FIRST PACTRUST BANCORP INC
Form 10-Q
November 14, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2011

FIRST PACTRUST BANCORP, INC.

(Exact name of registrant as specified in its charter)

000-49806

(Commission File Number)

Maryland

(State of incorporation)

04-3639825

(IRS Employer Identification No.)

610 Bay Boulevard, Chula Vista, California

(Address of Principal Executive Offices)

91910

(ZIP Code)

(619) 691-1519

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its Corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of regulation S-T (p232.405) of this chapter) during the proceeding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the Registrant is a large accelerated filer; an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of accelerated filer and large accelerated filer in Rule 12B-2 of the Exchange Act.

Large accelerated Filer ¨	Accelerated Filer ¨	Non-accelerated Filer ¨	Smaller reporting company x

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of the latest practicable date.

As of November 7, 2011 the Registrant had 11,723,673 outstanding shares of common stock.

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Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995

This report contains certain forward-looking statements within the meaning of Section 27a of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. First PacTrust Bancorp, Inc. (the Company) and Pacific Trust Bank (the Bank) intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Reform Act of 1995, as amended, and are including this statement for purposes of these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies, and expectations of the Company and the Bank, are generally identifiable by use of the words such as believe, expect, intend, anticipate, estimate, project, or similar expressions. The ability Company and the Bank to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors that could have a material adverse effect on the operations and future prospects of the Company, the Bank, and the Bank s wholly owned subsidiaries include, but are not limited to, changes in: interest rates; the economic health of the local real estate market; general economic conditions; legislative/regulatory provisions; monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board; the quality or composition of the loan and securities portfolios; demand for loan products; deposit flows; competition; demand for financial services in the Bank s market area; and impact of new accounting pronouncements. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

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ITEM 1 FINANCIAL STATEMENTS

First PacTrust Bancorp, Inc.

Consolidated Statements of Financial Condition

(In thousands of dollars except share and per share data)

(Unaudited)

	September 30, 2011	December 31, 2010
ASSETS		
Cash and due from banks	$ 5,556	$ 5,371
Interest-bearing deposits	69,544	53,729
Total cash and cash equivalents	75,100	59,100
Securities available-for-sale	64,926	64,790
Federal Home Loan Bank stock, at cost	7,310	8,323
Loans, net of allowance of $8,993 at September 30, 2011 and $14,637 at December 31, 2010	695,740	678,175
Accrued interest receivable	3,220	3,531
Real estate owned, net	20,551	6,562
Premises and equipment, net	9,385	6,344
Bank owned life insurance investment	18,372	18,151
Prepaid FDIC assessment	2,603	3,521
Other assets	31,770	13,124
Total assets	$ 928,977	$ 861,621
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits		
Noninterest-bearing	$ 20,934	$ 15,171
Interest-bearing	49,242	44,860
Money market accounts	87,029	89,708
Savings accounts	135,836	124,620
Certificates of deposit	418,568	371,949
Total deposits	711,609	646,308
Advances from Federal Home Loan Bank	20,000	75,000
Accrued expenses and other liabilities	5,880	4,304
Total liabilities	737,489	725,612
Commitments and contingent liabilities		
SHAREHOLDERS EQUITY		
Preferred stock, $.01 par value per share, $1,000 per share liquidation preference, 50,000,000 shares authorized, 32,000 shares issued and outstanding at September 30, 2011; No shares issued or outstanding at December 31, 2010		
Common stock, $.01 par value per share, 196,863,844 shares authorized; 11,715,595 shares issued and 10,552,205 shares outstanding at September 30, 2011; 9,863,390 shares issued and 8,693,228 shares outstanding at December 31, 2010	117	99
Class B non-voting non-convertible Common stock, $.01 par value per share, 3,136,156 shares authorized; 1,044,065 shares issued and outstanding at September 30, 2011 and 1,036,156 shares issued and outstanding at December 31, 2010	10	10
Additional paid-in capital	178,754	119,998

Additional paid-in capital-warrants	3,172	3,172
Retained earnings	35,065	35,773
Treasury stock, at cost (September 30, 2011-1,163,390 shares, December 31, 2010-1,170,162 shares,)	(24,986)	(25,135)
Unearned Employee Stock Ownership Plan (ESOP) shares (September 30, 2011 10,580 shares, December 31, 2010 42,320 shares)	(127)	(507)
Accumulated other comprehensive income/(loss)	(517)	2,599
Total shareholders equity	191,488	136,009
Total liabilities and shareholders equity	$ 928,977	$ 861,621

See accompanying notes to consolidated financial statements.

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First PacTrust Bancorp, Inc.

Consolidated Statements of Income and Comprehensive Income/(Loss)

(In thousands of dollars except share and per share data)

(Unaudited)

	Three months ended September 30, 2011	Three months ended September 30, 2010	Nine months ended September 30, 2011	Nine months ended September 30, 2010
Interest and dividend income				
Loans, including fees	$ 7,757	$ 9,164	$ 22,936	$ 26,967
Securities	1,017	1,410	3,263	4,026
Dividends and other interest-earning assets	49	64	155	153
Total interest income	8,823	10,638	26,354	31,146
Interest expense				
Savings	95	186	283	673
NOW	18	24	50	87
Money market	62	138	189	482
Certificates of deposit	1,072	1,559	3,225	5,116
Federal Home Loan Bank advances	92	592	960	2,285
Total interest expense	1,339	2,499	4,707	8,643
Net interest income	7,484	8,139	21,647	22,503
Provision for loan losses	823	781	1,274	8,629
Net interest income after provision for loan losses	6,661	7,358	20,373	13,874
Noninterest income				
Customer service fees	396	336	1,107	995
Mortgage loan prepayment penalties	54		80	
Income from bank owned life insurance	77	57	221	165
Net gain on sales of securities available-for-sale	1,450		2,887	
Other	35	61	119	25
Total noninterest income	2,012	454	4,414	1,185
Noninterest expense				
Salaries and employee benefits	3,251	1,614	9,488	4,778
Occupancy and equipment	730	437	1,926	1,386
Advertising	71	67	182	227
Professional fees	667	238	1,416	547
Stationery, supplies, and postage	105	86	336	266
Data processing	356	289	972	858
ATM costs	81	74	223	224
FDIC expense	222	391	997	1,172
Loan servicing and foreclosure	327	150	783	916
Operating loss on equity investment	79	82	235	254
Valuation allowance for OREO	1,329	386	1,887	1,414
Loss/(gain) on sale of other real estate owned	105	(259)	924	61
Other general and administrative	338	291	1,107	927
Total noninterest expense	7,661	3,846	20,476	13,030

Income before income taxes	1,012	3,966	4,311	2,029
Income tax expense	368	934	1,425	580
Net income	$ 644	$ 3,032	$ 2,886	$ 1,449
Preferred stock dividends and discount accretion	$ 138	$ 251	$ 138	$ 753
Net income available to common shareholders	$ 506	$ 2,781	$ 2,748	$ 696
Basic earnings per common share	$ .04	$ .66	$ .27	$ .17
Diluted earnings per common share	$ .04	$ .66	$ .27	$ .17
Weighted average common shares outstanding-basic	11,542,752	4,202,533	10,326,009	4,191,836
Weighted average common shares outstanding-diluted	11,544,142	4,202,533	10,329,271	4,191,836
Comprehensive income/(loss)	(760)	2,799	(230)	2,450

See accompanying notes to consolidated financial statements.

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First PacTrust Bancorp, Inc.

Consolidated Statements of Shareholder s Equity

(In thousands of dollars, except share and per share data)

(Unaudited)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Unearned ESOP	Additional Paid in capital Warrants	Accumulated Other Comprehensive Income	Total
Balance at January 1, 2010	$ 19,094	$ 54	$ 67,958	$ 35,515	$ (25,788)	$ (1,015)	$	$ 1,667	$ 97,485
Net Income				2,825					2,825
Change in net unrealized gain on securities available-for-sale, net of reclassification and tax effects								932	932
Total comprehensive income									3,757
Forfeiture and retirement of stock			10		(10)				
Stock option compensation expense			94						94
Stock awards earned			29						29
Amortization of preferred stock discount	35			(35)					
Repurchase of Preferred Stock	(19,129)		(171)						(19,300)
Issuance of stock awards			(668)		668				
Issuance of warrants							3,172		3,172
Purchase of 506 shares of treasury stock					(5)				(5)
Employee stock ownership plan shares earned			(53)			508			455
Tax benefit/(loss) of RRP shares vesting			(6)						(6)
Dividends declared ($.25 per common share)				(1,503)					(1,503)
Preferred stock dividends				(925)					(925)
Warrant dividends				(104)					(104)
Net proceeds from stock issuance		55	52,805						52,860
Balance at December 31, 2010	$	$ 109	$ 119,998	$ 35,773	$ (25,135)	$ (507)	$ 3,172	$ 2,599	$ 136,009
Net Income	$	$	$	$ 2,886	$	$	$	$	$ 2,886
Change in net unrealized gain (losses) on securities available-for-sale, net of reclassification and tax effects								(3,116)	(3,116)

Total comprehensive income/(loss)	(230)

See accompanying notes to consolidated financial statements.

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	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Unearned ESOP	Additional Paid in capital Warrants	Accumulated Other Comprehensive Income	Total
Forfeiture and retirement of stock			13		(13)				
Stock option compensation expense			614						614
Stock awards earned			130						130
Issuance of stock awards			(107)		107				
Purchase of 318 shares of treasury stock					(4)				(4)
Employee stock ownership plan shares earned			102			380			482
Tax benefit/(loss) of RRP shares vesting			(1)						(1)
Dividends declared ($.33 per common share)				(3,456)					(3,456)
Repurchase of Warrants-TARP			(1,003)						(1,003)
Tax Effect ESOP			148						148
Tax Effect Options Redeemed			147						147
Reissuance of ESOP shares			(59)		59				
Preferred stock dividends				(138)					(138)
Issuance of 32,000 shares of preferred stock, net of issuance costs of $60			31,940						31,940
Net proceeds from stock issuance		18	26,832						26,850
Balance at September 30, 2011	$	$ 127	$ 178,754	$ 35,065	$ (24,986)	$ (127)	$ 3,172	$ (517)	$ 191,488

See accompanying notes to consolidated financial statements.

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First PacTrust Bancorp, Inc.

Consolidated Statements of Cash Flows

(In thousands of dollars)

(Unaudited)

	Nine months ended September 30, 2011	2010
Cash flows from operating activities		
Net income	$ 2,886	$ 1,449
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	1,274	8,629
Net accretion of securities	(364)	(1,357)
Depreciation and amortization	451	283
Employee stock ownership plan compensation expense	482	262
Stock option compensation expense	614	9
Stock award compensation expense	130	18
Bank owned life insurance income	(221)	(165)
Operating loss on equity investment	235	254
Net gain on sales of securities available-for-sale	(2,887)	
Loss on sale of real estate owned	924	61
Deferred income tax (benefit)/expense	(2,136)	595
Increase in valuation allowances on other real estate owned	1,942	1,414
Net change in:		
Deferred loan costs	545	324
Accrued interest receivable	311	347
Other assets	133	5,945
Accrued interest payable and other liabilities	3,735	101
Net cash provided by operating activities	8,054	18,169
Cash flows from investing activities		
Proceeds from sales of securities available-for-sale	50,846	
Proceeds from maturities, calls, and principal repayments of securities available-for-sale	19,470	13,219
Purchases of securities available-for-sale	(84,483)	(29,110)
Loan originations and principal collections, net	(44,589)	28,018
Redemption of Federal Home Loan Bank stock	1,013	695
Proceeds from sale of real estate owned	4,397	9,525
Additions to premises and equipment	(3,492)	(203)
Net cash from investing activities	(56,838)	22,144
Cash flows from financing activities		
Repurchase of Warrants, TARP	(1,003)	
Net increase in deposits	65,301	26,356
Repayments of Federal Home Loan Bank advances	(55,000)	(60,000)
Net proceeds from issuance of common stock	26,850	
Net proceeds from issuance of preferred stock	31,940	
Purchase of treasury stock	(4)	(3)
Tax benefit/(loss) from RRP shares vesting	(1)	(6)
Tax Effect of ESOP	148	
Tax Effect of Options redeemed	147	
Dividends paid on preferred stock	(138)	(724)
Dividends paid on common stock	(3,456)	(624)

Net cash from financing activities	64,784	(35,001)
Net change in cash and cash equivalents	16,000	5,312
Cash and cash equivalents at beginning of year	59,100	34,596
Cash and cash equivalents at end of year	$ 75,100	$ 39,908
Supplemental cash flow information		
Interest paid on deposits and borrowed funds	$ 4,745	$ 8,755
Income taxes paid	950	2,700
Supplemental disclosure of noncash activities		
Transfer from loans to loans provided for sales of other real estate owned		
Transfer from loans to real estate owned, net	20,808	12,728

See accompanying notes to consolidated financial statements.

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FIRST PACTRUST BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011

(Amounts in thousands of dollars, except share and per share data)

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements include the accounts of First PacTrust Bancorp, Inc. (the Company) and its wholly owned subsidiary Pacific Trust Bank (the Bank) as of September 30, 2011 and December 31, 2010 and for the three and nine month periods ended September 30, 2011 and September 30, 2010. Significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations for reporting on Form 10-Q. Accordingly, certain disclosures required by U.S. generally accepted accounting principles are not included herein. These interim statements should be read in conjunction with the consolidated financial statements and notes included in the Annual Report on Form 10-K filed by the Company with the Securities and Exchange Commission. The December 31, 2010 balance sheet presented herein has been derived from the audited financial statements included in the Annual Report on Form 10-K filed with the Securities and Exchange Commission, but does not include all of the disclosures required by U.S. generally accepted accounting principles.

Interim statements are subject to possible adjustment in connection with the annual audit of the Company for the year ending December 31, 2011. In the opinion of management of the Company, the accompanying unaudited interim consolidated financial statements reflect all of the adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the consolidated financial position and consolidated results of operations for the periods presented. Certain reclassifications have been made in the prior period financial statements to conform to the current period presentation.

The results of operations for the three and nine month periods ended September 30, 2011 are not necessarily indicative of the results to be expected for the full year.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, the Bank. All significant intercompany transactions and balances are eliminated in consolidation.

Nature of Operations: The principal business of the Company is the ownership of the Bank. The Bank is a federally chartered stock savings bank and a member of the Federal Home Loan Bank (FHLB) system, which maintains insurance on deposit accounts with the Federal Deposit Insurance Corporation (FDIC).

The Bank is engaged in the business of retail banking, with operations conducted through its main office and ten branches located in San Diego and Riverside counties. In addition, the Bank opened a loan production office in Los Angeles, California during the first quarter of 2011. Loan production is expected to expand throughout southern California during the coming quarters. There are no significant concentrations of loans to any one industry or customer. However, the customers ability to repay their loans is dependent on the real estate market and general economic conditions in the area.

The accounting and reporting polices of the Company are based upon U.S. generally accepted accounting principles and conform to predominant practices within the banking industry. Significant accounting policies followed by the Company are presented below.

Use of Estimates in the Preparation of Financial Statements: The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and disclosures provided, and actual results could differ. The allowance for loan losses, real estate owned, realization of deferred tax assets, and the fair value of financial instruments are particularly subject to change.

Cash Flows: Cash and cash equivalents include cash on hand, deposits with other financial institutions with original maturities under 90 days, and daily federal funds sold. Net cash flows are reported for customer loan and deposit transactions, interest bearing deposits in other financial institutions, and federal funds purchased, including overnight borrowings with the Federal Home Loan Bank.

Interest-bearing Deposits in Other Financial Institutions: Interest-bearing deposits in other financial institutions mature within one year and are carried at cost.

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Securities: Debt securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available-for-sale when they might be sold before maturity. Equity securities with readily determinable fair values are classified as available-for-sale. Securities available-for-sale are carried at fair value with unrealized holding gains and losses, net of taxes, reported in other comprehensive income or loss, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment (OTTI) on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. See further discussion in Note 6- Securities.

Federal Home Loan Bank (FHLB) Stock: The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Affordable Housing Fund: The Company has a 19% equity investment in an affordable housing fund originally totaling $4.2 million for purposes of obtaining tax credits and for Community Reinvestment Act purposes. This investment is accounted for using the equity method of accounting. Under the equity method of accounting, the Company recognizes its ownership share of the profits and losses of the fund. The Company obtains tax credits from these investments which reduce income tax expense for a period of 10 years. This investment is regularly evaluated for impairment by comparing the carrying value to the remaining tax credits expected to be received. For the nine month periods ending September 30, 2011 and 2010 our share of the fund s operating loss was $235 thousand and $254 thousand, respectively. The balance of the investment at September 30, 2011 and December 31, 2010 was $1.6 million and $1.9 million, respectively, and is included in other assets.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of unearned interest, deferred loan fees and costs, and an allowance for loan losses. Interest income is accrued on the unpaid principal balance and includes amortization of net deferred loan fees and costs over the loan term. Interest income on mortgage and commercial loans is discontinued at the time the loan is 91 days delinquent unless the loan is well secured and in process of collection. Consumer loans, other than those secured by real estate, are typically charged off no later than 180 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not received for loans placed on nonaccrual, is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The Company s single family residential mortgage portfolio is comprised of a combination of traditional, fully-amortizing loans and non-traditional and/or interest only loans. In 2005, the Company introduced a fully-transactional flexible mortgage product called the Green Account. The Green Account is a mortgage line of credit which is secured by a first-deed of trust and which provides an associated clearing account that allows all types of deposits and withdrawals to be performed, including direct deposit, check, debit card, ATM, ACH debits and credits, and internet banking and bill payment transactions.

Concentration of Credit Risk: Most of the Company s business activity is with customers located within San Diego and Riverside Counties. Therefore, the Company s exposure to credit risk is significantly affected by changes in the economy in San Diego and Riverside County area.

Allowance for Loan Losses: The allowance for loan losses is maintained at a level considered adequate by management to provide for probable incurred loan losses. The allowance is increased by provisions charged against income, while loan losses are charged against the allowance when management deems a loan balance to be uncollectible. Subsequent recoveries, if any, are credited to the allowance. The Company performs an analysis of the adequacy of the allowance on a monthly basis. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management s judgment, should be charged off. The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. The Company evaluates all impaired loans individually under the guidance of ASC 310, primarily through the evaluation of collateral values and cash flows. Loans, for which the terms have

been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan s existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Troubled debt restructurings are also measured at the present value of estimated future cash flows using the loan s effective rate at inception or at the fair value of collateral if repayment is expected solely from the collateral. The general component covers loans that are not impaired and is determined by portfolio segment and is based on actual loss history experienced by the Company over the most recent 12 months. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; effects of changes in credit concentrations and other factors. The historical loss analysis is also combined with a comprehensive loan to value analysis to analyze the associated risks in the current loan portfolio. An updated loan to value analysis is obtained from an independent firm semi-annually, most recently in May 2011. Management uses available information to recognize loan losses, however, future loan loss provisions may be necessary based on changes in the above mentioned factors. In addition, regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses and may require the Bank to recognize additional provisions based on their judgment of information available to them at the time of their examination.

The following portfolio segments have been identified: commercial and industrial, real estate mortgage, multi-family, land, real estate one-to four- family first mortgage, real estate one-to four- family junior lien mortgage, and other revolving credit and installment. The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes all loans delinquent over 60 days and non-homogenous loans such as commercial and commercial real estate loans. Classification of problem single-family residential loans is performed on a monthly basis while analysis of non-homogenous loans is performed on a quarterly basis.

Loans secured by multi-family and commercial real estate properties generally involve a greater degree of credit risk than one-to four- family residential mortgage loans. Because payments on loan secured by multi-family and commercial real estate properties are often dependent on the successful operation or management of the properties, repayment of these loans may be subject to adverse conditions in the real estate market or the economy. Commercial business loans are also considered to have a greater degree of credit risk due to the fact these loans are typically 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 (which, in turn, is often dependent in part upon general economic conditions). Consumer and other real estate loans may entail greater risk than do one- to four- family residential mortgage loans given that collection of these loans is 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. Negatively amortizing and interest only loans are also considered to carry a higher degree of credit risk due to their unique cash flows. The Green Mortgages tend to have lower levels of delinquencies as a result of the borrower s ability to meet their monthly payments obligations by increasing the level of their line. Credit risk on this asset class is also managed through the completion of regular re-appraisals of the underlying collateral and monitoring of the borrowers usage of this account to determine if the borrower is making monthly payments from external sources or draw downs on their line. In cases where the property values have declined to levels less than the original loan-to-value, or other levels deemed prudent by the Bank, the Bank may freeze the line and/or require monthly payments or principal reductions to bring the loan in balance.

Classified Assets: Federal regulations provide for the classification of loans and other assets, such as debt and equity securities considered by the Office of Thrift Supervision, and, as of July 21, 2011, the Office of the Comptroller of the Currency, its successor regulator (collectively referred to as the the Office of the Comptroller of the Currency or OCC), to be of lesser quality, as substandard, doubtful or loss. An asset is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected. The Bank includes in its classification of Substandard Assets loans that are performing under terms of a TDR, but where the borrower has yet to make twelve or more payments under the TDR, and where the loan remains impaired, as well as loans where the borrower is current in his or her payments on the subject Classified Loan but may be a guarantor on another loan that is classified as a result of weakness in the credit or collateral (Relationship). TDR loans that have continued to make payments for twelve months or more, but where the collateral remains impaired and retain a Substandard classification. As of September 30, 2011, the Bank had $9.2 million of loans classified as substandard that were performing under a TDR for less than twelve months, $7.7 million of loans classified as substandard that were performing under a TDR for more than twelve months but here the asset remained impaired and $7.8 million of substandard loans where the borrower was current on all payments but where the Relationship was rated Substandard as result of the existence of personal guarantees. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard, with the

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added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. When an insured institution classifies problem assets as either substandard or doubtful, it may establish general or specific allowances for loan losses in an amount deemed prudent by management and approved by the Board of Directors. General allowances represent loss allowances which have been established to recognize the inherent risk associated with lending activities, but, unlike specific allowances, have not been allocated to particular problem assets. When an insured institution classifies problem assets as loss, it is required either to establish a specific allowance for losses equal to 100% of that portion of the asset so classified or to charge off such amount. An institution s determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the OCC and the FDIC, which may order the establishment of additional general or specific loss allowances.

In connection with the filing of our periodic reports with the OCC and in accordance with our classification of assets policy, we regularly review the problem assets in our portfolio to determine whether any assets require classification in accordance with applicable regulations.

Premises and Equipment: Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation and are depreciated using the straight-line method with average useful lives ranging from five to forty years.

Building and leasehold improvements are depreciated using the straight-line method over estimated useful lives not to exceed the lease term. Lease terms range up to ten years. Furniture, fixtures, and equipment are depreciated using the straight-line method with useful lives ranging from five to seven years. Maintenance and repairs are charged to expense as incurred, and improvements that extend the useful lives of assets are capitalized.

Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. In general, the Bank assumes a 9% cost when recording fair value based on historical selling expenses. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

Bank Owned Life Insurance: The Bank has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at its cash surrender value (or the amount that can be realized). Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Long-term Assets: Premises and equipment and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Loan Commitments and Related Financial Statements: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Stock-Based Compensation: Compensation cost is recognized for stock options and restricted stock awards issued to employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company s common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized. A tax position is recognized as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the more likely than not test, no tax benefit is recorded.

The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax of multiple state jurisdictions. The Company is no longer subject to examination by U.S. Federal taxing authorities for years before 2007 and for all state income taxes before 2006. The Company expects the total amount of unrecognized tax benefits to be recognized in 2011.

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The Company recognizes interest and/or penalties related to income tax matters in income tax expense. The Company had $0 accrued for interest and penalties at September 30, 2011 and December 31, 2010.

Employee Stock Ownership Plan: The cost of shares issued to the ESOP but not yet allocated to participants is shown as a reduction of shareholders equity. Compensation expense is based on the average market price of shares as they are committed to be released to participant accounts. Dividends on allocated ESOP shares reduce retained earnings; dividends on unearned ESOP shares reduce debt and accrued interest. There were no shares forfeited for the three or nine months ended September 30, 2011 and 2010.

Earnings Per Common Share: Basic earnings per common share is net income available to common shareholders divided by the weighted average number of common shares outstanding during the period. ESOP shares are considered outstanding for this calculation unless unearned. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock options and stock awards. Dividends paid, and the accretion of discount on the Company s preferred stock, reduce the earnings available to common shareholders.

Comprehensive Income/(Loss): Comprehensive income/(loss) consists of net income and other comprehensive income or loss. Other comprehensive income or loss includes unrealized gains and losses on securities available for sale, net of tax, which are also recognized as a separate component of shareholders equity.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the consolidated financial statements.

Restrictions on Cash: Cash on hand or on deposit with the Federal Reserve Bank was required to meet regulatory reserve and clearing requirements.

Fair Values of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Operating Segments: While the chief decision-makers monitor the revenue streams of the various products and services, the identifiable segments are not material and operations are managed and financial performance is evaluated on a Company-wide basis.

Operating segments are aggregated into one as operating results for all segments are similar. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable operating segment.

Adoption of New Accounting Standards: The FASB has issued Accounting Standard Update (ASU) No. 2010-29, *Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations*. This update clarifies the acquisition date that should be used for reporting the pro forma financial information disclosures in Topic 805 when comparative financial statements are presented. The amendments in this update specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments in this update also expand the supplemental pro forma disclosures under Topic 805 to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro form revenue and earnings. For public entities, the amendments are effective for fiscal years and interim periods within those years, beginning after December 15, 2010. The provisions of this update did not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In July 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-20 Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. This ASU requires significantly more disclosure about credit quality in a financial institution s portfolio and the allowance for credit losses. The required disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The required disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The adoption of ASU 2010-20 resulted in the disclosures included in Note 7 Loans to the Corporation s consolidated financial statements.

In April 2011, the FASB issued ASU 2011-02 A Creditor s Determination of Whether a Restructuring Is a Troubled Debt Restructuring. The amendments in ASU 2011-02 provide additional guidance to assist creditors in determining whether a restructuring of a receivable meets the criteria to be considered a troubled debt restructuring. ASU 2011-02 also implements the disclosure requirements regarding troubled debt restructurings set forth in ASU 2010-20. ASU 2011-02 is effective for interim or annual periods beginning after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. The adoption of ASU 2011-02 resulted in additional disclosures regarding troubled debt restructurings included in the Company s consolidated financial statements.

Newly Issued But Not Yet Effective Accounting Standards: The FASB has issued Accounting Standards Update (ASU) No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.* This ASU represents the converged guidance of the FASB and the IASB (the Boards) on fair value measurement. The collective efforts of the Boards and their staffs, reflected in ASU 2011-04, have resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term fair value. The Boards have concluded the common requirements will result in greater comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRSs. The amendments to the *FASB Accounting Standards Codification* (Codification) in this ASU are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. The provisions of this update are not expected to have a material impact on the Company s consolidated financial position, results of operations or cash flows.

The FASB has issued Accounting Standards Update (ASU) No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income.* This ASU amends the *FASB Accounting Standards Codification*™ (Codification) to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income or loss either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income or loss along with a total for other comprehensive income or loss, and a total amount for comprehensive income. ASU 2011-05 eliminates the option to present the components of other comprehensive income or loss as part of the statement of changes in shareholders equity. The amendments to the Codification in the ASU do not change the items that must be reported in other comprehensive income or loss or when an item of other comprehensive income or loss must be reclassified to net income. ASU 2011-05 should be applied retrospectively. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The provisions of this update are not expected to have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In September 2011, the FASB issued ASU 2011-08 Intangibles-Goodwill and Other. The amendments in ASU 2011-08 will allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under these amendments, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The amendments include a number of events and circumstances for an entity to consider in conducting the qualitative assessment. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The adoption of ASU 2011-08 is not expected to impact the Company s consolidated financial statements or disclosures.

NOTE 3 EMPLOYEE STOCK COMPENSATION

The Company has multiple share based compensation plans as described below. Total compensation cost that has been charged against income for the Company s stock compensation plans was $331 thousand and $744 thousand for the three and nine months ended September 30, 2011, respectively. Total compensation cost that has been charged against income for the Company s stock compensation plans was $8 thousand and $27 thousand for the three and nine months ended September 30, 2010, respectively. The total income tax benefit and/or recovery was none and $147 thousand, for the three and nine months ended September 30, 2011, respectively, and none for the three and nine months ended September 30, 2010.

Recognition and Retention Plan

A Recognition and Retention Plan (RRP) provides for the issuance of shares to directors, officers, and employees. Compensation expense is recognized over the vesting period of the shares based on the market value at date of grant. Pursuant to its 2003 stock-based incentive plan, total shares issuable under the plan are 211,600. At September 30, 2011, all 211,600 shares were issued. These shares vest over a five-year period. Compensation expense for the RRP awards totaled approximately $11 thousand and $24 thousand for the three and nine months ended September 30, 2011, respectively, and $6 thousand and $18 thousand for the three and nine months ended September 30, 2010, respectively. As of September 30, 2011, there was $112 thousand of total unrecognized compensation cost related to 11,078 nonvested awards. The cost is expected to be recognized over a weighted-average period of less than five years.

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A summary of changes in the Company s nonvested shares for the quarter ending September 30, 2011 follows:

Nonvested shares	**Shares**	**Weighted-Average Grant-Date Fair-Value**
Nonvested at July 1, 2011	11,078	$ 17.49
Granted		
Vested		
Forfeited/expired		
Nonvested at September 30, 2011	11,078	$ 17.49

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A summary of changes in the Company s nonvested shares for the nine months ended September 30, 2011 follows:

Nonvested shares	Shares	Weighted-Average Grant-Date Fair-Value
Nonvested at January 1, 2011	11,518	$ 17.67
Granted		
Vested		
Forfeited/expired	440	22.23
Nonvested at September 30, 2011	11,078	$ 17.49

A summary of changes in the Company s nonvested shares for the quarter ended September 30, 2010 follows:

Nonvested shares	Shares	Weighted-Average Grant-Date Fair-Value
Nonvested at July 1, 2010	3,280	$ 18.05
Granted		
Vested		
Forfeited/expired		
Nonvested at September 30, 2010	3,280	$ 18.05

A summary of changes in the Company s nonvested shares for the nine months ended September 30, 2010 follows:

Nonvested shares	Shares	Weighted-Average Grant-Date Fair-Value
Nonvested at January 1, 2010	3,580	$ 17.96
Granted		
Vested		
Forfeited/expired	300	17.00
Nonvested at September 30, 2010	3,280	$ 18.05

Additionally, one-time inducement restricted shares were granted during 2010 and 2011 to newly hired executive officers. During the nine months ended September 30, 2011, 5,000 shares were granted. No shares were granted during the three months ended September 30, 2011. Of these shares, none were exercised during 2011. No shares were awarded during the three or nine month periods ended September 30, 2010. These one-time inducement shares vest over a three year period. Compensation expense for the inducement awards totaled approximately $28 thousand and $71 thousand for the three and nine months ended September 30, 2011, respectively. As of September 30, 2011, there was $243 thousand of total unrecognized compensation cost related to 26,500 nonvested inducement awards. The cost is expected to be recognized over a weighted-average period of less than three years.

A summary of changes related to the Company s nonvested inducement awards for the quarter ending September 30, 2011 follows:

	Shares

		Weighted Average Exercise Price
Nonvested at July 1, 2011	26,500	$ 12.12
Granted		
Vested		
Forfeited or expired		
Nonvested at September 30, 2011	26,500	$ 12.12

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A summary of changes related to the Company s nonvested inducement awards for the nine months ended September 30, 2011 follows:

	Shares	Weighted Average Exercise Price
Nonvested at January 1, 2011	21,500	$ 11.57
Granted	5,000	14.48
Vested		
Forfeited or expired		
Nonvested at September 30, 2011	26,500	$ 12.12

During June, 2011, the Company adopted an Omnibus Incentive Plan under the terms of which 950,000 shares may be awarded as either stock options or restricted shares of the Company. There were 8,240 shares awarded as restricted shares from this plan during the quarter ended June 30, 2011. No shares were awarded from this plan during the three months ended September 30, 2011. These shares vest over a one year period. Compensation expense for these awards totaled approximately $26 thousand and $28 thousand for the three and nine months ended September 30, 2011, respectively. As of September 30, 2011, there was $95 thousand of total unrecognized compensation cost related to 8,240 nonvested awards. The cost is expected to be recognized over a weighted-average period of less than one year.

A summary of changes related to the Company s nonvested inducement awards for the quarter ended September 30, 2011 follows:

	Shares	Weighted Average Exercise Price
Nonvested at July 1, 2011	8,240	$ 15.81
Granted		
Vested		
Forfeited or expired		
Nonvested at September 30, 2011	8,240	$ 15.81

A summary of changes related to the Company s nonvested inducement awards for the nine months ended September 30, 2011 follows:

	Shares	Weighted Average Exercise Price
Nonvested at January 1, 2011		
Granted	8,240	$ 15.81
Vested		
Forfeited or expired		
Nonvested at September 30, 2011	8,240	$ 15.81

Stock Options

In addition to the Omnibus Incentive Plan discussed above, the Company has a Stock Option Plan (SOP) which provides for the issuance of options to directors, officers, and employees. The Company adopted the SOP during 2003 under the terms of which 529,000 shares of the

Company s common stock may be awarded. At September 30, 2011, the number of shares available for future awards was 16,500. The options become exercisable in equal installments over a five-year period from the date of grant. The options expire ten years from the date of grant. The fair value of options granted are computed using option pricing models, using the following weighted-average assumptions as of grant date. The fair value of each option is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected volatilities are based on historical volatilities of the Company s common stock. The Company uses historical data to estimate option exercise and post-vesting termination behavior. The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the

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option is based on the U.S. Treasury yield curve in effect at the time of grant. There were no options granted in 2011 or 2010 under the SOP. There were no options exercised or forfeited during the three or nine months ended September 30, 2011.

During 2010 and 2011, 850,000 inducement options were issued to newly hired executive officers, of which 80,000 inducement options were awarded during the nine months ended September 30, 2011. No options were issued during the quarter ended September 30, 2011. These one-time inducement options were granted outside of the existing SOP plan and the Omnibus Incentive Plan. None of these options were exercised during 2011. These options have a three year vesting. As of September 30, 2011, there was $1.7 million of total unrecognized compensation cost related to nonvested stock options. The cost is expected to be recognized over a weighted-average period of less than three years.

	May 6, 2011
Options granted	80,000
Estimated fair value of stock options granted	3.40
Risk-free interest rate	0.96%
Expected term	3 year
Expected stock price volatility	40.87%
Dividend yield	2.89%

The following table represents inducement option activity during the three months ended September 30, 2011:

	Shares	Weighted Average Exercise Price
Outstanding at beginning of period July 1, 2011	850,000	$ 11.71
Granted		
Exercised		
Forfeited or expired		
Outstanding at end of period September 30, 2011	850,000	$ 11.71
Fully vested and expected to vest	807,500	$ 11.12
Options exercisable at September 30, 2011		

The following table represents inducement option activity during the nine months ended September 30, 2011:

	Shares	Weighted Average Exercise Price
Outstanding at beginning of period January 1, 2011	770,000	$ 11.42
Granted	80,000	14.48
Exercised		
Forfeited or expired		
Outstanding at end of period September 30, 2011	850,000	$ 11.71
Fully vested and expected to vest	807,500	$ 11.12
Options exercisable at September 30, 2011		

During the nine months ended September 30, 2011, 68,569 shares were awarded as stock options from the Omnibus Incentive Plan. These options were awarded to Company and Bank directors in lieu of, or in combination with cash compensation for director services. No options were issued during the quarter ended September 30, 2011. The options become exercisable one-year from the date of grant. The options expire ten years from the date of grant. The fair value of options granted are computed using option pricing models, using the following weighted-average assumptions as of grant date. The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black Scholes) model that uses the assumptions noted in the table below. Expected volatilities are based on historical volatilities of the Company s common stock. The Company uses historical data to estimate option exercise and post-vesting termination behavior. The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

As of September 30, 2011, there was $205 thousand of total unrecognized compensation cost related to nonvested stock options. The cost is expected to be recognized over a weighted-average period of less than 1 year.

	June 20, 2011
Options granted	68,569
Estimated fair value of stock options granted	3.65
Risk-free interest rate	0.67%
Expected term	3 year
Expected stock price volatility	40.72%
Dividend yield	2.89%

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The following table represents option activity under the Omnibus Incentive Plan during the three months ended September 30, 2011:

	Shares	Weighted Average Exercise Price
Outstanding at beginning of period July 1, 2011	68,569	$ 15.81
Granted		
Exercised		
Forfeited or expired		
Outstanding at end of period September 30, 2011	68,569	$ 15.81
Fully vested and expected to vest	65,141	$ 15.02
Options exercisable at September 30, 2011		

The following table represents option activity under the Omnibus Incentive Plan during the nine months ended September 30, 2011:

	Shares	Weighted Average Exercise Price
Outstanding at beginning of period January 1, 2011		$
Granted	68,569	15.81
Exercised		
Forfeited or expired		
Outstanding at end of period September 30, 2011	68,569	$ 15.81
Fully vested and expected to vest	65,141	$ 15.02
Options exercisable at September 30, 2011		

Information related to the stock option plan during each year follows:

	2011	2010	2009
Intrinsic value of options exercised	$	$	$
Cash received from option exercises			
Tax benefit realized from option exercises			

The intrinsic value for stock options is calculated based on the exercise price of the underlying awards and the market price of our common stock as of the reporting date. ASC 718 and 505 require the recognition of stock based compensation for the number of awards that are ultimately expected to vest. As a result, recognized stock compensation expense was reduced for estimated forfeitures prior to vesting primarily based on historical annual forfeiture rates of approximately 5% for senior management and the board of directors and 45% for all other employees. Estimated forfeitures will be reassessed in subsequent periods and may change based on new facts and circumstances. The Company recorded stock compensation expense of $267 thousand and $614 thousand as salary and employee benefits expense during the three and nine months ended September 30, 2011, respectively. The Company recorded stock compensation expense of $3 thousand and $9 thousand as salary and employee benefits expense during the three and nine months ended September 30, 2010, respectively.

Warrants

On November 1, 2010, the Company issued warrants to TCW Shared Opportunity Fund V, L.P. for up to 240,000 shares of non-voting common stock at an exercise price of $11.00 per share, subject to anti-dilutive adjustments. These warrants are exercisable from the date of issuance through November 1, 2015. On November 1, 2010, the Company also issued warrants to COR Advisors LLC to purchase up to 1,395,000 shares of non-voting stock at an exercise price of $11.00 per share, subject to anti-dilutive adjustments. These warrants are exercisable with respect to 95,000 shares on January 1, 2011 and an additional 130,000 shares on the first day of each of the next ten calendar quarterly periods beginning on April 1, 2011, subject to earlier vesting upon a change in control of the Company or in the discretion of our board of directors. These warrants are exercisable with respect to each vesting tranche for five years after the tranche s vesting date. The warrants are exercisable for voting common stock in lieu of non-voting common stock following the transfer of the warrants in a widely disbursed offering or in other limited circumstances.

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NOTE 4 EARNINGS PER COMMON SHARE

Basic earnings per common share were computed by dividing net income by the weighted average number of shares outstanding. Diluted earnings per common share were computed by dividing net income by the weighted average number of shares outstanding, adjusted for the dilutive effect of the outstanding stock options and restricted stock awards. Computations for basic and diluted earnings per common share are provided below.

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Basic				
Net income	$ 644	$ 3,032	$ 2,886	$ 1,449
Less: Dividends on preferred stock	138	241	138	724
Less: Imputed dividends		10		29
Net income available to common shareholders	$ 506	$ 2,781	$ 2,748	$ 696
Weighted average common shares outstanding	11,542,752	4,202,533	10,326,009	4,191,836
Basic earnings per share	$ .04	$ .66	$ .27	$ .17
Diluted				
Net income available to common shareholders	$ 506	$ 2,781	$ 2,748	$ 696
Weighted average common shares outstanding for basic earnings per common share	11,542,752	4,202,533	10,326,009	4,191,836
Add: Dilutive effects of stock options			228	
Add: Dilutive effects of stock awards	1,390		3,034	
Average shares and dilutive potential common shares	11,544,142	4,202,533	10,329,271	4,191,836
Diluted earnings per common share	$ .04	$ .66	$ .27	$ .17

There was a total of 453,569 and 11,652 stock options and stock awards that were not considered in computing diluted earnings per common share for the three and nine month periods ended September 30, 2011, respectively, because they were anti-dilutive. All stock options and stock awards for the three and nine month periods ended September 30, 2010 were anti-dilutive. They were anti-dilutive since the exercise prices were greater than the average market price of the common stock.

NOTE 5 FAIR VALUES OF FINANCIAL INSTRUMENTS

Fair Value Hierarchy. ASC 820-10 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The topic describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity s own assumptions about the assumptions that market participants would use in pricing and asset or liability.

Investment Securities Available for Sale. The fair values of securities available for sale are determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities relationship to other benchmark quoted securities (Level 2 inputs). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). The fair values of the Company s Level 3 securities are determined by the Company and an independent third-party provider using a discounted cash flow methodology. The methodology uses discount rates that are based upon observed market yields for similar securities. Prepayment speeds are estimated based upon the prepayment history of each bond and a detailed analysis of the underlying collateral. Gross weighted average coupon, geographic concentrations, loan to value, FICO and seasoning are among the different loan attributes that are factored into our prepayment curve. Default rates and severity are estimated based upon geography of the collateral, delinquency, modifications, loan to value ratios, FICO scores, and past performance.

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Impaired Loans. The fair value of impaired loans with specific allocations of the allowance for loan losses based on collateral values is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value. For the three and nine months ended September 30, 2011, the Company experienced $439 thousand in specific allowance allocation expense and a specific allowance recovery of $2.0 million for these loans, respectively. For the three and nine months ended September 30, 2010, the Company experienced a specific allowance recovery of $228 thousand and a $109 specific allowance allocation expense for those loans, respectively.

Real Estate Owned Assets. Real estate owned assets OREO are recorded at the lower of cost or fair value less estimated costs to sell at the time of foreclosure. The fair value of real estate owned assets is generally based on recent real estate appraisals adjusted for estimated selling costs. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value. Only OREO with a valuation allowance are considered to be carried at fair value. For the three and nine months ended September 30, 2011, the Company experienced $1.3 million in valuation allowance expense and a valuation allowance recovery of $1.9 million for those assets, respectively. The Company did not experience any valuation allowance expense associated with those loans for the three and nine month period ended September 30, 2010.

Assets and Liabilities Measured on a Recurring and Non Recurring Basis

Available for sale securities are measured at fair value on a recurring basis, impaired loans and real estate owned are measured at fair value on a non-recurring basis.

		Fair Value Measurements at September 30, 2011 Using		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level One)	Significant Other Observable Inputs (Level Two)	Significant Unobservable Inputs (Level Three)
Assets				
Municipal securities (recurring)	$ 3,325	$	$ 3,325	$
Private label residential mortgage-backed securities (recurring)	61,598			61,598
Federal National Mortgage Association mortgage-backed securities (recurring)	3		3	
Government National Mortgage Association securities (recurring)				
Impaired loans (non recurring)	8,349			8,349
Real estate owned assets (non recurring)	6,879			6,879

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and nine month period ended September 30, 2011:

	Investment Securities Available-for-sale
For the three months ended September 30, 2011:	
Balance of recurring Level 3 assets at July 1, 2011	$ 58,363
Total gains or losses (realized/unrealized):	
Included in earnings realized	1,278
Included in earnings unrealized	

Included in other comprehensive income		(4,402)
Purchases		37,830
Sales, issuances and settlements		(31,471)
Net transfers in and/or out of Level 3		
Balance of recurring Level 3 assets at September 30, 2011	$	61,598

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		Investment Securities Available-for-sale
For the nine months ended September 30, 2011:		
Balance of recurring Level 3 assets at January 1, 2011	$	54,246
Total gains or losses (realized/unrealized):		
Included in earnings realized		2,699
Included in earnings unrealized		
Included in other comprehensive income		(6,073)
Purchases		69,033
Sales, issuances and settlements		(58,307)
Net transfers in and/or out of Level 3		
Balance of recurring Level 3 assets at September 30, 2011	$	61,598

There were no significant transfers between Level 1 and Level 2 during the three or nine months ended September 30, 2011.

Impaired loans with specific allowance allocations are measured for impairment using the fair value of the collateral for collateral dependent loans totaled $10.0 million and had a carrying amount of $8.3 million, net of a specific allowance allocations of $1.7 million at September 30, 2011. Other real estate owned which is measured at fair value less costs to sell having a valuation, had a net carrying amount of $6.9 million, which is made up of the outstanding balance of $8.3 million, net of a valuation allowance of $1.4 million at September 30, 2011.

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The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31, 2010:

		Fair Value Measurements at December 31, 2010 Using		
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level One)	Significant Other Observable Inputs (Level Two)	Significant Unobservable Inputs (Level Three)
Assets				
U.S. government sponsored entities and agency securities (recurring)	$ 5,055	$	$ 5,055	$
Private label residential mortgage-backed securities (recurring)	54,246			54,246
Federal National Mortgage mortgage-backed Association securities (recurring)	3		3	
Government National Mortgage Association securities (recurring)	5,486		5,486	
Impaired loans (non recurring)	8,349			8,349
Real estate owned assets (non recurring)	3,409			3,409

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31, 2010:

	Investment Securities Available-for-sale
Balance of recurring Level 3 assets at January 1, 2010	$ 47,131
Total gains or losses (realized/unrealized):	
Included in earnings realized	
Included in earnings unrealized	
Included in other comprehensive income	1,590
Purchases	29,110
Sales, issuances and settlements	(23,585)
Net transfers in and/or out of Level 3	
Balance of recurring Level 3 assets at December 31, 2010	$ 54,246

There were no significant transfers between Level 1 and Level 2 during 2010.

Impaired loans, with specific allowances allocations are measured for impairment using the fair value of the collateral for collateral dependent loans totaled $10.0 million and had a carrying amount of $8.3 million, net of specific allowance allocations of $1.7 million at December 31, 2010. At December 31, 2010, these impaired loans consisted of $15.3 million single-family loans, $8.5 million multi-family loans and one HELOC totaling $108 thousand. During the year ended December 31, 2010, a provision of $4.4 million was made for these loans, net of charge-offs previously provided.

Other real estate owned which is measured at fair value less costs to sell having a valuation allowance, had a net carrying amount of $3.4 million, which is made up of the outstanding balance of $4.4 million, net of a valuation allowance of $1.0 million at for the year ended December 31, 2010, resulting in expense of $2.7 million for the year ended December 31, 2010.

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In accordance with ASC 825-10, the carrying amounts and estimated fair values of financial instruments, at September 30, 2011 and December 31, 2010 were as follows:

	September 30, 2011		December 31, 2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Cash and cash equivalents	$ 75,100	$ 75,100	$ 59,100	$ 59,100
Securities available-for-sale	64,926	64,926	64,790	64,790
FHLB stock	7,310	N/A	8,323	N/A
Loans receivable, net	$ 695,740	$ 697,797	$ 678,175	$ 690,229
Real estate owned, net	20,551	20,551	6,562	6,562
Accrued interest receivable	3,220	3,220	3,531	3,531
Financial liabilities				
Deposits	$ 711,609	$ 714,129	$ 646,308	$ 628,319
Advances from the FHLB	20,000	20,167	75,000	75,959
Accrued interest payable	187	187	225	225

The methods and assumptions used to estimate fair value are described as follows:

Carrying amount is the estimated fair value for cash and cash equivalents, accrued interest receivable and payable, demand deposits, short-term debt, and variable rate loans or deposits that re-price frequently and fully. The methods for determining the fair values for securities available for sale were described previously. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent re-pricing or re-pricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair value of long-term debt is based on current rates for similar financing. It was not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability. The fair value of off-balance-sheet items is not considered material (or is based on the current fees or costs that would be charged to enter into or terminate such arrangements).

NOTE 6 SECURITIES

The following tables summarize the amortized cost and fair value of the available-for-sale investment securities portfolio at September 30, 2011 and December 31, 2010, respectively, and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2011				
Available-for-sale				
Municipal securities	$ 3,366	$ 6	$ (47)	$ 3,325
Private label residential mortgage-backed securities	62,436	164	(1,002)	61,598
Federal National Mortgage Association mortgage-backed securities	3			3
Government National Mortgage Association securities				
Total securities available for sale	$ 65,805	$ 170	$ (1,049)	$ 64,926

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2010				

Available-for-sale				
U.S. government-sponsored entities and agency securities	$ 5,036	$ 19	$	$ 5,055
Private label residential mortgage-backed securities	49,933	4,545	(232)	54,246
Federal National Mortgage Association mortgage-backed securities	3			3
Government National Mortgage Association securities	5,402	84		5,486
Total securities available for sale	$ 60,374	$ 4,648	$ (232)	$ 64,790

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The amortized cost and fair value of the available-for-sale securities portfolio are shown by expected maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

	September 30, 2011	
	Amortized Cost	Fair Value
Maturity		
Available-for-sale		
Within one year	$	$
One to five years	2,515	2,500
Five to ten years	851	825
Private label residential mortgage backed and FNMA mortgage-backed securities	62,439	61,601
Total	$ 65,805	$ 64,926

At September 30, 2011 and December 31, 2010, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders equity.

The following table summarizes the investment securities with unrealized losses at September 30, 2011 by aggregated major security type and length of time in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale						
Municipal securities	$ 1,898	$ (47)	$	$	$ 1,898	$ (47)
Private label residential mortgage-backed securities	42,696	(924)	7,829	(78)	50,525	(1,002)
Total available-for-sale	$ 44,594	$ (971)	$ 7,829	$ (78)	$ 52,423	$ (1,049)

The following table summarizes the investment securities with unrealized losses at December 31, 2010 by aggregated major security type and length of time in a continuous unrealized loss position:

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale						
Private label residential mortgage-backed securities	$ 11,547	$ (232)	$	$	$ 11,547	$ (232)
Total available-for-sale	$ 11,547	$ (232)	$	$	$ 11,547	$ (232)

Other-Than-Temporary Impairment. Management evaluates securities for OTTI on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. The investment securities portfolio is evaluated for OTTI by segregating the portfolio into two general segments and applying the appropriate OTTI model. Investment securities classified as available for sale or held-to-maturity are generally evaluated for OTTI under Statement of Financial Accounting Standards ASC 320, *Accounting for Certain Investments in Debt and Equity Securities.* However, certain purchased beneficial interests, including non-agency mortgage-backed securities, asset-backed securities, and collateralized debt obligations, that had credit ratings at the time of purchase of below AA are evaluated using the model outlined in ASC 325, *Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests that Continue to be Held by a Transfer in Securitized Financial Assets.*

In determining OTTI under the ASC 320 model, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Company has the intent to sell the debt security or it is more likely than not that the Company will be required to sell the debt security before its anticipated recovery. The assessment of whether OTTI exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

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The second segment of the portfolio uses the OTTI guidance provided by ASC 325 that is specific to purchased beneficial interests that, on the purchase date, were rated below AA. Under the ASC 325 model, the Company compares the present value of the remaining cash flows as estimated at the preceding evaluation date to the current expected remaining cash flows. An OTTI is deemed to have occurred if there has been an adverse change in the remaining expected future cash flows.

When OTTI occurs under either model, the amount of the OTTI recognized in earnings depends on whether the Company intends to sell the security or it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss. If the Company intends to sell or it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss, the OTTI is recognized in earnings equal to the entire difference between the investment s amortized cost basis and its fair value at the balance sheet date. If the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the OTTI is separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total OTTI related to other factors is recognized in other comprehensive income or loss, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment.

As of September 30, 2011, the Company s securities available for sale portfolio consisted of thirty-eight securities, twenty-six of which were in an unrealized loss position. The unrealized losses are related to the Company s municipal securities and private label residential mortgage-backed securities as discussed below.

The Company s private label residential mortgage-backed securities that are in an unrealized loss position had a market value of $50.5 million with unrealized losses of $1.0 million at September 30, 2011. These non-agency private label residential mortgage-backed securities were rated AAA at purchase and are not within the scope of ASC 325. The Company monitors to insure it has adequate credit support and as of September 30, 2011, the Company believes there is no OTTI and it does not have the intent to sell these securities and it is not likely that it will be required to sell the securities before their anticipated recovery. Of the $64.9 million securities portfolio, $59.7 million were rated AAA, AA or A, and $5.2 million were rated BBB based on the most recent credit rating as of September 30, 2011. The Company considers the lowest credit rating for identification of OTTI. During the second quarter of 2011, the Company sold all of its credit impaired securities for a net gain. During the third quarter, Company also sold all securities that became credit impaired during the quarter. As rates interest rates fell to historic low levels which resulted in increases in market prices for its securities, the Company took the opportunity to divest several of its private label residential mortgage-backed securities that had been purchased in early 2011 and earlier periods. Some of the municipal bonds purchased were zero coupon bonds. Because of this feature, these zero coupon bonds traditionally trade at a significant discount to their par value and are not considered impaired.

During the three and nine months ended September 30, 2011, the Company determined that no securities were other-than-temporarily impaired due to current market conditions.

NOTE 7 LOANS

Loans receivable consist of the following:

	September 2011	December 2010
Commercial:		
Commercial and industrial	$ 9,054	$ 6,744
Real estate mortgage	94,251	46,568
Multi-family	26,565	33,040
Real estate construction		
Land	2,459	14,828
Consumer:		
Real estate 1-4 family first mortgage	553,516	568,854
Real estate 1-4 family junior lien mortgage	8,788	9,923
Other revolving credit and installment	8,821	11,031
Total	703,454	690,988
Allowance for loan losses	(8,993)	(14,637)

Net deferred loan costs	1,279	1,824
Loans receivable, net	$ 695,740	$ 678,175

At September 30, 2011, the Company had a total of $383.6 million in interest only mortgage loans and $23.6 million in loans with potential for negative amortization. At December 31, 2010, the Company had a total of $423.4 million in interest only mortgage loans (including Green Account loans) and $32.1 million in loans with potential for negative amortization. These loans pose a potentially higher credit risk because of the lack of principal amortization and potential for negative amortization, however,

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management believes the risk is mitigated through the Company s loan terms and underwriting standards, including its policies on loan-to-value ratios.

Activity in the allowance for loan losses is summarized as follows for the nine months ended September 30, 2011 and the twelve months ended December 31, 2010 and 2009:

	2011	2010	2009
Balance at beginning of year	$ 14,637	$ 13,079	$ 18,286
Loans charged off	(7,117)	(7,531)	(22,505)
Recoveries of loans previously charged off	199	132	2
Provision for loan losses	1,274	8,957	17,296
Balance at end of period	$ 8,993	$ 14,637	$ 13,079

The following table presents the activity in the allowance for loan losses and the recorded investment in loans, excluding accrued interest receivable and net deferred loan costs as they are not considered to be material, in loans by portfolio segment and is based on the impairment method for the nine months ended as of September 30, 2011. Total accrued interest receivable and net deferred loan costs were $3.2 million and $1.3 million, respectively at September 30, 2011.

	Commercial and Industrial	Commercial Real Estate Mortgage	Multi-family	Real estate construction	Land	Real Estate 1-4 family first mortgage	Real Estate 1-4 family junior lien mortgage	Other Revolving Credit	TOTAL
Allowance for loan losses:									
Balance as of December 31, 2010	$ 50	$ 332	$ 2,389	$	$ 1,067	$ 10,191	$ 258	$ 350	$ 14,637
Charge-offs			(2,068)		(1,900)	(3,021)	(108)	(20)	(7,117)
Recoveries					24	165		10	199
Provision	18	881	221		821	(549)	119	(237)	1,274
Balance as of September 30, 2011	$ 68	$ 1,213	$ 542	$	$ 12	$ 6,786	$ 269	$ 103	$ 8,993
Individually evaluated for impairment	$	$	$ 349	$	$	$ 1,627	$	$	$ 1,976
Collectively evaluated for impairment	68	1,213	193		12	5,159	269	103	7,017
Total ending allowance balance	$ 68	$ 1,213	$ 542	$	$ 12	$ 6,786	$ 269	$ 103	$ 8,993
Loans:									
Loans individually evaluated for impairment	$	$	$ 5,015	$	$ 1,734	$ 24,410	$	$ 7	$ 31,166
Loans collectively evaluated for impairment	9,054	94,251	21,550		725	529,106	8,788	8,814	672,288
Total ending loans balance	$ 9,054	$ 94,251	$ 26,565	$	$ 2,459	$ 553,516	$ 8,788	$ 8,821	$ 703,454

See accompany notes to consolidated financial statements.

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The following table presents the activity in the allowance for loan losses and the recorded investment in loans, excluding accrued interest receivable and net deferred loan costs as they are not considered to be material, by portfolio segment and is based on the impairment method for the three months ended as of September 30, 2011. Total accrued interest receivable and net deferred loan costs were $3.2 million and $1.3 million, respectively at September 30, 2011.

	Commercial and Industrial	Commercial Real Estate Mortgage	Multi-family	Real estate construction	Land	Real Estate 1-4 family first mortgage	Real Estate 1-4 family junior lien mortgage	Other Revolving Credit	TOTAL
Allowance for loan losses:									
Balance as of June 30, 2011	$ 68	$ 655	$ 692	$	$ 278	$ 6,162	$ 360	$ 217	$ 8,432
Charge-offs		68			(57)	(275)	(108)	(10)	(382)
Recoveries						116		4	121
Provision		558	(218)		(210)	783	17	(108)	822
Balance as of September 30, 2011	$ 68	$ 1,213	$ 542	$	$ 12	$ 6,786	$ 269	$ 103	