



March 5, 2009

Mr. Neil M. Barofsky
Special Inspector General – TARP
Office of the Inspector General
Trouble Asset Relief Program
1500 Pennsylvania Avenue, NW
Suite 1064
Washington, DC 20220

Dear Mr. Barofsky:

This letter is in response to your request of February 6, 2009 for information concerning the funds Security Federal Corporation (“Company”) received in connection with the Troubled Asset Relief Program (“TARP”) Capital Purchase Program (“CPP”). In connection with our response, we have provided some information on the background of the Company and our financial institution subsidiary, Security Federal Bank (“Bank”). The responses that follow provide information regarding our use of the TARP funds and correspond with the items set forth in your letter.

Company Description

The Company became a participant in the TARP CPP as a result of the sale of \$18 million in Senior Preferred stock, with a related warrant to purchase up to \$2.7 million in common stock, to the U.S. Treasury on December 19, 2008. The Company is a savings and loan holding company incorporated in the State of South Carolina and is the parent company of the Bank. The Bank is a federally chartered savings bank that conducts business from its main office in Aiken, South Carolina, and its 12 branch offices located in South Carolina and Georgia.

The Bank’s primary business is that of a traditional savings and loan institution, accepting deposits and originating loans in locations surrounding its offices in Aiken, Richland and Lexington counties of South Carolina and in Evans, Georgia. The Bank is also an active participant in the secondary market, engaging in mortgage banking operations largely through the origination and sale of one- to four-family residential loans. Lending activities include one- to four-family residential loans, multi-family residential and commercial real estate loans, consumer loans, commercial loans, construction loans on single family residences, multi-family dwellings and commercial real estate, and loans for the acquisition, development and construction of residential subdivisions and commercial projects.

As of December 31, 2008, the Company had total consolidated assets of \$935.0 million, total loans of \$597.3 million, total deposits of \$620.6 million and total stockholders’ equity, including the senior preferred stock, of \$65.2 million.

Response to Letter of February 6, 2009 Regarding Use of TARP Funds

1. a. As noted above, we received \$18 million of TARP funds on December 19, 2008. As we provided in TARP CPP application, the TARP funds are being used as capital to support the lending efforts of the Bank, in our local communities. During the December 2008 quarter, our net loans increased 13% annualized as reflected in our Thrift Financial Report for the quarter ended December 31, 2008. During the month of January 2009, our net loans increased at an annual rate of 26%. For the twelve months ending January 31, 2009, our net loans increased approximately 21%.

If the TARP funds had not been available to us, we would have needed to slow our loan growth to approximately 3% per annum, based on our earnings for the September and December 2008 quarters. The TARP funds allowed us to continue and increase our primary lending practice despite the turndown in the national and local housing markets. In turn, our continued lending activity has allowed us to support the economic development of the communities we serve, which was our intention when we agreed to participate in the TARP CPP.

- b. As we provided in our TARP CPP application, \$5 million of the TARP funds were reserved at the Company level and \$13 million of the TARP funds were down-streamed to the Bank to be used as capital. The TARP funds held at the Bank are not specifically segregated.

- c. As noted above in Item 1.a., the TARP funds have allowed us to continue our lending practice, which has also allowed us to support the economic development of the communities we serve. In addition to augmenting our lending capabilities, the TARP funds also provided the Bank with the ability to invest \$14 million in government agency mortgage backed securities and small business administration ("SBA") securities, and \$4.1 million in a local loan. These investments partially offset the dividend expense of approximately 8% after tax. Without the TARP funds and the additional capital available at the Bank, our investment ability, particularly in the local loan, would have been limited. It is anticipated that the returns on the investments in the government agency mortgage backed securities and the SBA securities also will be used to enhance our lending efforts.

As disclosed in the Company's 2008 Annual Report to Stockholders and Annual Report on Form 10-K for the year ended March 31, 2008, during the past three fiscal years ending March 31, our net loans have increased 18.8%, 16.2%, and 18.4%, respectively. However, as a result of the challenging environment, we do not believe that it will be possible for us to sustain the loan growth we experienced in the past (b) (8)

(b) (8)

- d. The balance of the TARP funds reserved at the Company level remain available, as necessary, to further strengthen the capital position of the Bank.
2. The Company's plans and actions for addressing the executive compensation requirements associated with the TARP CPP funding are designed to ensure substantive compliance with those requirements.

The Board of Directors has assigned the oversight of these requirements to its Compensation Committee, whose members are independent directors. The Compensation Committee's oversight duties are described in the resolution it adopted on December 11, 2008 in connection with the Company's participation in the TARP CPP.

The Compensation Committee is assisted in the fulfillment of its duties by the management of the Company and the Bank. Both the Compensation Committee and management are responsible for review of the initial and subsequent requirements imposed by contract, law or U.S. Treasury regulations. They have access to competent legal counsel and other resources necessary to fulfill their obligations.

The principal action steps we have completed and those that are currently scheduled are described in the table below:

Principal Action Plan Steps	Current Status
The Company obtained and reviewed the UST's terms for participation in TARP CPP funds, inclusive of the UST's interim final rule published on October 20, 2008 (the Compensation Guidelines).	Completed.
Compensation Modification Agreements obtained from Senior Executive Officers (SEOs) for the purpose of ensuring compliance with the Compensation Guidelines, including "golden parachute" restrictions and "clawback" provisions.	Completed. Contract modifications dated December 19, 2008.
Board of Directors authorized the Compensation Committee to take all actions required to ensure compliance with Section 111(b) of the EESA and the Compensation Guidelines.	Completed. Documented in Board minutes of December 11, 2008.
Compensation Committee passed a resolution acknowledging its responsibility for ensuring Banner Corporation's compliance with the Compensation Guidelines.	Completed. Resolution passed on December 11, 2008.
Compensation Committee met with the CFO, acting in the capacity of the senior risk officer, and the CEO to review company risks and compensation agreements.	Completed. Meeting held December 11, 2008.

<p>The Company obtained and reviewed the UST's revised interim final rule, amending the Compensation Guidelines, published in mid-January 2009.</p>	<p>Completed.</p>
<p>Compensation Committee met with the senior risk officer within 90 days of the purchase under the TARP CPP to discuss and certify that incentive compensation arrangements for SEOs "do not encourage unnecessary and excessive risk that would threaten the value of the institution."</p>	<p>Completed. Meeting held December 11, 2008.</p>
<p>The Company identifies its SEOs for the purposes of the TARP CPP during 2009, namely the CEO, CFO, and the three "named executive officers" for the fiscal year ended March 31, 2009.</p>	<p>To be completed at the meeting held March 12, 2009</p>
<p>Principal Executive Officer of Company to provide the "120 Day Certification" of the review of SEO incentive compensation arrangements by the Compensation Committee to the UST's Chief Compliance Officer of TARP and to the transfer agent under the CPP.</p>	<p>By April 18, 2009.</p>
<p>Compensation Committee to provide statements concerning its review of incentive plans for SEOs and related actions taken, if any, in the annual proxy statement to comply with TARP CPP.</p>	<p>To be completed June 29, 2009.</p>
<p>Company to provide certification of compliance with TARP executive compensation limits under Section 111 of EESA in Annual Report on Form 10-K for year ended March 31, 2009.</p>	<p>To be completed June 29, 2009.</p>
<p>Principal Executive Officer of Company to provide the "First Fiscal Year Certification" of the review of relationship between the risk management policies and practice of the Company and the incentive compensation arrangements of the SEOs to the UST's Chief Compliance Officer of TARP and to the transfer agent under the CPP.</p>	<p>By August 13, 2009.</p>
<p>Compensation Committee to meet with the senior risk officer at least annually to discuss and review risk-management policies and SEO incentive compensation arrangements.</p>	<p>To be completed annually.</p>
<p>Principal Executive Officer of Company to provide subsequent certifications of the review of relationship between the risk management policies and practice of the Company and the incentive compensation arrangements of the SEOs to the UST's Chief Compliance Officer of TARP and to the transfer agent under the CPP.</p>	<p>By August 13, 2009 and annually thereafter for each fiscal year ending March 31.</p>
<p>Company to obtain and review the new executive compensation requirements and restrictions contained in "The American Recovery and Reinvestment Act of 2009" (Stimulus Bill), and the related UST, SEC, or other federal agency regulations or standards.</p>	<p>Ongoing.</p>

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Company to ensure that appropriate records are retained of compliance activities for the required time periods. Ongoing.
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We do not anticipate any problems in complying with the executive compensation requirements of TARP. The Company has not taken, and its current position is not to take, any actions to offset SEO incentive compensation limitations with other, longer-term or deferred forms of SEO compensation as long as the UST holds securities of the Company that were acquired under the TARP CPP. Since receiving the TARP funds, neither the Company nor the Bank has paid any short- or long-term incentive compensation to its SEOs or awarded any equity-based compensation grants to those officers. (b) (4)

I certify that I am a duly authorized officer of Security Federal Corporation and that, to the best of my knowledge, all of the statements, representations and supporting information provided herewith are accurate and truthful.

Sincerely,



Timothy W. Simmons
President & CEO

