COOPERATIVE BANKSHARES INC
Form 10-K
March 29, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K
FOR ANNUAL AND TRANSITION REPORTS
PURSUANT TO SECTIONS 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

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

For the Fiscal Year Ended December 31, 2001

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

For the Transition Period from __________________ to _________________

Commission File Number: 0-24626

COOPERATIVE BANKSHARES, INC.
(Exact name of registrant as specified in its charter)

North Carolina	56-1886527
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
201 Market Street, Wilmington, North Carolina	28401
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (910) 343-0181

Securities registered pursuant to Section 12(b) of the Act: None

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

Common Stock, par value $1.00 per share
(Title of Class)

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

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

As of February 27, 2002, the aggregate market value of the voting stock held by non-affiliates of the registrant, based on the closing sales price of the registrant's common stock as quoted on the NASDAQ Stock Market was $27,897,607 (2,317,077 shares at $12.04 per share). For purposes of this calculation, directors, executive officers and beneficial owners of more than 10% of the registrant's outstanding voting stock are treated as affiliates.

As of March 22, 2002, there were issued and outstanding 2,835,447 shares of the registrant's common stock.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of Annual Report to Stockholders for the Fiscal Year Ended December 31, 2001. (Parts I and II)

2. Portions of Proxy Statement for the 2002 Annual Meeting of Stockholders. (Part III)

PART I

ITEM 1. BUSINESS

GENERAL

THE COMPANY. Cooperative Bankshares, Inc. (the "Company") is a registered bank holding company incorporated in North Carolina in 1994. The Company was formed for the purpose of serving as the holding company for Cooperative Bank for Savings, Inc., SSB ("Cooperative Bank" or the "Bank"), a North Carolina chartered savings bank. The Company's primary activities consist of holding the stock of Cooperative Bank and operating the business of the Bank. Accordingly, the information set forth in this report, including financial statements and related data, relates primarily to Cooperative Bank.

COOPERATIVE BANK. Chartered in 1898, the Bank's headquarters is located in Wilmington, North Carolina. Cooperative operates 17 financial centers throughout the coastal and inland communities of eastern North Carolina. These centers extend from Corolla, located on the Outer Banks of North Carolina, to Tabor City, located on the South Carolina border. The Bank's deposit accounts are insured up to applicable limits by the Federal Deposit Insurance Corporation ("FDIC"). At December 31, 2001, Cooperative Bank had total assets of $458.1 million, deposits of $339.8 million and stockholders' equity of $33.6 million.

Through its financial centers, the Bank provides a wide range of banking products, including interest bearing and non-interest bearing checking accounts, certificates of deposit and individual retirements accounts. It offers an array of loan products: overdraft protection, commercial, consumer, agricultural, real estate, residential mortgage and home equity loans. Also offered are safe deposit boxes and automated banking services through ATMs and Access24 Phone Banking. In addition, the Bank also offers discount brokerage services, annuity sales and mutual funds through a third party arrangement with UVEST Investment Services.

The Bank has chosen to sell a larger percentage of its fixed rate mortgage loan originations through broker arrangements. This enables the Bank to invest its funds in commercial loans, while increasing fee income. This is part of the continuing effort to restructure the balance sheet and operations to be more reflective of a commercial bank.

A new financial center was opened in Whiteville, North Carolina, (Columbus County) in April of 2001.

The common stock of Cooperative Bankshares, Inc. is traded on the NASDAQ National Market under the symbol "COOP".

MARKET AREA

Cooperative Bank considers its primary market area to be the communities of eastern North Carolina extending from the Virginia to the South Carolina borders. The market is generally segmented into the coastal communities and the inland areas. The economies of the coastal communities (concentrated in Dare, Carteret, Currituck, Onslow, Pender, New Hanover and Brunswick Counties) are seasonal and largely dependent on the summer tourism industry. The economy of Wilmington (the largest city in the market area), a historic seaport with a population of approximately 92,000 is also reliant upon summer tourism but is diversified into the chemicals, shipping, aircraft engines, and fiber optics industries. Wilmington also serves as a regional retail center, a regional medical center and is home of the University of North Carolina at Wilmington. The inland communities served by the Bank (concentrated in Bladen, Brunswick, Columbus, Duplin, Hyde, Beaufort and Pender Counties) are largely service areas for the agricultural activities in eastern North Carolina.

LENDING ACTIVITIES

GENERAL. Cooperative Bank's lending activities have concentrated on the origination of loans for the purpose of constructing, financing or refinancing residential properties. As of December 31, 2001, approximately $273 million, or 73%, of the Bank's loan portfolio consisted of loans secured by residential properties. To a lesser extent, the Bank originates nonresidential real estate loans, home equity line of credit loans, and secured and unsecured consumer and business loans. While continuing to place emphasis on residential mortgage loans, the Bank is taking a more aggressive position in pursuing business lending, and nonresidential real estate lending involving loans secured by small commercial properties with balances generally ranging from $100,000 to $1,000,000. The Bank originates adjustable rate and fixed rate loans. As of December 31, 2001, adjustable rate and fixed rate loans totaled approximately 63% and 37%, respectively, of the Bank's total loan portfolio.

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ANALYSIS OF LOAN PORTFOLIO. Set forth below is selected data relating to the composition of the Bank's loan portfolio by type of loan and type of collateral on the dates indicated. Other than as set forth below, there were no concentrations of loans which exceeded 10% of total loans at December 31, 2001.

	AT DECEMBER 31,				
	2001		2000		
	(DOLLARS IN THOUSANDS)				
	AMOUNT	%	AMOUNT	%	AMO
Real estate:					
Construction and land development	$ 62,142	16.64%	$ 37,542	10.80%	$ 1
Mortgage:					
1-4 family residential	209,622	56.13	234,383	67.45	253
Multi-family residential	15,626	4.18	17,081	4.92	17
Commercial	55,664	14.90	31,300	9.01	38

Equity line	13,131	3.52	11,954	3.44	9
Other	254	0.07	174	0.05	
Total real estate loans	356,439	95.44	332,434	95.67	321
Commercial, industrial and agricultural	13,430	3.60	10,970	3.16	10
Consumer	7,285	1.95	7,236	2.08	5
Total gross loans	377,154	100.99	350,640	100.91	337
Less:					
Unearned discounts and net deferred fees	1,173	0.31	994	0.29	1
Allowance for loan losses	2,523	0.68	2,160	0.62	1
Net loans	$373,458	100.00%	$347,486	100.00%	$334

	AT DECEMBER 31,			
	1998		1997	
	(DOLLARS IN THOUSANDS)			
	AMOUNT	%	AMOUNT	%
Real estate:				
Construction and land development	$ 1,376	0.43%	$ --	-- %
Mortgage:				
1-4 family residential	265,172	82.52	252,645	88.12
Multi-family residential	12,941	4.03	9,209	3.21
Commercial	26,296	8.18	11,715	4.09
Equity line	8,811	2.74	8,074	2.82
Other	52	0.02	89	0.03
Total real estate loans	314,648	97.92	281,732	98.27
Commercial, industrial and agricultural	3,997	1.24	2,752	0.96
Consumer	5,073	1.59	4,356	1.52
Total gross loans	323,718	100.75	288,840	100.75
Less:				
Unearned discounts and net deferred fees	1,216	0.38	1,274	0.44
Allowance for loan losses	1,178	0.37	874	0.31
Net loans	$321,324	100.00%	$286,692	100.00%

The following table sets forth as of December 31, 2001, certain information regarding the dollar amount of loans maturing in the Bank's loan portfolio based on their contractual terms to maturity.

	DUE WITHIN ONE YEAR	DUE AFTER 1 THROUGH 5 YEARS	DUE AFTER 5 YEARS
		(IN THOUSANDS)	

Real Estate			
Construction and land development	$ 29,045	$ 28,232	$ 4,865
Mortgage			
1-4 family residential	6,459	12,461	190,702
Multi-family residential	3,051	6,345	6,230
Commercial	7,620	35,127	12,917
Equity line	2,751	1,256	9,124
Other	15	239	--
Commercial, Industrial & Agricultural	7,694	4,375	1,361
Consumer	3,442	3,316	527
Total	$ 60,077	$ 91,351	$ 225,726

The next table shows at December 31, 2001, the dollar amount of all the Bank's loans due after one year from December 31, 2001 which have fixed interest rates and have floating or adjustable interest rates.

	ONE TO FIVE YEARS	AFTER FIVE YEARS	
		(IN THOUSANDS)	
Loans maturing after one year with:			
Fixed interest rates	$ 41,341	$ 81,330	$
Floating or adjustable rates	50,010	144,396	
Total	$ 91,351	$ 225,726	$

RESIDENTIAL REAL ESTATE LOANS. The Bank originates one-to four-family residential mortgage loans collateralized by property located in its market area. While a majority of the Bank's residential real estate loans are collateralized by owner-occupied primary residences, the Bank's portfolio also includes some second home and investor properties. The Bank also originates residential lot loans collateralized by vacant lots located in approved subdivisions.

The Bank's loan originations are generally for a term of 15 to 30 years, amortized on a monthly basis, with principal and interest due each month. Residential real estate loans often remain outstanding for significantly shorter periods than their contractual terms. Borrowers may refinance or prepay loans at their option.

The Bank has offered adjustable rate mortgage loans ("ARMs") since 1979 and presently offers one-year ARMs with rate adjustments tied to prime or the weekly average yield on U.S. Treasury Securities adjusted to a constant maturity of one year. The Bank offers introductory interest rates on ARMs which are not generally fully indexed. The interest rates on these loans generally include a cap of 2% per adjustment and 6% over the life of the loan. The Bank's underwriting policies require that the borrower qualify for a fully indexed 1 year ARM at the fully indexed rate. While the proportion of fixed and adjustable rate loan originations in the Bank's portfolio largely depends on the level of interest rates, the Bank has strongly emphasized ARMs in recent years and has been relatively successful in maintaining the level of ARM originations even during periods of declining interest rates. In addition to the one-year ARM, the Bank offers 3/1 and 5/1 ARM products. These loans adjust annually after the end of the first three or five-year period. A "Low Doc" program is available for the non-conforming loans.

Cooperative Bank also originates 15 to 30 year fixed rate mortgage loans on one- to four-family units. The Bank generally charges a higher interest rate on such loans if the property is not owner-occupied. The majority of

fixed rate loans are underwritten according to Federal Home Loan Mortgage Corporation ("FHLMC") or Federal National Mortgage Association ("FNMA") guidelines, so that the loans qualify for sale in the secondary market. The Bank has sold fixed rate loans in the secondary market from time to time when such sales were consistent with the Bank's liquidity and asset/liability goals.

The Bank actively lends on the security of properties located in the Outer Banks region of North Carolina. This region's economic base is seasonal and driven by beach tourism, and a large number of the loans made by the Bank in this area are secured by vacation rental properties. These loans are inherently more risky than loans secured by the borrower's permanent residence, since the borrower is typically dependent upon rental income to meet debt service requirements, and repayment is therefore subject to a greater extent to adverse economic, weather and other conditions affecting vacation rentals. Management seeks to minimize these risks by employing what it believes are conservative underwriting criteria.

The Bank's lending policies generally limit the maximum loan-to-value ratio on conventional residential mortgage loans to 95% of the lesser of the appraised value or purchase price, with the condition that private mortgage insurance is required on loans with loan-to-value ratios in excess of 80%.

Cooperative Bank also originates loans secured by multi-family properties. At December 31, 2001, the Bank had $15.6 million of such loans, representing 4.2% of its total loan portfolio. These loans are primarily secured by apartment buildings located in the Bank's market area.

CONSTRUCTION LOANS. The Bank originates loans to finance the construction of one-to four- and multi-family dwellings, housing developments, commercial projects and condominiums. Construction loans amounted to approximately $62.1 million, or 16.6%, of the Bank's total loan portfolio at December 31, 2001. In recent years, the Bank has emphasized the origination of construction loans in response to the significant demand for such loans by borrowers engaged in building and development activities in the growing communities of its market area. In addition, construction loans afford the Bank the opportunity to increase the interest rate sensitivity of its loan portfolio.

Many of the Bank's construction loans are converted to permanent loans. At the time the loan is converted to a permanent loan, the Bank underwrites the creditworthiness of the purchaser prior to approving the assumption, at which time the original borrower is released from liability. Construction/permanent loans have either fixed or adjustable rates and have terms of up to 30 years. The Bank also will make short term construction loans which have fixed rates and terms of up to 12 months. These loans are generally made in amounts up to 80% of appraised value. Loan proceeds generally are disbursed in increments as construction progresses and as inspections warrant.

The Bank's risk of loss on a construction loan is largely dependent upon the accuracy of the initial estimate of the property's value at completion of construction and the bid price (including interest) of construction. If the estimate of construction costs proves to be inaccurate, the Bank may be required to advance funds beyond the amount originally committed to permit completion of the project. If the estimate of the value proves to be inaccurate, the Bank may be confronted, at or prior to the maturity of the loan, with a project whose value is insufficient to assure full repayment. When lending to speculation builders, the cost of construction breakdown is provided by the builder, as well as supported by the appraisal.

The Bank's underwriting criteria are designed to evaluate and minimize the risks of each construction loan. Among other things, the Bank considers the reputation of the borrower and the contractor, the amount of the borrower's equity in the project, independent valuations and reviews of cost estimates, pre-construction sale and leasing information, and cash flow projections of the borrower. In addition, the Bank reviews the builder's current financial reports, tax returns, credit reports and, if the builder has not previously borrowed from Cooperative Bank, credit references. The Bank only makes construction loans within its primary market area.

The Bank has in the past originated loans for the acquisition and development of unimproved property to be used for residential purposes. Land development lending is generally considered to involve a higher level of credit risk than one- to four-family residential lending due to the concentration of principal in a limited number of loans and borrowers and the effects of general economic conditions on development projects.

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The following table sets forth certain information as of December 31, 2001 regarding the dollar amount of construction loans secured by real estate and real estate mortgage loans maturing in the Bank's portfolio based on their contractual terms to maturity. A portion of these loans have provisions to convert to permanent loans upon completion of construction. For further information, see Note 3 of Notes to Consolidated Financial Statements included in the Company's Annual Report to Stockholders for the Fiscal Year Ended December 31, 2001 (the "Annual Report").

	(IN THOUSANDS)
Real estate - construction	
1-4 residential	$17,523
Multi-family residential	17,136
Commercial	27,483
Total	$62,142

LOANS SECURED BY NONRESIDENTIAL REAL ESTATE. Loans secured by nonresidential real estate constituted approximately $83.4 million, or 22.1% of the Bank's total loans at December 31, 2001. The Bank is emphasizing the origination of these loans because of their profitability, since they generally carry a higher interest rate than single family residential mortgage loans as well as being more interest rate sensitive. The Bank originates both construction loans and permanent loans on nonresidential properties. Nonresidential real estate loans are generally made in amounts up to 80% of the lesser of appraised value or purchase price of the property and have generally been made in amounts under $2.0 million. The Bank's permanent nonresidential real estate loans are secured by improved property such as office buildings, retail centers, warehouses, and other types of buildings located in the Bank's primary market area. Nonresidential real estate loans are either fixed or variable rate. The variable rate loans have interest rates tied to prime or the weekly average yield on U.S. Treasury Securities adjusted to a constant maturity of one year.

Loans secured by nonresidential properties are generally larger and involve greater risks than residential mortgage loans. Because payments on loans secured by nonresidential properties are often dependent on successful operation or management of the properties, repayment of such loans may be subject to a greater extent to adverse conditions in the real estate market or the economy. The Bank seeks to minimize these risks in a variety of ways, including limiting the size of its nonresidential real estate loans, generally restricting such loans to its primary market area and attempting to employ conservative underwriting criteria.

CONSUMER LENDING. At December 31, 2001, the Bank's consumer loan portfolio totaled approximately $7.3 million, representing 1.9% of the Bank's total loans receivable. The Bank also offers home equity loans, which are made for terms of up to 15 years at adjustable interest rates. As of December 31, 2001, the Bank's home equity loan portfolio totaled approximately $13.1 million, representing 3.5% of its total loans receivable.

Consumer loans entail greater risk than do residential mortgage loans, particularly in the case of consumer loans which are unsecured or collateralized by rapidly depreciable assets such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. The remaining deficiency often does not warrant further substantial collection efforts against the borrower. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans. Such loans may also give rise to claims and defenses by a consumer loan borrower against an assignee of such loans such as the Bank, and a borrower may be able to assert against such assignee claims and defenses which it has against the seller of the underlying collateral.

NON-REAL ESTATE BUSINESS LENDING. In late 1996, the Bank initiated a program for originating loans to small businesses in the Bank's market area, which are secured by various forms of non-real estate collateral or are unsecured. At December 31, 2001, these loans totaled approximately $13.4 million. Management of Cooperative Bank believes that these loans are attractive to the Bank in light of the typically higher interest rate yields associated

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with them and the opportunity they present for expanding the Bank's relationships with existing customers and developing broader relationships with new customers. Accordingly, the Bank plans to actively pursue this type of lending in the future in an effort to maintain a profitable spread between the Bank's average loan yield and its cost of funds.

Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment and other income and which are collateralized by real property whose value tends to be more easily ascertainable, commercial business loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself. Further, the collateral securing the loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. The management of Cooperative Bank seeks to minimize these risks as the Bank's commercial business loan portfolio grows by attempting to employ conservative underwriting criteria.

LOAN SOLICITATION AND PROCESSING. Loan originations are derived from a number of sources, including "walk-in" customers at the Bank's offices and solicitations by Cooperative Bank employees.

Mortgage loan applications are accepted at all full-service branches, and are reviewed by a loan officer or branch manager. Upon receipt of a loan application, central processing orders a credit report and verifications to verify specific information relating to the applicant's employment, income and credit standing. An appraisal of the real estate intended to secure the proposed loan is undertaken by an internal appraiser or an outside appraiser approved by the Bank. In the case of "Low Doc" loans, a tax valuation is acceptable.

Loan authorities and limits have been delegated by the Board of Directors to a group of senior officers who function as the loan committee, except for consumer loans, which may be approved by branch loan officers. Loans exceeding $700,000 up to $1,000,000 can be approved by three members of the loan committee. Any loan exceeding $1,000,000 is approved by the Bank's Board of Directors. Fire and casualty insurance is required on all loans secured by improved real estate.

ORIGINATIONS, PURCHASES, AND SALES OF MORTGAGE LOANS. The Bank's general policy is to originate conventional residential mortgage loans under terms, conditions and documentation which permit sale to the FHLMC, FNMA or private investors in the secondary market. The Bank has chosen to begin selling a larger percentage of its fixed rate mortgage loan originations through broker arrangements. This enables the Bank to invest its funds in commercial loans, while increasing fee income. The Bank has from time to time sold fixed rate, long term mortgage loans in the secondary market to meet liquidity requirements or as part of the asset/liability management program. In connection with such sales, the Bank may retain the servicing of the loans (i.e., collection of principal and interest payments), for which it generally receives a fee payable monthly of up to 1/4% per annum of the unpaid balance of each loan. As of December 31, 2001, the Bank was servicing approximately 1,100 loans for others aggregating approximately $56.0 million.

The Bank generally does not purchase loans, and did not purchase any loans during the last three fiscal years.

LOAN COMMITMENTS. The Bank issues loan origination commitments to qualified borrowers primarily for the construction and purchase of residential real estate. Such commitments are made on specified terms and conditions and are typically for terms of up to 30 days. A non-refundable appraisal, flood certificate, credit report and underwriting fee is collected at the time of application. Management estimates that historically, less than 20% of such commitments expire unfunded. At December 31, 2001, the Bank had outstanding loan origination commitments of approximately $2.5 million. For further information, see Note 3 of Notes to Consolidated Financial Statements included in the Annual Report.

LOAN ORIGINATION AND OTHER FEES. In addition to receiving interest at the stated rate on loans, the Bank receives loan origination fees or "points" for originating loans. Origination fees generally are calculated as a percentage of the principal amount of the loan and are charged to the borrower for creation of the loan account.

Loan origination fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income over the contractual life of the related loan.

The Bank is currently approved to broker loans to Wells Fargo and InterFirst Wholesale Mortgage Lending. These are done on the wholesale side with Cooperative Bank processing the loan using Wells Fargo or InterFirst closing documents. Cooperative Bank receives a settlement service fee for processing these loans. The Bank was successful in 2001, in originating more loans through wholesalers to generate fee income and relieve the Bank of the interest rate risk.

Loan origination, settlement service and commitment fees are volatile sources of funds. Such fees vary with the volume and type of loans and commitments made and purchased and with competitive market conditions, which in turn respond to the demand for and availability of money.

The Bank also recognizes other fees and service charges on loans. Other fees and service charges consist of late fees, fees collected with a change in borrower or other loan modifications.

DELINQUENCIES. The Bank's collection procedures provide that when a loan is 30 days past due, the borrower is contacted by mail, and payment is requested. If the delinquency continues, subsequent efforts are made to contact the borrower. If the loan continues in a delinquent status for 60 days or more, the Bank generally initiates legal proceedings. At December 31, 2001, the Bank had accruing loans which are contractually past due 90 or more days totaling $2.6 million.

NON-PERFORMING ASSETS AND ASSET CLASSIFICATION. Loans are generally classified as nonaccrual if they are past due for a period of more than 90 days, unless such loans are well secured and in the process of collection. If any portion of a loan is classified as doubtful or is partially charged off, the loan is generally classified as nonaccrual. Loans that are less than 90 days past due may also be classified as nonaccrual if repayment in full of principal and/or interest is in doubt. As of December 31, 2001, the Bank had four loans in non-accrual status with an aggregate principal balance of $505,000.

Real estate acquired by the Bank as a result of foreclosure is classified as real estate owned until such time as it is sold. When such property is acquired, it is recorded at the lower of the unpaid principal balance plus unpaid accrued interest of the related loan or the fair value of the real estate less costs to sell the property. Any required write-down of the loan upon foreclosure is charged to the allowance for loan losses. At December 31, 2001, the Bank owned approximately $759,000 of property acquired as the result of foreclosure or by deed in lieu of foreclosure and classified as "real estate owned." At December 31, 2001, the Bank had 31 loans in the process of foreclosure and/or bankruptcy with an aggregate principal balance of approximately $3.3 million. Loans in bankruptcy paying as agreed are not included in non-performing assets. Any losses management anticipates on loans in the process of foreclosure and/or bankruptcy have already been recorded through the allowance for loan losses.

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The following table sets forth information with respect to the Bank's non-performing assets for the periods indicated. During the periods shown, the Bank had no restructured loans within the meaning of Statement of Financial Accounting Standards ("SFAS") No. 15.

	AT DECEMBER 31,			
	2001	2000	1999	1998

(DOLLARS IN THOUSANDS)

Non-accruing loans	$ 505	$ 333	$ 267	$
Accruing loans which are contractually past due 90 days or more	2,563	358	934	1,7
Total	$ 3,068	$ 691	$ 1,201	$ 1,7
Percentage of total loans	.81%	.20%	.36%	.
Other non-performing assets (1)	$ 759	$ 234	$ 245	$ 2,4
Total non-performing assets	$ 3,827	$ 925	$ 1,446	$ 4,2
Total non-performing assets to total assets	.84%	.22%	.35%	1.

During the year ended December 31, 2001, gross interest income of approximately $16,795 would have been recorded on nonaccrual loans had such loans been current throughout the period. Approximately $10,622 in interest income from such loans was included in income for the year ended December 31, 2001.

Except as set forth above, the Bank had no loans which were not classified as non-accrual, 90 days past due or restructured but which may be so classified in the near future because management has concerns as to the ability of borrowers to comply with repayment terms. For further information, see Note 3 of Notes to Consolidated Financial Statements in the Annual Report.

ALLOWANCE FOR LOAN LOSSES. Management considers a variety of factors in establishing the appropriate levels for the provision and the allowance for loan losses. Consideration is given to, among other things, the impact of current economic conditions, the diversification of the loan portfolio, historical loss experience, the review of loans by the loan review personnel, the individual borrower's financial and managerial strengths, and the adequacy of underlying collateral.

The process used to allocate the allowance for loan losses considers, among other factors, whether the borrower is a mortgage, retail or commercial customer, whether the loan is secured or unsecured, and whether the loan is an open or closed-end agreement. Generally, loans are reviewed and risk graded among groups of loans with similar characteristics. The probable loss estimates for each risk grade group are the basis for the allowance allocation. The loss estimates are based on prior experience, general risk associated with each loan group and current economic conditions. The unallocated allowance for loan losses primarily represents the impact of certain conditions that were not considered in allocating the allowance to the specific components of the loan portfolio.

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The following table analyzes activity in the Bank's allowance for loan losses for the periods indicated.

	YEAR ENDED DECEMBER 31,			
	2001	2000	1999	1998
	(DOLLARS IN THOUSANDS)			

Balance at beginning of period	$ 2,160	$ 1,306	$ 1,178	$ 87
Provision for loan losses	460	970	210	33
Gross loans charged-off	(106)	(146)	(94)	(2
Gross recoveries	9	30	12	
Balance at end of period	$ 2,523	$ 2,160	$ 1,306	$ 1,17
Ratio of net charge-offs to average loans outstanding during the period	.03%	.03%	.03%	.0
Ratio of loan loss reserve to total loans	.67%	.62%	.39%	.3

Management believes that it has established the Bank's existing allowance for loan losses in accordance with generally accepted accounting principles. Additions to the allowance may be necessary, however, due to changes in economic conditions, real estate market values, growth in the portfolio, and other factors. In addition, bank regulators may require Cooperative Bank to make additional provisions for losses in the course of their examinations based on their judgments as to the value of the Bank's assets. For further information regarding the Bank's allowance for loan losses see "Management's Discussion and Analysis" and Note 3 of Notes to Consolidated Financial Statements in the Annual Report.

The following table sets forth information about the Bank's allowance for loan losses by asset category at the dates indicated. The allocation of the allowance to each category is not necessarily indicative of future losses and does not restrict the use of the allowance to absorb losses in any category.

	AT DECEMBER 31,				
	2001		2000		
	AMOUNT	PERCENT OF LOANS IN CATEGORY TO TOTAL LOANS	AMOUNT	PERCENT OF LOANS IN CATEGORY TO TOTAL LOANS	AMO
			(DOLLARS IN THOUSANDS)		
Real estate:					
Construction and land development	$ 672	16%	$ 428	10%	$
Mortgage:					
1-4 family residential	698	56	499	67	
Multi-family residential	143	4	213	5	
Commercial	589	15	526	9	
Equity line	132	3	65	3	
Other	2	--	2	1	
Total real estate loans	2,236	94%	1,733	95%	
Commercial, industrial & agricultural	214	4	166	3	
Consumer	70	2	77	2	
Unallocated	3	--	184	--	
Total gross loans	$ 2,523	100%	$ 2,160	100%	$

	AT DECEMBER 31, 1998 AMOUNT	PERCENT OF LOANS IN CATEGORY TO TOTAL LOANS	1997 AMOUNT	PERCENT OF LOANS IN CATEGORY TO TOTAL LOANS
	(DOLLARS IN THOUSANDS)			
Real estate:				
Construction and land development	$ 14	1%	$ --	0%
Mortgage:				
1-4 family residential	605	81	571	87
Multi-family residential	129	4	92	3
Commercial	301	8	123	4
Equity line	13	3	12	3
Other	1	--	1	--
Total real estate loans	1,063	97%	799	97%
Commercial, industrial & agricultural	59	1	41	1
Consumer	40	2	34	2
Unallocated	16	--	--	--
Total gross loans	$ 1,178	100%	$ 874	100%

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INVESTMENT ACTIVITIES

The Bank is required under applicable regulations to maintain liquid assets equal to at least 10% of its total assets. For purposes of this requirement, liquid assets consist of cash and readily marketable investments. Cooperative Bank has generally maintained a liquidity portfolio in excess of regulatory requirements. Liquidity levels may be increased or decreased depending upon the yields on investment alternatives and upon management's judgment as to the attractiveness of the yields then available in relation to other opportunities and its expectation of the level of yield that will be available in the future, as well as management's projections as to the short term demand for funds to be used in the Bank's loan origination and other activities.

The following table sets forth the carrying value of the Bank's investment securities portfolio at the dates indicated. For additional information regarding the Bank's investments, see Note 2 of Notes to Consolidated Financial Statements in the Annual Report.

	AT DECEMBER 31, 2001	2000
	(IN THOUSANDS)	
Securities held to maturity:		
U.S. Government and agency securities	$ 5,000	$18,015
Mortgage-backed securities	--	963

Total securities held to maturity	$ 5,000	$18,978
Securities available for sale:		
U.S. Government and agency securities	$ 25,758	$16,049
Mortgage-backed securities	11,123	--
Marketable equity securities	5,099	--
Corporate bond	990	--
Total securities available for sale	$ 42,970	$16,049
Total investment securities portfolio	$ 47,970	$35,027

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The following table sets forth the scheduled maturities, carrying values, market values and average yields for the Bank's investment securities portfolio at December 31, 2001.

	ONE YEAR OR LESS		AFTER ONE THROUGH FIVE YEARS		AFTER FIVE THROUGH TEN YEARS	
	CARRYING VALUE	AVERAGE YIELD	CARRYING VALUE	AVERAGE YIELD	CARRYING VALUE	AVERAGE YIELD
	(DOLLARS IN THOUSANDS)					
Securities held to maturity:						
U.S. government and agency	$ --	--	$ 5,000	6.20%	$ --	--
Total securities held	$ --	--	$ 5,000	6.20%	$ --	--
Securities available for sale:						
U.S. Government and agency securities	$ --	--	$17,157	5.25%	$8,601	5.75%
Mortgage-backed securities	--	--	--	--	--	--
Marketable equity securities	--	--	--	--	--	--
Corporate bond	$ --	--	990	6.12%	--	--
Total securities available for sale	$ --	--	$18,147	5.30%	$8,601	5.75%
Total investment securities portfolio	$ --	--	$23,147	5.50%	$8,601	5.75%

	MORE THAN TEN YEARS		TOTAL INVESTMENT PORTFOLIO		
	CARRYING VALUE	AVERAGE YIELD	CARRYING VALUE	FAIR VALUE	AVERAGE YIELD
	(DOLLARS IN THOUSANDS)				
Securities held to maturity:					
U.S. government and agency	$ --	--	$ 5,000	$ 5,283	6.20%

Total securities held	$ --	--	$ 5,000	$ 5,283	6.20%
Securities available for sale:					
U.S. Government and agency securities	$ --	--	$25,758	$25,758	5.42%
Mortgage-backed securities	11,123	6.22%	11,123	11,123	6.22%
Marketable equity securities	5,099	6.11%	5,099	5,099	6.11%
Corporate bond	--	--	990	990	6.12%
Total securities available for sale	$16,222	6.19%	$42,970	$42,970	5.72%
Total investment securities portfolio	$16,222	6.19%	$47,970	$48,253	5.77%

DEPOSIT ACTIVITIES AND OTHER SOURCES OF FUNDS

GENERAL. Deposits are the major source of the Bank's funds for lending and other investment purposes. In addition to deposits, Cooperative Bank derives funds from interest payments, loan principal repayments, borrowed funds and funds provided by operations. Scheduled loan repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are significantly influenced by general interest rates and money market conditions. Borrowings may be used to compensate for reductions in the availability of funds from other sources. The Bank intends to fund its activities primarily through deposits.

DEPOSITS. Deposits are attracted from within the Bank's primary market area through the offering of a broad selection of deposit instruments including checking, savings, money market deposit, and term certificate accounts (including negotiated jumbo certificates in denominations of $100,000 or more) as well as individual retirement plans. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit and the interest rate, among other factors. The Bank does not obtain funds through brokers; however, the Bank attracts deposits over the Internet and considers this a viable alternative to borrowed funds. For further information regarding the Bank's deposits, see "Management's Discussion and Analysis" and Note 5 of Notes to Consolidated Financial Statements in the Annual Report.

The following table indicates the amount of the Company's certificates of deposit of $100,000 or more by time remaining until maturity as of December 31, 2001.

MATURITY PERIOD	CERTIFICATES OF DEPOSIT (IN THOUSANDS)
Three months or less	$ 22,532
Over three through six months	17,045
Over six months through twelve months	24,196
Over twelve months	10,837
Total	$ 74,610

BORROWINGS. Deposits are the primary source of funds for Cooperative Bank's lending and investment activities and for its general business purposes. If the need arises, the Bank may obtain advances from the FHLB of

Atlanta to supplement its supply of loanable funds and to meet deposit withdrawal requirements. Advances from the FHLB are typically secured by the Bank's stock in the FHLB and a lien on a portion of the Bank's first mortgage loans. The Bank has utilized FHLB advances in recent periods in order to meet a larger than typical loan demand in the Bank's market area.

The FHLB of Atlanta functions as a central reserve bank providing credit for the Bank and other member financial institutions. As a member, Cooperative Bank is required to own capital stock in the FHLB and is authorized to apply for advances on the security of such stock and certain of its home mortgages and other assets (principally, securities which are obligations of, or guaranteed by, the United States), provided certain standards related to creditworthiness have been met. Advances are made pursuant to several different programs. Each credit program has its own interest rate and range of maturities. Depending on the program, limitations on the amount of advances are based either on a fixed percentage of a member institution's net worth or on the FHLB's assessment of the institution's creditworthiness.

For further information regarding the Bank's borrowings, see Note 6 of Notes to Consolidated Financial Statements in the Annual Report.

COMPETITION

Cooperative Bank encounters strong competition both in the attraction of deposits and in the making of real estate and other loans. Its most direct competition for deposits has historically come from financial institutions in its market area. Competition for deposits is also realized from brokerage firms and credit unions. The Bank competes for deposits by offering depositors competitive rates and a high level of personal service together with a wide range of banking products and convenient office locations.

Competition for real estate and other loans comes principally from financial institutions and mortgage companies. The Bank competes for loans primarily through the interest rates and loan fees it charges, and the efficiency and quality of services it provides borrowers. Factors which affect competition include the general and local economic conditions, current interest rate levels and volatility in the mortgage markets.

EMPLOYEES

At December 31, 2001, the Bank had 114 full-time employees and 9 part-time employees. The employees are not represented by a collective bargaining unit. The Bank believes its relationship with its employees to be good.

EXECUTIVE OFFICERS

At December 31, 2001, the executive officers of the Bank who were not also directors were as follows:

NAME	AGE AT DECEMBER 31, 2001	POSITION
O.C. Burrell, Jr.	53	Executive Vice President and Chief
Todd L. Sammons, CPA	40	Senior Vice President and Chief Fin

Dickson B. Bridger	43	Senior Vice President-Mortgage Lend

O. C. BURRELL, JR. was employed in May 1993 as Senior Vice President of Retail Banking. Mr. Burrell was elected Executive Vice President and Chief Operating Officer in 1997. Mr. Burrell has been in the banking industry since 1970 and has served in leadership capacities in various civic and professional organizations. He is active in

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the Wilmington Rotary Club and serves as treasurer and director of the Child Development Center and is a member of the Retail Lending Committee of the North Carolina Bankers Association.

TODD L. SAMMONS was employed in March 1986 as Auditor. He was promoted to Senior Vice President-and Chief Financial Officer in December 2000. He previously worked with a public accounting firm. He has served in leadership capacities in various professional, church and civic organizations. He is a Certified Public Accountant. He serves on the Board of Winter Park Optimist. He serves as Treasurer of the Wilmington Vikings, a junior Legion Baseball Team.

DICKSON B. BRIDGER was employed in March 1984 as a mortgage loan originator. He was promoted to Vice President in February 1990 and Senior Vice President-Mortgage Lending in December 2000. He is a member of Wilmington Rotary West and serves as an Elder of the Little Chapel on the Boardwalk church at Wrightsville Beach, North Carolina.

REGULATION

GENERAL. As a North Carolina savings bank with deposits insured by the SAIF, Cooperative Bank is subject to extensive regulation by the North Carolina Office of the Commissioner of Banks (the Commissioner) and the FDIC. The lending activities and other investments of Cooperative Bank must comply with various federal regulatory requirements. The Commissioner and the FDIC periodically examine Cooperative Bank for compliance with various regulatory requirements. The Bank must file reports with the Commissioner and the FDIC describing its activities and financial condition. The Bank is also subject to certain reserve requirements promulgated by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"). This supervision and regulation is intended primarily for the protection of depositors. Certain of these regulatory requirements are referred to below or appear elsewhere herein.

The Company is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended (the "Holding Company Act") and, as such, is subject to supervision and regulation by the Federal Reserve Board. The Company is also subject to regular examination by the Federal Reserve Board. In addition, as a savings institution holding company, the Company is subject to supervision by the Commissioner under North Carolina law.

The following is a brief summary of certain statutes, rules and regulations affecting the Company and the Bank. A number of other statutes and regulations have an impact on their operations. The following summary of applicable statutes and regulations does not purport to be complete and is qualified in its entirety by reference to such statutes and regulations.

FINANCIAL MODERNIZATION LEGISLATION. The Gramm-Leach-Bliley ("G-L-B") Act, which was enacted in November 1999, authorizes affiliations between banking, securities and insurance firms and authorizes bank holding companies and national banks to engage in a variety of new financial activities. Among the new activities that are permitted to bank holding companies are securities and insurance brokerage, securities underwriting, insurance underwriting and merchant banking. The Federal Reserve Board, in consultation with the Secretary of the Treasury, may approve additional financial activities. The G-L-B Act imposed new requirements on financial institutions with respect to customer privacy.

BANK HOLDING COMPANY REGULATION. As a bank holding company, the Company is required to furnish to the Federal Reserve Board annual and quarterly reports of its operations at the end of each period and to furnish such additional information as the Federal Reserve Board may require pursuant to the Holding Company Act.

Under the Holding Company Act, a bank holding company must obtain the prior approval of the Federal Reserve Board before (1) acquiring direct or indirect ownership or control of any voting shares of any bank or bank holding company if, after such acquisition, the bank holding company would directly or indirectly own or control more than 5% of such shares; (2) acquiring all or substantially all of the assets of another bank or bank holding company; (3) merging or consolidating with another bank holding company; or (4) acquiring direct or indirect ownership or control of more than 5% of the voting shares of a company that is not a bank or a bank holding

company, or from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. In addition to the above restrictions under the Holding Company Act, the Company's investments are limited under North Carolina law to those investments permitted for North Carolina savings banks. See " -- State Law and Regulation."

The Holding Company Act prohibits the Federal Reserve Board from approving an application by a bank holding company to acquire voting shares of a bank located outside the state in which the operations of the holding company's bank subsidiaries are principally conducted, unless such an acquisition is specifically authorized by state law. The State of North Carolina has enacted reciprocal interstate banking statutes that authorize banks and their holding companies in North Carolina to be acquired by banks or their holding companies in states that have also enacted reciprocal banking legislation, and permit North Carolina banks and their holding companies to acquire banks in such other states.

Under the Holding Company Act, any company must obtain approval of the Federal Reserve Board prior to acquiring control of the Company or the Bank. For purposes of the Holding Company Act, "control" is defined as ownership of more than 25% of any class of voting securities of the Company or the Bank, the ability to control the election of a majority of the directors, or the exercise of a controlling influence over management or policies of the Company or the Bank.

The Change in Bank Control Act and the regulations of the Federal Reserve Board thereunder require any person or persons acting in concert (except for companies required to make application under the Holding Company Act), to file a written notice with the Federal Reserve Board before such person or persons may acquire control of the Company or the Bank. The Change in Bank Control Act defines "control" as the power, directly or indirectly, to vote 25% or more of any voting securities or to direct the management or policies of a bank holding company or an insured bank.

The Federal Reserve Board has adopted guidelines regarding the capital adequacy of bank holding companies, which require bank holding companies to maintain specified minimum ratios of capital to total assets and capital to risk-weighted assets. See " -- Capital Requirements."

The Federal Reserve Board has the power to prohibit dividends by bank holding companies if their actions constitute unsafe or unsound practices. The Federal Reserve Board has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve Board's view that a bank holding company should pay cash dividends only to the extent that the company's net income for the past year is sufficient to cover both the cash dividends and a rate of earning retention that is consistent with the company's capital needs, asset quality, and overall financial condition.

Bank holding companies generally are required to give the Federal Reserve Board notice of any purchase or redemption of outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of the Company's consolidated net worth.

CAPITAL REQUIREMENTS. The regulations of the Federal Reserve Board and the FDIC require bank holding companies and state-chartered banks that are not members of the Federal Reserve System to maintain a minimum leverage capital requirement consisting of a ratio of Tier 1 capital to total assets (as defined) of 3%. Although setting a minimum 3% leverage ratio, the capital regulations state that only the strongest bank holding companies and banks, with composite examination ratings of 1 under the rating system used by the federal bank regulators, would be permitted to operate at or near such minimum level of capital. For all but the most highly rated institutions meeting the conditions set forth above, the minimum leverage capital ratio is 3% plus an additional "cushion" amount of at least 100 to 200 basis points. Any bank or bank holding company experiencing or anticipating significant growth would be expected to maintain capital well above the minimum levels. As a SAIF-insured, state-chartered bank, the Bank must also deduct from Tier 1 capital an amount equal to its investments in, and extensions of credit to, subsidiaries engaged in activities that are not permissible to national banks, other than debt and equity

investments in subsidiaries engaged in activities undertaken as agent for customers or in mortgage banking activities or in subsidiary depository institutions or their holding companies.

The risk-based capital rules of the Federal Reserve Board and the FDIC require bank holding companies and state non-member banks to maintain minimum regulatory capital levels based upon a weighting of their assets and off-balance sheet obligations according to risk. The risk-based capital rules have two basic components: a core capital (Tier 1) requirement and a supplementary capital (Tier 2) requirement. The risk-based capital regulations assign balance sheet assets and credit equivalent amounts of off-balance sheet obligations to one of four broad risk categories based principally on the degree of credit risk associated with the obligor. The assets and off-balance sheet items in the four risk categories are weighted at 0%, 20%, 50% and 100%. These computations result in the total risk-weighted assets.

The risk-based capital regulations require all banks and bank holding companies to maintain a minimum ratio of total capital to total risk-weighted assets of 8%, with at least 4% as core capital. For the purpose of calculating these ratios: (i) supplementary capital will be limited to no more than 100% of core capital; and (ii) the aggregate amount of certain types of supplementary capital will be limited. In addition, the risk-based capital regulations limit the allowance for loan losses includable as capital to 1.25% of total risk-weighted assets.

The federal bank regulatory agencies, including the Federal Reserve Board and the FDIC, have revised their risk-based capital requirements to ensure that such requirements provide for explicit consideration by commercial banks of interest rate risk. Under these requirements, a bank's interest rate risk exposure is quantified using either the measurement system set forth in the rule or the bank's internal model for measuring such exposure, if such model is determined to be adequate by the bank's examiner. If the dollar amount of a bank's interest rate risk exposure, as measured under either measurement system, exceeds 1% of the bank's total assets, the bank is required to hold additional capital equal to the dollar amount of the excess. The Bank's current interest rate risk exposure does not exceed 1% of the Bank's total assets. Management of the Bank does not believe that this interest rate risk component has an adverse effect on the Bank's capital. Under North Carolina law, savings banks must maintain a net worth of not less than 5% of assets. In computing its compliance with this requirement, the savings bank must deduct intangible assets from both net worth and assets.

The Bank was in compliance with both the FDIC capital requirements and the North Carolina net worth requirement at December 31, 2001. For further information regarding the Bank's capital requirements, see Note 7 of Notes to Consolidated Financial Statements in the Annual Report.

LIQUIDITY. North Carolina savings banks must maintain cash and readily marketable investments in an amount not less than 10% of the assets of the savings banks. The Bank was in compliance with this requirement at December 31, 2001.

PROMPT CORRECTIVE REGULATORY ACTION. Under the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), the federal banking regulators are required to take prompt corrective action if an insured depository institution fails to satisfy certain minimum capital requirements. All institutions, regardless of their capital levels, are restricted from making any capital distribution or paying any management fees if the institution would thereafter fail to satisfy the minimum levels for any of its capital requirements. An institution that fails to meet the minimum level for any relevant capital measure (an "undercapitalized institution") may be: (i) subject to increased monitoring by the appropriate federal banking regulator; (ii) required to submit an acceptable capital restoration plan within 45 days; (iii) subject to asset growth limits; and (iv) required to obtain prior regulatory approval for acquisitions, branching and new lines of businesses. The capital restoration plan must include a guarantee by the institution's holding company that the institution will comply with the plan until it has been adequately capitalized on average for four consecutive quarters, under which the holding company would be liable up to the lesser of 5% of the institution's total assets or the amount necessary to bring the institution into capital compliance as of the date it failed to comply with its capital restoration plan. A "significantly undercapitalized" institution, as well as any undercapitalized institution that did not submit an acceptable capital restoration plan, may be subject to regulatory demands for recapitalization, broader application of restrictions on transactions with affiliates, limitations on interest rates paid on deposits, asset growth and other activities, possible replacement of

directors and officers, and restrictions on capital distributions by any bank holding company controlling the institution.

Under regulations jointly adopted by the federal banking regulators, a savings association's capital adequacy for purposes of the FDICIA prompt corrective action rules is determined on the basis of the institution's total risk-based capital ratio (the ratio of its total capital to risk-weighted assets), Tier 1 risk-based capital ratio (the ratio of its core capital to risk-weighted assets) and leverage ratio (the ratio of its Tier 1 or core capital to adjusted total assets).

The following table shows the capital ratio requirements for each prompt corrective action category:

	WELL-CAPITALIZED	ADEQUATELY CAPITALIZED	UNDERCAPITALIZED	S U
Total risk-based capital ratio	10.0% or more	8.0% or more	Less than 8.0%	
Tier 1 risk-based capital ratio	6.0% or more	4.0% or more	Less than 4.0%	
Leverage ratio	5.0% or more	4.0% or more *	Less than 4.0% *	

For information regarding the position of the Bank with respect to the FDICIA prompt corrective action rules, see Note 7 of Notes to Consolidated Financial Statements included under Item 7 hereof.

COMMUNITY REINVESTMENT ACT. The Bank, like other financial institutions, is subject to the Community Reinvestment Act ("CRA"). The purpose of the CRA is to encourage financial institutions to help meet the credit needs of their entire communities, including the needs of low-and moderate-income neighborhoods. During the Bank's last compliance examination, the Bank received a "satisfactory" rating with respect to CRA compliance. The Bank's rating with respect to CRA compliance would be a factor to be considered by the Federal Reserve Board and the FDIC in considering applications submitted by the Bank to acquire branches or to acquire or combine with other financial institutions and take other actions and, if such rating was less than "satisfactory," could result in the denial of such applications.

DIVIDEND LIMITATIONS. The Bank may not pay dividends on its capital stock if its regulatory capital would thereby be reduced below the amount then required for the liquidation account established for the benefit of certain depositors of the Bank at the time of its conversion to stock form.

Earnings of the Bank appropriated to bad debt reserves and deducted for federal income tax purposes are not available for payment of cash dividends or other distributions to stockholders without payment of taxes at the then current tax rate by the Bank on the amount of earnings removed from the reserves for such distributions. See "Taxation." The Bank intends to make full use of this favorable tax treatment and does not contemplate use of any earnings in a manner which would limit the Bank's bad debt deduction or create federal tax liabilities.

Under applicable regulations, the Bank is prohibited from making any capital distributions if after making the distribution, the Bank would have: (i) a total risk-based capital ratio of less than 8.0%; (ii) a Tier 1 risk-based capital ratio of less than 4.0%; (iii) a leverage ratio of less than 4.0%, (iv) a regulatory net worth less than the liquidation account established in connection with the Bank's conversion to a stock institution, or (v) a regulatory net worth less than the minimum amount required by the Commissioner.

DEPOSIT INSURANCE. The Bank is required to pay assessments based on a percentage of its insured deposits to the FDIC for insurance of its deposits by the SAIF. Under the FDIC's risk-based deposit insurance assessment system, the assessment rate for an insured depository institution depends on the assessment risk classification assigned to the institution by the FDIC, which is determined by the institution's capital level and supervisory

evaluations. Within each capital group, institutions are assigned to one of three subgroups on the basis of supervisory evaluations by the institution's primary supervisory authority and such other information as the FDIC determines to be relevant to the institution's financial condition and the risk posed to the deposit insurance fund. The Bank is currently classified as well capitalized under this assessment system.

RESTRICTIONS ON CERTAIN ACTIVITIES. Under applicable law, state-chartered banks with deposits insured by the FDIC are generally prohibited from acquiring or retaining any equity investment of a type or in an amount that is not permissible for a national bank. The foregoing limitation, however, does not prohibit FDIC-insured state banks from acquiring or retaining an equity investment in a subsidiary in which the bank is a majority owner. State-chartered banks are also prohibited from engaging as principal in any type of activity that is not permissible for a national bank and subsidiaries of state-chartered, FDIC-insured state banks have been prohibited from engaging as principal in any type of activity that is not permissible for a subsidiary of a national bank unless in either case the FDIC determines that the activity would pose no significant risk to the appropriate deposit insurance fund and the bank is, and continues to be, in compliance with applicable capital standards.

The FDIC has adopted regulations to clarify the foregoing restrictions on activities of FDIC-insured state-chartered banks and their subsidiaries. An activity permissible for a national bank includes any activity expressly authorized for national banks by statute or recognized as permissible in regulations, official circulars or bulletins or in any order or written interpretation issued by the Office of the Comptroller of the Currency ("OCC"). In its regulations, the FDIC indicates that it will not permit state banks to directly engage in commercial ventures or directly or indirectly engage in any insurance underwriting activity other than to the extent such activities are permissible for a national bank or a national bank subsidiary or except for certain other limited forms of insurance underwriting permitted under the regulations. Under the regulations, the FDIC permits state banks that meet applicable minimum capital requirements to engage as principal in certain activities that are not permissible to national banks including guaranteeing obligations of others, activities which the Federal Reserve Board has found by regulation or order to be closely related to banking and certain securities activities conducted through subsidiaries.

Subject to limitation by the Commissioner, North Carolina-chartered savings banks may make any loan or investment or engage in any activity which is permitted to federally chartered institutions. However, a North Carolina-chartered savings bank cannot invest more than 15% of its total assets in business, commercial, corporate and agricultural loans. In addition to such lending authority, North Carolina-chartered savings banks are authorized to invest funds, in excess of loan demand, in certain statutorily permitted investments, including but not limited to (i) obligations of the United States, or those guaranteed by it; (ii) obligations of the State of North Carolina; (iii) bank demand or time deposits; (iv) stock or obligations of the federal deposit insurance fund or a FHLB; (v) savings accounts of any savings institution as approved by the board of directors; and (vi) stock or obligations of any agency of the State of North Carolina or of the United States or of any corporation doing business in North Carolina whose principal business is to make education loans.

TRANSACTIONS WITH AFFILIATES. Transactions between savings banks and any affiliate are governed by Sections 23A and 23B of the Federal Reserve Act. An affiliate of a savings bank is any company or entity which controls, is controlled by or is under common control with the savings bank. Generally, Sections 23A and 23B (i) limit the extent to which the savings bank or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10% of such institution's capital stock and surplus, and contain an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus and (ii) require that all such transactions be on terms substantially the same, or at least as favorable, to the institution or subsidiary as those provided to a non-affiliate. A bank holding company and its subsidiaries are considered "affiliates" of the bank under Section 23A and 23B. The term "covered transaction" includes the making of loans, purchase of assets, issuance of a guarantee and similar other types of transactions. In addition to the restrictions imposed by Sections 23A and 23B, the Bank may not (i) lend or otherwise extend credit to an affiliate, except for any affiliate which engages only in activities which are permissible for bank holding companies, or (ii) purchase or invest in any stocks, bonds, debentures, notes or similar obligations of any affiliate, except for affiliates which are subsidiaries of the Bank.

FEDERAL HOME LOAN BANK SYSTEM. The Bank is a member of the FHLB System, which consists of 12 district FHLBs subject to supervision and regulation by the Federal Housing Finance Board ("FHFB"). As a member of the FHLB of Atlanta, the Bank is required to acquire and hold shares of capital stock in the FHLB of Atlanta in an amount at least equal to 1% of the aggregate unpaid principal of its home mortgage loans, home purchase contracts, and similar obligations at the beginning of each year, or 1/20 of its advances (borrowings) from the FHLB of Atlanta, whichever is greater. Cooperative Bank was in compliance with this requirement with investment in FHLB of Atlanta stock at December 31, 2001 of approximately $4.2 million.

FEDERAL RESERVE BOARD REGULATION. Pursuant to regulations of the Federal Reserve Board, all FDIC-insured depository institutions must maintain average daily reserves against their transaction accounts. Because required reserves must be maintained in the form of vault cash or in a noninterest bearing account at a Federal Reserve Bank, the effect of the reserve requirement is to reduce the amount of the institution's interest-earning assets. At December 31, 2001, the Bank met its reserve requirements.

STATE LAW AND REGULATION. North Carolina law contains comprehensive provisions for the regulation of a savings bank business in the State of North Carolina, including the manner of chartering a savings bank, capital requirements, the composition and qualifications of boards of directors, the number and manner of selection of officers, and record keeping requirements.

North Carolina savings banks may conduct operations through branch offices located in the State of North Carolina. The North Carolina Banking Commission of the Department of Commerce conducts hearings on all branch applications, and any interested person may present evidence and argument.

Any plan adopted by the directors of a savings bank under which the savings bank would reorganize or merge or consolidate with another savings bank must be approved by the Commissioner. The plan must also be approved by the members or stockholders who are entitled to vote, at an annual or special meeting.

The Commissioner is required to conduct a periodic examination of each institution under his jurisdiction. The examination provides directors with an independent assessment of the Bank's operations and compliance with applicable laws, regulations and prudent operating policies. The Commissioner may make such examination jointly with examiners of the FDIC.

TAXATION

The Bank is subject to the provisions of the Internal Revenue Code of 1986, as amended (the "Code") in the same general manner as other corporations.

Legislation that was effective for tax years beginning after December 31, 1995 required savings institutions to recapture into taxable income over a six taxable year period the portion of the tax loan reserve that exceeds the pre-1988 tax loan loss reserve. The Bank is no longer allowed to use the reserve method for tax loan loss provisions, but is allowed to use the experience method of accounting for bad debts used by commercial banks under Code section 585. There will be no future effect on net income from the recapture because the taxes on these bad debt reserves has already been accrued as a deferred tax liability.

For additional information regarding federal and state taxes, see Note 10 of Notes to Consolidated Financial Statements in the Annual Report.

STATE INCOME TAXATION

Under North Carolina law, the Bank is subject to an annual corporate income tax of 6.90% of its federal taxable income as computed under the Code, subject to certain prescribed adjustments. In addition to the state corporate income tax, the Bank is subject to an annual state franchise tax, which is imposed at a rate of .15% applied to the greatest of the Bank's (i) capital stock, surplus and undivided profits, (ii) investment in tangible property in

North Carolina or (iii) appraised valuation of property in North Carolina. The filing of consolidated returns is not permitted under North Carolina law.

ITEM 2. PROPERTIES

The Bank operated 17 offices throughout the coastal and inland communities of eastern North Carolina at December 31, 2001. The Bank has a total of four offices that are subject to leases. The land is leased for two of these offices on which the Bank has built it's own buildings. One office is a lease of the land and the building on it and one is an office condominium that is leased by the bank. For additional information relating to premises and equipment, see Note 4 to Consolidated Financial Statements in the Annual Report.

ITEM 3. LEGAL PROCEEDINGS

None.

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

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year ended December 31, 2001.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The information contained under the section captioned "Corporate Information" in the Annual Report is incorporated by reference.

ITEM 6. SELECTED FINANCIAL DATA

The information required by this item is incorporated herein by reference to the tables captioned "Selected Financial and Other Data" in the Annual Report.

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

The information contained in the section captioned "Management's Discussion & Analysis" in the Annual Report is incorporated herein by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information contained in the section captioned "Management's Discussion and Analysis" in the Annual Report is incorporated herein by reference.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements contained in the Annual Report which are listed under Item 14 herein are incorporated herein by reference.

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

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

(a) Directors of the Registrant

The information contained under the section captioned "Proposal I -- Election of Directors" in the Proxy Statement for the 2002 Annual Meeting of Stockholders (the "Proxy Statement") is incorporated herein by reference.

(b) Principal Officers of the Registrant

The information contained under the caption "Executive Officers" under Part I of this Form 10-K is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information contained under the section captioned "Proposal I -- Election of Directors" in the Proxy Statement is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

(a) Security Ownership of Certain Beneficial Owners

Information required by this item is incorporated herein by reference to the sections captioned "Voting Securities and Principal Holders Thereof" in the Proxy Statement.

(b) Security Ownership of Management

Information required by this item is incorporated herein by reference to the sections captioned "Proposal I -- Election of Directors" in the Proxy Statement.

(c) Changes in Control

Management of the Bank knows of no arrangements, including any pledge of any person of securities of the Bank, the operation of which may at a subsequent date result in a change in control of the Bank.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this item is incorporated herein by reference to the sections captioned "Proposal I -- Election of Directors" and "Voting Securities and Principal Holders Thereof" in the Proxy Statement.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) Contents. The following financial statements are filed as part of this Annual Report on Form 10-K.

(1) Consolidated Financial Statements

1. Independent Auditors' Report of KPMG LLP *
2. Consolidated Statements of Financial Condition as of December 31, 2001 and 2000 *

3. Consolidated Statements of Operations for the Years Ended December 31, 2001, 2000 and 1999 *
4. Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2001, 2000 and 1999 *
5. Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2001, 2000 and 1999 *
6. Consolidated Statements of Cash Flows for the Years Ended December 31, 2001, 2000, and 1999 *
7. Notes to Consolidated Financial Statements *

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* Incorporated by reference to the Annual Report attached hereto as Exhibit 13.

(2) Financial Statement Schedules (All financial statement schedules

have been omitted as the required information is either inapplicable or included in the Consolidated Financial Statements or related notes.)

(b) During the fourth quarter of 2001, the Registrant filed one Current Report on Form 8-K on October 22, 2001 reporting third quarter earnings.

(c) The following exhibits are either filed as part of this report or are incorporated herein by reference:

No.	Description	Pa
3.1	Articles of Incorporation	
3.2	Bylaws	
10.1	Cooperative Bankshares, Inc. 1998 Stock Option and Incentive Plan	*
10.2	Employment Agreement with Frederick Willetts, III	
10.3	Severance Agreement with Todd L. Sammons	
10.4	Severance Agreement with O.C. Burrell, Jr.	*
10.5	Severance Agreement with Dickson B. Bridger	**
10.6	Amendment to Severance Agreement of O.C. Burrell, Jr.	
10.7	Indemnity Agreement with Directors and Executive Officers	
10.8	Director Retirement Agreements between Cooperative Bank for Savings and Each Non-Employee Director of Cooperative Bank	
10.9	Director Deferred Fee Agreements between Cooperative Bankshares, Inc. and each Director of the Company	
10.10	Director Deferred Fee Agreements between Cooperative Bank for Savings and Each Non-Employee Director of Cooperative Bank	

10.11	Executive Indexed Retirement Agreements between Cooperative Bank for Savings and Frederick Willetts, III and O. C. Burrell	
11	Statement re: computation of per share earnings - Reference is made to the Company's Consolidated Statements of Operations attached hereto as Exhibit 13, which are incorporated herein by reference	
13	Annual Report to Stockholders for the year ended December 31, 2001	
21	Subsidiaries	
23.1	Consent of KPMG LLP	

23.2	Consent of PricewaterhouseCoopers, LLP
23.3	PricewaterhouseCoopers, LLP Report of Independent Accountants

SIGNATURES

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

COOPERATIVE BANKSHARES, INC.

Date: March 28, 2002

By:/s/ Frederick Willetts, III

Frederick Willetts, III
President and Chief Executive Officer
(Duly Authorized Representative)

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.

By: /s/ Frederick Willetts, III — Date: March 28, 2002

Frederick Willetts, III
President, Chief Executive Officer and Chairman
(Principal Executive Officer and Director)

By: /s/ Todd Sammons — Date: March 28, 2002

Todd Sammons
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

By: /s/ James D. Hundley, M.D. — Date: March 28, 2002

James D. Hundley, M.D.
(Director)

By: /s/ O. Richard Wright, Jr. — Date: March 28, 2002

O. Richard Wright, Jr.
(Director)

By: /s/ Paul G. Burton — Date: March 28, 2002

Paul G. Burton
(Director)

By: /s/ H. Thompson King, III — Date: March 28, 2002

H. Thompson King, III
(Director)

By: /s/ F. Peter Fensel, Jr. Date: March 28, 2002

F. Peter Fensel, Jr.
(Director)

By: /s/ R. Allen Rippy Date: March 28, 2002

R. Allen Rippy
(Director)

By: /s/ Russell M. Carter Date: March 20, 2002

Russell M. Carter
(Director)