UNITY BANCORP INC /NJ/
Form 10-Q
May 11, 2011

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

# FORM 10-Q

(Mark One)
(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED March 31, 2011

OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM ____ TO ____.

Commission file number 1-12431

Unity Bancorp, Inc.
(Exact Name of Registrant as Specified in Its Charter)

| | |
|---|---|
| New Jersey | 22-3282551 |
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |
| | |
| 64 Old Highway 22, Clinton, NJ | 08809 |
| (Address of Principal Executive Offices) | (Zip Code) |

Registrant's Telephone Number, Including Area Code (908) 730-7630

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, as amended, 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 o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a nonaccelerated filer (as defined in Exchange Act Rule 12b-2):
Large accelerated filer o Accelerated filer o Nonaccelerated filer o 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 o No x

The number of shares outstanding of each of the registrant's classes of common equity stock, as of May 1, 2011
common stock, no par value: 7,222,449 shares outstanding

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PART I - CONSOLIDATED FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements (Unaudited)

Unity Bancorp, Inc.
Consolidated Balance Sheets
(Unaudited)

| Amounts in thousands, except percentages | March 31, 2011 | December 31, 2010 | March 31, 2010 |
|---|---|---|---|
| ASSETS | | | |
| Cash and due from banks | $ 15,478 | $ 17,637 | $ 22,654 |
| Federal funds sold and interest-bearing deposits | 39,880 | 26,289 | 43,734 |
| Cash and cash equivalents | 55,358 | 43,926 | 66,388 |
| Securities: | | | |
| Securities available for sale, at fair value | 103,238 | 107,131 | 113,465 |
| Securities held to maturity (fair value of $17,774, $21,351, and $25,310, respectively) | 17,577 | 21,111 | 24,977 |
| Total securities | 120,815 | 128,242 | 138,442 |
| Loans: | | | |
| SBA loans held for sale | 9,933 | 10,397 | 22,617 |
| SBA loans held to maturity | 74,657 | 75,741 | 75,191 |
| SBA 504 loans | 60,092 | 64,276 | 67,000 |
| Commercial loans | 283,135 | 281,205 | 292,557 |
| Residential mortgage loans | 132,512 | 128,400 | 135,596 |
| Consumer loans | 54,193 | 55,917 | 58,239 |
| Total loans | 614,522 | 615,936 | 651,200 |
| Allowance for loan losses | (15,275) | (14,364) | (14,055) |
| Net loans | 599,247 | 601,572 | 637,145 |
| | | | |
| Premises and equipment, net | 10,782 | 10,967 | 11,525 |
| Bank owned life insurance (BOLI) | 8,885 | 8,812 | 8,574 |
| Deferred tax assets | 7,833 | 7,550 | 7,856 |
| Federal Home Loan Bank stock, at cost | 4,206 | 4,206 | 4,677 |
| Accrued interest receivable | 3,725 | 3,791 | 4,009 |
| Prepaid FDIC insurance | 2,994 | 3,266 | 4,136 |
| Other real estate owned (OREO) | 2,602 | 2,346 | 3,318 |
| Goodwill and other intangibles | 1,541 | 1,544 | 1,555 |
| Other assets | 2,845 | 2,188 | 2,302 |
| | | | |
| Total Assets | $ 820,833 | $ 818,410 | $ 889,927 |
| | | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | |
| Liabilities: | | | |
| Deposits: | | | |
| Noninterest-bearing demand deposits | $ 91,247 | $ 91,272 | $ 84,858 |

| | | | |
|---|---|---|---|
| Interest-bearing demand deposits | 101,878 | 105,530 | 102,846 |
| Savings deposits | 293,750 | 277,394 | 291,870 |
| Time deposits, under $100,000 | 110,050 | 119,478 | 149,934 |
| Time deposits, $100,000 and over | 59,851 | 61,114 | 85,294 |
| Total deposits | 656,776 | 654,788 | 714,802 |
| | | | |
| Borrowed funds | 75,000 | 75,000 | 86,554 |
| Subordinated debentures | 15,465 | 15,465 | 15,465 |
| Accrued interest payable | 569 | 556 | 706 |
| Accrued expenses and other liabilities | 2,642 | 2,516 | 3,688 |
| Total liabilities | 750,452 | 748,325 | 821,215 |
| Commitments and contingencies | - | - | - |
| | | | |
| Shareholders' equity: | | | |
| Cumulative perpetual preferred stock | 19,146 | 19,019 | 18,650 |
| Common stock | 52,842 | 55,884 | 55,536 |
| Accumuluated deficit | (2,006) | (772) | (1,117) |
| Treasury stock at cost | - | (4,169) | (4,169) |
| Accumulated other comprehensive income (loss) | 399 | 123 | (188) |
| Total Shareholders' Equity | 70,381 | 70,085 | 68,712 |
| | | | |
| Total Liabilities and Shareholders' Equity | $ 820,833 | $ 818,410 | $ 889,927 |
| | | | |
| Preferred shares | 21 | 21 | 21 |
| Issued common shares | 7,222 | 7,636 | 7,581 |
| Outstanding common shares | 7,222 | 7,211 | 7,156 |

The accompanying notes to the Consolidated Financial Statements are an integral part of these statements.

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Unity Bancorp
Consolidated Statements of Operations
(Unaudited)

| | For the three months ended March 31, | |
|---|---|---|
| (In thousands, except per share amounts) | 2011 | 2010 |
| INTEREST INCOME | | |
| Federal funds sold and interest-bearing deposits | $ 11 | $ 26 |
| Federal Home Loan Bank stock | 66 | 34 |
| Securities: | | |
| Available for sale | 864 | 1,280 |
| Held to maturity | 287 | 338 |
| Total securities | 1,151 | 1,618 |
| Loans: | | |
| SBA loans | 1,236 | 1,452 |
| SBA 504 loans | 955 | 1,087 |
| Commercial loans | 4,306 | 4,604 |
| Residential mortgage loans | 1,831 | 1,961 |
| Consumer loans | 686 | 731 |
| Total loans | 9,014 | 9,835 |
| Total interest income | 10,242 | 11,513 |
| INTEREST EXPENSE | | |
| Interest-bearing demand deposits | 139 | 258 |
| Savings deposits | 581 | 901 |
| Time deposits | 1,097 | 1,813 |
| Borrowed funds and subordinated debentures | 950 | 1,077 |
| Total interest expense | 2,767 | 4,049 |
| Net interest income | 7,475 | 7,464 |
| Provision for loan losses | 2,500 | 1,500 |
| Net interest income after provision for loan losses | 4,975 | 5,964 |
| NONINTEREST INCOME | | |
| Branch fee income | 344 | 362 |
| Service and loan fee income | 243 | 209 |
| Gain on sale of SBA loans held for sale, net | 111 | - |
| Gain on sale of mortgage loans | 169 | 145 |
| Bank owned life insurance (BOLI) | 73 | 73 |
| Net security gains | 125 | 4 |
| Other income | 190 | 117 |
| Total noninterest income | 1,255 | 910 |
| NONINTEREST EXPENSE | | |
| Compensation and benefits | 3,057 | 2,999 |
| Occupancy | 720 | 677 |
| Processing and communications | 507 | 524 |
| Furniture and equipment | 384 | 423 |
| Professional services | 202 | 229 |
| Loan collection costs | 224 | 184 |

| | | | | | |
|---|---|---|---|---|---|
| OREO expense | | 222 | | | 30 |
| Deposit insurance | | 319 | | | 330 |
| Advertising | | 118 | | | 106 |
| Other expenses | | 405 | | | 439 |
| Total noninterest expense | | 6,158 | | | 5,941 |
| Income before provision for income taxes | | 72 | | | 933 |
| (Benefit) provision for income taxes | | (148 | ) | | 185 |
| Net income | | 220 | | | 748 |
| Preferred stock dividends & discount accretion | | 384 | | | 373 |
| (Loss attributable) income available to common shareholders | $ | (164 | ) | $ | 375 |
| | | | | | |
| Net (loss) income per common share - Basic | $ | (0.02 | ) | $ | 0.05 |
| - Diluted | $ | (0.02 | ) | $ | 0.05 |
| | | | | | |
| Weighted average common shares outstanding - Basic | | 7,219 | | | 7,150 |
| - Diluted | | 7,219 | | | 7,294 |
| | | | | | |

The accompanying notes to the Consolidated Financial Statements are an integral part of these statements.

Unity Bancorp, Inc.
Consolidated Statements of Changes in Shareholders' Equity
For the three months ended March 31, 2011 and 2010

| (In thousands) | Preferred Stock | Common Stock Shares | Common Stock Amount | Retained Earnings (Deficit) | Treasury Stock | Accumulated Other Comprehensive Loss | Total Shareholders' Equity |
|---|---|---|---|---|---|---|---|
| Balance, December 31, 2009 | $ 18,533 | 7,144 | $ 55,454 | $ (1,492) | $ (4,169) | $ (461) | $ 67,865 |
| Comprehensive income: | | | | | | | |
| Net income | | | | 748 | | | 748 |
| Net unrealized gains on securities | | | | | | 272 | 272 |
| Net unrealized gains on cash flow hedge derivatives | | | | | | 1 | 1 |
| Total comprehensive income | | | | | | | 1,021 |
| Accretion of discount on preferred stock | 117 | | | (117) | | | - |
| Dividends on preferred stock (5% annually) | | | | (256) | | | (256) |
| Common stock issued and related tax effects (a) | | 12 | 82 | | | | 82 |
| Balance, March 31, 2010 | $ 18,650 | 7,156 | $ 55,536 | $ (1,117) | $ (4,169) | $ (188) | $ 68,712 |

| (In thousands) | Preferred Stock | Common Stock Shares | Common Stock Amount | Retained Earnings (Deficit) | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|---|---|---|---|---|---|---|---|
| Balance, December 31, 2010 | $ 19,019 | 7,211 | $ 55,884 | $ (772) | $ (4,169) | $ 123 | $ 70,085 |
| Comprehensive income: | | | | | | | |
| Net income | | | | 220 | | | 220 |
| Net unrealized gains on securities | | | | | | 192 | 192 |
| Net unrealized gains on cash flow hedge derivatives | | | | | | 84 | 84 |
| Total comprehensive income | | | | | | | 496 |
| Accretion of discount on preferred stock | 127 | | | (127) | | | - |
| Dividends on preferred stock (5% annually) | | | | (259) | | | (259) |
| Retire Treasury stock | | | (3,101 ) | (1,068 ) | 4,169 | | - |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Common stock issued and related tax effects (a) | | 11 | 59 | | | | 59 |
| Balance, March 31, 2011 | $ 19,146 | 7,222 | $ 52,842 | $ (2,006) | $ - | $ 399 | $ 70,381 |

(a) Includes the issuance of common stock under employee benefit plans, which includes nonqualified stock options and restricted stock expense related entries, employee option exercises and the tax benefit of options exercised.

The accompanying notes to the Consolidated Financial Statements are an integral part of these statements.

Unity Bancorp, Inc.
Consolidated Statements of Cash Flows
(Unaudited)

| | For the three months ended March 31, | |
|---|---|---|
| (In thousands) | 2011 | 2010 |
| OPERATING ACTIVITIES | | |
| Net income | $ 220 | $ 748 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 2,500 | 1,500 |
| Net amortization of purchase premiums and discounts on securities | 146 | 219 |
| Depreciation and amortization | 302 | 316 |
| Deferred income tax benefit | (467) | (740) |
| Net security gains | (125) | (4) |
| Stock compensation expense | 35 | 87 |
| Gain on sale of SBA loans held for sale, net | (111) | - |
| Gain on sale of mortgage loans | (169) | (145) |
| Origination of mortgage loans held for sale | (9,671) | (7,837) |
| Origination of SBA loans held for sale | (601) | (1,211) |
| Proceeds from the sale of mortgage loans held for sale, net | 9,840 | 7,982 |
| Proceeds from the sale of SBA loans held for sale, net | 1,177 | - |
| Loss on the sale of premises and equipment | - | 3 |
| Net change in other assets and liabilities | 257 | 1,730 |
| Net cash provided by operating activities | 3,333 | 2,648 |
| INVESTING ACTIVITIES: | | |
| Purchases of securities available for sale | (10,953) | - |
| Maturities and principal payments on securities held to maturity | 3,584 | 1,279 |
| Maturities and principal payments on securities available for sale | 9,922 | 18,820 |
| Proceeds from sale of securities held to maturity | - | 1,893 |
| Proceeds from sale of securities available for sale | 5,172 | 8,838 |
| Proceeds from the sale of other real estate owned | - | 1,698 |
| Net (decrease) increase in loans | (1,246) | 2,235 |
| Purchase of bank owned life insurance | - | (2,499) |
| Proceeds from the sale of premises and equipment | - | 26 |
| Purchases of premises and equipment | (112) | (76) |
| Net cash provided by investing activities | 6,367 | 32,214 |
| FINANCING ACTIVITIES: | | |
| Net increase (decrease) in deposits | 1,988 | (43,437) |
| Proceeds from new borrowings | - | 1,554 |
| Proceeds from the exercise of stock options | 2 | 32 |
| Cash dividends paid on preferred stock | (258) | (258) |
| Net cash provided by (used in) financing activities | 1,732 | (42,109) |
| Increase (decrease) in cash and cash equivalents | 11,432 | (7,247) |
| Cash and cash equivalents, beginning of period | 43,926 | 73,635 |

| | | |
|---|---|---|
| Cash and cash equivalents, end of period | $ 55,358 | $ 66,388 |
| SUPPLEMENTAL DISCLOSURES: | | |
| Cash: | | |
| Interest paid | $ 2,755 | $ 4,053 |
| Income taxes paid | 334 | 303 |
| Noncash investing activities: | | |
| Transfer of loans to other real estate owned | 605 | 3,486 |

The accompanying notes to the Consolidated Financial Statements are an integral part of these statements.

Unity Bancorp, Inc.
Notes to the Consolidated Financial Statements (Unaudited)
March 31, 2011

NOTE 1. Significant Accounting Policies

The accompanying Consolidated Financial Statements include the accounts of Unity Bancorp, Inc. (the "Parent Company") and its wholly-owned subsidiary, Unity Bank (the "Bank" or when consolidated with the Parent Company, the "Company"), and reflect all adjustments and disclosures which are generally routine and recurring in nature, and in the opinion of management, necessary for a fair presentation of interim results. Unity Investment Services, Inc., a wholly-owned subsidiary of the Bank, is used to hold part of the Bank's investment portfolio. All significant intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications have been made to prior period amounts to conform to the current year presentation, with no impact on current earnings. The financial information has been prepared in accordance with U.S. generally accepted accounting principles and has not been audited. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and revenues and expenses during the reporting periods. Actual results could differ from those estimates. The Company has evaluated subsequent events for potential recognition and/or disclosure through the date the consolidated financial statements included in this Quarterly Report on Form 10-Q were issued.

Estimates that are particularly susceptible to significant changes relate to the determination of the allowance for loan losses, the valuation of deferred income tax assets and the fair value of financial instruments. Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance for loan losses may be necessary based on changes in economic conditions. The interim unaudited consolidated financial statements included herein have been prepared in accordance with instructions for Form 10-Q and the rules and regulations of the Securities and Exchange Commission ("SEC"). The results of operations for the three months ended March 31, 2011 are not necessarily indicative of the results which may be expected for the entire year. As used in this Form 10-Q, "we" and "us" and "our" refer to Unity Bancorp, Inc., and its consolidated subsidiary, Unity Bank, depending on the context. Certain information and financial disclosures required by generally accepted accounting principles have been condensed or omitted from interim reporting pursuant to SEC rules. Interim financial statements should be read in conjunction with the Company's consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

Stock Transactions

The Company has incentive and nonqualified option plans, which allow for the grant of options to officers, employees and members of the Board of Directors. In addition, restricted stock is issued under the stock bonus program to reward employees and directors and to retain them by distributing stock over a period of time.

Stock Option Plans

Grants under the Company's incentive and nonqualified option plans generally vest over 3 years and must be exercised within 10 years of the date of grant. The exercise price of each option is the market price on the date of grant. As of March 31, 2011, 1,520,529 shares have been reserved for issuance upon the exercise of options, 729,912 option grants are outstanding, and 758,212 option grants have been exercised, forfeited or expired, leaving 32,405 shares available for grant.

No options were granted during the three months ended March 31, 2011 or 2010.

Financial Accounting Standards Board Accounting Statndards Codification("FASB ASC") Topic 718, "Compensation - Stock Compensation," requires an entity to recognize the fair value of equity awards as compensation expense over the period during which an employee is required to provide service in exchange for such an award (vesting period). Compensation expense related to stock options totaled $19 thousand and $52 thousand for the three months ended March 31, 2011 and 2010, respectively. The related income tax benefit was approximately $8 thousand and $21 thousand for the three months ended March 31, 2011 and 2010, respectively. As of March 31, 2011, unrecognized compensation costs related to nonvested share-based compensation arrangements granted under the Company's stock option plans totaled approximately $89 thousand. That cost is expected to be recognized over a weighted average period of 1.4 years.

Transactions under the Company's stock option plans for the three months ended March 31, 2011 are summarized in the following table:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (in years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding at December 31, 2010 | 775,468 | $ 5.90 | 3.9 | $ 1,049,184 |
| Options granted | - | - | | |
| Options exercised | (40,472) | 4.39 | | |
| Options forfeited | (3,782) | 6.43 | | |
| Options expired | (1,302) | 7.29 | | |
| Outstanding at March 31, 2011 | 729,912 | $ 5.98 | 3.6 | $ 1,394,230 |
| Exercisable at March 31, 2011 | 658,364 | $ 6.19 | 3.1 | $ 1,187,432 |

The following table summarizes information about stock options outstanding at March 31, 2011:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Options Outstanding | Weighted Average Remaining Contractual Life (in years) | Weighted Average Exercise Price | Options Exercisable | Weighted Average Exercise Price |
| $ 0.00 - 4.00 | 317,718 | 3.4 | $ 3.45 | 257,222 | $ 3.35 |
| 4.01 - 8.00 | 218,476 | 4.0 | 5.79 | 207,424 | 5.84 |
| 8.01 - 12.00 | 128,256 | 2.8 | 9.20 | 128,256 | 9.20 |
| 12.01 - 16.00 | 65,462 | 4.9 | 12.55 | 65,462 | 12.55 |
| Total | 729,912 | 3.6 | $ 5.98 | 658,364 | $ 6.19 |

The following table presents information about options exercised during the three months ended March 31, 2011 and 2010:

| | Three months ended March 31, | |
|---|---|---|
| | 2011 | 2010 |
| Number of options exercised | 40,472 | 11,739 |
| Total intrinsic value of options exercised | $ 81,347 | $ 16,855 |
| Cash received from options exercised | 2,364 | 31,731 |
| Tax deduction realized from options exercised | 32,490 | 6,732 |

Upon exercise, the Company issues shares from its authorized but unissued common stock to satisfy the options.

Restricted Stock Awards

Restricted stock awards granted to date vest over a period of 4 years and are recognized as compensation to the recipient over the vesting period. The awards are recorded at fair market value and amortized into salary expense on a straight line basis over the vesting period. As of March 31, 2011, 121,551 shares of restricted stock were reserved for issuance, of which 13,661 shares are available for grant.

There were no restricted stock awards granted during the three months ended March 31, 2011 and 2010.

Compensation expense related to the restricted stock awards totaled $16 thousand and $35 thousand for the three months ended March 31, 2011 and 2010, respectively. As of March 31, 2011, there was approximately $143 thousand of unrecognized compensation cost related to nonvested restricted stock awards granted under the Company's stock incentive plans. That cost is expected to be recognized over a weighted average period of 2.8 years.

The following table summarizes nonvested restricted stock activity for the three months ended March 31, 2011:

| | Shares | Average Grant Date Fair Value |
|---|---|---|

| | | | |
|---|---|---|---|
| Nonvested restricted stock at December 31, 2010 | 43,367 | $ | 5.83 |
| Granted | - | | - |
| Vested | (6,245) | | 11.05 |
| Forfeited | (1,326) | | 8.72 |
| Nonvested restricted stock at March 31, 2011 | 35,796 | $ | 4.81 |

Income Taxes

The Company follows FASB ASC Topic 740, "Income Taxes," which prescribes a threshold for the financial statement recognition of income taxes and provides criteria for the measurement of tax positions taken or expected to be taken in a tax return. ASC 740 also includes guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition of income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the enacted tax rates applicable to taxable income for the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation reserves are established against certain deferred tax assets when it is more likely than not that the deferred tax assets will not be realized. Increases or decreases in the valuation reserve are charged or credited to the income tax provision.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that ultimately would be sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. The evaluation of a tax position taken is considered by itself and not offset or aggregated with other positions. Tax positions that meet the more likely than not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

Interest and penalties associated with unrecognized tax benefits are recognized in income tax expense on the income statement.

Derivative Instruments and Hedging Activities

The Company uses derivative instruments, such as interest rate swaps, to manage interest rate risk. The Company recognizes all derivative instruments at fair value as either assets or liabilities in other assets or other liabilities. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship. For derivatives not designated as an accounting hedge, the gain or loss is recognized in trading noninterest income. As of March 31, 2011, all of the Company's derivative instruments qualified as hedging instruments.

For those derivative instruments that are designated and qualify as hedging instruments, the Company must designate the hedging instrument, based on the exposure being hedged, as a fair value hedge, a cash flow hedge or a hedge of a net investment in a foreign operation. The Company does not have any fair value hedges or hedges of foreign operations.

The Company formally documents the relationship between the hedging instruments and hedged item, as well as the risk management objective and strategy before undertaking a hedge. To qualify for hedge accounting, the derivatives and hedged items must be designated as a hedge. For hedging relationships in which effectiveness is measured, the Company formally assesses, both at inception and on an ongoing basis, if the derivatives are highly effective in offsetting changes in fair values or cash flows of the hedged item. If it is determined that the derivative instrument is not highly effective as a hedge, hedge accounting is discontinued.

For derivatives that are designated as cash flow hedges, the effective portion of the gain or loss on derivatives is reported as a component of other comprehensive income or loss and subsequently reclassified in interest income in the same period during which the hedged transaction affects earnings. As a result, the change in fair value of any ineffective portion of the hedging derivative is recognized immediately in earnings.

The Company will discontinue hedge accounting when it is determined that the derivative is no longer qualifying as an effective hedge; the derivative expires or is sold, terminated or exercised; or the derivative is de-designated as a fair value or cash flow hedge or it is no longer probable that the forecasted transaction will occur by the end of the originally specified time period. If the Company determines that the derivative no longer qualifies as a cash flow or fair value hedge and therefore hedge accounting is discontinued, the derivative will continue to be recorded on the balance sheet at its fair value with changes in fair value included in current earnings.

Loans Held To Maturity and Loans Held For Sale

Loans held to maturity are stated at the unpaid principal balance, net of unearned discounts and net of deferred loan origination fees and costs. Loan origination fees, net of direct loan origination costs, are deferred and are recognized over the estimated life of the related loans as an adjustment to the loan yield utilizing the level yield method.

Interest is credited to operations primarily based upon the principal amount outstanding. When management believes there is sufficient doubt as to the ultimate ability to collect interest on a loan, interest accruals are discontinued and all past due interest, previously recognized as income, is reversed and charged against current period earnings. Payments received on nonaccrual loans are applied as principal. Loans are returned to an accrual status when the ability to collect is reasonably assured and when the loan is brought current as to principal and interest.

Loans are reported as past due when either interest or principal is unpaid in the following circumstances: fixed payment loans when the borrower is in arrears for two or more monthly payments; open end credit for two or more billing cycles; and single payment notes if interest or principal remains unpaid for 30 days or more.

Loans are charged off when collection is sufficiently questionable and when the Company can no longer justify maintaining the loan as an asset on the balance sheet. Loans qualify for charge-off when, after thorough analysis, all possible sources of repayment are insufficient. These include: 1) potential future cash flows, 2) value of collateral, and/or 3) strength of co-makers and guarantors. All unsecured loans are charged off upon the establishment of the loan's nonaccrual status. Additionally, all loans classified as a loss or that portion of the loan classified as a loss are charged off. All loan charge-offs are approved by the Board of Directors.

Nonperforming loans consist of loans that are not accruing interest (nonaccrual loans) as a result of principal or interest being in default for a period of 90 days or more or when the ability to collect principal and interest according to the contractual terms is in doubt. When a loan is classified as nonaccrual, interest accruals discontinue and all past due interest previously recognized as income is reversed and charged against current period income. Generally, until the loan becomes current, any payments received from the borrower are applied to outstanding principal until such time as management determines that the financial condition of the borrower and other factors merit recognition of a portion of such payments as interest income.

The Company evaluates its loans for impairment. A loan is considered 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 has defined impaired loans to be all troubled debt restructurings and nonperforming loans. Impairment is evaluated in total for smaller-balance loans of a similar nature (consumer and residential mortgage loans), and on an individual basis for other loans. Troubled debt restructurings ("TDRs") occur when a creditor, for economic or legal reasons related to a debtor's financial condition, grants a concession to the debtor that it would not otherwise consider, such as a below market interest rate. Interest income on accruing TDRs is credited to operations primarily based upon the principal amount outstanding, as stated in the paragraphs above. Impairment of a loan is measured based on the present value of expected future cash flows, net of estimated costs to sell, discounted at the loan's effective interest rate. Impairment can also be measured based on a loan's observable market price or the fair value of collateral, net of estimated costs to sell, if the loan is collateral dependent. If the measure of the impaired loan is less than the recorded investment in the loan, the Company establishes a valuation allowance, or adjusts existing valuation allowances, with a corresponding charge or credit to the provision for loan losses.

Loans held for sale are SBA loans and are reflected at the lower of aggregate cost or market value. The net amount of loan origination fees on loans sold is included in the carrying value and in the gain or loss on the sale.

The Company originates loans to customers under an SBA program that generally provides for SBA guarantees of up to 90 percent of each loan. In the past, the Company generally sold the guaranteed portion of its SBA loans to a third party and retained the servicing, holding the nonguaranteed portion in its portfolio. During late 2008, the Company withdrew from SBA lending outside of its primary trade area, but continues to offer SBA loan products as an additional credit product within its primary trade area. If sales of SBA loans do occur, the premium received on the sale and the present value of future cash flows of the servicing assets are recognized in income.

Serviced loans sold to others are not included in the accompanying consolidated balance sheets. Income and fees collected for loan servicing are credited to noninterest income when earned, net of amortization on the related servicing assets.

For additional information see the section titled "Loan Portfolio" under Item 2. Management's Discussion and Analysis.

Allowance for Loan Losses and Unfunded Loan Commitments

The allowance for loan losses is maintained at a level management considers adequate to provide for probable loan losses as of the balance sheet date. The allowance is increased by provisions charged to expense and is reduced by net charge-offs.

The level of the allowance is based on management's evaluation of probable losses in the loan portfolio, after consideration of prevailing economic conditions in the Company's market area, the volume and composition of the loan portfolio, and historical loan loss experience. The allowance for loan losses consists of specific reserves for individually impaired credits, reserves for nonimpaired loans based on historical loss factors and reserves based on general economic factors and other qualitative risk factors such as changes in delinquency trends, industry concentrations or local/national economic trends. This risk assessment process is performed at least quarterly, and, as adjustments become necessary, they are realized in the periods in which they become known.

Although management attempts to maintain the allowance at a level deemed adequate to provide for probable losses, future additions to the allowance may be necessary based upon certain factors including changes in market conditions and underlying collateral values. In addition, various regulatory agencies periodically review the adequacy of the Company's allowance for loan losses. These agencies may require the Company to make additional provisions based on their judgments about information available to them at the time of their examination.

The Company maintains an allowance for unfunded loan commitments that is maintained at a level that management believes is adequate to absorb estimated probable losses. Adjustments to the allowance are made through other expenses and applied to the allowance which is maintained in other liabilities.

For additional information, see the sections titled "Asset Quality" and "Allowance for Loan Losses and Unfunded Loan Commitments" under Item 2. Management's Discussion and Analysis.

Other-Than-Temporary Impairment

The Company has a process in place to identify debt securities that could potentially incur credit impairment that is other-than-temporary. This process involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concern warrants such evaluation. This evaluation considers relevant facts and circumstances in evaluating whether a credit or interest rate-related impairment of a security is other-than-temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events and (4) for fixed maturity securities, our intent to sell a security or whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity and for equity securities, our ability and intent to hold the security for a forecasted period of time that allows for the recovery in value.

Management assesses its intent to sell or whether it is more likely than not that it will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other-than-temporarily impaired with no intent to sell and no requirement to sell prior to recovery of its amortized cost basis, the amount of the impairment is separated into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and is recognized in other comprehensive income.

The present value of expected future cash flows is determined using the best estimate cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best estimate cash flows vary depending on the type of security. The asset-backed securities cash flow estimates are based on bond specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds and structural support, including subordination and guarantees. The corporate bond cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or the disposition of assets using bond specific facts and circumstances including timing, security interests and loss severity.

NOTE 2.  Litigation

From time to time, the Company is subject to legal proceedings and claims in the ordinary course of business.  The Company currently is not aware of any such legal proceedings or claims that it belives will have, individually or in the aggregate, a material adverse effect on the business, financial condition, or the results of operations of the Company.

NOTE 3. Net Income per Share

Basic net income per common share is calculated as net income available to common shareholders divided by the weighted average common shares outstanding during the reporting period. Net income available to common shareholders is calculated as net income less accrued dividends and discount accretion related to preferred stock.

Diluted net income per common share is computed similarly to that of basic net income per common share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if all potentially dilutive common shares, principally stock options, were issued during the reporting period utilizing the Treasury stock method. However, when a net loss rather than net income is recognized, diluted earnings per share equals basic earnings per share.

The following is a reconciliation of the calculation of basic and diluted income per share.

| | Three months ended March 31, | |
|---|---|---|
| (In thousands, except per share amounts) | 2011 | 2010 |
| Net income (loss) | $ 220 | $ 748 |
| Less: Preferred stock dividends and discount accretion | 384 | 373 |
| (Loss attributable ) income available to common shareholders | $ (164) | $ 375 |
| Weighted average common shares outstanding - Basic | 7,219 | 7,150 |
| Plus: Potential dilutive common stock equivalents | - | 144 |
| Weighted average common shares outstanding - Diluted | 7,219 | 7,294 |
| Net (loss) income per common share - | | |
| Basic | $ (0.02) | $ 0.05 |
| Diluted | (0.02) | 0.05 |
| Stock options and common stock excluded from the income per share computation as their effect would have been anti-dilutive | 361 | 697 |

The "potential dilutive common stock equivalents" and the "stock options and common stock excluded from the income per share calculation as their effect would have been anti-dilutive" shown in the table above include the impact of 764,778 common stock warrants issued to the U.S. Department of Treasury under the Capital Purchase Program in December 2008. These warrants were dilutive for the three months ended March 31, 2011; however, since there was a loss attributable to common shareholders there are no shares reported as potentially dilutive common stock equivalents in the table above. For the three months ended March 31, 2010 the warrants were anti-dilutive and included in the figure above.

NOTE 4. Income Taxes

The Company follows FASB ASC Topic 740, “Income Taxes,” which prescribes a threshold for the financial statement recognition of income taxes and provides criteria for the measurement of tax positions taken or expected to be taken in a tax return. ASC 740 also includes guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition of income taxes.

The Company did not recognize or accrue any interest or penalties related to income taxes during the three months ended March 31, 2011 and 2010. The Company does not have an accrual for uncertain tax positions as of March 31, 2011 or December 31, 2010, as deductions taken and benefits accrued are based on widely understood administrative practices and procedures and are based on clear and unambiguous tax law. Tax returns for all years 2007 and thereafter are subject to future examination by tax authorities.

NOTE 5. Other Comprehensive Income (Loss)

Changes in Other Comprehensive Income (Loss) for the three months ended March 31, 2011 and 2010:

| (In thousands) | Pre-tax | Tax | After-tax |
|---|---|---|---|
| Net unrealized gains (losses) on securities: | | | |
| Balance at December 31, 2009 | | | $ 5 |
| Unrealized holding gain on securities arising during the period | $ 468 | $ 193 | 275 |
| Less: Reclassification adjustment for gains included in net income | 4 | 1 | 3 |
| Net unrealized gain on securities arising during the period | 464 | 192 | 272 |
| Balance at March 31, 2010 | | | $ 277 |
| | | | |
| Balance at December 31, 2010 | | | $ 423 |
| Unrealized holding gain on securities arising during the period | $446 | $171 | 275 |
| Less: Reclassification adjustment for gains included in net income | 125 | 42 | 83 |
| Net unrealized gain on securities arising during the period | 321 | 129 | 192 |
| Balance at March 31, 2011 | | | $615 |
| | | | |
| Net unrealized gains (losses) on cash flow hedges: | | | |
| Balance at December 31, 2009 | | | $ (466) |
| Unrealized holding gain on cash flow hedges arising during the period | $ 1 | $ - | 1 |
| Balance at March 31, 2010 | | | $ (465) |
| | | | |
| Balance at December 31, 2010 | | | $ (300) |
| Unrealized holding gain on cash flow hedges arising during the period | $ 139 | $ 55 | 84 |
| Balance at March 31, 2011 | | | $ (216) |
| | | | |
| Total Accumulated Other Comprehensive Income at March 31, 2011 | | | $ 399 |

NOTE 6. Fair Value

Fair Value Measurement

The Company follows FASB ASC Topic 820, “Fair Value Measurement and Disclosures,” which requires additional disclosures about the Company’s assets and liabilities that are measured at fair value. Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. Based on these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and/or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Company utilizes techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in valuation techniques, the Company is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed as follows:

Level 1 Inputs

- Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Generally, this includes debt and equity securities and derivative contracts that are traded in an active exchange market (i.e. New York Stock Exchange), as well as certain U.S. Treasury, U.S. Government and sponsored entity agency mortgage-backed securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 Inputs

- Quoted prices for similar assets or liabilities in active markets.
- Quoted prices for identical or similar assets or liabilities in inactive markets.
- Inputs other than quoted prices that are observable, either directly or indirectly, for the term of the asset or liability (i.e., interest rates, yield curves, credit risks, prepayment speeds or volatilities) or "market corroborated inputs."
- Generally, this includes U.S. Government and sponsored entity mortgage-backed securities, corporate debt securities and derivative contracts.

Level 3 Inputs

- Prices or valuation techniques that require inputs that are both unobservable (i.e. supported by little or no market activity) and that are significant to the fair value of the assets or liabilities.
- These assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Fair Value on a Recurring Basis

The following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis:

Securities Available for Sale
The fair value of available for sale ("AFS") securities is the market value based on quoted market prices, when available, or market prices provided by recognized broker dealers (Level 1). If listed prices or quotes are not available, fair value is based upon quoted market prices for similar or identical assets or other observable inputs (Level 2) or externally developed models that use unobservable inputs due to limited or no market activity of the instrument (Level 3).

As of March 31, 2011, the fair value of the Company's AFS securities portfolio was $103.2 million. Approximately 77 percent of the portfolio was made up of residential mortgage-backed securities, which had a fair value of $79.2 million at March 31, 2011. Approximately $69.6 million of the residential mortgage-backed securities are guaranteed by the Government National Mortgage Association ("GNMA"), the Federal National Mortgage Association ("FNMA") or the Federal Home Loan Mortgage Corporation ("FHLMC"). The underlying loans for these securities are residential mortgages that are geographically dispersed throughout the United States. All AFS securities were classified as Level 2 assets at March 31, 2011. The valuation of AFS securities using Level 2 inputs was primarily determined using the market approach, which uses quoted prices for similar assets or liabilities in active markets and all other relevant information. It includes model pricing, defined as valuing securities based upon their relationship with other benchmark securities.

Interest Rate Swap Agreements
Based on the complex nature of interest rate swap agreements, the markets these instruments trade in are not as efficient and are less liquid than that of Level 1 markets. These markets do, however, have comparable, observable inputs in which an alternative pricing source values these assets or liabilities in order to arrive at a fair value. The fair values of our interest swaps are measured based on the difference between the yield on the existing swaps and the yield on current swaps in the market (i.e. The Yield Book); consequently, they are classified as Level 2 instruments.

There were no changes in the inputs or methodologies used to determine fair value during the periods ended March 31, 2011 as compared to the periods ended December 31, 2010 and March 31, 2010. The tables below present the balances of assets and liabilities measured at fair value on a recurring basis as of March 31, 2011 and December 31, 2010.

| | As of March 31, 2011 | | | |
|---|---|---|---|---|
| (In thousands) | Level 1 | Level 2 | Level 3 | Total |
| Financial Assets: | | | | |
| Securities available for sale: | | | | |
| U.S. government sponsored entities | $ - | $ 8,866 | $ - | $ 8,866 |
| State and political subdivisions | - | 11,397 | - | 11,397 |
| Residential mortgage-backed securities | - | 79,186 | - | 79,186 |
| Commercial mortgage-backed securities | - | 1,656 | - | 1,656 |
| Trust preferred securities | - | 561 | - | 561 |
| Other equities | - | 1,572 | - | 1,572 |
| Total securities available for sale | - | 103,238 | - | 103,238 |
| Financial Liabilities: | | | | |
| Interest rate swap agreements | - | 360 | - | 360 |

| | As of December 31, 2010 | | | |
|---|---|---|---|---|
| (In thousands) | Level 1 | Level 2 | Level 3 | Total |
| Financial Assets: | | | | |
| Securities available for sale: | | | | |
| U.S. government sponsored entities | $ - | $ 6,462 | $ - | $ 6,462 |
| State and political subdivisions | - | 10,963 | - | 10,963 |
| Residential mortgage-backed securities | - | 85,741 | - | 85,741 |
| Commercial mortgage-backed securities | - | 1,826 | - | 1,826 |
| Trust preferred securities | - | 565 | - | 565 |
| Other equities | - | 1,574 | - | 1,574 |
| Total securities available for sale | - | 107,131 | - | 107,131 |
| Financial Liabilities: | | | | |
| Interest rate swap agreements | - | 499 | - | 499 |

The changes in Level 2 assets and liabilities measured at fair value on a recurring basis as of March 31, 2011 are summarized as follows:

| | As of March 31, 2011 | |
|---|---|---|
| (In thousands) | Securities Available for Sale | Interest Rate Swap Agreements |
| Beginning balance December 31, 2010 | $ 107,131 | $ 499 |
| Total net gains (losses) included in: | | |
| Net income | 125 | - |
| Other comprehensive income | 321 | (139) |
| Purchases, sales, issuances and settlements, net | 4,339 | - |
| Transfers in and/or out of Level 2 | - | - |
| Ending balance March 31, 2011 | $ 103,238 | $ 360 |

Fair Value on a Nonrecurring Basis

Certain assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following is a description of the valuation methodologies used for instruments measured at fair value on a nonrecurring basis:

Other Real Estate Owned ("OREO")
The fair value was determined using appraisals, which may be discounted based on management's review and changes in market conditions (Level 3 Inputs).

Impaired Collateral-Dependent Loans
The fair value of impaired collateral-dependent loans is derived in accordance with FASB ASC Topic 310, "Receivables." Fair value is determined based on the loan's observable market price or the fair value of the collateral. The valuation allowance for impaired loans is included in the allowance for loan losses in the consolidated balance sheets. At March 31, 2011, the valuation allowance for impaired loans was $2.8 million, an increase of $320 thousand from $2.5 million at December 31, 2010.

The following tables present the assets and liabilities carried on the balance sheet by caption and by level within the hierarchy (as described above) as of March 31, 2011:

| | As of March 31, 2011 | | | | |
|---|---|---|---|---|---|
| (In thousands) | Level 1 | Level 2 | Level 3 | Total | Total fair value gain (loss) during three months ended March 31, 2011 |
| Financial Assets: | | | | | |
| Other real estate owned ("OREO") | $ - | $ - | $ 605 | $ 605 | $ (404) |

| | | | | | |
|---|---|---|---|---|---|
| Impaired collateral-dependent loans | - | - | 11,498 | 11,498 | (320) |

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Fair Value of Financial Instruments

FASB ASC Topic 825, "Financial Instruments," requires the disclosure of the estimated fair value of certain financial instruments, including those financial instruments for which the Company did not elect the fair value option. These estimated fair values as of March 31, 2011 and December 31, 2010 have been determined using available market information and appropriate valuation methodologies. Considerable judgment is required to interpret market data to develop estimates of fair value. The estimates presented are not necessarily indicative of amounts the Company could realize in a current market exchange. The use of alternative market assumptions and estimation methodologies could have had a material effect on these estimates of fair value. The methodology for estimating the fair value of financial assets and liabilities that are measured on a recurring or nonrecurring basis are discussed above. The following methods and assumptions were used to estimate the fair value of other financial instruments for which it is practicable to estimate that value:

Cash and Cash Equivalents
For these short-term instruments, the carrying value is a reasonable estimate of fair value.

Loans
The fair value of loans is estimated by discounting the future cash flows using current market rates that reflect the interest rate risk inherent in the loan, except for previously discussed impaired loans.

SBA loans held for sale
The fair value of SBA loans held for sale is estimated by using a market approach that includes significant other observable inputs.

Federal Home Loan Bank Stock
Federal Home Loan Bank stock is carried at cost. Carrying value approximates fair value based on the redemption provisions of the issues.

Deposit Liabilities
The fair value of demand deposits and savings accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated by discounting the future cash flows using current market rates.

Borrowed Funds & Subordinated Debentures
The fair value of borrowings is estimated by discounting the projected future cash flows using current market rates.

Accrued Interest
The carrying amounts of accrued interest approximate fair value.

Standby Letters of Credit
At March 31, 2011, the Bank had standby letters of credit outstanding of $2.1 million, as compared to $1.5 million at December 31, 2010. The fair value of these commitments is nominal.

The table below presents the estimated fair values of the Company's financial instruments as of March 31, 2011 and December 31, 2010:

| | March 31, 2011 | | December 31, 2010 | |
|---|---|---|---|---|
| (In thousands) | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial assets: | | | | |

| | | | | |
|---|---|---|---|---|
| Cash and cash equivalents | $55,358 | $ 55,358 | $ 43,926 | $ 43,926 |
| Securities available for sale | 103,238 | 103,238 | 107,131 | 107,131 |
| Securities held to maturity | 17,577 | 17,774 | 21,111 | 21,351 |
| SBA loans held for sale | 9,933 | 10,568 | 10,397 | 11,048 |
| Loans, net of allowance for loan losses | 589,314 | 583,408 | 591,175 | 588,519 |
| Federal Home Loan Bank stock | 4,206 | 4,206 | 4,206 | 4,206 |
| SBA servicing assets | 440 | 440 | 512 | 512 |
| Accrued interest receivable | 3,725 | 3,725 | 3,791 | 3,791 |
| Financial liabilities: | | | | |
| Deposits | 656,776 | 635,198 | 654,788 | 634,713 |
| Borrowed funds and subordinated debentures | 90,465 | 103,595 | 90,465 | 103,704 |
| Accrued interest payable | 569 | 569 | 556 | 556 |
| Interest rate swap agreements | 360 | 360 | 499 | 499 |

Note 7.Securities

This table provides the major components of securities available for sale ("AFS") and held to maturity ("HTM") at amortized cost and estimated fair value at March 31, 2011 and December 31, 2010:

| | March 31, 2011 | | | | December 31, 2010 | | | |
|---|---|---|---|---|---|---|---|---|
| (In thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Available for sale: | | | | | | | | |
| US Government sponsored entities | $ 8,839 | $ 59 | $ (32 ) | $ 8,866 | $ 6,415 | $ 47 | $ - | $ 6,462 |
| State and political subdivisions | 11,243 | 199 | (45 ) | 11,397 | 11,246 | 23 | (306 ) | 10,963 |
| Residential mortgage-backed securities | 77,902 | 1,808 | (524 ) | 79,186 | 84,359 | 2,022 | (640 ) | 85,741 |
| Commercial mortgage-backed securities | 1,649 | 12 | (5 ) | 1,656 | 1,827 | 3 | (4 ) | 1,826 |
| Trust preferred securities | 978 | - | (417 ) | 561 | 977 | - | (412 ) | 565 |
| Other securities | 1,610 | 3 | (41 ) | 1,572 | 1,610 | - | (36 ) | 1,574 |
| Total securities available for sale | $ 102,221 | $ 2,081 | $ (1,064 ) | $ 103,238 | $ 106,434 | $ 2,095 | $ (1,398 ) | $ 107,131 |
| Held to maturity: | | | | | | | | |
| State and political subdivisions | $ 2,297 | $ 2 | $ (9 ) | $ 2,290 | $ 2,297 | $ - | $ (66 ) | $ 2,231 |
| Residential mortgage-backed securities | 11,965 | 374 | (292 ) | 12,047 | 14,722 | 444 | (318 ) | 14,848 |
| Commercial mortgage-backed securities | 3,265 | 160 | - | 3,425 | 4,042 | 217 | - | 4,259 |
| Trust preferred securities | 50 | - | (38 ) | 12 | 50 | - | (37 ) | 13 |
| Total securities held to maturity | $ 17,577 | $ 536 | $ (339 ) | $ 17,774 | $ 21,111 | $ 661 | $ (421 ) | $ 21,351 |

This table provides the remaining contractual maturities and yields of securities within the investment portfolios. The carrying value of securities at March 31, 2011 is primarily distributed by contractual maturity. Mortgage-backed securities and other securities, which may have principal prepayment provisions, are distributed based on contractual maturity. Expected maturities will differ materially from contractual maturities as a result of early prepayments and calls. The total weighted average yield excludes equity securities.

| | Within one year | After one year | After five years | After ten years | Total carrying value |
|---|---|---|---|---|---|

| | | | through five years | | through ten years | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| (In thousands) | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| Available for sale at fair value: | | | | | | | | | | |
| US Government sponsored entities | $- | - % | $865 | 2.32 % | $5,093 | 2.62 % | $2,908 | 4.30 % | $8,866 | 3.15 % |
| State and political subdivisions | - | - | 170 | 6.50 | 3,677 | 3.11 | 7,550 | 3.84 | 11,397 | 3.64 |
| Residential mortgage-backed securities | - | - | 787 | 3.10 | 6,327 | 0.78 | 72,072 | 3.48 | 79,186 | 3.55 |
| Commercial mortgage-backed securities | - | - | - | - | - | - | 1,656 | 6.09 | 1,656 | 6.09 |
| Trust preferred securities | - | - | - | - | - | - | 561 | 1.08 | 561 | 1.08 |
| Other securities | - | - | - | - | - | - | 1,572 | 3.44 | 1,572 | 3.44 |
| Total securities available for sale | $- | - % | $1,822 | 3.05 % | $15,097 | 1.97 % | $86,319 | 3.58 % | $103,238 | 3.55 % |
| | | | | | | | | | | |
| Held to maturity at cost: | | | | | | | | | | |
| State and political subdivisions | $- | - % | $- | - % | $- | - % | $2,297 | 5.15 % | $2,297 | 5.15 % |
| Residential mortgage-backed securities | - | - | 423 | 4.25 | 3,367 | 4.75 | 8,175 | 4.75 | 11,965 | 4.73 |
| Commercial mortgage-backed securities | - | - | - | - | - | - | 3,265 | 10.14 | 3,265 | 10.14 |
| Trust preferred securities | - | - | - | - | - | - | 50 | - | 50 | - |
| Total securities held to maturity | $- | - % | $423 | 4.25 % | $3,367 | 4.75 % | $13,787 | 6.08 % | $17,577 | 5.78 % |

The fair value of securities with unrealized losses by length of time that the individual securities have been in a continuous unrealized loss position at March 31, 2011 and December 31, 2010 are as follows:

| | | March 31, 2011 | | | | | |
|---|---|---|---|---|---|---|---|
| | | Less than 12 months | | 12 months and greater | | Total | |
| (In thousands) | Total Number in a Loss Position | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss |
| Available for sale: | | | | | | | |
| U.S. Government sponsored entities | 2 | $1,469 | $(32) | $- | $- | $1,469 | $(32) |
| State and political subdivisions | 8 | 2,586 | (45) | - | - | 2,586 | (45) |
| Residential mortgage-backed securities | 17 | 15,417 | (325) | 2,916 | (199) | 18,333 | (524) |
| Commercial mortgage-backed securities | 1 | - | - | 1,344 | (5) | 1,344 | (5) |
| Trust preferred securities | 1 | - | - | 561 | (417) | 561 | (417) |
| Other equities | 3 | - | - | 1,019 | (41) | 1,019 | (41) |
| Total temporarily impaired investments | 32 | $19,472 | $(402) | $5,840 | $(662) | $25,312 | $(1,064) |
| Held to maturity: | | | | | | | |
| State and political subdivisions | 3 | $1,803 | $(9) | $- | $- | $1,803 | $(9) |
| Residential mortgage-backed securities | 6 | 2,783 | (75) | 2,449 | (217) | 5,232 | (292) |
| Trust preferred securities | 2 | - | - | 13 | (38) | 12 | (38) |
| Total temporarily impaired investments | 11 | $4,586 | $(84) | $2,462 | $(255) | $7,047 | $(339) |

| | | December 31, 2010 | | | | | |
|---|---|---|---|---|---|---|---|
| | | Less than 12 months | | 12 months and greater | | Total | |
| (In thousands) | Total Number in a Loss Position | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss |
| Available for sale: | | | | | | | |
| State and political subdivisions | 31 | $ 9,051 | $ (306) | $ - | $ - | $ 9,051 | $ (306) |
| Residential mortgage-backed securities | 17 | 14,651 | (422) | 3,547 | (218) | 18,198 | (640) |
| | 1 | - | - | 1,516 | (4) | 1,516 | (4) |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Commercial mortgage-backed securities | | | | | | | |
| Trust preferred securities | 1 | - | - | 565 | (412 ) | 565 | (412 ) |
| Other equities | 4 | - | - | 1,074 | (36 ) | 1,074 | (36 ) |
| Total temporarily impaired investments | 54 | $ 23,702 | $ (728 ) | $ 6,702 | $ (670 ) | $ 30,404 | $ (1,398 ) |
| Held to maturity: | | | | | | | |
| State and political subdivisions | 4 | $ 2,231 | $ (66 ) | $ - | $ - | $ 2,231 | $ (66 ) |
| Residential mortgage-backed securities | 5 | 2,243 | (75 ) | 2,651 | (243 ) | 4,894 | (318 ) |
| Trust preferred securities | 2 | - | - | 13 | (37 ) | 13 | (37 ) |
| Total temporarily impaired investments | 11 | $ 4,474 | $ (141 ) | $ 2,664 | $ (280 ) | $ 7,138 | $ (421 ) |

Unrealized Losses

The unrealized losses in each of the categories presented in the tables above are discussed in the paragraphs that follow:

U.S. Government sponsored entities and state and political subdivision securities: The unrealized losses on investments in this type of security were caused by the increase in interest rate spreads. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the par value of the investment. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be at maturity, the Company does not consider these investments to be other-than-temporarily impaired as of March 31, 2011.

Residential and commercial mortgage-backed securities: The unrealized losses on investments in mortgage-backed securities were caused by interest rate increases. The majority of contractual cash flows of these securities are guaranteed by Fannie Mae, Ginnie Mae and the Federal Home Loan Mortgage Corporation. It is expected that the securities would not be settled at a price significantly less than the par value of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be at maturity, the Company does not consider these investments to be other-than-temporarily impaired as of March 31, 2011.

Trust preferred securities: The unrealized losses on trust preferred securities were caused by an inactive trading market and changes in market credit spreads. At March 31, 2011, this category consisted of one single-issuer trust preferred security. The issuer of the trust preferred security is considered a well capitalized institution per regulatory standards and significantly strengthened its capital position. In addition, the issuer has ample liquidity, bolstered its allowance for loan losses, was profitable in 2010 and is projected to be profitable in 2011. The contractual terms do not allow the security to be settled at a price less than the par value. Because 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, which may be at maturity, the Company does not consider this security to be other-than-temporarily impaired as of March 31, 2011.

Other securities: Included in this category is stock of other financial institutions and Community Reinvestment Act ("CRA") investments.  The unrealized losses on other securities are caused by decreases in the market prices of the shares.  The Company has evaluated the prospects of the issuer and has forecasted a recovery period; therefore these investments are not considered other-than-temporarily impaired as of March 31, 2011.

Realized Gains and Losses and Other-Than-Temporary Impairment

Gross realized gains (losses) on securities and other-than-temporary impairment charges for the three months ended March 31, 2011 and 2010 are detailed in the table below:

| (In thousands) | For the three months ended March 31, 2011 | 2010 |
|---|---|---|
| Available for sale: | | |
| Realized gains | $126 | $244 |
| Realized losses | (1) | (150) |
| Other-than-temporary impairment charges | - | - |
| Total securities available for sale | $125 | $94 |
| | | |
| Held to maturity: | | |
| Realized gains | $ - | $- |
| Realized losses | - | (90) |
| Other-than-temporary impairment charges | - | - |
| Total securities held to maturity | $- | $(90) |
| | | |
| Net gains on sales of securities and other-than-temporary impairment charges | $125 | $4 |

The net realized gains and losses are included in noninterest income in the Consolidated Statements of Operations as net securities gains. For the three months ended March 31, 2011 and 2010, gross realized gains on sales of securities amounted to $126 thousand and $244 thousand, respectively, and gross realized losses were $1 thousand and $150 thousand, respectively. The gross gains during the three months ending March 31, 2011 are primarily attributed to the Company selling approximately $5 million in book value of mortgage-backed securities, resulting in pretax gains of approximately $126 thousand. These gains were partially offset by losses of $1 thousand on the sale of approximately $30 thousand in book value of two mortgage-backed securities. The gross gains of $244 thousand in the first three months of 2010 are primarily attributed to the Company selling approximately $6.4 million in book value of mortgage-backed securities, resulting in pretax gains of approximately $241 thousand on the sales and one called structured agency security with a resulting gain of $3 thousand. These gains were partially offset by losses of $150 thousand on the sale of two mortgage backed securities and losses of $90 thousand on the sale of five held to maturity tax-exempt municipal securities with a total book value of $2.0 million Although designated as held to maturity, these municipal securities were sold due to the deterioration in the issuer's creditworthiness, as evidenced by downgrades in their credit ratings.

Pledged Securities

Securities with a carrying value of $76.2 million and $67.7 million at March 31, 2011 and 2010, respectively, were pledged to secure Government deposits, secure other borrowings and for other purposes required or permitted by law. Included in these figures was $21.4 million and $3 million pledged against Government deposits at March 31, 2011 and 2010.

Note 8.Allowance for Loan Losses & Unfunded Loan Commitments

Management reviews the level of the allowance for loan losses on a quarterly basis. The standardized methodology used to assess the adequacy of the allowance includes the allocation of specific and general reserves. The same standard methodology is used, regardless of loan type. Specific reserves are made to individual impaired loans, (see Note 1 for additional information on this term). The general reserve is set based upon a representative average historical net charge-off rate adjusted for certain environmental factors such as: delinquency and impairment trends, charge-off and recovery trends, volume and loan term trends, risk and underwriting policy trends, staffing and experience changes, national and local economic trends, industry conditions and credit concentration changes.

Beginning in the third quarter of 2009, when calculating the five-year historical net charge-off rate, the Company weights the past three years more heavily due to the higher amount of charge-offs experienced during those years. All of the environmental factors are ranked and assigned a basis points value based on the following scale: low, low moderate, moderate, high moderate, and high risk. The factors are evaluated separately for each type of loan. For example, commercial loans are broken down further into commercial loans, commercial real estate loans, and commercial construction loans. Each type of loan is risk weighted for each environmental factor based on its individual characteristics.

For SBA 7(a), SBA 504 and commercial loans, the estimate of loss based on pools of loans with similar characteristics is made through the use of a standardized loan grading system that is applied on an individual loan level and updated on a continuous basis. The loan grading system incorporates reviews of the financial performance of the borrower, including cash flow, debt-service coverage ratio, earnings power, debt level and equity position, in conjunction with an assessment of the borrower's industry and future prospects. It also incorporates analysis of the type of collateral and the relative loan to value ratio.

For residential mortgage and consumer loans, the estimate of loss is based on pools of loans with similar characteristics. Factors such as credit score, delinquency status and type of collateral are evaluated. Factors are updated frequently to capture the recent behavioral characteristics of the subject portfolios, as well as any changes in loss mitigation or credit origination strategies, and adjustments to the reserve factors are made as needed.

According to the Company’s policy, a loss (“charge-off”) is to be recognized and charged to the allowance for loan losses as soon as a loan is recognized as uncollectable. All credits which are 90 days past due must be analyzed for the Company’s ability to collect on the credit. Once a loss is known to exist, the charge-off approval process is immediately expedited. This charge-off policy is followed for all loan types.

An analysis of the change in the allowance for loan losses for the three months ended March 31, 2011 and 2010 is presented in the table below. The allocated allowance is the total of identified specific and general reserves by loan category. The allocation is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any segment of the portfolio.

| For the three months ended March 31, 2011 | | | | | | | |
|---|---|---|---|---|---|---|---|
| (In thousands) | SBA | SBA 504 | Commercial | Residential | Consumer | Unallocated | Total |
| Allowance for credit losses: | | | | | | | |
| Beginning balance | $ 4,198 | $ 1,551 | $ 6,011 | $ 1,679 | $ 586 | $ 339 | $ 14,364 |
| Charge-offs | (711 ) | - | (848 ) | (142 ) | - | - | (1,701 ) |
| Recoveries | 8 | - | 98 | 4 | 2 | - | 112 |
| Net charge-offs | (703 ) | - | (750 ) | (138 ) | 2 | - | (1,589 ) |
| Provision for loan losses charged to expense | 759 | 71 | 1,524 | 258 | (61 ) | (51 ) | 2,500 |
| Ending balance | $ 4,254 | $ 1,622 | $ 6,785 | $ 1,799 | $ 527 | $ 288 | $ 15,275 |
| | | | | | | | |
| Ending balance: | | | | | | | |
| Individually evaluated for impairment | $ 1,421 | $ 85 | $ 1,271 | $ - | $ - | $ - | $ 2,777 |
| Collectively evaluated for impairment | 2,833 | 1,537 | 5,514 | 1,799 | 527 | 288 | 12,498 |
| Totals | $ 4,254 | $ 1,622 | $ 6,785 | $ 1,799 | $ 527 | $ 288 | $ 15,275 |
| | | | | | | | |
| Loan ending balances: | | | | | | | |
| Individually evaluated for impairment | $ 6,474 | $ 9,521 | $ 16,491 | $ - | $ - | $ - | $ 32,486 |
| Collectively evaluated for impairment | 78,116 | 50,571 | 266,644 | 132,512 | 54,193 | - | 582,036 |
| Total ending balance | $ 84,590 | $ 60,092 | $ 283,135 | $ 132,512 | $ 54,193 | $ - | $ 614,522 |

| For the three months ended March 31, 2010 | |
|---|---|
| Allowance for credit losses: | |
| Beginning balance | $ 13,842 |
| Charge-offs | (1,335 ) |
| Recoveries | 48 |
| Net charge-offs | (1,287 ) |
| Provision for loan losses charged to expense | 1,500 |

| | |
|---|---|
| Ending balance | $14,055 |

In addition to the allowance for loan losses, the Company maintains an allowance for unfunded loan commitments that is maintained at a level that management believes is adequate to absorb estimated probable losses. Adjustments to the allowance are made through other expense and applied to the allowance which is maintained in other liabilities. At March 31, 2011 and December 31, 2010, a $65 thousand commitment reserve was reported on the balance sheet as an "other liability".

Credit Risk: Inherent in the lending function is credit risk, which is the possibility a borrower may not perform in accordance with the contractual terms of their loan. A borrower's inability to pay their obligations according to the contractual terms can create the risk of past due loans and, ultimately, credit losses, especially on collateral deficient loans. The Company minimizes its credit risk by loan diversification and adhering to credit administration policies and procedures. Due diligence on loans begins when we initiate contact regarding a loan with a borrower. Documentation, including a borrower's credit history, materials establishing the value and liquidity of potential collateral, the purpose of the loan, the source of funds for repayment of the loan, and other factors, are analyzed before a loan is submitted for approval. The loan portfolio is then subject to on-going internal reviews for credit quality, as well as independent credit reviews by an outside firm.

For SBA 7(a), SBA 504 and commercial loans, management uses internally assigned risk ratings as the best indicator of credit quality. A loan's internal risk rating is updated at least annually and more frequently if circumstances warrant a change in risk rating. The Company uses a 1 through 10 loan grading system that follows regulatory accepted definitions.

- Risk ratings of 1 through 6 are used for loans that are performing, as they meet, and are expected to continue to meet, all of the terms and conditions set forth in the original loan documentation, and are generally current on principal and interest payments. These performing loans are termed "Pass".
- Criticized loans are assigned a risk rating of 7 and termed "Special Mention", as the borrowers exhibit potential credit weaknesses or downward trends deserving management's close attention. If not checked or corrected, these trends will weaken the Bank's collateral and position. While potentially weak, these borrowers are currently marginally acceptable and no loss of interest or principal is anticipated. As a result, special mention assets do not expose an institution to sufficient risk to warrant adverse classification. Included in "Special Mention" could be turnaround situations, such as borrowers with deteriorating trends beyond one year, borrowers in start up or deteriorating industries, or borrowers with a poor market share in an average industry. "Special Mention" loans may include an element of asset quality, financial flexibility, or management below average. Management and ownership may have limited depth or experience. Regulatory agencies have agreed on a consistent definition of "Special Mention" as an asset with potential weaknesses which, if left uncorrected, may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. This definition is intended to ensure that the "Special Mention" category is not used to identify assets that have as their sole weakness credit data exceptions or collateral documentation exceptions that are not material to the repayment of the asset.
- Classified loans are assigned a risk rating of an 8 or 9, depending upon the prospect for collection, and deemed "Substandard". A risk rating of 8 is used for borrowers with well-defined weaknesses that jeopardize the orderly liquidation of debt. The loan is inadequately protected by the current sound worth and paying capacity of the obligor or by the collateral pledged, if any. Normal repayment from the borrower is in jeopardy, although no loss of principal is envisioned. There is a distinct possibility that a partial loss of interest and/or principal will occur if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified "Substandard". A risk rating of 9 is used for borrowers that have all the weaknesses inherent in a loan with a risk rating of 8, with the added characteristic that the weaknesses make collection of debt in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Serious problems exist to the point where partial loss of principal is likely. The possibility of loss is extremely high, but because of certain important, reasonably specific pending factors that may work to strengthen the assets, the loans' classification as estimated losses is deferred until a more exact status may be

determined.  Pending factors include proposed merger, acquisition, or liquidation procedures; capital injection; perfecting liens on additional collateral; and refinancing plans.  Partial charge-offs are likely.

- Once a borrower is deemed incapable of repayment of unsecured debt, the risk rating becomes a 10, the loan is termed a “Loss”, and charged-off immediately.  Loans to such borrowers are considered uncollectible and of such little value that continuance as active assets of the Bank is not warranted.  This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off these basically worthless assets even though partial recovery may be affected in the future.

For residential mortgage and consumer loans,management uses performing versus nonperforming as the best indicator of credit quality. Nonperforming loans consist of loans that are not accruing interest (nonaccrual loans) as a result of principal or interest being in default for a period of 90 days or more or when the ability to collect principal and interest according to the contractual terms is in doubt. These credit quality indicators are updated on an ongoing basis, as a loan is placed on nonaccrual status as soon as management believes there is sufficient doubt as to the ultimate ability to collect interest on a loan.

The tables below detail the Company's loans by class according to their credit quality indicators discussed in the paragraphs above as of March 31, 2011 and December 31, 2010:

| | March 31, 2011 | | | |
|---|---|---|---|---|
| | SBA, SBA 504 & Commercial Loans - Internal Risk Ratings | | | |
| (In thousands) | Pass | Special Mention | Substandard | Total |
| SBA loans | $48,383 | $21,863 | $ 14,344 | $84,590 |
| SBA 504 loans | 31,663 | 13,821 | 14,608 | 60,092 |
| Commercial loans | | | | |
| Commercial other | 17,971 | 4,586 | 1,983 | 24,540 |
| Commercial real estate | 178,783 | 60,942 | 9,061 | 248,786 |
| Commercial real estate construction | 6,735 | 2,190 | 884 | 9,809 |
| Total commercial loans | 203,489 | 67,718 | 11,928 | 283,135 |
| Total SBA, SBA 504 and Commercial loans | $283,535 | $103,402 | $ 40,880 | $427,817 |

| | March 31, 2011 | | |
|---|---|---|---|
| | Residential Mortgage & Consumer Loans - Performing/Nonperforming | | |
| (In thousands) | Performing | Nonperforming | Total |
| Residential mortgage loans | | | |
| Residential mortgages | $119,588 | $ 2,292 | $121,880 |
| Residential construction | 2,247 | - | 2,247 |
| Purchased residential mortgages | 6,268 | 2,117 | 8,385 |
| Total residential mortgage loans | $128,103 | 4,409 | $132,512 |
| Consumer loans | | | |
| Home equity | $52,502 | $ 405 | $52,907 |
| Consumer other | 1,285 | 1 | 1,286 |
| Total consumer loans | $53,787 | $ 406 | $54,193 |
| Total loans | | | $614,522 |

| | December 31, 2010 | | | |
|---|---|---|---|---|
| | SBA, SBA 504 & Commercial Loans - Internal Risk Ratings | | | |
| (In thousands) | Pass | Special Mention | Substandard | Total |
| SBA loans | $ 48,500 | $ 25,668 | $ 11,970 | $ 86,138 |
| SBA 504 loans | 30,235 | 15,366 | 18,675 | 64,276 |

| | | | | |
|---|---|---|---|---|
| Commercial loans | | | | |
| Commercial other | 17,402 | 4,764 | 2,102 | 24,268 |
| Commercial real estate | 169,093 | 67,305 | 10,493 | 246,891 |
| Commercial real estate construction | 6,197 | 2,715 | 1,134 | 10,046 |
| Total commercial loans | 192,692 | 74,784 | 13,729 | 281,205 |
| Total SBA, SBA 504 and Commercial loans | $ 271,427 | $ 115,818 | $ 44,374 | $ 431,619 |

| | December 31, 2010 | | |
|---|---|---|---|
| | Residential Mortgage & Consumer Loans - Performing/Nonperforming | | |
| (In thousands) | Performing | Nonperforming | Total |
| Residential mortgage loans | | | |
| Residential mortgages | $114,716 | $ 2,453 | $117,169 |
| Residential construction | 2,711 | - | 2,711 |
| Purchased residential mortgages | 5,888 | 2,632 | 8,520 |
| Total residential mortgage loans | $123,315 | $ 5,085 | $128,400 |
| Consumer loans | | | |
| Home equity | $54,024 | $ 249 | $54,273 |
| Consumer other | 1,644 | - | 1,644 |
| Total consumer loans | $55,668 | $ 249 | $55,917 |
| Total loans | | | $615,936 |

Nonperforming and past due loans: Nonperforming loans consist of loans that are not accruing interest (nonaccrual loans) as a result of principal or interest being in default for a period of 90 days or more or when the ability to collect principal and interest according to the contractual terms is in doubt. When a loan is classified as nonaccrual, interest accruals discontinue and all past due interest previously recognized as income is reversed and charged against current period income. Generally, until the loan becomes current, any payments received from the borrower are applied to outstanding principal, until such time as management determines that the financial condition of the borrower and other factors merit recognition of a portion of such payments as interest income. Loans past due 90 days or more and still accruing interest are not included in nonperforming loans. Loans past due 90 days or more generally represent loans that are well collateralized and in a continuing process that is expected to result in repayment or restoration to current status.

The risk of loss is difficult to quantify and is subject to fluctuations in collateral values, general economic conditions and other factors. The current state of the economy and the downturn in the real estate market have resulted in increased loan delinquencies and defaults. In some cases, these factors have also resulted in significant impairment to the value of loan collateral. The Company values its collateral through the use of appraisals, broker price opinions, and knowledge of its local market. In response to the credit risk in its portfolio, the Company has increased staffing in its credit monitoring department and increased efforts in the collection and analysis of borrowers' financial statements and tax returns.

The following tables set forth an aging analysis of past due and nonaccrual loans as of March 31, 2011 and December 31, 2010:

| | March 31, 2011 | | | | | | |
|---|---|---|---|---|---|---|---|
| (In thousands) | 30-59 Days Past Due | 60-89 Days Past Due | 90+ Days and Still Accruing | Nonaccrual | Total Past Due | Current | Total Loans |
| SBA loans | $5,187 | $- | $299 | $9,057 | $14,543 | $70,047 | $84,590 |
| SBA 504 loans | 5,264 | - | 1,339 | 4,300 | 10,903 | 49,189 | 60,092 |
| Commercial loans | | | | | | | |
| Commercial other | - | 151 | 591 | 185 | 927 | 23,613 | 24,540 |
| Commercial real estate | 6,744 | 85 | 533 | 4,682 | 12,044 | 236,742 | 248,786 |
| Commercial real estate construction | - | - | - | 884 | 884 | 8,925 | 9,809 |
| Residential mortgage loans | | | | | | | |
| Residential mortgages | 953 | 1,879 | 1,059 | 2,292 | 6,183 | 115,697 | 121,880 |
| Residential construction | 47 | - | - | - | 47 | 2,200 | 2,247 |
| Purchased residential mortgages | 31 | - | 427 | 2,117 | 2,575 | 5,810 | 8,385 |
| Consumer loans | | | | | | | |
| Home equity | 511 | 48 | - | 405 | 964 | 51,943 | 52,907 |
| Consumer other | - | - | - | 1 | 1 | 1,285 | 1,286 |
| Total loans | $18,737 | $2,163 | $4,248 | $23,923 | $49,071 | $565,451 | $614,522 |

December 31, 2010

| (In thousands) | 30-59 Days Past Due | 60-89 Days Past Due | 90+ Days and Still Accruing | Nonaccrual | Total Past Due | Current | Total Loans |
|---|---|---|---|---|---|---|---|
| SBA loans | $1,297 | $1,181 | $374 | $8,162 | $11,014 | $75,124 | $86,138 |
| SBA 504 loans | - | 1,339 | - | 2,714 | 4,053 | 60,223 | 64,276 |
| Commercial loans | | | | | | | |
| Commercial other | 693 | 86 | - | 179 | 958 | 23,310 | 24,268 |
| Commercial real estate | 3,051 | 176 | - | 4,139 | 7,366 | 239,525 | 246,891 |
| Commercial real estate contruction | - | - | - | 1,134 | 1,134 | 8,912 | 10,046 |
| Residential mortgage loans | | | | | | | |
| Residential mortgages | 2,123 | 144 | - | 2,453 | 4,720 | 112,449 | 117,169 |
| Residential construction | - | - | - | - | - | 2,711 | 2,711 |
| Purchased residential mortgages | 117 | - | - | 2,632 | 2,749 | 5,771 | 8,520 |
| Cosumer loans | | | | | | | |
| Home equity | 175 | 325 | - | 249 | 749 | 53,524 | 54,273 |
| Consumer other | 5 | - | - | - | 5 | 1,639 | 1,644 |
| Total loans | $7,461 | $3,251 | $374 | $21,662 | $32,748 | $583,188 | $615,936 |

Impaired Loans: The Company has defined impaired loans to be all nonperforming loans and troubled debt restructurings.  Impairment is evaluated in total for smaller-balance loans of a similar nature, (consumer and residential mortgage loans), and on an individual basis for other loans.  Troubled debt restructurings (“TDRs”) occur when a creditor, for economic or legal reasons related to a debtor’s financial condition, grants a concession to the debtor that it would not otherwise consider, such as a below market interest rate, extending the maturity of a loan, or a combination of both.  At March 31, 2011, there were eighteen loans totaling $17.4 million that were classified as TDRs by the Company and are deemed impaired, compared to fifteen such loans totaling $14.1 million at December 31, 2010.  There was one TDR for $265 thousand which is included in the nonperforming loan figures listed above.  The remaining TDRs are not included in the nonperforming loan figures, as they continue to perform under their modified terms.

The following tables provide detail on the Company's impaired loans as of March 31, 2011 and December 31, 2010:

| | March 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| (In thousands) | Recorded Investment (Balance less specific reserves) | Outstanding Principal Balance | Related Allowance | Average Recorded Investment | Year to Date Lost Interest on Impaired Loans | Year to Date Interest Income Collected on Impaired Loans |
| With no related allowance: | | | | | | |
| SBA loans(1) | $2,226 | $2,226 | $- | | | |
| SBA 504 loans | 7,046 | 7,046 | - | | | |
| Commercial loans | | | | | | |
| Commercial other | 177 | 177 | - | | | |
| Commercial real estate | 13,374 | 13,374 | - | | | |
| Total commercial loans | 13,551 | 13,551 | - | | | |
| Total impaired loans with no related allowance | $22,823 | $22,823 | $- | | | |
| | | | | | | |
| With an allowance: | | | | | | |
| SBA loans(1) | $2,827 | $4,248 | $1,421 | | | |
| SBA 504 loans | 2,390 | 2,475 | 85 | | | |
| Commercial loans | | | | | | |
| Commercial other | 61 | 993 | 932 | | | |
| Commercial real estate | 857 | 1,063 | 206 | | | |
| Commercial real estate construction | 751 | 884 | 133 | | | |
| Total commercial loans | 1,669 | 2,940 | 1,271 | | | |
| Total impaired loans with a related allowance | $6,886 | $9,663 | $2,777 | | | |
| | | | | | | |
| Total individually evaluated impaired loans: | | | | | | |
| SBA loans(1) | $5,053 | $6,474 | $1,421 | $6,872 | $119 | $23 |
| SBA 504 loans | 9,436 | 9,521 | 85 | 8,487 | 78 | - |
| Commercial loans | | | | | | |
| Commercial other | 238 | 1,170 | 932 | 509 | 4 | - |
| Commercial real estate | 14,231 | 14,437 | 206 | 10,731 | 101 | 20 |
| Commercial real estate construction | 751 | 884 | 133 | 1,051 | 32 | - |
| Total commercial loans | 15,220 | 16,491 | 1,271 | 12,291 | 137 | 20 |
| Total individually evaluated impaired loans | $29,709 | $32,486 | $2,777 | $27,650 | $334 | $43 |
| | | | | | | |
| Homogeneous loans collectively evaluated for impairment: | | | | | | |
| Residential mortgage loans | | | | | | |
| Residential mortgages | $2,292 | $2,292 | $- | $2,217 | $38 | $- |
| Purchased mortgages | 2,117 | 2,117 | - | 2,143 | 32 | - |
| Total residential mortgage loans | 4,409 | 4,409 | - | 4,360 | 70 | - |

| | | | | | | |
|---|---|---|---|---|---|---|
| Consumer loans | | | | | | |
| Home equity | 405 | 405 | - | 228 | - | 4 |
| Consumer Other | 1 | | | | | |