit from their effects.

Financial Condition at December 31, 2008 and 2007

During the year ended December 31, 2008, our total assets increased by $234.6 million, or 15.0%, to $1.8 billion. Of the increase in total assets, $230.2 million represented growth in interest earning assets. Investment securities increased $105.5 million or 46.1% to provide sufficient liquidity to fund loan growth and manage scheduled deposit and borrowing maturities as well as unforeseen deposit outflows. Loan demand remained strong through the first three quarters of 2008, resulting in an increase of $124.8 million for the year; however, loans decreased $9.2 million in the fourth quarter due largely to the economic slowdown. The increase in earning assets was funded primarily by increased deposit growth, especially through the growth in certificates of deposit. Total deposits grew to $1.2 billion at December 31, 2008, an increase of $187.9 million or 18.0% from the year ago period. Other assets increased $15.2 million in 2008 including the purchase of an additional $10.0 million in Bank Owned Life Insurance which reduced the Company's effective tax rate for the year.

Our total loan growth of $124.8 million in 2008 was concentrated in residential mortgage loans, commercial mortgage loans and commercial and industrial loans which increased by $75.3 million, $28.3 million and $23.4 million respectively. A portion of the increase in residential mortgage loans was attributable to real estate collateral which was used to secure commercial and industrial loans. Construction loans increased $809 thousand as this segment of our portfolio reflected the reduction in housing starts and related current economic conditions throughout our market area. During 2008 the Bank continued our program of originating residential mortgage loans primarily for sale. At the year-end 2008, mortgage loans held for sale were $316 thousand compared to $1.9 million at the prior year end due to the significant decrease in mortgage origination volumes in fourth quarter 2008 as the economy experienced further slowing.

Our total liquid assets, defined as cash and due from banks, federal funds sold, interest-bearing deposits and investment securities, increased by $98.7 million during the year, to $361.9 million at December 31, 2008. Liquid assets represented 20.1% of total assets at December 31, 2008 as compared to 16.8% at the beginning of the year. Cash equivalents and federal funds sold decreased $6.8 million while investment securities increased $105.5 million. The investment portfolio was built to a more normal percentage of assets to provide adequate liquidity to fund the loan growth and provide resources to manage current as well as unforeseen deposit and borrowing outflows. As of year-end, we believe our liquidity is adequate to fund future loan demand and manage deposit and borrowing outflows.

Customer deposits which have traditionally been our primary funding source supplemented by wholesale funding provided the funding for loan growth during 2008. Deposits totaled $1.23 billion, an increase of $187.9 million or 18.0% from year-end 2007. Deposit growth during the current year shifted from non-maturity deposits to time deposits as customers focused on higher yields and longer terms during the falling interest rate environment. The change in market conditions were reflected in a $27.5 million or 11.1% decrease year-over-year in demand, money market, NOW and savings account deposits, which ended the year at $577.8 million. Time deposits which increased $215.4 million or 49.0% were generated through our growing branch network and out-of-market and brokered deposits. Brokered and out-of-market deposits totaling $262.1 million and $132.6 million at year-end 2008 and 2007, respectively, increased as a funding source to meet loan funding demands during the first three quarters of 2008. Management will continue to focus on growing the core deposit base; however, we will continue to monitor the costs of our various funding alternatives and our funding mix may change from time to time as a result.

Total borrowings aggregated $373.2 million at December 31, 2008, and included $154.1 million of advances from the Federal Home Loan Bank of Atlanta (FHLB), junior subordinated debentures with a carrying value of $45.9 million, securities sold under agreements to repurchase of $113.2 million and Term Auction Facility advances from the Federal Reserve Bank of $60.0 million. The Company began borrowing funds from the Term Auction Facility during the second quarter of 2008 as an additional source of funds. The Bank has entered into long-term financing through term repurchase agreements with various parties, which total $90.0 million at December 31, 2008. Management will use FHLB advances and other funding sources as necessary to support balance sheet management and growth. However, management expects that as our branch network grows and matures, the volume of core deposits will become an increasingly larger portion of our funding mix, which over time should contribute to a reduction in our overall funding cost.

The Company's capital position remains strong with all of our regulatory capital ratios at levels that make us "well capitalized" under federal bank regulatory capital guidelines. At December 31, 2008, our stockholders' equity totaled $187.7 million, an increase of $45.4 million from the December 31, 2007 balance. This net change includes $5.9 million of net income, $408 thousand of proceeds from shares purchased through stock option and stock purchase plans, $155 thousand of stock-based compensation, and $2.0 million in other comprehensive income due primarily to unrealized holding gains on available for sale investment securities. These increases in capital were offset by decreases from shares repurchased at a cost of $2.7 million, cash dividends paid of $2.8 million, $185 thousand of dividends accrued on preferred stock and $185 thousand from the cumulative effect of change in accounting method. The most significant increase in capital during 2008 was the issuance of non-voting cumulative perpetual preferred stock for $40.7 million and common stock warrants for $2.1 million as the Company elected to participate in the United States Treasury's Capital Purchase Program (CPP) at the maximum amount available to the Company. The dividend on this preferred stock is payable quarterly at an annualized rate of 5% for the first five years and 9% thereafter. The issuer may redeem this preferred stock after three years at par plus any accrued interest. Until the third anniversary of the preferred stock, the issuer needs Treasury consent to increase common stock dividends or to conduct share repurchases of common stock or junior preferred stock. The Treasury received warrants to purchase common shares having an aggregate market value equal to 15% of the preferred stock issued. These warrants have a term of 10 years and a strike price of $3.95 per share. These warrants are transferable by the Treasury. The total amount of the new securities issued qualifies as Tier 1 capital.

NET INTEREST INCOME

Like most financial institutions, the primary component of our earnings is net interest income. Net interest income is the difference between interest income, principally from loans and investments and interest expense, principally on customer deposits and borrowings. Changes in net interest income result from changes in volume and changes in interest rates earned and paid. By volume, we mean the average dollar level of interest-earning assets and interest-bearing liabilities. Spread refers to the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities, and margin refers to net interest income divided by average interest-earning assets. Spread and margin are influenced by the levels and relative mix of interest-earning assets and interest-bearing liabilities, as well as by levels of noninterest-bearing liabilities. During the years ended December 31, 2008, 2007 and 2006, our average interest-earning assets were $1.59 billion, $1.37 billion and $1.23 billion, respectively. During these same years, our net interest margins were 2.99%, 3.19% and 3.30%, respectively.

During 2008, the Federal Reserve decreased the targeted federal funds rate seven times for a total of 400 basis points to end the year at a range of 0.00% to 0.25%. The Federal Reserve's reductions in the federal funds rate along with the introduction of new programs provided increased liquidity into credit markets in response to unprecedented systemic shocks to the United States and world financial markets caused by failures and near collapses of major market participants and large banking institutions, slumping consumer confidence and the overall weakening of the economy in the United States. The federal funds rate is currently at an historical low surpassing the previous low of 1.00% in June of 2003. The rate reductions in 2008 continued a trend of three decreases totaling 100 basis points in the last quarter of 2007. The rate reductions of 2008 and 2007 were preceded by four increases for 100 basis points during 2006. As the federal funds rate decreased, the prime interest rate changed by the same amount resulting in a 300 basis point spread between the two rates leaving the prime rate at 3.25% at the end of the year. Margin compression resulted during 2008 as asset yields declined faster than deposit costs due to increased competition for deposits and the resulting irrational pricing. Competition for deposits intensified in 2008 as large regional banks turned to retail markets to replace commercial paper and other wholesale funding sources that became limited to non-existent as credit markets underwent severe stress. While it is management's goal to remain relatively interest rate neutral, the Bank's interest rate sensitivity has been slightly liability sensitive in 2007 and 2008, as the funding mix has remained relatively stable. Net interest income totaled $47.5 million, an increase of $3.7 million or 8.4% over the $43.8 million for the same period in 2007. Net interest income benefited from strong growth in average earning assets; however the Bank's asset yields decreased at a faster pace (1.13% from 7.22% to 6.09%) than cost of funds (1.07% from 4.41% to 3.34%), leading to a shrinkage in net interest margin from 3.19% to 2.99%. Due to strong loan demand during the first three quarters and increased levels of investment securities, the level of average earning assets has increased $218.1 million or 15.9% for the year ending December 31, 2008. Average interest bearing liabilities increased $223.6 million or 17.9% to $1.5 billion from $1.3 billion for the period ended December 31, 2008.

Average Balances and Average Rates Earned and Paid. The following table sets forth, for the years 2006 through 2008, information with regard to average balances of assets and liabilities, as well as the total dollar amounts of interest income from interest-earning assets and interest expense on interest-bearing liabilities, resultant yields or costs, net interest income, net interest spread, net interest margin and ratio of average interest-earning assets to average interest-bearing liabilities. Average loans include nonaccruing loans, the effect of which is to lower the average yield.

NET INTEREST INCOME

	For the Years Ended December 31,								
	2008			2007			2006		
	Average balance	Interest earned/paid	Average yield/cost	Average balance	Interest earned/paid	Average yield/cost	Average balance	Interest earned/paid	Average yield/cost
	(Dollars in thousands)								
Interest-earning assets:									
Loans (1)	$ 1,279,041	$ 82,125	6.42%	$ 1,114,677	$ 86,673	7.78%	$ 958,001	$ 73,492	7.67%
Investment securities available for sale	257,153	12,378	4.81%	179,995	8,819	4.90%	185,713	8,529	4.59%
Investment securities held to maturity	48,252	2,184	4.53%	71,510	3,208	4.49%	86,328	3,390	3.93%
Federal funds sold	4,096	55	1.34%	4,231	208	4.92%	2,263	109	4.82%
Total interest-earning assets	1,588,542	96,742	6.09%	1,370,413	98,908	7.22%	1,232,305	85,520	6.94%
Other assets	150,326			143,206			135,918		
Total assets	$ 1,738,868			$ 1,513,619			$ 1,368,223		
Interest-bearing liabilities:									
Deposits:									
NOW and money market	$ 512,717	$ 11,412	2.23%	$ 441,716	$ 15,499	3.51%	$ 348,486	$ 10,552	3.03%
Time deposits greater than $100,000	137,841	6,695	4.86%	311,125	14,135	4.54%	326,864	14,303	4.38%
Other time deposits	428,950	16,541	3.86%	169,236	8,889	5.25%	208,733	8,564	4.10%
Borrowings	395,031	14,634	3.70%	328,909	16,618	5.05%	231,664	11,379	4.91%
Total interest-bearing liabilities	1,474,539	49,282	3.34%	1,250,986	55,141	4.41%	1,115,747	44,798	4.02%
Demand deposits	104,978			108,874			105,755		
Other liabilities	13,597			15,066			11,835		
Stockholders' equity	145,754			138,693			134,886		
Total liabilities and stockholders' equity	$ 1,738,868			$ 1,513,619			$ 1,368,223		
Net interest income and net interest spread		$ 47,460	2.75%		$ 43,767	2.81%		$ 40,722	2.92%
Net interest margin			2.99%			3.19%			3.30%
Ratio of average interest-earning assets to average interest-bearing liabilities		107.73%			109.55%			110.45%	

(1) Nonaccrual notes are included in the loan amounts.

RATE/VOLUME ANALYSIS

The following table analyzes the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities. The table distinguishes between (i) changes attributable to volume (changes in volume multiplied by the prior period's rate), (ii) changes attributable to rate (changes in rate multiplied by the prior period's volume), and (iii) net change (the sum of the previous columns). The change attributable to both rate and volume (changes in rate multiplied by changes in volume) has been allocated equally to both the changes attributable to volume and the changes attributable to rate.

	December 31, 2008 vs. 2007			December 31, 2007 vs. 2006		
	Increase (Decrease) Due to			Increase (Decrease) Due to		
	Volume	Rate	Total	Volume	Rate	Total
			(Amounts in thousands)			
Interest income:						
Loans	$ 11,667	$ (16,215)	$ (4,548)	$ 12,101	$ 1,080	$ 13,181
Investment securities available for sale	3,747	(188)	3,559	(271)	561	290
Investment securities held to maturity	(1,048)	24	(1,024)	(623)	441	(182)
Federal funds sold	(4)	(149)	(153)	96	3	99
Total interest income	14,362	(16,528)	(2,166)	11,302	2,086	13,388
Interest expense:						
Deposits:						
NOW and money market	2,036	(6,123)	(4,087)	3,047	1,900	4,947
Time deposits greater than $100,000	(8,145)	705	(7,440)	(702)	534	(168)
Other time deposits	11,829	(4,177)	7,652	(1,848)	2,173	325
Borrowings	2,895	(4,879)	(1,984)	4,845	394	5,239
Total interest expense	8,615	(14,474)	(5,859)	5,343	5,000	10,343
Net interest income increase (decrease)	$ 5,747	$ (2,054)	$ 3,693	$ 5,959	$ (2,914)	$ 3,045

RESULTS OF OPERATIONS
Years Ended December 31, 2008 and 2007

Net Income. Our net income for 2008 was $5.9 million, a decrease of $1.7 million from net income of $7.6 million earned in 2007. Net income available to common shareholders was $5.7 million for 2008. Net income per common share was $0.33 basic and diluted for the year ended December 31, 2008 and $0.43 basic and diluted for 2007. The decrease is due primarily to the increase in the provision for loan losses and the decrease in income from our small business investment company (SBIC) activities. We have continued to experience strong asset growth, driven by solid loan growth of $124.8 million or 10.5% and an increase of $105.5 million or 46.1% in investment securities, which was supported by an increase of $187.9 million in our deposit base and an increase of $808 thousand in our borrowings. During 2008, average earning assets increased $218.1 million or 15.9% to $1.59 billion, and average interest bearing liabilities rose $223.6 million or 17.9%. The impact of the strong loan growth produced a favorable total volume variance ($5.7 million), partially offset by the impact of margin compression resulting in a negative total rate variance ($2.0 million), produced a net increase in net interest income of $3.7 million, or 8.4% for 2008 compared with 2007. The provision for loan losses increased to $8.2 million from $2.8 million in 2007 as nonperforming loans and net charge-offs have increased substantially in 2008 compared with 2007.

Non-interest income remained relatively unchanged in total from the prior year at $11.3 million, with a decrease of $49 thousand although the components changed significantly. Income from the investment in SBIC activities decreased $2.0 million from the prior year which was offset by increases in service charges of $928 thousand, hedging activities of $855 thousand, other non-interest income of $165 thousand and gains from sales of investment securities of $98 thousand. These increases in non-interest income categories were offset by decreases in income from mortgage banking activities of $49 thousand and income from wealth management of $3 thousand as well as income from SBIC activities. Non-interest expenses increased $1.2 million or 2.9% as the Company's pace of infrastructure expansion moderated significantly.

Net Interest Income. During 2008, our net interest income increased $3.7 million or 8.4% to $47.5 million. Interest income increased as a result of growth in our overall level of average earning assets primarily from strong loan demand and additional purchases of investment securities. Average total interest-earning assets increased $218.1 million, or 15.9% during 2008, as the average loan balances increased $164.3 million and the average investment securities portfolio and federal funds sold increased $53.8 million or 21.0%. Our average total interest-bearing liabilities increased by $223.6 million, or 17.9%. Approximately 44% of the loan portfolio is composed of fixed rate loans while 56% have a variable interest rate which generally adjusts immediately when index rates, such as our prime rate, changes. Transaction deposit accounts including NOW and money market accounts also have variable interest rates; although changes are determined by management and are not based on a specific index such as prime. Our certificates of deposit and certain borrowings have rates that are fixed until maturity. While repricing of fixed rate certificates of deposit and borrowings are delayed until renewal, our floating rate borrowings are primarily LIBOR-based, and changes in LIBOR rates typically are in advance of changes in the prime rate. As a result, interest rate decreases have generally resulted in an immediate decrease in our interest income on loans.

Interest rates declined steadily during 2008 as the Federal Reserve decreased the targeted federal funds rate seven times for a total of 400 basis points to end the year at a range of 0.00% to 0.25%. The federal funds rate is currently at an historical low surpassing the previous low of 1.00% in June of 2003. The rate reductions in 2008 continued a trend of three decreases totaling 100 basis points in the last quarter of 2007. As the federal funds rate decreased, the prime interest rate changed by the same amount leaving the prime rate at 3.25% at the end of the year. The declining interest rate environment throughout the year resulted in a decrease of 113 basis points for earning assets (136 basis points decrease in loan yields and only 6 basis point decrease in the yields of investment securities); while our funding costs decreased 107 basis points. Although net interest income increased on increased earning asset balances compared to the prior year, the net interest margin decreased 20 basis points due to lags in deposit repricing, a shift in deposit composition from lower yielding to higher yielding time deposits and deposit pricing as a result of intense competition for deposits.

We will continue to evaluate ways to improve our net interest margin; however, we expect the impact of the current interest rate environment, and the impact of competition on loan yields and deposit costs, will continue to put pressure on our net interest margin in 2009. A significant portion of the funds received from the TARP program will be used to fund asset growth. The cost of these funds will be paid as a dividend and not recorded as interest expense which will increase net interest income and improve the net interest margin.

Provision for Loan Losses. We recorded a $8.2 million provision for loan losses for the year ended December 31, 2008, representing an increase of $5.4 million from the $2.8 million provision we made for the year ended December 31, 2007. The level of provisions is reflective of the trends in the loan portfolio, including loan growth, levels of nonperforming loans and other loan portfolio quality measures, and analyses of impaired loans. Provisions for loan losses are charged to income to bring our allowance for loan losses to a level deemed appropriate by management based on the factors discussed under "Analysis of Allowance for Loan Losses." The provision for loan losses was 0.64% and 0.25% of average loans in 2008 and 2007 respectively. On an annualized basis, our percentage of net loan charge-offs to average loans outstanding was 0.28% for the year ended December 31, 2008, compared with 0.14% for the year ended December 31, 2007. Nonperforming loans totaled $14.4 million or 1.10% of total loans at December 31, 2008, compared with $2.1 million or 0.17% of total loans at December 31, 2007. Nonperforming loans and increased net charge-offs continue to be predominantly related to residential construction and development lending. The allowance for loan losses at December 31, 2008 of $18.9 million represents 1.43% of total loans and 1.31 times nonperforming loans. The allowance for loan losses at December 31, 2007 of $14.3 million was 1.20% of total loans outstanding and 6.95 times nonperforming loans at that date.

Non-Interest Income. For the year ended December 31, 2008, non-interest income decreased $49 thousand, or 0.43%, to remain relatively unchanged at $11.3 million compared to the prior year; although the components changed significantly. Income from the investment in SBIC activities decreased $2.0 million with income of $60 thousand in 2008 compared to $2.1 million in 2007. The SBIC recognized write-downs in their investments in small companies who were not able to survive the current economic weakness during 2008. In 2007, the SBIC recorded some substantial gains including a $1.2 million gain from the exit of certain portfolio companies in the first quarter. Gains on economic hedges for 2008 were $934 thousand, an increase of $855 thousand compared to $79 thousand in the prior year. Since 2003, the Company has entered into various interest rate swaps to hedge the interest rate risk inherent in certain of its brokered certificates of deposit and believes these swaps have been effective as economic hedges. Due to the decline in market interest rates during the year, all of the brokered certificates of deposit and the related derivatives were called during the first six months of 2008. As these derivatives and the related brokered deposits were called prior to maturity, a gain was recognized in non-interest income which totaled $1.4 million for the first six months of 2008. During the third quarter of 2008, Lehman Brothers, the counterparty for two economic hedges, became insolvent and unable to comply with the terms of the hedges thereby causing a termination of these derivative contracts by Lehman's technical default. The Company was "in the money" on these contracts, creating an asset whose collectibility was in doubt and therefore was written off creating the $440 thousand loss in the third quarter. Service charges increased $928 thousand or 18.8% during the year primarily due to an increase of $746 thousand in NSF charges. Income from investment brokerage and trust fees increased from the prior year by $223 thousand to $1.1 million on higher transaction volumes in the first half of 2008. Fees and income from the origination and sale of residential mortgage loans decreased $49 thousand or 3.7% to $1.3 million as purchase application volumes decreased sharply in the second half of 2008.

We expect a continued positive trend in service charge fee income in the future as we expand our branch network and deposit base. We are looking to make selective investments in experienced personnel to support our mortgage and investment areas. While we anticipate some variations in the performance of these business lines due primarily to external market conditions in 2009, we believe these investments provide us with an infrastructure that will support us with a solid base of revenue in the future. As the SCP I (SBIC) fund portfolio matures, we anticipate some fluctuation in our non-interest income as gains and losses on their investments are recognized.

Non-Interest Expense. We strive to maintain non-interest expenses at levels that we believe are appropriate given the nature of our operations and the investments in personnel and facilities that have been necessary to support our growth. From 1998 forward, we have consistently maintained our ratio of non-interest expenses to average total assets below 3.0%. For 2008 our ratio was 2.42%, down from 2.70% in 2007. As our franchise expansion slowed during 2008, the rate of increase in non-interest expense also decreased. This is also reflected in the decrease in our efficiency ratio to 71.65% for 2008 from 74.23% for 2007. For the year ended December 31, 2008, our non-interest expense grew by $1.2 million, or 2.9%. Salary and employee benefits expense increased $820 thousand, or 3.9%, and were attributable to normal increases in operation for salaries, commissions and employee benefits. Occupancy and equipment expense decreased $249 thousand, or 3.1%, as the depreciation expense for facilities and equipment moderated and other efficiencies were realized. Other non-interest expenses increased $618 thousand, or 5.3%, reflecting the increased volume of business activity, an increase of $367 thousand in the Bank's FDIC deposit insurance assessment and the writeoff of $291 thousand of goodwill from a former investment in a mortgage company.

Provision for Income Taxes. Our provision for income taxes, as a percentage of income before income taxes, was 31.0% for the year ending December 31, 2008 and 33.9% for the year ended December 31, 2007, reflective of the impact of tax-exempt interest income and increased income from bank owned life insurance as a larger percentage of pre-tax income.

RESULTS OF OPERATIONS
Years Ended December 31, 2007 and 2006

Net Income. Our net income for 2007 was $7.6 million, an increase of $3.4 million from net income of $4.2 million earned in 2006. Net income per share was $0.43 basic and diluted for the year ended December 31, 2007 and $0.24 basic and diluted for 2006. The increase is due primarily to the strong growth in interest and non-interest income and the major initiative undertaken by the Company to restructure our balance sheet, which resulted in an after tax charge of $2.7 million in the second quarter of 2006. We have continued to experience strong asset growth, driven by solid loan growth of $157.0 million or 15.2%, which was supported by an increase of $107.1 million in borrowings, an increase of $20.7 million in our deposit base and a decrease of $26.6 million in our securities portfolio. During 2007, average earning assets increased $138.1 million or 11.2% to $1.37 billion, and average interest bearing liabilities rose $135.2 million or 12.1%. The impact of the strong loan growth ($5.9 million), partially offset by the impact of margin compression ($2.9 million), produced a net increase in net interest income of $3.0 million, or 7.5% for 2007 compared with 2006. The provision for loan losses increased to $2.8 million from $2.5 million in 2006.

Non-interest income returned to a more normal level at $11.3 million, an increase of $7.7 million. The increase in non-interest income was due primarily to an increase in investment brokerage income, income from the investment in SBIC activities at Salem Capital Partners, an increase in services charges and the absence of losses from the restructuring of our investment security portfolio and economic hedging activity which resulted in unusually low non-interest income in 2006. Non-interest expenses increased $5.1 million, or 14.2%. The increase was due to our investment in the infrastructure of the company through technology and the addition of people through branch expansion in Asheville and Raleigh. Increased operating expenses including a full year of expenses on our operations center and an increase of $318 thousand in our FDIC assessment also contributed to the overall increase.

Net Interest Income. During 2007, our net interest income increased by $3.0 million or 7.5% to $43.8 million. Interest income increased as a result of growth in our overall level of average earning assets primarily from strong loan demand. Average total interest-earning assets increased $138.1 million, or 11.2% during 2007, as the increase in average loan balances of $156.7 million was offset somewhat by a decrease in our average investment portfolio of $20.5 million or 7.5%. Our average total interest-bearing liabilities increased by $135.2 million, or 12.1%. The rates earned on a significant portion (approximately 56%) of our loans adjust immediately when index rates such as our prime rate changes. Transaction deposit accounts including NOW and money market accounts also have variable interest rates although changes are determined by management and are not based on a specific index such as prime while our certificates of deposit and certain borrowings had rates that were fixed until maturity. As a result, interest rate decreases have generally resulted in an immediate decrease in our interest income on loans. While repricing of fixed rate certificates of deposit and borrowings are delayed until renewal, our floating rate borrowings are primarily LIBOR-based, and changes in LIBOR rates typically are in advance of changes in the prime rate.

Interest rates based on prime remained unchanged during the last two quarters of 2006 and through the first two quarters of 2007. Late in the third quarter of 2007 the Federal Reserve reduced the discount rate by 50 basis points resulting in the reduction of prime by the same amount. This action was followed by two 25 basis point reductions in the fourth quarter of 2007. The steady interest rate environment in the first three quarters of 2007 resulted in a slight increase of 11 basis points in yields on our loan portfolio while our funding costs increased 39 basis points. As a result of our balance sheet restructuring, in 2006, the yields on the available for sale investment portfolio increased 31 basis points to 4.90%. The increase in cost of funds for both deposits and borrowings resulted in a decrease in our net interest margin for the year of 11 basis points.

Provision for Loan Losses. We recorded a $2.8 million provision for loan loss for the year ended December 31, 2007, representing an increase of $265 thousand from the $2.5 million provision we made for the year ended December 31, 2006. The level of provisions is reflective of the trends in the loan portfolio, including loan growth, levels of non-performing loans and other loan portfolio quality measures, and analyses of impaired loans. Provisions for loan losses are charged to income to bring our allowance for loan losses to a level deemed appropriate by management based on the factors discussed under "Analysis of Allowance for Loan Losses." The provision for loan losses was 0.25% and 0.26% of average loans in 2007 and 2006 respectively. On an annualized basis, our percentage of net loan charge-offs to average loans outstanding was 0.14% for the year ended December 31, 2007, compared with 0.13% for the year ended December 31, 2006. Nonperforming loans totaled $2.1 million or 0.17% of total loans at December 31, 2007, compared with $2.6 million or 0.26% of total loans at December 31, 2006. The allowance for loan losses at December 31, 2007 of $14.3 million represents 1.20% of total loans and 695% of nonperforming loans. The allowance for loan losses at December 31, 2006 of $13.0 million was 1.26% of total loans outstanding and 495% nonperforming loans at that date.

Non-Interest Income. For the year ended December 31, 2007, non-interest income increased $7.7 million, or 208.1%, to $11.3 million from $3.7 million for the prior year. This increase is primarily due to a $4.2 million pre-tax loss on the sale of investment securities recorded in the second quarter of 2006 related to our balance sheet restructuring. During 2007, service charges and fees on deposit accounts increased $613 thousand, or 14.2%, as we continued our focus on attracting transaction accounts. Fees and income from the origination and sale of residential mortgage loans increased $138 thousand or 11.5% to $1.3 million. Income from investment brokerage and trust fees increased from the prior year by $361 thousand, to $1.1 million. Income from our investments in and management fees from Salem Capital Partners, our SBIC affiliate, of $2.1 million were up $1.3 million from 2006. The first quarter of 2007 included a gain of $1.2 million from the exit of certain investments made by Salem.

We continue to invest in experienced personnel to support our mortgage and investment areas. While we anticipate some variations in the performance of these business lines due primarily to external market conditions, we believe these investments provide us with an infrastructure that will support us with a solid base of revenue in the future. As Salem Capital Partners' portfolio matures, we anticipate some fluctuation in our non-interest income as gains and losses on their investments are recognized.

Non-Interest Expense. We strive to maintain non-interest expenses at levels that we believe are appropriate given the nature of our operations and the investments in personnel and facilities that have been necessary to support our growth. From 1998 forward, we have consistently maintained our ratio of non-interest expenses to average total assets below 3.0%. For 2007 our ratio was 2.70%, up from 2.62% in 2006. Because of our continued strong growth, we have seen increases in every major component of our non-interest expenses. For the year ended December 31, 2007, our non-interest expense grew by $5.1 million, or 14.2%. Salary and employee benefits expense increased $2.4 million, or 12.7%, and reflect the addition of personnel associated with our expansion in Raleigh and Asheville, the addition of personnel to expand and support our lines of business, and normal increases in salaries and employee benefits. Occupancy and equipment expense increased $1.1 million, or 16.0%, reflecting the expenses associated with our continued banking office expansion and a full year of expenses on our operations center in 2007 compared to a partial year in 2006. Other non-interest expenses increased $1.6 million, or 15.9%, reflecting the increased volume of business activity, an increase of $318 thousand in the Bank's FDIC deposit insurance assessment and a full year of expenses on our operations center compared to a partial year in 2006.

Provision for Income Taxes. Our provision for income taxes, as a percentage of income before income taxes, was 33.9% for the year ending December 31, 2007 and 31.0% for the year ended December 31, 2006, reflective of the impact of tax-exempt interest income as a smaller percentage of pre-tax income.

LIQUIDITY

Market and public confidence in our financial strength and in the strength of financial institutions in general will largely determine our access to appropriate levels of liquidity. This confidence is significantly dependent on our ability to maintain sound asset quality and appropriate levels of capital resources.

The term "liquidity" refers to our ability to generate adequate amounts of cash to meet our needs for funding loan originations, deposit withdrawals, maturities of borrowings and operating expenses. Management measures our liquidity position by giving consideration to both on- and off-balance sheet sources of, and demands for, funds on a daily and weekly basis.

Beginning in December 2007 and throughout 2008, the United States Department of the Treasury in coordination with the Federal Reserve and Federal Deposit Insurance Corporation (FDIC) have implemented several initiatives to stimulate the economy and maintain liquidity in our national financial markets in the face of unprecedented economic conditions. The Federal Reserve introduced three new liquidity facilities, in addition to its primary discount window borrowing program, the Term Auction Facility (TAF), the Term Securities Lending Facility (TSLF) and the Primary Dealer Credit Facility (PDCF). These initiatives were designed to lengthen the duration of access to liquidity, broaden the types of eligible collateral, expand the range of counterparties for some activities and reduce the cost of borrowings from the Fed relative to the federal funds rate. PDCF for primary dealers provided daily access to funding to eligible institutions. The TAF and TSLF constitute a second type of facility in which a pre-determined amount of longer-term funding (for a 28 day period or 84 day period) is available at auction on pre-announced dates for settlement on a later date. The interest rate and the distribution of the awards across bidding institutions are determined by the results of each auction. The TAF allows banks to borrow against a wide range of collateral, including securities that are not widely pledged in private markets and bank loans. The Federal Reserve has committed to keep this new array of liquidity facilities in place for as long as is necessary to maintain liquidity and promote stability in our financial markets. As discussed below, the Company has utilized the Term Auction Facility and will continue to consider it one of our funding alternatives.

In addition to the increase in deposit insurance coverage limit from $100,000 per account to $250,000, the FDIC announced in October 2008 two new programs under its Temporary Liquidity Guarantee Program. The first is an extension of deposit insurance coverage to all non-interest bearing transaction accounts with no limitation as to dollar amount through December 31, 2009 at a premium cost of 10 basis points per annum to depository institutions. Under the second program, the FDIC will guarantee the timely payment of principal and interest on newly issued senior unsecured debt by eligible depository institutions through June 30, 2012. New issuance of senior unsecured debt under this program is limited to a maximum of 125 percent of the par or face value of senior unsecured debt outstanding as of September 30, 2008 that was scheduled to mature on or before June 30, 2009. For institutions with no qualifying senior unsecured debt other than fed funds purchased, the applicable limit is two percent of consolidated total liabilities as of September 30, 2009. As the Bank had $20.0 million in overnight (fed funds purchased) borrowings and no other qualifying senior unsecured debt at September 30, 2008, our applicable limit under this program would be $33.1 million. The annual cost of this guarantee is tiered from 50 basis points for terms of 180 days or less to 100 basis points for terms over one year. The Company has elected to opt-in for both programs and particularly the second program at the bank level and the holding company level to preserve the opportunity to participate in the senior unsecured debt guarantee program in the future.

Sources of liquidity include cash and cash equivalents, (net of federal requirements to maintain reserves against deposit liabilities), investment securities eligible for pledging to secure borrowings from correspondent banks pursuant to securities sold under repurchase agreements, investments available for sale, loan repayments, loan sales, deposits and borrowings. The primary sources of borrowed funds are from the Federal Home Loan Bank, under the Federal Reserve's Term Auction Facility and discount window, issuance of senior unsecured debt under the FDIC's Temporary Liquidity Guarantee Program and from correspondent banks under overnight federal funds credit lines and revolving lines of credit. In addition to managing deposit and borrowing outflows, the Company's primary demand for liquidity is anticipated funding under credit commitments to customers.

We have maintained a sufficient level of liquidity in the form of federal funds sold and investment securities. These liquid assets aggregated $300.9 million at December 31, 2008, compared to $231.2 million and $256.3 million at December 31, 2007 and 2006, respectively. The increase in 2008 resulted from a decision to rebuild our investment portfolio to a more normal level as a percentage of our total assets to provide sufficient liquidity to fund loan growth and to manage the current and unforeseen deposit and borrowing outflows. Supplementing customer deposits as a source of funding, we have available lines of credit from various correspondent banks to purchase federal funds on a short-term basis of approximately $121.0 million. As of December 31, 2008, the Bank has the credit capacity to borrow up to $450.0 million, from the Federal Home Loan Bank of Atlanta, with $154.1 million outstanding as of that date. Under the Federal Reserve's Term Auction Facility discussed above, the Company had borrowings outstanding of $60.0 million as of December 31, 2008. Given the flexibility in the types of eligible collateral that may be pledged for borrowings under the TAF, the Company has up to $308.3 million in additional borrowing capacity under this facility. As mentioned above, the Company has capacity to issue new senior unsecured debt of up to $33.1 million through the FDIC's Temporary Liquidity Guarantee Program. At December 31, 2008, we had funding of $90.0 million in the form of long term repurchase agreements with maturities from one to ten years and short term repurchase agreements totaling $10.0 million. We also had short-term repurchase agreements with total outstanding balances of $13.2 million and $22.7 million at December 31, 2008 and 2007, respectively, all of which were done as accommodations for our deposit customers. Securities sold under agreements to repurchase are collateralized by U.S. government agency obligations. As of December 31, 2008, the Bank had repurchase lines of credit aggregating $150.0 million from various institutions. The repurchases must be adequately collateralized.

Throughout our twelve-year history, our loan demand has typically exceeded our growth in core deposits. We have therefore relied heavily on certificates of deposit as a source of funds. While the majority of these funds are generally from our local market area, the Bank has utilized brokered and out-of-market certificates of deposit to diversify and supplement our deposit base. In 2008, deposit growth shifted from non-maturity deposits to time deposits as customers focused on higher yields and longer terms during the declining interest rate environment. Certificates of deposit represented 63.1% of our total deposits at December 31, 2008, an increase from 42.1% at December 31, 2007. Brokered and out-of-market certificates of deposit totaled $261.2 million at year-end 2008 and $132.6 million at year-end 2007, which comprised 21.2% and 12.7% of total deposits, respectively. The Company relied more on brokered and out-of-market certificates of deposit during periods of irrational deposit pricing this past year as banks in our market area paid premium deposit rates to secure their necessary funding for liquidity purposes. We will continue to monitor the costs of our various funding alternatives and our funding mix may change from time to time. Certificates of deposit of $100 thousand or more, inclusive of brokered and out-of-market certificates, represented 14.5% of our total deposits at December 31, 2008 and 25.9% at December 31, 2007. A portion of these deposits are controlled by members of our Board of Directors and Advisory Board members, or otherwise come from customers considered to have long-standing relationships with our management. Based upon the nature of these relationships, management does not believe we are subject to significant liquidity risk related to these deposits. Large certificates of deposit are generally considered rate sensitive. While we will need to pay competitive rates to retain these deposits at their maturities, there are other subjective factors that will determine their continued retention.

At December 31, 2008, our outstanding commitments to extend credit consisted of loan commitments of $315.1 million, including amounts available under home equity credit lines and letters of credit of $102.2 million and $7.1 million, respectively. We believe that our combined aggregate liquidity position from all sources is sufficient to meet the funding requirements of loan demand, deposit and borrowings maturities and deposit withdrawals in the near term.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

In the normal course of business there are various outstanding contractual obligations of the Company that will require future cash outflows. In addition, there are commitments and contingent liabilities, such as commitments to extend credit, which may or may not require future cash outflows. The following table reflects contractual obligations of the Company outstanding as of December 31, 2008.

	Payments Due by Period				
Contractual Obligations	Total	On Demand or Within 1 Year	2 - 3 Years	4 - 5 Years	After 5 Years
			(In thousands)		
Short-term borrowings	$ 145,197	$ 145,197	$ -	$ -	$ -
Long-term debt	228,016	-	45,000	35,000	148,016
Operating leases	5,132	1,053	1,499	682	1,898
Total contractual cash obligations excluding deposits	378,345	146,250	46,499	35,682	149,914
Deposits	1,233,112	1,152,393	67,187	13,532	-
Total contractual cash obligations	$ 1,611,457	$ 1,298,643	$ 113,686	$ 49,214	$ 149,914

The following table reflects other commitments of the Company outstanding as of December 31, 2008.

	Amount of Commitment Expiration Per Period				
Other Commitments	Total	Within 1 Year	2 - 3 Years	4 - 5 Years	After 5 Years
			(In thousands)		
Undisbursed portion of home equity credit lines collateralized primarily by junior liens on 1-4 family properties	$ 102,239	$ 82	$ 886	$ 5,229	$ 96,042
Other commitments and credit lines	133,898	114,971	12,360	2,774	3,793
Undisbursed portion of construction loans	55,850	30,744	14,349	482	10,275
Mortgage loan commitments	23,075	23,075	-	-	-
Other purchase commitments	800	400	400	-	-
Total other commitments	$ 315,862	$ 169,272	$ 27,995	$ 8,485	$ 110,110

OFF-BALANCE SHEET ARRANGEMENTS

Information about the Company's off-balance sheet risk exposure is presented in Note 18 to the accompanying consolidated financial statements. As part of its ongoing business, the Company does not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as special purpose entities (SPEs), which generally are established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of December 31, 2008, the Company's SPE activity is with Southern Community Capital Trust II, the subsidiary that issued 3,450,000 shares of Trust Preferred Securities in November 2003 and Southern Community Capital Trust III which issued $10.0 million in Trust Preferred Securities in June 2007. The Trust Preferred Securities are backed by junior subordinated debentures issued by the Company, which are included in long-term debt on the balance sheet.

CAPITAL RESOURCES

Stockholders' equity at December 31, 2008 was $187.7 million. At that date, the Company's capital to asset ratio was 10.4% and all of our regulatory capital ratios exceeded the minimums established for a well capitalized bank holding company.

The Bank and the Company are subject to minimum capital requirements. See "SUPERVISION AND REGULATION." As the following table indicates, at December 31, 2008, the Company exceeded its regulatory capital requirements.

	At December 31, 2008		
	Actual Ratio	Minimum Requirement	Well Capitalized Requirements
Total risk-based capital ratio	13.80%	8.00%	10.00%
Tier 1 risk-based capital ratio	12.46%	4.00%	6.00%
Leverage ratio	10.57%	4.00%	5.00%

Under the United States Treasury's Capital Purchase Program (CPP), the Company issued $42.75 million in Cumulative Perpetual Preferred Stock, Series A, on December 5, 2008. In addition, the Company provided warrants to the Treasury to purchase 1,623,418 shares of the Company's common stock at an exercise price of $3.95 per share. These warrants are immediately exercisable and expire ten years from the date of issuance. The preferred stock is non-voting, other than having class voting rights on certain matters, and pays cumulative dividends quarterly at a rate of 5% per annum for the first five years and 9% per annum thereafter. The preferred shares are redeemable at the option of the Company subject to regulatory approval.

As a condition of the CPP, the Company must obtain consent from the United States Department of the Treasury to repurchase its common stock or to increase its cash dividend on its common stock from the September 30, 2008 quarterly level of $0.04 per common share. The Company has agreed to certain restrictions on executive compensation, including limitations on amounts payable to certain executives under severance arrangements and change in control provisions of employment contracts and clawback provisions in compensation plans, as part of the CPP.

During 2008 and 2007, the Company declared and paid four cash dividends each year. In the first quarter of 2005 the Company paid a $0.12 per share annual dividend. In the second quarter of 2005, we began paying quarterly dividends of $0.03 per share. In June 2006, the quarterly dividend was increased to $0.035 per share and increased in June of 2007 to $0.04 per share. In total the Company returned $2.7 million or $0.16 per share and $2.7 million or $0.155 per share to common shareholders in the form of cash dividends during 2008 and 2007, respectively.

The Company's dividend policy is subject to the discretion of our board of directors and will depend upon such factors as future earnings, growth, financial condition, cash needs, capital adequacy, compliance with applicable statutory and regulatory requirements and general business conditions. Our ability to pay dividends in the future will directly depend on future profitability, which cannot be accurately estimated or assured. In light of the current economic environment, the FDIC Chairman has encouraged banks to consider reducing their dividends to preserve capital. We cannot guarantee that we will continue to pay quarterly cash dividends to shareholders.

The Company's Board of Directors authorized programs in March and September 2005 and July 2006 to repurchase up to 300,000 shares, 600,000 shares and 1 million shares of common stock, respectively. During 2008 and 2007, 733,175 and 286,972 shares of common stock were repurchased and retired at an average price of $3.68 and $8.21 per share, respectively.

The Company's trust preferred securities presently qualify as Tier 1 regulatory capital and are reported in Federal Reserve regulatory reports as a minority interest in our consolidated subsidiaries. The junior subordinated debentures do not qualify as Tier 1 regulatory capital. The Board of Governors of the Federal Reserve, on March 1, 2005, adopted a final rule allowing the continued limited inclusion of trust preferred securities in Tier 1 capital. The Board's final rule limits restricted core capital elements to twenty-five percent of all core capital elements.

In June 2007, $10.0 million of trust preferred securities were placed through Southern Community Capital Trust III ("Trust III"), as part of a pooled trust preferred security. The Trust issuer invested the total proceeds from the sale of the Trust Preferred Securities in Junior Subordinated Deferrable Interest Debentures (the "Junior Subordinated Debentures") issued by the Company. The terms of the trust preferred securities require payment of cumulative cash distributions quarterly at an annual rate, reset quarterly, equal to LIBOR plus 1.43%. During 2008, the Company entered into an interest rate swap derivative contract with a counterparty that shifted this debt service from a variable rate to a fixed rate of 4.7% per annum. The dividends paid to holders of the trust preferred securities, which are recorded as interest expense, are deductible for income tax purposes. The trust preferred securities are redeemable in 30 years with a five year call provision. The Company has fully and unconditionally guaranteed the trust preferred securities through the combined operation of the debentures and other related documents. The Company's obligation under the guarantee is unsecured and subordinate to senior and subordinated indebtedness of the Company. The principal use of the net proceeds from the sale of the debentures was to provide additional capital into the Company to fund its operations and continued expansion, and to maintain the Company's and the Bank's status as "well capitalized" under regulatory guidelines.

In November of 2003, Southern Community Capital Trust II ("Trust II"), a newly formed subsidiary of the Company, issued 3,450,000 shares of Trust Preferred Securities ("Trust II Securities"), generating total proceeds of $34.5 million. The Trust II Securities pay distributions at an annual rate of 7.95% and mature on December 31, 2033. The Trust II Securities began paying quarterly distributions on December 31, 2003. The Company has fully and unconditionally guaranteed the obligations of Trust II. The Trust II Securities are redeemable in whole or in part at any time after December 31, 2008. The proceeds from the Trust II Securities were utilized to purchase junior subordinated debentures from the Bank under the same terms and conditions as the Trust II Securities. We have the right to defer payment of interest on the debentures at any time and from time to time for a period not exceeding five years, provided that no deferral period extend beyond the stated maturities of the debentures. Such deferral of interest payments by the Company will result in a deferral of distribution payments on the related Trust II Securities. Should we defer the payment of interest on the debentures; the Company will be precluded from the payment of cash dividends to shareholders. The principal uses of the net proceeds from the sale of the debentures were to provide cash for the acquisition of The Community Bank, to increase our regulatory capital, and to support the growth and operations of our subsidiary bank. The amount of proceeds qualifying for Tier 1 capital cannot comprise more than 25% of our core capital elements. Amounts in excess of the 25% limitation count as Tier 2 supplementary capital for regulatory purposes.

ASSET/LIABILITY MANAGEMENT

Our results of operations depend substantially on net interest income. Like most financial institutions, our interest income and cost of funds are affected by general economic conditions and by competition in the market place. The purpose of asset/liability management is to provide stable net interest income growth by protecting earnings from undue interest rate risk, which arises from volatile interest rates and changes in the balance sheet mix, and by managing the risk/return relationships between liquidity, interest rate risk, market risk and capital adequacy. We adhere to a Board-approved asset/liability management policy that provides guidelines for controlling, monitoring and reporting exposure to interest rate risk. Our policy is to manage the Company's net interest income exposure by measuring the impact of changing interest rate environments and adjusting the mix of assets and liabilities to provide an acceptable return within established risk limits. Net interest income simulation and gap reports in conjunction with other tools are utilized to measure and monitor interest rate risk.

When suitable lending opportunities are not sufficient to utilize available funds, we have generally invested such funds in securities, primarily securities issued by governmental agencies and mortgage-backed securities. The securities portfolio contributes to increased profitability and plays an important part in our overall interest rate risk management. However, management of the securities portfolio alone cannot balance overall interest rate risk. The securities portfolio must be used in combination with other asset/liability techniques to actively manage the balance sheet. The primary objectives in the overall management of the securities portfolio are safety, liquidity, yield, asset/liability management (interest rate risk), and investing in securities that can be pledged for public deposits or for borrowings.

In reviewing the needs of our Bank with regard to proper management of its asset/liability program, we estimate future needs, taking into consideration investment portfolio purchases, calls and maturities in addition to estimated loan and deposit increases (due to increased demand through marketing) and forecasted interest rate changes. We use a number of measures to monitor and manage interest rate risk, including net interest income simulations and gap analyses. A net interest income simulation model is the primary tool used to assess the direction and magnitude of changes in net interest income resulting from changes in interest rates. Key assumptions in the model include prepayment speeds on mortgage-related assets, cash flows and maturities of other investment securities, loan and deposit volumes and pricing. These assumptions are inherently uncertain and, as a result, the model cannot precisely estimate net interest income or precisely predict the impact of higher or lower interest rates on net interest income. Actual results will differ from simulated results due to timing, magnitude and frequency of interest rate changes and changes in market conditions and management strategies, among other factors. Based on the results of the income simulation model as of December 31, 2008, if interest rates increase instantaneously by two percentage points, our net interest income over a one-year time frame could decrease by approximately 1.0% or $364 thousand. As of December 31, 2008, if interest rates decrease instantaneously by two percentage points, our net interest income over a one-year time frame could decrease by approximately 7.7% or $2.9 million.

The analysis of interest rate gap (the difference between the amount of interest-earning assets and interest-bearing liabilities re-pricing or maturing during a given period of time) is another standard tool we use to measure exposure to interest rate risk. We believe that because interest rate gap analysis does not address all factors that can affect earnings performance, it should be used in conjunction with other methods of evaluating interest rate risk.

Our balance sheet, based on gap measurements, was liability-sensitive at December 31, 2008 in the three-month to one-year horizon and asset-sensitive beyond one year. An asset-sensitive position means that there are more assets than liabilities subject to repricing in that period as market rates change, and conversely with a liability-sensitive position. As a result, in a falling rate environment, our earnings position could improve initially followed by a reduction in net interest income, with the opposite expectation in a rising rate environment, depending on the correlation of rate changes in these categories.

The following table presents information about the periods in which the interest-sensitive assets and liabilities at December 31, 2008 will either mature or be subject to repricing in accordance with market rates, and the resulting interest-sensitivity gaps. This table shows the sensitivity of the balance sheet at one point in time and is not necessarily indicative of what the sensitivity will be on other dates. Included in interest-bearing liabilities subject to rate changes within 90 days is 100% of the money market, NOW and savings deposits. These types of deposits historically have not repriced coincidentally with or in the same proportion as general market indicators. As simplifying assumptions concerning repricing behavior, all money market, NOW and savings deposits are assumed to reprice immediately and fixed rate loans and mortgage-backed securities are assumed to reprice at their contractual maturity.

	At December 31, 2008				
	3 Months or Less	Over 3 Months to 12 Months	Total Within 12 Months	Over 12 Months	Total
			(Dollars in thousands)		
Interest-earning assets					
Loans	$ 391,133	$ 214,532	$ 605,665	$ 709,146	$ 1,314,811
Investment securities available for sale	-	3,974	3,974	281,875	285,849
Investment securities held to maturity	-	3,400	3,400	31,831	35,231
Federal funds sold and other interest-bearing deposits	2,180	-	2,180	-	2,180
Total interest-earning assets	$ 393,313	$ 221,906	$ 615,219	$ 1,022,852	$ 1,638,071
Interest-bearing liabilities					
Deposits:					
Money market, NOW and savings deposits	$ 475,772	$ -	$ 475,772	$ -	$ 475,772
Time deposits greater than $100,000	24,753	112,164	136,917	26,684	163,601
Other time deposits	177,081	260,575	437,656	54,035	491,691
Borrowings	130,197	15,000	145,197	228,016	373,213
Total interest-bearing liabilities	$ 807,803	$ 387,739	$ 1,195,542	$ 308,735	$ 1,504,277
Interest sensitivity gap per period	$ (414,490)	$ (165,833)	$ (580,323)	$ 714,117	$ 133,794
Cumulative gap	$ (414,490)	$ (580,323)	$ (580,323)	$ 133,794	$ 133,794
Cumulative ratio of interest-sensitive assets to interest-sensitive liabilities	48.69%	51.46%	51.46%	108.89%	108.89%

MARKET RISK

Market risk reflects the risk of economic loss resulting from adverse changes in market price and interest rates. This risk of loss can be reflected in diminished current market values and/or reduced potential net interest income in future periods. Our market risk arises primarily from interest rate risk inherent in our lending and deposit-taking activities. The structure of our loan and deposit portfolios is such that a significant decline in interest rates may adversely impact net market values and net interest income. We do not maintain a trading account nor are we subject to currency exchange risk or commodity price risk. Interest rate risk is monitored as part of the Bank's asset/liability management function, which is discussed in "Asset/Liability Management" above. The following table presents information about the contractual maturities, average interest rates and estimated fair values of our financial instruments that are considered market risk sensitive at December 31, 2008.

	Expected Maturities of Market Sensitive Instruments Held at December 31, 2008 Occurring in the Indicated Year (Dollars in thousands)							Average	Estimated
	2009	2010	2011	2012	2013	Beyond Five Years	Total	Interest Rate	Fair Value
FINANCIAL ASSETS									
Federal funds sold	$ 2,180	$ -	$ -	$ -	$ -	$ -	$ 2,180	1.34%	$ 2,180
Investment securities (1) (2)	7,374	5,034	7,994	18,908	20,725	264,662	324,697	4.82%	324,996
Loans (3)									
Fixed rate	91,067	62,199	87,784	77,881	116,000	141,674	576,605	6.43%	581,476
Variable rate	379,083	92,096	48,313	54,888	34,390	129,436	738,206	4.98%	741,482
Total	$ 479,704	$ 159,329	$ 144,091	$ 151,677	$ 171,115	$ 535,772	$1,641,688	5.45%	$1,650,134
FINANCIAL LIABILITIES									
Money market, NOW and savings deposits	$ 475,772	$ -	$ -	$ -	$ -	$ -	$ 475,772	1.03%	$ 475,772
Time deposits	574,573	29,300	37,887	1,401	12,131	-	655,292	3.43%	649,186
Short-term borrowings	145,197	-	-	-	-	-	145,197	3.18%	145,197
Long-term borrowings	-	45,000	-	25,000	10,000	148,016	228,016	3.97%	247,223
Total	$1,195,542	$ 74,300	$ 37,887	$ 26,401	$ 22,131	$ 148,016	$1,504,277	2.73%	$1,517,378

(1) Yields on tax-exempt investments have been adjusted to a taxable equivalent basis using federal and state tax rates of 34% and 6.9%, respectively, less estimated disallowed interest expense.

(2) Callable securities and borrowings with favorable market rates at December 31, 2008 are assumed to mature at their call dates for purposes of this table.

(3) Includes nonaccrual loans but not the allowance for loan losses.

QUARTERLY FINANCIAL INFORMATION

The following table sets forth, for the periods indicated, certain of our consolidated quarterly financial information. This information is derived from our unaudited financial statements, which include, in the opinion of management, all normal recurring adjustments which management considers necessary for a fair presentation of the results for such periods. This information should be read in conjunction with our consolidated financial statements included elsewhere in this report. The results for any quarter are not necessarily indicative of results for any future period.

	Year Ended December 31, 2008				Year Ended December 31, 2007			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
	(In thousands, except per share data and common stock price)							
Interest income	$ 24,278	$ 24,412	$ 23,727	$ 24,325	$ 25,370	$ 25,339	$ 24,626	$ 23,573
Interest expense	11,459	12,553	11,947	13,323	14,132	14,350	13,607	13,052
Net interest income	12,819	11,859	11,780	11,002	11,238	10,989	11,019	10,521
Provision for loan losses	2,360	1,350	3,530	925	750	575	600	850
Net interest income after provision for loan losses	10,459	10,509	8,250	10,077	10,488	10,414	10,419	9,671
Non-interest income	2,518	2,077	3,098	3,589	2,840	2,546	2,813	3,132
Non-interest expense	10,653	10,204	10,672	10,560	10,487	10,349	10,305	9,759
Income before income taxes	2,324	2,382	676	3,106	2,841	2,611	2,927	3,044
Income taxes	766	754	73	1,041	948	890	996	1,035
Net income	1,558	1,628	603	2,065	1,893	1,721	1,931	2,009
Effective dividend on preferred stock	185	-	-	-	-	-	-	-
Net income available to common shareholders	$ 1,373	$ 1,628	$ 603	$ 2,065	$ 1,893	$ 1,721	$ 1,931	$ 2,009
Per common share data:								
Net income:								
Basic	$ 0.08	$ 0.09	$ 0.03	$ 0.12	$ 0.11	$ 0.10	$ 0.11	$ 0.12
Diluted	0.08	0.09	0.03	0.12	0.11	0.10	0.11	0.11
Common stock price:								
High	$ 4.97	$ 6.30	$ 7.73	$ 7.89	$ 8.80	$ 8.94	$ 10.23	$ 10.97
Low	2.11	3.86	5.52	6.26	6.40	6.25	8.65	10.04

LENDING ACTIVITIES

General. We provide to our customers residential, commercial and construction loans secured by real estate, as well as a full range of short- to medium-term commercial and industrial, Small Business Administration guaranteed and personal loans, both secured and unsecured. We have implemented loan policies and procedures that establish the basic guidelines governing our lending operations. Generally, those guidelines address the types of loans that we seek, our target markets, underwriting and collateral requirements, terms, interest rate and yield considerations and compliance with laws and regulations. All loans or credit lines are subject to approval procedures and amount limitations. These limitations apply to the borrower's total outstanding indebtedness to us, including the indebtedness of any guarantor. The policies are reviewed and approved at least annually by our Board of Directors. We supplement our supervision of the loan underwriting and approval process with periodic loan audits by internal loan examiners. We have focused our lending activities on the types of loans that we believe will be most in demand by our target customers, as presented in the loan portfolio composition tables below.

	At December 31,					
	2008		2007		2006	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(Amounts in thousands)					
Residential mortgage loans	$ 393,360	29.9%	$ 318,038	26.8%	$ 258,885	25.1%
Commercial mortgage loans	419,212	31.9%	390,948	32.9%	359,987	35.0%
Construction loans	260,549	19.8%	259,740	21.9%	211,858	20.6%
Commercial and industrial loans	221,231	16.8%	197,851	16.6%	177,706	17.3%
Loans to individuals	20,459	1.6%	21,861	1.8%	21,380	2.0%
Subtotal	1,314,811	100.0%	1,188,438	100.0%	1,029,816	100.0%
Less: Allowance for loan losses	(18,851)		(14,258)		(13,040)	
Net loans	$ 1,295,960		$ 1,174,180		$ 1,016,776	

	At December 31,			
	2005		2004	
	Amount	Percent of Total	Amount	Percent of Total
	(Amounts in thousands)			
Residential mortgage loans	$ 244,177	28.0%	$ 238,454	30.0%
Commercial mortgage loans	286,658	33.0%	295,130	37.1%
Construction loans	156,900	18.1%	102,282	12.8%
Commercial and industrial loans	151,950	17.5%	127,432	16.0%
Loans to individuals	29,142	3.4%	32,805	4.1%
Subtotal	868,827	100.0%	796,103	100.0%
Less: Allowance for loan losses	(11,785)		(12,537)	
Net loans	$ 857,042		$ 783,566	

The following table presents at December 31, 2008 the aggregate maturities of loans in the named categories of our loan portfolio which mature during the periods indicated.

	At December 31, 2008							
	Due within one year		Due after one year but within five years		Due after five years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
	(Amounts in thousands)							
Residential mortgage loans	$ 149,372	4.79%	$ 99,043	6.77%	$ 143,462	6.02%	$ 391,877	5.74%
Commercial mortgage loans	95,489	5.58%	266,442	6.67%	54,903	6.56%	416,834	6.40%
Construction loans	195,681	4.95%	43,675	6.63%	11,381	7.09%	250,737	5.34%
Commercial and industrial loans	142,476	5.00%	68,543	6.63%	9,476	5.69%	220,495	5.54%
Loans to individuals	10,484	8.09%	8,162	8.46%	1,789	4.20%	20,435	7.89%
Total	593,502	5.08%	485,865	6.71%	221,011	6.18%	1,300,378	5.87%
Nonaccrual loans	12,163		1,385		885		14,433	
Loans, gross	$ 605,665		$ 487,250		$ 221,896		$1,314,811	

The above table is based on contractual scheduled maturities. Early repayments of loans or renewals at maturity are not considered in this table.

Real Estate Loans. Loans secured by real estate represent our greatest concentration of loans and are divided into three categories: residential mortgage, commercial mortgage and construction loans. We make real estate loans for purchasing, constructing and refinancing one-to-four family residential, five or more family residential and commercial properties. We also make loans secured by real estate to commercial and individual borrowers who use the loan proceeds for other purposes. Our real estate loans totaled $1.07 billion at December 31, 2008, representing 81.6% of our total loans outstanding. Our loan policy requires appraisal prior to funding a real estate loan and also outlines the requirements for appraisals on renewals.

We pursue an aggressive policy of evaluation and monitoring on any real estate loan that becomes troubled, including reappraisal when appropriate. We recognize and reserve for potential exposures as soon as we identify them. However, the pace of absorption of real properties is affected by each property's individual nature and characteristics, the status of the real estate market at the time, general economic conditions and other factors that could adversely affect our volume of non-performing real estate loans and our ability to dispose of foreclosed properties without loss.

Residential Mortgage Loans. We provide our customers access to long-term conventional real estate loans through the origination of Federal National Mortgage Association-conforming loans. Many of the fixed-rate one-to-four family owner occupied residential mortgage loans that we originate are for sale in the secondary market and have been pre-sold for the account of third parties. As it relates to loans sold to third party investors, the Bank has no repurchase obligation on sold loans as long as the underlying borrowers make their first mortgage payment when due. Residential mortgage loans held for sale totaled $316 thousand at December 31, 2008.

Residential loans are generated through our in-house staff as well as the Bank's existing customer base, referrals from real estate agents and builders and local marketing efforts. Our lending efforts include the origination of loans secured by first mortgages on one–to-four family residences and on home equity credit lines. Our residential mortgage loans totaled $393.4 million at December 31, 2008 and included $264.8 million in one-to-four family permanent mortgage loans, $110.5 million in outstanding advances under home equity credit lines and $18.1 million of other loans secured by residential real estate. Substantially all our residential mortgage loans are secured by properties located within our market area, although we will make loans secured by properties outside our market area to qualifying existing customers. We believe that the amount of risk associated with this group of loans is mitigated in part due to the type of loans involved. Historically, the amount of losses suffered on this type of loan has been significantly less than those loans collateralized by other types of properties.

Our one-to-four family residential loans generally have maturities ranging from 1 to 30 years. These loans are either fully amortizing with monthly payments sufficient to repay the total amount of the loan or amortizing with a balloon feature, typically due in fifteen years or less. We review information concerning the income, financial condition, employment history and credit history when evaluating the creditworthiness of an applicant for a residential mortgage loan.

Commercial Mortgage Loans. Our commercial mortgage loans totaled $419.2 million at December 31, 2008. These loans are secured principally by commercial buildings for office, retail, manufacturing, storage and warehouse properties. Generally, in underwriting commercial mortgage loans, we require the personal guaranty of borrowers and a demonstrated cash flow capability sufficient to service the debt. Loans secured by commercial real estate may be in greater amount and involve a greater degree of risk than one-to-four family residential mortgage loans, and payments on such loans are often dependent on successful operation or management of the properties and the underlying businesses. We make commercial mortgage loans at both fixed and variable rates for terms generally up to 15 years.

Construction Loans. We originate one-to-four family residential construction loans for the construction of custom homes (where the home buyer is the borrower or the home is presold), and we provide construction financing to builders including acquisition development and "spec" home financing. We have a staff of lending professionals and assistants who service only our construction loan portfolio. We generally receive a pre-arranged permanent financing commitment from an outside banking entity prior to financing the construction of pre-sold homes. We lend to builders who have demonstrated a favorable record of performance and profitable operations and who are building in our market area. We also make commercial real estate construction loans, as noted in the preceding paragraph. We endeavor to limit our construction lending risk through adherence to established underwriting procedures. Also, we generally require documentation of all draw requests and utilize loan officers to inspect the project prior to funding any draw requests from the builder. With few exceptions, the Bank requires personal guarantees and secondary sources of repayment on construction loans. Construction loans aggregated $260.5 million at December 31, 2008.

Commercial Loans. Commercial business lending is a primary focus of our lending activities. At December 31, 2008, our commercial loan portfolio equaled $221.2 million or 16.8% of total loans. Commercial loans include both secured and unsecured loans for working capital, expansion and other business purposes. Short-term working capital loans generally are secured by accounts receivable, inventory and/or equipment. The Bank also makes term commercial loans secured by equipment and real estate. Lending decisions are based on an evaluation of the financial strength, management and credit history of the borrower and the quality of the collateral securing the loan. With few exceptions, the Bank requires personal guarantees and secondary sources of repayment.

Commercial loans generally provide greater yields and reprice more frequently than other types of loans, such as real estate loans. More frequent repricing means that the yields on our commercial loans adjust with changes in interest rates.

Loans to Individuals. Loans to individuals include automobile loans, boat and recreational vehicle financing and miscellaneous secured and unsecured personal loans. Consumer loans generally can carry significantly greater risks than other loans, even if secured, if the collateral consists of rapidly depreciating assets such as automobiles and equipment. Repossessed collateral securing a defaulted consumer loan may not provide an adequate source of repayment of the loan. We attempt to manage the risks inherent in consumer lending by following established credit guidelines and underwriting practices designed to minimize risk of loss.

Loan Approvals. Our loan policies and procedures establish the basic guidelines governing our lending operations. Generally, the guidelines address the type of loans that we seek, our target markets, underwriting and collateral requirements, terms, interest rate and yield considerations and compliance with laws and regulations. All loans or credit lines are subject to approval procedures and amount limitations. These limitations apply to the borrower's total outstanding indebtedness to us, including the indebtedness of any guarantor. The policies are reviewed and approved at least annually. We supplement our supervision of the loan underwriting and approval process with periodic internal loan audits.

Individual lending authorities are established by the Board of Directors as periodically requested by management. All individual lending authorities are reviewed and approved at least annually by the Board of Directors.

The Board Loan Committee consists of the CEO, President, Managing EVP of Commercial Lending, EVP and Chief Credit Officer and five outside Directors as appointed by the Board of Directors. This Committee meets on a monthly basis to review for approval all loan requests from borrowers with aggregate exposure in excess of $9.0 million. As of December 31, 2008, the legal lending limit for the Bank was approximately $24.8 million. The Bank also has an internal bank loan committee comprised of seven members who review all loan requests with aggregate exposure between $6.0 million and $9.0 million.

ASSET QUALITY

We consider asset quality to be of primary importance. We employ a formal internal loan review process to ensure adherence to the Lending Policy as approved by the Board of Directors. It is the responsibility of each lending officer to assign an appropriate risk grade to every loan originated. Credit Administration, through the loan review process, validates the accuracy of the initial risk grade assessment. In addition, as a given loan's credit quality improves or deteriorates, it is Credit Administration's responsibility to change the borrower's risk grade accordingly. The function of determining the allowance for loan losses is fundamentally driven by the risk grade system. In determining the allowance for loan losses and any resulting provision to be charged against earnings, particular emphasis is placed on the results of the loan review process. We also give consideration to historical loan loss experience, the value and adequacy of collateral, economic conditions in our market area and other factors. For loans determined to be impaired, the allowance is based on discounted cash flows using the loan's initial effective interest rate or the fair value of the collateral for certain collateral dependent loans. This evaluation is inherently subjective as it requires material estimates, including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. The allowance for loan losses represents management's estimate of the appropriate level of reserve to provide for potential losses inherent in the loan portfolio.

Our policy in regard to past due loans normally requires a charge-off to the allowance for loan losses within a reasonable period after collection efforts and a thorough review has been completed. Further collection efforts are then pursued through various means including legal remedies. Loans carried in a nonaccrual status and probable losses are considered in the determination of the allowance for loan losses.

Nonperforming Assets

The table sets forth, for the period indicated, information about our nonaccrual loans, restructured loans, total nonperforming loans (nonaccrual loans plus restructured loans), and total nonperforming assets.

	At December 31,				
	2008	2007	2006	2005	2004
	(Dollars in thousands)				
Nonaccrual loans	$ 14,433	$ 2,052	$ 2,636	$ 1,408	$ 2,174
Restructured loans	-	-	-	-	-
Total nonperforming loans	14,433	2,052	2,636	1,408	2,174
Foreclosed assets	5,745	775	895	280	1,085
Total nonperforming assets	$ 20,178	$ 2,827	$ 3,531	$ 1,688	$ 3,259
Accruing loans past due 90 days or more	$ -	$ 8	$ -	$ -	$ -
Allowance for loan losses	18,851	14,258	13,040	11,785	12,537
Nonperforming loans to period end loans	1.10%	0.17%	0.26%	0.16%	0.27%
Allowance for loan losses to period end loans	1.43%	1.20%	1.26%	1.36%	1.57%
Allowance for loan losses to nonperforming loans	131%	695%	495%	837%	577%
Nonperforming assets to total assets	1.12%	0.18%	0.25%	0.13%	0.27%

Our financial statements are prepared on the accrual basis of accounting, including the recognition of interest income on loans, unless we place a loan on nonaccrual basis. We account for loans on a nonaccrual basis when we have serious doubts about the collectibility of principal or interest. Generally, our policy is to place a loan on nonaccrual status when the loan becomes past due 90 days. We also place loans on nonaccrual status in cases where we are uncertain whether the borrower can satisfy the contractual terms of the loan agreement. Amounts received on nonaccrual loans generally are applied first to principal and then to interest only after all principal has been collected. Restructured loans are those for which concessions, including the reduction of interest rates below a rate otherwise available to that borrower or the deferral of interest or principal have been granted due to the borrower’s weakened financial condition. We record interest on restructured loans at the restructured rates, as collected, when we anticipate that no loss of original principal will occur.

The recorded investment in loans that were considered individually impaired in accordance with SFAS 114 at December 31, 2008 totaled $23.3 million. Of these $23.3 million in loans considered individually impaired at December 31, 2008, there were $14.4 million of nonaccrual loans and $8.9 million of potential problem loans. Approximately 80% of these nonaccrual loans and potential problem loans were related to residential construction and development lending. At that time, the largest nonaccrual balance of any one borrower was $2.9 million, with the average balance for the seventy-two nonaccrual loans being $200 thousand. At December 31, 2008, the recorded investment in impaired loans requiring a valuation allowance based on individual analysis per SFAS 114 guidelines were $19.0 million, with a corresponding valuation allowance of $2.8 million.

In addition to nonperforming loans there were $19.7 million of loans at December 31, 2008, for which management has concerns regarding the ability of the borrowers to meet existing repayment terms, compared with $7.0 million at December 31, 2007. Approximately 80% of these potential problem loans at December 31, 2008 were related to residential construction and development lending. The increase in potential problem loans is primarily due to an increase in residential construction and development loans that were downgraded due to the borrower's exposure to the housing market. Potential problem loans are primarily classified as substandard for regulatory purposes and reflect the distinct possibility, but not the probability, that the Company will not be able to collect all amounts due according to the contractual terms of the loan agreement. Although these loans have been identified as potential problem loans they may never become delinquent, nonperforming or impaired. Additionally, these loans are generally secured by residential real estate or other assets, thus reducing the potential for loss should they become nonperforming. Potential problem loans are considered in the determination of the adequacy of the allowance for loan losses.

Foreclosed assets consist of real estate acquired through foreclosure, repossessed assets and idled properties. At December 31, 2008 foreclosed assets totaled $5.7 million or 0.32% of total assets, and consisted of 30 properties. The largest dollar value of a foreclosed property at December 31, 2008 was $890 thousand. We have reviewed recent appraisals of these properties and believe that the fair values, less estimated costs to sell, equal or exceed their carrying value.

Analysis of Allowance for Loan Losses

Our allowance for loan losses ("ALLL") is established through charges to earnings in the form of a provision for loan losses. We increase our allowance for loan losses by provisions charged to operations and by recoveries of amounts previously charged off and we reduce our allowance by loans charged off. We evaluate the adequacy of the allowance monthly. In addition, on a monthly basis our Board Loan Committee reviews our loan portfolio and conducts an evaluation of our credit quality. The Board Loan Committee reports directly to the Board of Directors. Quarterly the Board of Directors reviews the loan loss provision and the adequacy of the allowance for loan losses. In evaluating the adequacy of the allowance, we consider the growth, composition and industry diversification of the portfolio, historical loan loss experience, current delinquency levels, trends in past dues and classified assets, adverse situations that may affect a borrower's ability to repay, estimated value of any underlying collateral, prevailing economic conditions and other relevant factors deriving from our history of operations. In addition, regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses and may require us to make adjustments for estimated losses based upon judgments different from those of our management.

We use our risk grading program, as described under "ASSET QUALITY," to facilitate our evaluation of probable inherent loan losses and the adequacy of the allowance for loan losses. In this program, risk grades are initially assigned by loan officers, reviewed by Credit Administration, and tested by our internal auditors, and our internal loan review function. Third party loan reviews are conducted at various times to supplement internal efforts. The testing program includes an evaluation of a sample of new loans, large loans, loans that are identified as having potential credit weaknesses, loans past due 90 days or more, and nonaccrual loans as well as other factors randomly assigned. We strive to maintain our loan portfolio in accordance with conservative loan underwriting policies that result in loans specifically tailored to the needs of our market area. Every effort is made to identify and minimize the credit risks associated with such lending strategies. We have no foreign loans and we do not engage in lease financing or highly leveraged transactions.

We follow a loan review program designed to evaluate the credit risk in our loan portfolio. Through this loan review process, we maintain an internally classified watch list that helps management assess the overall quality of the loan portfolio and the adequacy of the allowance for loan losses. In establishing the appropriate classification for specific assets, management considers, among other factors, the estimated value of the underlying collateral, the borrower's ability to repay, the borrower's payment history and the current status. As a result of this process, certain loans are categorized as substandard, doubtful or loss and reserves are allocated based on management's judgment, objective criteria and historical experience.

The Bank's format for the calculation of ALLL begins with the evaluation of loans under SFAS 114. For the purposes of evaluating loans for impairment under SFAS 114, loans are considered impaired when it is considered probable that all amounts due under the contractual terms of the loan will not be collected when due (minor shortfalls in amount or timing excepted). The Bank has established policies and procedures for identifying loans that should be considered for impairment. Loans are reviewed through multiple means such as delinquency management, credit risk reviews, watch and criticized loan monitoring meetings and general account management. Loans that are outside of the Bank's established criteria for evaluation may be considered for SFAS 114 impairment testing when management deems the risk sufficient to warrant this approach. For loans determined to be impaired, the specific allowance is based on the most appropriate of the three measurement methods: present value of expected future cash flows, fair value of collateral, or the observable market price of a loan method. While management uses the best information available to make evaluations, future adjustments to the allowance may be necessary if conditions differ substantially from the assumptions used in making the evaluations. Once a loan is considered impaired, it is not included in the determination of the SFAS 5 component of the allowance, even if no specific allowance (the SFAS 114 component) is considered necessary.

The Bank also utilizes various other factors to further evaluate the portfolio for risk to determine the appropriate level of allowance to provide for probable losses in the loan portfolio. The other factors utilized include the rate of loan growth, credit grade migration, policy exceptions, account officer experience, interest rate trends and various economic factors. These factors are examined for trends and the risk that they represent to the Bank's loan portfolio. Each of these other factors is assigned a level of risk and this risk factor is applied to only the SFAS 5 pool of loans to calculate the appropriate allowance.

The Company has evaluated the guidance in the Interagency Policy Statement and has made applicable enhancements to our processes for determining our allowance for loan losses starting with year-end 2007. While management believes that it uses the best information available to establish the allowance for loan losses, future adjustments to the allowance may be necessary and results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while the Company believes the allowance for loan losses has been established in conformity with accounting principles generally accepted in the United States, there can be no assurance that regulators, in reviewing our portfolio, will not require adjustments to our 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 increases will not be necessary should the quality of any loans deteriorate as a result of the factors discussed herein. Any material increase in the allowance for loan losses may adversely affect our financial condition and results of operations.

Growth in loans outstanding has, throughout our history, been the primary reason for increases in our allowance for loan losses and the resultant provisions for loan losses necessary to provide for those increases. However, in 2008 we experienced significant increases in nonperforming loans and net charge-offs, primarily related to our residential construction and land development loan portfolio segments and businesses that support the housing industry, which were brought on by weakness in the housing market and an overall slowdown in housing purchase activity, particularly in new construction. Nonperforming loans increased by $12.3 million of 603% during 2008 from $2.1 million, or 0.17% of total loans, at year-end 2007 to $14.4 million, or 1.10% of total loans, as of December 31, 2008. Of these $14.4 million in nonperforming loans, 82% are related to residential construction and land development activities, directly or indirectly. Net charge-offs in 2008 of $3.6 million, or 0.28% of average loans outstanding increased significantly from 2007 when net charge offs were $1.6 million, or 0.14% of average loans outstanding. Our allowance for loan losses at December 31, 2008 was $18.9 million and represented 1.43% of total loans and 1.31 times non-performing loans. Our allowance for loan losses at December 31, 2007 of $14.3 million represented 1.20% of total loans and 6.95 times nonperforming loans.

During 2008, we established an unallocated segment in our calculation methodology for determining the adequacy of the allowance for loan losses which amounted to $1.1 million as of December 31, 2008. This unallocated segment of the allowance is to compensate for expected loss exposures higher than our historical loss rates given the unprecedented economic conditions occurring nationally and the trend of this economic impact on our local markets.

The following table describes the allocation of the allowance for loan losses among various categories of loans and certain other information for the dates indicated. The allocation is made for analytical purposes only and is not necessarily indicative of the categories in which future losses may occur.

	At December 31,					
	2008		2007		2006	
	Amount	% of Total Loans (1)	Amount	% of Total Loans (1)	Amount	% of Total Loans (1)
	(Dollars in thousands)					
Residential mortgage loans	$ 5,170	29.9%	$ 3,994	26.9%	$ 1,771	25.4%
Commercial mortgage loans	3,645	31.9%	2,950	32.8%	4,173	34.8%
Construction loans	4,378	19.8%	3,175	21.8%	3,240	20.5%
Commercial and industrial loans	3,499	16.9%	2,829	16.6%	2,099	17.2%
Loans to individuals	1,058	1.5%	1,158	1.9%	553	2.1%
Unallocated (2)(3)	1,101	-%	152	-%	1,204	-%
Total	$ 18,851	100.0%	$ 14,258	100.0%	$ 13,040	100.0%

	At December 31,			
	2005		2004	
	Amount	% of Total Loans (1)	Amount	% of Total Loans (1)
	(Dollars in thousands)			
Residential mortgage loans	$ 1,394	28.0%	$ 1,419	30.0%
Commercial mortgage loans	3,151	33.0%	3,500	37.1%
Construction loans	2,454	18.1%	1,924	12.8%
Commercial and industrial loans	1,784	17.5%	1,815	16.0%
Loans to individuals	956	3.4%	1,304	4.1%
Unallocated	2,046	-%	2,575	-%
Total	$ 11,785	100.0%	$ 12,537	100.0%

(1) Represents total of all outstanding loans in each category as a percentage of total loans outstanding.
(2) During 2007, the ALLL methodology was revised to comply with the Interagency Policy Statement on the ALLL. As a result the unallocated portion of the allowance decreased due to the methodology enhancements.
(3) During 2008, an unallocated segment was re-established as an additional qualitative factor due to the current economic environment presenting potential loss exposures in excess of our historical loss rates.

The following table presents for the periods indicated information regarding changes in our allowance for loan losses.

	As of or for the Years Ended December 31,				
	2008	2007	2006	2005	2004
	(Dollars in thousands)				
Balance at beginning of period	$ 14,258	$ 13,040	$ 11,785	$ 12,537	$ 7,275
Charge-offs:					
Residential mortgage loans	921	974	248	566	210
Commercial mortgage loans	165	-	68	-	43
Construction loans	1,452	140	130	4	312
Commercial and industrial loans	702	239	508	349	120
Loans to individuals	594	541	600	443	889
Total charge-offs	3,834	1,894	1,554	1,362	1,574
Recoveries:					
Residential mortgage loans	113	86	142	41	29
Construction loans	4	7	-	3	-
Commercial and industrial loans	28	63	36	35	7
Loans to individuals	117	181	121	72	114
Total recoveries	262	337	299	151	150
Net charge-offs	(3,572)	(1,557)	(1,255)	(1,211)	(1,424)
Provision for loan losses	8,165	2775	2,510	950	2,239
Allowance for loans acquired in purchase transactions, net	-	-	-	(491)	4,447
Balance at end of period	$ 18,851	$ 14,258	$ 13,040	$ 11,785	$ 12,537
Total loans outstanding	$ 1,314,811	$ 1,188,438	$ 1,029,816	$ 868,827	$ 796,103
Average loans outstanding	$ 1,279,041	$ 1,114,677	$ 958,001	$ 837,467	$ 742,433
Allowance for loan losses to loans outstanding	1.43%	1.20%	1.27%	1.36%	1.57%
Ratio of net loan charge-offs to average loans outstanding	0.28%	0.14%	0.13%	0.14%	0.19%

INVESTMENT ACTIVITIES

Our investment portfolio plays a primary role in management of liquidity and interest rate sensitivity and, therefore, is managed in the context of the overall balance sheet. The securities portfolio generates approximately 15% of our interest income and serves as a necessary source of liquidity.

Management attempts to deploy investable funds into instruments that are expected to increase the overall return of the portfolio given the current assessment of economic and financial conditions, while maintaining acceptable levels of capital, and interest rate and liquidity risk.

The following table summarizes the amortized cost, gross unrealized gains and losses and the resulting fair value of securities at the dates indicated.

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(Amounts in thousands)		
December 31, 2008				
Securities available for sale:				
U. S. government agencies	$ 76,061	$ 2,183	$ 37	$ 78,207
Mortgage-backed securities	196,386	4,268	194	200,460
Municipals	2,393	19	7	2,405
Other	9,072	4	682	8,394
	$ 283,912	$ 6,474	$ 920	$ 289,466
Securities held to maturity:				
U. S. government agencies	$ 25,500	$ 340	$ -	$ 25,840
Mortgage-backed securities	1,792	26	-	1,818
Municipals	7,939	149	215	7,873
	$ 35,231	$ 515	$ 215	$ 35,531
December 31, 2007				
Securities available for sale:				
U. S. government agencies	$ 72,922	$ 1,754	$ 5	$ 74,671
Mortgage-backed securities	62,782	428	500	62,710
Municipals	2,391	5	8	2,388
Other	8,066	24	433	7,657
	$ 146,161	$ 2,211	$ 946	$ 147,426
Securities held to maturity:				
U. S. government agencies	$ 58,794	$ 89	$ 419	$ 58,464
Mortgage-backed securities	2,197	8	30	2,175
Municipals	8,821	125	121	8,825
	$ 69,812	$ 222	$ 570	$ 69,464
December 31, 2006				
Securities available for sale:				
U. S. government agencies	$ 77,942	$ 592	$ 431	$ 78,103
Mortgage-backed securities	72,258	234	1,249	71,243
Municipals	1,303	9	-	1,312
Other	8,141	-	340	7,801
	$ 159,644	$ 835	$ 2,020	$ 158,459
Securities held to maturity:				
U. S. government agencies	$ 74,793	$ 5	$ 2,235	$ 72,563
Mortgage-backed securities	2,795	5	61	2,739
Municipals	8,887	128	104	8,911
	$ 86,475	$ 138	$ 2,400	$ 84,213

The following table presents the carrying values, fair values, intervals of maturities or repricings and weighted average yields of our investment portfolio at December 31, 2008.

	2008		
	Amortized Cost	Fair Value	Weighted Average Yield
	(Amount in thousands)		(1)
Securities available for sale:			
U. S. government agencies			
Due within one year	$ 3,010	$ 3,117	4.27%
Due after one but within five years	39,999	41,429	5.56%
Due after five but within ten years	28,052	28,698	5.23%
Due after ten years	5,000	4,963	6.00%
	76,061	78,207	5.42%
Mortgage-backed securities			
Due within one year	6	6	6.50%
Due after one but within five years	5,871	5,876	4.16%
Due after five but within ten years	66,148	68,346	4.28%
Due after ten years	124,361	126,232	5.20%
	196,386	200,460	4.86%
Municipals			
Due within one year	140	141	5.13%
Due after one but within five years	950	962	4.90%
Due after ten years	1,303	1,302	6.35%
	2,393	2,405	5.70%
Other			
Due within one year	1,000	710	2.35%
Due after five but within ten years	-	-	0.00%
Due after ten years	4,250	4,067	6.28%
Other equity securities	3,822	3,617	3.95%
	9,072	8,394	4.86%
Total securities available for sale			
Due within one year	4,156	3,974	3.78%
Due after one but within five years	46,820	48,267	5.34%
Due after five but within ten years	94,200	97,044	4.78%
Due after ten years	134,914	136,564	5.26%
Other equity securities	3,822	3,617	3.95%
	$ 283,912	$ 289,466	5.07%
Securities held to maturity:			
U. S. government agencies			
Due within one year	$ 3,000	$ 3,091	4.20%
Due after one but within five years	2,500	2,626	5.00%
Due after five but within ten years	20,000	20,123	5.14%
	25,500	25,840	4.17%
Mortgage-backed securities			
Due after one but within five years	104	106	5.49%
Due after five but within ten years	948	963	4.54%
Due after ten years	740	749	5.26%
	1,792	1,818	4.89%
Municipals			
Due within one year	400	402	5.00%
Due after one but within five years	1,789	1,815	2.95%
Due after five but within ten years	3,219	3,324	4.33%
Due after ten years	2,531	2,332	3.24%
	7,939	7,873	3.70%
Total securities held to maturity			
Due within one year	3,400	3,493	4.29%

Due after one but within five years	4,393	4,547	4.19%
Due after five but within ten years	24,167	24,410	5.01%
Due after ten years	3,271	3,081	3.73%
	$ 35,231	$ 35,531	4.10%

(1) Yields on tax-exempt investments have been adjusted to a taxable equivalent basis using federal and state tax rates of 34% and 6.9%, respectively, less estimated disallowed interest expense.

At December 31, 2008, there were no securities of any issuer (other than U.S. government agencies) that exceeded 10% of the Company's stockholders' equity.

Derivative Financial Instruments

A derivative is a financial instrument that derives its cash flows, and therefore its value, by reference to an underlying instrument, index or reference rate. These instruments primarily consist of interest rate swaps, caps, floors, financial forward and futures contracts and options written or purchased. Derivative contracts are written in amounts referred to as notional amounts. Notional amounts only provide the basis for calculating payments between counterparties and do not represent amounts to be exchanged between parties and are not a measure of financial risks. Credit risk arises when amounts receivable from counterparties exceed amounts payable. We control our risk of loss on derivative contracts by subjecting counterparties to credit reviews and approvals similar to those used in making loans and other extensions of credit.

We have used interest rate swaps, caps and floors in the management of interest rate risk. Interest rate swaps are contractual agreements between two parties to exchange a series of cash flows representing interest payments. A swap allows both parties to alter the re-pricing characteristics of assets or liabilities without affecting the underlying principal positions. Through the use of a swap, assets and liabilities may be transformed from fixed to floating rates, from floating rates to fixed rates, or from one type of floating rate to another. At December 31, 2008, interest rate swap arrangements with total notional amounts of $20.0 million, with terms ranging up to five years, were outstanding. In addition, we had $10.0 million notional of interest rate caps with thirty-five months remaining until maturity at year end. These instruments help protect the Company from changes in interest rates by allowing us to receive payments from the counterparty on these contracts when the referenced rate falls outside the level specified in the agreement.

The Company is exposed to credit-related losses in the event of nonperformance by the counterparties to these agreements. The Company controls the credit risk of its financial contracts through credit approvals, limits and monitoring procedures, and does not expect any counterparties to fail their obligations. Although the Company deals only with primary dealers, a nonrecurring loss of $440 thousand was included in noninterest income during the third quarter of 2008 related to the value of certain derivative positions on our balance sheet due to the bankruptcy and technical default of Lehman Brothers, the counterparty in the contracts. In addition, Lehman Brothers currently holds $1.0 million of the Company's U.S. Government Agency investment securities as collateral as a part of these derivative agreements. The Company has filed a claim against Lehman Brothers for all funds due to the Company as a result of their technical default including the return of this collateral. We expect to recover the value of these investment securities held as collateral either through legal proceedings with Lehman or through, in whole or in part, insurance coverage.

A discussion of derivatives is presented in Note 17 to our consolidated financial statements, which are presented under Item 8 in this Form 10-K.

Sources of Funds

Deposit Activities

We provide a range of deposit services, including non-interest-bearing checking accounts, interest-bearing checking and savings accounts, money market accounts and certificates of deposit. These accounts generally earn interest at rates established by management based on competitive market factors and our desire to increase or decrease certain types or maturities of deposits. We have used brokered deposits and out-of-market deposits as funding sources. As of December 31, 2008, we have $261.1 million of brokered deposits and $99 thousand of out-of-market deposits. However, we strive to establish customer relationships to attract core deposits in non-interest-bearing and other transactional accounts and thus to reduce our costs of funds.

The following table sets forth for the periods indicated the average balances outstanding and average interest rates for each of our major categories of deposits.

	For the Years Ended December 31,					
	2008		2007		2006	
	Average Amount	Average Rate	Average Amount	Average Rate	Average Amount	Average Rate
	(Dollars in thousands)					
Interest-bearing NOW and money market accounts	$ 512,717	2.23%	$ 441,716	3.51%	$ 348,486	3.03%
Time deposits $100,000 or more	137,841	4.86%	311,125	4.54%	326,864	4.38%
Other time deposits	428,950	3.86%	169,236	5.25%	208,733	4.10%
Total interest-bearing deposits	1,079,508	3.21%	922,077	4.18%	884,083	3.78%
Demand and other non-interest-bearing deposits	104,978		108,874		105,755	
Total average deposits	$ 1,184,486	2.93%	$ 1,030,951	3.74%	$ 989,838	3.38%

The following table presents the amounts and maturities of our certificates of deposit with balances of $100,000 or more at December 31, 2008:

	At December 31, 2008
	(In thousands)
Remaining Maturity	
Less than three months	$ 24,753
Three to six months	28,191
Six to twelve months	83,973
Over twelve months	26,684
Total	$ 163,601

Borrowings

To supplement deposits, our primary source of funding, the Company utilizes borrowings for loan growth and other liquidity needs. The following is a summary of our borrowings at December 31, 2008 and 2007:

	2008	2007
	(Amounts in thousands)	
Short-term borrowings		
FHLB advances	$ 62,000	$ 73,000
Federal funds purchased	-	22,100
Term Auction Facility	60,000	-
Repurchase agreements	23,197	22,672
	$ 145,197	$ 117,772
Long-term borrowings		
FHLB advances	$ 92,139	$ 129,522
Term repurchase agreements	90,000	80,000
Jr. subordinated debentures	45,877	45,111
	$ 228,016	$ 254,633

Short term advances from the FHLB are collateralized as described below and are scheduled to be repaid within one year based on the terms of the individual borrowing. Securities sold under agreements to repurchase are scheduled to be repaid within one year based on the terms of the individual borrowing, or provided solely as an accommodation to our customers. Customer repurchase agreements are collateralized by U.S. government agency obligations and generally mature within ninety days from the transaction date. The Company purchases federal funds through unsecured lines of credit with various banks aggregating $121.0 million. Federal funds purchased are subject to restrictions limiting the frequency and term of advances, are payable on demand and bear interest based upon the daily federal funds rate. The following table presents the activity in short term borrowings for the years ended December 31, 2008 and 2007.

	2008		2007	
Short term borrowings	Amount	Rate	Amount	Rate
	(In thousands)		(In thousands)	
Federal Home Loan Bank				
At December 31	$ 62,000	2.52%	$ 73,000	4.68%
Average during year	54,057	3.43%	61,297	4.73%
Maximum month-end balance during year	70,000	-	88,000	-
Securities sold under agreements to repurchase				
At December 31	$ 23,197	2.99%	$ 22,672	3.05%
Average during year	20,150	2.63%	26,531	4.18%
Maximum month-end balance during year	30,455	-	22,672	-
Federal funds purchased				
At December 31	$ -	-	$ 22,100	4.28%
Average during year	52,240	2.33%	15,921	5.34%
Maximum month-end balance during year	88,000	-	37,873	-
Term Auction Facility				
At December 31	$ 60,000	1.00%	-	-
Average during year	53,423	1.97%	-	-
Maximum month-end balance during year	70,000	-	-	-

As an additional source of funding, the Company has long term borrowings including long term advances from the FHLB, term repurchase agreements from other commercial and investment banks and debt associated with the issuance of Trust Preferred Securities. Total FHLB advances outstanding of $154.1 million at December 31, 2008 are collateralized by loans with a carrying amount of $86.7 million, which approximates market value, and investment securities with a market value of $88.6 million. The Company also has term repurchase lines of $150.0 million from various institutions that were collateralized by investment securities having a carrying value of $100.7 million. Certain of these agreements contain embedded interest rate or call options that may be exercised by us or the counterparty. The following table presents the maturities for long term FHLB advances and term repurchase agreements.

Long term borrowings	At December 31, 2008			
	FHLB Advances		Term Repo	
Years of maturity	Interest Rate	Amount	Interest Rate	Amount
		(In thousands)		(In thousands)
2010	4.05%	35,000	4.95%	10,000
2011	-	-	-	-
2012	3.84%	5,000	4.56%	20,000
2013	3.46%	10,000	-	-
Thereafter	5.38%	42,139	1.74%	60,000
		$ 92,139		$ 90,000

In November 2003, Southern Community Capital Trust II ("Trust II"), a newly formed subsidiary of the Company, issued 3,450,000 shares of Trust Preferred Securities ("Trust II Securities"), generating total proceeds of $34.5 million. The Trust II Securities pay distributions at an annual rate of 7.95% and mature on December 31, 2033. The Trust II Securities began paying quarterly distributions on December 31, 2003. The Company has fully and unconditionally guaranteed the obligations of Trust II. The Trust II Securities are redeemable in whole or in part at any time after December 31, 2008. The Company is amortizing the issuance costs of these securities over their contractual life of thirty years. The unamortized balance of these issuance costs at December 31, 2008 was $1.3 million. The proceeds from the Trust II Securities were utilized to purchase junior subordinated debentures from the Bank under the same terms and conditions as the Trust II Securities. We have the right to defer payment of interest on the debentures at any time and from time to time for a period not exceeding five years, provided that no deferral period extends beyond the stated maturities of the debentures. Such deferral of interest payments by the Company will result in a deferral of distribution payments on the related Trust II Securities. Should we defer the payment of interest on the debentures; the Company will be precluded from the payment of cash dividends to shareholders. The principal uses of the net proceeds from the sale of the debentures were to provide cash for the acquisition of The Community Bank, to increase our regulatory capital, and to support the growth and operations of our subsidiary bank. The amount of proceeds we count as Tier 1 capital cannot comprise more than 25% of our core capital elements. Amounts in excess of that 25% limitation count as Tier 2 supplementary capital on our books.

In June 2007, $10.0 million of trust preferred securities were placed through Southern Community Capital Trust III ("Trust III"), as part of a pooled trust preferred security. The Trust issuer invested the total proceeds from the sale of the Trust Preferred Securities in Junior Subordinated Deferrable Interest Debentures (the "Junior Subordinated Debentures") issued by the Company. The terms of the trust preferred securities require payment of cumulative cash distributions quarterly at an annual rate, reset quarterly, equal to LIBOR plus 1.43%. During 2008, the Company entered into an interest rate swap derivative contract with a counterparty that shifted this debt service from a variable rate to a fixed rate of 4.7% per annum. The dividends paid to holders of the trust preferred securities, which are recorded as interest expense, are deductible for income tax purposes. The trust preferred securities are redeemable in 30 years with a five year call provision. The Company has fully and unconditionally guaranteed the trust preferred securities through the combined operation of the debentures and other related documents. The Company's obligation under the guarantee is unsecured and subordinate to senior and subordinated indebtedness of the Company. The principal use of the net proceeds from the sale of the debentures was to provide additional capital into the Company to fund its operations and continued expansion, and to maintain the Company's and the Bank's status as "well capitalized" under regulatory guidelines.

The carrying value of the junior subordinated debentures in connection with the two issues of trust preferred securities described above was $45.9 million at December 31, 2008.

Other Recent Developments

On January 23, 2009 the Company announced the declaration of a quarterly dividend of $0.04 per share of the common stock, to be paid on February 27, 2009 to shareholders on record as of the close of business on February 13, 2009.

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 was enacted to provide funds for job creation, investment in infrastructure and energy efficiency, unemployment assistance and municipal fiscal stabilization. Under this bill, a number of obligations and restrictions related to executive compensation were added for CPP recipients. These restrictions extend beyond the scope of those included in the Treasury's Capital Purchase Program documents, both in terms of numbers of executives impacted and in extent of restriction. Under this legislation, CPP holders

- Are restricted to using only long term restricted stock as the form of payment for any bonus, retention or incentive compensation plan. There are further restrictions on vesting and amount of award per executive.
- Must extend golden parachute payment restrictions and clawback provisions on incentive compensation plans beyond the senior executives to a number of the most highly compensated employees.
- Must adopt a company-wide policy regarding excessive or luxury expenditures.

In addition, beginning for filings in 2010, the chief executive officer and chief financial officer of each CPP holder are required to include a written certification of compliance with these executive compensation and other restrictions in the Form 10K for every year during which the financial institution holds preferred stock investments by the Treasury.

RECENT ACCOUNTING PRONOUNCEMENTS

A discussion of recent accounting pronouncements is presented in Note 2 to our consolidated financial statements, which are presented under Item 8 in this Form 10-K.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Statements contained in this annual report, which are not historical facts, are forward-looking statements, as that term is defined in the Private Securities Litigation Reform Act of 1995. Amounts herein could vary as a result of market and other factors. Such forward-looking statements are subject to risks and uncertainties which could cause actual results to differ materially from those currently anticipated due to a number of factors, which include, but are not limited to, factors discussed in documents filed by the Company with the Securities and Exchange Commission and the Bank with the Federal Reserve Bank from time to time. Such forward-looking statements may be identified by the use of such words as “believe,” “expect,” “anticipate,” “should,” “planned,” “estimated,” and “potential.” Examples of forward-looking statements include, but are not limited to, estimates with respect to the financial condition, expected or anticipated revenue, results of operations and business of the Company that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include, but are not limited to, general economic conditions, changes in interest rates, deposit flows, loan demand, real estate values and competition; changes in accounting principles, policies, or guidelines; changes in legislation or regulation; and other economic, competitive, governmental, regulatory and technological factors affecting the Company's operations, pricing, products and services.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

See “MARKET RISK” under Item 7.

Item 8. Financial Statements and Supplementary Data

The information required by this item is filed herewith.

DIXON HUGHES PLLC
Certified Public Accountants and Advisors

Report of Independent Registered Public Accounting Firm

To the Stockholders and the Board of Directors
Southern Community Financial Corporation and Subsidiary
Winston-Salem, North Carolina

We have audited the accompanying consolidated balance sheets of Southern Community Financial Corporation and Subsidiary as of December 31, 2008 and 2007, and the related consolidated statements of operations, comprehensive income, changes in stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated 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 financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Southern Community Financial Corporation and Subsidiary at December 31, 2008 and 2007 and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Southern Community Financial Corporation's internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 16, 2009 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ Dixon Hughes PLLC

Raleigh, North Carolina
March 16, 2009

SOUTHERN COMMUNITY FINANCIAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
December 31, 2008 and 2007

	2008	2007
	(Amounts in thousands, except share data)	
Assets		
Cash and due from banks	$ 25,215	$ 31,905
Federal funds sold and other interest-earning deposits	2,180	2,250
Investment securities (Note 3)		
Available for sale, at fair value	289,466	147,426
Held to maturity, (fair value of $35,531 and $69,464 at December 31, 2008 and 2007, respectively)	35,231	69,812
Federal Home Loan Bank stock	9,757	11,695
Loans held for sale	316	1,929
Loans (Note 4)	1,314,811	1,188,438
Allowance for loan losses (Note 5)	(18,851)	(14,258)
Net Loans	1,295,960	1,174,180
Premises and equipment (Note 6)	40,030	38,997
Goodwill (Note 7)	49,501	49,792
Other assets (Notes 4, 7 and 14)	56,122	41,196
Total Assets	$ 1,803,778	$ 1,569,182
Liabilities and Stockholders' Equity		
Deposits		
Demand	$ 102,048	$ 109,895
Money market and NOW	465,156	485,428
Savings	10,616	10,020
Time (Note 8)	655,292	439,894
Total Deposits	1,233,112	1,045,237
Short-term borrowings (Note 9)	145,197	117,772
Long-term debt (Notes 9 and 10)	228,016	254,633
Other liabilities (Note 12)	9,743	9,201
Total Liabilities	1,616,068	1,426,843
Stockholders' Equity (Notes 10, 11 and 16)		
Cumulative perpetual preferred stock (Series A), no par value, 1,000,000 shares authorized; issued and outstanding 42,750 shares at December 31, 2008	40,690	-
Common stock, no par value, 30,000,000 shares authorized; issued and outstanding 16,769,675 shares and 17,399,882 shares at December 31, 2008 and 2007, respectively	119,054	119,101
Retained earnings	24,901	22,198
Accumulated other comprehensive income	3,065	1,040
Total Stockholders' Equity	187,710	142,339
Commitments and contingencies (Notes 13 and 18)		
Total Liabilities and Stockholders' Equity	$ 1,803,778	$ 1,569,182

See accompanying notes.

SOUTHERN COMMUNITY FINANCIAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
	(Amounts in thousands, except share and per share data)		
Interest Income			
Loans	$ 82,125	$ 86,673	$ 73,492
Investment securities available for sale	12,378	8,819	8,529
Investment securities held to maturity	2,184	3,208	3,390
Federal funds sold and other interest-earning deposits	55	208	109
Total Interest Income	96,742	98,908	85,520
Interest Expense			
Money market, savings, and NOW deposits	11,412	15,499	10,552
Time deposits	23,236	23,024	22,867
Short-term borrowings	3,808	4,758	2,897
Long-term debt	10,826	11,860	8,482
Total Interest Expense	49,282	55,141	44,798
Net Interest Income	47,460	43,767	40,722
Provision for Loan Losses (Note 5)	8,165	2,775	2,510
Net Interest Income After Provision for Loan Losses	39,295	40,992	38,212
Non-Interest Income (Note 15)	11,282	11,331	3,678
Non-Interest Expense			
Salaries and employee benefits	22,038	21,218	18,826
Occupancy and equipment	7,679	7,928	6,835
Other (Note 15)	12,372	11,754	10,141
Total Non-Interest Expense	42,089	40,900	35,802
Income Before Income Taxes	8,488	11,423	6,088
Income Tax Expense (Note 14)	2,634	3,869	1,890
Net Income	5,854	7,554	4,198
Effective dividend on preferred stock (Note 11)	185	-	-
Net income available to common shareholders	$ 5,669	$ 7,554	$ 4,198
Net Income Per Common Share			
Basic	$ 0.33	$ 0.43	$ 0.24
Diluted	0.33	0.43	0.24
Weighted Average Common Shares Outstanding			
Basic	17,363,395	17,559,352	17,566,315
Diluted	17,398,318	17,624,399	17,757,436

See accompanying notes.

SOUTHERN COMMUNITY FINANCIAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
	(Amounts in thousands)		
Net income	$ 5,854	$ 7,554	$ 4,198
Other comprehensive income:			
Securities available for sale:			
Unrealized holding gains (losses) on available for sale securities	4,387	2,450	(213)
Tax effect	(1,692)	(945)	81
Reclassification of (gains) losses recognized in net income	(98)	-	4,156
Tax effect	38	-	(1,602)
Net of tax amount	2,635	1,505	2,422
Cash flow hedging activities:			
Unrealized holding gains (losses) on cash flow hedging activities	(982)	274	69
Tax effect	343	(105)	(27)
Loss due to counterparty default net of amortization	240	-	-
Reclassification of (gains) losses recognized in net income, net	78	54	28
Tax effect	(29)	(21)	(10)
Net of tax amount	(350)	202	60
Net defined benefit pension adjustment	(423)	150	-
Tax effect	163	(58)	-
Net of tax amount	(260)	92	-
Total other comprehensive income	2,025	1,799	2,482
Comprehensive income	$ 7,879	$ 9,353	$ 6,680

See accompanying notes.

SOUTHERN COMMUNITY FINANCIAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years Ended December 31, 2008, 2007 and 2006

	Preferred Stock		Common Stock		Retained	Accumulated Other Comprehensive	Total Stockholders'
	Shares	Amount	Shares	Amount	Earnings	Income (Loss)	Equity
				(Amounts in thousands, except share data)			
Balance at December 31, 2005	-	-	17,612,472	$ 122,490	$ 15,546	$ (3,151)	$ 134,885
Net income	-	-	-	-	4,198	-	4,198
Other comprehensive income, net of tax	-	-	-	-	-	2,482	2,482
Common shares repurchased	-	-	(377,126)	(3,682)	-	-	(3,682)
Stock options exercised including income tax benefit of $69	-	-	170,594	749	-	-	749
Stock-based compensation	-	-	-	59	-	-	59
Cash dividends of $0.135 per share	-	-	-	-	(2,376)	-	(2,376)
SFAS158 transition adjustment, net of tax	-	-	-	-	-	(90)	(90)
Balance at December 31, 2006	-	-	17,405,940	119,616	17,368	(759)	136,225
Net income	-	-	-	-	7,554		7,554
Other comprehensive income, net of tax	-	-	-	-	-	1,799	1,799
Common shares repurchased	-	-	(286,972)	(2,357)	-	-	(2,357)
Stock options exercised including income tax benefit of $559	-	-	263,414	1,737	-	-	1,737
Restricted stock issued	-	-	17,500	-	-	-	-
Stock-based compensation	-	-	-	105	-	-	105
Cash dividends of $0.155 per share	-	-	-	-	(2,724)	-	(2,724)
Balance at December 31, 2007	-	-	17,399,882	119,101	22,198	1,040	142,339
Net income	-	-	-	-	5,854	-	5,854
Other comprehensive income, net of tax	-	-	-	-	-	2,025	2,025
Common shares repurchased	-	-	(733,175)	(2,700)	-	-	(2,700)
Stock options exercised including income tax benefit of $51	-	-	73,968	408	-	-	408
Restricted stock issued	-	-	29,000	44	-	-	44
Stock-based compensation	-	-	-	111	-	-	111
Cash dividends of $0.16 per share	-	-	-	-	(2,781)	-	(2,781)
Cumulative effect of accounting method change	-	-	-	-	(185)	-	(185)

Preferred stock transaction:							
Issuance of preferred stock	42,750	42,750	-	-	-	-	42,750
Discount on preferred stock	-	(2,090)	-	2,090	-	-	-
Accretion of discount	-	30	-	-	(30)	-	-
Preferred stock dividend accrued	-	-	-	-	(155)	-	(155)
Balance at December 31, 2008	42,750	$ 40,690	16,769,675	$ 119,054	$ 24,901	$ 3,065	$ 187,710

See accompanying notes.

SOUTHERN COMMUNITY FINANCIAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
	(Amounts in thousands)		
Cash Flows from Operating Activities			
Net income	$ 5,854	$ 7,554	$ 4,198
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	3,817	4,184	3,732
Provision for loan losses	8,165	2,775	2,510
Proceeds from sales of loans held for sale	68,928	81,563	63,789
Originations of loans held for sale	(67,315)	(79,897)	(66,078)
Stock option compensation	155	105	59
Net increase in cash surrender value of life insurance	(841)	(670)	(548)
Realized (gain) loss on sales of available for sale securities	(98)	-	4,156
Realized (gain) loss on sale of premises and equipment	74	(119)	6
Gain (loss) on economic hedges	(934)	(79)	432
Deferred income taxes	(2,475)	(814)	(1,237)
Realized (gain) loss on sale of foreclosed assets	65	(2)	(42)
Goodwill impairment	291	-	-
Change in assets and liabilities:			
Increase in other assets	1,706	(3,440)	(105)
Increase (decrease) in other liabilities	1,019	(787)	917
Total Adjustments	12,557	2,819	7,591
Net Cash Provided by Operating Activities	18,411	10,373	11,789
Cash Flows from Investing Activities			
(Increase) decrease in federal funds sold	70	(1,467)	(135)
Purchases of:			
Available for sale investment securities	(233,507)	(17,892)	(80,123)
Held to maturity investment securities	-	(1,719)	(1,871)
Proceeds from maturities and calls of:			
Available for sale investment securities	48,143	30,117	28,189
Held to maturity investment securities	34,568	18,266	3,466
Proceeds from sale of:			
Available for sale investment securities	49,602	-	86,126
Net increase in loans	(135,984)	(158,513)	(165,693)
OREO capitalized cost	(43)	-	-
Purchases of premises and equipment	(4,599)	(2,260)	(13,921)
Proceeds from disposal of premises and equipment	8	6	307
Proceeds from sale of foreclosed assets	1,047	1,415	336
Purchase of bank-owned life insurance	(10,000)	-	(5,000)
Net Cash Used in Investing Activities	(250,695)	(132,047)	(148,319)
Cash Flows from Financing Activities			
Net increase (decrease) in demand deposits	(27,523)	103,241	(2,276)
Net increase (decrease) in time deposits	215,398	(82,586)	84,909
Net increase (decrease) in short-term borrowings	27,425	25,024	43,562
Proceeds from long-term debt	50,000	120,238	80,814
Repayment of long-term debt	(77,383)	(38,154)	(60,616)
Net proceeds from issuance of preferred stock	42,750	-	-
Net proceeds from exercise of stock options	408	1,737	749
Cost of shares repurchased	(2,700)	(2,357)	(3,682)
Cash dividends paid	(2,781)	(2,724)	(2,376)
Net Cash Provided by Financing Activities	225,594	124,419	141,084
Net Increase (decrease) in Cash and Cash Equivalents	(6,690)	2,745	4,554
Cash and Cash Equivalents, Beginning of Year	31,905	29,160	24,606

Cash and Cash Equivalents, End of Year	$ 25,215	$ 31,905	$ 29,160

See accompanying notes.

SOUTHERN COMMUNITY FINANCIAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
Years Ended December 31, 2008, 2007 and 2006

	2008	2007	2006
	(Amounts in thousands)		
Supplemental Disclosures of Cash Flow Information			
Interest paid on deposits and borrowed funds	$ 46,370	$ 55,944	$ 44,143
Income taxes paid	5,140	4,663	2,458
Supplemental Schedule of Noncash Investing and Financing Activities			
Transfer of loans to foreclosed assets	$ 6,082	$ 1,294	$ 916
Increase (decrease) in fair value of securities available for sale, net of tax	2,635	1,505	(132)
Increase (decrease) in fair value of cash flow hedges, net of tax	(350)	201	42
Unrealized gain (loss) on fair value hedges	456	238	(200)

See accompanying notes.

(1) NATURE OF OPERATIONS

Southern Community Bank and Trust (the "Bank") was incorporated November 14, 1996 and began banking operations on November 18, 1996. The Bank is engaged in general commercial and retail banking principally in the Piedmont area of North Carolina, operating under the banking laws of North Carolina and the rules and regulations of the Federal Deposit Insurance Corporation. In October 2001, Southern Community Financial Corporation (the "Company") was formed as a financial holding company for Southern Community Bank and Trust, and is subject to the rules and regulations of the Federal Reserve System. The Bank and the Company undergo periodic examinations by those regulatory authorities.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements include the accounts of Southern Community Financial Corporation and its wholly-owned subsidiary, Southern Community Bank and Trust and its wholly-owned subsidiary, VCS Management, L.L.C., the managing general partner for Salem Capital Partners, L.P., a Small Business Investment Company. All material intercompany transactions and balances have been eliminated in consolidation. Southern Community Financial Corporation and its subsidiary are collectively referred to herein as the "Company".

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans.

Cash and Cash Equivalents

For the purpose of presentation in the consolidated statements of cash flows, cash and cash equivalents are defined as those amounts included in the balance sheet caption "Cash and due from banks", which include cash on hand and amounts due from banks.

Federal regulations require institutions to set aside specified amounts of cash as reserves against transaction and time deposits. As of December 31, 2008, the daily average gross reserve requirement was $7.2 million.

Investment Securities

Available for sale securities are carried at fair value and consist of bonds, mortgage-backed securities and municipal securities not classified as trading securities or as held to maturity securities. The cost of debt securities available for sale is adjusted for amortization of premiums and accretion of discounts to maturity. Amortization of premiums, accretion of discounts, interest and dividend income are included in investment income. Unrealized holding gains and losses on available for sale securities are reported as a net amount in accumulated other comprehensive income, net of income taxes. Gains and losses on the sale of available for sale securities are determined using the specific identification method. Bonds and mortgage-backed securities for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using a method that approximates the interest method over the period to maturity. Declines in the fair value of individual held to maturity and available for sale securities below their cost that are other than temporary would result in a permanent write downs of the individual securities to their fair value. Such write-downs would be included in earnings as realized losses. The classification of securities is generally determined at the date of purchase.

Certain equity security investments that do not have readily determinable fair values and for which the Company does not exercise significant influence are carried at cost and classified within other investments. As of December 31, 2008 and 2007, these equity securities totaled $10.2 million and $12.1 million, respectively. The securities classified within other investments consisted primarily of shares of Federal Home Loan Bank of Atlanta and Silverton Bank (formerly The Bankers Bank) stock. These equity securities are reviewed for impairment at least annually or sooner if events or changes in circumstances indicate the carrying value may not be recoverable.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans Held for Sale

The Company originates single family, residential first mortgage loans on a pre-sold basis. Loans held for sale are carried at the lower of cost or fair value in the aggregate as determined by outstanding commitments from investors. Upon closing, these loans, together with their servicing rights, are sold to mortgage loan investors under prearranged terms. The Company recognizes certain origination and service release fees upon the sale, which are included in non-interest income in the consolidated statement of operations.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity are reported at their outstanding principal adjusted for any charge-offs, the allowance for loan losses and any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment to yield over the life of the related loan. Interest on loans is recorded based on the principal amount outstanding. The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed against interest income. Interest income is subsequently recognized only to the extent cash payments are received. Loans are written down or charged off when management has determined the loan to be uncollectible in part or in total.

Allowance for Loan Losses

The provision for loan losses is based upon management's estimate of the amount needed to maintain the allowance for loan losses at a level believed adequate to absorb probable losses inherent in the loan portfolio. Management evaluates smaller balance, homogeneous loans such as consumer and residential mortgage loans for impairment on a collective basis. Larger balance commercial loans are considered impaired when it is probable that all amounts due will not be collected in accordance with the contractual terms of the loan agreement. The measurement of impaired loans is generally based on the present value of expected future cash flows discounted at the historical effective interest rate, or upon the fair value of the collateral if the loan is collateral dependent. If the recorded investment in the loan exceeds the measure of fair value, a valuation allowance is established as a component of the allowance for loan losses. In addition to the portion of the allowance for loan losses allocated to specific loans and segments of the loan portfolio, the Company has developed a component of the allowance based on qualitative and environmental factors that is not applied to specific loan groups. Qualitative factors are identified by management that relate to the Bank's specific profile and influences from economic factors including interest rate trends, unemployment rates, commercial real estate vacancy rates, inflation, housing sales and energy cost. Other qualitative factors considered include portfolio growth, credit grade migration, loan to value exceptions and account officer tenure at the Bank. In December 2006, the federal banking regulators released an Interagency Policy Statement on the Allowance for Loan and Lease Losses, and related Questions and Answers on Accounting for Loan and Lease Losses. The Company has evaluated the guidance in the Interagency Policy Statement and has made applicable enhancements to our processes for determining our allowance for loan losses effective as of year end 2007 and years thereafter. While management believes that it uses the best information available to establish the allowance for loan losses, future adjustments to the allowance may be necessary and results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while the Company believes the allowance for loan losses has been established in conformity with generally accepted accounting principles, there can be no assurance that regulators, in reviewing the loan portfolio, will not require adjustments to 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 increases will not be necessary should the quality of any loans deteriorate as a result of the factors discussed herein. Any material increase in the allowance for loan losses may adversely affect the Company's financial condition and results of operations.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets which are 11 to 30 years for buildings and 3 to 7 years for furniture and equipment. Leasehold improvements are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. Repairs and maintenance costs are charged to operations as incurred and additions and improvements to premises and equipment are capitalized. Upon sale or retirement, the cost and related accumulated depreciation are removed from the accounts and any gains or losses are reflected in current operations. Long-lived depreciable assets are evaluated periodically for impairment when events or changes in circumstances indicate the carrying amount may not be recoverable.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Foreclosed Assets

Assets acquired through, or in lieu of, foreclosure are held for sale and are initially recorded at fair value less estimated cost to sale at the date of foreclosure, establishing a new cost basis. Principal and interest losses existing at the time of acquisition of such assets are charged against the allowance for loan losses and interest income, respectively. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less estimated cost to sell. Revenue and expenses from operations and the impact of any subsequent changes in the carrying value are included in other expenses.

Goodwill and Other Intangibles

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Other intangible assets represent purchased intangible assets that can be separately distinguished from goodwill. Goodwill impairment testing is performed annually or more frequently if events or circumstances indicate possible impairment. The evaluation of goodwill for impairment uses both the income and market approaches to value the Company. The income approach consists of discounting projected long-term future cash flows, which are derived from internal forecasts and economic expectations for the Company. The significant inputs to the income approach include the long-term target tangible equity to tangible assets ratio and the discount rate, which is determined utilizing the Company's cost of capital adjusted for a company-specific risk factor. The company-specific risk factor is used to address the uncertainty of growth estimates and earnings projections of management. Under the market approach, a value is calculated from an analysis of comparable acquisition transactions based on earnings, book value, assets and deposit premium multiples from the sale of similar financial institutions.

Intangible assets with finite lives include core deposits and other intangibles. Intangible assets other than goodwill are subject to impairment testing whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Core deposit intangibles are amortized on the straight-line method over a period not to exceed 10 years. Note 7 contains additional information regarding goodwill and other intangible assets.

Income Taxes

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. These temporary differences consist primarily of the allowance for loan losses, differences in the financial statement and income tax basis in premises and equipment and differences in financial statement and income tax basis in accrued liabilities. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which the temporary differences are expected to be recovered or settled. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that the tax benefits will not be realized.

Derivative Instruments

The Company utilizes derivative instruments, principally interest rate swaps and option agreements, to mitigate exposure to adverse changes in fair value or cash flows of certain assets and liabilities. Under the guidelines of SFAS 133, derivative financial instruments generally are required to be carried at fair value. Derivative instruments designated in a hedge relationship to mitigate exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges under SFAS 133. Derivative instruments designated in a hedge relationship to mitigate exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges.

Fair value hedges are accounted for by recording the fair value of the derivative instrument and the fair value related to the risk being hedged of the hedged asset or liability on the balance sheet with corresponding offsets recorded in the income statement.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Derivative Instruments (Continued)

The adjustment to the hedged asset or liability is included in the basis of the hedged item, while the fair value of the derivative is recorded as a freestanding asset or liability. Actual cash receipts or payments and related amounts accrued during the period on derivatives included in a fair value hedge relationship are recorded as adjustments to the income or expense recorded on the hedged asset or liability. Cash flow hedges are accounted for by recording the fair value of the derivative instrument on the balance sheet as either a freestanding asset or liability, with a corresponding offset recorded in accumulated other comprehensive income within stockholders' equity, net of tax. Amounts are reclassified from accumulated other comprehensive income to the income statement in the period or periods the hedged transaction affects earnings. Under both the fair value and cash flow hedge methods, derivative gains and losses not effective in hedging the change in fair value or expected cash flows of the hedged item are recognized immediately in the income statement.

The Company has utilized interest rate swap and option agreements to convert a portion of its variable-rate loans to a fixed rate (cash flow hedge), and to convert a portion of its fixed-rate debt to a variable rate (fair value hedge). Interest rate swaps are contracts in which a series of interest rate flows are exchanged over a prescribed period. The notional amount on which the interest payments are based is not exchanged.

Gains and losses from early terminations of derivatives are deferred and amortized as yield adjustments over the shorter of the remaining term of the hedged asset or liability or the remaining term of the derivative instrument. Upon disposition or settlement of the asset or liability being hedged, deferral accounting is discontinued and any gains or losses are recognized in income.

The Company does not enter into derivative financial instruments for speculative or trading purposes. For derivatives that are economic hedges, but are not designated as hedging instruments or otherwise do not qualify for hedge accounting treatment, all changes in fair value are recognized in noninterest income during the period of change. The net cash settlement on these derivatives is included in noninterest income.

Per Share Data

Basic net income per common share is computed by dividing net income available to common shareholders by the weighted average number of shares of common stock outstanding during each period. Diluted net income per common share reflects the potential dilution that could occur if stock options or warrants were exercised resulting in the issuance of common stock that would then share in the net income of the Company. Diluted earnings per common share is computed by dividing net income available to common shareholders by the weighted average number of shares of common stock, common stock equivalents and other potentially dilutive securities using the treasury stock method.

Basic and diluted net income per common share have been computed based upon net income available to common shareholders as presented in the accompanying consolidated statements of operations divided by the weighted average number of common shares outstanding or assumed to be outstanding as summarized below:

	2008	2007	2006
Weighted average number of common shares used in computing basic net income per common share	17,363,395	17,559,352	17,566,315
Effect of dilutive stock options	34,923	65,047	191,121
Weighted average number of common shares and dilutive potential common shares used in computing diluted net income per common share	17,398,318	17,624,399	17,757,436

For the year ended December 31, 2008, net income for determining earnings per common share was reported net income less the dividend on preferred stock. For the years ended December 31, 2007 and 2006, net income for determining diluted earnings per common share was the same as reported net income. For the years ended December 31, 2008, 2007 and 2006 there were 744,266, 573,269 and 438,203 options, respectively, that were antidilutive since the exercise price exceeded the average market price for the year. These antidilutive common stock equivalents have been omitted from the calculation of diluted earnings per common share for their respective years.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Stock-Based Compensation

The Company has certain stock-based employee compensation plans, described more fully in Note 12. Effective January 1, 2006, the Company adopted SFAS 123 (revised 2004), "Share-Based Payment," ("SFAS 123R") using the modified prospective application method and accordingly did not restate prior period amounts. SFAS 123R requires recognition of the cost of employee services received in exchange for an award of equity instruments in the financial statements over the period the employee is required to perform the services in exchange for the award (usually the vesting period). SFAS 123R also requires the compensation cost for all awards granted after the date of adoption and any unvested awards that remained outstanding as of the date of adoption to be measured based on the fair value of the award on the grant date.

Comprehensive Income

Comprehensive income is defined as the change in equity during a period for non-owner transactions and comprises net income and other comprehensive income. Other comprehensive income includes revenues, expenses, gains and losses that are excluded from earnings under current accounting standards. Components of other comprehensive income for the Company consist of the unrealized gains and losses, net of taxes, in the Company's available for sale securities portfolio, unrealized gains and losses, net of taxes, in the Company's cash flow hedge instruments, and the components of changes in net benefit plan liabilities that are not recognized as benefit costs.

Accumulated other comprehensive income at December 31, 2008 and 2007 consists of the following:

	2008	2007
	(In thousands)	
Unrealized holding gain - investment securities available for sale	$ 5,554	$ 1,265
Deferred income taxes	(2,142)	(488)
Net unrealized holding gain - investment securities available for sale	3,412	777
Unrealized holding gain (loss) - cash flow hedge instruments	(482)	422
Deferred income taxes	392	(162)
Net unrealized holding gain (loss) - cash flow hedge instruments	(90)	260
Postretirement benefit plans adjustment	(418)	5
Deferred income taxes	161	(2)
Net postretirement benefit plans adjustment	(257)	3
Total accumulated other comprehensive income	$ 3,065	$ 1,040

Segment Reporting

SFAS 131, Disclosures about Segments of an Enterprise and Related Information, requires management to report selected financial and descriptive information about reportable operating segments. It also establishes standards for related disclosures about products and services, geographic areas and major customers. Generally, disclosures are required for segments internally identified to evaluate performance and resource allocation. In all material respects, the Company's operations are entirely within the commercial banking segment, and the consolidated financial statements presented herein reflect the results of that segment. Also, the Company has no foreign operations or customers.

Risk and Uncertainties

In the normal course of its business, the Company encounters two significant types of risk: economic and regulatory. The two primary components of economic risk to the Company are credit risk and market risk. Credit risk is the risk of default on the Bank's loan portfolio that results from borrowers' failure to make contractually required payments. Market risk arises principally from interest rate risk inherent in our lending, investing, deposit and borrowing activities.

The Company is subject to the regulations of various government agencies. These regulations may change significantly from period to period. The Company 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 or operating restrictions resulting from the regulators' judgments based on information available to them at the time of their examination.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Reclassifications

Certain amounts reported in prior years have been reclassified to conform to current year presentation. Such reclassifications had no effect on income or equity.

Recent Accounting Pronouncements

SFAS 161, *Disclosures about Derivative Instruments and Hedging Activities – an Amendment of FASB Statement 133,* requires additional disclosures for derivatives and hedging activities. The enhanced disclosures will include a description of an entity's objectives including how and why derivative instruments are used. Other disclosures will include how derivative instruments and related hedged items are accounted for under SFAS 133 and related interpretations and how derivatives and related hedged items affect an entity's financial position, financial performance and cash flows. The statement also requires cross-referencing within the footnotes to improve the reader's ability to locate information about derivative instruments. This statement is effective for the Company's financial statements issued for the years beginning after November 15, 2008 with early adoption encouraged. The Company believes that the adoption of SFAS 161 in 2009 will not have a material impact on the consolidated financial statements.

SFAS 162, *The Hierarchy of Generally Accepted Accounting Principles,* establishes the framework and sources of accounting principles for determining the appropriate principles to be used when preparing financial statements in conformity with generally accepted accounting principles in the United States. This statement is effective following SEC approval and will not have a material effect on the Company's financial statements.

In December 2007, the FASB issued FASB Staff Position 157-2, Effective Date of FASB Statement No. 157 ("FSP 157-2"). FSP 157-2 delays the effective date of SFAS 157 for all non-financial assets and liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. The Company believes that the adoption of SFAS 157-2 in the first quarter 2009 will not have a material impact on the consolidated financial statements.

From time to time the FASB issues exposure drafts for proposed statements of financial accounting standards. Such exposure drafts are subject to comment from the public, to revisions by the FASB and to final issuance by the FASB as statements of financial accounting standards. Management considers the effect of the proposed statements on the consolidated financial statements of the Company and monitors the status of changes to and proposed effective dates of exposure drafts.

(3) INVESTMENT SECURITIES

The following is a summary of the securities portfolio by major classification at December 31, 2008 and 2007:

	2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Amount in thousands)			
Securities available for sale:				
U. S. government agencies	$ 76,061	$ 2,183	$ 37	$ 78,207
Mortgage-backed securities	196,386	4,268	194	200,460
Municipals	2,393	19	7	2,405
Other	9,072	4	682	8,394
	$ 283,912	$ 6,474	$ 920	$ 289,466
Securities held to maturity:				
U. S. government agencies	$ 25,500	$ 340	$ -	$ 25,840
Mortgage-backed securities	1,792	26	-	1,818
Municipals	7,939	149	215	7,873
	$ 35,231	$ 515	$ 215	$ 35,531

	2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Amount in thousands)			
Securities available for sale:				
U. S. government agencies	$ 72,922	$ 1,754	$ 5	$ 74,671
Mortgage-backed securities	62,782	428	500	62,710
Municipals	2,391	5	8	2,388
Other	8,066	24	433	7,657
	$ 146,161	$ 2,211	$ 946	$ 147,426
Securities held to maturity:				
U. S. government agencies	$ 58,794	$ 89	$ 419	$ 58,464
Mortgage-backed securities	2,197	8	30	2,175
Municipals	8,821	125	121	8,825
	$ 69,812	$ 222	$ 570	$ 69,464

(3) INVESTMENT SECURITIES (Continued)

The following tables show the gross unrealized losses and fair values for our investments aggregated by category and length of time that the individual securities have been in a continuous unrealized loss position as of December 31, 2008 and December 31, 2007. For available for sale securities, the unrealized losses relate to one U.S. government agency bond, four mortgage-backed securities, three municipal and four other securities. For held to maturity securities, the unrealized losses relate to ten municipal securities. All investment securities with unrealized losses are considered by management to be temporarily impaired given the credit ratings on these investment securities and management's intent and ability to hold these securities until recovery. Should the Company decide in the future to sell securities in an unrealized loss position, or determine that impairment of any securities is other than temporary, irrespective of a decision to sell, an impairment loss would be recognized in the period such determination is made.

	2008					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized losses	Fair Value	Unrealized losses	Fair Value	Unrealized losses
	(Amount in thousands)					
Securities available for sale:						
U. S. government agencies	$ 4,963	$ 37	$ -	$ -	$ 4,963	$ 37
Mortgage-backed securities	15,779	194	-	-	15,779	194
Municipals	742	7	-	-	742	7
Other	1,176	324	892	358	2,068	682
Total temporarily impaired securities	$ 22,660	$ 562	$ 892	$ 358	$ 23,552	$ 920
Securities held to maturity:						
Municipals	$ 1,869	$ 81	$ 923	$ 134	$ 2,792	$ 215

	2007					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized losses	Fair Value	Unrealized losses	Fair Value	Unrealized losses
	(Amount in thousands)					
Securities available for sale:						
U. S. government agencies	$ 2,998	$ 2	$ 3,996	$ 3	$ 6,994	$ 5
Mortgage-backed securities	-	-	31,894	500	31,894	500
Municipals	994	8	-	-	994	8
Other	-	-	732	433	732	433
Total temporarily impaired securities	$ 3,992	$ 10	$ 36,622	$ 936	$ 40,614	$ 946
Securities held to maturity:						
U. S. government agencies	$ 999	$ 1	$ 50,581	$ 418	$ 51,580	$ 419
Mortgage-backed securities	-	-	1,558	30	1,558	30
Municipals	1,045	5	3,077	116	4,122	121
Total temporarily impaired securities	$ 2,044	$ 6	$ 55,216	$ 564	$ 57,260	$ 570

(3) INVESTMENT SECURITIES (Continued)

The amortized cost and fair values of securities available for sale and held to maturity at December 31, 2008 by contractual maturity are shown below. Actual expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligation.

	Securities Available for Sale		Securities Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Amount in thousands)			
Due within one year	$ 4,150	$ 3,968	$ 3,400	$ 3,493
Due after one but through five years	40,949	42,391	4,289	4,441
Due after five but through ten years	28,052	28,698	23,219	23,447
Due after ten years	10,553	10,332	2,531	2,332
Mortgage-backed securities	196,386	200,460	1,792	1,818
Other equity securities	3,822	3,617	-	-
	$ 283,912	$ 289,466	$ 35,231	$ 35,531

Securities with carrying values of $18.6 million and $23.0 million and fair values of $18.9 million and $22.8 million at December 31, 2008 and 2007, respectively, were pledged to secure public deposits as required by law. Additionally, at December 31, 2008, securities with carrying values and fair values of $89.0 million and $91.4 million were pledged to secure the Company's borrowings from the FHLB. Securities with carrying values of $133.6 million and fair values of $137.0 million were pledged for other purposes, primarily to secure repurchase agreements and derivative positions.

During 2008, the Company sold approximately $49.5 million of available for sale mortgage-backed securities at a gain of $98 thousand as part of its asset liability management.

For the years ended December 31, 2008, 2007 and 2006, income from taxable and nontaxable securities were $14.1 million and $433 thousand, $11.6 million and $427 thousand, and $11.6 million and $367 thousand, respectively.

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(4) LOANS

Following is a summary of loans at December 31, 2008 and 2007:

	2008	2007
	(Amounts in thousands)	
Residential mortgage loans	$ 393,360	$ 318,038
Commercial mortgage loans	419,212	390,948
Construction and development loans	260,549	259,740
Commercial and industrial loans	221,231	197,851
Loans to individuals	20,459	21,861
Total	$ 1,314,811	$ 1,188,438

Loans are primarily made in the Piedmont area of North Carolina. Real estate loans can be affected by the condition of the local real estate market. Commercial and installment loans can be affected by the local economic conditions.

The following is a summary of nonperforming assets at December 31, 2008 and 2007:

	2008	2007
	(Amounts in thousands)	
Nonaccrual loans	$ 14,433	$ 2,052
Foreclosed assets	5,745	775
Total	$ 20,178	$ 2,827

The recorded investment in loans that were considered individually impaired in accordance with SFAS No. 114 at December 31, 2008 and 2007 totaled $23.3 million and $7.3 million, respectively. At December 31, 2008 and 2007, the recorded investment in impaired loans requiring a valuation allowance based on individual analysis per SFAS 114 guidelines were $19.0 million and $4.0 million, respectively, with a corresponding valuation allowance of $2.8 million and $638 thousand. No valuation allowance for the other impaired loans was considered necessary.

The average recorded investment in certain impaired loans for the years ended December 31, 2008, 2007, and 2006 was approximately $15.3 million, $4.5 million and $2.7 million, respectively. The amount of interest income recognized on impaired loans during the portion of the year they were considered impaired for 2008, 2007 and 2006 was $252 thousand, $412 thousand and $155 thousand, respectively. The interest income foregone for loans in a nonaccrual status for 2008, 2007 and 2006 was $879 thousand, $81 thousand and $108 thousand, respectively.

The Company has granted loans to certain directors and executive officers of the Company and their related interests. Such loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other borrowers and, in management's opinion, do not involve more than the normal risk of collectibility. All loans to directors and executive officers or their interests are submitted to the Board of Directors for approval. A summary of loans to directors and their interests follows (amounts in thousands):

	2008
Balance at beginning of year	$ 22,181
Disbursements	11,184
Repayments	(16,094)
Other increases (decreases) in exposure due to:	

New insiders	2,367
Directors no longer on board	(4,439)
Other	10,386
Balance at end of year	$ 25,585

(4) LOANS (Continued)

The “other” increase in insiders’ exposure represents the expansion of an existing insider’s total exposure, resulting from the inheritance of an ownership portion in an entity with guarantor obligations.

At December 31, 2008, the Company had pre-approved but unused lines of credit totaling $3.8 million to executive officers, directors and their affiliates.

(5) ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses follows:

	2008	2007	2006
	(Amounts in thousands)		
Balance at beginning of year	$ 14,258	$ 13,040	$ 11,785
Provision for loan losses	8,165	2,775	2,510
Charge-offs	(3,834)	(1,894)	(1,554)
Recoveries	262	337	299
Net charge-offs	(3,572)	(1,557)	(1,255)
Balance at end of year	$ 18,851	$ 14,258	$ 13,040

(6) PREMISES AND EQUIPMENT

Following is a summary of premises and equipment at December 31, 2008 and 2007:

	2008	2007
	(Amounts in thousands)	
Land	$ 10,621	$ 9,699
Buildings and leasehold improvements	31,185	29,726
Furniture and equipment	16,358	15,803
	$ 58,164	$ 55,228
Less accumulated depreciation	(18,134)	(16,231)
Total	$ 40,030	$ 38,997

Depreciation and amortization amounting to $3.5 million in 2008, $3.7 million in 2007 and $3.3 million in 2006, is included in occupancy and equipment expense.

(7) GOODWILL AND OTHER INTANGIBLES

The following is a summary of goodwill and other intangible assets at December 31, 2008 and 2007. Other intangible assets are included in other assets in the consolidated balance sheet.

	2008	2007
	(Amounts in thousands)	
Goodwill, beginning of year	$ 49,792	$ 49,792
Davidson Mortgage write-off	(291)	-
Goodwill, end of year	$ 49,501	$ 49,792
Other intangibles - gross	2,225	2,627
Less accumulated amortization	1,070	1,207
Other intangibles - net	$ 1,155	$ 1,420

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Goodwill impairment testing is performed annually or more frequently if events or circumstances indicate possible impairment. The evaluation of goodwill for impairment uses both the income and market approaches to value the Company. The income approach consists of discounting projected long-term future cash flows, which are derived from internal forecasts and economic expectations for the Company. The significant inputs to the income approach include the long-term target tangible equity to tangible assets ratio and the discount rate, which is determined utilizing the Company's cost of capital adjusted for a company-specific risk factor. The company-specific risk factor is used to address the uncertainty of growth estimates and earnings projections of management. Under the market approach, a value is calculated from an analysis of comparable acquisition transactions based on earnings, book value, assets and deposit premium multiples from the sale of similar financial institutions. Our goodwill testing for 2008, which was updated as of December 31, 2008, indicated that the goodwill booked at the time of the acquisition of The Community Bank continues to properly value the acquired company and has not been impaired. No impairment has been recorded as a result of goodwill testing performed during 2008 or 2007. Given the substantial decline in our common stock price and the economic outlook for our industry, the excess of the fair value over carrying value has narrowed compared with previous assessments. If our stock price continues to decline, if the Company does not produce anticipated cash flows, or if comparable banks begin selling at significantly lower prices than in the past, our goodwill may be impaired in the future.

During the fourth quarter 2008, management wrote off the total amount of goodwill recorded with the acquisition of Davidson Mortgage Company totaling $291 thousand as substantially all of its assets and employees no longer generate revenues for the Company.

Amortization expense associated with acquired intangibles amounted to $265 thousand, $301 thousand and $362 thousand, for 2008, 2007 and 2006, respectively. The following table presents estimated future amortization expense for other intangibles.

	Estimated Amortization Expense (Amounts in thousands)
For the Years Ended December 31:	
2010	265
2011	218
2012	218
2013	218
Thereafter	236
	$ 1,155

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(8) DEPOSITS

Time deposits in denominations of $100,000 or more were approximately $163.6 million and $270.3 million at December 31, 2008 and 2007, respectively. At December 31, 2008, the scheduled maturities of certificates of deposit are as follows:

	$100,000 and Over	Under $100,000	Total
	(Amounts in thousands)		
2009	136,916	437,657	574,573
2010	9,963	19,337	29,300
2011	14,841	23,046	37,887
2012	541	860	1,401
2013	1,340	10,791	12,131
Thereafter	-	-	-
Total	$ 163,601	$ 491,691	$ 655,292

(9) BORROWINGS

The following is a summary of the Company's borrowings at December 31. 2008 and 2007:

	2008	2007
	(Amounts in thousands)	
Short-term borrowings		
FHLB advances	$ 62,000	$ 73,000
Federal funds purchased	-	22,100
Term Auction Facility	60,000	-
Repurchase agreements	23,197	22,672
	$ 145,197	$ 117,772
Long-term borrowings		
FHLB advances	$ 92,139	$ 129,522
Term repurchase agreements	90,000	80,000
Jr. subordinated debentures	45,877	45,111
	$ 228,016	$ 254,633

At December 31, 2008, the interest rates on the Federal Home Loan Bank advances ranged from 0.00% to 5.12% with a weighted average rate of 3.30%. At the prior year end, the rates ranged from 0.50% to 5.47% with a weighted average rate of 4.63%. The Company has an available line of credit of $450.0 million with the Federal Home Loan Bank of Atlanta for advances. These advances are secured by both loans with a carrying value of $86.7 million and pledged investment securities with a market value of $91.4 million and lendable collateral value of $88.6 million.

In December 2007, the Federal Reserve introduced a new liquidity facility, the Term Auction Facility (TAF), to lengthen the duration of access for depository institutions to liquidity beyond the overnight access of its discount window borrowings, to broaden the types of eligible collateral and to reduce the cost of borrowing from the Fed relative to the federal funds rate. Under the TAF, eligible institutions may bid on a pre-determined amount of longer term funding (for a 28 day period or 84 day period) that is available via auction on pre-announced dates for subsequent settlement. The interest rate and the distribution of the funding to bidding institutions are determined by an auction. The TAF allows banks to borrow against a wide range of collateral, including securities that are not widely pledged in private markets and bank loans. At December 31, 2008, borrowings outstanding under this facility amounted to $60.0 million with an average interest rate of 1.0%.

(9) BORROWINGS (Continued)

The Company has also entered into long-term financing through term repurchase agreements with various parties. At December 31, 2008, the interest rates on these term repurchase agreements, which are variable rate agreements based upon LIBOR, range from 1.81% to 4.95%.

Certain of the FHLB advances and the term repurchase agreements contain embedded interest rate options. Some of the options are exercisable by the holder and relate to converting a floating rate to a fixed rate. Other options are held by the bank, and relate to reducing the interest rate charged should the reference rate fall below a rate specified in the agreement. Several of the FHLB advances and Term Repurchase Agreements contain options which allow them to be called prior to their contractual maturity.

The contractual maturities of the Federal Home Loan Bank advances and term repurchase agreements at December 31, 2008 are as follows:

	FHLB Advances	Term Repurchase Agreements
	(Amounts in thousands)	
Due in 2009	$ 62,000	$ 10,000
Due in 2010	35,000	10,000
Due in 2011	-	-
Due in 2012	5,000	20,000
Due in 2013	10,000	-
Thereafter	42,139	60,000
	$ 154,139	$ 100,000

In addition to the above advances and term repurchase agreements, the Company also had repurchase agreements with outstanding balances of $13.2 million and $22.7 million at December 31, 2008 and 2007, respectively, which were for customer accommodations. Securities sold under agreements to repurchase generally mature within ninety days from the transaction date and are collateralized by U.S. Government Agency obligations. The Company has repurchase lines of credit of $150.0 million from various institutions, which must be adequately collateralized.

The Company also has lines of credit of $121.0 million from various correspondent banks to purchase federal funds on a short-term basis. The Company had no outstanding balances of federal funds purchased as of December 31, 2008.

The Company has an unsecured line of credit of $5.0 million with a correspondent bank for general corporate purposes. The borrowing agreement requires maintenance of certain financial performance ratios. There was no outstanding balance under this line of credit during 2008.

(10) JUNIOR SUBORDINATED DEBENTURES

In November of 2003, Southern Community Capital Trust II ("Trust II"), wholly owned by the Company, issued 3,450,000 shares of Trust Preferred Securities ("Trust II Securities"), generating total proceeds of $34.5 million. The Trust II Securities pay distributions at an annual rate of 7.95% and mature on December 31, 2033. The Trust II Securities began paying quarterly distributions on December 31, 2003. The Company has fully and unconditionally guaranteed the obligations of Trust II. The Trust II Securities are redeemable in whole or in part at any time after December 31, 2008. The proceeds from the Trust II Securities were utilized to purchase junior subordinated debentures from the Bank under the same terms and conditions as the Trust II Securities. We have the right to defer payment of interest on the debentures at any time and from time to time for a period not exceeding five years, provided that no deferral period extends beyond the stated maturities of the debentures. Such deferral of interest payments by the Company will result in a deferral of distribution payments on the related Trust II Securities. Should we defer the payment of interest on the debentures, the Company will be precluded from the payment of cash dividends to shareholders. The principal uses of the net proceeds from the sale of the debentures were to provide cash for the acquisition of The Community Bank, to increase our regulatory capital, and to support the growth and operations of our subsidiary bank. The amount of proceeds we count as Tier 1 capital cannot comprise more than 25% of our core capital elements. Amounts in excess of that 25% limitation count as Tier 2 supplementary capital for regulatory capital purposes.

(10) JUNIOR SUBORDINATED DEBENTURES (Continued)

At December 31, 2008 and 2007, the Company had outstanding 3.45 million shares of the trust preferred securities from Trust II used to purchase related junior subordinated debentures from the Bank, with carrying amounts of $35.1 million and $34.9 million, respectively.

In June 2007, $10.0 million of trust preferred securities were placed through Southern Community Capital Trust III ("Trust III"), as part of a pooled trust preferred security. The Trust issuer invested the total proceeds from the sale of the Trust Preferred Securities in Junior Subordinated Deferrable Interest Debentures (the "Junior Subordinated Debentures") issued by the Company. The terms of the trust preferred securities require payment of cumulative cash distributions quarterly at an annual rate, reset quarterly, equal to LIBOR plus 1.43%. During 2008, the Company entered into an interest rate swap derivative contract with a counterparty that shifted this debt service from a variable rate to a fixed rate of 4.7% per annum. The dividends paid to holders of the trust preferred securities, which are recorded as interest expense, are deductible for income tax purposes. The trust preferred securities are redeemable in 30 years with a five year call provision. The Company has fully and unconditionally guaranteed the trust preferred securities through the combined operation of the debentures and other related documents. The Company's obligation under the guarantee is unsecured and subordinate to senior and subordinated indebtedness of the Company. The principal use of the net proceeds from the sale of the debentures was to provide additional capital into the Company to fund its operations and continued expansion, and to maintain the Company's and the Bank's status as "well capitalized" under regulatory guidelines.

(11) CUMULATIVE PERPETUAL PREFERRED STOCK

Under the United States Treasury's Capital Purchase Program (CPP), the Company issued $42.75 million in Cumulative Perpetual Preferred Stock, Series A, on December 5, 2008. In addition, the Company provided warrants to the Treasury to purchase 1,623,418 shares of the Company's common stock at an exercise price of $3.95 per share. These warrants are immediately exercisable and expire ten years from the date of issuance. The preferred stock is non-voting, other than having class voting rights on certain matters, and pays cumulative dividends quarterly at a rate of 5% per annum for the first five years and 9% per annum thereafter. The preferred shares are redeemable at the option of the Company subject to regulatory approval.

Based on a Black-Scholes options pricing model, the common stock warrants have been assigned a fair value of $1.29 per share or $2.09 million in the aggregate as of December 5, 2008. As a result, $2.09 million has been recorded as the discount on the preferred stock and will be accreted as a reduction in net income available for common shareholders over the next five years at approximately $0.4 million per year. Correspondingly, $40.66 million has been assigned to the preferred stock. Through the discount accretion over the next five years, the preferred stock will be accreted up to the redemption amount of $42.75 million. For purposes of these calculations, the fair value of the common stock warrants as of December 5, 2008 was estimated using the Black-Scholes option pricing model and the following assumptions:

Risk-free interest rate	2.70%
Expected life of warrants	10 years
Expected dividend yield	4.57%
Expected volatility	33%

The Company's computation of expected volatility is based on daily historical volatility since December 1998. The risk-free interest rate is based on the market yield for ten year U.S. Treasury securities as of December 5, 2008.

As a condition of the CPP, the Company must obtain consent from the United States Department of the Treasury to repurchase its common stock or to increase its cash dividend on its common stock from the September 30, 2008 quarterly level of $0.04 per common share. Furthermore, the Company has agreed to certain restrictions on executive compensation.

(12) EMPLOYEE AND DIRECTOR BENEFIT PLANS

401(k) Retirement Plan

The Company maintains a qualified profit sharing 401(k) Plan for employees of age 21 years or over with at least three months of service. Under the plan, employees may contribute up to an annual maximum as determined under the Internal Revenue Code. The Bank matches 100% of such contributions not exceeding 6% of the participants' compensation. In addition, the Board of Directors can authorize additional discretionary contributions to the plan. The plan provides that employees' contributions are 100% vested at all times and the Company's contributions vest at 20% each year of participation in the plan. The expense related to this plan for the years ended December 31, 2008, 2007 and 2006 totaled approximately $846 thousand, $780 thousand and $761 thousand, respectively.

Employment Agreements

The Company has entered into employment agreements with its chief executive officer and certain other executive officers to ensure a stable and competent management base. The agreements provide for a two or three-year term, but the agreements may annually be extended for an additional year. The agreements provide for benefits as spelled out in the contracts and cannot be terminated by the Board of Directors, except for cause, without prejudicing the officers' rights to receive certain vested benefits, including compensation. In the event of a change in control of the Company, as outlined in the agreements, the acquirer will be bound to the terms of the contracts.

Termination Agreements

Prior to 2005, the Company entered into termination agreements with substantially all other employees, which provide for severance pay benefits in the event of a change in control of the Company which results in the termination of such employee or diminished compensation, duties or benefits. As of December 31, 2008, approximately 39% of the Company's employees were covered under such agreements. As a condition of the Company's participation in the United States Treasury's Capital Purchase Program, the Company agreed to modify these agreements for the five senior executive officers (SEOs) to restrict the severance pay benefit the SEOs would receive in the event of a change in control while the Treasury maintains a preferred stock investment in the Company.

(12) EMPLOYEE AND DIRECTOR BENEFIT PLANS (Continued)

Defined Benefit Pension Plan

The Company also has a non-contributory Defined Benefit Pension Plan covering substantially all employees of an acquired bank, The Community Bank. This plan was assumed as part of the purchase of The Community Bank in January 2004. Benefits under the plan are based on length of service and qualifying compensation during the final years of employment. Contributions to the plan are based upon the projected unit credit actuarial funding method to comply with the funding requirements of the Employee Retirement Income Security Act. The plan was frozen effective May 1, 2004. No contribution was required for the years ended December 31, 2008, 2007 or 2006. The changes in benefit obligations and plan assets, as well as the funded status, actuarial assumptions and components of net periodic pension cost of the plan at December 31 were:

	2008	2007	2006
	(Amounts in thousands)		
Change in Benefit Obligation			
Beginning of year	$ 868	$ 845	$ 823
Actuarial loss	6	6	2
Service cost	-	-	-
Interest cost	56	54	53
Settlement	-	-	-
Benefits paid	(40)	(37)	(33)
End of year - Benefit obligations	$ 890	$ 868	$ 845
Change in Fair Value of Plan Assets			
Beginning of year	$ 1,216	$ 1,171	$ 1,109
Benefits paid	(40)	(37)	(33)
Return on assets	(303)	82	95
End of year - Fair value	$ 873	$ 1,216	$ 1,171
Amounts recognized in the consolidated statement of financial condition consist of:			
Noncurrent Asset	$ -	$ 348	$ 326
Noncurrent Liability	(17)	-	
Funded status	$ (17)	$ 348	$ 326

Because the total unrecognized net gain or loss exceeds the greater of 10 percent of the projected benefit obligation or 10 percent of the pension plan assets, the excess will be amortized over the average expected future working life of active plan participants. As of January 1, 2008, the average expected future working life of active plan participants was 15 years. The components of accumulated other comprehensive income relating to pension adjustments are entirely comprised of actuarial losses, which amount to $418 thousand, excluding income taxes.

(12) EMPLOYEE AND DIRECTOR BENEFIT PLANS (Continued)

(Defined Benefit Pension Plan (Continued)

Actuarial assumptions used in accounting for net periodic pension cost were:

Weighted average discount rate	6.50%	6.50%	6.50%
Weighted average rate of increase in compensation level	N/A	N/A	N/A
Weighted average expected long-term rate of return on plan assets	7.50%	7.50%	7.50%

Components of Net Periodic Pension Cost (Benefit)

Service cost	$ -	$ -	$ -
Interest cost	56	54	53
Expected return on plan assets	(90)	(87)	(82)
Loss	-	-	-
Amortization of prior service cost	-	-	-
Net periodic pension cost (benefit)	$ (34)	$ (33)	$ (29)

The measurement date used for the plan was December 31, 2008. As of that date, the pension plan had a funded status with the fair value of plan assets of $873 thousand compared to an accumulated projected benefit obligation of $890 thousand. Due to the recent decline in market value of the plan assets a contribution is probable during 2009.

The overall expected long-term rate of return on assets assumption is based on: (1) the target asset allocation for plan assets, (2) long-term capital markets forecasts for asset classes employed and (3) active management excess return expectations to the extent asset classes are actively managed.

Plan assets are invested using allocation guidelines as established by the Plan. The primary objective is to provide long-term capital appreciation through investments in equities and fixed income securities. These guidelines ensure risk control by maintaining minimum and maximum exposure in equity and fixed income/cash equivalents portfolios. The minimum equity and fixed income/cash equivalents investment exposure is 35% and 25%, respectively. The maximum equity and fixed income/cash equivalents investment exposure is 75% and 65%, respectively. The current asset allocation is 51% equity securities and 49% fixed income/cash equivalents securities, which meets the criteria established by the Plan.

Allowable investment types include both U.S. and international equity and fixed income funds. The equity component is composed of common stocks, convertible notes and bonds, convertible preferred stocks and ADR's of non U.S. companies as well as various mutual funds, including government and corporate bonds, large to mid cap value, growth and world/international equity funds and index funds. The fixed income/cash equivalents component is composed of money market funds, commercial paper, certificates of deposit, U.S. government and agency securities, corporate notes and bonds, preferred stock and fixed income securities of foreign governments and corporations.

The plan's weighted-average asset allocations at December 31, 2008, by asset category are as follows.

U.S. equity	46%
International blend	5
Fixed income and cash equivalents	49

(12) EMPLOYEE AND DIRECTOR BENEFIT PLANS (Continued)

(Defined Benefit Pension Plan (Continued)

Estimated future benefits payments are shown below (in thousands):

Year	Pension Benefits
2009	39
2010	39
2011	38
2012	39
2013	48
2014-2017	286

Supplemental Retirement

The Company during 2001 implemented a non-qualifying supplemental retirement plan for certain key executive and senior officers. The Company has purchased life insurance policies on the participating officers in order to provide future funding of benefit payments. Benefits will accrue during employment based upon the performance of the underlying life insurance policies both during employment and after retirement. Such benefits will continue to accrue and be paid throughout each participant's life assuming satisfactory performance of the funding life insurance policies. The plan also provides for payment of death or disability benefits in the event a participating officer becomes permanently disabled or dies prior to attainment of retirement age. Provisions of $405 thousand, $309 thousand and $166 thousand in 2008, 2007 and 2006, respectively, were expensed for future benefits to be provided under this plan. The accrued liability related to this plan was approximately $1.7 million and $1.3 million as of December 31, 2008 and 2007, respectively.

During 1994, The Community Bank had established an unfunded Supplemental Executive Retirement Plan, which is a nonqualified plan that provides additional retirement benefits to certain key management personnel. The accrued liability related to this plan was approximately $789 thousand and $816 thousand at December 31, 2008 and 2007, respectively. Total expense for this plan aggregated $46 thousand for the years ended December 31, 2008 and 2007 and $88 thousand for the year ended December 31, 2006. Payouts for this plan were $95 thousand for years ended December 31, 2008 and 2007 and are expected to continue at this level until the plan is terminated.

The Company adopted Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans", at December 31, 2006. The Statement requires an employer to recognize the over funded or under funded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. As a result of the adoption, the Company recorded an additional minimum pension liability of $147 thousand and a reduction (net of tax) in accumulated other comprehensive income of $90 thousand.

Deferred Compensation

The Company during 2007 implemented a non-qualifying deferred compensation plan for certain key executive and senior officers whose participation in the Company's 401(k) plan is limited by Internal Revenue Service regulations. Under the plan, participants are entitled to elect to defer from 1% to 25% of current compensation until their normal retirement date. The Bank matches 100% of such contributions not exceeding 6% of the participants' compensation. The plan provides that employees' contributions are 100% vested at all times and the Company's contributions vest at 20% for each year of service. The expense related to this plan totaled approximately $10 thousand and $33 thousand for the years ended December 31, 2008 and 2007 respectively.

Employee Stock Purchase Plan

On December 19, 2002, the Board approved the creation of, and on February 20, 2003 the Board adopted, the 2002 Employee Stock Purchase Plan (the "2002 ESPP"). An aggregate of 1,000,000 shares of common stock of the Company has been reserved for issuance by the Company upon exercise of options to be granted from time to time under the 2002 ESPP. The purpose of the 2002 ESPP is to provide employees of the Company with an opportunity to purchase shares of the common stock of the Company in order to encourage employee participation in the ownership and economic success of the Company.

(12) EMPLOYEE AND DIRECTOR BENEFIT PLANS (Continued)

(Defined Benefit Pension Plan (Continued)

The 2002 ESPP as amended provides employees of the Company the right to purchase, annually, shares of the Company's common stock at 95% of fair market value. The number of shares that can be purchased in any calendar year by any individual is limited to the lesser of: (1) shares with a fair market value of $25 thousand; or (2) shares with a fair market value of 20% of the individual's annual compensation. Shares purchased through the 2002 ESPP must be held by the employee for one year, after which time the employee is free to dispose of the stock.

For the years ended December 31, 2008, 2007 and 2006, employees of the Company purchased 20,470, 15,622 and 16,508 shares, respectively, under the ESPP. During 2008, the shares purchased for the ESPP were purchased on the open market.

Stock Option Plans

During 1997 the Company adopted, with stockholder approval, the 1997 Incentive Stock Option Plan and the 1997 Nonstatutory Stock Option Plan. Both plans were amended in 2000 and in 2001, with stockholder approval, to increase the number of shares available for grant. Each of these plans makes available options to purchase 875,253 shares of the Company's common stock. During 2002 the Company adopted, with stockholder approval in 2003, the 2002 Incentive Stock Option Plan with 350,000 options available and the 2002 Nonstatutory Stock Option Plan with 150,000 options available. During 2006 the Company adopted, with shareholder approval, the 2006 Nonstatutory Stock Option Plan with 150,000 options available. The exercise price of all options granted to date is the fair value of the Company's common shares on the date of grant.

All options had an initial vesting period of five years. During the first quarter 2005, the Company vested all unvested stock options. As a result of this decision 623,725 non-vested options were accelerated from their established vesting over a five-year period from date of grant to being fully vested. Stock options granted after December 31, 2005 and stock options granted to advisory board members generally vest over a five-year period. All unexercised options expire ten years after the date of grant.

A summary of the Company's option plans as of and for the year ended December 31, 2008 is as follows:

		Outstanding Options		Exercisable Options	
	Shares Available for Future Grants	Number Outstanding	Weighted Average Exercise Price	Number Outstanding	Weighted Average Exercise Price
At December 31, 2007	504,038	836,783	$ 9.19	759,683	$ 9.13
Options authorized	-	-	-	-	-
Options granted/vested	(34,500)	34,500	5.07	35,800	5.07
Options exercised	-	(73,968)	4.84	(73,968)	4.84
Options forfeited	34,373	(34,373)	6.41	(34,373)	6.41
Options expired	-	(18,676)	8.56	(18,676)	8.56
At December 31, 2008	503,911	744,266	$ 9.58	668,466	$ 9.75

(12) EMPLOYEE AND DIRECTOR BENEFIT PLANS (Continued)

Stock Option Plans (Continued)

The weighted average remaining life of options outstanding and options exercisable at December 31, 2008 and 2007 is 5.27 years and 5.30 years, respectively. Information pertaining to options outstanding at December 31, 2008 is as follows:

Range of Exercise Prices	Number of Options Outstanding	Number of Options Exercisable
$3.45 - $7.15	119,190	96,589
$7.16 - $10.10	314,725	283,126
$10.11 - $14.64	310,351	288,751
Outstanding at end of year	744,266	668,466

The estimated average per share fair value of options granted, using the Black-Scholes methodology, together with the assumptions used in estimating those fair values, are displayed below:

	2008	2007	2006
Estimated fair value of options granted	$ 0.99	$ 3.40	$ 3.31
Assumptions in estimating average option values:			
Risk-free interest rate	2.45%	4.58%	4.69%
Dividend yield	4.56%	2.22%	1.34%
Volatility	29%	27%	28%
Expected life	5 - 7 years	7 years	7 years

The total intrinsic value of options exercised during the years ended December 31, 2008, and 2007 was $131 thousand and $1.5 million, respectively. The aggregate intrinsic value of options outstanding and options exercisable at December 31, 2008, and 2007 was zero and $166 thousand, respectively. As of December 31, 2008, there was $208 thousand of unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the plans. That cost is expected to be recognized over a weighted average period of 2.3 years.

Cash received from option exercises under all share-based payment arrangements for the years ended December 31, 2008, 2007 and 2006 was $357 thousand, $1.2 million and $680 thousand, respectively. The tax benefit realized for tax deductions from option exercise of the share-based payment arrangements for the years ended December 31, 2008, 2007 and 2006 were $51 thousand, $559 thousand and $69 thousand, respectively.

Restricted Stock

During 2007 the Company adopted the Southern Community Financial Corporation Restricted Stock Plan. The plan initially makes 300,000 shares available to be issued as restricted stock. The plan is administered by the Compensation Committee of the Board of Directors who may authorize the grant of restricted stock to certain current directors, officers and employees of the Corporation. The shares vest over a five year period and are taxable to the recipient at their option either when received or after the vesting period at the current fair market value. The recipient must be employed with the Company at the end of the five year period or the shares are forfeited. For the year ended December 31, 2008, 29,500 shares were granted and 500 shares were forfeited. A total of 48,000 shares have now been issued since the inception of the plan leaving 252,000 shares available for future grants. Under this plan, the Company expensed $73 thousand and $40 thousand for the years ended December 31, 2008 and 2007, respectively.

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(13) LEASES

The Company leases office space and equipment under non-cancelable operating leases. Future minimum lease payments under these leases for the years ending December 31 are as follows (amounts in thousands):

2009	$ 1,053
2010	878
2011	621
2012	365
2013	317
Thereafter	1,898
	$ 5,132

Total rental expense for office space under operating leases was $674 thousand in 2008, $757 thousand in 2007 and $551 thousand in 2006.

(14) INCOME TAXES

The significant components of the provision for income taxes for the years ended December 31, 2008, 2007 and 2006 are as follows:

	2008	2007	2006
	(Amounts in thousands)		
Current tax provision			
Federal	$ 4,349	$ 4,079	$ 2,857
State	825	604	270
	5,174	4,683	3,127
Deferred tax provision (benefit)			
Federal	(2,085)	(731)	(1,070)
State	(455)	(83)	(167)
	(2,540)	(814)	(1,237)
Net provision for income taxes	$ 2,634	$ 3,869	$ 1,890

The difference between the provision for income taxes and the amounts computed by applying the statutory federal income tax rate of 34% to income before income taxes is summarized below:

	2008	2007	2006
	(Amounts in thousands)		
Tax computed at the statutory federal rate	$ 2,886	$ 3,884	$ 2,070
Increase (decrease) resulting from:			
State income taxes, net of federal benefit	244	344	68
Tax exempt income	(498)	(435)	(377)
Other permanent differences	2	76	129
	(252)	(15)	(180)
Provision for income taxes	$ 2,634	$ 3,869	$ 1,890

(14) INCOME TAXES (Continued)

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 purposes. Significant components of deferred taxes at December 31, 2008 and 2007 are as follows:

	2008	2007
	(Amounts in thousands)	
Deferred tax assets relating to:		
Allowance for loan losses	$ 7,268	$ 5,497
Deferred compensation	1,321	1,316
Derivative financial instruments	222	244
Other	930	370
Total deferred tax assets	9,741	7,427
Deferred tax liabilities relating to:		
Property and equipment	(786)	(831)
Loan fees and costs	(647)	(672)
Core deposit intangible	(392)	(457)
Accumulated other comprehensive income	(1,772)	(562)
Prepaid expenses	(292)	(307)
Other	(71)	(146)
Total deferred tax liabilities	(3,960)	(2,975)
Net recorded deferred tax asset	$ 5,781	$ 4,452

The Company adopted FIN 48 ("Accounting for Uncertainty in Income Taxes") on January 1, 2007. The Company classifies interest and penalties related to income tax assessments, if any, in income tax expense in the consolidated statements of operations. Tax years 2005 through 2007 are subject to examination by the Internal Revenue Service and the North Carolina Department of Revenue. The Company has approximately $71 thousand accrued for payment of interest and penalties as of December 31, 2008.

A reconciliation of the beginning and ending balance of unrecognized tax benefit is as follows:

	2008	2007
	(Amounts in thousands)	
Balance at January 1, 2008	$ 135	$ 100
Additions based on tax positions related to the current year	42	35
Additions for tax positions of prior years	-	-
Reductions for tax positions of prior years	(20)	-
Settlements	-	-
Balance at December 31, 2008	$ 157	$ 135

(15) NON-INTEREST INCOME AND OTHER NON-INTEREST EXPENSE

The major components of non-interest income for the years ended December 31, 2008, 2007 and 2006 are as follows:

	2008	2007	2006
	(Amounts in thousands)		
Service charges and fees on deposit accounts	$ 5,859	$ 4,931	$ 4,318
Income from mortgage banking activities	1,294	1,343	1,205
Investment brokerage and trust fees	1,138	1,141	780
SBIC income and management fees	60	2,103	792
Gain (loss) on economic hedges	934	79	(432)
Net cash settlement on economic hedges	-	-	(366)
Gain (loss) on sale of investment securities	98	-	(4,156)
Other	1,899	1,734	1,537
Total	$ 11,282	$ 11,331	$ 3,678

The major components of other non-interest expense for the years ended December 31, 2008, 2007 and 2006 are as follows:

	2008	2007	2006
	(Amounts in thousands)		
Postage, printing and office supplies	$ 847	$ 865	$ 846
Telephone and communication	954	866	897
Advertising and promotion	1,164	1,245	1,085
Data processing and other outsourced services	805	763	905
Professional services	1,811	1,809	1,476
Other	6,791	6,206	4,932
Total	$ 12,372	$ 11,754	$ 10,141

(16) REGULATORY MATTERS

The Bank, as a North Carolina banking corporation, may pay cash dividends to the Company only out of retained earnings as determined pursuant to North Carolina banking laws. However, regulatory authorities may limit payment of dividends by any bank when it is determined that such limitation is in the public interest and is necessary to ensure financial soundness of the bank. The Bank is subject to various regulatory capital requirements administered by federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated 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 classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

(16) REGULATORY MATTERS (Continued)

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios, as prescribed by regulations, of total and Tier I capital to risk-weighted assets and of Tier I capital to average assets. As of December 31, 2008 and 2007, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum amounts and ratios, as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank's category. Information regarding the Bank's capital and capital ratios is set forth below:

	Actual		Minimum For Capital Adequacy Purposes		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Amounts in thousands)			
As of December 31, 2008						
Total Capital (to Risk-Weighted Assets)	$ 165,013	11.55%	$ 114,300	8.00%	$ 142,900	10.00%
Tier I Capital (to Risk-Weighted Assets)	147,138	10.30%	57,200	4.00%	85,700	6.00%
Tier I Capital (to Average Assets)	147,138	8.42%	69,900	4.00%	87,400	5.00%
As of December 31, 2007						
Total Capital (to Risk-Weighted Assets)	$ 139,128	10.61%	$ 104,900	8.00%	$ 131,200	10.00%
Tier I Capital (to Risk-Weighted Assets)	124,870	9.52%	52,500	4.00%	78,700	6.00%
Tier I Capital (to Average Assets)	124,870	8.30%	60,200	4.00%	75,200	5.00%

The Company is also subject to these capital requirements. Information regarding the Company's capital and capital ratios is set forth below:

	At December 31, 2008		At December 31, 2007	
	Actual		Actual	
	Amount	Ratio	Amount	Ratio
		(Amounts in thousands)		
Total risk-based capital ratio	$ 197,790	13.80%	$ 150,432	11.44%
Tier 1 risk-based capital ratio	178,489	12.46%	135,107	10.28%
Leverage ratio	178,489	10.57%	135,107	8.96%

(17) DERIVATIVES

Derivative Financial Instruments

The Company utilizes stand-alone derivative financial instruments, primarily in the form of interest rate swap and option agreements, in its asset/liability management program. These transactions involve both credit and market risk. Direct credit exposure is limited to the net difference between the calculated amounts to be received and paid, if any. Such difference, which represents the fair value of the derivative instruments, is reflected on the Company's consolidated balance sheets as derivative assets and derivative liabilities.

The Company is exposed to credit-related losses in the event of nonperformance by the counterparties to these agreements. The Company controls the credit risk of its financial contracts through credit approvals, limits and monitoring procedures, and does not expect any counterparties to fail their obligations. Although the Company deals only with primary dealers, a nonrecurring loss of $440 thousand was included in noninterest income during the third quarter of 2008 related to the value of certain derivative positions on our balance sheet due to the bankruptcy and technical default of Lehman Brothers, the counterparty in the contracts. In addition, Lehman Brothers currently holds $1.0 million of the Company's U.S. Government Agency investment securities as collateral as a part of these derivative agreements. The Company has filed a claim against Lehman Brothers for all funds due to the Company as a result of their technical default including the return of this collateral. We expect to recover in whole or in part, the value of these investment securities held as collateral either through legal proceedings with Lehman or through insurance coverage.

SOUTHERN COMMUNITY FINANCIAL CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2008, 2007 and 2006

(17) DERIVATIVES (Continued)

Risk Management Policies - Hedging Instruments

The primary focus of the Company's asset/liability management program is to monitor the sensitivity of the Company's net portfolio value and net income under varying interest rate scenarios to take steps to control its risks. On a quarterly basis, the Company simulates the net portfolio value and net income expected to be earned for a period following the date of simulation. The simulation is based on a projection of market interest rates at varying levels and estimates the impact of such market rates on the levels of interest-earning assets and interest-bearing liabilities during the measurement period. Based upon the outcome of the simulation analysis, the Company considers the use of derivatives as a means of reducing the volatility of net portfolio value and projected net income within certain ranges of projected changes in interest rates. The Company evaluates the effectiveness of entering into any derivative instrument agreement by measuring the cost of such an agreement in relation to the reduction in net portfolio value and net income volatility within an assumed range of interest rates. The Company has certain derivative financial instruments that have been designated as hedges under SFAS 133, and has other derivative financial instruments used as economic hedges but have not been currently qualified by the Company for hedge accounting treatment.

The fair value of the Company's derivative assets and liabilities and their related notional amounts is summarized below.

	December 31, 2008		December 31, 2007	
	Fair Value	Notional Amount	Fair Value	Notional Amount
	(Amounts in thousands)			
Fair value hedges				
Interest rate swaps associated with borrowing activities	$ -	$ -	$ (490)	$ 20,000
Interest rate swaps associated with deposit taking activities	(69)	10,000	66	40,500
Cash flow hedges				
Derivatives not designated as accounting hedges				
Interest rate swaps associated with borrowing activities	(483)	10,000	-	-
Interest rate options associated with borrowing activities	3	10,000	33	10,000
Interest rate options associated with lending activities	-	-	423	25,000
Derivatives not designated as accounting hedges				
Interest rate options associated with lending activities	-	-	7	50,000
	$ (549)	$ 30,000	$ 39	$ 145,500

Certain derivative liabilities were collateralized by securities, which are held by the counterparty or in safekeeping by third parties. The fair value of these securities at December 31, 2008 was $2.9 million.

As part of our banking activities, the Company originates certain residential loans and commits these loans for sale. The commitments to originate residential loans and the sales commitments are freestanding derivative instruments and are generally funded within 90 days. The fair value of these commitments was not significant at December 31, 2008.

(17) DERIVATIVES (Continued)

Interest Rate Risk Management - Cash Flow Hedging Instruments

To mitigate exposure to variability in expected future cash flows resulting from changes in interest rates, management may enter into interest rate swap and option agreements. At December 31, 2008, the Company had interest rate option agreements that provide for payments to the Company in the event interest rates increase or decrease above or below levels provided in the agreements. At December 31, 2008, one such agreement was designated as a cash flow hedge, and two of these agreements were not designated as hedges under SFAS 133. The gains and losses from such hedges not designated as cash flow hedges are recognized in non-interest income in the line item net cash settlement and change in fair value of economic hedges

Interest Rate Risk Management – Fair Value Hedging Instruments

As part of interest rate risk management, the Company from time to time has entered into interest rate swap agreements to convert certain fixed-rate obligations to floating rates. At December 31, 2008 and 2007, the Company had interest rate swap agreements related to fixed-rate obligations that provide for the Company to pay floating and receive fixed interest payments, certain of which had been designated as a fair value hedges under SFAS 133, others of which were not designated as fair value hedges. The gains (losses) from such interest rate swaps that were not designated as accounting hedges are recognized in non-interest income in the line item net cash settlement and change in fair value of economic hedges. The interest rate swap related to the fixed rate Trust Preferred Securities (the Trust II Securities) has been designated as a fair value hedge. Due to certain differences between the terms of the debt and the terms of the swap, the Company has assessed and evaluated hedge effectiveness of the swap under the "long-haul" method since its inception. Effective July 31, 2006, certain of the interest rate swap agreements used to convert brokered CD liabilities to floating rates were designated as fair value hedges. Prior to designation as fair value hedges, the change in the fair value of the interest rate swap agreements were included in noninterest income. Subsequent to the designation as fair value hedges, the changes in the fair value of the interest rate swap and the changes to the fair value of the hedged CD are included in noninterest income. The difference between the changes in the fair values of the interest rate swaps and the related CDs represents hedge ineffectiveness. The amount of hedge ineffectiveness related to the interest rate swap agreements included in income for the year ended December 31, 2008 and 2007 was zero and $12 thousand, respectively. The Company currently has no fair value hedges for which hedge effectiveness is evaluated using the "short-cut" method.

(18) OFF-BALANCE SHEET RISK, COMMITMENTS AND CONTINGENCIES

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis.

The amount of collateral obtained, if deemed necessary by the Company, upon extension of credit is based on management's credit evaluation of the borrower. Collateral obtained varies but may include real estate, stocks, bonds and certificates of deposit.

A summary of the contract amount of the Company's exposure to off-balance sheet risk as of December 31, 2008 and 2007 is as follows (amounts in thousands):

	2008	2007
Financial instruments whose contract amounts represent credit risk:		
Loan commitments and undisbursed lines of credit	$ 252,129	$ 313,839
Undisbursed standby letters of credit	7,083	7,488

Undisbursed portion of construction loans	55,850	98,148

(18) OFF-BALANCE SHEET RISK, COMMITMENTS AND CONTINGENCIES (Continued)

The Company is a party to legal proceedings and potential claims arising in the normal conduct of business. Management believes that this litigation is not material to the financial position or results of operations of the Company.

(19) DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS

Financial instruments include cash and due from banks, federal funds sold, investment securities, loans, bank-owned life insurance, deposit accounts and other borrowings, accrued interest and derivatives. Fair value estimates are made at a specific moment in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no active market readily exists for a portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and due from banks, federal funds sold and other interest-bearing deposits

The carrying amounts for cash and due from banks, federal funds sold and other interest-bearing deposits approximate fair value because of the short maturities of those instruments.

Investment securities

Fair value for investment securities equals quoted market price if such information is available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Loans

For certain homogeneous categories of loans, such as residential mortgages, fair value is estimated using the quoted market prices for securities backed by similar loans, adjusted for differences in loan characteristics. The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Investment in bank-owned life insurance

The carrying value of bank-owned life insurance approximates fair value because this investment is carried at cash surrender value, as determined by the insurer.

Deposits

The fair value of demand deposits is the amount payable on demand at the reporting date. The fair value of time deposits is estimated based on discounting expected cash flows using the rates currently offered for deposits of similar remaining maturities.

Borrowings

The fair values are based on discounting expected cash flows at the current interest rate for debt with the same or similar remaining maturities and collateral requirements.

Accrued interest

The carrying amounts of accrued interest approximate fair value.

(19) DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

Derivative financial instruments

Fair values for interest rate swap and option agreements are based upon the amounts required to settle the contracts. Fair values for commitments to originate loans held for sale are based on fees currently charged to enter into similar agreements. Fair values for fixed-rate commitments also consider the difference between current levels of interest rates and the committed rates.

Financial instruments with off-balance sheet risk

With regard to financial instruments with off-balance sheet risk discussed in Note 18, it is not practicable to estimate the fair value of future financing commitments.

The carrying amounts and estimated fair values of the Company's financial instruments, none of which are held for trading purposes, are as follows at December 31, 2008 and 2007:

	2008		2007	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
	(Amounts in thousands)			
Financial assets:				
Cash and due from banks	$ 25,215	$ 25,215	$ 31,905	$ 31,905
Federal funds sold and other interest-bearing deposits	2,180	2,180	2,250	2,250
Investment securities available for sale	289,466	289,466	147,426	147,426
Investment securities held to maturity	35,231	35,531	69,812	69,464
Loans, net	1,295,960	1,304,117	1,174,180	1,187,953
Investment in life insurance	27,665	27,665	16,824	16,824
Accrued interest receivable	7,690	7,690	8,009	8,009
Financial liabilities:				
Deposits	1,233,112	1,227,006	1,045,237	1,044,588
Short-term borrowings	145,197	145,197	117,772	117,772
Long-term borrowings	228,016	247,223	254,633	244,039
Accrued interest payable	6,427	6,427	3,516	3,516
On-balance sheet derivative financial instruments:				
Interest rate swap and option agreements:				
(Assets) Liabilities, net	549	549	(39)	(39)

(20) FAIR VALUES OF ASSETS AND LIABILITIES

Effective January 1, 2008, the Company adopted SFAS 157, *Fair Value Measurements* (SFAS 157) and SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment for FASB Statement No. 115 (SFAS 159).* The effect of adopting these two pronouncements was not material to the financial statements.

SFAS 157 defines fair value establishes a framework for measuring fair value according to generally accepted accounting principles, and expands disclosures about fair value measurements. This statement establishes a three level fair value hierarchy that is fully described below. While this standard does not require any financial instruments to be measured at fair value the provisions of the statement must be applied in situations where other accounting pronouncements either permit or require fair value measurement. The Company reports fair value on a recurring basis for certain financial instruments, most notably for available for sale investment securities and certain derivative instruments in compliance with the provisions of SFAS 157. The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis. These include assets that are measured at the lower of cost or market that were recognized at fair value which was below cost at the end of the period. Assets subject to nonrecurring use of fair value measurements could include loans held for sale, goodwill, and foreclosed assets. At December 31, 2008, the Company had certain impaired loans that are measured at fair value on a nonrecurring basis.

(20) – FAIR VAULES OF ASSETS AND LIABILITIES (Continued)

In accordance with SFAS 157, we group our financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1 – Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury, other U.S. government and agency mortgage-backed securities that are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

- Level 2 – Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party services for similar or comparable assets or liabilities.

- Level 3 – Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and not based on market exchange, dealer, or brokered traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis.

	At December 31, 2008			
	Total	Level 1	Level 2	Level 3
	(Amounts in thousands)			
Securities available for sale	$ 289,466	$ 340	$ 286,121	$ 3,005
Net Derivatives	(549)	-	(480)	(69)

The table below presents reconciliation for the period of January 1, 2008 to December 31, 2008, for all Level 3 assets and liabilities that are measured at fair value on a recurring basis.

	Fair Value Measurements Using Significant Unobservable Inputs	
	Securities Available for sale	Net Derivatives
	(Dollars in Thousands)	
Beginning Balance January 1, 2008	$ -	$ -
Total realized and unrealized gains or losses:		
Included in earnings	-	69
Included in other comprehensive income	(40)	-
Purchases, issuances and settlements	500	-
Transfers in and/or out of Level 3	2,545	-
Ending Balance	$ 3,005	$ 69

The Company utilizes a third party pricing service to provide valuations on its securities portfolio. Most of these securities are U.S. government agency debt obligations and agency mortgage-backed securities traded in active markets. The third party valuations are determined based on the characteristics of each security (such as maturity, duration, rating, etc.) and in reference to similar or comparable securities. Due to the nature and methodology of these valuations, the Company considers these fair value measurements as Level 2.

(20) – FAIR VAULES OF ASSETS AND LIABILITIES (Continued)

SFAS 159 allows an entity to make an irrevocable election to measure certain financial instruments at fair value. The changes in fair value from one reporting period to the next period must be reported in the income statement with additional disclosures to identify the effect on net income. The Company continued to account for securities available for sale at fair value as reported in prior years which is required by SFAS 115. Derivative activity is also reported at fair value as required by SFAS 133. Securities available for sale and derivative activity are reported on a recurring basis. Upon adoption of SFAS 159, no additional financial assets or liabilities were reported at fair value and there was no material effect on earnings.

The Company records loans in the ordinary course of business and does not record loans at fair value on a recurring basis. Loans are considered impaired when it is determined to be probable that all amounts due under the contractual terms of the loan will not be collected when due. Loans considered individually impaired are evaluated under the provisions of SFAS 114 and a specific allowance is established if required based on the most appropriate of the three measurement methods: present value of expected future cash flows, fair value of collateral, or the observable market price of a loan method. A specific allowance is required if the fair value of the expected repayments or the collateral is less than the recorded investment in the loan. At December 31, 2008, loans with a book value of $23.3 million were evaluated for impairment. Of this total, $19.0 million required a specific allowance totaling $2.8 million for a net fair value of $16.2 million. The methods used to determine the fair value of these loans were generally either the present value of expected future cash flows or fair value of collateral and were considered level three.

The table below presents the balances of assets and liabilities measured at fair value on a nonrecurring basis.

	At December 31, 2008			
	Total	Level 1	Level 2	Level 3
	(Amounts in thousands)			
Impaired loans	$ 16,223	$ -	$ -	$ 16,223
Foreclosed assets	5,745			5,745

(21) PARENT COMPANY FINANCIAL DATA

Southern Community Financial Corporation's condensed balance sheets as of December 31, 2008 and 2007 and its related condensed statements of operations and cash flows for each of the years in the three-year period ended December 31, 2008 are as follows:

Condensed Balance Sheets
December 31, 2008 and 2007
(Amounts in thousands)

	2008	2007
Assets:		
Cash and due from banks	$ 31,409	$ 7,795
Investment in subsidiary	202,509	178,174
Investment securities available for sale	1,223	783
Other assets	1,298	817
Total assets	$ 236,439	$ 187,569
Liabilities:		
Junior subordinated debentures	$ 45,877	$ 45,156
Other liabilities	2,605	74
Total liabilities	48,482	45,230
Stockholders' equity		
Preferred Stock	40,690	-
Common stock	119,054	119,101
Retained earnings	24,901	22,198
Accumulated other comprehensive income (loss)	3,312	1,040
Total stockholders' equity	187,957	142,339
Total liablilites and stockholders' equity	$ 236,439	$ 187,569

Condensed Statements of Operations
Years Ended December 31, 2008, 2007 and 2006
(Amounts in thousands)

	2008	2007	2006
Equity in income of subsidiaries	$ 8,242	$ 9,936	$ 6,216
Interest income	58	16	150
Other income	128	70	70
Interest expense	(3,202)	(3,184)	(2,740)
Other expense	(594)	(513)	(543)
Income tax benefit	1,222	1,229	1,045
Net income	5,854	7,554	4,198
Effective dividend on preferred stock	185	-	-
Net income available to common shareholders	$ 5,669	$ 7,554	$ 4,198

(21) PARENT COMPANY FINANCIAL DATA (Continued)

Condensed Statements of Cash Flows
Years Ended December 31, 2008, 2007 and 2006
(Amounts in thousands)

	2008	2007	2006
Operating activities:			
Net income	$ 5,854	$ 7,554	$ 4,198
Equity in income of subsidiaries	(8,242)	(9,936)	(6,216)
Amortization of debt issuance costs	51	51	51
(Increase) decrease in other assets	(23)	138	596
Increase in other liabilities	2,297	-	-
Net cash used by operating activities	(63)	(2,193)	(1,371)
Investing activities:			
Cash dividend from subsidiary	1,500	-	-
Purchase of investments	(500)	-	(550)
Net cash provided (used) by investing activities	1,000	-	(550)
Financing activities:			
Proceeds from issuance of preferred stock	42,750	-	-
Proceeds from issuance of long-term debt	-	10,000	-
Net proceeds from issuance of common stock	408	1,737	749
Investment in bank subsidiary	(15,000)	-	-
Cost of shares repurchased	(2,700)	(2,357)	(3,682)
Dividends paid common shareholders	(2,781)	(2,724)	(2,376)
Net cash provided (used) by financing activities	22,677	6,656	(5,309)
Net increase (decrease) in cash	23,614	4,463	(7,230)
Cash, beginning of year	7,795	3,332	10,562
Cash, end of year	$ 31,409	$ 7,795	$ 3,332

(22) SUBSEQUENT EVENTS

On January 23, 2009, the Company announced that its Board of Directors, at its regular meeting on January 21, 2009, declared a quarterly cash dividend of $0.04 per share on the Company's common stock, payable February 27, 2009 to shareholders of record on February 13, 2009.

On February 27, 2009, the FDIC also approved as a part of its restoration plan the imposition of a 20 basis point emergency special assessment on insured depository institutions as of June 30, 2009. The assessment will be collected on September 30, 2009. This final rule would also permit the FDIC to impose an emergency special assessment after June 30, 2009, of up to ten basis points if necessary to maintain public confidence in federal deposit insurance. Based on assessable deposit balances as of December 31, 2008, this special assessment, if implemented as approved, would equal approximately $2.5 million. This special assessment if implemented as proposed will have a significant impact on the results of operations of the Company for the quarter ending June 30, 2009 and the full year 2009.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Southern Community Financial Corporation's management, with the participation of its Chief Executive Officer and its Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of December 31, 2008. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of December 31, 2008.

Management's Report On Internal Control Over Financial Reporting

Management of Southern Community Financial Corporation and Subsidiary (the "Company") is responsible for establishing and maintaining effective internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Under the supervision and with the participation of management, including the principal executive officer and principal financial officer, the Company conducted an evaluation of the effectiveness of internal control over financial reporting, including controls over the preparation of financial statements in accordance with the instructions to the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C), based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation under the framework in Internal Control – Integrated Framework, management of the Company has concluded the Company maintained effective internal control over financial reporting as of December 31, 2008.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting can also be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. 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.

Management is also responsible for compliance with laws and regulations relating to safety and soundness which are designated by the FDIC and the appropriate federal banking agency. Management assessed its compliance with these designated laws and regulations relating to safety and soundness and believes that the Company complied, in all significant respects, with such laws and during the year ended December 31, 2008.

Dixon Hughes PLLC, an independent, registered public accounting firm, has audited the Company's consolidated financial statements as of and for the year ended December 31, 2008 included in this annual report, and has issued an attestation report on management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2008, which is included herein.

Changes in Internal Controls over Financial Reporting

The Company assesses the adequacy of its internal control over financial reporting quarterly and enhances its controls in response to internal control assessments and internal and external audit and regulatory recommendations. No such control enhancements during the quarter ended December 31, 2008 have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

DIXON HUGHES PLLC
Certified Public Accountants and Advisors

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders
Southern Community Bank & Trust

We have audited Southern Community Financial Corporation and Subsidiary (the "Company")'s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included, performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because management's assessment and our audit were conducted to also meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), management's assessment and our audit of the Company's internal control over financial reporting included controls over the preparation of financial statements in accordance with the instructions to the Consolidated Financial Statements for Bank Holding Companies (form FR Y-9 C). A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. 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.

In our opinion, Southern Community Financial Corporation and Subsidiary maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of Southern Community Financial Corporation and Subsidiary as of and for the year ended December, 31, 2008, and our report dated March 16, 2009, expressed an unqualified opinion on those consolidated financial statements.

We do not express an opinion or any other form of assurance on management's statement referring to compliance with designated laws and regulations related to safety and soundness.

/s/ Dixon Hughes PLLC

Raleigh, North Carolina
March 16, 2009

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Incorporated by reference from the Company's definitive proxy statement, to be filed with the Securities and Exchange Commission with respect to the Annual Meeting of Shareholders to be held on May 26, 2009.

Item 11. Executive Compensation

Incorporated by reference from the Company's definitive proxy statement, to be filed with the Securities and Exchange Commission with respect to the Annual Meeting of Shareholders to be held on May 26, 2009.

Item 12. Security Ownership of Certain Beneficial Owners and Management

Incorporated by reference from the Company's definitive proxy statement, to be filed with the Securities and Exchange Commission with respect to the Annual Meeting of Shareholders to be held on May 26, 2009.

The following table sets forth equity compensation plan information at December 31, 2008.

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercised of outstanding options warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders			
Stock Option Plans	744,266	$ 9.58	503,911
Employee Stock Purchase Plan	14,591	$ 6.72	889,400
Equity compensation plans not approved by security holders	N/A	N/A	N/A
Total	758,857	$ 9.53	1,393,311

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

Incorporated by reference from the Company's definitive proxy statement, to be filed with the Securities and Exchange Commission with respect to the Annual Meeting of Shareholders to be held on May 26, 2009.

Item 14. Principal Accountant Fees and Services

Incorporated by reference from the Company's definitive proxy statement, to be filed with the Securities and Exchange Commission with respect to the Annual Meeting of Shareholders to be held on May 26, 2009.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a)(1) Financial Statements. The following financial statements and supplementary data are included in Item 8 of this report.

Exhibit No.	Description
Exhibit 3.1:	Articles of Incorporation (incorporated by reference to Exhibit 3(i) to the Current Report on Form 8-K dated October 1, 2001)
Exhibit 3.2:	Bylaws
Exhibit 3.3:	Amendment to Articles of Incorporation (incorporated by reference to Exhibit 3.3 to the Annual Report on Form 10-K for the year ended December 31, 2001 (“2001 Annual Report”))
Exhibit 4.1:	Specimen certificate for Common Stock of Southern Community Financial Corporation (incorporated by reference to Exhibit 4 to the Current Report on Form 8-K dated October 1, 2001)
Exhibit 4.2:	Form of 7.95% Junior Subordinated Debenture (incorporated by reference to Exhibit 4.2 to the Registration Statement on Form S-3 dated September 26, 2003, Registration No. 333-109167 (the “S-3 Registration Statement”))
Exhibit 4.3:	Form of Certificate for 7.95% Trust Preferred Security of Southern Community Capital Trust II (incorporated by reference to Exhibit 4.6 to the S-3 Registration Statement)
Exhibit 10.1:	1997 Incentive Stock Option Plan of Southern Community Financial Corporation (incorporated by reference to Exhibit 10.1 to Amendment Number One to the Registration Statement on Form S-2 dated January 10, 2002, Registration Number 333-74084 (the “Amended S-2 Registration Statement”))
Exhibit 10.2:	1997 Non-Statutory Stock Option Plan of Southern Community Financial Corporation (incorporated by reference to Exhibit 10.2 to the Amended S-2 Registration Statement)
Exhibit 10.3:	2002 Incentive Stock Option Plan of Southern Community Financial Corporation (incorporated by reference to Exhibit 10.7 to the Annual Report on Form 10-K for the year ended December 31, 2003 (“2003 Annual Report”))
Exhibit 10.4:	2002 Non-Statutory Stock Option Plan of Southern Community Financial Corporation (incorporated by reference to Exhibit 10.8 to the 2003 Annual Report)
Exhibit 10.5:	Indenture with respect to the Company’s 7.95% Junior Subordinated Debentures (incorporated by reference to Exhibit 10.9 to the 2003 Annual Report)
Exhibit 10.6:	Amended and Restated Trust Agreement of Southern Community Capital Trust II (incorporated by reference to Exhibit 10.10 to the 2003 Annual Report)
Exhibit 10.7:	Guarantee Agreement for Southern Community Capital Trust II (incorporated by reference to Exhibit 10.11 to the 2003 Annual Report)

Exhibit 10.8:	Agreement as to Expenses and Liabilities with respect to Southern Community Capital Trust II (incorporated by reference to Exhibit 10.12 to the 2003 Annual Report)
Exhibit 10.9:	2002 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.13 to the 2003 Annual Report)
Exhibit 10.10:	The Community Bank Amended and Restated Stock Option Plan for Key Employees (incorporated by reference to Exhibit 4.2 to the Registration Statement on Form S-8 dated April 29, 2004, Registration Number 333-114997)
Exhibit 10.11:	2001 Incentive Stock Option Plan of Southern Community Financial Corporation (incorporated by reference to Exhibit 4.2 to the Registration Statement on Form S-8 dated April 29, 2004, Registration Number 333-114993)
Exhibit 10.12:	2001 Stock Option Plan for Directors of Southern Community Financial Corporation (incorporated by reference to Exhibit 4.2 to the Registration Statement on Form S-8 dated April 29, 2004, Registration Number 333-114991)
Exhibit 10.13:	2006 Nonstatutory Stock Option Plan of Southern Community Financial Corporation (incorporated by reference to Exhibit 4.2 to the Registration Statement on Form S-8 dated November 11, 2006, Registration Number 333-138601)
Exhibit 10.14:	Employment Agreement with F. Scott Bauer (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2006 ("2006 First Quarter Form 10-Q"))
Exhibit 10.15:	Employment Agreement with Jeff T. Clark (incorporated by reference to Exhibit 10.2 to the 2006 First Quarter Form 10-Q)
Exhibit 10.16:	Amended & Restated Salary Continuation Agreement of F. Scott Bauer (incorporated by reference to Exhibit 10.1 to the 2007 First Quarter Form 10-Q)
Exhibit 10.17:	Amended & Restated Salary Continuation Agreement of Jeff T. Clark (incorporated by reference to Exhibit 10.2 to the 2007 First Quarter Form 10-Q)
Exhibit 10.18:	Employment Agreement with James C. Monroe, Jr. (incorporated by reference to the Annual Report of Form 10-K for the year ended December 31, 2007)
Exhibit 10.19:	Amendment Number One to Employment Agreement with F. Scott Bauer (incorporated by reference to Exhibit 10.1 to the 2007 Third Quarter Form 10-Q)
Exhibit 10.20:	Amendment Number One to Employment Agreement with Jeff T. Clark (incorporated by reference to Exhibit 10.2 to the 2007 Third Quarter Form 10-Q)
Exhibit 10.21:	Amendment Number One to Employment agreement with James C. Monroe, Jr. (incorporated by reference to Exhibit 10.3 to the 2007 Third Quarter Form 10-Q)
Exhibit 10.22:	Salary Continuation Agreement with James C. Monroe, Jr. (incorporated by reference to Exhibit 10.22 to the Annual Report on Form 10-K for the year ended December 31, 2007)
Exhibit 10.23:	Amendment Number One to Salary Continuation Agreement with James C. Monroe, Jr. (incorporated by reference to Exhibit 10.23 to the Annual Report on Form 10-K for the year ended December 31, 2007)
Exhibit 10.24:	Addendum A to Split Dollar Agreement with F. Scott Bauer (incorporated by reference to Exhibit 10.24 to the Annual Report on Form 10-K for the year ended December 31, 2007)
Exhibit 10.25:	Addendum A to Split Dollar Agreement with Jeff T. Clark (incorporated by reference to Exhibit 10.25 to the Annual Report on Form 10-K for the year ended December 31, 2007)
Exhibit 10.26:	Employment Agreement with James Hastings (incorporated by reference to Exhibit 10.1 to the Current report on Form 8-K dated June 17, 2008)
Exhibit 10:27:	Salary Continuation Agreement with James Hastings (incorporated by reference to Exhibit 10.2 to the Current report on Form 8-K dated June 17, 2008)
Exhibit 10.28	Waiver Agreement and Acknowledgement with F. Scott Bauer
Exhibit 10.29	Waiver Agreement and Acknowledgement with Jeffrey T. Clark
Exhibit 10.30	Waiver Agreement and Acknowledgement with Robert L. Davis, Jr.
Exhibit 10.31	Waiver Agreement and Acknowledgement with James Hastings
Exhibit 10.32	Waiver Agreement and Acknowledgement with James C. Monroe, Jr.
Exhibit 10.33:	Amendment Number Two to Employment Agreement with James C. Monroe, Jr.
Exhibit 10.34:	Amendment Number One to Salary Continuation Agreement with F. Scott Bauer
Exhibit 10.35:	Amendment Number One to Salary Continuation Agreement with Jeff T. Clark
Exhibit 10.36:	Amendment Number One to Salary Continuation Agreement with James Hastings

Exhibit 10.37:	Amendment Number One to Employment Agreement with James Hastings
Exhibit 10.38:	Amendment Number Two to Employment Agreement with F. Scott Bauer
Exhibit 10.39:	Amendment Number Two to Employment Agreement with Jeff T. Clark
Exhibit 10.40:	Amendment Number One to Salary Continuation Agreement with Robert L. Davis
Exhibit 10.41:	Amendment Number Two to Employment Agreement with Robert L. Davis
Exhibit 10.42:	Amendment Number Two to Salary Continuation Agreement with James C. Monroe, Jr.
Exhibit 10.43:	Amendment Number Three to Employment Agreement with James C. Monroe, Jr.
Exhibit 21:	Subsidiaries of the Registrant
Exhibit 23:	Consent of Dixon Hughes PLLC
Exhibit 31.1:	Rule 13a-14(a)/15d-14(a) Certification by Chief Executive Officer
Exhibit 31.2:	Rule 13a-14(a)/15d-14(a) Certification by Chief Financial Officer
Exhibit 32:	Section 1350 Certifications

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on behalf of the undersigned, thereunto duly authorized.

SOUTHERN COMMUNITY FINANCIAL CORPORATION

Date: March 16, 2009

By: */s/ F, Scott Bauer*
F. Scott Bauer
Chairman and Chief Executive Officer
(principal executive officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

SIGNATURE	TITLE	DATE
/s/ F. Scott Bauer F. Scott Bauer	Chairman of the Board and Chief Executive Officer (principal executive officer)	March 16, 2009
/s/ James Hastings James Hastings	Executive Vice President and Chief Financial Officer (principal financial and accounting officer)	March 16, 2009
/s/ Edward T. Brown Edward T. Brown	Director	March 16, 2009
/s/ James G. Chrysson James G. Chrysson	Director	March 16, 2009
/s/ James O. Frye James O. Frye	Director	March 16, 2009
/s/ Matthew G. Gallins Matthew G. Gallins	Director	March 16, 2009
/s/ Beverly H. Godfrey Beverly H. Godfrey	Director	March 16, 2009

SIGNATURE	TITLE	DATE
/s/ Lynn L. Lane Lynn L. Lane	Director	March 16, 2009
/s/ H. Lee Merritt, Jr. H. Lee Merritt, Jr.	Director	March 16, 2009
/s/ Stephen L. Robertson Stephen L. Robertson	Director	March 16, 2009
/s/ W. Samuel Smoak W. Samuel Smoak	Director	March 16, 2009
William G. Ward, Sr., M.D.	Director	March 16, 2009