



P.O. Box 18949 | Raleigh, NC 27619-8949 | Phone 919.645.6400 | Fax 919.645.6353 | capitalbank-nc.com

Via electronically at SIGTARP.response@do.treas.gov
and original mailed to:
Mr. Neil M. Barofsky
Special Inspector General – Troubled Asset Relief Program
1500 Pennsylvania Ave., N.W., Suite 1064
Washington, D.C. 20220

Re: **Capital Bank Corporation**

March 5, 2009

Dear Mr. Barofsky:

On behalf of Capital Bank Corporation (“Capital Bank”), I am providing the information requested by the Office of Special Inspector General – Troubled Asset Relief Program in your letter to me dated February 6, 2009.

As a duly authorized executive officer of Capital Bank, I certify as to the accuracy of all statements, representations and supporting information being provided this response, subject to the requirements and penalties set forth in Title 18, United States Code, Section 1001.

The information contained in this letter is commercially sensitive and involves forward-looking statements that the Company has not yet made public and may not make public. Therefore, Capital Bank hereby requests that the Office of Special Inspector General afford the information being provided in this letter confidential treatment under the Freedom of Information Act (“FOIA”). If anyone requests that the Office of Special Inspector General release the information contained in this letter, Capital Bank respectfully requests that it be given an opportunity to discuss with the Office whether such release is appropriate under FOIA.

The text of each item of your letter is repeated in bold with Capital Bank’s response set forth immediately below.

- (1) **A narrative response specifically outlining (a) your anticipated use of TARP funds; (b) whether the TARP funds were segregated from other institutional funds; (c) your actual use of TARP funds to date; and (d) your expected use of unspent TARP funds. In your response, please take into consideration your anticipated use of TARP funds at the time that you applied for such funds, or any actions that have taken that you would not have been able to take absent the infusion of TARP funds.**

RESPONSE:

(a) Anticipated Use of TARP Funds

Capital Bank was well capitalized at the time that it applied for and received capital under the Capital Purchase Program (“CPP”) of the U.S. Department of the Treasury (“U.S. Treasury”). However, Capital Bank was experiencing a decline in its capital ratios due to strong loan growth throughout 2008. During the first eleven months of 2008 and prior to receiving funds under the CPP, Capital Bank had grown its loan portfolio by \$112.7 million or approximately 10.3% as compared to its loan portfolio as of December 31, 2007. In addition to net growth that was already booked by November, the estimated pipeline for new loans indicated an additional potential loan demand of \$102 million, the majority of which could be funded by December 31, 2008 or the first quarter of fiscal 2009.

Prior to the announcement of the CPP, management of Capital Bank concluded that it would either have to raise new capital or curtail or even eliminate that future loan growth. Management was actively seeking new sources of capital when the U.S. Treasury announced the CPP. In analyzing the situation management and Capital Bank’s board of directors (the “Board”) with the advice of outside financial advisors concluded that there were no new immediate sources of capital other than the CPP. Further, management and its Board believed that continuing to grow its loans was in the best interest of its community, customers and shareholders so the decision to accept the capital available under the CPP was made.

At the time of the CPP closing and through and including today, Capital Bank’s anticipated use of the CPP funds was to support loan growth in its local communities. Capital Bank’s actual use of the CPP funds to date is described in depth below under its response to Item 1(c).

(b) Segregation of TARP Funds

Capital Bank, the financial holding company parent of Capital Bank (the “bank”), received \$41,279,000 from the U.S. Treasury under the CPP on December 12, 2008. In order for the proceeds to be treated as Tier 1 capital of the bank, Capital Bank purchased shares of Series A Preferred Stock from CB Capital Purchase, Inc. (“CBCP”), a wholly-owned subsidiary of the bank, for a purchase price of \$41,279,000. The bank then borrowed the entirety of the proceeds from CBCP on similar terms and conditions to the preferred stock issued by CBCP to Capital Bank. Under this arrangement, interest payments will be made by the bank to CBCP and CBCP in turn to Capital Bank. The interest payments received by Capital Bank will be used to make interest payments to the U.S. Treasury under the CPP.

Upon receiving the equity injection the bank deployed the CPP funds to a combination of paying off short-term borrowed funds and short-term investments. These temporary transactions provided a low risk use of the funds until new loans could be closed. It is not the intent of Capital Bank to track the CPP funds as a separate capital pool because one of the actual benefits of the CPP capital injection is the support of lending by leveraging the bank's overall capital. In the fullest form of the leverage, that would lead to the conclusion that \$413 million of new loans could be supported. To achieve this leverage the bank must grow retail deposits and prudently extend credit. Based upon organic loan growth patterns of the bank over the last several years this would be achieved within three to four years.

(c) Actual Use of TARP Funds to Date

As stated above under Capital Bank's response to Item 1(a), it has been and remains the intent of Capital Bank to use the injection of the CPP capital to support loan growth in its local communities. During the month of December 2008 Capital Bank's loan portfolio increased \$46.6 million over the prior month-end, which was primarily due to Capital Bank's ability to leverage the CPP capital with its existing capital as described in the response to Item 1(b) above.

Capital Bank management has also set a goal of growing net loans by \$120 million over fiscal 2008 during fiscal 2009 and in order to accomplish this goal is working on the following initiatives:

- The vast majority of the loans produced by this unit is intended to be for homeowners who will qualify for conforming loans to be sold to FNMA, FHLMC or GNMA for the purchase or refinance of owner occupied residential property. Particular emphasis will be given to increased production of FHA and VA loans. This initiative is underway and is expected to be fully implemented by the second quarter of fiscal 2009.
- The bank is in process of extending a warehouse facility to its mortgage partner, which is designed to increase the capacity of the bank to extend credit to finance primary residence. This initiative is targeted to allow the bank to extend better pricing to the consumer. It is anticipated that this initiative will be completed by the end of March.
- The bank has introduced special financing for consumers who purchase a home from a Capital Bank financed builder / developer. Under this program 30-year fixed rate mortgage loans at a discount to market pricing

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currently are being extended to qualified buyers of houses that are in the builder inventory. The discount currently provides financing to a maximum of 1% below market rates. This initiative was fully implemented during January of 2009.

- This one project alone is estimated to extend \$27 million to the community. If successful the project would fund in early April 2009. b(4)
- Capital Bank has reached out to its community through the press by granting interviews, public speaking engagements and press releases on its participation in the CPP. Capital Bank has consistently represented that its participation in the CPP was to enhance its lending efforts in the communities that it serves. In particular Capital Bank has announced and promoted its efforts to support the purchase or refinance of residential properties.

We are currently working on Capital Bank's annual report on Form 10-K, which will be filed by March 15 with the Securities and Exchange Commission and contain pertinent audited financial information as of and for the year ended December 31, 2008. In the meantime, I have enclosed with this response letter a copy of the earnings release announcing Capital Bank's financial results for the quarterly period ended December 31, 2008 as well as Capital Bank's press release announcing its selection to participate in the CPP and press release announcing the closing of the CPP and issuance of the preferred shares.

- (2) **Your specific plans, and the status of implementation of those plans, for addressing executive compensation requirements associated with the funding. Information provided regarding executive compensation should also include any assessments made of loan risks and their relationship to executive compensation; how limitations on executive compensation will be implemented in line with Department of Treasury guidelines; and whether any such limitations may be offset by other changes to other, longer-term or deferred forms of executive compensation.**

RESPONSE:

As a result of its receipt of CPP funds, Capital Bank and its senior executive officers (“SEOs”) became subject to various executive compensation limitations and requirements pursuant to Section 111 of the Emergency Economic Stabilization Act of 2008 (“EESA”). Specifically, Section 4.10 of the Securities Purchase Agreement executed by Capital Bank in conjunction with the receipt of CPP funds on December 12, 2008 requires Capital Bank to take all necessary action to cause its executive compensation and benefits programs for SEOs to comply in all respects with Section 111(b) of the EESA.

In preparation for receipt of the CPP funds, Capital Bank’s Board and its Compensation / Human Resources Committee comprised entirely of independent directors (the “Committee”) worked with Capital Bank’s SEOs to implement several immediate changes to the executive compensation programs and employment agreements covering the SEOs. As required by the CPP transaction, each of Capital Bank’s SEOs entered into formal waivers agreeing to voluntarily waive any and all claims against Capital Bank and the United States arising out of any reductions in compensation or benefits as a result of Capital Bank’s participation in the CPP. These waivers specifically contemplated and required each of the SEOs to consent to possible modification of the compensation, bonus, incentive and other benefit plans, arrangements, policies and agreements (including possible “golden parachute” agreements) previously in place between the SEOs and Capital Bank.

Each SEO of Capital Bank immediately prior to the CPP transaction also entered into individual agreements amending their existing employment agreements with Capital Bank, to the extent necessary, to comply with the executive compensation requirements associated with CPP funding. In particular, each SEO’s agreement expressly acknowledges and provides that the SEO will be subject to new and additional executive compensation rules imposed by the CPP and acknowledged and agreed that: (1) Capital Bank will not pay any golden parachute payments to the SEO during any period in which Capital Bank remains subject to the CPP executive compensation rules (a “CPP Covered Period”) and (2) any bonus or incentive compensation paid to the SEO during a CPP Covered Period will be subject to forfeiture and recovery or “clawback” by Capital Bank if it is determined that the payments were based on materially inaccurate financial statements or other materially inaccurate performance measures or criteria. In addition, each agreement provides for the automatic and unilateral amendment of Capital Bank’s compensation, bonus, incentive and other benefit plans to the extent necessary to ensure compliance with applicable CPP rules. Each SEO further agreed to promptly and in good faith execute such additional amendments or other documents as may be necessary to comply with the CPP compensation rules in the future. I have enclosed a copy of the form of employment agreement amendment to this response letter.

As part of its commitment to comply with Section 111 of the EESA (as supplemented by applicable Treasury guidance set forth in IRS Notice 2008-94), Capital Bank is prohibited from

taking a corporate income tax deduction under Section 162(m) of the Internal Revenue Code of 1986, as amended (the "Code") for compensation expenses paid to an SEO in excess of \$500,000 per year. Although Capital Bank has not historically sought deductions for individual executive compensation amounts in excess of \$500,000, Capital Bank's Chief Financial Officer (CFO) will coordinate closely with Capital Bank's tax department and tax return preparers, to the extent necessary, to ensure that Capital Bank does not claim any tax deductions for individual SEO compensation expenses in excess of \$500,000 per year during the CPP Covered Period.

Since closing the CPP transaction, the Committee has engaged outside legal counsel and Capital Bank's independent compensation consultant, Silverton Bank, to assist Capital Bank in reviewing and assessing Capital Bank's overall compensation programs to comply with the CPP executive compensation rules as well as to monitor and advise Capital Bank on additional regulations or changes required in light of evolving executive compensation requirements in U.S. Treasury guidance and in the American Recovery and Reinvestment Act of 2009 ("ARRA"). Capital Bank is committed to full compliance with applicable CPP or other TARP-related compensation requirements while maintaining reasonable and appropriate compensation and benefits programs to permit the company to recruit, retain, and motivate the key employees necessary for Capital Bank's continued long-term success.

The executive compensation requirements associated with the CPP funding also require the Committee to meet with Capital Bank's senior risk officers to review all bonus or other incentive compensation programs and revise such programs, if necessary, to ensure the arrangements do not encourage senior executive officers to take unnecessary and excessive risks that threaten the value of Capital Bank. As required by the CPP, Capital Bank timely concluded this review within 90 days of closing the CPP transaction (i.e., by March 12, 2009). The Committee met on March 2, 2009 and reviewed all bonus, incentive and other similar compensation programs and components of its SEO's executive compensation packages. The Committee received assistance in this review from Silverton Bank, Capital Bank's independent compensation consultant, who assisted the Committee in developing and undertaking a comprehensive framework and checklist for evaluating its current bonus, incentive and other similar compensation programs in light of the CPP requirements.

At the conclusion of its review, the Committee determined that no revisions to Capital Bank's bonus and other incentive compensation programs or compensation elements for SEOs were necessary at this time. Capital Bank intends on certifying that these reviews have taken place and building this certification into its Proxy Statement as required under the applicable EESA compensation requirements.

Your letter requests that information provided regarding executive compensation should also include any assessments made of loan risks and their relationship to executive compensation. In assessing loan risks and their relationship to executive compensation, Capital Bank believes its bonus and other incentive compensation programs do not encourage unnecessary and excessive

risks that threaten the value of Capital Bank. (

portion of prior annual bonus measures for SEOs has been based specifically on the bank's loan portfolio credit quality based on the ratio of nonperforming loans to total loans thus placing primary emphasis on the quality of Capital Bank's loan portfolio. Although commission payments made to certain employees below the SEO level are based on loan originations, Capital Bank believes such commissions are set at reasonable and appropriate levels and include maximum annual caps to guard against loan risks as a result of the compensation programs. All loan programs are subject to broad oversight of the company's loan programs, and loan officers are required to satisfy Capital Bank's various lending and underwriting requirements to ensure that loans do not result in unnecessary or excessive risks.

At the current time, Capital Bank has not made any changes to its longer-term or deferred forms of executive compensation to offset the changes and potential limitations imposed by the CPP rules. Although the Committee has reviewed and will continue to review Capital Bank's long-term, deferred and similar compensation arrangements for SEOs and other executives on an ongoing basis to ensure that such programs provide reasonable and appropriate compensation programs, no future changes are currently planned to those programs to offset limitations imposed by the CPP rules. (

Additional elements of the compensation package for SEOs and senior executives, including equity compensation awards, are generally determined by the Committee on a discretionary basis after review of overall performance of the company and individual performance criteria. Accordingly, any future equity awards or other similar incentive compensation awards will remain subject to the strict oversight of the Committee and its ability to maintain compliance with evolving CPP compensation restrictions. Capital Bank and the Committee will continue to monitor guidelines released by the Department of Treasury and will coordinate with SEOs and other covered employees to ensure compliance with applicable guidelines. In addition, the Committee has already commenced its review and analysis of applicable ARRA compensation requirements and potential changes needed to its overall compensation and benefits program and will begin to identify and implement changes necessary to comply with those rules in the near-term.

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Mr. Neil M. Barofsky
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Please be assured that Capital Bank desires to cooperate fully with the Office of the Inspector General. Please let me know if you require further information.

Sincerely,

CAPITAL BANK CORPORATION

/s/ B. Grant Yarber

B. Grant Yarber
Chief Executive Officer

Enclosures

cc: Michael R. Moore (Chief Financial Officer)
Margaret N. Rosenfeld, Esq. (Smith Anderson)



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CONTACT:

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FOR IMMEDIATE RELEASE

Capital Bank Selected To Participate in U.S. Treasury Capital Purchase Program

RALEIGH, N.C., November 17, 2008 – Capital Bank Corporation (Nasdaq: CBKN), the parent company of Capital Bank, today announced that it has received preliminary approval of its \$42.9 million application to participate in the U.S. Department of the Treasury’s Capital Purchase Program (TCPP). The program is designed to attract broad participation by healthy banking institutions to help stabilize the financial system and increase lending for the benefit of the U.S. economy. This approval is subject to certain conditions and the execution of definitive agreements.

“Capital Bank is pleased to be one of the early community banks to be selected for participation in this historic program which many believe is an essential part of restoring the economy to its full potential. We see the approval of Capital Bank’s participation in this program as a recognition of its strength and financial health and believe it will enhance our efforts to emerge from this environment as an even stronger financial institution. Capital Bank intends to use this capital injection to expand lending in the communities that we serve. We expect that the injection of capital under the program will allow Capital Bank to expand our loan portfolio by approximately \$400 million, or 33% above the current level. This capital will also allow us to consider strategic opportunities that are expected to arise as the financial services industry continues to consolidate,” stated B. Grant Yarber, president and CEO.

Under the TCPP, the U.S. Treasury Department will purchase 42,900 shares of senior preferred stock which will pay a dividend of 5% for the first five years and 9% thereafter. The Treasury will also receive warrants to purchase Capital Bank common stock with an aggregate market value of \$6.4 million, or approximately 15% of the senior preferred stock investment. Capital Bank will have the right to redeem the preferred shares at any time after three years. A summary of the TCPP can be found on the U.S. Treasury Department’s website at <http://www.ustreas.gov/initiatives/eesa/>.

Capital Bank Corporation, headquartered in Raleigh, N.C., with approximately \$1.6 billion in total assets, offers a broad range of financial services. Capital Bank operates 28 banking offices in Asheville (4), Burlington (4), Cary, Clayton, Graham (2), Hickory, Mebane, Morrisville, Oxford, Pittsboro, Raleigh (5), Sanford (3), Siler City, Wake Forest and Zebulon. The Company’s website is <http://www.capitalbank-nc.com>.

Information in this press release contains forward-looking statements. These statements involve risks and uncertainties that could cause actual results to differ materially, including without limitation, the effects of future economic conditions, governmental fiscal and monetary policies, legislative and regulatory changes, the risks of changes in interest rates, and the effects of competition. Additional factors that could cause actual results to differ materially are discussed in Capital Bank Corporation’s filings with the Securities and Exchange Commission, including without limitation its Annual Report on Form 10-K, its Quarterly Reports on Form 10-Q and its Current Reports on Form 8-K. Capital Bank Corporation does not undertake a duty to update any forward-looking statements in this press release.

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FOR IMMEDIATE RELEASE

Capital Bank Completes Sale of Preferred Shares under the U.S. Treasury's Capital Purchase Program

RALEIGH, N.C., December 15, 2008 – Capital Bank Corporation (Nasdaq: CBKN), the parent company of Capital Bank, announced today that it has completed the issuance and sale of \$41.3 million in senior preferred stock under the U.S. Treasury's Capital Purchase Program (TCPP). Capital Bank's preliminary approval to participate in the program was announced on November 17, 2008.

"We believe the Treasury's investment is a recognition of Capital Bank's financial strength and provides us with greater resources and flexibility for lending within our communities in a challenging economic environment," stated B. Grant Yarber, president and CEO. "This cost-effective capital further strengthens our solid capital position and will enhance our efforts to emerge from this environment as an even stronger financial institution."

As of September 30, 2008, Capital Bank's regulatory capital ratios remained in excess of "well-capitalized" regulatory requirements. After the Treasury's capital infusion, Capital Bank's pro forma September 30, 2008 Tier 1 risk-based capital would increase to 12.86% from 9.86%, and its pro forma total risk-based ratio would increase to 13.91% from 10.91%.

Under the TCPP, the U.S. Treasury Department purchased 41,279 shares of senior preferred stock which will pay a dividend of 5% for the first five years and 9% thereafter. The Treasury also received 10-year warrants to purchase 749,619 shares of Capital Bank common stock at an exercise price of \$8.26 per share. Capital Bank will have the right to redeem the senior preferred stock at any time after three years. A summary of the TCPP can be found on the U.S. Treasury Department's website at <http://www.ustreas.gov/initiatives/eesa/>.

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FOR IMMEDIATE RELEASE

Capital Bank Corporation Announces 2008 Financial Results

RALEIGH, N.C., January 20, 2009 – Capital Bank Corporation (Nasdaq: CBKN), the parent company of Capital Bank, today reported net income for the year ended December 31, 2008 of \$6.3 million compared to \$7.9 million for the year ended December 31, 2007. Earnings per share on a fully diluted basis were \$0.54 for 2008 compared to \$0.68 for 2007.

“The past five quarters, beginning with the fourth quarter of 2007 through today, have been the most challenging for the banking industry since the Great Depression,” stated B. Grant Yarber, president and CEO. “Although Capital Bank has fared much better than many of our peers, we have nevertheless been profoundly affected by the economy and the monetary policy of the Federal Reserve. Throughout 2008, and particularly in the fourth quarter, the significant reduction in the prime lending rate along with the severe liquidity crisis in the marketplace compressed our margin and impacted our profits. At the same time, our clients’ businesses have also suffered. It has been our policy and our practice to proactively work with our clients in good times and bad; therefore, we continued to identify and resolve problem loans throughout the year, which increased our provision expense. Despite these adverse circumstances, the relative strength of Capital Bank has provided the opportunity to grow our franchise by adding the Fayetteville market to our footprint. Further, Capital Bank participated in the U.S. Treasury’s Capital Purchase Plan, which injected an additional \$41.3 million dollars of capital into our bank during December 2008. As evidenced by our strong loan growth in 2008, we plan to continue to grow our loans throughout 2009 and 2010, making full use of our strengthened capital position. Specifically, we recently announced that we would increase our mortgage lending practices, continue our flexible treatment of homebuyers that may be in financial distress, and provide low-cost mortgage products for buyers of existing inventories of homes throughout our markets. Capital Bank remains committed to doing our part to keep credit flowing in the markets we serve during this difficult economic environment.”

Partially contributing to lower profitability during 2008 was a decline in net interest income. Net interest income decreased \$1.5 million during the year, falling from \$44.1 million in 2007 to \$42.6 million in 2008, largely due to unprecedented steps taken by the Federal Reserve to revive an ailing national economy. One of the actions taken by the Federal Reserve was to lower the Prime Rate by 400 basis points during 2008. This rapid decline in rates, coupled with competitive pressures in the marketplace for retail deposits, compressed the net interest margin from 3.53% in 2007 to 3.08% in 2008. The margin compression was partially offset by 9.6% growth in average earning assets over the same periods.

Loans grew by \$159.3 million during 2008 while deposits increased by \$216.6 million. Much of the loan growth occurred in our Triangle and Western N.C. markets, which we believe continue to present quality growth opportunities. On the deposit side, checking and savings accounts increased \$32.5 million during the year as the bank continued to emphasize growth in this critical product area. Time deposits increased \$200.9 million over the same period. Some of the growth in time deposits was due to a new deposit product offering through CDARS, which provides large-balance customers the opportunity for increased FDIC insurance through the convenience of working with one financial institution. Another reason for growth in time deposits was due to retail customers electing to shift funds from money market savings products to CDs as evidenced by a decline in money market deposits of \$16.8 million during 2008. Another contributor to balance sheet growth was the entrance into the Fayetteville market through the purchase of four branches during December 2008, which added \$42.3 million and \$101.9 million to loans and deposits, respectively.

Due to continued weakening in the overall economy, asset quality remained a major focus throughout 2008. While our markets remain some of the most resilient in the country, the Company took steps to increase the provision for loan losses in the fourth quarter in response to some softening experienced in the loan portfolio as reflected by certain credit quality ratios. Past due loans as a percent of total loans increased to 1.09% at December 31, 2008 from 0.75% at September 30, 2008 and 0.98% at December 31, 2007. Nonperforming assets, which include loans on nonaccrual and other real estate owned, increased to 0.61% as a percent of total assets at December 31, 2008 compared to 0.47% at September 30, 2008 and 0.50% at December 31, 2007. Allowance for loan losses totaled 1.18% of total loans at December 31, 2008 compared to 1.17% at September 30, 2008 and 1.24% at December 31, 2007. Finally, the allowance for loan losses was 162% of nonperforming loans at December 31, 2008, a decline from 219% at September 30, 2008 and 227% at December 31, 2007.

Provision for loan losses increased \$270 thousand for the year ended December 31, 2008 compared to the same period one year ago. The increase in the provision was partially due to loan growth and softening credit quality but was also partially due to enhancements in the methodology for calculating the allowance for loan losses. The enhancements to the allowance methodology were implemented during 2007 based on updated guidance issued through an interagency policy statement by the FDIC, Federal Reserve, and other regulatory agencies. Management continues to thoroughly review its loan portfolio and the adequacy of its allowance for loan losses.

Noninterest income increased \$1.5 million, or 16.2%, during 2008 compared to last year despite a \$976 thousand decline in mortgage revenue. Service charge income, bank card income and other loan-related fees increased a combined \$1.5 million, or 28.4%, compared to last year primarily as a result of management's continued emphasis on increasing income from these sources. Gains on the sale of certain investment securities and the sale of a branch in Greensboro contributed \$249 thousand and \$374 thousand, respectively, to the increase in noninterest income.

"Our noninterest income improvement strategies, which were implemented early in the second quarter, continue to show success," stated Mr. Yarber. "These strategies are based on fee collection efforts, restructured pricing and innovative product enhancements, including our *Smart Checking* product. Capital Bank remains committed to providing our customers with value added products and services that also allow our shareholders to benefit from a greater diversity of revenue-generating services. Most recently we announced that we will expand our mortgage origination staff to assist customers with either the purchase or refinancing of their primary residence."

Noninterest expense increased from \$39.0 million during 2007 to \$41.5 million during 2008. Salaries, furniture and equipment, and data processing costs increased a combined \$2.4 million over the same periods. Salaries increased 8.0% from last year due to routine annual compensation adjustments and staffing needs at branches opened in Asheville, Clayton and Zebulon in addition to the four branches purchased in the Fayetteville market. Furniture and equipment expense rose due to equipment and building upgrades as well as higher maintenance costs. Data processing costs increased partially due to system upgrades and enhancements to support growth in the Company's primary business lines as well as the implementation of an internet-based phone system. Noninterest expense also increased from additional training costs necessary to prepare new associates for the transition at our recently purchased Fayetteville branches as well as additional legal costs from professional advice related to several transactions completed during 2008. In addition, FDIC deposit insurance rose \$415 thousand as the regulatory agency continued to increase premiums to cover higher monitoring costs and claims.

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CAPITAL BANK CORPORATION

Summary of Operations

(Unaudited)

	Three Months Ended December 31,		Year Ended December 31,	
	2008	2007	2008	2007
<i>(In thousands except per share data)</i>				
Interest income	\$ 20,088	\$ 23,840	\$ 85,020	\$ 94,537
Interest expense	10,156	12,875	42,424	50,423
Net interest income	9,932	10,965	42,596	44,114
Provision for loan losses	1,701	3,099	3,876	3,606
Net interest income after provision for loan losses	8,231	7,866	38,720	40,508
Noninterest income	2,297	2,455	11,051	9,511
Noninterest expense	11,095	10,401	41,471	39,037
Income (loss) before taxes	(567)	(80)	8,300	10,982
Income tax expense (benefit)	(500)	(125)	1,973	3,124
Net income (loss)	\$ (67)	\$ 45	\$ 6,327	\$ 7,858
Earnings (loss) per common share – basic	\$ (0.02)	\$ –	\$ 0.55	\$ 0.69
Earnings (loss) per common share – fully diluted	\$ (0.02)	\$ –	\$ 0.54	\$ 0.68
Weighted average shares outstanding:				
Basic	11,309	11,252	11,303	11,424
Fully diluted	11,325	11,316	11,426	11,493

End of Period Balances

(Unaudited)

	2008				2007
	December 31	September 30	June 30	March 31	December 31(a)
<i>(Dollars in thousands except per share data)</i>					
Total assets	\$ 1,716,198	\$ 1,594,402	\$ 1,592,034	\$ 1,575,301	\$ 1,517,603
Investment securities	278,138	244,310	246,468	258,086	259,116
Loans (gross)*	1,254,368	1,194,149	1,178,157	1,150,497	1,095,107
Allowance for loan losses	14,795	14,017	13,910	13,563	13,571
Total earning assets	1,533,354	1,444,727	1,435,020	1,419,174	1,362,048
Deposits	1,315,314	1,197,721	1,182,615	1,150,897	1,098,698
Shareholders' equity	210,525	166,521	165,731	167,967	164,300
Book value per common share	\$ 15.06	\$ 14.83	\$ 14.76	\$ 14.95	\$ 14.71
Tangible book value per common share	\$ 8.92	\$ 9.26	\$ 9.16	\$ 9.33	\$ 9.04

(a) Derived from audited consolidated financial statements

*Includes loans held for sale

Average Quarterly Balances

(Unaudited)

	2008				2007
	December 31	September 30	June 30	March 31	December 31
<i>(Dollars in thousands)</i>					
Total assets	\$ 1,620,817	\$ 1,574,810	\$ 1,578,357	\$ 1,555,986	\$ 1,492,563
Investment securities	246,658	245,408	256,406	256,538	242,272
Loans (gross)*	1,213,027	1,176,491	1,166,795	1,142,728	1,090,801
Total earning assets	1,473,422	1,425,516	1,429,301	1,407,345	1,347,727
Deposits	1,238,343	1,164,362	1,148,671	1,139,106	1,066,438
Shareholders' equity	171,227	166,570	170,945	167,610	166,222

*Includes loans held for sale

CAPITAL BANK CORPORATION
Quarterly Results
(Unaudited)

	2008				2007
	December 31	September 30	June 30	March 31	December 31
<i>(In thousands except per share data)</i>					
Net interest income	\$ 9,932	\$ 10,827	\$ 10,928	\$ 10,909	\$ 10,965
Provision for loan losses	1,701	760	850	565	3,099
Net interest income after provision for loan losses	8,231	10,067	10,078	10,344	7,866
Noninterest income	2,297	3,267	2,974	2,227	2,455
Noninterest expense	11,095	10,517	9,968	9,605	10,401
Income (loss) before taxes	(567)	2,817	3,084	2,966	(80)
Income tax expense (benefit)	(500)	805	869	799	(125)
Net income (loss)	\$ (67)	\$ 2,012	\$ 2,215	\$ 2,167	\$ 45
Earnings (loss) per common share – basic	\$ (0.02)	\$ 0.18	\$ 0.20	\$ 0.19	\$ –
Earnings (loss) per common share – fully diluted	\$ (0.02)	\$ 0.18	\$ 0.20	\$ 0.19	\$ –
Weighted average shares outstanding:					
Basic	11,309	11,302	11,310	11,289	11,252
Fully diluted	11,325	11,313	11,324	11,306	11,316

Quarterly Net Interest Margin*
(Unaudited)

	2008				2007
	December 31	September 30	June 30	March 31	December 31
Yield on earning assets	5.51%	5.94%	6.09%	6.60%	7.17%
Cost of interest bearing liabilities	3.05	3.12	3.24	3.76	4.34
Net interest spread	2.46	2.82	2.85	2.83	2.83
Net interest margin	2.78	3.13	3.18	3.23	3.38

*Annualized and on a fully taxable equivalent basis

Nonperforming Assets
(Unaudited)

	2008				2007
	December 31	September 30	June 30	March 31	December 31(a)
<i>(Dollars in thousands)</i>					
Commercial	\$ 4,682	\$ 4,343	\$ 3,650	\$ 2,919	\$ 4,489
Construction	3,843	1,570	418	230	562
Consumer	92	25	42	61	28
Home equity	275	275	515	579	397
Residential mortgage	223	198	582	463	506
Total nonperforming loans	9,115	6,411	5,207	4,252	5,982
Other real estate owned	1,347	1,019	663	890	1,571
Total nonperforming assets	\$ 10,462	\$ 7,430	\$ 5,870	\$ 5,142	\$ 7,553

Nonperforming assets include loans that are 90 days or more past due or in nonaccrual status and other real estate owned.

(a) Derived from audited consolidated financial statements

CAPITAL BANK CORPORATION

Key Ratios

(Unaudited)

	2008				2007
	December 31	September 30	June 30	March 31	December 31
<i>(Dollars in thousands)</i>					
Past due loans	\$ 13,642	\$ 8,933	\$ 9,239	\$ 9,380	\$ 10,769
Past due loans as a percent of total loans	1.09%	0.75%	0.78%	0.82%	0.98%
Net charge-offs	\$ 1,768	\$ 653	\$ 503	\$ 573	\$ 2,894
Net charge-offs as a percent of average loans (annualized)	0.58%	0.22%	0.17%	0.20%	1.06%
Allowance for loan losses as a percent of total loans	1.18%	1.17%	1.18%	1.18%	1.24%
Nonperforming assets as a percent of total assets	0.61%	0.47%	0.37%	0.33%	0.50%
Allowance for loan losses as a percent of nonperforming loans	162%	219%	267%	319%	227%

CAPITAL BANK CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
December 31, 2008 and 2007

	December 31, 2008	December 31, 2007
	<i>(Unaudited)</i>	
<i>(Dollars in thousands except share data)</i>		
Assets		
Cash and due from banks:		
Interest earning	\$ 719	\$ 7,815
Noninterest earning	53,607	32,347
Federal funds sold and short term investments	129	10
Total cash and cash equivalents	<u>54,455</u>	<u>40,172</u>
Investment securities – available for sale, at fair value	272,944	249,094
Investment securities – held to maturity, at amortized cost	5,194	10,022
Loans – net of unearned income and deferred fees	1,254,368	1,095,107
Allowance for loan losses	<u>(14,795)</u>	<u>(13,571)</u>
Net loans	1,239,573	1,081,536
Premises and equipment, net	24,640	23,863
Bank-owned life insurance	22,368	21,589
Goodwill and deposit premium, net	69,002	63,345
Deferred income tax	6,163	5,829
Accrued interest receivable	6,225	7,789
Other assets	15,634	14,364
Total assets	<u>\$ 1,716,198</u>	<u>\$ 1,517,603</u>
Liabilities		
Deposits:		
Demand, noninterest bearing	\$ 125,281	\$ 114,780
Savings and interest bearing checking	173,711	151,698
Money market deposit accounts	212,780	229,560
Time deposits less than \$100,000	509,231	370,416
Time deposits \$100,000 and greater	<u>294,311</u>	<u>232,244</u>
Total deposits	1,315,314	1,098,698
Repurchase agreements and federal funds purchased	15,010	45,295
Borrowings	132,000	163,347
Subordinated debentures	30,930	30,930
Other liabilities	<u>12,419</u>	<u>15,033</u>
Total liabilities	1,505,673	1,353,303
Commitments and contingencies		
Shareholders' Equity		
Preferred stock, \$1,000 par value; 100,000 and 0 shares authorized; 41,279 and 0 issued and outstanding as of December 31, 2008 and 2007, respectively (liquidation preference of \$41,279,000 as of December 31, 2008)	39,839	–
Common stock, no par value; 20,000,000 shares authorized; 11,238,085 and 11,169,777 shares issued and outstanding as of December 31, 2008 and 2007, respectively	139,209	136,154
Retained earnings	30,591	27,985
Accumulated other comprehensive income	<u>886</u>	<u>161</u>
Total shareholders' equity	210,525	164,300
Total liabilities and shareholders' equity	<u>\$ 1,716,198</u>	<u>\$ 1,517,603</u>

CAPITAL BANK CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three and Twelve Month Periods Ended December 31, 2008 and 2007 (Unaudited)

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2008	2007	2008	2007
<i>(Dollars in thousands except per share data)</i>				
Interest income:				
Loans and loan fees	\$ 17,009	\$ 20,835	\$ 72,494	\$ 82,066
Investment securities:				
Taxable interest income	2,319	1,889	8,935	7,731
Tax-exempt interest income	734	825	3,169	3,237
Dividends	1	122	294	451
Federal funds and other interest income	25	169	128	1,052
Total interest income	<u>20,088</u>	<u>23,840</u>	<u>85,020</u>	<u>94,537</u>
Interest expense:				
Deposits	8,107	9,929	33,042	39,700
Borrowings and repurchase agreements	2,049	2,946	9,382	10,723
Total interest expense	<u>10,156</u>	<u>12,875</u>	<u>42,424</u>	<u>50,423</u>
Net interest income	9,932	10,965	42,596	44,114
Provision for loan losses	1,701	3,099	3,876	3,606
Net interest income after provision for loan losses	<u>8,231</u>	<u>7,866</u>	<u>38,720</u>	<u>40,508</u>
Noninterest income:				
Service charges and other fees	1,054	1,011	4,459	3,780
Mortgage fees and revenues	237	336	1,005	1,981
Other loan fees	251	124	1,143	555
Brokerage fees	162	192	732	601
Bank card services	322	309	1,332	1,064
Bank-owned life insurance	135	218	952	841
Net gain (loss) on sale of investment securities	—	(49)	249	(49)
Gain on sale of branch	(52)	—	374	—
Other	188	314	805	738
Total noninterest income	<u>2,297</u>	<u>2,455</u>	<u>11,051</u>	<u>9,511</u>
Noninterest expense:				
Salaries and employee benefits	5,771	4,553	21,255	19,674
Occupancy	1,161	1,844	4,458	4,897
Furniture and equipment	817	933	3,135	2,859
Data processing and telecommunications	610	436	2,135	1,637
Advertising	515	450	1,515	1,442
Office expenses	339	325	1,317	1,389
Professional fees	466	420	1,479	1,289
Business development and travel	360	308	1,393	1,217
Amortization of deposit premiums	267	298	1,037	1,198
Miscellaneous loan handling costs	278	198	848	743
Directors fees	38	(145)	740	424
Insurance	(61)	172	275	435
FDIC deposit insurance	243	71	685	270
Other	291	538	1,199	1,563
Total noninterest expense	<u>11,095</u>	<u>10,401</u>	<u>41,471</u>	<u>39,037</u>
Net income (loss) before tax expense (benefit)	(567)	(80)	8,300	10,982
Income tax expense (benefit)	(500)	(125)	1,973	3,124
Net income (loss)	<u>\$ (67)</u>	<u>\$ 45</u>	<u>\$ 6,327</u>	<u>\$ 7,858</u>
Net income (loss) applicable to preferred shareholder	124	—	124	—
Net income (loss) applicable to common shareholders	<u>\$ (191)</u>	<u>\$ 45</u>	<u>\$ 6,203</u>	<u>\$ 7,858</u>
Earnings (loss) per common share – basic	<u>\$ (0.02)</u>	<u>\$ —</u>	<u>\$ 0.55</u>	<u>\$ 0.69</u>
Earnings (loss) per common share – diluted	<u>\$ (0.02)</u>	<u>\$ —</u>	<u>\$ 0.54</u>	<u>\$ 0.68</u>

CAPITAL BANK CORPORATION

Average Balances, Interest Earned or Paid, and Interest Yields/Rates

For the Three Months Ended December 31, 2008, September 30, 2008 and December 31, 2007 (Unaudited)

Tax Equivalent Basis (1)

<i>(Dollars in thousands)</i>	December 31, 2008			September 30, 2008			December 31, 2007		
	Average Balance	Amount Earned	Average Rate	Average Balance	Amount Earned	Average Rate	Average Balance	Amount Earned	Average Rate
Assets									
Loans receivable: (2)									
Commercial	\$ 1,052,172	\$ 14,719	5.55%	\$ 1,018,947	\$ 15,469	6.02%	\$ 933,847	\$ 17,821	7.57%
Consumer	47,537	888	7.41	46,480	875	7.47	43,042	895	8.25
Home equity	89,125	1,047	4.66	84,441	1,133	5.32	78,221	1,547	7.85
Residential mortgages	24,193	355	5.87	26,623	398	5.98	35,691	572	6.36
Total loans	1,213,027	17,009	5.56	1,176,491	17,875	6.03	1,090,801	20,835	7.58
Investment securities (3)	246,658	3,430	5.56	245,408	3,452	5.63	242,272	3,347	5.48
Federal funds sold and other interest on short-term investments	13,737	25	0.72	3,617	15	1.65	14,654	169	4.58
Total interest-earning assets	1,473,422	\$ 20,464	5.51%	1,425,516	\$ 21,342	5.94%	1,347,727	\$ 24,351	7.17%
Cash and due from banks	25,018			25,554			27,617		
Other assets	136,387			137,792			130,340		
Allowance for loan losses	(14,010)			(14,052)			(13,121)		
Total assets	<u>\$ 1,620,817</u>			<u>\$ 1,574,810</u>			<u>\$ 1,492,563</u>		
Liabilities and Equity									
Savings deposits	\$ 27,948	\$ 11	0.16%	\$ 30,169	\$ 30	0.39%	\$ 32,800	\$ 56	0.68%
Interest-bearing demand deposits	336,011	1,363	1.61	342,575	1,802	2.09	350,580	2,749	3.11
Time deposits	758,491	6,733	3.52	679,162	6,005	3.51	568,604	7,124	4.97
Total interest-bearing deposits	1,122,450	8,107	2.87	1,051,906	7,837	2.96	951,984	9,929	4.14
Borrowed funds	145,962	1,605	4.36	174,735	1,786	4.06	156,853	2,010	5.08
Subordinated debt	30,930	424	5.44	30,930	407	5.22	30,930	597	7.66
Repurchase agreements and fed funds purchased	22,050	20	0.34	27,039	74	1.09	38,499	339	3.49
Total interest-bearing liabilities	1,321,392	\$ 10,156	3.05%	1,284,610	\$ 10,104	3.12%	1,178,266	\$ 12,875	4.34%
Noninterest-bearing deposits	115,893			112,456			114,454		
Other liabilities	12,305			11,174			33,621		
Total liabilities	1,449,590			1,408,240			1,326,341		
Shareholders' equity	171,227			166,570			166,222		
Total liabilities and shareholders' equity	<u>\$ 1,620,817</u>			<u>\$ 1,574,810</u>			<u>\$ 1,492,563</u>		
Net interest spread (4)			2.46%			2.82%			2.83%
Tax equivalent adjustment		\$ 376			\$ 411			\$ 511	
Net interest income and net interest margin (5)		<u>\$ 10,308</u>	<u>2.78%</u>		<u>\$ 11,238</u>	<u>3.13%</u>		<u>\$ 11,476</u>	<u>3.38%</u>

(1) The tax equivalent basis is computed using a blended federal and state tax rate of approximately 34%.

(2) Loans receivable include nonaccrual loans for which accrual of interest has not been recorded.

(3) The average balance for investment securities excludes the effect of their mark-to-market adjustment, if any.

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

(5) Net interest margin represents net interest income divided by average interest-earning assets.

CAPITAL BANK CORPORATION
Average Balances, Interest Earned or Paid, and Interest Yields/Rates
For the Years Ended December 31, 2008 and 2007 (Unaudited)
Tax Equivalent Basis (1)

<i>(Dollars in thousands)</i>	December 31, 2008			December 31, 2007		
	Average Balance	Amount Earned	Average Rate	Average Balance	Amount Earned	Average Rate
Assets						
Loans receivable: (2)						
Commercial	\$ 1,017,157	\$ 62,678	6.15%	\$ 877,876	\$ 69,203	7.88%
Consumer	46,767	3,542	7.55	40,579	3,459	8.52
Home equity	83,511	4,602	5.50	80,177	6,682	8.33
Residential mortgages	27,435	1,672	6.09	43,227	2,722	6.30
Total Loans	1,174,870	72,494	6.15	1,041,859	82,066	7.88
Investment securities (3)	251,224	14,026	5.58	246,736	13,476	5.46
Federal funds sold and other interest on short-term investments	7,888	128	1.62	20,417	1,052	5.15
Total interest-earnings assets	1,433,981	\$ 86,648	6.03%	1,309,012	\$ 96,594	7.38%
Cash and due from banks	25,882			27,740		
Other assets	136,559			129,629		
Allowance for loan losses	(13,846)			(13,307)		
Total assets	\$ 1,582,576			\$ 1,453,074		
Liabilities and Equity						
Savings deposits	\$ 29,756	\$ 122	0.41%	\$ 33,559	\$ 194	0.58%
Interest-bearing demand deposits	336,899	6,655	1.97	359,373	12,165	3.38
Time deposits	691,140	26,265	3.79	568,604	27,341	4.81
Total interest-bearing deposits	1,057,795	33,042	3.12	961,536	39,700	4.13
Borrowed funds	168,501	7,234	4.28	134,590	6,920	5.14
Subordinated debt	30,930	1,761	5.68	30,930	2,387	7.72
Repurchase agreements and fed funds purchased	29,929	387	1.29	34,689	1,416	4.08
Total interest-bearing liabilities	1,287,156	\$ 42,424	3.29%	1,161,745	\$ 50,423	4.34%
Noninterest-bearing deposits	114,982			111,829		
Other liabilities	11,352			14,940		
Total liabilities	1,413,489			1,288,514		
Shareholders' equity	169,087			164,560		
Total liabilities and shareholders' equity	\$ 1,582,576			\$ 1,453,074		
Net interest spread (4)			2.74%			3.04%
Tax equivalent adjustment		\$ 1,628			\$ 2,057	
Net interest income and net interest margin (5)		\$ 44,224	3.08%		\$ 46,171	3.53%

- (1) The tax equivalent basis is computed using a blended federal and state tax rate of approximately 34%.
- (2) Loans receivable include nonaccrual loans for which accrual of interest has not been recorded.
- (3) The average balance for investment securities excludes the effect of their mark-to-market adjustment, if any.
- (4) Net interest spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities.
- (5) Net interest margin represents net interest income divided by average interest-earning assets.



P.O. Box 18949 | Raleigh, NC 27619-8949 | Phone 919.645.6400 | Fax 919.645.6353 | capitalbank-nc.com

December 5, 2008

BY HAND DELIVERY

[Insert Name of SEO]
Capital Bank Corporation
333 Fayetteville Street, Suite 700
Raleigh, North Carolina 27601

Dear [Insert SEO's Name]:

Capital Bank Corporation anticipates entering into a Securities Purchase Agreement (the "*Participation Agreement*"), with the United States Department of Treasury ("*Treasury*") that provides for Capital Bank Corporation's participation in the Treasury's TARP Capital Purchase Program (the "*CPP*"). Capital Bank Corporation has been informed by Treasury that the investment contemplated by the Participation Agreement is scheduled to close on December 12, 2008.

If Capital Bank Corporation does not participate in the CPP, this letter shall be of no further force and effect. Furthermore, if Capital Bank Corporation ceases to participate in the CPP, this letter shall be of no further force and effect as of the earliest possible time permitted following the "CPP Covered Period." A "*CPP Covered Period*" for such purposes shall be any period during which (A) you are a senior executive officer of Capital Bank Corporation and (B) Treasury holds an equity or debt position acquired from Capital Bank Corporation in the CPP.

For Capital Bank Corporation to participate in the CPP and as a condition to the closing of the investment contemplated by the Participation Agreement, Capital Bank and its wholly owned subsidiary, Capital Bank (collectively with Capital Bank Corporation referred to herein as "Capital Bank"), are required to establish specified standards for incentive compensation for Capital Bank's senior executive officers and to make changes to Capital Bank's compensation arrangements. To comply with these requirements, and in consideration of the benefits that you will receive as a result of Capital Bank's participation in the CPP and other good and valuable consideration, you agree as follows:

1. *No Golden Parachute Payments.* Capital Bank is prohibiting any golden parachute payment to you during any CPP Covered Period.
2. *Recovery of Bonus and Incentive Compensation.* Any bonus and incentive compensation paid to you during a CPP Covered Period is subject to recovery or "clawback" by Capital Bank if the payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria.
3. *Compensation Program Amendments.* Each of Capital Bank's compensation, bonus, incentive and other benefit plans, arrangements and agreements (including golden parachute, severance and employment agreements) (collectively, "*Benefit Plans*") with respect to you is hereby amended to the extent necessary to give effect to provisions (1) and (2). In addition, Capital Bank is required to review its Benefit Plans to ensure that they do not encourage senior executive officers to take unnecessary and excessive risks that threaten the value of Capital Bank. To the extent any such review requires revisions to any Benefit Plan with respect to you, you and Capital Bank agree to negotiate such changes promptly and in good faith and execute such additional documents as Capital Bank deems necessary to effect such revisions.
4. *Definitions and Interpretation.* This letter shall be interpreted as follows:
 - "Senior executive officer" means Capital Bank's "senior executive officers" as defined in subsection 111(b)(3) of EESA.
 - "Golden parachute payment" shall have the same meaning as in EESA Section 111(b)(2)(C).

- “EESA” means the Emergency Economic Stabilization Act of 2008 as implemented by guidance or regulation issued by the Department of the Treasury and as published in the Federal Register on October 20, 2008.
 - The term “Capital Bank” includes any entities treated as a single employer with Capital Bank Corporation under 31 C.F.R. § 30.1(b) (as in effect on the Closing Date). You are also delivering a waiver pursuant to the Participation Agreement, and, as between Capital Bank and you, the term “employer” in that waiver will be deemed to mean Capital Bank as used in this letter.
 - The term “CPP Covered Period” shall be limited by, and interpreted in a manner consistent with, 31 C.F.R. § 30.11 (as in effect on the Closing Date).
 - Provisions (1) and (2) of this letter are intended to, and will be interpreted, administered and construed to, comply with EESA Section 111 (and, to the maximum extent consistent with the preceding, to permit operation of the Benefit Plan in accordance with their terms before giving effect to this letter).
5. Miscellaneous. To the extent not subject to federal law, this letter will be governed by and construed in accordance with the laws of the State of North Carolina. This letter may be executed in two or more counterparts, each of which will be deemed to be an original. A signature transmitted by facsimile will be deemed an original signature.

The Board appreciates the concessions you are making and looks forward to your continued leadership during these financially turbulent times.

Yours sincerely,

CAPITAL BANK CORPORATION

CAPITAL BANK

By: _____
Name: _____
Title: _____

By: _____
Name: _____
Title: _____

EXECUTIVE

Intending to be legally bound, I agree with and accept the foregoing terms on the date set forth below.

_____(SEAL)
[Insert Name]

Date: _____