

FIRST RELIANCE BANCSHARES INC
Form 10-K
March 31, 2008

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-K

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

(Mark One)

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

For the fiscal year ended December 31, 2007

OR

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

For the transition period from _____ to _____

Commission File Number 000-49757

FIRST RELIANCE BANCSHARES, INC.
(Exact Name of Registrant as Specified in its Charter)

South Carolina
(State of Incorporation)

80-0030931
(I.R.S. Employer Identification No.)

2170 W. Palmetto Street, Florence, South Carolina
(Address of Principal Executive Offices)

29501
(Zip Code)

(843) 656-5000
(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act:
None

Securities Registered Pursuant to Section 12(g) of the Act:
Common Stock, \$0.01 Par Value

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (229.405 of this chapter) 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 the definitions of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

The aggregate market value of the registrant's outstanding common stock held by nonaffiliates of the registrant as of June 30, 2007, was approximately \$41.7 million, based on the registrant's closing sales price of \$14.00 as reported on the Over-the Counter Bulletin Board on June 29, 2007. There were 3,513,174 shares of the registrant's common stock outstanding as of March 14, 2008.

DOCUMENTS INCORPORATED BY REFERENCE

| Document | Parts Into Which Incorporated |
|---|-------------------------------|
| Annual Report to Shareholders for the Year Ended December 31, 2007 | Part II |
| Proxy Statement for the Annual Meeting of Shareholders to be held June 19, 2008 | Part III |

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PART I

ITEM 1. BUSINESS

Special Cautionary Notice Regarding Forward-Looking Statements

This Report contains statements that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and the Securities Exchange Act of 1934. Various matters discussed in this document and in documents incorporated by reference herein, including matters discussed under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” may constitute forward-looking statements for purposes of the Securities Act and the Securities Exchange Act. These forward-looking statements are based on many assumptions and estimates and are not guarantees of future performance, and may involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of First Reliance Bancshares, Inc. (the “Company”) or its wholly owned subsidiary, First Reliance Bank (the “Bank”), to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. The words “expect,” “anticipate,” “intend,” “plan,” “believe,” “seek,” “estimate,” and similar expressions are intended to identify such forward-looking statements. The Company’s and the Bank’s actual results may differ materially from the results anticipated in these forward-looking statements due to a variety of factors, including, without limitation:

- significant increases in competitive pressure in the banking and financial services industries;
- changes in the interest rate environment that could reduce anticipated or actual margins;
- changes in political conditions or the legislative or regulatory environment;
- general economic conditions, either nationally or regionally and especially in our primary service area, becoming less favorable than expected resulting in, among other things, a deterioration in credit quality;
- changes occurring in business conditions and inflation;
- changes in technology;
- changes in monetary and tax policies;
- the level of allowance for loan loss;
- the rate of delinquencies and amounts of charge-offs;
- the rates of loan growth;
- adverse changes in asset quality and resulting credit risk-related losses and expenses;
- changes in the securities markets; and
- other risks and uncertainties detailed from time to time in our filings with the Securities and Exchange Commission.

All written or oral forward-looking statements attributable to the Company are expressly qualified in their entirety by these cautionary statements.

General

The Company was incorporated under the laws of the State of South Carolina on April 12, 2001 to be the holding company for First Reliance Bank (the "Bank"), and acquired all of the shares of the Bank on April 1, 2002 in a statutory share exchange. The Bank, a South Carolina banking corporation, is the Company's only subsidiary, and the Company conducts no business other than through its ownership of the Bank. The Company has no indirect subsidiaries or special purpose entities. The Bank commenced operations in August 1999 and currently operates out of its main office, 4 branch offices, and three loan production offices. The Bank serves the Florence, Lexington, Charleston, Greenville, Myrtle Beach, and Rock Hill areas in South Carolina as an independent, community-oriented commercial bank emphasizing high-quality, responsive and personalized service. The Bank provides a broad range of consumer and commercial banking services, concentrating on individuals and small and medium-sized businesses desiring a high level of personalized services. The Bank continues to focus on its Easy To Do Business With(TM) standard of banking by offering products and services including: Totally FREE Checking, Totally FREE Business Checking, FREE Coin Machines, a 5 Way Mortgage Service Promise, a Nationwide NO FEE ATM Network, and 8-8 Extended Hours in their Florence, Lexington, and Mt. Pleasant locations.

Marketing Focus

The Bank advertises aggressively, using popular forms of media and direct mail, to target market segments and emphasizes the Bank's substantial local ownership, community bank nature, locally oriented operations and ability to provide prompt, knowledgeable and personalized service.

Location and Service Area

The executive or main office facilities of the Company and the Bank are located at 2170 W. Palmetto Street, Florence, South Carolina 29501. The Bank also has branches located at 411 Second Loop Road, Florence, South Carolina, 709 North Lake Drive, Lexington, South Carolina, 800 South Shelmore Blvd., Mount Pleasant, South Carolina and 51 Cumberland Street, Suite 101, Charleston, South Carolina. The Bank's primary market areas are the cities of Florence, Lexington, Charleston, Myrtle Beach, Rock Hill, Greenville and the surrounding areas.

According to the South Carolina Department of Commerce, in 2000, Florence County had an estimated population of 125,761. Florence County, which covers approximately 805 square miles, is located in the eastern portion of South Carolina and is bordered by Darlington, Marlboro, Dillon, Williamsburg, Marion, Clarendon, Sumter and Lee Counties. Florence County has a number of large employers, including, Wellman, Inc., Honda, Nan Ya Plastics, ESAB, McLeod Regional Medical Center, and Carolinas Medical Center. The principal components of the economy of Florence County are the wholesale and retail trade sector, the manufacturing sector, the services sector and the financial, insurance and real estate sector.

First Reliance Bank opened a branch office at 709 North Lake Drive, Lexington, South Carolina in 2004. Lexington County had an estimated population in 2003 of 226,528. The primary market area is the City of Lexington and the surrounding areas of Lexington County, South Carolina. Lexington County is centrally located in the Midlands of South Carolina just outside the capital city in Columbia and is bordered by Richland, Newberry, Saluda, Aiken, Orangeburg and Calhoun Counties. Lexington County has a number of large employers, including, Westinghouse Electric Corporation, Michelin North America, Winnsboro Assembly Opera, Amick Farms, Inc., and Bose Corporation. Lexington County is a major transportation crossroads for the Midlands with I-26, I-77 and I-20 bordering or running through the county. The Columbia Metropolitan Airport is located in Lexington County, just 10 miles from the town of Lexington, and is the Southeastern hub for United Parcel Service. The principal components of the economy of Lexington County are the wholesale and retail trade sector, the manufacturing sector, the government sector, the services sector and the financial, insurance and real estate sector.

First Reliance Bank opened a branch office in Mount Pleasant, South Carolina as well a branch office in Charleston, South Carolina in 2005. Charleston County has a population of 309,969 and the Metro Area has a population of 549,033 according to the 2000 census. Charleston is located on the central and southern east coast surrounded by Berkeley and Dorchester counties. Major employers in the area include US Navy, Medical University of South Carolina, and the Charleston Air Force Base.

First Reliance Bank opened a loan production office in Greenville, SC. Greenville has a population of 407,383 according to the 2000 census. Greenville is the most populated region in South Carolina and is home to Michelin, BMW, General Electric, Robert Bosch, Lockheed Martin, and Bowater.

First Reliance Bank opened a loan production office in Myrtle Beach, South Carolina. Myrtle Beach is located in Horry County which had an estimated population of 210,757 in 2004. Myrtle Beach's largest manufacturing employers are AVX Corporation, Sun Publishing Company, and Precision Southeast, Inc.

First Reliance Bank opened a loan production office in Rock Hill, SC. Rock Hill is the largest city in York County, SC, and a satellite city of Charlotte, NC. According to 2006 estimates the population was 61,620 making it the fourth largest city in South Carolina. The city is included in the Charlotte-Gastonia-Concord metropolitan statistical which has a population of 1,521,278 according to the 2005 estimate by the U.S. Census Bureau.

Banking Services

The Bank strives to provide its customers with the breadth of products and services comparable to those offered by large regional banks, while maintaining the quick response and personal service of a locally owned and managed bank. In addition to offering a full range of deposit services and commercial and personal loans, the Bank offers investment services and products such as mortgage loan origination, wholesale mortgage services and title insurance services.

The Bank continues to focus on its Easy To Do Business With(TM) standard of banking by continuously introducing new innovative products and services all with the goal of providing our customers a convenient and first class banking experience. To allow our customers immediate access to their deposits, the Bank introduced Same Day Banking in 2007, extending the cutoff time for transactions until 8:00pm Monday through Friday. The Bank also added Easy Link Remote Deposit Capture to its suite of convenient products and services, making it quick and easy for our business customers to make their deposits from their place of business. In addition, the Bank announced that we will now remain open on six traditional bank holidays in 2008.

First Reliance, has been recognized for its success including being named to The Top 25 Fastest Growing Companies(TM) in South Carolina four times. For the past two consecutive years, we have been named One of the Best Places to Work in SC(TM).

The Bank seeks to promote continuous long-term relationships. Because management of the Bank is located in Florence, Lexington, Charleston, Greenville, Rock Hill, and Myrtle Beach, South Carolina, all credit and related decisions are made locally, which facilitates prompt responses by persons familiar with the borrower's local business environment.

Deposit Services. The Bank offers a full range of deposit services that are typically available in most banks and savings and loan associations, including checking accounts, NOW accounts, savings accounts and other time deposits of various types, ranging from daily money market accounts to longer-term certificates of deposit. The transaction accounts and time certificates are tailored to the Bank's principal market area at rates competitive to those offered by other banks in the area. In addition, the Bank offers certain retirement account services, such as Individual Retirement Accounts. The Bank also offers free courier service for business accounts. All deposit accounts are insured by the FDIC up to the maximum amount allowed by law. The Bank solicits these accounts from individuals, businesses, associations and organizations and governmental authorities.

Loan Products. The Bank offers a full range of commercial and consumer loans, as well as real estate, construction and acquisition loans. Commercial loans are extended primarily to small and middle market customers. Such loans include both secured and unsecured loans for working capital needs (including loans secured by inventory and accounts receivable), business expansion (including acquisition of real estate and improvements), asset acquisition and agricultural purposes. Commercial term loans generally will not exceed a five-year maturity and may be based on a ten or fifteen-year amortization. The extensions of term loans are based upon (1) the ability and stability of current management; (2) earnings and trends in cash flow; (3) earnings projections based on reasonable assumptions; (4) the financial strength of the industry and the business itself; and (5) the value and marketability of the collateral. In considering loans for accounts receivable and inventory, the Bank generally uses a declining scale for advances based on an aging of the accounts receivable or the quality and utility of the inventory. With respect to loans for the acquisition of equipment and other assets, the terms depend on the economic life of the respective assets.

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As of December 31, 2007, the classification of the commercial loans of the Bank and the respective percentage of the Bank's total loan portfolio of each are as follows:

| Description | Total Outstanding as of December 31, 2007 | Percentage of Total Loan Portfolio |
|---|---|--|
| Loans to finance agricultural production and other farm loans | \$ - | -% |
| Commercial and industrial loans | \$ 67,772 | 14% |

Commercial loans involve significant risk because there is generally a small market available for an asset held as collateral that needs to be liquidated. Commercial loans for working capital needs are typically difficult to monitor.

As of December 31, 2007, the classification of the consumer loans of the Bank and the respective percentage of the Bank's total loan portfolio of each are as follows:

| Description | Total Outstanding as of December 31, 2007 | Percentage of Total Loan Portfolio |
|---|---|---------------------------------------|
| Individuals (household, personal, single pay, installment and other) | \$ 10,362 | 2% |
| Individuals (household, family, personal credit cards and overdraft protection) | \$ 1,035 | 1% |
| All other consumer loans | \$ 7,774 | 1% |

The risks associated with consumer lending are largely related to economic conditions and increase during economic downturns. Other major risk factors relating to consumer loans include high debt to income ratios and poor loan-to-value ratios. All of the consumer loans set forth above require a debt service income ratio of no greater than 36% based on gross income.

The Bank's lending activities are subject to a variety of lending limits imposed by federal law. Under South Carolina law, loans by the Bank to a single customer may not exceed 10% of the Bank's unimpaired capital, except that by two-thirds vote of the directors of the Bank such limit may be increased to 15% of the Bank's unimpaired capital. The Bank's Board of Directors has approved that increase in its lending limit. Based on the Bank's unimpaired capital as of December 31, 2007, the Bank's lending limit to a single customer is approximately \$8.0 million. Even with the increase, the size of the loans that the Bank is able to offer to potential customers is less than the size of the loans that the Bank's competitors with larger lending limits are able to offer. This limit affects the ability of the Bank to seek relationships with the area's larger businesses. However, the Bank may request other banks to participate in loans to customers when requested loan amounts exceed the Bank's legal lending limit.

Mortgage Loan Division. The Bank has established a mortgage loan division through which it has broadened the range of services that it offers to its customers. The mortgage loan division originates secured real estate loans to purchase existing or to construct new homes and to refinance existing mortgages. The following are the types of real estate loans originated by the Bank and the general loan-to-value limits set by the Bank with respect to each type.

| | |
|---|-----|
| · Raw Land | 65% |
| · Land Development | 75% |
| · Commercial, multifamily and other nonresidential construction | 80% |
| · One to four family residential construction | 85% |
| · Improved property | 85% |

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- Owner occupied, one to four family and home equity 90% (or less)
- Commercial property 80% (or less)

As of December 31, 2007, the classification of the mortgage loans of the Bank and the respective percentage of the Bank's total loan portfolio of each are as follows:

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| Description | Total Amount as of December 31, 2007 | Percentage of Total Loan Portfolio |
|--|--------------------------------------|------------------------------------|
| Secured by non-farm, non-residential properties | \$ 189,265 | 39% |
| Construction and land development | \$ 65,432 | 13% |
| Farmland (including farm residential and other improvements) | \$ 6,727 | 1% |
| Revolving, open end loans secured by 1-4 family extended under line of credit | \$ 39,504 | 8% |
| All other loans secured by 1-4 family residential (1 st lien) | \$ 85,861 | 18% |
| All other loans secured by 1-4 family residential (junior lien) | \$ 4,611 | 1% |
| Secured by multi-family (5 or more) residential properties - condos and apartments | \$ 9,823 | 2% |

Of the loan types listed above, commercial real estate loans are generally more risky because they are the most difficult to liquidate. Construction loans also involve risks due to weather delays and cost overruns.

The Bank generates additional fee income by selling most of its mortgage loans in the secondary market and cross-selling other products and services to its mortgage customers. In 2007, the Bank sold mortgage loans in a total amount of approximately \$146,067,873 or 56% of the total number of mortgage loans originated by the Bank.

The Bank does not originate or hold subprime residential mortgage loans which were originally intended for sale on the secondary mortgage market.

All FHA, VA and State Housing loans sold by the Bank involve the right to recourse. The FHA and VA loans are subject to recourse if the loan shows 60 days or more past due in the first 4 months or goes in to foreclosure within the first 12 months. The State Housing loans are subject to recourse if the loan becomes delinquent prior to purchase by State Housing or if final documentation is not delivered within 90 days of purchase. All investors have a right to require the Bank to repurchase a loan in the event the loan involved fraud. In 2007, of the 980 loans sold by the Bank, 19 were FHA or VA loans and 43 were State Housing loans. Such loans represented .46% of the dollar volume or 6.3% of the total number of loans sold by the Bank in 2007.

In addition, an increase in interest rates may decrease the demand for consumer and commercial credit, including real estate loans. Net fees from residential mortgage originations were \$1.8 million, or 4.23%, of our gross revenue in 2007. We expect to originate more real estate loans in 2008 with the addition of more mortgage originators. Accordingly, a period of rising interest rates could negatively affect our residential mortgage origination business.

Other Banking Services. First Reliance Bank focuses heavily on personal customer service and offers a full range of financial services. Personal products include Totally FREE Checking, and savings accounts, money market accounts, CDs and IRAs, and personal mortgage loans, while business products include Totally FREE Business checking and savings accounts, commercial lending services, money market accounts, and business deposit courier service. In September 2004, the Company began offering Wholesale Mortgage Services and Title Insurance Services. In December 2004, the Company began offering business customers a courier service. The Company also provides Internet banking, electronic bill paying services, free ATMs, free coin machines at all branches, and an overdraft privilege to its customers. The Company's stock is traded on the OTC Bulletin Board under the symbol "FSRL". Information about the Company is available on our website at <http://firstreliance.com>.

2007 was a year of growth and expansion. Focusing on our Easy To Do Business With standard of banking, we introduced new innovative products and increased our locations, all with the goal of providing our customers a convenient and first class banking experience.”

Much of our loan and deposit growth can be attributed to these new innovative and competitive products. To allow our customers immediate access to their deposits, we introduced Same Day Banking, extending the cutoff time for transactions until 8pm Monday through Friday. We also added Remote Deposit Capture to our suite of convenient products and services, making it quick and easy for our business customers to make their deposits from their place of business. In addition, we announced that we will now remain open on 6 traditional bank holidays in 2008.

In line with our Easy to Do Business With standard, our 2007 expansion efforts included a new regional headquarters in Lexington, a full service branch in Mount Pleasant, and loan production offices in Rock Hill, Greenville, and Myrtle Beach. Our expansion efforts proved successful as we have seen a record number of new accounts and a strong growth in services per household.

We believe that the quality of our work environment has a direct impact on our customers' experience. Providing a great place to work, allows us to recruit and retain high performing associates. For the past two consecutive years, we have been named One of the Best Places to Work in SC. A positive and high quality work environment along with our Easy to Do Business With standard of banking has earned us a customer satisfaction rating of 94.7%.

First Reliance's strong balance sheet growth led it to be recognized as one of South Carolina's Top 25 Fastest Growing Companies™ by Elliott Davis, LLC, in association with the SC Chamber of Commerce. The most recent award is the fourth time First Reliance has received this distinction, and it is the only SC bank to receive this honor this many times.

Investments. In addition to its loan operations, the Bank makes other investments primarily in obligations of the United States or obligations guaranteed as to principal and interest by the United States and other taxable securities. The Bank also invests in certificates of deposits in other financial institutions. The amount invested in such time deposits, as viewed on an institution by institution basis, does not exceed \$100,000. Therefore, the amounts invested in certificates of deposit are fully insured by the FDIC. No investment held by the Bank exceeds any applicable limitation imposed by law or regulation. Our Finance Committee reviews the investment portfolio on an ongoing basis to ascertain investment profitability and to verify compliance with the Bank's investment policies.

Other Services. In addition to its banking services, the Bank offers securities brokerage services and life insurance products to its customers through a financial services division of the Bank. The Bank obtained an insurance agency license under South Carolina law to sell life insurance and has relationships with brokers and carriers. The Bank's financial services division uses professional money managers who diversify a client's portfolio into several different asset classes. Some of the products offered are mutual funds, annuities, stocks, bonds, insurance, IRAs and 401(k) rollovers.

Competition

The Bank faces strong competition for deposits, loans and other financial services from numerous other banks, thrifts, credit unions, other financial institutions and other entities that provide financial services, some of which are not subject to the same degree of regulation as the Bank. Because South Carolina law permits statewide branching by banks and savings and loan associations, many financial institutions in the state have branch networks. In addition, subject to certain conditions, South Carolina law permits interstate banking. Reflecting this opportunity provided by law plus the growth prospects of the Charleston, Florence and Lexington markets, all of the five largest (in terms of local deposits) commercial banks in our market are branches of or affiliated with regional or super-regional banks.

As of June 30, 2006, 30 banks and five savings institutions operated 236 offices within Charleston, Florence and Lexington Counties. All of these institutions aggressively compete for business in the Bank's market area. Some of these competitors have been in business for many years have established customer bases, are larger than the Bank, have substantially higher lending limits than the Bank has and are able to offer certain services, including trust and international banking services, that the Bank is able to offer only through correspondents, if at all.

The Bank currently conducts business principally through its five branches in Charleston, Florence and Lexington Counties, South Carolina. Based upon data available on the FDIC website as of June 30, 2007, the Bank's total deposits ranked 8th among financial institutions in our market area, representing approximately 3.6% of the total deposits in our market area. The table below shows our deposit market share in the counties we serve according to data from the FDIC website as of June 30, 2007.

| Market | Number of Branches | Our Market Deposits | Total Market Deposits | Ranking | Market Share Percentage (%) |
|------------------------------|--------------------|---------------------|-----------------------|---------|-----------------------------|
| (Dollar amounts in millions) | | | | | |
| South Carolina | | | | | |
| Charleston County | 2 | \$ 68 | \$ 7,108 | 14 | 1.0% |
| Florence County | 2 | 273 | 2,097 | 3 | 13.0 |
| Lexington County | 1 | 84 | 2,582 | 7 | 3.3 |
| First Reliance Bank | 5 | \$ 426 | \$ 11,787 | 8 | 3.6% |

The Bank competes based on providing its customers with high-quality, prompt and knowledgeable personalized service at competitive rates, which is a combination that the Bank believes customers generally find lacking at larger institutions. The Bank offers a wide variety of financial products and services at fees that it believes are competitive with other financial institutions.

Employees

On December 31, 2007, the Bank had 141 full-time employees and 23 part-time employees. The executive officers of the Company are the only officers of the Company, but they receive no compensation from the Company. The Company has no employees.

Supervision and Regulation

Both the Company and the Bank are subject to extensive state and federal banking regulations that impose restrictions on and provide for general regulatory oversight of their operations. These laws generally are intended to protect depositors and not shareholders. Legislation and regulations authorized by legislation influence, among other things:

- how, when and where we may expand geographically;

- into what product or service market we may enter;

- how we must manage our assets; and

- under what circumstances money may or must flow between the parent bank holding company and the subsidiary bank.

Set forth below is an explanation of the major pieces of legislation affecting our industry and how that legislation affects our actions. The following summary is qualified by reference to the statutory and regulatory provisions

discussed. Changes in applicable laws or regulations may have a material effect on our business and prospects, and legislative changes and the policies of various regulatory authorities may significantly affect our operations. We cannot predict the effect that fiscal or monetary policies, or new federal or state legislation may have on our business and earnings in the future.

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First Reliance Bancshares, Inc.

Since the Company owns all of the capital stock of the Bank, it is a bank holding company under the federal Bank Holding Company Act of 1956. As a result, the Company is primarily subject to the supervision, examination, and reporting requirements of the Bank Holding Company Act and the regulations of the Federal Reserve.

Acquisitions of Banks. The Bank Holding Company Act requires every bank holding company to obtain the Federal Reserve's prior approval before:

- acquiring direct or indirect ownership or control of any voting shares of any bank if, after the acquisition, the bank holding company will directly or indirectly own or control more than 5% of the bank's voting shares;
- acquiring all or substantially all of the assets of any bank; or
- merging or consolidating with any other bank holding company.

Additionally, the Bank Holding Company Act provides that the Federal Reserve may not approve any of these transactions if it would result in or tend to create a monopoly or, substantially lessen competition or otherwise function as a restraint of trade, unless the anti-competitive effects of the proposed transaction are clearly outweighed by the public interest in meeting the convenience and needs of the community to be served. The Federal Reserve is also required to consider the financial and managerial resources and future prospects of the bank holding companies and banks concerned and the convenience and needs of the community to be served. The Federal Reserve's consideration of financial resources generally focuses on capital adequacy, which is discussed below.

Under the Bank Holding Company Act, if adequately capitalized and adequately managed, the Company or any other bank holding company located in South Carolina may purchase a bank located outside of South Carolina. Conversely, an adequately capitalized and adequately managed bank holding company located outside of South Carolina may purchase a bank located inside South Carolina. In each case, however, restrictions may be placed on the acquisition of a bank that has only been in existence for a limited amount of time or will result in specified concentrations of deposits. For example, South Carolina law prohibits a bank holding company from acquiring control of a financial institution until the target financial institution has been incorporated for five years. As a result, no bank holding company may acquire control of the Company until after the fifth anniversary date of the Bank's incorporation. Because the Bank has not been incorporated for more than five years, this limitation does apply to the Bank and the Company.

Additionally, In July 1994, South Carolina enacted legislation which effectively provided that, after June 30, 1996, out-of-state bank holding companies may acquire other banks or bank holding companies in South Carolina, subject to certain conditions. Accordingly, effective July 1, 1996, South Carolina law was amended to permit interstate branching but not de novo branching by an out-of-state bank. The Company believes that the foregoing legislation has increased takeover activity of South Carolina financial institutions by out-of-state financial institutions.

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

- the bank holding company has registered securities under Section 12 of the Securities Exchange Act of 1934; or
- no other person owns a greater percentage of that class of voting securities immediately after the transaction.

Our common stock is registered under Section 12 of the Securities Exchange Act of 1934. The regulations provide a procedure for challenging any rebuttable presumption of control.

Permitted Activities. The Bank Holding Company Act has generally prohibited a bank holding company from engaging in activities other than banking or managing or controlling banks or other permissible subsidiaries and from acquiring or retaining direct or indirect control of any company engaged in any activities other than those determined by the Federal Reserve to be closely related to banking or managing or controlling banks as to be a proper incident thereto. Provisions of the Gramm-Leach-Bliley Act have expanded the permissible activities of a bank holding company that qualifies as a financial holding company. Under the regulations implementing the Gramm-Leach-Bliley Act, a financial holding company may engage in additional activities that are financial in nature or incidental or complementary to financial activity. Those activities include, among other activities, certain insurance and securities activities.

To qualify to become a financial holding company, the Bank and any other depository institution subsidiary of the Company must be well capitalized and well managed and must have a Community Reinvestment Act rating of at least “satisfactory.” Additionally, the Company must file an election with the Federal Reserve to become a financial holding company and must provide the Federal Reserve with 30 days’ written notice prior to engaging in a permitted financial activity. While the Company meets the qualification standards applicable to financial holding companies, the Company has not elected to become a financial holding company at this time.

Support of Subsidiary Institutions. Under Federal Reserve policy, the Company is expected to act as a source of financial strength for the Bank and to commit resources to support the Bank. This support may be required at times when, without this Federal Reserve policy, the Company might not be inclined to provide it. In addition, any capital loans made by the Company to the Bank will be repaid only after its deposits and various other obligations are repaid in full. In the unlikely event of the Company’s bankruptcy, any commitment by it to a federal bank regulatory agency to maintain the capital of the Bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

South Carolina Law. As a bank holding company with its principal offices in South Carolina, the Company is subject to limitations on sale or merger and to regulation by the South Carolina State Board of Financial Institutions (the “State Board”). The Company must receive the approval of the State Board prior to acquiring control of a bank or bank holding company or all or substantially all of the assets of a bank or a bank holding company. The Company also must file with the State Board periodic reports with respect to its financial condition, operations and management, and the intercompany relationships between the Company and its subsidiaries.

First Reliance Bank

The Bank is a state chartered bank insured by the FDIC and not a member of the Federal Reserve. As such, the Bank is subject to supervision and regulation by the FDIC and the State Board. Supervision, regulation and examination of banks by regulatory agencies are intended primarily for the protection of depositors rather than stockholders of the banks.

South Carolina Law. Commercial banks chartered in South Carolina have only those powers granted by law or the regulations of the State Board. State law sets specific requirements for bank capital and regulates deposits in and loans and investments by banks, including the amounts, types and, in some cases, rates. In addition, the State Board regulates, among other activities, the payment of dividends, the opening of branches, loans to officers and directors, record keeping and the use of automated teller machines. The State Board periodically examines state banks to determine their compliance with the law and regulations, and state banks must make periodic reports of their condition to the State Board.

Prompt Corrective Action. The Federal Deposit Insurance Corporation Improvement Act of 1991 establishes a system of prompt corrective action to resolve the problems of undercapitalized financial institutions. Under this system, the federal banking regulators have established five capital categories (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized) in which all institutions are placed. Federal banking regulators are required to take various mandatory supervisory actions and are authorized to take other discretionary actions with respect to institutions in the three undercapitalized categories. The severity of the action depends upon the capital category in which the institution is placed. Generally, subject to a narrow exception, the banking regulator must appoint a receiver or conservator for an institution that is critically undercapitalized. The federal banking agencies have specified by regulation the relevant capital level for each category.

FDIC Insurance Assessments. The FDIC has adopted a risk-based assessment system for insured depository institutions that takes into account the risks attributable to different categories and concentrations of assets and liabilities. The system assesses higher rates on those institutions that pose greater risks to the Deposit Insurance Fund (the “DIF”). The FDIC places each institution in one of four risk categories using a two-step process based first on capital ratios (the capital group assignment) and then on other relevant information (the supervisory group assignment). Within the lower risk category, Risk Category I, rates will vary based on each institution’s CAMELS component ratings, certain financial ratios, and long-term debt issuer ratings.

Capital group assignments are made quarterly and an institution is assigned to one of three capital categories: (1) well capitalized; (2) adequately capitalized; and (3) undercapitalized. These three categories are substantially similar to the prompt corrective action categories described above, with the “undercapitalized” category including institutions that are undercapitalized, significantly undercapitalized and critically undercapitalized for prompt corrective action purposes. The FDIC also assigns an institution to one of three supervisory subgroups based on a supervisory evaluation that the institution’s primary federal banking regulator provides to the FDIC and information that the FDIC determines to be relevant to the institution’s financial condition and the risk posed to the deposit insurance funds. Assessments range from 5 to 43 cents per \$100 of deposits, depending on the institution’s capital group and supervisory subgroup. Institutions that are well capitalized will be charged a rate between 5 and 7 cents per \$100 of deposits.

The FDIC may terminate its insurance of deposits if it finds that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order, or condition imposed by the FDIC.

Community Reinvestment Act. The Bank is subject to evaluation by the FDIC under the Community Reinvestment Act of 1977 (“CRA”). The Bank is evaluated under guidelines established for “small banks.” These guidelines call for an evaluation of an institution’s performance in meeting the credit needs of its entire community, including low- and moderate-income areas, consistent with the safe and sound operation of the institution. The relevant factors under these “small bank” guidelines include the bank’s loan-to-deposit ratio within its community, the bank’s percentage of loans and other lending activities within its community, the bank’s record of lending to and engaging in other lending-related activities for borrowers of different income levels and businesses and farms of different sizes, the geographic distribution of the bank’s loans and the bank’s record of acting, if warranted, in response to written complaints about its performance in helping to meet credit needs in its community. The FDIC takes a bank’s CRA performance into account in considering applications for approval of deposit insurance, establishment or relocation of

branches and business combinations. Accordingly, failure to adequately meet these criteria could impose additional requirements and limitations on the Bank. Since our aggregate assets are not more than \$250 million, under the Gramm-Leach-Bliley Act, we are generally subject to a Community Reinvestment Act examination only once every 60 months if we receive an “outstanding” rating, once every 48 months if we receive a “satisfactory” rating and as needed if our rating is “less than satisfactory.” Additionally, we must publicly disclose the terms of various Community Reinvestment Act-related agreements.

Allowance for Loan and Lease Losses. The Allowance for Loan and Lease Losses (the “ALLL”) represents one of the most significant estimates in the Bank’s financial statements and regulatory reports. Because of its significance, the Bank has developed a system by which it develops, maintains and documents a comprehensive, systematic and consistently applied process for determining the amounts of the ALLL and the provision for loan and lease losses. The Interagency Policy Statement on the Allowance for Loan and Lease Losses, issued on December 13, 2006, encourages all banks to ensure controls are in place to consistently determine the ALLL in accordance with GAAP, the bank’s stated policies and procedures, management’s best judgment and relevant supervisory guidance. Consistent with supervisory guidance, the Bank maintains a prudent and conservative, but not excessive, ALLL, that is at a level that is appropriate to cover estimated credit losses on individually evaluated loans determined to be impaired as well as estimated credit losses inherent in the remainder of the loan and lease portfolio. The Bank’s estimate of credit losses reflects consideration of all significant factors that affect the collectibility of the portfolio as of the evaluation date. See “Management’s Discussion and Analysis - Accounting and Financial Reporting Issues.”

Commercial Real Estate Lending. The Bank’s lending operations may be subject to enhanced scrutiny by federal banking regulators based on its concentration of commercial real estate loans. On December 6, 2006, the federal banking regulators issued final guidance to remind financial institutions of the risk posed by commercial real estate (“CRE”) lending concentrations. CRE loans generally include land development, construction loans and loans secured by multifamily property, and nonfarm, nonresidential real property where the primary source of repayment is derived from rental income associated with the property.

Other Regulations. Interest and other charges collected or contracted for by the Bank are subject to state usury laws and federal laws concerning interest rates. The Bank’s loan operations are also subject to federal laws applicable to credit transactions, such as the:

- Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- Fair Credit Reporting Act of 1978, as amended by the Fair and Accurate Credit Transactions Act, governing the use and provision of information to credit reporting agencies, certain identity theft protections, and certain credit and other disclosures;
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies;
- Soldiers’ and Sailors’ Civil Relief Act of 1940, as amended by the Service members Civil Relief Act, governing the repayment terms of, and property rights underlying, secured obligations of persons currently on active duty with the United States military;
- Talent Amendment in the 2007 Defense Authorization Act, establishing a 36% annual percentage rate ceiling, which includes a variety of charges including late fees, for consumer loans to military service members and their dependents; and
- rules and regulations of the various federal agencies charged with the responsibility of implementing these federal laws.

The Bank's deposit operations are subject to federal laws applicable to depository accounts , such as the:

- Truth-in-Savings Act, requiring certain disclosures for consumer deposit accounts;
- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve to implement that act, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services; and
- rules and regulations of the various federal agencies charged with the responsibility of implementing these federal laws.

Capital Adequacy

The Company and the Bank are required to comply with the capital adequacy standards established by the Federal Reserve, in the case of the Company, and the FDIC, in the case of the Bank. The Federal Reserve has established a risk-based and a leverage measure of capital adequacy for bank holding companies. The Bank is also subject to risk-based and leverage capital requirements adopted by the FDIC, which are substantially similar to those adopted by the Federal Reserve for bank holding companies.

The risk-based capital standards are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance-sheet exposure, and to minimize disincentives for holding liquid assets. Assets and off-balance-sheet items, such as letters of credit and unfunded loan commitments, are assigned to broad risk categories, each with appropriate risk weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance-sheet items.

The minimum guideline for the ratio of total capital to risk-weighted assets is 8%. Total capital consists of two components, Tier 1 Capital and Tier 2 Capital. Tier 1 Capital generally consists of common stock, minority interests in the equity accounts of consolidated subsidiaries, noncumulative perpetual preferred stock, and a limited amount of qualifying cumulative perpetual preferred stock, less goodwill and other specified intangible assets. Tier 1 Capital must equal at least 4% of risk-weighted assets. Tier 2 Capital generally consists of subordinated debt, other preferred stock, and a limited amount of loan loss reserves. The total amount of Tier 2 Capital is limited to 100% of Tier 1 Capital. At December 31, 2007, our ratio of total capital to risk-weighted assets was 10.29% and our ratio of Tier 1 Capital to risk-weighted assets was 9.26%.

In addition, the Federal Reserve has established minimum leverage ratio guidelines for bank holding companies. These guidelines provide for a minimum ratio of Tier 1 Capital to average assets, less goodwill and other specified intangible assets, of 3% for bank holding companies that meet specified criteria, including having the highest regulatory rating and implementing the Federal Reserve's risk-based capital measure for market risk. All other bank holding companies generally are required to maintain a leverage ratio of at least 4%. At December 31, 2007, our leverage ratio was 9.46%. The guidelines also provide that bank holding companies experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without reliance on intangible assets. The Federal Reserve considers the leverage ratio and other indicators of capital strength in evaluating proposals for expansion or new activities.

Failure to meet capital guidelines could subject a bank or bank holding company to a variety of enforcement remedies, including issuance of a capital directive, the termination of deposit insurance by the FDIC, a prohibition on accepting brokered deposits, and certain other restrictions on its business. As described above, significant additional restrictions can be imposed on FDIC-insured depository institutions that fail to meet applicable capital requirements.

Payment of Dividends

The Company is a legal entity separate and distinct from the Bank. The principal sources of the Company's cash flow, including cash flow to pay dividends to its shareholders, are dividends that the Bank pays to its sole shareholder, the Company. Statutory and regulatory limitations apply to the Bank's payment of dividends to the Company as well as to the Company's payment of dividends to its shareholders.

Under South Carolina law, the Bank is authorized to upstream to the Company, by way of a cash dividend, up to 100% of the Bank's net income in any calendar year without obtaining the prior approval of the State Board, provided that the Bank received a composite rating of one or two at the last examination conducted by a state or federal regulatory authority. All other cash dividends require prior approval by the State Board. South Carolina law requires each state nonmember bank to maintain the same reserves against deposits as are required for a state member bank under the Federal Reserve Act. This requirement is not expected to limit the ability of the Bank to pay dividends on its common stock.

The payment of dividends by the Company and the Bank may also be affected by other factors, such as the requirement to maintain adequate capital above regulatory guidelines. If, in the opinion of the FDIC, the Bank were engaged in or about to engage in an unsafe or unsound practice, the FDIC could require, after notice and a hearing, that the Bank stop or refrain engaging in the practice. The federal banking agencies have indicated that paying dividends that deplete a depository institution's capital base to an inadequate level would be an unsafe and unsound banking practice. Under the Federal Deposit Insurance Corporation Improvement Act of 1991, a depository institution may not pay any dividend if payment would cause it to become undercapitalized or if it already is undercapitalized. Moreover, the federal agencies have issued policy statements that provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings.

Restrictions on Transactions with Affiliates

The Company and the Bank are subject to the provisions of Section 23A of the Federal Reserve Act. Section 23A places limits on the amount of:

- a bank's loans or extensions of credit to affiliates;
- a bank's investment in affiliates;
- assets a bank may purchase from affiliates, except for real and personal property exempted by the Federal Reserve;
- loans or extensions of credit to third parties collateralized by the securities or obligations of affiliates; and
- a bank's guarantee, acceptance or letter of credit issued on behalf of an affiliate.

The total amount of the above transactions is limited in amount, as to any one affiliate, to 10% of a bank's capital and surplus and, as to all affiliates combined, to 20% of a bank's capital and surplus. In addition to the limitation on the amount of these transactions, each of the above transactions must also meet specified collateral requirements. The Bank must also comply with other provisions designed to avoid the taking of low-quality assets.

The Company and the Bank are also subject to the provisions of Section 23B of the Federal Reserve Act which, among other things, prohibit an institution from engaging in the above transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to the institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies.

The Bank is also subject to restrictions on extensions of credit to its executive officers, directors, principal shareholders and their related interests. These extensions of credit (1) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and (2) must not involve more than the normal risk of repayment or present other unfavorable features.

Proposed Legislation and Regulatory Action

New regulations and statutes are regularly proposed that contain wide-ranging changes to the structures, regulations and competitive relationships of financial institutions operating and doing business in the United States. We cannot predict whether or in what form any proposed regulation or statute will be adopted or the extent to which our business may be affected by any new regulation or statute.

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Effect of Governmental Monetary Policies

Our earnings are affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The Federal Reserve Bank's monetary policies have had, and are likely to continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The monetary policies of the Federal Reserve affect the levels of bank loans, investments and deposits through its control over the issuance of United States government securities, its regulation of the discount rate applicable to member banks and its influence over reserve requirements to which member banks are subject. We cannot predict the nature or impact of future changes in monetary and fiscal policies.

Selected Statistical Information

The selected statistical information required by Item 1 is included in the Company's 2007 Annual Report to Shareholders, which is Exhibit 13.1 to this Report, under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" and is incorporated herein by reference.

ITEM 1A. RISK FACTORS

An investment in our common stock involves risks. 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. In such a case, the trading price of our common stock could decline, and you may lose all or part of your investment. The risks discussed below also include forward-looking statements, and our actual results may differ substantially from those discussed in these forward-looking statements.

We could suffer loan losses from a decline in credit quality.

We could sustain losses if borrowers, guarantors and related parties fail to perform in accordance with the terms of their loans. We have adopted underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for credit losses, which we believe are appropriate to minimize this risk by assessing the likelihood of nonperformance, tracking loan performance and diversifying our credit portfolio. These policies and procedures, however, may not prevent unexpected losses that could materially adversely affect our results of operations.

We are subject to the local economies in Charleston, Florence and Lexington Counties, South Carolina.

Our success depends upon the growth in population, income levels, deposits and housing starts in our primary market areas. If the communities in which First Reliance Bank operate do not grow, or if prevailing economic conditions locally or nationally are unfavorable, our business may not succeed. Unpredictable economic conditions may have an adverse effect on the quality of our loan portfolio and our financial performance. Economic recession over a prolonged period or other economic problems in our market areas could have a material adverse impact on the quality of the loan portfolio and the demand for our products and services. Future adverse changes in the economies in our market areas may have a material adverse effect on our financial condition, results of operations or cash flows. Further, the banking industry in South Carolina is affected by general economic conditions such as inflation, recession, unemployment and other factors beyond our control. As a community bank, we are less able to spread the risk of unfavorable local economic conditions than larger or more regional banks. Moreover, we cannot give any assurance that we will benefit from any market growth or favorable economic conditions in our primary market areas if they do occur.

In addition to considering the financial strength and cash flow characteristics of borrowers, we often secure loans with real estate 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. The market value of the real estate securing our loans as collateral has been adversely affected by the slowing economy and unfavorable changes in economic conditions in our market areas and could be further adversely affected in the future.

As of December 31, 2007, more than 80% of our loans receivable were secured by real estate. Any sustained period of increased payment delinquencies, foreclosures or losses caused by the adverse market and economic conditions, including the downturn in the real estate market, in our markets will adversely affect the value of our assets, revenues, results of operations and financial condition. Currently, we are experiencing such an economic downturn, and if it continues, our operations could be further adversely affected.

Our business strategy includes the continuation of significant growth plans, and 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 significant 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 growth occurs more slowly than anticipated or 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. While we believe we have the management resources and internal systems in place to successfully manage our future growth, there can be no assurance growth opportunities will be available or growth will be successfully managed.

Changes in the interest rate environment could reduce our profitability.

As a financial institution, our earnings are significantly dependent upon our net interest income, which is the difference between the interest income that we earn on interest-earning assets, such as investment securities and loans, and the interest expense that we pay on interest-bearing liabilities, such as deposits and borrowings. Therefore, any change in general market interest rates, including changes resulting from changes in the Federal Reserve's fiscal and monetary policies, affects us more than nonfinancial institutions and can have a significant effect on our net interest income and total income. Our assets and liabilities may react differently to changes in overall market rates or conditions because there may be mismatches between the repricing or maturity characteristics of the assets and liabilities. As a result, an increase or decrease in market interest rates could have material adverse effects on our net interest margin and results of operations.

In response to the dramatic deterioration of the subprime, mortgage, credit and liquidity markets, the Federal Reserve recently has taken action on six occasions to reduce interest rates by a total of 300 basis points since September 2007, which likely will reduce our net interest income during the first half of 2008 and the foreseeable future. Any reduction in our net interest income will negatively affect our business, financial condition, liquidity, operating results, cash flows and/or the price of our securities. Additionally, in 2008, we expect to have continued margin pressure given these interest rate reductions, along with elevated levels of non-performing assets.

Our continued pace of growth may require us to raise additional capital in the future, but that capital may not be available when it is needed.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. We anticipate our capital resources following this offering will satisfy our capital requirements for the foreseeable future. We may at some point, however, need to raise additional capital to support our continued growth.

Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside our control, and on our financial performance. Accordingly, we cannot assure you of our ability to raise additional capital if needed on terms acceptable to us. If we cannot raise additional capital when needed, our ability to further expand our operations through internal growth and acquisitions could be materially impaired.

We face strong competition from larger, more established competitors.

The banking business is highly competitive, and we experience strong competition from many other financial institutions. We compete with commercial banks, credit unions, savings and loan associations, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market funds and other financial institutions, which operate in our primary market areas and elsewhere.

We compete with these institutions both in attracting deposits and in making loans. In addition, we have to attract our customer base from other existing financial institutions and from new residents. Many of our competitors are well-established and much larger financial institutions. While we believe we can and do successfully compete with these other financial institutions in our markets, we may face a competitive disadvantage as a result of our smaller size and lack of geographic diversification.

Although we compete by concentrating our marketing efforts in our primary market area with local advertisements, personal contacts and greater flexibility in working with local customers, we can give no assurance that this strategy will be successful.

We face risks with respect to future expansion and acquisitions or mergers.

We continually seek to acquire other financial institutions or parts of those institutions and may continue to engage in de novo branch expansion 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 may negatively affect our business;
- the estimates and judgments used to evaluate credit, operations, management and market risks with respect to the target institution may not be accurate;
- 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 may negatively affect our business;
- we may not be able to finance an acquisition without diluting our existing shareholders;
- the diversion of our management's attention to the negotiation of a transaction may detract from their business productivity;
- we may enter into new markets where we lack experience;
- we may introduce new products and services into our business with which we have no prior experience; and
- we may incur an impairment of goodwill associated with an acquisition and experience adverse short-term effects on our results of operations.

In addition, no assurance can be given that we will be able to integrate our operations after an acquisition without encountering difficulties including, without limitation, the loss of key employees and customers, the disruption of our respective ongoing businesses or possible inconsistencies in standards, controls, procedures and policies. Successful integration of our operations with another entity's will depend primarily on our ability to consolidate operations, systems and procedures and to eliminate redundancies and costs. If we have difficulties with the integration, we might not achieve the economic benefits we expect to result from any particular acquisition or merger. In addition, we may experience greater than expected costs or difficulties relating to such integration.

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

The economy of South Carolina's coastal region is affected, from time to time, by adverse weather events, particularly hurricanes. Our Charleston County market area consists primarily of coastal communities, and we cannot predict whether, or to what extent, damage caused by future hurricanes will affect our operations, our customers or the economies in our banking markets. However, weather events could cause a decline in loan originations, destruction or decline in the value of properties securing our loans, or an increase in the risks of delinquencies, foreclosures and loan losses. Even if a hurricane does not cause any physical damage in our market area, a turbulent hurricane season could significantly affect the market value of all coastal property.

Our recent results may not be indicative of our future results.

We may not be able to sustain our historical rate of growth or may not even be able to grow our business at all. In addition, our recent and rapid growth may distort some of our historical financial ratios and statistics. In the future, we may not have the benefit of several recently favorable factors, such as a generally predictable interest rate environment, a strong residential mortgage market or the ability to find suitable expansion opportunities. Various factors, such as economic conditions, regulatory and legislative considerations and competition, may also impede or prohibit our ability to expand our market presence. If we experience a significant decrease in our historical rate of growth, our results of operations and financial condition may be adversely affected due to a high percentage of our operating costs being fixed expenses.

Lack of seasoning of our loan portfolio may increase the risk of credit defaults in the future.

Due to the rapid growth of the Bank over the past several years, a large portion of the loans in our loan portfolio and our lending relationships are of relatively recent origin. In general, loans do not begin to show signs of credit deterioration or default until they have been outstanding for some period of time, a process we refer to as “seasoning.” As a result, a portfolio of older loans will usually behave more predictably than a newer loan portfolio. Because of the growth of our loan portfolio over the last two years, a significant portion of our loan portfolio is relatively new, and the current level of delinquencies and defaults may not be representative of the level that will prevail when the portfolio becomes more seasoned. If delinquencies and defaults increase, we may be required to increase our provision for loan losses, which would adversely affect our results of operations and financial condition.

Our corporate culture has contributed to our success, and if we cannot maintain this culture as we grow, we could lose the teamwork and increased productivity fostered by our culture, which could harm our business.

We believe that a critical contributor to our success has been our corporate culture, which we believe fosters teamwork and increased productivity. As our organization grows and we are required to implement more complex organization management structures, we may find it increasingly difficult to maintain the beneficial aspects of our corporate culture. This could negatively impact our future success.

As a community bank, we have different lending risks than larger banks.

We provide services to our local communities. Our ability to diversify our economic risks is limited by our own local markets and economies. We lend primarily to individuals and to small to medium-sized businesses, which may expose us to greater lending risks than those of banks lending to larger, better-capitalized businesses with longer operating histories.

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

We are subject to extensive regulation that could limit or restrict our activities and impose financial requirements or limitations on the conduct of our business.

As a bank holding company, we are primarily regulated by the Federal Reserve. Our subsidiary is primarily regulated by the State Board and the FDIC. Our compliance with Federal Reserve, State Board and FDIC regulations is costly and may limit our growth and restrict certain of our activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates charged, interest rates paid on deposits and locations of offices. We are also subject to capital requirements of our regulators.

The laws and regulations applicable to the banking industry could change at any time, and we cannot predict the effects of these changes on our business and profitability. Because government regulation greatly affects the business and financial results of all commercial banks and bank holding companies, our cost of compliance could adversely affect our ability to operate profitably.

The Sarbanes-Oxley Act of 2002 and the related rules and regulations promulgated by the Securities and Exchange Commission, have increased the scope, complexity and cost of corporate governance, reporting and disclosure practices. As a result, we may experience greater compliance costs.

Changes in monetary policies may have an adverse effect on our business.

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

Our ability to pay dividends is limited and we may be unable to pay future dividends.

We make no assurances that we will pay any dividends in the future. Any future determination relating to dividend policy will be made at the discretion of our Board of Directors and will depend on a number of factors, including our future earnings, capital requirements, financial condition, future prospects, regulatory restrictions and other factors that our Board of Directors may deem relevant.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not Applicable.

ITEM 2. PROPERTIES

The executive and main offices of the Company and the Bank are located at 2170 W. Palmetto Street in Florence, South Carolina. The facility at that location is owned by the Bank. The Bank also owns an adjacent lot that is used as a parking lot. The headquarters building is a two-story building having approximately 12,000 square feet. The building has six inside teller stations, two teller stations servicing four drive-through lanes and a night depository and automated teller machine drive-through lane that is accessible after the Bank's normal business hours.

On April 26, 2000, the Bank opened a branch at 411 Second Loop Road in Florence, South Carolina. The Second Loop branch facility, which is owned by the Bank, is located on approximately one acre of land and contains approximately 3,000 square feet.

On May 15, 2002, the Bank purchased an additional facility located at 2145 Fernleaf Drive in Florence, South Carolina. The Fernleaf Drive site contains approximately 0.5 acres of land and includes a 7,500 square foot building. The facility will serve as additional space for the operational and information technology activities of the Bank,

including data processing and auditing. No customer services will be conducted in this facility.

On June 17, 2004, the Bank opened a temporary branch at 709 North Lake Drive in Lexington, South Carolina. On July 1, 2008, the bank subsequently moved into its permanent branch facility at 801 N. Lake Drive in Lexington, South Carolina. The Lexington branch facility, which is owned by the Bank, is located on approximately two acres of land and contains approximately 13,000 square feet.

On March 15, 2005, the Bank opened a branch at 51 State Street, Charleston, South Carolina. This property is leased. On August 8, 2005, the bank changed the street address of this location to 25 Cumberland Street, Charleston, South Carolina because of a change in the primary entrance to the branch.

On March 24, 2005, the Bank leased approximately five acres at 2211 West Palmetto Street in Florence, South Carolina for development of a future headquarters location.

On October 3, 2005, the Bank opened a temporary branch at 800 South Shelmore Blvd., Mount Pleasant, South Carolina. The land is owned by the Bank. On August 1, 2007, the bank moved into its permanent branch facility at 800 South Shelmore Blvd., Mount Pleasant, South Carolina. The Mount Pleasant branch facility is located on approximately one acre of land and contains approximately 6,500 square feet.

On December 15, 2005, the Bank purchased approximately 1.72 acres at 2031 Sam Rittenberg Blvd., Charleston, South Carolina for future branch expansion

On February 09, 2006, the Bank purchased approximately 0.75 acres at 2148 West Palmetto Street, Florence, South Carolina for a future training facility. On April 1, 2007, the Bank opened its Learning Center which contains approximately 6,000 square feet.

On January 18, 2007, the Bank opened a loan production office at 1154_B Haywood Road, Greenville, SC. The property is leased.

On January 22, 2007, the Bank opened a loan production office at 1033 Bayshore Drive, Rock Hill, SC. This property is leased.

On April 16, 2007, the Bank opened a loan production office at 1125 48th Avenue North, 3rd Floor, Myrtle Beach, SC. This is a temporary location that is now being leased. On August 17, 2007, the bank purchased property at 44th Business Park, Lots 1, 2 & 3, North Myrtle Beach, SC, which will be the permanent location of this office.

Other than the Bank facilities described in the preceding paragraphs and the real estate-related loans funded by the Bank previously described in "Item 1. Business—First Reliance Bank," the Company does not invest in real estate, interests in real estate, real estate mortgages, or securities of or interests in persons primarily engaged in real estate activities.

ITEM 3. LEGAL PROCEEDINGS

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

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PART II

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

(a) The response to this Item 5(a) is included in the Company's 2007 Annual Report to Shareholders under the heading, "Market for First Reliance Bancshares, Inc.'s Common Stock; Payment of Dividends," and is incorporated herein by reference.

(b) Not Applicable

(c) Not Applicable

ITEM 6. SELECTED FINANCIAL DATA

Pursuant to the revised disclosure requirements for smaller reporting companies effective February 4, 2008, no disclosure under this Item is required.

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

The response to this Item is included in the Company's 2007 Annual Report to Shareholders under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" and is incorporated herein by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Pursuant to the revised disclosure requirements for smaller reporting companies effective February 4, 2008, no disclosure under this Item is required.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following financial statements are included in the Company's 2007 Annual Report to Shareholders, and are incorporated herein by reference:

Management's Report on Internal Control Over Financial Reporting

Report of Independent Registered Public Accounting Firm

Financial Statements:

1. Consolidated Balance Sheets dated as of December 31, 2007 and 2006.
2. Consolidated Statements of Income for the Years Ended December 31, 2007, 2006 and 2005.
3. Consolidated Statements of Changes in Shareholders' Equity and Comprehensive Income for the Years Ended December 31, 2007, 2006 and 2005.
4. Consolidated Statements of Cash Flows for the Years Ended December 31, 2006, 2005 and 2004.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not Applicable

ITEM 9A(T). CONTROLS AND PROCEDURES

Disclosure Controls

As of the end of the period covered by this Annual Report on Form 10-K, our principal executive officer and principal financial officer have evaluated the effectiveness of our “disclosure controls and procedures” (“Disclosure Controls”). Disclosure Controls, as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), are procedures that are designed with the objective of ensuring that information required to be disclosed in our reports filed under the Exchange Act, such as this Annual Report, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms. Disclosure Controls are also designed with the objective of ensuring that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Our management, including the CEO and CFO, does not expect that our Disclosure Controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based upon their controls evaluation, our CEO and CFO have concluded that our Disclosure Controls are effective at a reasonable assurance level.

Management’s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. Our internal control over financial reporting is a process designed to provide reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition, transactions are executed in accordance with appropriate management authorization and accounting records are reliable for the preparation of financial statements in accordance with generally accepted accounting principles.

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.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2007. Management based this assessment on criteria for effective internal control over financial reporting described in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management’s assessment included an evaluation of the design of our internal control over financial

reporting and testing of the operational effectiveness of its internal control over financial reporting. Management reviewed the results of its assessment with the Audit Committee of our Board of Directors.

Based on this assessment, management believes that First Reliance Bancshares, Inc. maintained effective internal control over financial reporting as of December 31, 2007.

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

Changes to Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting during our fourth fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

Not Applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

The Company has adopted a Code of Ethics that applies to its principal executive, financial and accounting officers. The Code of Ethics has been posted to the Company's website at www.firstreliance.com. A copy may also be obtained, without charge, upon written request addressed to First Reliance Bancshares, Inc., 2170 W. Palmetto Street, , Florence, South Carolina 29501, Attention: Corporate Secretary. The request may be delivered by letter to the address set forth above or by fax to the attention of the Company's Corporate Secretary at 843-656-3045.

The remaining information for this Item is included in the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on June 19, 2008, under the headings "Proposal: Election of Directors", "Security Ownership of Certain Beneficial Owners and Management," "Section 16(a) Beneficial Ownership Reporting Compliance" and "Corporate Governance" and are incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The responses to this Item are included in the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on June 19, 2008, under the headings "Proposal: Election of Directors - Director Compensation" and "Executive Compensation" and are incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table provides information regarding compensation plans under which equity securities of the Company are authorized for issuance. All data is presented as of December 31, 2007.

Equity Compensation Plan Table

| Plan category | (a) Number of securities to be issued upon exercise of outstanding options, warrants and rights | (b) Weighted-average exercise price of outstanding options, warrants and rights | (c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
|--|--|--|--|
| Equity compensation plans approved by security holders | 270,747 | 8.25 | 0 |
| Equity compensation plans not approved by security holders | 102,081 | 14.59 | 238,265 |
| Total | 372,828 | \$9.98 | 238,265 |

The equity compensation plans not approved by our shareholders include non-qualified option grants to four employees of the Company to purchase a total of 8,100 shares of the Company's common stock. All of the non-qualified option grants are fully vested as of December 31, 2007. The table below breaks down the exercise prices of the non-qualified options that have been granted by the Company.

| Price | Number of Options |
|---------|-------------------|
| \$9.32 | 2,800 |
| \$11.00 | 5,000 |
| \$13.50 | 300 |

On January 19, 2006, the Board of Directors approved the First Reliance Bancshares, Inc. 2006 Equity Incentive Plan (the "2006 Plan"). The 2006 Plan provides that the Company may grant stock incentives to participants in the form of nonqualified stock options, dividend equivalent rights, phantom shares, stock appreciation rights, stock awards and performance unit awards (each a "Stock Incentive"). The Company reserved up to 350,000 shares of the Company's common stock for issuance pursuant to awards granted under the Plan. This number of shares may change in the event of future stock dividends, stock splits, recapitalizations and similar events. If a Stock Incentive expires or terminates without being paid, exercised or otherwise settled, the shares subject to that Stock Incentive may again be available for awards under the 2006 Plan.

The additional responses to this Item are included in the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on June 19, 2008, under the heading "Security Ownership of Certain Beneficial Owners and

Management” and are incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The responses to this Item are included in the Company’s Proxy Statement for the Annual Meeting of Shareholders held on June 19, 2008, under the headings “Related Party Transactions” and “Proposal: Election of Directors - Director Independence” and are incorporated herein by reference.

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ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The responses to this Item are included in the Company Proxy Statement for the Annual Meeting of Shareholders to be held on June 19, 2008, under the heading “Audit Committee Matters - Independent Registered Public Accounting Firm” and are incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

A list of exhibits included as part of this annual report is set forth in the Exhibit Index that immediately precedes the exhibits and is incorporated by reference herein.

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SIGNATURES

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

FIRST RELIANCE BANCSHARES, INC.

By: /s/ F. R. Saunders, Jr.

F. R. Saunders, Jr.
 President and
 Chief Executive Officer

Date: March 31, 2008

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears on the signature page to this Report constitutes and appoints F. R. Saunders, Jr. and Jeffrey A. Paolucci, his or her true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him or her and in his or her name, place, and stead, in any and all capacities, to sign any and all amendments to this Report, and to file the same, with all exhibits hereto, and other documents in connection herewith with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as they might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

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. R. Saunders, Jr. F. R. Saunders, Jr. | Director, President and Chief Executive Officer (Principal Executive Officer) | March 31, 2008 |
| /s/ Paul C. Saunders Paul C. Saunders | Director | March 31, 2008 |
| /s/ A. Dale Porter A. Dale Porter | Director | March 31, 2008 |
| /s/ Leonard A. Hoogenboom | Chairman of the Board | |

March 31,
2008

Leonard A. Hoogenboom

/s/ John M. Jebaily

Director

March 31,
2008

John M. Jebaily

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| Signature | Title | Date |
|--|--|--|
| /s/ Andrew G. Kampiziones Andrew G. Kampiziones | Director | March 31, 2008 |
| /s/ C. Dale Lusk C. Dale Lusk | Director | March 31, 2008 |
| /s/ J. Munford Scott J. Munford Scott | Director | March 31, 2008 |
| /s/ T. Daniel Turner T. Daniel Turner | Director | March 31, 2008 |
| /s/ A. Joe Willis A. Joe Willis | Director | March 31, 2008 |
| /s/ Jeffrey A. Paolucci Jeffrey A. Paolucci | Director Director, Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer) | March 31, 2008 March 31, 2008 |

EXHIBIT INDEX

| Exhibit Number | Description |
|-----------------------|---|
| 3.1 | Articles of Incorporation of First Reliance Bancshares, Inc. ¹ |
| 3.2 | Bylaws of First Reliance Bancshares, Inc. ¹² |
| 4.1 | See Articles of Incorporation at Exhibit 3.1 hereto and Bylaws at Exhibit 3.2 hereto. |
| 4.2 | Indenture between the Registrant and the Trustee. ³ |
| 4.3 | Guarantee Agreement. ³ |
| 4.4 | Amended and Restated Declaration. ³ |
| 10.1* | 1999 First Reliance Bank Employee Stock Option Plan. ⁴ |
| 10.2* | Amendment No. 1 to the 1999 First Reliance Bank Employee Stock Option Plan. ⁴ |
| 10.3* | Amendment No. 2 to the 1999 First Reliance Bank Employee Stock Option Plan. ⁵ |
| 10.4* | First Reliance Bancshares, Inc. 2003 Stock Incentive Plan. ⁶ |
| 10.5* | First Reliance Bancshares, Inc. 2006 Equity Incentive Plan. ⁷ |
| 10.6 | Lease Agreement between SP Financial, LLC and First Reliance Bank. ⁷ |
| 10.7* | Employment Agreement with F. R. Saunders, Jr., dated November 24, 2006. ⁸ |
| 10.8* | Salary Continuation Agreement with F. R. Saunders, Jr., dated November 24, 2006. ⁸ |
| 10.9* | Endorsement Split Dollar Agreement with F. R. Saunders, Jr., dated November 24, 2006. ⁸ |
| 10.10* | Amended Supplemental Life Insurance Agreement with F. R. Saunders, Jr., dated December 28, 2007. ⁹ |
| 10.11* | Employment Agreement with Jeffrey A. Paolucci, dated November 24, 2006. ⁸ |
| 10.12* | Salary Continuation Agreement with Jeffrey A. Paolucci, dated November 24, 2006. ⁸ |
| 10.13* | Endorsement Split Dollar Agreement with Jeffrey A. Paolucci, dated November 24, 2006. ⁸ |
| 10.14* | Employment Agreement with Paul Saunders, dated November 24, 2006. ⁸ |
| 10.15* | Salary Continuation Agreement with Paul Saunders, dated November 24, 2006. ⁸ |
| 10.16* | Endorsement Split Dollar Agreement with Paul Saunders, dated November 24, 2006. ⁸ |
| 10.17* | Form of Director Retirement Agreement, with Schedule. ⁸ |

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- 10.18* Amended and Restated Employment Agreement with Dale Porter. ⁸
- 10.19* Employment Agreement with Thomas C. Ewart, Sr. ⁶
- 13.1 First Reliance Bancshares, Inc. 2007 Annual Report to Shareholders. Except with respect to those portions specifically incorporated by reference into this Report, the Company's 2007 Annual Report to Shareholders is not deemed to be filed as part of this Report.
- 21.1 Subsidiaries of First Reliance Bancshares, Inc. ⁷
- 23.1 Consent of Elliot Davis, LLC.
- 24.1 Power of Attorney (appears on the signature page to this Annual Report on Form 10-K).
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15(d)-14(a).
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15(d)-14(a).
- 32.1 Certification of Chief Executive and Financial Officers pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

*Indicates management contract or compensatory plan or arrangement.

¹ Incorporated by reference to Quarterly Report on Form 10-QSB, for the quarter ended September 30, 2007.

² Incorporated by reference to Current Report on Form 8-K, dated April 1, 2002.

³ Incorporated by reference to Current Report on Form 8-K, dated July 1, 2005.

⁴ Incorporated by reference to Quarterly Report on Form 10-QSB, for the quarter ended March 31, 2002.

⁵ Incorporated by reference to Quarterly Report on Form 10-QSB, for the quarter ended June 30, 2002.

⁶ Incorporated by reference to Annual Report on Form 10-KSB for the year ended December 31, 2003.

⁷ Incorporated by reference to Annual Report on Form 10-KSB for the year ended December 31, 2005.

⁸ Incorporated by reference to Annual Report on Form 10-K for the year ended December 31, 2006.

⁹ Incorporated by reference to Current Report on Form 8-K, dated December 28, 2007.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Selected Financial Data**

The following selected financial data is derived from the consolidated financial statements and other data of First Reliance Bancshares, Inc. and Subsidiary (the Company). The selected financial data should be read in conjunction with the consolidated financial statements of the Company, including the accompanying notes, included elsewhere herein.

| | 2007 | 2006 | 2005 | 2004 | 2003 |
|---|------------|------------|------------|------------|------------|
| <i>(Dollars in thousands, except per share)</i> | | | | | |
| Income Statement Data: | | | | | |
| Interest income | \$ 37,540 | \$ 31,717 | \$ 23,131 | \$ 13,291 | \$ 8,499 |
| Interest expense | 18,433 | 14,214 | 8,979 | 4,061 | 2,460 |
| Net interest income | 19,107 | 17,503 | 14,152 | 9,230 | 6,039 |
| Provision for loan losses | 1,643 | 1,393 | 1,811 | 1,362 | 792 |
| Net interest income after provision for loan losses | 17,464 | 16,110 | 12,341 | 7,868 | 5,247 |
| Noninterest income | 5,302 | 4,591 | 2,871 | 2,380 | 2,138 |
| Noninterest expense | 18,961 | 16,272 | 12,475 | 8,338 | 5,966 |
| Income before income taxes | 3,805 | 4,429 | 2,737 | 1,910 | 1,419 |
| Income tax expense | 1,245 | 1,183 | 789 | 571 | 403 |
| Net income | \$ 2,560 | \$ 3,246 | \$ 1,948 | \$ 1,339 | \$ 1,016 |
| Balance Sheet Data: | | | | | |
| Assets | \$ 591,704 | \$ 456,211 | \$ 403,038 | \$ 284,971 | \$ 180,364 |
| Earning assets | 550,559 | 412,687 | 381,158 | 271,020 | 169,205 |
| Securities available for sale ⁽¹⁾ | 58,580 | 35,931 | 37,121 | 28,568 | 27,689 |
| Loans ⁽²⁾ | 487,739 | 360,123 | 319,539 | 239,695 | 140,361 |
| Allowance for loan losses | 5,271 | 4,002 | 3,419 | 2,758 | 1,752 |
| Deposits | 449,498 | 372,938 | 334,437 | 225,494 | 139,415 |
| Shareholders' equity | 37,028 | 34,093 | 29,651 | 27,359 | 17,703 |
| Per-Share Data: | | | | | |
| Basic earnings | \$ 0.74 | \$ 0.96 | \$.60 | \$ 0.52 | \$ 0.48 |
| Diluted earnings | 0.72 | 0.91 | .57 | 0.48 | 0.46 |
| Book value (period end) | 10.60 | 9.95 | 8.97 | 8.54 | 7.18 |
| Performance Ratios: | | | | | |
| Return on average assets | 0.52% | 0.75% | 0.54% | 0.59% | 0.70% |
| Return on average equity | 7.16 | 10.19 | 6.82 | 7.04 | 7.07 |
| Net interest margin ⁽³⁾ | 4.20 | 4.42 | 4.20 | 4.41 | 4.53 |
| Efficiency ⁽⁴⁾ | 77.69 | 73.65 | 73.28 | 71.82 | 72.99 |
| Capital and Liquidity Ratios: | | | | | |
| Average equity to average assets | 7.15% | 7.39% | 7.96% | 8.43% | 9.93% |
| Leverage (4.00% required minimum) | 10.07 | 9.90 | 10.02 | 10.11 | 10.30 |
| Risk-based capital | | | | | |

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| | | | | | |
|-----------------------------------|-------|-------|--------|--------|-------|
| Tier 1 | 9.85 | 11.42 | 12.02 | 11.36 | 12.60 |
| Total | 10.88 | 12.45 | 13.05 | 12.52 | 13.85 |
| Average loans to average deposits | 99.37 | 96.86 | 102.07 | 101.16 | 94.43 |

(1) Securities available-for-sale are stated at fair value.

(2) Loans are stated at gross amounts before allowance for loan losses and include loans held for sale.

(3) Tax equivalent net interest income divided by average earning assets.

(4) Noninterest expense divided by the sum of net interest income and noninterest income, excluding gains and losses on sales of assets.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

**Management's Discussion and Analysis
of Financial Condition and Results of Operations**

Basis of Presentation

The following discussion should be read in conjunction with the preceding "Selected Financial Data" and the Company's Consolidated Financial Statements and the Notes thereto and the other financial data included elsewhere herein. The financial information provided below has been rounded in order to simplify its presentation. However, the ratios and percentages provided below are calculated using the detailed financial information contained in the Consolidated Financial Statements, the Notes thereto and the other financial data included elsewhere herein.

General

First Reliance Bank (the Bank) is a state-chartered bank headquartered in Florence, South Carolina. The Bank opened for business on August 16, 1999. The principal business activity of the Bank is to provide banking services to domestic markets, principally in Florence County, Lexington County, Charleston County, and Greenville County, South Carolina. The deposits of the Bank are insured by the Federal Deposit Insurance Corporation.

On June 7, 2001, the shareholders of the Bank approved a plan of corporate reorganization (the "Reorganization") under which the Bank would become a wholly owned subsidiary of First Reliance Bancshares, Inc. (the "Company"), a South Carolina corporation. The Reorganization was accomplished through a statutory share exchange between the Bank and the Company, whereby each outstanding share of common stock of the Bank was exchanged for one share of common stock of the Company. The Reorganization was completed on April 1, 2002, and the Bank became a wholly-owned subsidiary of First Reliance Bancshares, Inc.

Organizing activities for the Bank began on November 23, 1998. Upon the completion of the application process with the South Carolina State Board of Financial Institutions for a state charter and with the Federal Deposit Insurance Corporation for deposit insurance, the Bank issued 723,518 shares of common stock at a price of \$10.00 per share, resulting in capital totaling \$7,173,293, net of selling expenses of \$61,887.

The Bank began operations on August 16, 1999 at its temporary facility on West Palmetto Street in Florence, South Carolina. In June of 2000, the Bank moved into its headquarters at 2170 West Palmetto Street in Florence, South Carolina. The Bank also opened a banking office on Second Loop Road in Florence, South Carolina in April of 2001. On May 15, 2002, the Bank purchased an additional facility located at 2145 Fernleaf Drive in Florence, South Carolina. The Fernleaf Drive site contains approximately 0.5 acres of land and includes a 7,500 square foot building. The facility serves as additional space for operational activities of the Bank, including data processing and auditing. No customer services are being conducted in this facility.

On November 12, 2002, the Company commenced a stock offering whereby a minimum of 125,000 shares and a maximum of 1,250,000 shares of common stock were offered to fund continued expansion through First Reliance Bank. The offering price was \$8.00 per share. This was a best efforts offering and was conducted without an underwriter. The Company had sold 1,007,430 shares resulting in additional capital of \$8,059,439 net of selling expenses of \$162,965, at the close of the offering in May 2003. Also 10,400 stock options were exercised in 2003 for a total amount of \$52,000.

During the second quarter of 2004, the Bank opened its third branch in Lexington, South Carolina. On March 15, 2005, the Bank opened its fourth branch in Charleston, South Carolina located at 51 State Street. The Bank also opened its fifth branch in Mount Pleasant, South Carolina located at 800 South Shelmore Blvd on October 3, 2005.

The Bank also has loan production offices in Greenville, Rock Hill, and Myrtle Beach.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Management's Discussion and Analysis
of Financial Condition and Results of Operations****General - continued**

On June 30, 2005 the Company formed First Reliance Capital Trust I (the "Trust") for the purpose of issuing trust preferred securities, which enable the Company to obtain Tier 1 capital on a consolidated basis for regulatory purposes. On July 1, 2005, the Company closed a private offering of \$10,000,000 of floating rate preferred securities offered and sold by the Trust. The proceeds from such issuance, together with the proceeds from a related issuance of common securities of the Trust purchased by the Company in the amount of \$310,000, were invested by the Trust in floating rate Junior Subordinated Notes issued by the Company (the "Notes") totaling \$10.3 million. The Notes are due and payable on November 23, 2035 and may be redeemed by the Company after five years, and sooner in certain specific events, including in the event that certain circumstances render the Notes ineligible for treatment as Tier 1 capital, subject to prior approval by the Federal Reserve Board, if then required. The Notes presently qualify as Tier 1 capital for regulatory reporting. The sole assets of the Trust are the Notes. The Company owns 100% of the common securities of the Trust. The Notes are unsecured and rank junior to all senior debt of the Company. For the quarter ended December 31, 2007, the floating rate preferred securities and the Notes had an annual interest rate of 5.93%. This interest rate is fixed until August 23, 2010, when the interest rate will adjust quarterly. After August 23, 2010, the interest rate will equal three-month LIBOR plus 1.83%.

On December 28, 2007 the Company borrowed 3,000,000, which was injected into the Bank as permanent capital. The debt is unsecured and has a fixed interest rate of 6.00%, and is due and payable on December 28, 2008.

Like most financial institutions, our profitability depends largely upon net interest income, which is the difference between the interest received on earning assets, such as loans and investment securities, and the interest paid on interest-bearing liabilities, principally deposits and borrowings. Our results of operations are also affected by our provision for loan losses; non-interest expenses, such as salaries, employee benefits, and occupancy expenses; and non-interest income, such as mortgage loan fees and service charges on deposit accounts.

Economic conditions, competition and federal monetary and fiscal policies also affect financial institutions. Lending activities are also influenced by regional and local economic factors, such as housing supply and demand, competition among lenders, customer preferences and levels of personal income and savings in our primary market area.

Our balanced growth continued during 2007, with increases in assets, loans, investment securities, deposits and shareholders' equity. The following chart shows our growth in these areas from December 31, 2006 to December 31, 2007:

| <i>(Dollars in millions)</i> | December 31, | | Percent Increase (Decrease) |
|------------------------------|--------------|----------|-----------------------------------|
| | 2007 | 2006 | |
| Total assets | \$ 591.7 | \$ 456.2 | 29.70% |
| Loans | 468.1 | 353.5 | 32.42 |
| Investment securities | 62.8 | 38.4 | 63.54 |
| Deposits | 449.5 | 372.9 | 20.54 |
| Shareholders' equity | 37.0 | 34.1 | 8.50 |

The additional capital increased our legal lending limit, thereby allowing us to extend larger loans to our customers. Our loan portfolio increased \$114.6 million from December 31, 2006 to December 31, 2007. Our deposit base also

increased in 2007 by \$76.6 million from \$372.9 million in 2006 to \$449.5 million in 2007.

The significant increase in average earning assets had a positive impact on our results of operations for 2007. Average earning assets increased from \$401.0 million in 2006 to \$461.1 million in 2007. Our increased volume in deposits also increased our fees from service charges and deposit accounts by approximately \$209,845 from 2006 to 2007. Gains on sales of mortgage loans were also an important source of noninterest income in 2007, increasing \$271,173, or 14.26% from \$1.9 million in 2006 to \$2.2 million in 2007.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

**Management's Discussion and Analysis
of Financial Condition and Results of Operations**

Results of Operations

Year ended December 31, 2007, compared with year ended December 31, 2006

Net interest income increased \$1,604,392 or 9.17%, to \$19,107,278 in 2007 from \$17,502,886 in 2006. The increase in net interest income was due primarily to an increase in average earning assets. Average earning assets increased \$60,051,000 or 14.97%, mainly due to continued growth in the loan portfolio. The primary components of interest income were interest on loans, including fees, of \$35,325,242 and interest on taxable investment securities of \$892,277. Net interest income increased \$3,350,453 or 23.67%, to \$17,502,886 in 2006 from \$14,152,433 in 2005. The increase in net interest income was due primarily to an increase in average earning assets. Average earning assets increased \$59,278,000 or 17.35%, mainly due to continued growth in the loan portfolio. The primary components of interest income were interest on loans, including fees, of \$29,222,425, and interest on taxable investment securities of \$1,029,560.

The Company's net interest spread and net interest margin were 3.78% and 4.20%, respectively, in 2007, compared to 3.96% and 4.42%, respectively, in 2006. The decrease in net interest spread was primarily the result of an increase in average rates on paying liabilities which outpaced the increase in average rates on earning assets. Yields on loans, our largest category of earnings assets, increased in 2007. Overall yields on earning assets increased from 7.96% in 2006 to 8.20% in 2007. Yields on interest-bearing liabilities increased from 4.00% in 2006 to 4.42% in 2007.

The provision for loan losses was \$1,643,100 in 2007 compared to \$1,392,491 in 2006. The allowance for loan losses was 1.13% of total loans at December 31, 2007 and 2006. The Company continues to maintain the allowance for loan losses at a level management believes to be sufficient to cover known and inherent losses in the loan portfolio.

Noninterest income increased \$711,106, or 15.49%, to \$5,301,799 in 2007 from \$4,590,693 in 2006. The increase is primarily attributable to gain on sale of mortgage loans and increased service charges on deposit accounts. The gain on sale of mortgage loans increased \$271,173 or 14.26% to \$2,173,140 for the year ended December 31, 2007 as the demand for new mortgage loans and refinancings remained strong. Service charges on deposit accounts increased \$209,845, or 12.40% from 2006, to \$1,901,758 for the year ended December 31, 2007. The increase in service charges on deposit accounts was attributable to an overall increase in the number of deposit accounts in 2007.

Noninterest expense increased \$2,688,891, or 16.52%, to \$18,961,275 in 2007 from \$16,272,384 in 2006. Noninterest expenses increased in all categories as a result of our continued growth. The increase is primarily attributable to increased salaries and benefits and other operating expenses. Salaries and employee benefits increased \$1,173,766, or 12.37%, to \$10,661,153 in 2007 from \$9,487,387 in 2006. A large portion of the increase in salaries was due to the addition of new staff to facilitate the new branch locations and growth of the Bank. Other operating expenses increased \$1,178,113 from 2006 to \$6,104,948 for the year ended December 31, 2007. This increase was due to the expected increases in overhead caused by the growth of the Company. The Company's efficiency ratio was 77.69% in 2007, compared to 73.65% in 2006.

Net income was \$2,559,520 in 2007, compared to \$3,245,908 in 2006, and \$1,947,546 in 2005. The decrease in net income can be attributed to net interest margin compression due to declining interest rate movements and our investment in branch expansion. Additionally, while mortgage income increased in 2007, we realized lower than anticipated results due to slowing economic conditions and tightening of mortgage standards within the secondary markets. In 2008, we anticipate limited asset growth as we focus on growing core deposit amounts while reducing our

dependence on wholesale funding. Additionally, we intend to focus on improving operational efficiencies with an emphasis on expense management, and leveraging our customer loyalty ratings. Return on average assets during 2007 was .52%, compared to 0.75% in 2006 and 0.54% during 2005, and return on average equity was 7.16% during 2007, compared to 10.19% during 2006.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

**Management's Discussion and Analysis
of Financial Condition and Results of Operations**

Net Interest Income

General. The largest component of the Company's net income is its net interest income, which is the difference between the income earned on assets and interest paid on deposits and on borrowings used to support such assets. Net interest income is determined by the yields earned on the Company's interest-earning assets and the rates paid on its interest-bearing liabilities, the relative amounts of interest-earning assets and interest-bearing liabilities, and the degree of mismatch and the maturity and repricing characteristics of its interest-earning assets and interest-bearing liabilities. Total interest earning assets yield less total interest bearing liabilities rate represents the Company's net interest rate spread.

Average Balances, Income and Expenses, and Rates. The following table sets forth, for the years indicated, certain information related to the Company's average balance sheet and its average yields on assets and average costs of liabilities. Such yields are derived by dividing income or expense by the average balance of the corresponding assets or liabilities. Average balances have been derived from the daily balances throughout the periods indicated.

Average Balances, Income and Expenses, and Rates

| Year ended December 31, (Dollars in thousands) | 2007 | | | 2006 | | | 2005 | | |
|---|--------------------|--------------------|----------------|--------------------|--------------------|----------------|--------------------|--------------------|----------------|
| | Average Balance | Income/ Expense | Yield/ Rate | Average Balance | Income/ Expense | Yield/ Rate | Average Balance | Income/ Expense | Yield/ Rate |
| Assets: | | | | | | | | | |
| Earning Assets: | | | | | | | | | |
| Loans ⁽¹⁾⁽²⁾ | \$ 414,907 | \$ 35,325 | 8.51% | \$ 348,709 | \$ 29,222 | 8.38% | \$ 294,740 | \$ 21,237 | 7.21% |
| Securities, taxable ⁽²⁾ | 17,967 | 892 | 4.96% | 21,891 | 1,030 | 4.70 | 17,491 | 771 | 4.41 |
| Securities, tax exempt ⁽²⁾ | 18,204 | 1,045 | 5.74% | 14,820 | 857 | 5.78 | 13,007 | 742 | 5.70 |
| Federal funds sold | 7,479 | 391 | 5.23% | 13,807 | 687 | 4.98 | 14,462 | 479 | 3.31 |
| Nonmarketable equity securities | 2,529 | 152 | 6.01% | 1,807 | 138 | 7.64 | 2,057 | 91 | 4.42 |
| Total earning assets | 461,086 | 37,805 | 8.20% | 401,034 | 31,934 | 7.96 | 341,757 | 23,320 | 6.82 |
| Cash and due from banks | 8,586 | | | 7,772 | | | 5,316 | | |
| Premises and equipment | 18,049 | | | 11,445 | | | 7,379 | | |
| Other assets | 16,758 | | | 14,757 | | | 7,596 | | |
| Allowance for loan losses | (4,433) | | | (3,764) | | | (3,150) | | |
| Total assets | \$ 500,046 | | | \$ 431,244 | | | \$ 358,898 | | |
| Liabilities: | | | | | | | | | |
| Interest-bearing liabilities: | | | | | | | | | |
| | \$ 36,625 | \$ 710 | 1.94% | \$ 27,084 | 185 | 0.68% | \$ 20,067 | \$ 153 | 0.76% |

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| | | | | | | | | | |
|--|-------------------|------------------|-------|-------------------|------------------|-------|-------------------|------------------|-------|
| Interest-bearing transaction Accounts | | | | | | | | | |
| Savings deposits | 80,943 | 3,184 | 3.93% | 85,887 | 3,243 | 3.78 | 68,499 | 1,877 | 2.74 |
| Time deposits | 254,934 | 12,874 | 5.05% | 204,935 | 9,068 | 4.42 | 166,541 | 5,552 | 3.33 |
| Note payable | 8 | - | 6.00% | - | - | - | - | - | - |
| Junior subordinated debentures | 10,310 | 620 | 6.01% | 10,310 | 618 | 5.99 | 4,875 | 306 | 6.28 |
| Other borrowings | 33,921 | 1,045 | 3.08% | 27,154 | 1,100 | 4.05 | 35,041 | 1,090 | 3.11 |
| Total interest-bearing liabilities | 416,74 | 18,433 | 4.42% | 355,370 | 14,214 | 4.00 | 295,023 | 8,978 | 3.04 |
| Demand deposits | 45,038 | | | 42,100 | | | 33,652 | | |
| Accrued interest and other liabilities | 2,515 | | | 1,911 | | | 1,666 | | |
| Shareholders' equity | 35,752 | | | 31,863 | | | 28,557 | | |
| Total liabilities and shareholders' equity | \$ 500,046 | | | \$ 431,244 | | | \$ 358,898 | | |
| Net interest spread | | | 3.78% | | | 3.96% | | | 3.78% |
| Net interest income | | \$ 19,372 | | | \$ 17,720 | | | \$ 14,342 | |
| Net interest margin | | | 4.20% | | | 4.42% | | | 4.20% |

(1) Nonaccrual loans are included in the balances. The effect of these loans is not significant to the computations. All loans and deposits are domestic.

(2) Fully tax-equivalent basis at 34% tax rate for non-taxable securities and loans.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Management's Discussion and Analysis
of Financial Condition and Results of Operations****Rate/Volume Analysis**

Analysis of Changes in Net Interest Income. Net interest income can also be analyzed in terms of the impact of changing rates and changing volume. The following table describes the extent to which changes in interest rates and changes in the volume of earning assets and interest-bearing liabilities have affected the Bank's interest income and interest expense during the periods indicated. Information on changes in each category attributable to (i) changes due to volume (change in volume multiplied by prior period rate), (ii) changes due to rates (changes in rates multiplied by prior period volume) and (iii) changes in rate/volume (change in rate multiplied by the change in volume) is provided in the table below. Changes to both rate and volume (in iii above) which cannot be segregated have been allocated proportionately.

| <i>(Dollars in thousands)</i> | 2007 Compared to 2006 | | |
|---------------------------------|--------------------------------------|-------------|--------------|
| | Due to increase (decrease) in | | |
| | Volume | Rate | Total |
| Interest income: | | | |
| Loans | \$ 5,642 | \$ 461 | \$ 6,103 |
| Securities, taxable | (191) | 53 | (138) |
| Securities, tax exempt | 194 | (6) | 188 |
| Federal funds sold and other | (329) | 33 | (296) |
| Nonmarketable equity securities | 47 | (33) | 14 |
| Total interest income | 5,363 | 508 | 5,871 |
| Interest expense: | | | |
| Interest-bearing deposits | 84 | 441 | 525 |
| Savings deposits | (188) | 129 | (59) |
| Time deposits | 2,403 | 1,403 | 3,806 |
| Junior subordinated debentures | 0 | 2 | 2 |
| Other borrowings | 240 | (295) | (55) |
| Total interest expense | 2,539 | 1,680 | 4,219 |
| Net interest income | \$ 2,824 | \$ (1,172) | \$ 1,652 |

| <i>(Dollars in thousands)</i> | 2006 Compared to 2005 | | |
|---------------------------------|--------------------------------------|-------------|--------------|
| | Due to increase (decrease) in | | |
| | Volume | Rate | Total |
| Interest income: | | | |
| Loans | \$ 4,234 | \$ 3,751 | \$ 7,985 |
| Securities, taxable | 192 | 67 | 259 |
| Securities, tax exempt | 105 | 10 | 115 |
| Federal funds sold and other | (23) | 231 | 208 |
| Nonmarketable equity securities | (2) | 49 | 47 |
| Total interest income | 4,506 | 4,108 | 8,614 |
| Interest expense: | | | |
| Interest-bearing deposits | 49 | (17) | 32 |
| Savings deposits | 547 | 819 | 1,366 |
| Time deposits | 1,453 | 2,063 | 3,516 |
| Junior subordinated debentures | 327 | (15) | 312 |

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| | | | |
|------------------------|----------|--------|----------|
| Other borrowings | (277) | 287 | 10 |
| Total interest expense | 2,099 | 3,137 | 5,236 |
| Net interest income | \$ 2,407 | \$ 971 | \$ 3,378 |

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Management's Discussion and Analysis
of Financial Condition and Results of Operations****Net Interest Income**

Interest Sensitivity. The Company monitors and manages the pricing and maturity of its assets and liabilities in order to diminish the potential adverse impact that changes in interest rates could have on its net interest income. The principal monitoring technique employed by the Company is the measurement of the Company's interest sensitivity "gap," which is the positive or negative dollar difference between assets and liabilities that are subject to interest rate repricing within a given period of time. Interest rate sensitivity can be managed by repricing assets or liabilities, selling securities available-for-sale, replacing an asset or liability at maturity, or adjusting the interest rate during the life of an asset or liability. Managing the amount of assets and liabilities repricing in this same time interval helps to hedge interest sensitivity and minimize the impact on net interest income of rising or falling interest rates.

The following table sets forth the Company's interest rate sensitivity at December 31, 2007.

Interest Sensitivity Analysis

| December 31, 2007 <i>(Dollars in thousands)</i> | Within One Month | After One Through Three Months | After Three Through Twelve Months | Within One Year | Greater Than One Year or Non-Sensitive | Total |
|---|-------------------------|---------------------------------------|--|------------------------|---|----------------|
| Assets | | | | | | |
| Interest-earning assets | | | | | | |
| Loans, including held for sale | \$ 279,499 | \$ 5,547 | \$ 23,502 | \$ 308,548 | \$ 179,191 | \$ 487,739 |
| Securities, taxable | 513 | 519 | 2,218 | 3,250 | 24,261 | 27,511 |
| Securities, nontaxable | | 501 | 1,618 | 2,119 | 28,950 | 31,069 |
| Nonmarketable securities | 3,930 | | | 3,930 | | 3,930 |
| Investment in trust | | | | | 310 | 310 |
| Total earning assets | 283,942 | 6,567 | 27,338 | 317,847 | 232,712 | 550,559 |
| Liabilities | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Interest-bearing deposits: | | | | | | |
| Demand deposits | 39,450 | | | 39,450 | | 39,450 |
| Savings deposits | 85,819 | | | 85,819 | | 85,819 |
| Time deposits | 34,047 | 69,583 | 167,759 | 271,389 | 9,296 | 280,685 |
| Total interest-bearing deposits | 159,316 | 69,583 | 167,759 | 396,658 | 9,296 | 405,954 |

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| | | | | | | |
|---|-----------|-------------|--------------|--------------|------------|---------|
| Advances from Federal Home Loan Bank | 9,000 | 13,000 | 16,000 | 38,000 | 31,000 | 69,000 |
| Federal Funds Purchased | 13,359 | | | 13,359 | | 13,359 |
| Note payable | - | - | 3,000 | 3,000 | | 3,000 |
| Junior subordinated debentures | | | | | 10,310 | 10,310 |
| Repurchase agreements | 7,928 | | | 7,928 | | 7,928 |
| Total interest-bearing liabilities | 189,603 | 82,583 | 186,759 | 458,945 | 50,606 | 509,551 |
| Period gap | \$ 94,339 | \$ (76,016) | \$ (159,421) | \$ (141,098) | \$ 182,106 | |
| Cumulative gap | \$ 94,339 | \$ 18,323 | \$ (141,098) | \$ (141,098) | \$ 44,008 | |
| Ratio of cumulative gap to total earning assets | 17.14I% | 3.33% | -25.63% | -25.63% | 7.45% | |

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

**Management's Discussion and Analysis
of Financial Condition and Results of Operations**

Net Interest Income - *continued*

The above table reflects the balances of earning assets and interest-bearing liabilities at the earlier of their repricing or maturity dates. Federal funds sold are reflected at the earliest pricing interval due to the immediately available nature of the instruments. Securities are reflected at each instrument's ultimate maturity date. Scheduled payment amounts of fixed rate amortizing loans are reflected at each scheduled payment date. Scheduled payment amounts of variable rate amortizing loans are reflected at each scheduled payment date until the loan may be repriced contractually; the unamortized balance is reflected at that point. Interest-bearing liabilities with no contractual maturity, such as demand deposits and savings deposits, are reflected in the earliest repricing period due to contractual arrangements which give the Company the opportunity to vary the rates paid on those deposits within one month or shorter period. However, the Company is not obligated to vary the rates paid on these deposits within any given period. Fixed rate time deposits, principally certificates of deposit, are reflected at their contractual maturity dates. Repurchase agreements mature on a daily basis and are reflected in the earliest repricing period. Advances from the Federal Home Loan Bank and junior subordinated debentures are reflected at their contractual maturity date.

The Company is in a liability sensitive position (or a negative gap) of \$138.1 million over the 12 month time frame. The gap is negative when interest-bearing liabilities exceed interest sensitive earning assets, as was the case at the end of 2007 with respect to the one-year time horizon. When interest sensitive earning assets exceed interest-bearing liabilities for a specific repricing "horizon", a positive interest sensitivity gap is the result.

A positive gap generally has a favorable effect on net interest income during periods of rising rates. A positive one year gap position occurs when the dollar amount of earning assets maturing or repricing within one year exceeds the dollar amount of interest-bearing liabilities maturing or repricing during that same period. As a result, during periods of rising interest rates, the interest received on earning assets will increase faster than interest paid on interest-bearing liabilities, thus increasing interest income. The reverse is true in periods of declining interest rates resulting generally in a decrease in net interest income.

The Company's Board of Directors and management review the Asset Liability Management with information obtained from our system which measure the interest rate sensitivity. The Company's asset and liability policies are to focus on maximizing long term profitability while managing acceptable interest rate risk.

However, the Company's gap analysis is not a precise indicator of its interest sensitivity position. The analysis presents only a static view of the timing of maturities and repricing opportunities, without taking into consideration that changes in interest rates do not affect all assets and liabilities equally. For example, rates paid on a substantial portion of core deposits may change contractually within a relatively short time frame, but those rates are viewed by management as significantly less interest-sensitive than market-based rates such as those paid on non-core deposits. Net interest income may be impacted by other significant factors in a given interest rate environment, including changes in the volume and mix of earning assets and interest-bearing liabilities. The Company has positioned itself where there is minimal impact on interest income in a rising or falling rate environment.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

**Management's Discussion and Analysis
of Financial Condition and Results of Operations**

Provision and Allowance for Loan Losses

General. The Company has developed policies and procedures for evaluating the overall quality of its credit portfolio and the timely identification of potential problem credits. On a quarterly basis, the Company's Board of Directors reviews and approves the appropriate level for the Company's allowance for loan losses based upon management's recommendations, the results of the internal monitoring and reporting system, and an analysis of economic conditions in its market. The objective of management has been to fund the allowance for loan losses at a level greater or equal to the Company's internal risk measurement system for loan risk. The Board maintained an allowance for loan losses level of 1.13% of total loans at December 31, 2007 and 2006. Management believes the allowance is adequate to meet any loan losses the Company may experience.

Additions to the allowance for loan losses, which are expensed as the provision for loan losses on the Company's income statement, are made periodically to maintain the allowance at an appropriate level based on management's analysis of the potential risk in the loan portfolio. Loan losses and recoveries are charged or credited directly to the allowance. The amount of the provision is a function of the level of loans outstanding, the level of nonperforming loans, historical loan loss experience, the amount of loan losses actually charged against the reserve during a given period, and current and anticipated economic conditions.

The allowance represents an amount which we believe will be adequate to absorb inherent losses on existing loans that may become uncollectible. Our judgment in determining the adequacy of the allowance is based on evaluations of the collectibility of loans, including consideration of factors such as the balance of impaired loans; the quality, mix and size of our overall loan portfolio; economic conditions that may affect the borrower's ability to repay the amount and quality of collateral securing the loans; our limited historical loan loss experience and a review of specific problem loans.

The Company adjusts the amount of the allowance periodically based on changing circumstances as a component of the provision for loan losses. We charge recognized losses against the allowance and add subsequent recoveries back to the allowance. We do not allocate the allowance for loan losses to specific categories of loans (i.e., real estate, consumer, commercial and mortgage), but evaluate the adequacy on an overall portfolio basis utilizing our credit grading system which we apply to each loan. We combine our estimates of the reserves needed for each component of the portfolio, including loans analyzed on a pool basis and loans analyzed individually. The allowance is divided into two portions: (1) an amount for specific allocations on significant individual credits and (2) a general reserve amount. We analyze individual loans within the portfolio and make allocations to the allowance based on each individual loan's specific factors and other circumstances that affect the collectibility of the credit. Significant, individual credits classified as doubtful or substandard/special mention within our credit grading system require both individual analysis and specific allocation. Loans in the substandard category are characterized by deterioration in quality exhibited by any number of well-defined weaknesses requiring corrective action such as declining or negative earnings trends and declining or inadequate liquidity. Loans in the doubtful category exhibit the same weaknesses found in the substandard loan; however, the weaknesses are more pronounced. However, these loans are not yet rated as loss because certain events may occur which could salvage the debt such as injection of capital, alternative financing or liquidation of assets. As of December 31, 2007 and 2006, the Company had no specific allocations on its significant credits in its calculation of the allowance for loan losses.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Management's Discussion and Analysis
of Financial Condition and Results of Operations****Provision and Allowance for Loan Losses - *continued***

The Company calculates its general reserve based on percentages tied to our credit grading system. Each loan is assigned one of eight loan risk ratings, based on the loan's specific characteristics. Any loan assigned an adverse ranking is specifically allocated a loss. For all remaining loans, the general reserve amount is calculated based upon a reserve percentage for each risk rating. The Company may adjust these percentages as appropriate given consideration of local economic conditions, exposure concentration that may exist in the portfolio, changes in trends of past due loans, problem loans and charge-offs and anticipated loan growth.

The Bank has developed a loan risk monitoring system that assesses the potential risk the Bank may have in its loan portfolio. This system is monitored monthly by management to insure that adequate provisions and loan allowances are maintained. In addition, various regulatory agencies review our allowance for loan losses through their periodic examinations, and they may require us to record additions to the allowance for loan losses based on their judgment about information available to them at the time of their examinations. Our losses will undoubtedly vary from our estimates, and it is possible that charge-offs in future periods will exceed the allowance for loan losses as estimated at any point in time. As of December 31, 2007, the Company's general reserves totaled \$5,270,607, an increase of \$1,268,726 from 2006. As of December 31, 2005, the Company's general reserves totaled \$3,419,368, an increase of \$661,143 from 2004. The categories and concentrations of loans have been consistent between the past two years.

The following table sets forth certain information with respect to the Company's allowance for loan losses and the composition of chargeoffs and recoveries for the years ended December 31, 2007, 2006, 2005, 2004 and 2003.

Allowance for Loan Losses

| <i>(Dollars in thousands)</i> | 2007 | 2006 | 2005 | 2004 | 2003 |
|---|-------------|-------------|-------------|-------------|-------------|
| Total loans outstanding at end of year | \$ 468,138 | \$ 353,491 | \$ 311,544 | \$ 238,362 | \$ 139,389 |
| Average loans outstanding | \$ 414,907 | \$ 348,709 | \$ 294,740 | \$ 182,996 | \$ 100,051 |
| Balance of allowance for loan losses at beginning of year | 4,002 | \$ 3,419 | \$ 2,758 | \$ 1,752 | \$ 1,137 |
| Loans charged off: | | | | | |
| Real estate - construction | - | 17 | 142 | - | - |
| Real estate - mortgage | 205 | 718 | 472 | 166 | 47 |
| Commercial and industrial | 58 | 170 | 317 | 44 | 42 |
| Consumer and other | 193 | 151 | 300 | 181 | 106 |
| Total loan losses | 456 | 1,056 | 1,231 | 391 | 195 |
| Recoveries of previous loan losses: | | | | | |
| Real estate - construction | - | - | - | - | - |
| Real estate - mortgage | 36 | 105 | 38 | - | - |
| Commercial and industrial | 24 | 111 | 12 | - | - |
| Consumer and other | 22 | 31 | 31 | 35 | 18 |
| Total recoveries | 82 | 247 | 81 | 35 | 18 |
| Net charge-offs | 374 | 809 | 1,150 | 356 | 177 |
| Provision for loan losses | 1,643 | 1,392 | 1,811 | 1,362 | 792 |

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| | | | | | | | | | | |
|---|----|--------------|----|--------------|----|--------------|----|--------------|----|--------------|
| Balance of allowance for loan losses at end of year | \$ | 5,271 | \$ | 4,002 | \$ | 3,419 | \$ | 2,758 | \$ | 1,752 |
| Ratios: | | | | | | | | | | |
| Net charge-offs to average loans outstanding | | 0.09% | | 0.23% | | 0.39% | | 0.20% | | 0.18% |
| Net charge-offs to loans at end of year | | 0.08% | | 0.23 | | 0.37 | | 0.15 | | 0.13 |
| Allowance for loan losses to average loans | | 1.27 | | 1.15 | | 1.16 | | 1.51 | | 1.75 |
| Allowance for loan losses to loans at end of year | | 1.13 | | 1.13 | | 1.10 | | 1.16 | | 1.26 |
| Net charge-offs to allowance for loan losses | | 7.10 | | 20.21 | | 33.64 | | 12.90 | | 10.10 |
| Net charge-offs to provisions for loan losses | | 22.76 | | 58.11 | | 63.50 | | 26.13 | | 22.35 |

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Management's Discussion and Analysis
of Financial Condition and Results of Operations****Nonperforming Assets**

Nonperforming Assets. There were \$1,657,607 and \$670,650 loans in nonaccrual status at December 31, 2007 and 2006, respectively. There were \$1,780,505 and \$463,991 in loans ninety days or more overdue and still accruing interest at December 31, 2007 and 2006, respectively. There were \$218,616 and \$137,421 in restructured loans at December 31, 2007 and 2006, respectively.

The following table shows the nonperforming assets, percentages of net charge-offs, and the related percentage of allowance for loan losses for the five years ended December 31, 2007. All loans over 90 days past due are on and included in loans on nonaccrual.

| <i>(Dollars in thousands)</i> | 2007 | 2006 | 2005 | 2004 | 2003 |
|---|----------|----------|----------|----------|--------|
| Loans over 90 days past due and still accruing | \$ 1,781 | \$ 464 | \$ 705 | \$ 59 | \$ 460 |
| Loans on nonaccrual: | | | | | |
| Mortgage | 1,465 | 637 | 1,619 | 1,078 | - |
| Commercial | 114 | - | 95 | 17 | - |
| Consumer | 79 | 34 | 78 | 91 | - |
| Total nonaccrual loans | 1,658 | 671 | 1,792 | 1,186 | - |
| Total of nonperforming loans | 3,439 | 1,135 | 2,497 | 1,245 | 460 |
| Other nonperforming assets | 197 | 1,386 | 346 | 321 | 279 |
| Total nonperforming assets | \$ 3,636 | \$ 2,521 | \$ 2,843 | \$ 1,566 | \$ 739 |
| Percentage of total assets | 0.61% | 0.55% | 0.71% | 0.55% | 0.41% |
| Percentage of nonperforming loans and assets to gross loans | 0.78% | 0.71% | 0.91% | 0.66% | 0.53% |
| Allowance for loan losses to gross loans | 1.13% | 1.13% | 1.10% | 1.16% | 1.26% |
| Net charge-offs to average loans | 0.09% | 0.23% | 0.39% | 0.19% | 0.18% |

Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts, the borrower's financial condition is such that the collection of interest is doubtful. A delinquent loan is generally placed in nonaccrual status when it becomes 90 days or more past due. When a loan is placed in nonaccrual status, all interest which has been accrued on the loan but remains unpaid is reversed and deducted from current earnings as a reduction of reported interest income. No additional interest is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain. When a problem loan is finally resolved, there may ultimately be an actual write-down or chargeoff of the principal balance of the loan which would necessitate additional charges to earnings. For all periods presented, the additional interest income, which would have been recognized into earnings if the Company's nonaccrual loans had been current in accordance with their original terms, and the amount of interest income on such loans that was included in net income is immaterial.

Potential Problem Loans. At December 31, 2007, the Company had classified loans totaling \$3,822,735 as compared to \$2,697,063 at December 31, 2006. Classified loans as a percentage of total loans was .82% at December 31, 2007 as compared to 0.76% at December 31, 2006. The loan portfolio increased 32.43% during the same period. Management anticipates an increased level of nonperforming assets and an increased level of charged off loans due to

slowing economic conditions expected through 2008.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Management's Discussion and Analysis
of Financial Condition and Results of Operations****Noninterest Income and Expense**

Noninterest Income. Noninterest income for year ended December 31, 2007 was \$5,301,799, an increase of \$711,106 from \$4,590,693 in 2006. The increase is primarily attributable to increased service charges on deposit accounts and gain on sale of mortgage loans. Deposit service charges increased \$209,845 or 12.40% from 2006, to \$1,901,758 for the year ended December 31, 2007. The increase in service charges on deposit accounts was attributable to an overall increase in the number of deposit accounts in 2007. The gain on sale of mortgage loans increased \$271,173 or 14.26% to \$2,173,140 in 2007, from \$1,901,967 in 2006.

The following table sets forth the principal components of noninterest income for the years ended December 31, 2007, 2006 and 2005.

| <i>(Dollars in thousands)</i> | 2007 | 2006 |
|--|-----------------|-----------------|
| Service charges on deposit accounts | \$ 1,902 | \$ 1,692 |
| Credit life insurance commissions | 6 | 23 |
| Gain on sale of mortgage loans | 2,173 | 1,902 |
| Securities and insurance brokerage commissions | 149 | 138 |
| Other income | 1,072 | 836 |
| Total noninterest income | \$ 5,302 | \$ 4,591 |

Noninterest Expense. Noninterest expense increased \$2,688,891 or 16.52%, to \$18,961,275 for year ended December 31, 2007 as compared to 2006. Of this total, other operating expenses increased \$1,178,113 or 23.91%, to \$6,104,948 in 2007 from \$4,926,835 in 2006. Salaries and employee benefits increased \$1,173,766 or 12.37%, to \$10,661,153 in 2007 from \$9,487,387 in 2006. This increase is primarily attributable to new hire employee compensation as the Bank expands into different markets. Net occupancy and equipment expense increased \$337,012 or 18.14%, to \$2,195,174 in 2007 largely due to operating costs associated with the Bank's branch expansion effort in 2006.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Management's Discussion and Analysis
of Financial Condition and Results of Operations****Noninterest Income and Expense - continued**

The following table sets forth the primary components of noninterest expense for the years ended December 31, 2007 and 2006.

| <i>(Dollars in thousands)</i> | 2007 | 2006 |
|---|-------------|-------------|
| Salaries and employee benefits | \$ 10,661 | 9,487 |
| Net occupancy | 1,360 | 1,131 |
| Furniture and equipment | 835 | 727 |
| Advertising and public relations | 526 | 373 |
| Office supplies, stationery, and printing | 327 | 275 |
| Data processing and supplies | 38 | 32 |
| Computer and software | 459 | 441 |
| Professional fees and services | 555 | 471 |
| Employee education and conventions | 53 | 65 |
| Loan origination costs | 233 | 208 |
| Other | 3,914 | 3,062 |
| Total noninterest expense | \$ 18,961 | \$ 16,272 |
| Efficiency ratio | 77.69% | 73.65% |

Earning Assets

Loans. Loans are the largest category of earning assets and typically provide higher yields than the other types of earning assets. Associated with the higher loan yields are the inherent credit and liquidity risks which management attempts to control and counterbalance. Loans averaged \$414,907,406 in 2007 compared to \$348,709,226 in 2006, an increase of \$66,198,180 or 18.98%. At December 31, 2007, total loans were \$468,137,690 compared to \$353,491,036 at December 31, 2006, an increase of \$114,646,654 or 32.43%.

The following table sets forth the composition of the loan portfolio by category at the dates indicated and highlights the Company's general emphasis on all types of lending.

Composition of Loan Portfolio

December 31, *(Dollars in thousands)*

| | 2007 | | 2006 | | 2005 | |
|---------------------------|---------------|---------------------------------|---------------|---------------------------------|---------------|---------------------------------|
| | Amount | Percent of Total | Amount | Percent of Total | Amount | Percent of Total |
| Commercial and industrial | \$ 67,772 | 14.48% | \$ 51,710 | 14.63% | \$ 50,320 | 16.15% |
| Real estate | | | | | | |
| Construction | 65,432 | 13.98 | 64,118 | 18.14 | 52,268 | 16.78 |
| Mortgage-residential | 120,198 | 25.67 | 91,039 | 25.75 | 86,716 | 27.83 |
| Mortgage-nonresidential | 195,992 | 41.87 | 127,214 | 35.99 | 106,125 | 34.06 |
| Consumer | 11,342 | 2.42 | 12,729 | 3.60 | 13,953 | 4.48 |
| Other | 7,402 | 1.58 | 6,681 | 1.89 | 2,162 | 0.70 |

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| | | | | | | |
|---------------------------|-------------------|----------------|-------------------|----------------|-------------------|----------------|
| Total loans | 468,138 | 100.00% | 353,491 | 100.00% | 311,544 | 100.00% |
| Allowance for loan losses | (5,271) | | (4,002) | | (3,419) | |
| Net loans | \$ 462,867 | | \$ 349,489 | | \$ 308,125 | |

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Management's Discussion and Analysis
of Financial Condition and Results of Operations****Earning Assets - continued****Composition of Loan Portfolio - continued**

December 31,

(Dollars in thousands)

| | 2004 | | 2003 | |
|---------------------------|------------|---------------------|------------|---------------------|
| | Amount | Percent of Total | Amount | Percent of Total |
| Commercial and industrial | \$ 47,890 | 20.09% | \$ 27,893 | 20.00% |
| Real estate | | | | |
| Construction | 39,023 | 16.37 | 18,343 | 13.16 |
| Mortgage-residential | 69,921 | 29.33 | 42,267 | 30.32 |
| Mortgage-nonresidential | 63,189 | 26.51 | 32,826 | 23.56 |
| Consumer | 13,931 | 5.84 | 13,200 | 9.47 |
| Other | 4,408 | 1.86 | 4,860 | 3.49 |
| Total loans | 238,362 | 100.00% | 139,389 | 100.00% |
| Allowance for loan losses | (2,758) | | (1,752) | |
| Net loans | \$ 235,604 | | \$ 137,637 | |

In the context of this discussion, a "real estate mortgage loan" is defined as any loan, other than a loan for construction purposes, secured by real estate, regardless of the purpose of the loan. It is common practice for financial institutions in the Company's market area to obtain a mortgage on real estate whenever possible, in addition to any other available collateral. This collateral is taken to reinforce the likelihood of the ultimate repayment of the loan and tends to increase management's willingness to make real estate loans and, to that extent, also tends to increase the magnitude of the real estate loan portfolio component.

The largest component of the Company's loan portfolio is real estate mortgage loans. At December 31, 2007, real estate mortgage loans totaled \$316,189,973 and represented 67.54% of the total loan portfolio, compared to \$218,252,208 or 61.74%, at December 31, 2006.

Residential mortgage loans totaled \$120,197,668 at December 31, 2007, and represented 25.67% of the total loan portfolio, compared to \$91,038,240 at December 31, 2006 or 25.75%. Residential real estate loans consist of first and second mortgages on single or multi-family residential dwellings. Nonresidential mortgage loans, which include commercial loans and other loans secured by multi-family properties and farmland, totaled \$195,992,305 at December 31, 2007, compared to \$127,213,968 at December 31, 2006. This represents an increase of \$68,778,337 or 54.07%, from the December 31, 2006 balance. Construction loans increased \$1,313,204, or 2.05%, from \$64,118,098 at December 31, 2006 to \$65,431,302 at December 31, 2007. The demand for residential and commercial real estate loans in the Bank's market area remained strong.

Commercial and industrial loans increased \$16,061,415 or 31.06%, to \$67,771,665 at December 31, 2007, from \$51,710,250 at December 31, 2006.

The Company's loan portfolio is also comprised of consumer loans. Consumer loans decreased \$ 1,385,918, or 10.89%, to \$11,342,435 at December 31, 2007, from \$12,728,353 at December 31, 2006.

The Company's loan portfolio reflects the diversity of its markets. The economies of the Company's markets contains elements of medium and light manufacturing, higher education, regional health care, and distribution facilities. Management expects the area to remain stable with continued growth in the near future. The diversity of the economy creates opportunities for all types of lending. The Company does not engage in foreign lending.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Management's Discussion and Analysis
of Financial Condition and Results of Operations****Earning Assets - continued**

The repayment of loans in the loan portfolio as they mature is also a source of liquidity for the Company. The following table sets forth the Company's loans maturing within specified intervals at December 31, 2007.

Loan Maturity Schedule and Sensitivity to Changes in Interest Rates

| December 31, 2007 <i>(Dollars in thousands)</i> | One Year or Less | Over One Year Through Five Years | Over Five Years | Total |
|---|-----------------------------|---|----------------------------|-------------------|
| Commercial and industrial | \$ 36,988 | \$ 28,867 | \$ 1,917 | \$ 67,772 |
| Real estate | 142,136 | 190,428 | 49,058 | 381,622 |
| Consumer and other | 7,439 | 10,965 | 340 | 18,744 |
| | \$ 186,563 | \$ 230,260 | \$ 51,315 | \$ 468,138 |
| Loans maturing after one year with: | | | | |
| Fixed interest rates | | | \$ 156,682 | |
| Floating interest rates | | | 124,893 | |
| | | | \$ 281,575 | |

The information presented in the above table is based on the contractual maturities of the individual loans, including loans which may be subject to renewal at their contractual maturity. Renewal of such loans is subject to review and credit approval as well as modification of terms upon maturity. Consequently, management believes this treatment presents fairly the maturity and repricing structure of the loan portfolio shown in the above table.

Investment Securities. The investment securities portfolio is also a component of the Company's total earning assets. Total securities available-for-sale averaged \$36,170,565 in 2007, compared to \$36,711,400 in 2006. Investment securities also contains Federal Home Loan Bank stock and the stock of several unrelated financial institutions. These stocks are recorded at their original cost and totaled \$3,930,400 and \$2,187,600 at December 31, 2007 and 2006, respectively.

The following table sets forth the fair market value of the securities available-for-sale held by the Bank at December 31, 2007 and 2006.

Fair Value of Securities available-for-sale

| December 31, <i>(Dollars in thousands)</i> | 2007 | 2006 |
|--|-------------|-------------|
| Government sponsored enterprises | \$ - | \$ 4,950 |
| U.S. government agencies and corporations | 193 | 381 |
| Municipals | 27,067 | 15,086 |
| Mortgage-backed securities | 31,069 | 15,202 |
| Other Securities | 252 | 312 |

| | | | | |
|-------------------------------------|----|--------|----|--------|
| Total securities available-for-sale | \$ | 58,580 | \$ | 35,931 |
|-------------------------------------|----|--------|----|--------|

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Management's Discussion and Analysis
of Financial Condition and Results of Operations****Earning Assets - continued**

The following table sets forth the scheduled maturities and average yields of securities held at December 31, 2007.

Investment Securities Maturity Distribution and Yields

| December 31, 2007 <i>(Dollars in thousands)</i> | Within One Year | | After One But Within Five Years | | After Five But Within Ten Years | | After Ten Years | | Total | |
|---|--------------------|--------------|---------------------------------------|--------------|---------------------------------------|--------------|--------------------|--------------|-----------|--------------|
| | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| U.S. government agencies and corporations | \$ 19 | 5.90% | \$ 174 | 6.10% | \$ — | — | \$ — | — | \$ 193 | 6.08% |
| Municipals ⁽²⁾ | — | — | 1,103 | 5.37 | 1,039 | 6.36 | 28,927 | 6.22 | 31,069 | 6.20 |
| Total securities ⁽¹⁾ | \$ 19 | 5.90% | \$ 1,277 | 5.47% | \$ 1,039 | 6.36% | \$ 28,927 | 6.22% | \$ 31,262 | 6.20% |

(1) Excludes mortgage-backed securities totaling \$27,066,963 with a yield of 5.27 % and other and non-marketable equity securities totaling \$251,650.

(2) Yields are based on a tax equivalent basis of 34%.

Other attributes of the securities portfolio, including yields and maturities, are discussed above in "Net Interest Income-Interest Sensitivity Analysis."

Federal Funds Sold. Federal funds sold averaged \$7,479,356 in 2007 compared to \$13,806,773 in 2006. At December 31, 2007 and 2006, federal funds sold totaled \$0 and \$14,135,000.

Deposits and Other Interest-Bearing Liabilities

Average interest-bearing liabilities increased \$61,372,246, or 17.27%, to \$416,742,720 in 2007, from \$355,370,474 in 2006. The increase is primarily a result of the continued growth of the Company.

Deposits. Average total deposits increased \$57,534,327, or 15.98%, to \$417,540,949 in 2007, from \$360,006,622 in 2006. At December 31, 2007, total deposits were \$449,497,715 compared to \$372,938,083 a year earlier, an increase of 20.53%.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Management's Discussion and Analysis
of Financial Condition and Results of Operations****Deposits and Other Interest-Bearing Liabilities - continued**

The following table sets forth the average balance amounts and the average rates paid on deposits of the Company by category at December 31, 2007 and 2006.

Deposits

| December 31, | 2007 | | 2006 | |
|----------------------------------|-------------------|-------------------------|-------------------|-------------------------|
| | Average Amount | Average Rate Paid | Average Amount | Average Rate Paid |
| <i>(Dollars in thousands)</i> | | | | |
| Demand deposit accounts | \$ 45,038 | -% | 42,100 | -% |
| NOW accounts | 36,625 | 1.94 | 27,084 | 0.68 |
| Savings accounts | 80,943 | 3.93 | 85,887 | 3.78 |
| Time deposits \$100,000 and over | 140,926 | 4.97 | 112,132 | 4.23 |
| Other time deposits | 114,008 | 5.15 | 92,803 | 4.66 |
| Total deposits | \$ 417,540 | 4.02 % | \$ 360,006 | 3.47 % |

Core deposits, which exclude time deposits of \$100,000 or more, provide a relatively stable funding source for the Company's loan portfolio and other earning assets. The Company's core deposits were \$279,672,463 and \$260,946,219 at December 31, 2007 and 2006, respectively. Included in time deposits \$100,000 and over, at December 31, 2007 and 2006 are brokered time deposits of \$85,330,473 and \$29,515,694, respectively.

Deposits, and particularly core deposits, have been the Company's primary source of funding and have enabled the Company to meet successfully both its short-term and long-term liquidity needs. Management anticipates that such deposits will continue to be the Company's primary source of funding in the future. However, advances from the Federal Home Loan Bank are being used as an alternative source of funds. The Company's loan-to-deposit ratio was 104.15% at December 31, 2007, and 94.79% at December 31, 2006. The maturity distribution of the Company's time deposits over \$100,000 and over at December 31, 2007, is set forth in the following table:

Maturities of Time Deposits of \$100,000 or over

| <i>(Dollars in thousands)</i> | Within Three Months | After Three Through Six Months | After Six Through Twelve Months | After Twelve Months | Total |
|---|------------------------|--------------------------------------|--|------------------------|------------|
| Certificates of deposit of \$100,000 or over | \$ 103,630 | \$ 96,420 | \$ 71,339 | \$ 9,296 | \$ 280,685 |

Approximately 36.92% of the Company's time deposits of \$100,000 or more had scheduled maturities within three months, and 34.34% had maturities within three to six months. Large certificate of deposit customers tend to be extremely sensitive to interest rate levels, making these deposits less reliable sources of funding for liquidity planning purposes than core deposits. The current interest rate environment has led depositors to invest in short term deposit accounts. The Company expects most certificates of deposits with maturities less than twelve months to be renewed upon maturity. However, there is the possibility that some certificates may not be renewed. Management believes that,

should that occur, the impact would be minimal on the Company's operations and liquidity due to the availability of other funding sources. The Company has an available line to borrow funds from the Federal Home Loan Bank up to 30% of the Bank's total assets which provided additional available funds of \$177,073,140 at December 31, 2007 and available lines to purchase federal funds with various financial institutions up to \$37,000 000 at December 31, 2007. Management believes that these funds would be sufficient to meet future liquidity needs.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Management's Discussion and Analysis
of Financial Condition and Results of Operations****Deposits and Other Interest-Bearing Liabilities - continued**

Other Borrowings. The following table summarizes the Company's borrowings for the years ended December 31, 2007, 2006, and 2005. These borrowings consist of securities sold under agreements to repurchase, advances from the Federal Home Loan Bank, federal funds purchased, a note payable and junior subordinated debentures. Securities sold under agreements to repurchase mature on a one to seven day basis. These agreements are secured by U.S. government agencies. Advances from Federal Home Loan Bank mature at different periods as discussed in the footnotes to the financial statements and are secured by the Company's one to four family residential mortgage loans and the Company's investment in Federal Home Loan Bank stock. Federal funds purchased are short-term borrowings from other financial institutions that mature daily.

| <i>(Dollars in thousands)</i> | Maximum Outstanding at any Month End | Average Balance | Weighted Average Interest Rate | Balance December 31, | Interest Rate at December 31 |
|---|---|----------------------------|---|-------------------------------------|---|
| December 31, 2007 | | | | | |
| Securities sold under agreement to repurchase | \$ 11,651 | \$ 9,128 | 4.38% | \$ 7,928 | 4.43% |
| Advances from Federal Home Loan Bank | 69,000 | 22,985 | 3.61 | 69,000 | 4.40 |
| Federal funds purchased | 13,359 | 1,809 | 5.11 | 13,359 | 4.50 |
| Note payable | 3,000 | 8 | 6.00 | 3,000 | 6.00 |
| Junior subordinated debentures | 10,310 | 10,310 | 6.01 | 10,310 | 5.93 |
| December 31, 2006 | | | | | |
| Securities sold under agreement to repurchase | \$ 8,190 | \$ 6,065 | 4.27% | \$ 8,120 | 6.02% |
| Advances from Federal Home Loan Bank | 29,800 | 21,028 | 4.24 | 28,500 | 3.81 |
| Federal funds purchased | 955 | 61 | 3.72 | - | - |
| Junior subordinated debentures | 10,310 | 10,310 | 5.99 | 10,310 | 5.93 |
| December 31, 2005 | | | | | |
| Securities sold under agreement to repurchase | \$ 4,223 | \$ 3,600 | 2.54% | \$ 3,860 | 3.88% |
| Advances from Federal Home Loan Bank | 36,000 | 31,301 | 3.28 | 23,500 | 3.28 |
| Federal funds purchased | - | - | - | - | - |
| Junior subordinated debentures | 10,310 | 4,875 | 6.28 | 10,310 | 5.93 |

Capital

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a 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 Company's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Management's Discussion and Analysis
of Financial Condition and Results of Operations****Capital - continued**

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum ratios of Tier 1 and total capital as a percentage of assets and off-balance-sheet exposures, adjusted for risk weights ranging from 0% to 100%. Tier 1 capital of the Company consists of common shareholders' equity, excluding the unrealized gain or loss on securities available-for-sale, minus certain intangible assets. The Company's Tier 2 capital consists of the allowance for loan losses subject to certain limitations. Total capital for purposes of computing the capital ratios consists of the sum of Tier 1 and Tier 2 capital. The regulatory minimum requirements are 4% for Tier 1 capital and 8% for total risk-based capital.

The Company and the Bank are also required to maintain capital at a minimum level based on quarterly average assets, which is known as the leverage ratio. Only the strongest banks are allowed to maintain capital at the minimum requirement of 3%. All others are subject to maintaining ratios 1% to 2% above the minimum.

The Company and the Bank exceeded the regulatory capital requirements at December 31, 2007. The following table shows the Company's and the Bank's ratios at December 31, 2007.

Analysis of Capital and Capital Ratios

| | Company | Bank |
|--|------------|------------|
| <i>(Dollars in thousands)</i> | | |
| Tier 1 capital | \$ 50,361 | \$ 48,554 |
| Tier 2 capital | 2,225 | 5,271 |
| Total qualifying capital | \$ 52,586 | \$ 53,824 |
| Risk-adjusted total assets (including off-balance-sheet exposures) | \$ 511,207 | \$ 510,959 |
| Risk-based capital ratios: | | |
| Tier 1 risk-based capital ratio | 9.26% | 9.50% |
| Total risk-based capital ratio | 10.29% | 10.53% |
| Tier 1 leverage ratio | 9.46% | 8.85% |

Impact of Off-Balance Sheet Instruments

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 the Company's customers. These financial instruments consist of commitments to extend credit and standby letters of credit. Commitments to extend credit are legally binding agreements to lend to a customer at predetermined interest rates as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. A commitment involves, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The exposure to credit loss in the event of nonperformance by the other party to the instrument is represented by the contractual notional amount of the instrument. Since certain commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Letters of credit are conditional commitments issued to guarantee a customer's performance to a third party and have essentially the same credit risk as other lending facilities. Standby letters of credit often expire without being used.

The Company uses the same credit underwriting procedures for commitments to extend credit and standby letters of credit as it does for its on-balance sheet instruments. The credit worthiness of each borrower is evaluated and the amount of collateral, if deemed necessary, is based on the credit evaluation. Collateral held for commitments to extend credit and standby letters of credit varies but may include accounts receivable, inventory, property, plant, equipment, and income-producing commercial properties.

The Company is not involved in off-balance sheet contractual relationships, other than those disclosed in this report, that could result in liquidity needs or other commitments or that could significantly impact earnings.

As of December 31, 2007, commitments to extend credit totaled \$76,545,909 and its standby letters of credit totaled \$2,721,249.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Management's Discussion and Analysis
of Financial Condition and Results of Operations****Impact of Off-Balance Sheet Instruments - continued**

The following table sets forth the length of time until maturity for unused commitments to extend credit and standby letters of credit at December 31, 2007.

| <i>(Dollars in thousands)</i> | Within One Month | After One Through Three Months | After Three Through Twelve Months | Within One Year | Greater Than One Year | Total |
|-------------------------------------|-----------------------------|---|--|----------------------------|--------------------------------------|------------------|
| Unused commitments to extend credit | \$ 8,909 | \$ 3,941 | \$ 27,415 | \$ 40,265 | \$ 36,281 | \$ 76,546 |
| Standby letters of credit | 114 | 400 | 542 | 1,056 | 1,665 | 2,721 |
| Totals | \$ 9,023 | \$ 4,341 | \$ 27,957 | \$ 41,321 | \$ 37,946 | \$ 79,267 |

The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on its credit evaluation of the borrower. Collateral varies but may include accounts receivable, inventory, property, plant and equipment, and commercial and residential real estate.

Liquidity Management and Capital Resources

Liquidity is the ability to meet current and future obligations through liquidation or maturity of existing assets or the acquisition of additional liabilities. Adequate liquidity is necessary to meet the requirements of customers for loans and deposit withdrawals in the most timely and economical manner. Some liquidity is ensured by maintaining assets that may be immediately converted into cash at minimal cost (amounts due from banks and federal funds sold). However, the most manageable sources of liquidity are composed of liabilities, with the primary focus on liquidity management being on the ability to obtain deposits within the Company's service area. Core deposits (total deposits less time deposits greater than \$100,000) provide a relatively stable funding base, and were equal to 47.27% of total assets at December 31, 2007. Asset liquidity is provided from several sources, including amounts due from banks, federal funds sold, securities available for sale, and funds from maturing loans. The Company had \$7,164,650 in cash and cash equivalents and \$58,580,313 in securities available for sale at December 31, 2007. The Company has \$37,000,000 available through a line of credit with other banks as an additional source of liquidity funding. The Company also has a line of credit to borrow funds from the Federal Home Loan Bank up to \$177,073,140 of which \$108,073,140 is available at December 31, 2007.

Contractual Obligations

The following table provides payments due by period for various contractual obligations as of December 31, 2007:

| <i>(Dollars in thousands)</i> | Within One Year | Over One to Two Years | Over Two to Three Years | Over Three to Five Years | After Five Years | Total |
|--------------------------------------|----------------------------|----------------------------------|------------------------------------|---|-----------------------------|--------------|
| Certificate accounts ⁽¹⁾ | \$ 271,389 | \$ 5,770 | \$ 1,486 | \$ 2,040 | \$ - | \$ 280,685 |
| Short-term borrowings ⁽²⁾ | 10,928 | | | | | 10,928 |
| Long-term debt ⁽³⁾ | 40,000 | 20,000 | 8,000 | 1,000 | 10,310 | 79,310 |

| | | | | | | |
|------------------------------------|------------|-----------|-----------|----------|-----------|------------|
| Purchases | - | - | - | - | - | - |
| Operating lease obligations (4) | 608 | 539 | 518 | 958 | - | 2,623 |
| Totals | \$ 322,925 | \$ 26,309 | \$ 10,004 | \$ 3,998 | \$ 10,310 | \$ 373,546 |

(1) Certificates of deposit give customers rights to early withdrawal. Early withdrawals may be subject to penalties. The penalty amount depends on the remaining time to maturity at the time of early withdrawal.

(2) Short-term borrowings consist of securities sold under agreements to repurchase and a note payable. We expect securities repurchase agreements to be re-issued and, as such, do not necessarily represent an immediate need for cash.

(3) Long term debt consists of FHLB borrowings and junior subordinated debentures.

(4) Operating lease obligations include existing and future property and equipment non-cancelable lease commitments.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Management's Discussion and Analysis of Financial Condition and Results of Operations

Liquidity Management and Capital Resources - *continued*

During 2007, the Company's primary sources of cash were \$ 76,559,631 from deposits. The Company's primary uses of cash resources were to fund loans of approximately \$114,646,654. These trends are consistent with those of a growing bank operation and consistent with past cash uses and sources. Management believes that the Company's overall liquidity sources are adequate to meet its operating needs in the ordinary course of its business. Accordingly, the Company does not expect to have to raise additional funds in 2007 to meet either short or long-term needs.

Impact of Inflation

Unlike most industrial companies, the assets and liabilities of financial institutions such as the Company are primarily monetary in nature. Therefore, interest rates have a more significant effect on the Company's performance than do the general rate of inflation and of goods and services. In addition, interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. As discussed previously, management seeks to manage the relationships between interest sensitive assets and liabilities in order to protect against wide interest rate fluctuations, including those resulting from inflation.

Accounting and Financial Reporting Issues

The Company has adopted various accounting policies which govern the application of accounting principles generally accepted in the United States in the preparation of its financial statements. The significant accounting policies are described in the footnotes to the financial statements at December 31, 2007 as filed on the annual report on Form 10-K. Certain accounting policies involve significant judgments and assumptions by management which have a material impact on the carrying value of certain assets and liabilities. The Company considers these accounting policies to be critical accounting policies. The judgments and assumptions used are based on historical experience and other factors, which management believes to be reasonable under the circumstances. Because of the nature of the judgments and assumptions made, actual results could differ from these judgments and estimates which could have a material impact on the carrying values of assets and liabilities and the results of operations.

Of these significant accounting policies, the Company considers its policies regarding the allowance for loan losses (the Allowance) to be its most critical accounting policy due to the significant degree of management judgment involved in determining the amount of Allowance. The Company has developed policies and procedures for assessing the adequacy of the Allowance, recognizing that this process requires a number of assumptions and estimates with respect to its loan portfolio. The Company's assessments may be impacted in future periods by changes in economic conditions, the impact of regulatory examinations, and the discovery of information with respect to borrowers, which is not known to management at the time of the issuance of the consolidated financial statements. Refer to the discussion under Provision and Allowance for Loan Losses section of this document for a detailed description of the Company's estimation process and methodology related to the allowance for loan losses.

Industry Developments

From time to time, various bills are introduced in the United States Congress with respect to the regulation of financial institutions. Certain legislation, if adopted, could significantly change the regulation of banks and the financial services industry. The Company cannot predict whether any such legislation will be adopted or, if adopted, how it would affect the Company.

MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in *Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934*. Our internal control over financial reporting is a process designed to provide reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition, transactions are executed in accordance with appropriate management authorization and accounting records are reliable for the preparation of financial statements in accordance with generally accepted accounting principles.

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.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2007. Management based this assessment on criteria for effective internal control over financial reporting described in *“Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.”* Management’s assessment included an evaluation of the design of our internal control over financial reporting and testing of the operational effectiveness of its internal control over financial reporting. Management reviewed the results of its assessment with the Audit Committee of the Board of Directors. Based on this assessment, management believes that First Reliance Bancshares, Inc. maintained effective internal control over financial reporting as of December 31, 2007.

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

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
First Reliance Bancshares, Inc. and Subsidiary
Florence, South Carolina

We have audited the accompanying consolidated balance sheets of First Reliance Bancshares, Inc. and subsidiary (the "Company") as of December 31, 2007 and 2006, and the related consolidated statements of income, changes in shareholders' equity and comprehensive income, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 First Reliance Bancshares, Inc. and subsidiary as of December 31, 2007 and 2006, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

We were not engaged to examine management's assertion about the effectiveness of First Reliance Bancshares, Inc.'s internal control over financial reporting as of December 31, 2007 included in the accompanying Management's Report on Internal Control Over Financial Reporting and, accordingly, we do not express an opinion thereon.

Elliott Davis, LLC
Columbia, South Carolina
March 25, 2008

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Consolidated Balance Sheets**

| | December 31, | |
|---|-----------------------|-----------------------|
| | 2007 | 2006 |
| Assets: | | |
| Cash and cash equivalents: | | |
| Cash and due from banks | \$ 7,164,650 | \$ 17,328,075 |
| Federal funds sold | - | 14,135,000 |
| Total cash and cash equivalents | 7,164,650 | 31,463,075 |
| Investment securities: | | |
| Securities available-for-sale | 58,580,313 | 35,931,271 |
| Nonmarketable equity securities | 3,930,400 | 2,187,600 |
| Total investment securities | 62,510,713 | 38,118,871 |
| Mortgage loans held for sale | 19,600,850 | 6,632,010 |
| Loans receivable | 468,137,690 | 353,491,036 |
| Less allowance for loan losses | (5,270,607) | (4,001,881) |
| Loans, net | 462,867,083 | 349,489,155 |
| Premises, furniture and equipment, net | 22,233,746 | 13,770,135 |
| Accrued interest receivable | 3,092,767 | 2,464,531 |
| Other real estate owned | 196,950 | 1,386,380 |
| Cash surrender value of life insurance | 10,540,273 | 10,134,036 |
| Other assets | 3,497,180 | 2,752,529 |
| Total assets | \$ 591,704,212 | \$ 456,210,722 |
| Liabilities: | | |
| Deposits: | | |
| Noninterest-bearing transaction accounts | \$ 43,542,528 | \$ 42,107,434 |
| Interest-bearing transaction accounts | 39,450,393 | 33,243,099 |
| Savings | 85,819,481 | 78,831,730 |
| Time deposits \$100,000 and over | 169,825,252 | 111,991,864 |
| Other time deposits | 110,860,061 | 106,763,956 |
| Total deposits | 449,497,715 | 372,938,083 |
| Securities sold under agreements to repurchase | 7,927,754 | 8,120,014 |
| Federal Funds Purchased | 13,359,000 | - |
| Advances from Federal Home Loan Bank | 69,000,000 | 28,500,000 |
| Note payable | 3,000,000 | - |
| Junior subordinated debentures | 10,310,000 | 10,310,000 |
| Accrued interest payable | 767,577 | 766,276 |
| Other liabilities | 814,262 | 1,483,086 |
| Total liabilities | 554,676,308 | 422,117,459 |
| Commitments and contingencies (Notes 4, and 14) | | |
| Shareholders' Equity: | | |
| Common stock, \$0.01 par value, 20,000,000 shares authorized; 3,494,646 and 3,424,878 shares issued and outstanding at December 31, 2007 and 2006, respectively | | |
| | 34,946 | 34,249 |
| Nonvested restricted stock | (152,762) | (66,131) |
| Capital surplus | 25,875,012 | 25,257,814 |
| Treasury stock (9,667 shares at cost at December 31, 2007) | (145,198) | - |
| Retained earnings | 11,417,275 | 8,857,755 |

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| | | |
|---|----------------|----------------|
| Accumulated other comprehensive income (loss) | (1,369) | 9,576 |
| Total shareholders' equity | 37,027,904 | 34,093,263 |
| Total liabilities and shareholders' equity | \$ 591,704,212 | \$ 456,210,722 |

The accompanying notes are an integral part of the consolidated financial statements.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Consolidated Statements of Income**

| | For the years ended December 31, | |
|--|---|---------------------|
| | 2007 | 2006 |
| Interest income: | | |
| Loans, including fees | \$ 35,325,242 | \$ 29,222,425 |
| Investment securities: | | |
| Taxable | 892,277 | 1,029,560 |
| Tax exempt | 780,191 | 639,710 |
| Federal funds sold | 390,944 | 687,352 |
| Other interest income | 151,833 | 137,538 |
| Total | 37,540,487 | 31,716,585 |
| Interest expense: | | |
| Time deposits \$100,000 and over | 7,002,414 | 4,747,647 |
| Other deposits | 9,765,871 | 7,748,192 |
| Other interest expense | 1,664,924 | 1,717,860 |
| Total | 18,433,209 | 14,213,699 |
| Net interest income | 19,107,278 | 17,502,886 |
| Provision for loan losses | 1,643,100 | 1,392,491 |
| Net interest income after provision for loan losses | 17,464,178 | 16,110,395 |
| Noninterest income: | | |
| Service charges on deposit accounts | 1,901,758 | 1,691,913 |
| Gain on sale of mortgage loans | 2,173,140 | 1,901,967 |
| Brokerage fees | 149,268 | 138,340 |
| Credit life insurance commissions | 6,100 | 23,173 |
| Other service charges, commissions, and fees | 366,172 | 263,610 |
| Gain on sale of investment securities | 5,996 | - |
| Gain on sale of other real estate | 29,186 | 7,387 |
| Gain (loss) on sale of fixed assets | 59,318 | (13) |
| Other | 610,861 | 564,316 |
| Total | 5,301,799 | 4,590,693 |
| Noninterest expenses: | | |
| Salaries and benefits | 10,661,153 | 9,487,387 |
| Occupancy | 1,360,295 | 1,130,705 |
| Furniture and equipment related expenses | 834,879 | 727,457 |
| Other operating | 6,104,948 | 4,926,835 |
| Total | 18,961,275 | 16,272,384 |
| Income before income taxes | 3,804,702 | 4,428,704 |
| Income tax expense | 1,245,182 | 1,182,796 |
| Net income | \$ 2,559,520 | \$ 3,245,908 |
| Earnings per share: | | |
| Basic | \$ 0.74 | \$ 0.96 |
| Diluted | \$ 0.72 | \$ 0.91 |

The accompanying notes are an integral part of the consolidated financial statements.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Consolidated Statements of Changes in Shareholders' Equity and Comprehensive Income
For the years ended December 31, 2007 and 2006

| | Common Stock | | Capital | Treasury | Nonvested | Retained | Accumulated Other Comprehensive | |
|--|--------------|-----------|---------------|------------|---------------------|--------------|---------------------------------------|---------------|
| | Shares | Amount | Surplus | Stock | Restricted Stock | Earnings | Income (Loss) | Total |
| Balance, December 31, 2005 | 3,306,117 | \$ 33,061 | \$ 24,127,329 | \$ (9,896) | - | \$ 5,611,847 | \$ (111,706) | \$ 29,650,635 |
| Net income | | | | | | 3,245,908 | | 3,245,908 |
| Other comprehensive income, net of tax expense of \$63,441 | | | | | | | 121,282 | 121,282 |
| Comprehensive income | | | | | | | | 3,367,190 |
| Sale of treasury stock | | | | 9,896 | | | | 9,896 |
| Issuance of advisory board shares | 945 | 9 | 15,016 | | | | | 15,025 |
| Restricted stock issuance | 6,771 | 68 | 99,695 | | (66,131) | | | 33,632 |
| Issuance of shares to 404(c) plan | 32,674 | 327 | 472,420 | | | | | 472,747 |
| Exercise of stock options | 78,371 | 784 | 543,354 | | | | | 544,138 |
| Balance, December 31, 2006 | 3,424,878 | 34,249 | 25,257,814 | - | (66,131) | 8,857,755 | 9,576 | 34,093,263 |
| Net income | | | | | | 2,559,520 | | 2,559,520 |
| Other comprehensive loss, net of tax | | | | | | | (10,945) | (10,945) |

benefit of
\$5,639

| | | | | | |
|-----------------------------------|------------------|------------------|----------------------|---------------------|----------------------|
| Comprehensive income | | | | | 2,548,575 |
| Purchase of treasury stock | | | (145,198) | | (145,198) |
| Issuance of advisory board shares | 1,559 | 15 | 16,744 | | 16,759 |
| Restricted stock issuance | 11,681 | 117 | 162,893 | (86,631) | 76,379 |
| Issuance of shares to 404(c) plan | 13,383 | 134 | 198,246 | | 198,380 |
| Exercise of stock options | 43,145 | 431 | 239,315 | | 239,746 |
| Balance, December 31, 2007 | 3,494,646 | \$ 34,946 | \$ 25,875,012 | \$ (145,198) | \$ (152,762) |
| | | | | | \$ 11,417,275 |
| | | | | | \$ (1,369) |
| | | | | | \$ 37,027,904 |

The accompanying notes are an integral part of the consolidated financial statements.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY
Consolidated Statements of Cash Flows

| | For the years ended December 31, | |
|---|----------------------------------|---------------|
| | 2007 | 2006 |
| Cash flows from operating activities: | | |
| Net income | \$ 2,559,520 | \$ 3,245,908 |
| Adjustments to reconcile net income to net cash provided (used) by operating activities: | | |
| Provision for loan losses | 1,643,100 | 1,392,491 |
| Depreciation and amortization expense | 812,762 | 904,367 |
| Gain on sales of securities available-for-sales | (3,496) | - |
| Gain on non marketable securities | (2,500) | |
| Gain on sale of equipment | (59,318) | |
| Gain on sale of other real estate owned | (29,186) | (7,387) |
| Discount accretion and premium amortization | 49,316 | 62,497 |
| Disbursements for mortgages held for sale | (146,067,873) | (129,199,377) |
| Proceeds from sales of mortgages held for sale | 133,099,033 | 130,561,970 |
| Writedown of other real estate owned | - | 169,146 |
| Deferred income tax benefit | (531,918) | (276,141) |
| Increase in interest receivable | (628,236) | (274,789) |
| Decrease in interest payable | 1,301 | 319,973 |
| Increase in other assets and cash surrender value of life insurance | (876,268) | (7,211,901) |
| Increase (decrease) in other liabilities | (663,890) | 648,942 |
| Net cash provided (used) by operating activities | (10,697,653) | 335,699 |
| Cash flows from investing activities: | | |
| Purchases of securities available-for-sale | (34,969,570) | (1,521,226) |
| Maturities of securities available-for-sale | 2,472,556 | 2,952,409 |
| Proceeds from sales of nonmarketable equity securities | 2,186,000 | 711,000 |
| Proceeds on sale of securities available-for-sale | 9,785,569 | |
| Purchases of nonmarketable equity securities | (3,927,000) | (1,271,500) |
| Net increase in loans receivable | (115,426,100) | (45,103,300) |
| Purchases of premises, furniture and equipment | (9,043,619) | (4,347,627) |
| Proceeds from disposal of premises, furniture and equipment | 84,566 | 19,908 |
| Proceeds from sale of other real estate owned | 1,623,689 | 1,144,082 |
| Net cash used by investing activities | (147,213,209) | (47,416,254) |
| Cash flows from financing activities: | | |
| Net increase in demand deposits, interest-bearing transaction accounts and savings accounts | 14,630,138 | 5,859,407 |
| Net increase in certificates of deposit and other time deposits | 61,929,493 | 32,641,778 |
| Increase in advances from Federal Home Loan Bank | 40,500,000 | 5,000,000 |
| Increase in federal funds purchased | 13,359,000 | - |
| Net increase (decrease) in securities sold under agreements to repurchase | (192,260) | 4,260,110 |
| Proceeds from note payable | 3,000,000 | - |
| Proceeds from junior subordinated debentures | - | - |
| Exercise of stock options | 239,746 | 544,138 |
| Advisory board stock - issuance of advisory board shares | 16,759 | 15,025 |

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| | | |
|---|---------------------|----------------------|
| 404(c) purchase - issuance of shares to 404(c) | 198,380 | 472,747 |
| Restricted stock | 76,379 | 33,632 |
| Sale (purchase) of treasury stock | (145,198) | 9,896 |
| Net cash provided by financing activities | 133,612,437 | 48,836,733 |
| Net increase (decrease) in cash and cash equivalents | 24,298,425 | 1,756,178 |
| Cash and cash equivalents, beginning of year | 31,463,075 | 29,706,897 |
| Cash and cash equivalents, end of year | \$ 7,164,650 | \$ 31,463,075 |
| Cash paid during the year for: | | |
| Income taxes | \$ 1,431,042 | \$ 1,475,090 |
| Interest | \$ 18,431,908 | \$ 13,893,726 |
| Supplemental noncash investing and financing activities: | | |
| Foreclosures on loans | \$ 405,072 | \$ 2,346,671 |

The accompanying notes are an integral part of the consolidated financial statements.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization - First Reliance Bancshares, Inc. (the Company) was incorporated to serve as a bank holding company for its subsidiary, First Reliance Bank (the Bank). First Reliance Bank was incorporated on August 9, 1999 and commenced business on August 16, 1999. The principal business activity of the Bank is to provide banking services to domestic markets, principally in Florence, Lexington, and Charleston Counties in South Carolina. The Bank is a state-chartered commercial Bank, and its deposits are insured by the Federal Deposit Insurance Corporation. The consolidated financial statements include the accounts of the parent company and its wholly-owned subsidiary after elimination of all significant intercompany balances and transactions. In 2005, the Company formed First Reliance Capital Trust I (the "Trust") for the purpose of issuing trust preferred securities. In accordance with current accounting guidance, the Trust is not consolidated in these financial statements.

Management's Estimates - The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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, including valuation allowances for impaired loans, and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowances for losses on loans and foreclosed real estate, management obtains independent appraisals for significant properties. Management must also make estimates in determining the estimated useful lives and methods for depreciating premises and equipment.

While management uses available information to recognize losses on loans and foreclosed real estate, future additions to the allowances may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowances for losses on loans and foreclosed real estate. Such agencies may require the Company to recognize additions to the allowances based on their judgments about information available to them at the time of their examinations. Because of these factors, it is reasonably possible that the allowances for losses on loans and foreclosed real estate may change materially in the near term.

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

The Company makes loans to individuals and small businesses for various personal and commercial purposes primarily in Florence, Lexington, Charleston and Mount Pleasant, South Carolina. At December 31, 2007, the majority of the total loan portfolio was to borrowers from within these areas.

The Company's loan portfolio is not concentrated in loans to any single borrower or a relatively small number of borrowers. Additionally, management is not aware of any concentrations of loans to groups of borrowers or industries that would be similarly affected by sector specific economic conditions.

In addition to monitoring potential concentrations of loans to particular borrowers or groups of borrowers, industries and geographic regions, management monitors exposure to credit risk from concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g. principal deferral periods, loans with initial interest-only periods, etc), and loans with high loan-to-value ratios. Management has determined that there is minimal concentration of credit risk associated with its lending policies or practices.

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

The Company's investment portfolio consists principally of obligations of the United States and its agencies or its corporations. In the opinion of management, there is no concentration of credit risk in its investment portfolio. The Company places its deposits and correspondent accounts with and sells its federal funds to high quality institutions. Management believes credit risk associated with correspondent accounts is not significant.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - *continued*

Securities Available-for-Sale - Securities available-for-sale are carried at amortized cost and adjusted to estimated market value by recognizing the aggregate unrealized gains or losses in a valuation account. Aggregate market valuation adjustments are recorded as part of the comprehensive income in shareholders' equity net of deferred income taxes. Reductions in market value considered by management to be other than temporary are reported as a realized loss and a reduction in the cost basis of the security. The adjusted cost basis of investments available-for-sale is determined by specific identification and is used in computing the gain or loss upon sale.

Nonmarketable Equity Securities - Nonmarketable equity securities include the cost of the Company's investment in the stock of Federal Home Loan Bank and the stock of another community bank holding company. The stock has no quoted market value and no ready market exists. Investment in the Federal Home Loan Bank is a condition of borrowing from the Federal Home Loan Bank, and the stock is pledged to collateralize such borrowings. At December 31, 2007, the Company's investment in Federal Home Loan Bank stock was \$3,930,400. Dividends received on this stock are included as a separate component of interest income.

Loans receivable - Loans receivable are stated at their unpaid principal balance. Interest income is computed using the simple interest method and is recorded in the period earned.

When serious doubt exists as to the collectibility of a loan or when a loan becomes contractually ninety days past due as to principal or interest, interest income is generally discontinued unless the estimated net realizable value of collateral exceeds the principal balance and accrued interest. When interest accruals are discontinued, income earned but not collected is reversed.

Loan origination and commitment fees and certain direct loan origination costs (principally salaries and employee benefits) are deferred and amortized to income over the contractual life of the related loans or commitments, adjusted for prepayments, using the straight-line method.

Allowance for Loan Losses - The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

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

specific and general losses in the portfolio.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - *continued*

Allowance for Loan Losses (*continued*) - A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significant of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Residential Mortgages Held-For-Sale - The Company's mortgage activities are comprised of accepting residential mortgage loan applications, qualifying borrowers to standards established by investors, funding residential mortgages and selling mortgages to investors under pre-existing commitments. Funded residential mortgages held temporarily for sale to investors are recorded at the lower of cost or market value. Gains or losses are recognized when control over these assets has been surrendered in accordance with SFAS No. 140 "Accounting for Transfer and Servicing of Financial Assets and Extinguishment of Liabilities," and are included in gain on sale of mortgage loan in the consolidated statements of income.

Other Real Estate Owned - Other real estate owned includes real estate acquired through foreclosure. Other real estate owned is carried at the lower of cost (principal balance at the date of foreclosure) or fair value minus estimated costs to sell. Any write-downs at the date of foreclosure are charged to the allowance for loan losses. Expenses to maintain such assets, subsequent changes in the valuation allowance, and gains and losses on disposal are included in other expenses.

Premises, Furniture and Equipment - Premises, furniture and equipment are stated at cost, less accumulated depreciation. The provision for depreciation is computed by the straight-line method, based on the estimated useful lives for buildings of 40 years and furniture and equipment of 5 to 10 years. Leasehold improvements are being amortized over 20 years. The cost of assets sold or otherwise disposed of and the related allowance for depreciation is eliminated from the accounts and the resulting gains or losses are reflected in the income statement when incurred. Maintenance and repairs are charged to current expense. The costs of major renewals and improvements are capitalized based upon the Company's policy.

Cash Surrender Value of Life Insurance - Cash surrender value of life insurance represents the cash value of policies on certain officers of the Bank.

Residential Mortgage Origination Fees Residential mortgage origination fees include fees from residential mortgage loans originated by the Company and subsequently sold in the secondary market. These fees are recognized as income at the time of the sale to the investor.

Income Taxes - Income taxes are the sum of amounts currently payable to taxing authorities and the net changes in income taxes payable or refundable in future years. Income taxes deferred to future years are determined utilizing a liability approach. This method gives consideration to the future tax consequences associated with differences between financial accounting and tax bases of certain assets and liabilities which are principally the allowance for loan losses and depreciable premises and equipment.

In 2006, the FASB issued Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes - an Interpretation of SFAS No. 109." FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." FIN 48 also prescribes a recognition threshold and measurement of a tax position taken or expected to be taken in an enterprise's tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. Accordingly, the Company adopted FIN 48 effective January 1, 2007. The adoption of FIN 48 did not have any impact on the Company's consolidated financial position.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - *continued*

Advertising Expense - Advertising and public relations costs are generally expensed as incurred. External costs incurred in producing media advertising are expensed the first time the advertising takes place. External costs relating to direct mailing costs are expensed in the period in which the direct mailings are sent. Advertising and public relations costs of \$525,787 and \$373,005 were included in the Company's results of operations for 2007 and 2006, respectively.

Retirement Benefits - A trusted retirement savings plan is sponsored by the Company and provides retirement benefits to substantially all officers and employees who meet certain age and service requirements. The plan includes a "salary reduction" feature pursuant to Section 401(k) of the Internal Revenue Code. In 2004, the Company converted the 401(k) plan to a 404(c) plan. The 404 (c) plan changes investment alternatives to include the Company's stock. Under the plan and present policies, participants are permitted to make contributions up to 15% of their annual compensation. At its discretion, the Company can make matching contributions up to 6% of the participants' compensation. The Company charged \$152,243 and \$229,032 to earnings for the retirement savings plan in 2007 and 2006, respectively.

During 2006, the Board of Directors approved a supplemental retirement plan for the directors and certain officers. These benefits are not qualified under the Internal Revenue Code and they are not funded. The current accrued but unfunded amount is \$242,837 and \$151,631 at December 31, 2007 and 2006, respectively. However, certain funding is provided informally and indirectly by bank owned life insurance policies. The cash surrender value of the life insurance policies are recorded as a separate line item in the accompanying consolidated balances sheets at \$10,540,273 and \$10,134,036 at December 31, 2007 and 2006, respectively.

Equity Incentive Plan - On January 19, 2006, the Company approved the 2006 Equity Incentive Plan. This plan provides for the granting of dividend equivalent rights, options, performance unit awards, phantom shares, stock appreciation rights and stock awards, each of which shall be subject to such conditions based upon continued employment, passage of time or satisfaction of performance criteria or other criteria as permitted by the plan. The plan allows granting up to 350,000 shares of stock, to officers, employees, and directors, consultants and service providers of the Company or its affiliates. Awards may be granted for a term of up to ten years from the effective date of grant. Under this Plan, our Board of Directors has sole discretion as to the exercise date of any awards granted. The per-share exercise price of incentive stock options may not be less than the market value of a share of common stock on the date the option is granted. Any options that expire unexercised or are canceled become available for re-issuance. The Company's equity incentive plan is further described in Note 16.

Stock-Based Compensation - On January 1, 2006, the Company adopted the fair value recognition provisions of Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 123(R), "Share-Based Payment," ("SFAS 123(R)") to account for compensation costs under its stock option and other equity incentive plans.

Common Stock Owned by the 401(k) Plan and Employee Stock Ownership Plan (ESOP) - All shares held by the 401(k) and ESOP Plans, collectively referred to as the "404(c)," are treated as outstanding for purposes of computing earnings per share. 404(c) purchases and redemptions of the Company's common stock are at estimated fair value as determined by independent valuations. Dividends on 404 (c) shares are charged to retained earnings. At December 31, 2007, the 404 (c) owned 116,227 shares of the Company's common stock with an estimated value of \$1,361,664. At December 31, 2006, the 404 (c) owned 107,445 shares of the Company's common stock with an estimated value of

\$1,676,142. All of these shares were allocated. Contributions to the 404 (c) in 2007 and 2006 were \$152,243 and \$229,032, respectively.

Earnings Per Share - Basic earnings per share represents income available to shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company relate solely to outstanding stock options and are determined using the treasury stock method (see Note 15).

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Notes to Consolidated Financial Statements****NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** - *continued*

Comprehensive Income - Accounting principles generally require that recognized income, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

The components of other comprehensive income and related tax effects are as follows:

| | Pre-tax Amount | Tax Benefit | Net-of-tax Amount |
|---|---------------------------|------------------------|------------------------------|
| For the Year Ended December 31, 2007: | | | |
| Unrealized losses on securities available-for-sale | \$ (20,080) | \$ 6,828 | \$ (13,252) |
| Reclassification adjustment for gains (losses) realized in net income | 3,496 | (1,189) | 2,307 |
| | \$ (16,584) | \$ 5,639 | \$ (10,945) |
| For the Year Ended December 31, 2006: | | | |
| Unrealized gains on securities available-for-sale | \$ 184,723 | \$ (63,441) | \$ 121,282 |
| Reclassification adjustment for gains (losses) realized in net income | - | - | - |
| | \$ 184,723 | \$ (63,441) | \$ 121,282 |

Derivative Instruments - SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," establishes comprehensive accounting and reporting standards for derivative instruments and hedging activities. SFAS No. 133 requires that all derivative instruments be recorded in the statement of financial position at fair value. The accounting for the gain or loss due to change in fair value of the derivative instrument depends on whether the derivative instrument qualifies as a hedge. If the derivative does not qualify as a hedge, the gains or losses are reported in earnings when they occur. However, if the derivative instrument qualifies as a hedge, the accounting varies based on the type of risk being hedged.

The Company has no material embedded derivative instruments requiring separate accounting treatment. The Company has freestanding derivative instruments consisting of fixed rate conforming loan commitments and commitments to sell fixed rate conforming loans. The Company does not currently engage in hedging activities.

Statements of Cash Flows - For purposes of reporting cash flows in the consolidated financial statements, the Company considers certain highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Cash equivalents include amounts due from banks and federal funds sold. Generally, federal funds are sold for one-day periods.

Changes in the valuation account of securities available-for-sale, including the deferred tax effects, are considered noncash transactions for purposes of the statement of cash flows and are presented in detail in the notes to the consolidated financial statements.

Off-Balance-Sheet Financial Instruments - In the ordinary course of business, the Company enters into off-balance-sheet financial instruments consisting of commitments to extend credit and letters of credit. These financial instruments are recorded in the consolidated financial statements when they become payable by the

customer.

Recent Accounting Pronouncements - The following is a summary of recent authoritative pronouncements that may affect accounting, reporting, and disclosure of financial information by the Company:

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This standard eliminates inconsistencies found in various prior pronouncements but does not require any new fair value measurements. SFAS 157 is effective for the Company on January 1, 2008 and will not impact the Company's accounting measurements but it is expected to result in additional disclosures.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - *continued*

Recent Accounting Pronouncements (*continued*) - In September 2006, The FASB ratified the consensuses reached by the FASB's Emerging Issues Task Force ("EITF") relating to EITF 06-4, "Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" ("EITF 06-4"). Entities purchase life insurance for various reasons including protection against loss of key employees and to fund postretirement benefits. The two most common types of life insurance arrangements are endorsement split dollar life and collateral assignment split dollar life. EITF 06-4 covers the former and EITF 06-10 (discussed below) covers the latter. EITF 06-4 states that entities with endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods should recognize a liability for future benefits in accordance with SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," (if, in substance, a postretirement benefit plan exists) or Accounting Principles Board ("APB") Opinion No. 12, "Omnibus Opinion - 1967" (if the arrangement is, in substance, an individual deferred compensation contract). Entities should recognize the effects of applying this Issue through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. EITF 06-4 is effective for the Company on January 1, 2008. The Company does not believe the adoption of EITF 06-4 will have a material impact on its financial position, results of operations or cash flows.

In September 2006, the FASB ratified the consensus reached on EITF 06-5, "Accounting for Purchases of Life Insurance - Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance" ("EITF 06-5"). EITF 06-5 states that a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the amount that could be realized under the insurance contract. EITF 06-5 also states that a policyholder should determine the amount that could be realized under the life insurance contract assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy). EITF 06-5 is effective for the Company on January 1, 2008. The Company does not believe the adoption of EITF 06-5 will have a material impact on its financial position, results of operations or cash flows.

In March 2007, the FASB ratified the consensus reached on EITF 06-10, "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements" ("EITF 06-10"). The postretirement aspect of this EITF is substantially similar to EITF 06-4 discussed above and requires that an employer recognize a liability for the postretirement benefit related to a collateral assignment split-dollar life insurance arrangement in accordance with either FASB Statement No. 106 or APB Opinion No. 12, as appropriate, if the employer has agreed to maintain a life insurance policy during the employee's retirement or provide the employee with a death benefit based on the substantive agreement with the employee. In addition, a consensus was reached that an employer should recognize and measure an asset based on the nature and substance of the collateral assignment split-dollar life insurance arrangement. EITF 06-10 is effective for the Company on January 1, 2008. The Company does not believe the adoption of EITF 06-10 will have a material impact on its financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115" ("SFAS 159"). This statement permits, but does not require, entities to measure many financial instruments at fair value. The objective is to provide entities with an opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Entities electing this option will apply it when the entity first recognizes an eligible instrument and will report unrealized gains and losses on such instruments in current

earnings. This statement 1) applies to all entities, 2) specifies certain election dates, 3) can be applied on an instrument-by-instrument basis with some exceptions, 4) is irrevocable and 5) applies only to entire instruments. One exception is demand deposit liabilities which are explicitly excluded as qualifying for fair value. With respect to SFAS 115, available-for-sale and held-to-maturity securities at the effective date are eligible for the fair value option at that date. If the fair value option is elected for those securities at the effective date, cumulative unrealized gains and losses at that date shall be included in the cumulative-effect adjustment and thereafter, such securities will be accounted for as trading securities. SFAS 159 is effective for the Company on January 1, 2008. The Company is currently analyzing the fair value option that is permitted, but not required, under SFAS 159.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - *continued*

Recent Accounting Pronouncements (*continued*) - In June 2007, the FASB ratified the consensus reached by the EITF with respect to EITF 06-11, "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards" ("EITF 06-11"). Under EITF 06-11, a realized income tax benefit from dividends or dividend equivalents that are charged to retained earnings and are paid to employees for equity-classified nonvested equity shares, nonvested equity share units and outstanding equity share options should be recognized as an increase in additional paid-in capital. This EITF is to be applied prospectively to the income tax benefits that result from dividends on equity-classified employee share-based payment awards that are declared beginning in 2008, and interim periods within those fiscal years. Early application is permitted. The Company does not believe the adoption of EITF 06-11 will have a material impact on its financial position, results of operations or cash flows.

In November 2007, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 109, "Written Loan Commitments Recorded at Fair Value Through Earnings" ("SAB 109"). SAB 109 expresses the current view of the SEC staff that the expected net future cash flows related to the associated servicing of the loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. SEC registrants are expected to apply this guidance on a prospective basis to derivative loan commitments issued or modified in the first quarter of 2008 and thereafter. The Company is currently analyzing the impact of this guidance, which relates to the Company's mortgage loans held for sale.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations," ("SFAS 141(R)") which replaces SFAS 141. SFAS 141(R) establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for acquisitions by the Company taking place on or after January 1, 2009. Early adoption is prohibited. Accordingly, a calendar year-end company is required to record and disclose business combinations following existing accounting guidance until January 1, 2009. The Company will assess the impact of SFAS 141(R) if and when a future acquisition occurs.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Before this statement, limited guidance existed for reporting noncontrolling interests (minority interest). As a result, diversity in practice exists. In some cases minority interest is reported as a liability and in others it is reported in the mezzanine section between liabilities and equity. Specifically, SFAS 160 requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent's equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. SFAS 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interests. SFAS 160 is effective for the Company on January 1, 2009. Earlier adoption is prohibited. The Company is currently evaluating the impact, if any, the adoption of SFAS 160 will have on its consolidated financial statements.

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

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Notes to Consolidated Financial Statements****NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** - continued

Risks and Uncertainties - In the normal course of its business, the Company encounters two significant types of risks: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different speeds, or on different basis, than its interest-earning assets. Credit risk is the risk of default on the Company's loan portfolio that results from borrower's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans receivable and the valuation of real estate held by the Company.

The Company is subject to the regulations of various governmental agencies. These regulations can and do 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 and operating restrictions from the regulators' judgments based on information available to them at the time of their examination.

Reclassifications - Certain captions and amounts in the 2006 consolidated financial statements were reclassified to conform with the 2007 presentation.

NOTE 2 - CASH AND DUE FROM BANKS

The Company is required to maintain balances with The Federal Reserve computed as a percentage of deposits. At December 31, 2007 and 2006, this requirement was \$25,000 and \$1,389,000, respectively. This requirement was met by vault cash and balances on deposit with the Federal Reserve.

NOTE 3 - INVESTMENT SECURITIES

The amortized cost and estimated fair values of securities available-for-sale were:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|----------------------------------|----------------------|---------------------------|----------------------------|-------------------------|
| December 31, 2007 | | | | |
| Government sponsored enterprises | \$ - | \$ - | \$ - | \$ - |
| U.S. Government agencies | 189,745 | 3,001 | - | 192,746 |
| Mortgage-backed securities | 27,028,064 | 152,788 | 113,890 | 27,066,962 |
| Municipals | 31,145,829 | 181,973 | 258,847 | 31,068,955 |
| Other | 218,750 | 32,900 | - | 251,650 |
| | \$ 58,582,388 | \$ 370,662 | \$ 372,737 | \$ 58,580,313 |
| December 31, 2006 | | | | |
| Government sponsored enterprises | \$ 4,990,352 | \$ - | \$ 40,039 | \$ 4,950,313 |
| U.S. Government agencies | 380,315 | 1,226 | 321 | 381,220 |
| Mortgage-backed securities | 15,521,860 | 20,151 | 339,685 | 15,202,326 |
| Municipals | 14,805,485 | 281,449 | 1,027 | 15,085,907 |
| Other | 218,750 | 92,755 | - | 311,505 |
| | \$ 35,916,762 | \$ 395,581 | \$ 381,072 | \$ 35,931,271 |

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Notes to Consolidated Financial Statements****NOTE 3 - INVESTMENT SECURITIES** - continued

The following is a summary of maturities of securities available-for-sale as of December 31, 2007. The amortized cost and estimated fair values are based on the contractual maturity dates. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalty.

| | Securities Available-For-Sale | |
|---|--|---------------------------------|
| | Amortized Cost | Estimated Fair Value |
| Due within one year | \$ 18,426 | \$ 18,508 |
| Due after one year but within five years | 1,266,081 | 1,277,045 |
| Due after five years but within ten years | 1,007,693 | 1,039,348 |
| Due after ten years | 29,043,374 | 28,926,800 |
| | 31,335,574 | 31,261,701 |
| Mortgage-backed securities | 27,028,064 | 27,066,962 |
| Other | 218,750 | 251,650 |
| Total | \$ 58,582,388 | \$ 58,580,313 |

The following table shows gross unrealized losses and fair value, aggregated by investment category, and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2007 and 2006.

Securities Available for Sale

| | Less than twelve months | | Twelve months or more | | Total | |
|----------------------------------|------------------------------------|------------------------------|----------------------------------|------------------------------|----------------------|------------------------------|
| | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair value | Unrealized losses |
| December 31, 2007 | | | | | | |
| Government sponsored enterprises | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| U.S. government agencies | - | - | - | - | - | - |
| Municipals | 10,733,254 | (258,847) | - | - | 10,733,254 | (258,847) |
| Mortgage-backed securities | - | - | 6,426,610 | (113,890) | 6,426,610 | (113,890) |
| Total | \$ 10,733,254 | \$ (258,847) | \$ 6,426,610 | \$ (113,890) | \$ 17,159,864 | \$ (372,737) |
| December 31, 2006 | | | | | | |
| Government sponsored enterprises | \$ - | \$ - | 4,950,313 | \$ (40,039) | 4,950,313 | \$ (40,039) |
| U.S. government agencies | - | - | 69,742 | (321) | 69,742 | (321) |
| Municipals | 2,035,393 | (1,027) | - | - | 2,035,393 | (1,027) |
| Mortgage-backed securities | - | - | 11,363,211 | (339,685) | 11,363,211 | (339,685) |
| Total | \$ 2,035,393 | \$ (1,027) | \$ 16,383,266 | \$ (380,045) | \$ 18,418,659 | \$ (381,072) |

At December 31, 2007, securities classified as available-for-sale are recorded at fair market value. Approximately 30.56% of the unrealized losses, or 6 individual securities, consisted of securities in a continuous loss position for twelve months or more. The Company has the ability and intent to hold these securities until such time as the value recovers or the securities mature. The Company believes, based on industry analyst reports and credit ratings, that the deterioration in value is attributable to changes in market interest rates and is not in the credit quality of the issuer and therefore, these losses are not considered other-than-temporary.

As of December 31, 2007 and 2006, the par value and market value of the securities held by the third-party for the underlying agreements were \$8,303,216 and \$6,087,273, respectively, and \$8,391,834 and \$6,148,139, respectively.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Notes to Consolidated Financial Statements****NOTE 4 - LOANS RECEIVABLE**

Major classifications of loans receivable are summarized as follows:

| | December 31, | |
|--------------------------------|-----------------------|-----------------------|
| | 2007 | 2006 |
| Mortgage loans on real estate: | | |
| Residential 1-4 family | \$ 66,259,730 | \$ 50,844,955 |
| Multifamily | 9,822,699 | 7,826,863 |
| Commercial | 195,992,305 | 127,213,968 |
| Construction | 65,431,302 | 64,118,098 |
| Second mortgages | 4,611,341 | 4,513,048 |
| Equity lines of credit | 39,503,898 | 27,853,374 |
| | 381,621,275 | 282,370,306 |
| Commercial and industrial | 67,771,665 | 51,710,250 |
| Consumer | 11,342,435 | 12,728,353 |
| Other | 7,402,315 | 6,682,127 |
| Total gross loans | \$ 468,137,690 | \$ 353,491,036 |

The Company has pledged certain loans as collateral to secure its borrowings from the Federal Home Loan Bank. The total of loans pledged was \$147,655,969 at December 31, 2007.

The Company identifies impaired loans through its normal internal loan review process. Loans on the Company's problem loan watch list are considered potentially impaired loans. These loans are evaluated in determining whether all outstanding principal and interest are expected to be collected. Loans are not considered impaired if a minimal delay occurs and all amounts due including accrued interest at the contractual interest rate for the period of delay are expected to be collected. At December 31, 2007, impaired loans totaled \$1,876,221 of which \$1,657,607 were in nonaccrual status, and there were no specific write downs on these loans. Accrued interest related to these loans totaled \$1,010. At December 31, 2006, impaired loans totaled \$1,313,993 of which \$670,650 were in nonaccrual status, and specific collected write downs on these loans totaled \$189,992. Accrued interest related to these loans totaled \$6,115. Average impaired loans at December 31, 2007 and 2006 were \$903,980 and \$808,286, respectively.

Transactions in the allowance for loan losses are summarized below:

| | For the years ended | |
|--|----------------------------|---------------------|
| | December 31, | |
| | 2007 | 2006 |
| Balance, beginning of year | \$ 4,001,881 | \$ 3,419,368 |
| Provision charged to operations | 1,643,100 | 1,392,491 |
| Recoveries on loans previously charged-off | 81,761 | 246,600 |
| Loans charged-off | (456,135) | (1,056,578) |
| Balance, end of year | \$ 5,270,607 | \$ 4,001,881 |

There were \$1,780,505 in loans past due ninety days or more and still accruing interest and \$1,657,607 in loans in nonaccrual status at December 31, 2007. As of December 31, 2006, there were \$463,991 in loans past due ninety days or more and still accruing interest and \$670,650 in loans on nonaccrual status.

Loans sold with limited recourse are 1-4 family residential mortgages originated by the Company and sold to various other financial institutions. These loans are sold with the agreement that a loan may be returned to the Company at any time in the event the Company fails to provide necessary documents related to the mortgages to the buyers, or if it makes false representations or warranties to the buyers. Loans sold under these agreements in 2007 total \$146,067,873. The Company uses the same credit policies in making loans held for sale as it does for on-balance-sheet instruments.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Notes to Consolidated Financial Statements****NOTE 4 - LOANS RECEIVABLE** - continued

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 consist of commitments to extend credit and standby letters of credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. A commitment involves, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The Company's exposure to credit loss in the event of nonperformance by the other party to the instrument is represented by the contractual notional amount of the instrument. Since certain commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company uses the same credit policies in making commitments to extend credit as it does for on-balance-sheet instruments. Letters of credit are conditional commitments issued to guarantee a customer's performance to a third party and have essentially the same credit risk as other lending facilities.

Collateral held for commitments to extend credit and standby letters of credit varies but may include accounts receivable, inventory, property, plant, equipment, and income-producing commercial properties.

The following table summarizes the Company's off-balance-sheet financial instruments whose contract amounts represent credit risk:

| | December 31, | |
|------------------------------|---------------------|---------------|
| | 2007 | 2006 |
| Commitments to extend credit | \$ 76,545,909 | \$ 67,370,404 |
| Standby letters of credit | 2,721,249 | 3,543,270 |

The Company originates certain fixed rate residential mortgage loans and commits these loans for sale. The commitments to originate fixed rate residential mortgage loans and the sales commitments are freestanding derivative instruments. The fair value of these commitments was not significant at December 31, 2006. The Company has forward sales commitments, totaling \$19.6 million at December 31, 2007 to sell loans held for sale of \$19.6 million. Such forward sales commitments are to sell loans at par value and are generally funded within 60 days. The difference in the fair value of these commitments and the associated loan held for sale was not significant at December 31, 2007. The Company has no material embedded derivative instruments requiring separate accounting treatment.

NOTE 5 - PREMISES, FURNITURE AND EQUIPMENT

Premises, furniture and equipment consisted of the following:

| | December 31, | |
|--------------------------|---------------------|--------------|
| | 2007 | 2006 |
| Land | \$ 6,446,267 | \$ 4,835,609 |
| Building | 6,679,702 | 4,349,778 |
| Leasehold improvements | 145,497 | 141,517 |
| Furniture and equipment | 4,367,496 | 2,676,121 |
| Construction in progress | 7,689,612 | 4,425,102 |
| Total | 25,328,574 | 16,428,127 |

| | | | | |
|--------------------------------|----|-------------------|----|-------------------|
| Less, accumulated depreciation | | 3,094,828 | | 2,657,992 |
| Premises and equipment, net | \$ | 22,233,746 | \$ | 13,770,135 |

Depreciation expense for the years ended December 31, 2007 and 2006 amounted to \$554,760 and \$558,262, respectively.

Construction in process consists of renovations to the Company's corporate office and architect fees and site work for new branches. The total amount of renovations unpaid at December 31, 2007 is \$109,136.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Notes to Consolidated Financial Statements****NOTE 6 - DEPOSITS**

At December 31, 2007, the scheduled maturities of time deposits were as follows:

| Maturing In | Amount |
|--------------------|-----------------------|
| 2008 | \$ 271,389,605 |
| 2009 | 5,770,421 |
| 2010 | 1,484,942 |
| 2011 | 1,647,458 |
| 2012 | 392,887 |
| Total | \$ 280,685,313 |

Included in total time deposits at December 31, 2007 and 2006 were brokered time deposits of \$85,330,473 and \$29,515,694, respectively.

NOTE 7 - SHORT-TERM BORROWINGS

Short-term borrowings payable are securities sold under agreements to repurchase which generally mature on a one to thirty day basis. Information concerning securities sold under agreements to repurchase is summarized as follows:

| | For the years ended | |
|---|----------------------------|--------------|
| | December 31, | |
| | 2007 | 2006 |
| Balance at end of the year | \$ 7,927,754 | \$ 8,120,014 |
| Average balance during the year | 9,127,643 | 6,064,366 |
| Average interest rate during the year | 4.39% | 4.27% |
| Maximum month-end balance during the year | 11,651,480 | 8,190,397 |

Under the terms of the repurchase agreement, the Company sells an interest in securities issued by United States Government agencies and agrees to repurchase the same securities the following business day. As of December 31, 2007 and 2006, the par value and market value of the securities held by the third-party for the underlying agreements were \$8,303,216 and \$6,087,273, respectively, and \$8,391,834 and \$6,148,139, respectively.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Notes to Consolidated Financial Statements****NOTE 8 - ADVANCES FROM FEDERAL HOME LOAN BANK**

Advances from the Federal Home Loan Bank consisted of the following:

| Description | Interest Rate | December 31, 2007 | 2006 |
|---|---------------|----------------------|----------------------|
| Fixed rate advances maturing: | | | |
| January 12, 2007 | 3.72% | \$ - | 2,000,000 |
| April 9, 2007 | 3.13% | - | 1,000,000 |
| July 2, 2007 | 3.56% | - | 500,000 |
| December 19, 2007 | 3.44% | - | 1,500,000 |
| January 28, 2008 | 4.59% | 5,000,000 | - |
| February 28, 2008 | 4.58% | 5,000,000 | - |
| March 28, 2008 | 4.57% | 5,000,000 | - |
| April 8, 2008 | 3.46% | 1,000,000 | 1,000,000 |
| September 27, 2008 | 4.71% | 5,000,000 | - |
| October 14, 2008 | 4.86% | 5,000,000 | - |
| December 22, 2008 | 4.14% | 5,000,000 | - |
| March 09, 2008 | 4.94% | 6,000,000 | - |
| May 29, 2009 | 4.078% | 8,000,000 | - |
| November 30, 2009 | 4.028% | 9,000,000 | - |
| November 29, 2010 | 4.11% | 8,000,000 | - |
| Variable rate advances maturing: | | | |
| March 19, 2009 | 2.48% | 3,000,000 | 3,000,000 |
| June 29, 2009 | 5.30% | - | 5,000,000 |
| July 5, 2012 | 4.08% | 1,000,000 | 1,000,000 |
| March 10, 2015 | 3.44% | - | 6,000,000 |
| Daily variable rate advances maturing: | | | |
| Daily | Variable | 3,000,000 | 7,500,000 |
| | | \$ 69,000,000 | \$ 28,500,000 |

Scheduled principal reductions of Federal Home Loan Bank advances are as follows:

| | Amount |
|-------|----------------------|
| 2008 | \$ 40,000,000 |
| 2009 | 20,000,000 |
| 2010 | 8,000,000 |
| 2011 | - |
| 2012 | 1,000,000 |
| Total | \$ 69,000,000 |

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Notes to Consolidated Financial Statements****NOTE 9 - JUNIOR SUBORDINATED DEBENTURES AND TRUST PREFERRED**

On June 30, 2005 the Company formed First Reliance Capital Trust I (the "Trust") for the purpose of issuing trust preferred securities, which enable the Company to obtain Tier 1 capital on a consolidated basis for regulatory purposes. On July 1, 2005, the Company closed a private offering of \$10,000,000 of floating rate preferred securities offered and sold by the Trust. The proceeds from such issuance, together with the proceeds from a related issuance of common securities of the Trust purchased by the Company in the amount of \$310,000, were invested by the Trust in floating rate Junior Subordinated Debentures issued by the Company (the "Debentures") totaling \$10,310,000. The Debentures are due and payable on November 23, 2035 and may be redeemed by the Company after five years, and sooner in certain specific events, including in the event that certain circumstances render the Debentures ineligible for treatment as Tier 1 capital, subject to prior approval by the Federal Reserve Board, if then required. The Debentures presently qualify as Tier 1 capital for regulatory reporting. The sole assets of the Trust are the Debentures. The Company owns 100% of the common securities of the Trust. The Debentures are unsecured and rank junior to all senior debt of the Company. At December 31, 2007, the floating rate preferred securities and the Debentures had an annual interest rate of 5.93%. This interest rate is fixed until August 23, 2010, when the interest rate will adjust quarterly. After August 23, 2010, the interest rate will equal three-month LIBOR plus 1.83%.

On December 28, 2007 the Company borrowed 3,000,000, which was injected into the Bank as permanent capital. The debt is unsecured and has a fixed interest rate of 6.00%, and is due and payable on December 28, 2008.

NOTE 10 - RESTRICTIONS ON SHAREHOLDERS' EQUITY

South Carolina banking regulations restrict the amount of dividends that can be paid to shareholders. All of the Bank's dividends to First Reliance Bancshares, Inc. are payable only from the undivided profits of the Bank. At December 31, 2007, the Bank had undivided profits of \$12,397,058. The Bank is authorized to upstream 100% of net income in any calendar year without obtaining the prior approval of the Commissioner of Banking provided that the Bank received a composite rating of one or two at the last Federal or State regulatory examination. Under Federal Reserve Board regulations, the amounts of loans or advances from the Bank to the parent company are also restricted.

NOTE 11 - OTHER OPERATING EXPENSE

Other operating expenses are summarized below:

| | For the years ended | |
|---|----------------------------|---------------------|
| | December 31, | |
| | 2007 | 2006 |
| Professional fees | \$ 634,214 | \$ 470,927 |
| Office supplies, forms, and stationery | 327,537 | 275,028 |
| Advertising | 525,787 | 373,005 |
| Employee education and conventions | 53,282 | 65,239 |
| Computer supplies and software amortization | 493,674 | 441,276 |
| Telephone | 315,201 | 197,085 |
| Directors fees | 175,309 | 172,426 |
| Other | 3,579,944 | 2,931,849 |
| Total | \$ 6,104,948 | \$ 4,926,835 |

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Notes to Consolidated Financial Statements****NOTE 12 - INCOME TAXES**

Income tax expense is summarized as follows:

| | For the years ended December 31, | |
|---|---|---------------------|
| | 2007 | 2006 |
| Currently payable | | |
| Federal | \$ 1,534,994 | \$ 1,294,202 |
| State | 117,553 | 164,735 |
| Total current | 1,652,547 | 1,458,937 |
| Deferred income taxes | (413,004) | (212,700) |
| Total income tax expense | \$ 1,239,543 | \$ 1,246,237 |
| Income tax expense is allocated as follows: | | |
| To continuing operations | \$ 1,245,182 | \$ 1,182,796 |
| To shareholders' equity | (5,639) | 63,441 |
| | \$ 1,239,543 | \$ 1,246,237 |

The components of deferred tax assets and deferred tax liabilities are as follows:

| | December 31, | |
|--|---------------------|---------------------|
| | 2007 | 2006 |
| Deferred tax assets: | | |
| Allowance for loan losses | \$ 1,532,913 | \$ 1,072,758 |
| Organizational costs | - | 1,202 |
| Non-accrual interest | 44,936 | 44,645 |
| Unrealized loss on securities available for sale | 705 | - |
| Deferred compensation | 122,868 | 51,555 |
| Other | 42,913 | 86,410 |
| Total gross deferred tax assets | 1,744,335 | 1,256,570 |
| Deferred tax liabilities: | | |
| Accumulated depreciation | 159,140 | 106,937 |
| Prepaid expenses | 88,657 | 67,603 |
| Other | 60,098 | 58,594 |
| Total gross deferred tax liabilities | 307,895 | 233,134 |
| Net deferred tax asset recognized | \$ 1,436,440 | \$ 1,023,436 |

Deferred tax assets represent the future tax benefit of deductible differences and, if it is more likely than not that a tax asset will not be realized, a valuation allowance is required to reduce the recorded deferred tax assets to net realizable value. As of December 31, 2007, management has determined that it is more likely than not that the total deferred tax asset will be realized and, accordingly, has not established a valuation allowance. Net deferred tax assets are included in other assets at December 31, 2007 and 2006.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Notes to Consolidated Financial Statements****NOTE 12 - INCOME TAXES** - *continued*

A reconciliation between the income tax expense and the amount computed by applying the federal statutory rate of 34% to income before income taxes follows:

| | For the years ended December 31, | |
|---|---|---------------------|
| | 2007 | 2006 |
| Tax expense at statutory rate | \$ 1,293,599 | \$ 1,505,759 |
| State income tax, net of federal income tax benefit | 77,585 | 108,725 |
| Tax-exempt interest income | (265,265) | (217,501) |
| Disallowed interest expense | 43,884 | 31,004 |
| Life insurance surrender value | (138,121) | (129,836) |
| Other, net | 233,500 | (115,355) |
| | \$ 1,245,182 | \$ 1,182,796 |

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

NOTE 13 - RELATED PARTY TRANSACTIONS

Certain parties (principally certain directors and executive officers of the Company, their immediate families and business interests) were loan customers of and had other transactions in the normal course of business with the Company. Related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collectibility. As of December 31, 2007 and 2006, the Company had related party loans totaling \$3,433,523 and \$2,929,127, respectively. During 2007, \$1,335,425 of advances were made to related parties and repayments totaled \$831,029. As of December 31, 2007, all related party loans were current.

Deposits from directors and executive officers and their related interests totaled \$4,591,514 and \$4,324,992 at December 31, 2007 and 2006, respectively.

During 2005, the Company entered into a lease agreement with SP Financial LLC (the LLC), a limited liability company owned 50% each by two of the Bank's executive officers. The LLC obtained third party financing to purchase the property which is leased to the Bank. The debt related to this property is guaranteed by these officers but not by the Company. Additionally, the Company has no investment risk related to the property, and has a valid lease agreement which will remain in place even if an ownership transfer occurs. For these reasons the LLC is not considered a Variable Interest Entity under FIN 46(R), and its financial statements have not been consolidated with the Company's. The lease has an initial five year term and is included in the total future rental payments discussed in Note 14. Total lease and tax payments to the LLC for December 31, 2007 and 2006 were \$288,000 and \$305,147.

NOTE 14 - COMMITMENTS AND CONTINGENCIES

In the ordinary course of business, the Company may, from time to time, become a party to legal claims and disputes. At December 31, 2007, management and legal counsel are not aware of any pending or threatened litigation or unasserted claims or assessments that could result in losses, if any, that would be material to the consolidated financial

statements.

The Company has entered into eight separate lease agreements for properties in West Columbia, Columbia, Florence, Charleston, Mount Pleasant and Lexington, South Carolina for branch banking and mortgage operations. The leases have various initial terms and expire on various dates. The lease agreements generally provide that the Bank is responsible for ongoing repairs and maintenance, insurance and real estate taxes. The leases also provide for renewal options and certain scheduled increases in monthly lease payments. Rental expenses recorded under leases for the years ended December 31, 2007 and 2006 were \$645,353 and \$528,230, respectively.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Notes to Consolidated Financial Statements****NOTE 14 - COMMITMENTS AND CONTINGENCIES** - *continued*

The minimal future rental payments under non-cancelable operating leases having remaining terms in excess of one year, for each of the next five years in the aggregate are:

| | |
|---------------------|----------------------|
| 2008 | \$ 686,426 |
| 2009 | 659,567 |
| 2010 | 638,900 |
| 2011 | 617,253 |
| 2012 and thereafter | 13,620,503 |
| | \$ 16,222,649 |

NOTE 15 - EARNINGS PER SHARE

Earnings per share - basic is computed by dividing net income by the weighted average number of common shares outstanding. Earnings per share - diluted is computed by dividing net income by the weighted average number of common shares outstanding and dilutive common share equivalents using the treasury stock method. Dilutive common share equivalents include common shares issuable upon exercise of outstanding stock options.

| | For the years ended December 31, | |
|---|---|--------------|
| | 2007 | 2006 |
| Basic earnings per share: | | |
| Net income available to common shareholders | \$ 2,559,520 | \$ 3,245,908 |
| Average common shares outstanding - basic | 3,466,008 | 3,388,457 |
| Basic earnings per share | \$ 0.74 | \$ 0.96 |
| Diluted earnings per share: | | |
| Net income available to common shareholders | \$ 2,559,520 | \$ 3,245,908 |
| Average common shares outstanding - basic | 3,466,008 | 3,388,457 |
| Incremental shares from assumed conversion of stock options | 70,953 | 171,100 |
| Average common shares outstanding - diluted | 3,536,961 | 3,559,557 |
| Diluted earnings per share | \$ 0.72 | \$ 0.91 |

NOTE 16 - EQUITY INCENTIVE PLAN

The 2006 Equity Incentive Plan provides for the granting of dividend equivalent rights options, performance unit awards, phantom shares, stock appreciation rights and stock awards, each of which shall be subject to such conditions based upon continued employment, passage of time or satisfaction of performance criteria or other criteria as permitted by the plan. The plan allows granting up to 350,000 shares of stock, to officers, employees, and directors, consultants and service providers of the Company or its affiliates. Awards may be granted for a term of up to ten years from the effective date of grant. Under this Plan, our Board of Directors has sole discretion as to the exercise date of any awards granted. The per-share exercise price of incentive stock awards may not be less than the market value of a share of common stock on the date the award is granted. Any awards that expire unexercised or are canceled become available for re-issuance

The Company can issue the restricted shares as of the grant date either by the issuance of share certificate(s) evidencing restricted shares or by documenting the issuance in uncertificated or book entry form on the Company's stock records. Except as provided by the Plan, the employee does not have the right to make or permit to exist any transfer or hypothecation of any restricted shares. When restricted shares vest the employee must either pay the Company within two business days the amount of all tax withholding obligations imposed on the Company or make an election pursuant to Section 83(b) of the Internal Revenue Code to pay taxes at grant date.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Notes to Consolidated Financial Statements****NOTE 16 - EQUITY INCENTIVE PLAN** - *continued*

Restricted shares may be subject to one or more objective employment, performance or other forfeiture conditions as established by the Plan Committee at the time of grant. Any shares of restricted stock that are forfeited will again become available for issuance under the Plan. An employee or director has the right to vote the shares of restricted stock after grant until they are forfeited or vested. Compensation cost for restricted stock is equal to the market value of the shares at the date of the award and is amortized to compensation expense over the vesting period. Dividends, if any, will be paid on awarded but unvested stock.

During 2007 we issued 12,987 shares of restricted stock pursuant to the 2006 Equity Incentive Plan. The shares cliff vest in three years and are fully vested on January 19, 2010. The weighted-average market value of restricted stock issued during 2007 was \$13.99. Total compensation cost associated with this issuance was \$178,574 for the year ended December 31, 2007, of which there was \$42,747 compensation expense recognized in 2007 and \$135,827 of total unrecognized compensation cost related to nonvested share based compensation. The remaining cost is expected to be recognized over a weighted-average period of 2.25 years. During 2007 there were 1,287 restricted shares forfeited with a weighted-average exercise price of \$14.91 and 2,276 restricted shares exercised with a weighted-average exercise price of \$14.86.

During 2007 we also granted 62,481 Stock Appreciation Rights ("SARs") under the 2006 Equity Incentive Plan. The SARs entitle the participant to receive the excess of (1) the market value of a specified or determinable number of shares of the stock at the exercise date over the fair value at grant date or (2) a specified or determinable price which may not in any event be less than the fair market value of the stock at the time of the award. Upon exercise, the Company can elect to settle the awards using either Company stock or cash. The compensation costs are classified as liabilities. The shares start vesting after five years and vest at 20% per year until fully vested.

A summary of the status of the Company's SARs as of December 31, 2007 is presented below:

| | Shares | Weighted-Average Exercise Price |
|----------------------------------|---------------|---------------------------------------|
| Outstanding at January 1 | 45,501 | \$ 14.87 |
| Granted | 62,481 | 15.00 |
| Exercised | - | |
| Forfeited | (14,001) | 14.94 |
| Outstanding at December 31, 2007 | 93,981 | 14.95 |

At December 31, 2007, we had 235,044 stock awards available for grant under the 2006 Equity Incentive Plan.

| | Shares | Weighted-Average Exercise Price |
|----------------------------------|---------------|---------------------------------------|
| Outstanding at January 1 | - | \$ - |
| Granted | 45,774 | 14.87 |
| Exercised | - | - |
| Forfeited | (273) | 14.85 |
| Outstanding at December 31, 2006 | 45,501 | 14.87 |

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY**Notes to Consolidated Financial Statements****NOTE 16 - EQUITY INCENTIVE PLAN** - *continued*

The Company measures compensation cost based on the fair value of SARs awards on the date of grant using the Black-Scholes option pricing model using the following assumptions: the risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of the grant; the dividend yield is based on the Company's dividend yield at the time of the grant subject to adjustment if the dividend yield on the grant date is not expected to approximate the dividend yield over the expected life of the options; the volatility factor is based on the historical volatility of the Company's stock (subject to adjustment if historical volatility is reasonably expected to differ from the past); the weighted-average expected life is based on the historical behavior of employees related to exercises, forfeitures and cancellations. These assumptions are summarized in the table following:

In calculating the pro forma disclosures for 2005, and the stock appreciation rights granted in 2007, and 2006, the fair value of options granted is estimated as of the date granted using the Black-Scholes option pricing model with the following weighted-average assumptions:

| | 2007 | 2006 |
|-------------------------|-------------|-------------|
| Dividend yield | 0.00% | 0.00% |
| Expected volatility | 26.00% | 20.0% |
| Risk-free interest rate | 4.78% | 4.38% |
| Expected life | 10 years | 10 years |

Compensation expense associated with the SARs grant was \$43,397 for the year ended December 31, 2007. The grant date per share weighted average fair value of the SARs granted during 2007 was \$15.00. As of December 31, 2007, there was \$411,207 of total unrecognized compensation cost related to nonvested SARs. The cost is expected to be recognized over a weighted-average period of 9.06 years.

NOTE 17 - STOCK COMPENSATION PLAN

On June 19, 2003, the Company established the 2003 First Reliance Bank Employee Stock Option Plan (Stock Plan) that provides for the granting of options to purchase up to 250,000 shares of the Company's common stock to directors, officers, or employees of the Company. This plan was preceded by the 1999 First Reliance Bank Employee Stock Option Plan, which provided for the granting of options to purchase up to 238,000 shares of the Company's common stock to directors, officers, or employees of the Company. The per-share exercise price of incentive stock options granted under the Stock Plan may not be less than the fair market value of a share on the date of grant. The per-share exercise price of stock options granted is determined by the Board of Directors. The expiration date of any option may not be greater than ten years from the date of grant. Options that expire unexercised or are canceled become available for reissuance. At December 31, 2007, there were no options available for grant under the 2003 plan and no options available for grant under the 1999 plan. In 2005, the Company accelerated vesting of all options outstanding at the end of that year.

The decision to accelerate vesting in 2005 of the 2003 plan-related options avoided recognition of pre-tax compensation expense by the Company upon the adoption of SFAS 123(R). In the Company's view, the future compensation expense could outweigh the incentive and retention value associated with the stock options. The future pre-tax compensation expense that was or will be avoided, based upon the effective date of January 1, 2006, is approximately \$419,263 and \$108,981 in fiscal years 2006 and 2007, respectively. The Company believes that the acceleration of vesting stock options meets the criteria for variable accounting under FIN No. 44. Based upon past

experience, the Company believes the grantees of these stock options will remain as an employee of the Company.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements

NOTE 17 - STOCK COMPENSATION PLAN - *continued*

A summary of the status of the Company's 2003 stock option plan as of December 31, 2007 and 2006, and changes during the period is presented below:

| | 2007 | | 2006 | |
|----------------------------------|----------------|---------------------------------------|----------------|---------------------------------------|
| | Shares | Weighted-Average Exercise Price | Shares | Weighted-Average Exercise Price |
| Outstanding at beginning of year | 321,992 | \$ 7.95 | 400,363 | \$ 7.75 |
| Granted | - | - | - | - |
| Exercised | (43,145) | 5.56 | (78,371) | 6.94 |
| Forfeited | - | - | - | - |
| Expired | - | - | - | - |
| Outstanding at end of year | 278,847 | 8.32 | 321,992 | 7.95 |

The total intrinsic value of options exercised during December 31, 2007 and 2006 was \$375,627 and \$678,693, respectively.

The following table summarizes information about stock options outstanding under the Company's plan at December 31, 2007:

| | Outstanding | Exercisable |
|---------------------------------|-------------|-------------|
| Number of options | 278,847 | 278,846 |
| Weighted average remaining life | 4.99 | 4.99 |
| Weighted average exercise price | \$ 8.32 | \$ 8.32 |

The aggregate intrinsic value of options outstanding at December 31, 2007 was \$731,057.

The Company measures the fair value of each option award on the date of grant using the Black-Scholes option pricing model with the following assumptions: the risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of the grant; the dividend yield is based on the Company's dividend yield at the time of the grant (subject to adjustment if the dividend yield on the grant date is not expected to approximate the dividend yield over the expected life of the options); the volatility factor is based on the historical volatility of the Company's stock (subject to adjustment if historical volatility is reasonably expected to differ from the past); the weighted-average expected life is based on the historical behavior of employees related to exercises, forfeitures and cancellations. These assumptions are summarized in a table appearing in Note 16 to these financial statements.

No stock options have been granted since June 2005. The Company received \$239,746 and \$544,138 as a result of stock option exercises during the years ended December 31, 2007 and 2006, respectively. In accordance with SFAS 123(R), the amounts received upon exercise will be included as a financing activity in the accompanying statements of cash flows for the period subsequent to the adoption of SFAS 123(R), and is reported as an operating activity in periods prior to its adoption.

NOTE 18 - REGULATORY MATTERS

The Company and the Bank are subject to various regulatory capital requirements administered by the federal 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 material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company's and the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk-weightings, and other factors.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements

NOTE 18 - REGULATORY MATTERS - *continued*

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum ratios (set forth in the table below) of Tier 1 and total capital as a percentage of assets and off-balance-sheet exposures, adjusted for risk-weights ranging from 0% to 100%. Tier 1 capital of the Company and the Bank consists of common shareholders' equity, excluding the unrealized gain or loss on securities available-for-sale, minus certain intangible assets. Tier 2 capital consists of the allowance for loan losses subject to certain limitations. Total capital for purposes of computing the capital ratios consists of the sum of Tier 1 and Tier 2 capital.

The Company and the Bank are also required to maintain capital at a minimum level based on average assets (as defined), which is known as the leverage ratio. Only the strongest institutions are allowed to maintain capital at the minimum requirement of 3%. All others are subject to maintaining ratios 1% to 2% above the minimum.

As of the most recent regulatory examination, the Bank was deemed well-capitalized under the regulatory framework for prompt corrective action. To be categorized well capitalized, the Bank must maintain total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events that management believes have changed the Bank's categories.

The following table summarizes the capital amounts and ratios of the Company and the Bank and the regulatory minimum requirements.

| <i>(Dollars in thousands)</i> | Actual | | Minimum Requirement For Capital Adequacy Purposes | | To Be Well- Capitalized Under Prompt Corrective Action Provisions | |
|--|---------------|--------------|--|--------------|--|--------------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| December 31, 2007 | | | | | | |
| The Company | | | | | | |
| Total capital (to risk-weighted assets) | \$ 52,586 | 10.29% | \$ 40,883 | 8.00% | N/A | N/A |
| Tier 1 capital (to risk-weighted assets) | 47,315 | 9.26% | 20,438 | 4.00% | N/A | N/A |
| Tier 1 capital (to average assets) | 47,315 | 9.46% | 20,006 | 4.00% | N/A | N/A |
| The Bank | | | | | | |
| Total capital (to risk-weighted assets) | \$ 53,824 | 10.53% | \$ 40,877 | 8.00% | \$ 51,096 | 10.00% |
| Tier 1 capital (to risk-weighted assets) | 48,554 | 9.50% | 20,438 | 4.00% | 30,658 | 6.00% |
| Tier 1 capital (to average assets) | 48,554 | 8.85% | 21,945 | 4.00% | 27,445 | 5.00% |
| December 31, 2006 | | | | | | |
| The Company | | | | | | |
| Total capital (to risk-weighted assets) | \$ 48,458 | 12.45% | \$ 31,149 | 8.00% | N/A | N/A |

| | | | | | | |
|--|-----------|--------|----------|-------|-----------|--------|
| Tier 1 capital (to risk-weighted assets) | 44,456 | 11.42% | 15,575 | 4.00% | N/A | N/A |
| Tier 1 capital (to average assets) | 44,456 | 9.90% | 17,968 | 4.00% | N/A | N/A |
| The Bank | | | | | | |
| Total capital (to risk-weighted assets) | \$ 46,444 | 11.86% | 4 31,333 | 8.00% | \$ 39,166 | 10.00% |
| Tier 1 capital (to risk-weighted assets) | 42,442 | 10.84% | 15,666 | 4.00% | 23,500 | 6.00% |
| Tier 1 capital (to average assets) | 42,442 | 9.45% | 17,968 | 4.00% | 22,460 | 5.00% |

NOTE 19 - UNUSED LINES OF CREDIT

As of December 31, 2007, the Company had unused lines of credit to purchase federal funds from unrelated companies totaling \$37,000,000. These lines of credit are available on a one to fourteen day basis for general corporate purposes. The Company also has a line of credit to borrow funds from the Federal Home Loan Bank of up to \$177,511,264. As of December 31, 2007 and 2006, the Company had borrowed \$69,000,000 and \$28,500,000, respectively, on this line. Additionally, the Company has the ability to buy brokered time deposits at December 31, 2007.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements

NOTE 20 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the amount for which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instruments. Because no market value exists for a significant portion of the 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.

The following methods and assumptions were used to estimate the fair value of significant financial instruments:

Cash and Due from Banks - The carrying amount is a reasonable estimate of fair value.

Federal Funds Sold and Purchased - Federal funds sold and purchased are for a term of one day and the carrying amount approximates the fair value.

Securities Available-for-Sale - Fair value equals the carrying amount which is the quoted market price. If quoted market prices are not available, fair values are based on quoted market prices of comparable securities.

Nonmarketable Equity Securities - The carrying amount of nonmarketable equity securities is a reasonable estimate of fair value since no ready market exists for these securities.

Loans Held-for-Sale - The carrying amount of loans held for sale is a reasonable estimate of fair value.

Loans Receivable - For certain categories of loans, such as variable rate loans which are repriced frequently and have no significant change in credit risk and credit card receivables, fair values are based on the carrying amounts. 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 the borrowers with similar credit ratings and for the same remaining maturities.

Deposits - The fair value of demand deposits, savings, and money market accounts is the amount payable on demand at the reporting date. The fair values of certificates of deposit are estimated using a discounted cash flow calculation that applies current interest rates to a schedule of aggregated expected maturities.

Securities Sold Under Agreements to Repurchase - The carrying amount is a reasonable estimate of fair value because these instruments typically have terms of one day.

Advances From Federal Home Loan Bank - The fair values of fixed rate borrowings are estimated using a discounted cash flow calculation that applies the Company's current borrowing rate from the Federal Home Loan Bank. The carrying amounts of variable rate borrowings are reasonable estimates of fair value because they can be repriced frequently.

Junior Subordinated Debentures - The carrying value of junior subordinated debentures approximates its fair value since the debentures were issued at a floating rate.

Accrued Interest Receivable and Payable - The carrying value of these instruments is a reasonable estimate of fair value.

Off-Balance-Sheet Financial Instruments - Fair values of off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

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FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements

NOTE 20 - FAIR VALUE OF FINANCIAL INSTRUMENTS - continued

The carrying values and estimated fair values of the Company's financial instruments were as follows:

| | December 31, | | | |
|--|--------------------|-------------------------|--------------------|-------------------------|
| | 2007 | | 2006 | |
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial Assets: | | | | |
| Cash and due from banks | \$ 7,164,650 | \$ 7,164,650 | \$ 17,328,075 | \$ 17,328,075 |
| Federal funds sold | - | - | 14,135,000 | 14,135,000 |
| Securities available-for-sale | 58,580,313 | 58,580,313 | 35,931,271 | 35,931,271 |
| Nonmarketable equity securities | 3,930,400 | 3,930,400 | 2,187,600 | 2,187,600 |
| Loans, including loans held for sale | 487,738,540 | 481,470,000 | 360,123,046 | 350,547,000 |
| Accrued interest receivable | 3,092,767 | 3,092,767 | 2,464,531 | 2,464,531 |
| Financial Liabilities: | | | | |
| Demand deposit, interest-bearing transaction, and savings accounts | \$ 168,812,402 | \$ 168,812,402 | \$ 154,182,263 | \$ 154,182,263 |
| Certificates of deposit | 280,685,313 | 280,593,000 | 218,755,820 | 219,450,000 |
| Securities sold under agreements to repurchase | 7,927,754 | 7,927,754 | 8,120,014 | 8,120,014 |
| Advances from Federal Home Loan Bank | 69,000,000 | 69,000,000 | 28,500,000 | 28,465,000 |
| Federal Funds Purchased | 13,359,000 | 13,359,000 | - | - |
| Note payable | 3,000,000 | 3,000,000 | - | - |
| Junior subordinated debentures | 10,310,000 | 10,310,000 | 10,310,000 | 10,310,000 |
| Accrued interest payable | 767,577 | 767,577 | 766,276 | 766,276 |
| | | Estimated | | Estimated |
| | Notional | Fair | Notional | Fair |
| | Amount | Value | Amount | Value |
| Off-Balance-Sheet Financial Instruments: | | | | |
| Commitments to extend credit | \$ 76,545,909 | \$ - | \$ 67,370,404 | \$ - |
| Standby letters of credit | 2,721,249 | - | 3,543,270 | - |

NOTE 21 - SUBSEQUENT EVENTS

On November 10, 2007, the Bank entered into a contract to purchase approximately 1.37 acres of land located in North Charleston, South Carolina. The purchase price for the property was \$1,400,000. The contract included an inspection period of ninety days from the effective date in which the Bank had the right to terminate the contract. The purchase of this property closed on March 10, 2008.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements

NOTE 22 - FIRST RELIANCE BANCSHARES, INC. (PARENT COMPANY ONLY)

Condensed Balance Sheets

| | December 31, | |
|---|----------------------|----------------------|
| | 2007 | 2006 |
| Assets | | |
| Cash | \$ 665,117 | \$ 923,308 |
| Investment in banking subsidiary | 48,530,277 | 42,389,421 |
| Marketable Investments | 251,650 | 311,505 |
| Nonmarketable equity securities | - | 100,000 |
| Investment in trust | 310,000 | 310,000 |
| Other assets | 773,761 | 499,301 |
| Total assets | \$ 50,530,805 | \$ 44,533,535 |
| Liabilities | | |
| Accounts payable | \$ 192,901 | \$ 130,272 |
| Note payable | 3,000,000 | - |
| Junior subordinated debentures | 10,310,000 | 10,310,000 |
| Total liabilities | 13,502,901 | 10,440,272 |
| Shareholders' equity | 37,027,904 | 34,093,263 |
| Total liabilities and shareholders' equity | \$ 50,530,805 | \$ 44,533,535 |

Condensed Statements of Income

| | December 31, | |
|--|---------------------|---------------------|
| | 2007 | 2006 |
| Income | \$ 21,533 | \$ 24,623 |
| Expenses | 850,585 | 755,001 |
| Loss before income taxes and equity in undistributed earnings of banking subsidiary | (829,052) | (730,378) |
| Income tax benefit | 276,275 | 315,501 |
| Income before equity in undistributed earning of banking subsidiary | (552,777) | (414,877) |
| Equity in undistributed earnings of banking subsidiary | 3,112,297 | 3,660,785 |
| Net income | \$ 2,559,520 | \$ 3,245,908 |

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements

NOTE 22 - FIRST RELIANCE BANCSHARES, INC. (PARENT COMPANY ONLY) - continued

Condensed Statements of Cash Flows

| | December 31, | |
|---|---------------------|-------------------|
| | 2007 | 2006 |
| Cash flows from operating activities | | |
| Net income | \$ 2,559,520 | \$ 3,245,908 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Increase in other assets | (276,960) | (441,960) |
| Increase in other liabilities | 82,980 | 65,476 |
| Equity in undistributed earnings of banking subsidiary | (3,112,297) | (3,660,785) |
| Net cash used by operating activities | (746,757) | (791,361) |
| Cash flows from investing activities | | |
| Purchase of nonmarketable equity securities | | (100,000) |
| Investment in banking subsidiary | (3,000,000) | |
| Proceeds on sale of non marketable securities | 102,500 | - |
| Net cash used by investing activities | (2,897,500) | (100,000) |
| Cash flows from financing activities | | |
| Proceeds from exercise of stock options | 239,746 | 544,138 |
| Issuance of shares to ESOP | 198,380 | 472,747 |
| Sale of treasury stock | (145,198) | 9,896 |
| Issuance of restricted stock | 76,379 | 33,632 |
| Issuance of shares to Advisory Board | 16,759 | 15,025 |
| Proceeds from note payable | 3,000,000 | - |
| Net cash provided (used) by financing activities | 3,386,066 | 1,075,438 |
| (Decrease) increase in cash | (258,191) | 184,077 |
| Cash and cash equivalents, beginning of year | 923,308 | 739,231 |
| Cash and cash equivalents, ending of year | \$ 665,117 | \$ 923,308 |

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY
Notes to Consolidated Financial Statements

NOTE 23 - QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The tables below represent the quarterly results of operations for the years ended December 31, 2007 and 2006, respectively:

| | December 31, 2007 | | | |
|--|--------------------------|--------------|---------------|--------------|
| | Fourth | Third | Second | First |
| Total interest and fee income | \$ 10,097,678 | \$ 9,708,594 | \$ 9,318,103 | \$ 8,416,112 |
| Total interest expense | 4,740,765 | 5,011,381 | 4,653,632 | 4,027,431 |
| Net interest income | 5,356,913 | 4,697,213 | 4,664,471 | 4,388,681 |
| Provision for loan losses | 773,702 | 408,962 | 325,202 | 135,234 |
| Net interest income after provisions for loan losses | 4,583,211 | 4,288,251 | 4,339,269 | 4,253,447 |
| Other income | 1,420,328 | 1,264,500 | 1,423,726 | 1,193,185 |
| Other expense | 5,344,626 | 4,624,605 | 4,486,802 | 4,505,242 |
| Income before income tax expense | 658,913 | 928,208 | 1,276,193 | 941,390 |
| Income tax expense | 299,182 | 343,331 | 368,486 | 234,183 |
| Net income | \$ 359,731 | \$ 584,877 | \$ 907,708 | \$ 707,207 |
| Basic income per common share | \$.10 | \$.17 | \$.26 | \$.21 |
| Diluted income per common share | \$.10 | \$.17 | \$.26 | \$.20 |

| | December 31, 2006 | | | |
|--|--------------------------|--------------|---------------|--------------|
| | Fourth | Third | Second | First |
| Total interest and fee income | \$ 8,571,562 | \$ 8,484,778 | \$ 7,635,918 | \$ 7,024,327 |
| Total interest expense | 4,001,265 | 3,938,100 | 3,258,676 | 3,015,658 |
| Net interest income | 4,570,297 | 4,546,678 | 4,377,242 | 4,008,669 |
| Provision for loan losses | 224,500 | 477,205 | 440,501 | 250,285 |
| Net interest income after provisions for loan losses | 4,345,797 | 4,069,473 | 3,936,741 | 3,758,384 |
| Other income | 1,166,574 | 1,232,896 | 1,252,768 | 938,455 |
| Other expense | 4,340,612 | 4,024,389 | 4,022,098 | 3,885,285 |
| Income before income tax expense | 1,171,759 | 1,277,980 | 1,167,411 | 811,554 |
| Income tax expense | 187,382 | 413,068 | 344,495 | 237,851 |
| Net income | \$ 984,377 | \$ 864,912 | \$ 822,916 | \$ 573,703 |
| Basic income per common share | \$.30 | \$.25 | \$.24 | \$.17 |
| Diluted income per common share | \$.27 | \$.25 | \$.23 | \$.16 |

**FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY
Corporate Data**

ANNUAL MEETING:

The annual meeting of Shareholders of First Reliance Bancshares, Inc. and Subsidiary will be held at First Reliance Bank on June 19, 2008.

CORPORATE OFFICE:

2170 West Palmetto Street
Florence, South Carolina 29501
Phone (843) 662-8802
Fax (843) 662-8373

INDEPENDENT AUDITORS:

Elliott Davis, LLC
1901 Main Street, Suite 1650
P.O. Box 2227
Columbia, S.C. 29202

STOCK TRANSFER DEPARTMENT:

Registrar and Transfer Company
10 Commerce Drive
Cranford, New Jersey 07016-3572

**MARKET FOR FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY COMMON STOCK;
PAYMENT OF DIVIDENDS**

On March 30, 2004, the Company's common stock became listed on the Over The Counter Bulletin Board. Arms-length transactions in the common stock are anticipated to be infrequent and negotiated privately between the persons involved in those transactions.

High and Low Stock Price Information for First Reliance Bancshares, Inc. and Subsidiary

| Applicable Period | 2007 | | 2006 | | 2005 | |
|-------------------|----------|----------|----------|----------|----------|----------|
| | High | Low | High | Low | High | Low |
| First Quarter | \$ 15.60 | \$ 14.75 | \$ 16.60 | \$ 14.60 | \$ 14.25 | \$ 12.51 |
| Second Quarter | \$ 15.00 | \$ 14.00 | \$ 19.50 | \$ 16.35 | \$ 14.00 | \$ 12.00 |
| Third Quarter | \$ 13.75 | \$ 12.00 | \$ 17.00 | \$ 16.60 | \$ 14.25 | \$ 13.10 |
| Fourth Quarter | \$ 12.85 | \$ 9.85 | \$ 17.25 | \$ 15.60 | \$ 16.00 | \$ 13.00 |

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY
Corporate Data - continued

As of March 8, 2004, the Company's common stock began trading in the over-the-counter market under the symbol FSRL. The development of an active secondary market requires the existence of an adequate number of willing buyers and sellers. The Company's current reported average daily trading volume is approximately 2,137 shares. This level of trading volume in the secondary market for the Company's common stock may materially impact a shareholder's ability to promptly sell a large block of the Company's common stock at a price acceptable to the selling shareholder. According to the Company's transfer agent, there are approximately 1,308 shareholders of record as of January 1, 2007.

The Company is a legal entity separate and distinct from the Bank. The principal sources of the Company's cash flow, including cash flow to pay dividends to its shareholders, are dividends that the Bank pays to its sole shareholder, the Company. Statutory and regulatory limitations apply to the Bank's payment of dividends to the Company as well as to the Company's payment of dividends to its shareholders. Statutory and regulatory limitations apply to the Bank's payment of dividends to the Company as well as to the Company's payment of dividends to its shareholders. For example, all FDIC insured institutions, regardless of their level of capitalization, are prohibited from paying any dividend or making any other kind of distribution if following the payment or distribution the institution would be undercapitalized. Moreover, federal agencies having regulatory authority over the Company or the Bank have issued policy statements that provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings.

Additionally, under South Carolina law, the Bank is authorized to pay cash dividends up to 100% of net income in any calendar year without obtaining the prior approval of the State Board, provided that the Bank received a composite rating of one or two at the last examination conducted by a state or federal regulatory authority. All other cash dividends require prior approval by the State Board. South Carolina law requires each state nonmember bank to maintain the same reserves against deposits as are required for a state member bank under the Federal Reserve Act. This requirement is not expected to limit the ability of the Bank to pay dividends on its common stock.

It is the current policy of the Bank to retain earnings to permit possible future expansion. As a result, the Company has no current plans to initiate the payment of cash dividends, and its future dividend policy will depend on the Bank's earnings, capital requirements, financial condition and other factors considered relevant by the board of directors of the Company and the Bank.

Shareholders may obtain, without charge, a copy of the Company's Annual Report filed with the Securities and Exchange Commission on Form 10-K for the period ended December 31, 2007. Written requests should be addressed to Jeffrey A. Paolucci, 2170 W. Palmetto Street, Florence, South Carolina 29501.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY
Corporate Data - continued

EXECUTIVE OFFICERS OF FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

F. R. Saunders, Jr.

President and Chief Executive Officer

Jeffrey A. Paolucci

Senior Vice President, Chief Financial and Operating Officer and Secretary

Thomas C. Ewart

Senior Vice President and Chief Banking Officer

Jess Nance

Senior Vice President and Chief Credit Officer

Paul C. Saunders

Senior Vice President and Senior Retail Banking Officer

DIRECTORS OF FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

F. R. Saunders, Jr.

President and Chief Executive Officer of First Reliance Bancshares, Inc. and First Reliance Bank

Jeffrey A. Paolucci

Senior Vice President, Chief Financial Officer and Secretary of First Reliance Bancshares, Inc. and First Reliance Bank

Paul C. Saunders

Senior Vice President of First Reliance Bancshares, Inc. and First Reliance Bank

A. Dale Porter

Senior Branch Administration Manager, First Reliance Bank

Leonard A. Hoogenboom

Chairman of the Board of Directors of First Reliance Bancshares, Inc.; Owner and Chief Executive Officer of Hoogenboom, CPA, PA

John M. Jebaily

Owner and President of Jebaily Properties, Inc, a real estate agency

Andrew G. Kampziones

Owner, President and Treasurer of Fairfax Development Corporation, a real estate development corporation; Professor, Florence-Darlington Technical College and Francis Marion University

C. Dale Lusk, MD

Physician and Owner/Partner of Advanced Women's Care

T. Daniel Turner

Owner and President of Turner's Custom Auto Glass Inc.; Owner of Glass Connection USA, a billing service company

A. Joe Willis, DC

Retired and former President of Willis Chiromed, a chiropractic practice

J. Munford Scott, Jr.

Attorney, Turner Padget Graham & Laney Attorneys

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