

ACCESS NATIONAL CORP  
Form 10-Q  
May 14, 2012

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended March 31, 2012

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: 000-49929**

**ACCESS NATIONAL CORPORATION**

(Exact name of registrant as specified in its charter)

**Virginia**

**82-0545425**

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(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

**1800 Robert Fulton Drive, Suite 300, Reston, Virginia 20191**

(Address of principal executive offices) (Zip Code)

**(703) 871-2100**

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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  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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

The number of shares outstanding of Access National Corporation's common stock, par value \$0.835, as of May 10, 2012 was 10,232,961 shares.

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**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements**

## ACCESS NATIONAL CORPORATION

## Consolidated Balance Sheets

(In Thousands, Except for Share and Per Share Data)

	March 31, 2012 (Unaudited)	December 31, 2011
<b>ASSETS</b>		
Cash and due from banks	\$ 6,769	\$ 5,362
Interest-bearing deposits in other banks and federal funds sold	30,009	38,547
Securities:		
Securities available-for-sale, at fair value	38,209	45,837
Securities held-to-maturity, at amortized cost (fair value of \$64,802 and \$39,978)	64,950	39,987
Total investment securities	103,159	85,824
Restricted stock	3,665	3,665
Loans held for sale, at fair value	75,552	95,126
Loans	573,315	569,400
Allowance for loan losses	(11,941 )	(11,738 )
Net loans	561,374	557,662
Premises and equipment	8,584	8,671
Accrued interest receivable	4,787	6,071
Other assets	10,856	8,830
Total assets	\$ 804,755	\$ 809,758
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Deposits</b>		
Noninterest-bearing deposits	\$ 136,895	\$ 113,885
Savings and interest-bearing deposits	193,396	182,005
Time deposits	336,934	349,123
Total deposits	667,225	645,013
<b>Other liabilities</b>		
Short-term borrowings	32,343	59,904
Long-term borrowings	3,268	4,821
Subordinated debentures	6,186	6,186
Other liabilities and accrued expenses	10,126	11,019
Total liabilities	\$ 719,148	\$ 726,943
<b>SHAREHOLDERS' EQUITY</b>		

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Common stock, par value, \$0.835; authorized, 60,000,000 shares; issued and outstanding, 10,228,761 shares at March 31, 2012 and 10,192,649 shares at December 31, 2011	\$ 8,541	\$8,511
Additional paid in capital	16,613	16,716
Retained earnings	60,434	57,529
Accumulated other comprehensive income, net	19	59
Total shareholders' equity	85,607	82,815
Total liabilities and shareholders' equity	\$ 804,755	\$809,758

See accompanying notes to consolidated financial statements (Unaudited).

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ACCESS NATIONAL CORPORATION  
Consolidated Statements of Income  
(In Thousands, Except for Share and Per Share Data)  
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
<b>Interest and Dividend Income</b>		
Interest and fees on loans	\$8,671	\$7,882
Interest on deposits in other banks	31	55
Interest and dividends on securities	649	633
Total interest and dividend income	9,351	8,570
<b>Interest Expense</b>		
Interest on deposits	1,273	1,511
Interest on short-term borrowings	112	377
Interest on long-term borrowings	41	62
Interest on subordinated debentures	57	53
Total interest expense	1,483	2,003
Net interest income	7,868	6,567
Provision for loan losses	718	223
Net interest income after provision for loan losses	7,150	6,344
<b>Noninterest Income</b>		
Service fees on deposit accounts	177	173
Gain on sale of loans	10,944	5,516
Mortgage broker fee income	7	336
Other income	973	(186 )
Total noninterest income	12,101	5,839
<b>Noninterest Expense</b>		
Salaries and employee benefits	8,335	5,393
Occupancy and equipment	651	665
Other operating expenses	4,778	2,573
Total noninterest expense	13,764	8,631
Income before income taxes	5,487	3,552
Income tax expense	2,050	1,265
NET INCOME	\$3,437	\$2,287
<b>Earnings per common share:</b>		
Basic	\$0.34	\$0.22
Diluted	\$0.33	\$0.22



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Average outstanding shares:

Basic	10,200,656	10,359,386
Diluted	10,312,845	10,404,677

See accompanying notes to consolidated financial statements (Unaudited).

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ACCESS NATIONAL CORPORATION  
 Consolidated Statements of Comprehensive Income  
 (In Thousands)  
 (Unaudited)

	Three Months Ended March 31,	
	2012	2011
Net income	\$3,437	\$2,287
Other comprehensive income:		
Unrealized gains (losses) on securities		
Unrealized holding (losses) gains arising during period	(61 )	717
Tax effect	21	(243 )
Net of tax amount	(40 )	474
Comprehensive income	\$3,397	\$2,761

See accompanying notes to consolidated financial statements (Unaudited).

## ACCESS NATIONAL CORPORATION

## Consolidated Statements of Changes in Shareholders' Equity

(In Thousands, Except for Share Data)

(Unaudited)

	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Compre- hensive Income (Loss)	Total
Balance, December 31, 2011	\$ 8,511	\$ 16,716	\$ 57,529	\$ 59	\$ 82,815
Net income	-	-	3,437	-	3,437
Other comprehensive income	-	-	-	(40 )	(40 )
Stock option exercises (110,412 shares)	92	539	-	-	631
Repurchased under share repurchase program (74,300 shares)	(62 )	(708 )	-	-	(770 )
Cash dividend	-	-	(532 )	-	(532 )
Stock-based compensation expense recognized in earnings	-	66	-	-	66
Balance, March 31, 2012	\$ 8,541	\$ 16,613	\$ 60,434	\$ 19	\$ 85,607
Balance, December 31, 2010	\$ 8,664	\$ 17,794	\$ 47,530	\$ (1,795 )	\$ 72,193
Net income	-	-	2,287	-	2,287
Other comprehensive income	-	-	-	474	474
Stock option exercises (0 shares)	-	-	-	-	-
Repurchased under share repurchase program (45,661 shares)	(38 )	(282 )	-	-	(320 )
Cash dividend	-	-	(222 )	-	(222 )
Stock-based compensation expense recognized in earnings	-	60	-	-	60
Balance, March 31, 2011	\$ 8,626	\$ 17,572	\$ 49,595	\$ (1,321 )	\$ 74,472

See accompanying notes to consolidated financial statements (Unaudited).

ACCESS NATIONAL CORPORATION  
Consolidated Statements of Cash Flows  
(In Thousands)

	Three Months Ended March 31,	
	2012	2011
Cash Flows from Operating Activities		
Net income	\$3,437	\$2,287
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	718	223
Provision for losses on mortgage loans sold	258	126
Provision for off balance sheet losses	10	-
Deferred tax benefit	(179 )	(4 )
Stock-based compensation	66	60
Valuation allowance on derivatives	(542 )	(43 )
(Accretion) amortization of discount/premiums on securities	(35 )	12
Depreciation and amortization	105	115
Changes in assets and liabilities:		
Decrease (increase) in valuation of loans held for sale carried at fair value	1,454	(109 )
Decrease in loans held for sale	18,120	48,664
Decrease in other assets	38	2,326
Decrease in other liabilities	(1,206 )	(1,494 )
Net cash provided by operating activities	22,244	52,163
Cash Flows from Investing Activities		
Proceeds from maturities and calls of securities available-for-sale	24,743	5,030
Purchases of securities available-for-sale	(17,141)	(5,000 )
Proceeds from maturities and calls of securities held-to-maturity	10,000	-
Purchases of securities held-to-maturity	(34,962)	-
Net increase in loans	(4,430 )	(5,968 )
Purchases of premises and equipment	(12 )	(52 )
Net cash used in investing activities	(21,802)	(5,990 )
Cash Flows from Financing Activities		
Net increase (decrease) in demand, interest-bearing demand and savings deposits	34,400	(6,242 )
Net decrease in time deposits	(12,188)	(125,447)
Net increase (decrease) in securities sold under agreement to repurchase	1,440	(4,160 )
Net (decrease) increase in other short-term borrowings	(30,250)	20,866
Net decrease in long-term borrowings	(304 )	(554 )
Proceeds from issuance of common stock	631	-
Repurchase of common stock	(770 )	(320 )
Dividends paid	(532 )	(222 )
Net cash used in financing activities	(7,573 )	(116,079)
Decrease in cash and cash equivalents	(7,131 )	(69,906 )
Cash and Cash Equivalents		

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Beginning	43,909	111,907
Ending	\$36,778	\$42,001
Supplemental Disclosures of Cash Flow Information		
Cash payments for interest	\$1,734	\$2,278
Cash payments for income taxes	\$1,955	\$655
Supplemental Disclosures of Noncash Investing Activities		
Unrealized gain (loss) on securities available-for-sale	\$(61	) \$717

See accompanying notes to consolidated financial statements (Unaudited).

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**Notes to Consolidated Financial Statements (Unaudited)**

**NOTE 1 – BASIS OF PRESENTATION**

Access National Corporation (the “Corporation”) is a bank holding company incorporated under the laws of the Commonwealth of Virginia. The Corporation has two wholly-owned subsidiaries, Access National Bank (the “Bank”), which is an independent commercial bank chartered under federal laws as a national banking association, and Access National Capital Trust II, which was formed for the purpose of issuing redeemable capital securities. The Bank has three active subsidiaries, Access Real Estate LLC (“Access Real Estate”), ACME Real Estate LLC (“ACME”), and Access Capital Management Holding LLC (“ACM”).

Prior to the third quarter of 2011, Access National Mortgage Corporation (the “Mortgage Corporation”) operated as a wholly owned subsidiary of the Bank. As a result of changes mandated by the implementation of the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”), the activities of the Mortgage Corporation were transitioned into an operating division of the Bank and the Mortgage Corporation became inactive beginning July 1, 2011.

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with rules and regulations of the Securities and Exchange Commission (“SEC”). The statements do not include all of the information and footnotes required by GAAP for complete financial statements. All adjustments have been made which, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented. Such adjustments are all of a normal and recurring nature. All significant inter-company accounts and transactions have been eliminated in consolidation. Certain prior period amounts have been reclassified to conform to the current period presentation. The results of operations for the three months ended March 31, 2012 are not necessarily indicative of the results that may be expected for the entire year ending December 31, 2012. These consolidated financial statements should be read in conjunction with the Corporation’s audited financial statements and the notes thereto as of December 31, 2011, included in the Corporation’s Annual Report on Form 10-K for the fiscal year ended December 31, 2011.

**NOTE 2 – STOCK-BASED COMPENSATION PLANS**

During the first three months of 2012, the Corporation granted 103,350 stock options to officers, directors, and employees under the 2009 Stock Option Plan (the “Plan”). Options granted under the Plan have an exercise price equal to the fair market value as of the grant date. Options granted vest over various periods ranging from two and one-half years to four years and expire one year after the full vesting date. Stock-based compensation expense recognized in

other operating expense during the first three months of 2012 and 2011 was \$66 thousand and \$60 thousand, respectively. The fair value of options is estimated on the date of grant using a Black Scholes option-pricing model with the assumptions noted below.

The total unrecognized compensation cost related to non-vested share based compensation arrangements granted under the Plan as of March 31, 2012 was \$500,444. The cost is expected to be recognized over a weighted average period of 3.03 years.

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**NOTE 2 – STOCK-BASED COMPENSATION PLANS (continued)**

A summary of stock option activity under the Plan for the three months ended March 31, 2012 and March 31, 2011 is presented as follows:

	Three Months Ended March 31, 2012			
Expected life of options granted, in years	4.84			
Risk-free interest rate	0.39	%		
Expected volatility of stock	43	%		
Annual expected dividend yield	2	%		
Fair Value of Granted Options	\$315,691			
Non-Vested Options	324,400			
			Weighted Avg.	Aggregate Intrinsic Value
	Number of Options	Weighted Avg. Exercise Price	Remaining Contractual Term, in years	
Outstanding at beginning of year	385,450	\$ 6.04	1.63	\$1,064,115
Granted	103,350	9.24	4.84	-
Exercised	(110,412)	5.72	0.11	513,695
Lapsed or Canceled	(4,357 )	\$ 6.92	2.65	\$-
Outstanding at March 31, 2012	374,031	\$ 7.01	2.71	\$1,302,175
Exercisable at March 31, 2012	49,631	\$ 4.11	0.31	\$316,782

Three Months Ended  
March 31, 2011

Expected life of  
options granted,  
in years

3.32



Risk-free interest rate	1.19	%
Expected volatility of stock	49	%
Annual expected dividend yield	1	%

Fair value of granted options	\$	225,698
Non-vested options		286,200

	Number of Options	Weighted Avg. Exercise Price	Weighted Avg. Remaining Contractual Term, in years	Aggregate Intrinsic Value
Outstanding at beginning of year	418,525	\$ 5.98	1.34	\$ 290,583
Granted	95,100	6.68	3.32	-
Exercised	-	-	-	-
Lapsed or canceled	(84,100 )	\$ 7.35	0.21	\$-
Outstanding at March 31, 2011	429,525	\$ 5.87	1.79	\$ 530,978
Exercisable at March 31, 2011	143,325	\$ 6.43	0.66	\$ 96,611

### **NOTE 3 – SECURITIES**

The following table provides the amortized cost and fair value for the categories of available-for-sale securities and held-to-maturity securities at March 31, 2012 and December 31, 2011. Held-to-maturity securities are carried at amortized cost, which reflects historical cost, adjusted for amortization of premiums and accretion of discounts. Available-for-sale securities are carried at estimated fair value with net unrealized gains or losses reported on an after tax basis as a component of cumulative other comprehensive income in shareholders' equity. The estimated fair value of available-for-sale securities is impacted by interest rates, credit spreads, market volatility, and liquidity.

**NOTE 3 – SECURITIES (continued)**

	March 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
	(In Thousands)			
Available-for-sale:				
U.S. Government agencies	\$19,987	\$38	\$ (93)	) \$ 19,932
Mortgage backed securities	10,420	65	-	) 10,485
Municipals - taxable	240	-	-	) 240
Corporate bonds	6,033	70	(45)	) 6,058
CRA mutual fund	1,500	-	(6)	) 1,494
	\$38,180	\$173	\$ (144)	) \$ 38,209

Held-to-maturity:				
U.S. Government agencies	\$64,950	\$123	\$ (271)	) \$ 64,802
	\$64,950	\$123	\$ (271)	) \$ 64,802

	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
	(In Thousands)			
Available-for-sale:				
U.S. Government agencies	\$39,402	\$152	\$ (36)	) \$ 39,518
Mortgage backed securities	582	38	-	) 620
Municipals - taxable	240	2	-	) 242
Corporate bonds	4,022	-	(61)	) 3,961
CRA mutual fund	1,500	-	(4)	) 1,496
	\$45,746	\$192	\$ (101)	) \$ 45,837

Held-to-maturity:				
U.S. Government agencies	\$39,987	\$80	\$ (89)	) \$ 39,978
	\$39,987	\$80	\$ (89)	) \$ 39,978

**NOTE 3 – SECURITIES (continued)**

The amortized cost and estimated fair value of securities available-for-sale and held-to-maturity as of March 31, 2012 and December 31, 2011 by contractual maturity are shown below. Actual maturities may differ from contractual maturities because some of the securities may be called or prepaid without any penalties.

	March 31, 2012		December 31, 2011	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
	(In Thousands)			
Available-for-sale:				
U.S. Government agencies:				
Due after one through five years	\$5,000	\$ 5,004	\$5,000	\$ 5,007
Due after five through ten years	5,000	5,016	14,994	15,037
Due after ten through fifteen years	9,987	9,912	19,408	19,474
Municipals - taxable:				
Due in one year or less	240	240	240	242
Mortgage backed securities:				
Due after five through ten years	4,585	4,605	-	-
Due after ten through fifteen years	5,280	5,282	-	-
Due after fifteen years	555	598	582	620
Corporate bonds:				
Due in one year or less	2,019	2,033	2,032	2,012
Due after one through five years	4,014	4,025	1,990	1,949
CRA Mutual Fund	1,500	1,494	1,500	1,496
	\$38,180	\$ 38,209	\$45,746	\$ 45,837
Held-to-maturity:				
U.S. Government agencies:				
Due in one year or less				
Due after one through five years	34,987	34,845	10,000	9,993
Due after five through ten years	14,993	15,051	29,987	29,985
Due after ten through fifteen years	14,970	14,906	-	-
	\$64,950	\$ 64,802	\$39,987	\$ 39,978

The estimated fair value of securities pledged to secure public funds, securities sold under agreements to repurchase, and for other purposes amounted to \$45.5 million at March 31, 2012 and \$50.1 million at December 31, 2011.

**NOTE 3 – SECURITIES (continued)**

Securities available-for-sale and held-to-maturity that have an unrealized loss position at March 31, 2012 and December 31, 2011 are as follows:

March 31, 2012	Securities in a loss Position for less than 12 Months Estimated		Securities in a loss Position for 12 Months or Longer Estimated		Total Estimated	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Investment securities available-for-sale:	(In Thousands)					
U.S. Government agencies	\$4,899	\$ (93 )	\$ -	\$ -	\$4,899	\$ (93 )
Corporate bonds	1,947	(45 )	-	-	1,947	(45 )
CRA Mutual fund	1,494	(6 )	-	-	1,494	(6 )
Total	\$8,340	\$ (144 )	\$ -	\$ -	\$8,340	\$ (144 )
Investment securities held-to-maturity:						
U.S. Government agencies	\$34,717	\$ (271 )	\$ -	\$ -	\$34,717	\$ (271 )
	\$34,717	\$ (271 )	\$ -	\$ -	\$34,717	\$ (271 )

December 31, 2011	Securities in a loss Position for less than 12 Months Estimated		Securities in a loss Position for 12 Months or Longer Estimated		Total Estimated	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Investment securities available-for-sale	(In Thousands)					
U.S. Government agencies	\$4,964	\$ (36 )	\$ -	\$ -	\$4,964	\$ (36 )
Corporate bonds	3,961	(61 )	-	-	3,961	(61 )
CRA Mutual fund	1,496	(4 )	-	-	1,496	(4 )
Total	\$10,421	\$ (101 )	\$ -	\$ -	\$10,421	\$ (101 )
Investment securities held-to-maturity:						

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U.S. Government agencies	\$24,905	\$ (89 )	\$ -	\$ -	\$24,905	\$ (89 )
	\$24,905	\$ (89 )	\$ -	\$ -	\$24,905	\$ (89 )

The Corporation evaluates securities for other than temporary impairment (“OTTI”) on a quarterly basis and more frequently when economic or market conditions warrant such evaluation. Consideration is given to various factors in determining whether the Corporation anticipates a recovery in fair value such as: the length of time and extent to which the fair value has been less than cost, and the financial condition and underlying credit quality of the issuer. When analyzing an issuer’s financial condition, the Corporation may consider whether the securities are issued by the federal government or its agencies, the sector or industry trends affecting the issuer, and whether any recent downgrades by bond rating agencies have occurred.

*U.S. Government agencies*

The Corporation’s unrealized losses on U.S. Government Agency obligations were caused by interest rate fluctuations. On March 31, 2012, seven held-to-maturity securities and one available-for-sale security had total unrealized losses of \$363,788. The severity and duration of these unrealized losses will fluctuate with interest rates in the economy. As the securities are obligations of government agencies, it is the Corporation’s intent to hold these securities until a market price recovery or maturity, and it is more likely than not that the Corporation will not be required to sell the securities before their anticipated recovery, the Corporation does not consider these investments other than temporarily impaired.

**NOTE 3 – SECURITIES (continued)***Corporate bonds*

The Corporation's unrealized losses on corporate obligations were caused by interest rate fluctuations. At March 31, 2012, one security had an unrealized loss of \$44,547. Based on the credit quality of the issuers, the Corporation's intent to hold these securities until a market price recovery or maturity, and the determination that it is more likely than not that the Corporation will not be required to sell the securities before their anticipated recovery, the Corporation does not consider these investments other than temporarily impaired.

*Mutual fund*

The Corporation's unrealized loss on its mutual fund investment was caused by interest rate fluctuations. At March 31, 2012, the sole mutual fund security had an unrealized loss of \$5,721. Based on the past performance of the fund, the Corporation's intent to hold this security until a market price recovery, and the determination that it is more likely than not that the Corporation will not be required to sell the securities before their anticipated recovery, the Corporation does not consider this investment other than temporarily impaired.

**Restricted Stock**

The Corporation's restricted stock consists of Federal Home Loan Bank of Atlanta ("FHLB") stock and Federal Reserve Bank ("FRB") stock. The amortized costs of the restricted stock as of March 31, 2012 and December 31, 2011 are as follows:

	March 31, 2012	December 31, 2011
Restricted Stock:	(In Thousands)	
Federal Reserve Bank stock	\$999	\$ 999
FHLB stock	2,666	2,666
	\$3,665	\$ 3,665

**NOTE 4 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES**

The following table presents the composition of the loans held for investment portfolio at March 31, 2012 and December 31, 2011:

(Dollars In Thousands)	March 31, 2012		December 31, 2011	
	Amount	Percentage of Total	Amount	Percentage of Total
Commercial real estate-owner occupied	\$ 170,207	29.69 %	\$ 171,599	30.14 %
Commercial real estate - non-owner occupied	106,177	18.52	104,976	18.44
Residential real estate	128,509	22.42	128,485	22.56
Commercial	138,285	24.12	131,816	23.15
Real estate construction	26,816	4.68	29,705	5.22
Consumer	3,321	0.57	2,819	0.49
Total loans	\$ 573,315	100.00 %	\$ 569,400	100.00 %
Less allowance for loan losses	11,941		11,738	
Net Loans	\$ 561,374		\$ 557,662	

Unearned income and net deferred loan fees and costs totaled \$1.6 million at March 31, 2012 and December 31, 2011. Loans pledged to secure borrowings at the FHLB totaled \$90.9 million and \$83.5 million at March 31, 2012 and December 31, 2011, respectively.

**NOTE 4 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (continued)**

**Allowance for Loan Losses**

The allowance for loan losses totaled \$11.9 million at March 31, 2012 compared to \$11.7 million at year end December 31, 2011. The allowance for loan losses was equivalent to 2.08% of total loans held for investment at March 31, 2012 and 2.06% at December 31, 2011. Adequacy of the allowance is assessed and the allowance is increased by provisions for loan losses charged to expense no less than quarterly. Charge-offs are taken when a loan is identified as uncollectible.

The methodology by which we systematically determine the amount of our allowance is set forth by the Board of Directors in our Loan Policy and implemented by management. The results of the analysis are documented, reviewed, and approved by the Board of Directors no less than quarterly.

The level of the allowance for loan losses is determined by management through an ongoing, detailed analysis of historical loss rates and risk characteristics. During each quarter, management evaluates the collectability of all loans in the portfolio and ensures an accurate risk rating is assigned to each loan. The risk rating scale and definitions commonly adopted by the Federal Banking Agencies is contained within the framework prescribed by the Bank's Loan Policy. Any loan that is deemed to have potential or well defined weaknesses that may jeopardize collection in full is then analyzed to ascertain its level of weakness. If appropriate, the loan may be charged-off or a specific reserve may be assigned if the loan is deemed to be impaired.

During the risk rating verification process, each loan identified as inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged is considered impaired and is placed on non-accrual status. On these loans, management analyzes the potential impairment of the individual loan and may set aside a specific reserve. Any amounts deemed uncollectible during that analysis are charged-off.

For the remaining loans in each segment, the Bank calculates the probability of loss as a group using the risk rating for each of the following loan types: Commercial Real Estate - Owner Occupied, Commercial Real Estate - Non-Owner Occupied, Residential Real Estate, Commercial, Real Estate Construction, and Consumer. Management calculates the historical loss rate in each group by risk rating using a period of at least five years. This historical loss rate may then be adjusted based on management's assessment of internal and external environmental factors. While management may consider other factors, the analysis generally includes factors such as unemployment, office vacancy rates, and any concentrations that exist within the portfolio. This adjustment is meant to account for changes between the historical economic environment and current conditions and for changes in the ongoing management of the portfolio which affects the loans' potential losses.



Once complete, management compares the condition of the portfolio using several different characteristics, as well as its experience, to the experience of other banks in its peer group in order to determine if it is directionally consistent with others' experience in our area and line of business. Based on that analysis, management aggregates the probabilities of loss of the remaining portfolio based on the specific and general allowances and may provide additional amounts to the allowance for loan losses as needed. Since this process involves estimates, the allowance for loan losses may also contain an amount that is non-material which is not allocated to a specific loan or to a group of loans but is deemed necessary to absorb additional losses in the portfolio.

Management and the Board of Directors subject the reserve adequacy and methodology to a review on a regular basis by internal auditors, external auditors and bank regulators, and such reviews have not resulted in any material adjustment to the allowance.

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**NOTE 4 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (continued)**

The following tables provide detailed information about the allowance for loan losses as of and for the periods indicated.

For the Quarter Ended March 31, 2012	Allowance for Loan Losses and Recorded Investment in Loans						
	Commercial real estate - owner occupied	Commercial real estate - non-owner occupied	Residential real estate	Commercial	Real estate construction	Consumer	Total
Allowance for credit losses:	(In Thousands)						
Beginning Balance	\$3,634	\$1,747	\$2,874	\$3,021	\$423	\$39	\$11,738
Charge-offs	(202)	-	(464)	(283)	-	(35)	(984)
Recoveries	-	33	211	225	-	-	469
Provisions	112	447	31	(78)	141	65	718
Ending balance	\$3,544	\$2,227	\$2,652	\$2,885	\$564	\$69	\$11,941
Ending balance: individually evaluated for impairment	\$563	\$45	\$644	\$471	\$-	\$-	\$1,723
Ending balance: collectively evaluated for impairment	\$2,981	\$2,182	\$2,008	\$2,414	\$564	\$69	\$10,218
Ending balance: loans acquired with deteriorated credit quality	\$-	\$-	\$-	\$-	\$-	\$-	\$-
Loans							
Ending balance	\$170,207	\$106,177	\$128,509	\$138,285	\$26,816	\$3,321	\$573,315
Ending balance: individually evaluated for impairment	\$1,714	\$317	\$2,089	\$1,230	\$-	\$-	\$5,350
Ending balance: collectively evaluated for impairment	\$168,493	\$105,860	\$126,420	\$137,055	\$26,816	\$3,321	\$567,965
Ending balance: loans acquired with deteriorated credit quality	\$-	\$-	\$-	\$-	\$-	\$-	\$-
For the Year Ended December 31, 2011	Commercial real estate -	Commercial real estate -	Residential real estate	Commercial	Real estate construction	Consumer	Total

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	owner occupied	non-owner occupied					
Allowance for credit losses:	(In Thousands)						
Beginning Balance	\$3,134	\$ 2,173	\$ 2,930	\$ 1,509	\$ 758	\$ 23	\$10,527
Charge-offs	(344 )	-	(596 )	(292 )	-	-	(1,232 )
Recoveries	405	234	89	536	30	-	1,294
Provisions	439	(660 )	451	1,268	(365 )	16	1,149
Ending balance	\$3,634	\$ 1,747	\$ 2,874	\$ 3,021	\$ 423	\$ 39	\$11,738
Ending balance: individually evaluated for impairment	\$672	\$ 70	\$ 537	\$ 644	\$ -	\$ -	\$1,923
Ending balance: collectively evaluated for impairment	\$2,962	\$ 1,677	\$ 2,337	\$ 2,377	\$ 423	\$ 39	\$9,815
Ending balance: loans acquired with deteriorated credit quality	\$-	\$ -	\$ -	\$ -	\$ -	\$ -	\$-
Loans							
Ending balance	\$171,599	\$ 104,976	\$ 128,485	\$ 131,816	\$ 29,705	\$ 2,819	\$569,400
Ending balance: individually evaluated for impairment	\$2,694	\$ 321	\$ 2,249	\$ 1,439	\$ -	\$ -	\$6,703
Ending balance: collectively evaluated for impairment	\$168,905	\$ 104,655	\$ 126,236	\$ 130,377	\$ 29,705	\$ 2,819	\$562,697
Ending balance: loans acquired with deteriorated credit quality	\$-	\$ -	\$ -	\$ -	\$ -	\$ -	\$-

### Identifying and Classifying Portfolio Risks by Risk Rating

At origination, loans are categorized into risk categories based upon original underwriting. Subsequent to origination, management evaluates the collectability of all loans in the portfolio and assigns a proprietary risk rating. Ratings range from the highest to lowest quality based on factors including measurements of ability to pay, collateral type and value, borrower stability, management experience, and credit enhancements. These ratings are consistent with the bank regulatory rating system.

A loan may have portions of its balance in one rating and other portions in a different rating. The Bank may use these “split ratings” when factors cause loan loss risk to exist for part but not all of the principal balance. Split ratings may also be used where cash collateral or a government agency has provided a guaranty that partially covers a loan.

For clarity of presentation, the Corporation’s loan portfolio is profiled below in accordance with the risk rating framework that has been commonly adopted by the federal banking agencies. The definitions of the various risk rating categories are as follows:

Pass - The condition of the borrower and the performance of the loan is satisfactory or better.

Special mention - A special mention asset has one or more potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date.

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**NOTE 4 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (continued)**

Substandard - A substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.

Doubtful - An asset classified doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loss - Assets classified loss are considered uncollectible and their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, and a partial recovery may be effected in the future.

The Bank did not have any loans classified as loss at March 31, 2012 or December 31, 2011. It is the Bank's policy to charge-off any loan once the risk rating is classified as loss.

The profile of the loan portfolio, as indicated by risk rating, as of March 31, 2012 and December 31, 2011 is shown below.

**Credit Quality Indicators****Credit Risk Profile by Regulatory Risk Rating**

	Commercial real estate - owner occupied		Commercial real estate - non-owner occupied		Residential real estate		Commercial		Real estate construction	
	3/31/12	12/31/11	3/31/12	12/31/11	3/31/12	12/31/11	3/31/12	12/31/11	3/31/12	12/31/11
	(In Thousands)									
Pass	\$152,992	\$152,495	\$96,575	\$91,685	\$123,288	\$122,501	\$122,137	\$121,717	\$26,872	\$29,791
	11,242	8,113	1,448	5,204	1,799	1,811	14,796	6,851	-	-

Special  
mention

Substandard	6,529	11,531	8,496	8,470	3,523	4,268	1,848	3,695	-	-
Doubtful	-	-	-	-	-	-	-	-	-	-
Loss	-	-	-	-	-	-	-	-	-	-
Unearned income	(556 )	(540 )	(342 )	(383 )	(101 )	(95 )	(496 )	(447 )	(56 )	(86 )
<b>Total</b>	<b>\$170,207</b>	<b>\$171,599</b>	<b>\$106,177</b>	<b>\$104,976</b>	<b>\$128,509</b>	<b>\$128,485</b>	<b>\$138,285</b>	<b>\$131,816</b>	<b>\$26,816</b>	<b>\$29,705</b>

Loans listed as non-performing are also placed on non-accrual status. The accrual of interest is discontinued at the time a loan is 90 days delinquent or when the credit deteriorates and there is doubt that the credit will be paid as agreed, unless the credit is well-secured and in process of collection. Once the loan is on non-accrual status, all accrued but unpaid interest is also charged-off, and all payments are used to reduce the principal balance. Once the principal balance is repaid in full, additional payments are taken into income. A loan may be returned to accrual status if the borrower shows renewed willingness and ability to repay under the term of the loan agreement. The risk profile based upon payment activity is shown below.

**Credit Risk Profile Based on Payment Activity**

	Commercial real estate - owner occupied		Commercial real estate - non-owner occupied		Residential real estate		Commercial		Real estate construction		Consumers
	3/31/12	12/31/11	3/31/12	12/31/11	3/31/12	12/31/11	3/31/12	12/31/11	3/31/12	12/31/11	3/31/11
Performing	\$168,493	\$168,905	\$105,860	\$104,655	\$126,420	\$126,236	\$137,055	\$130,377	\$26,816	\$29,705	\$3,321
Non-performing	714	2,694	317	321	2,089	2,249	1,230	1,439	-	-	-
<b>Total</b>	<b>\$170,207</b>	<b>\$171,599</b>	<b>\$106,177</b>	<b>\$104,976</b>	<b>\$128,509</b>	<b>\$128,485</b>	<b>\$138,285</b>	<b>\$131,816</b>	<b>\$26,816</b>	<b>\$29,705</b>	<b>\$3,321</b>

**NOTE 4 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (continued)**

Loans are considered past due if a contractual payment is not made by the calendar day after the payment is due. However, for reporting purposes loans past due 1 to 29 days are excluded from loans past due and are included in the total for current loans in the table below. The delinquency status of the loans in the portfolio is shown below as of March 31, 2012 and December 31, 2011. Loans that were on non-accrual status are not included in any past due amounts.

## Age Analysis of Past Due Loans

	March 31, 2012						
	30-59 Days past due	60-89 Days past due	Greater than 90 days	Total past due	Non-accrual loans	Current loans	Total loans
	(In Thousands)						
Commercial real estate - owner occupied	\$-	\$ -	\$ -	\$ -	\$ 1,714	\$ 168,493	\$ 170,207
Commercial real estate - non-owner occupied	-	-	-	-	317	105,860	106,177
Residential real estate	-	-	-	-	2,089	126,420	128,509
Commercial	-	-	-	-	1,230	137,055	138,285
Real estate construction	-	-	-	-	-	26,816	26,816
Consumer	-	-	-	-	-	3,321	3,321
Total	\$-	\$ -	\$ -	\$ -	\$ 5,350	\$ 567,965	\$ 573,315

	December 31, 2011						
	30-59 Days past due	60-89 Days past due	Greater than 90 days	Total past due	Non-accrual loans	Current loans	Total loans
	(In Thousands)						
Commercial real estate - owner occupied	\$-	\$-	\$ -	\$-	\$ 2,694	\$ 168,905	\$ 171,599
Commercial real estate - non-owner occupied	-	-	-	-	321	104,655	104,976
Residential real estate	154	63	-	217	2,249	126,019	128,485
Commercial	-	54	-	54	1,439	130,323	131,816
Real estate construction	-	-	-	-	-	29,705	29,705
Consumer	-	-	-	-	-	2,819	2,819
Total	\$ 154	\$ 117	\$ -	\$ 271	\$ 6,703	\$ 562,426	\$ 569,400

**Troubled Debt Restructurings**

A troubled debt restructuring ("TDR") is a formal restructure of a loan when the Bank, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to a borrower. The Bank classifies these transactions as a TDR if the transaction meets the following conditions: an existing credit agreement must be formally renewed, extended and/or modified; the borrower must be experiencing financial difficulty; and the Bank has granted a concession that it would not otherwise consider. ASU 2011-02 requires public companies to identify and account for TDRs for interim and annual periods beginning on or after June 15, 2011.

Once identified as TDRs, a loan is considered to be impaired, and an impairment analysis is performed for the loan individually, rather than under a general loss allowance based on the loan type and risk rating. Any resulting shortfall is charged-off.

Normally, loans identified as TDRs would be placed on non-accrual status. The loans are considered non-performing until sufficient history of timely collection or payment has occurred that allows them to return to performing status, generally 6 months.

No loans were modified in connection with a troubled debt restructuring during the first quarter of 2012 or 2011.



**NOTE 4 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (continued)**

The table below displays the balances of all loans classified as TDRs at the dates presented.

	Troubled Debt Restructurings					
	March 31, 2012			December 31, 2011		
	Number of loans	Outstanding balance	Recorded investment	Number of loans	Outstanding balance	Recorded investment
	(In Thousands)					
<b>Performing</b>						
Commercial real estate - owner occupied	-	\$ -	\$ -	-	\$ -	\$ -
Commercial real estate - non-owner occupied	-	-	-	-	-	-
Residential real estate	-	-	-	-	-	-
Commercial	2	148	148	2	159	159
Real estate construction	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
<b>Non-performing</b>						
Commercial real estate - owner occupied	-	\$ -	\$ -	-	\$ -	\$ -
Commercial real estate - non-owner occupied	1	317	317	1	321	321
Residential real estate	-	-	-	-	-	-
Commercial	2	1,058	1,058	3	1,107	1,107
Real estate construction	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
<b>Total</b>	<b>5</b>	<b>\$ 1,523</b>	<b>\$ 1,523</b>	<b>6</b>	<b>\$ 1,587</b>	<b>\$ 1,587</b>

**Impaired Loans**

A loan is classified as impaired when it is deemed probable by management's analysis that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement, or the recorded investment in the impaired loan is greater than the present value of expected future cash flows, discounted at the loan's effective interest rate. In the case of an impaired loan, management conducts an analysis which identifies if a quantifiable potential loss exists, and takes the necessary steps to record that loss when it has been identified as uncollectible.

**NOTE 4 – LOANS AND THE ALLOWANCE FOR LOAN LOSSES (continued)**

The table below shows the results of management's analysis of impaired loans as of March 31, 2012 and December 31, 2011.

	Impaired Loans				
	March 31, 2012				
	Recorded investment	Unpaid principal balance	Related allowance	Average recorded investment	Interest income recognized
With no specific related allowance recorded:	(In Thousands)				
Commercial real estate - owner occupied	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate - non-owner occupied	-	-	-	-	-
Residential real estate	-	-	-	-	-
Commercial	268	325	-	275	-
Real estate construction	-	-	-	-	-
Consumer	-	-	-	-	-
With a specific related allowance recorded:					
Commercial real estate - owner occupied	\$ 1,714	\$ 2,159	\$ 563	\$ 1,817	\$ -
Commercial real estate - non-owner occupied	317	422	45	317	-
Residential real estate	2,089	2,338	644	2,091	-
Commercial	962	1,383	471	994	-
Real estate construction	-	-	-	-	-
Consumer	-	-	-	-	-
Total:					
Commercial real estate - owner occupied	\$ 1,714	\$ 2,159	\$ 563	\$ 1,817	\$ -
Commercial real estate - non-owner occupied	317	422	45	317	-
Residential real estate	2,089	2,338	644	2,091	-
Commercial	1,230	1,708	471	1,269	-
Real estate construction	-	-	-	-	-
Consumer	-	-	-	-	-
	\$ 5,350	\$ 6,627	\$ 1,723	\$ 5,494	\$ -

	Impaired Loans				
	December 31, 2011				
	Recorded investment	Unpaid principal balance	Related allowance	Average recorded investment	Interest income recognized
With no specific related allowance recorded:	(In Thousands)				

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Commercial real estate - owner occupied	\$-	\$ -	\$ -	\$ -	\$ -
Commercial real estate - non-owner occupied	-	-	-	-	-
Residential real estate	183	183	-	183	-
Commercial	258	425	-	232	-
Real estate construction	-	-	-	-	-
Consumer	-	-	-	-	-
With a specific related allowance recorded:					
Commercial real estate - owner occupied	\$2,694	\$ 3,156	\$ 672	\$ 2,720	\$ -
Commercial real estate - non-owner occupied	321	422	70	324	-
Residential real estate	2,066	2,313	537	2,067	-
Commercial	1,181	1,200	644	1,189	-
Real estate construction	-	-	-	-	-
Consumer	-	-	-	-	-
Total:					
Commercial real estate - owner occupied	\$2,694	\$ 3,156	\$ 672	\$ 2,720	\$ -
Commercial real estate - non-owner occupied	321	422	70	324	-
Residential real estate	2,249	2,496	537	2,250	-
Commercial	1,439	1,625	644	1,421	-
Real estate construction	-	-	-	-	-
Consumer	-	-	-	-	-
	\$6,703	\$ 7,699	\$ 1,923	\$ 6,715	\$ -

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**NOTE 5 – SEGMENT REPORTING**

The Corporation has two reportable segments: traditional commercial banking and mortgage banking. Revenues from commercial banking operations consist primarily of interest earned on loans and securities and fees from deposit services. Mortgage banking operating revenues consist principally of interest earned on mortgage loans held for sale, gains on sales of loans in the secondary mortgage market, and loan origination fee income.

The commercial banking segment provides the mortgage banking segment with the short-term funds needed to originate mortgage loans through a warehouse line of credit and charges the mortgage banking segment interest based on the prime rate. These transactions are eliminated in the consolidation process.

The “Other” column in the following table includes the operations of the Corporation, Access Real Estate, and ACM. The primary source of income for the Corporation is derived from dividends from the Bank and its primary expense relates to interest on subordinated debentures. The primary source of income for Access Real Estate is derived from rents received from the Bank. ACM’s primary source of income is derived from fees related to its wealth management services.

The following table presents segment information for the three months ended March 31, 2012 and 2011:

March 31, 2012	Commercial Mortgage Banking Banking Other			Eliminations	Consolidated Totals
	(In Thousands)				
Revenues:					
Interest income	\$9,089	\$ 850	\$2	\$ (590	) \$ 9,351
Gain on sale of loans	-	12,359	-	(1,415	) 10,944
Other revenues	619	(939	) 525	952	) 1,157
Total revenues	9,708	12,270	527	(1,053	) 21,452
Expenses:					
Interest expense	1,428	485	160	(590	) 1,483
Salaries and employee benefits	2,835	5,204	296	-	) 8,335
Other expenses	2,205	3,749	656	(463	) 6,147
Total operating expenses	6,468	9,438	1,112	(1,053	) 15,965
Income (loss) before income taxes	\$3,240	\$ 2,832	\$(585	) \$ -	) \$ 5,487
Total assets	\$725,361	\$ 80,123	\$10,063	\$ (10,792	) \$ 804,755

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March 31, 2011	Commercial Banking	Mortgage Banking	Other	Eliminations	Consolidated Totals
	(In Thousands)				
Revenues:					
Interest income	\$8,437	\$ 349	\$3	\$ (219	) \$ 8,570
Gain on sale of loans	286	5,230	-	-	5,516
Other revenues	671	(206	) 288	(430	) 323
Total revenues	9,394	5,373	291	(649	) 14,409
Expenses:					
Interest expense	1,902	163	157	(219	) 2,003
Salaries and employee benefits	2,391	2,874	128	-	5,393
Other expenses	1,753	1,625	513	(430	) 3,461
Total operating expenses	6,046	4,662	798	(649	) 10,857
Income (loss) before income taxes	\$3,348	\$ 711	\$(507	) \$ -	\$ 3,552
Total assets	\$690,338	\$ 37,105	\$9,504	\$ (19,749	) \$ 717,198

**NOTE 6 – EARNINGS PER SHARE**

The following table shows the calculation of both basic and diluted earnings per share (“EPS”) for the three months ended March 31, 2012 and 2011, respectively. The numerator of both the basic and diluted EPS is equivalent to net income. The weighted average number of shares outstanding used as the denominator for diluted EPS is increased over the denominator used for basic EPS by the effect of potentially dilutive common stock options utilizing the treasury stock method.

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
	(In Thousands, Except for Share and Per Share Data)	
<b>BASIC EARNINGS PER SHARE:</b>		
Net income	\$3,437	\$2,287
Weighted average shares outstanding	10,200,656	10,359,386
Basic earnings per share	\$0.34	\$0.22
<b>DILUTED EARNINGS PER SHARE:</b>		
Net income	\$3,437	\$2,287
Weighted average shares outstanding	10,200,656	10,359,386
Dilutive stock options	112,189	45,291
Weighted average diluted shares outstanding	10,312,845	10,404,677
Diluted earnings per share	\$0.33	\$0.22

**NOTE 7 - DERIVATIVES**

As part of its mortgage banking activities, the Bank enters into interest rate lock commitments, which are commitments to originate loans where the interest rate on the loan is determined prior to funding and the customers have locked into that interest rate. The Bank then locks in the loan and interest rate with an investor and commits to deliver the loan if settlement occurs (“best efforts”) or commits to deliver the locked loan in a binding (“mandatory”) delivery program with an investor. Certain loans under interest rate lock commitments are covered under forward sales contracts of mortgage backed securities (“MBS”). Forward sales contracts of MBS are recorded at fair value with changes in fair value recorded in noninterest income. Interest rate lock commitments and commitments to deliver

loans to investors are considered derivatives. The market value of interest rate lock commitments and best efforts contracts are not readily ascertainable with precision because they are not actively traded in stand-alone markets. The Bank determines the fair value of interest rate lock commitments and delivery contracts by measuring the fair value of the underlying asset, which is impacted by current interest rates, taking into consideration the probability that the interest rate lock commitments will close or will be funded.

Certain additional risks arise from these forward delivery contracts in that the counterparties to the contracts may not be able to meet the terms of the contracts. The Bank does not expect any counterparty to any MBS to fail to meet its obligation. Additional risks inherent in mandatory delivery programs include the risk that, if the Bank does not close the loans subject to interest rate risk lock commitments, it will still be obligated to deliver MBS to the counterparty under the forward sales agreement. Should this be required, the Bank could incur significant costs in acquiring replacement loans or MBS and such costs could have an adverse effect on mortgage banking operations.

Since the Bank's derivative instruments are not designated as hedging instruments, the fair value of the derivatives are recorded as a freestanding asset or liability with the change in value being recognized in current earnings during the period of change. The Bank has not elected to apply hedge accounting to its derivative instruments as provided in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 815, Derivatives and Hedging.

**NOTE 7 – DERIVATIVES (continued)**

At March 31, 2012 and December 31, 2011, the Bank had derivative financial instruments with a notional value of \$178.0 million and \$145.0 million, respectively. The fair value of these derivative instruments at March 31, 2012 and December 31, 2011 was \$481 thousand and \$(61) thousand, respectively, and was included in other assets and other liabilities, respectively.

Included in other noninterest income for the three months ended March 31, 2012 and March 31, 2011 was a net gain of \$542 thousand and a net gain of \$43 thousand, respectively, relating to derivative instruments.

**NOTE 8 – RECENT ACCOUNTING PRONOUNCEMENTS**

In May 2011, the FASB issued 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.” The Corporation adopted ASU 2011-04, which generally aligns the principles of fair value measurements with International Financial Reporting Standards (IFRSs), in its consolidated financial statements in the first quarter 2012. The provisions of ASU 2011-04 clarify the application of existing fair value measurement requirements, and expand the disclosure requirements for fair value measurements. The increased provisions of ASU 2011-04 did not have a material effect on the Corporation’s financial condition and results of operations.

In June 2011, the FASB issued ASU No. 2011-05, “Comprehensive Income (Topic 220): Presentation of Comprehensive Income,” (ASU 2011-05). The Corporation adopted ASU 2011-05, which revises the way in which comprehensive income is presented in the financial statements, in its consolidated financial statements in the first quarter 2012. The provisions of ASU 2011-05 give companies the option to present total comprehensive income, components of net income, and components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The provisions of ASU 2011-05 did not have a material effect on the Corporation’s financial condition and results of operations.

**NOTE 9 - FAIR VALUE**

Fair value pursuant to FASB ASC 820-10, Fair Value Measurements and Disclosures, is the exchange price, in an orderly transaction that is not a forced liquidation or distressed sale, between market participants to sell an asset or transfer a liability in the market in which the reporting entity would transact for the asset or liability, that is, the principal or most advantageous market for the asset or liability. The transaction to sell the asset or transfer the



liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or liability. FASB ASC 820-10 provides a consistent definition of fair value which focuses on exit price and prioritizes, within a measurement of fair value, the use of market-based inputs over entity specific inputs. In addition, FASB ASC 820-10 provides a framework for measuring fair value and establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The standard describes three levels of inputs that may be used to measure fair values:

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 company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

**NOTE 9 - FAIR VALUE (continued)**

The Corporation used the following methods to determine the fair value of each type of financial instrument:

**Securities:** Fair values for securities available-for-sale are obtained from an independent pricing service. The prices are not adjusted. The independent pricing service uses industry-standard models to price U.S. Government agency obligations and mortgage backed securities that consider various assumptions, including time value, yield curves, volatility factors, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Securities of obligations of state and political subdivisions are valued using a type of matrix, or grid, pricing in which securities are benchmarked against the treasury rate based on credit rating.

Substantially all assumptions used by the independent pricing service are observable in the marketplace, can be derived from

observable data, or are supported by observable levels at which transactions are executed in the marketplace (Level 2).

**Residential loans held for sale:** The fair value of loans held for sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan (Level 2).

**Derivative financial instruments:** Derivative instruments are used to hedge residential mortgage loans held for sale and the related interest-rate lock commitments and include forward commitments to sell mortgage loans and mortgage-backed securities as further described in Note 7. The fair values of derivative financial instruments are based on derivative market data inputs as of the valuation date and the underlying value of mortgage loans for interest rate lock commitments (Level 3).

**Impaired loans:** The fair values of impaired loans are measured on a nonrecurring basis as the fair value of the loan's collateral for collateral-dependent loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The use of discounted cash flow models and management's best judgment are significant inputs in arriving at the fair value measure of the underlying collateral (Level 3).

**Other real estate owned:** The fair value of other real estate owned, which consists of real estate that has been foreclosed, is recorded at the lower of fair value less selling expenses or the book balance prior to foreclosure. Write downs are provided for subsequent declines in value and are recorded in other noninterest expense (Level 2).



**NOTE 9 - FAIR VALUE (continued)**

Assets and liabilities measured at fair value under FASB ASC 820-10 on a recurring and non-recurring basis, including financial assets and liabilities for which the Corporation has elected the fair value option as of March 31, 2012 and December 31, 2011, are summarized below:

Description	Fair Value Measurement at March 31, 2012 Using			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(In Thousands)				
Financial Assets-Recurring				
Available-for-sale investment securities				
US Government agency	\$ 19,932	\$ -	\$ 19,932	\$ -
Mortgage backed	10,485	-	10,485	-
Corporate bonds	6,058	-	6,058	-
Taxable municipals	240	-	240	-
CRA Mutual fund	1,494	-	1,494	-
Total available-for-sale investment securities	38,209	-	38,209	-
Residential loans held for sale	75,552	-	75,552	-
Derivative assets	1,110	-	-	1,110
Total Financial Assets-Recurring	\$ 114,871	\$ -	\$ 113,761	\$ 1,110
Financial Liabilities-Recurring				
Derivative liabilities	\$ 629	\$ -	\$ -	\$ 629
Total Financial Liabilities-Recurring	\$ 629	\$ -	\$ -	\$ 629
Financial Assets-Non-Recurring				
Impaired loans <sup>(1)</sup>	\$ 5,350	\$ -	\$ -	\$ 5,350
Total Financial Assets-Non-Recurring	\$ 5,350	\$ -	\$ -	\$ 5,350

(1) Represents the carrying value of loans for which adjustments are based on the appraised value of the collateral.

**NOTE 9 - FAIR VALUE (continued)**

Description	Fair Value Measurement at December 31, 2011 Using			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets-Recurring (In Thousands)				
Available-for-sale investment securities				
US Government agency	\$39,518	\$ -	\$ 39,518	\$ -
Mortgage backed	620	-	620	-
Corporate bonds	3,961	-	3,961	-
Taxable municipals	242	-	242	-
CRA Mutual fund	1,496	-	1,496	-
Total available-for-sale investment securities	45,837	-	45,837	-
Residential loans held for sale	95,126	-	95,126	-
Derivative assets	1,256	-	-	1,256
Total Financial Assets-Recurring	\$142,219	\$ -	\$ 140,963	\$ 1,256
Financial Liabilities-Recurring				
Derivative liabilities	\$1,317	\$ -	\$ -	\$ 1,317
Total Financial Liabilities-Recurring	\$1,317	\$ -	\$ -	\$ 1,317
Financial Assets-Non-Recurring				
Impaired loans <sup>(1)</sup>	\$6,703	\$ -	\$ -	\$ 6,703
Total Financial Assets-Non-Recurring	\$6,703	\$ -	\$ -	\$ 6,703

(1) Represents the carrying value of loans for which adjustments are based on the appraised value of the collateral.

It is the Corporation's policy to recognize transfers between levels as of the actual date of the event or change in circumstances that caused the transfer. There were no transfers between Level 1 and Level 2 during the three month periods ended March 31, 2012 and 2011.

The changes in Level 3 net derivatives measured at fair value on a recurring basis are summarized as follows:

	Three Months Ended March 31, 2012 2011 (In Thousands)	
Balance, beginning of period	\$(61 )	\$280
Realized and unrealized gains (losses) included in earnings	542	43
Unrealized gains (losses) included in other comprehensive income	-	-
Purchases, settlements, paydowns, and maturities	-	-
Transfer into Level 3	-	-
Balance, end of period	\$481	\$323

**NOTE 9 - FAIR VALUE (continued)**

The following table presents qualitative information about level 3 fair value measurements for financial instruments measured at fair value at March 31, 2012:

Description	Fair Value Estimate (In Thousands)	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Financial Assets - Recurring				
Derivative assets	\$1,110	Market pricing (3)	Estimated pullthrough	75% - 90%
Derivative liabilities	\$629	Market pricing (3)	Estimated pullthrough	75% - 90%
Financial Assets - Non-recurring				
Impaired loans - Real estate secured	\$4,120	Appraisal of collateral (1)	Liquidation expenses (2)	20% - 30%
Impaired loans - Non-real estate secured	\$1,230	Cash flow basis	Liquidation expenses (2)	10% - 20%

- (1) Fair value is generally determined through independent appraisals of the underlying collateral on real estate secured loans, which generally include various level 3 inputs which are not identifiable.
- (2) Valuations of impaired loans may be adjusted by management for qualitative factors such as liquidation expenses. The range and weighted average of liquidation expense adjustments are presented as a percent of the appraisal. Market pricing on derivative assets and liabilities is adjusted by management for the anticipated percent of derivative assets and liabilities that will create a realized gain or loss. The range and weighted average of estimated pull-through is presented as a percent of the volume.

**Financial instruments recorded using FASB ASC 825-10**

Under FASB ASC 825-10, Financial Instruments, the Corporation may elect to report most financial instruments and certain other items at fair value on an instrument-by-instrument basis with changes in fair value reported in net income. After the initial adoption the election is made at the acquisition of an eligible financial asset, financial liability or firm commitment or when certain specified reconsideration events occur. The fair value election, with respect to an item, may not be revoked once an election is made.

The following table reflects the differences between the fair value carrying amount of residential mortgage loans held for sale at March 31, 2012, measured at fair value under FASB ASC 825-10, and the aggregate unpaid principal amount the Corporation is contractually entitled to receive at maturity.

(In Thousands)	Aggregate Fair Value	Difference	Contractual Principal
Residential mortgage loans held for sale	\$ 75,552	\$ 2,690	\$ 72,862

The Corporation has elected to account for residential loans held for sale at fair value to eliminate the mismatch that would occur by recording changes in market value on derivative instruments used to hedge loans held for sale while carrying the loans at the lower of cost or market.

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**NOTE 9 - FAIR VALUE (continued)**

The following methods and assumptions not previously presented were used in estimating the fair value of financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis:

**Cash and Short-Term Investments**

For those short-term instruments, the carrying amount is a reasonable estimate of fair value. As such they are classified as Level 1 for noninterest bearing deposits and Level 2 for interest bearing deposits due from banks or federal funds sold.

**Restricted Stock**

It is not practical to determine the fair value of restricted stock due to the restrictions placed on its transferability.

**Loans, Net of Allowance**

For certain homogeneous categories of loans, such as some residential mortgages, and other consumer loans, fair value is estimated using the quoted market prices for securities backed by similar loans, adjusted for differences in loan characteristics resulting in a Level 3 classification. The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities resulting in a Level 3 classification.

**Accrued Interest**

The carrying amounts of accrued interest approximate fair value resulting in a Level 2 or Level 3 classification depending upon the level of the asset or liability, with which, the accrual is associated.

## **Deposits and Borrowings**

The fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date resulting in a Level 1 classification. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities also resulting in a Level 1 classification. The fair value of all other deposits and borrowings is determined using the discounted cash flow method thereby resulting in a Level 2 classification. The discount rate was equal to the rate currently offered on similar products.

## **Subordinated debentures**

Due to the pooled nature of these instruments, which are not actively traded, estimated fair value is based on broker prices from recent similar sales resulting in a Level 2 classification.

## **Off-Balance-Sheet Financial Instruments**

The fair value of commitments to extend credit is estimated using the fees currently charged to enter similar agreements, taking into account the remaining terms of the agreements and the present credit worthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed interest rates. The fair value of stand-by letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date.

At March 31, 2012 and December 31, 2011, the majority of off-balance-sheet items are variable rate instruments or convert to variable rate instruments if drawn upon. Therefore, the fair value of these items is largely based on fees, which are nominal and immaterial.

**NOTE 9 - FAIR VALUE (continued)**

The carrying amounts and estimated fair values of financial instruments at March 31, 2012 and December 31, 2011 were as follows:

	March 31, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets: (In Thousands)				
Cash and short-term investments	\$36,778	\$36,778	\$43,909	\$43,909
Securities available for sale	38,209	38,209	45,837	45,837
Securities held-to-maturity	64,950	64,802	39,987	39,978
Restricted stock	3,665	3,665	3,665	3,665
Loans held for sale	75,552	75,552	95,126	95,126
Loans, net of allowance	561,374	580,264	557,662	540,682
Accrued interest receivable	4,787	4,787	6,071	6,071
Derivatives	1,110	1,110	1,256	1,256
Total financial assets	\$786,425	\$805,167	\$793,513	\$776,524
Financial liabilities:				
Deposits	\$667,225	\$641,485	\$645,013	\$641,983
Short-term borrowings	32,343	32,370	59,904	60,190
Long-term borrowings	3,268	3,378	4,821	4,937
Subordinated debentures	6,186	6,243	6,186	6,242
Derivatives	629	629	1,317	1,317
Total financial liabilities	\$709,651	\$684,105	\$717,241	\$714,669

**NOTE 10 – FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK**

The Corporation is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments consist primarily of commitments to extend credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Corporation has in particular classes of financial instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee by the customer. Since many of the commitments are expected to expire without being drawn

upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral, if any, deemed necessary by the Corporation upon extension of credit is based on management's credit evaluation of the counterparty. Collateral normally consists of real property, liquid assets or business assets. The Corporation had \$23.3 million and \$17.9 million in outstanding commitments at March 31, 2012 and December 31, 2011, respectively.

The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual notional amount of those instruments. The Corporation uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. The Corporation had \$135.0 million and \$123.1 million in unfunded lines of credit whose contract amounts represent credit risk at March 31, 2012 and December 31, 2011, respectively.

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**NOTE 10 – FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK (continued)**

Standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Corporation generally holds collateral supporting those commitments if deemed necessary. The Corporation had standby letters of credit outstanding in the amount of \$8.6 million and \$4.1 million at March 31, 2012 and December 31, 2011, respectively.

The Bank maintains a reserve for potential off-balance sheet credit losses that is included in other liabilities on the balance sheet. At March 31, 2012 and December 31, 2011 the balance in this account totaled \$337 thousand and \$327 thousand, respectively.

The mortgage division of the Bank makes representations and warranties that loans sold to investors meet its program's guidelines and that the information provided by the borrowers is accurate and complete. In the event of a default on a loan sold, the investor may make a claim for losses due to document deficiencies, program compliance, early payment default, and fraud or borrower misrepresentations. The mortgage division maintains a reserve in other liabilities for potential losses on mortgage loans sold. At March 31, 2012, December 31, 2011, and March 31, 2011 the balance in this reserve totaled \$2.9 million, \$2.6 million, and \$2.1 million, respectively.

The following table shows the changes to the Allowance for Losses on Mortgage Loans Sold.

	Three Months ended March 31,		Year ended December 31, 2011
	2012	2011	
	(In Thousands)		
Allowance for losses on mortgage loans sold -beginning of period	\$2,616	\$1,991	\$ 1,991
Provision charged to operating expense	258	126	966
Charge-offs	-	(4 )	(341 )
Allowance for losses on mortgage loans sold - end of period	\$2,874	\$2,113	\$ 2,616

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis should be read in conjunction with the Corporation's consolidated financial statements, and notes thereto, included in the Corporation's Annual Report on Form 10-K for the fiscal year ended December 31, 2011. Operating results for the three months ended March 31, 2012 are not necessarily indicative of the results for the year ending December 31, 2012 or any future period.

### **CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

In addition to historical information, this Quarterly Report on Form 10-Q may contain forward-looking statements. For this purpose, any statements contained herein, including documents incorporated by reference, that are not statements of historical fact may be deemed to be forward-looking statements. Examples of forward-looking statements include discussions as to our expectations, beliefs, plans, goals, objectives and future financial or other performance or assumptions concerning matters discussed in this document. Forward-looking statements often use words such as "believes," "expects," "plans," "may," "will," "should," "projects," "contemplates," "anticipates," "forecasts," "other words of similar meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts. Forward-looking statements are subject to numerous assumptions, risks and uncertainties, and actual results could differ materially from historical results or those anticipated by such statements. Factors that could have a material adverse effect on the operations and future prospects of the Corporation include, but are not limited to, changes in: collateral values, especially in the real estate market; continued challenging economic conditions or deterioration in general business and economic conditions and in the financial markets; the impact of any laws, regulations, policies or programs implemented pursuant to the Dodd-Frank Act, the Emergency Economic Stabilization Act of 2008 (the "EESA"), as amended by the American Recovery and Reinvestment Act of 2009 (the "ARRA"); branch expansion plans; interest rates; monetary and fiscal policies of the U.S. Government, including policies of the Office of the Comptroller of the Currency ("Comptroller"), the U.S. Department of the Treasury and the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of Richmond; the economy of Northern Virginia, including governmental spending and commercial and residential real estate markets; the quality or composition of the loan or investment portfolios; demand for loan products; deposit flows; competition; the liquidity of the Corporation; and accounting principles, policies and guidelines. These risks and uncertainties should be considered in evaluating the forward-looking statements contained herein, and readers are cautioned not to place undue reliance on such statements. Any forward-looking statement speaks only as of the date on which it is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which it is made.

For additional discussion of risk factors that may cause our actual future results to differ materially from the results indicated within forward looking statements, please see "Item 1A – Risk Factors" of the Corporation's Annual Report on Form 10-K for the fiscal year ended December 31, 2011.

**CRITICAL ACCOUNTING POLICIES**

The Corporation's consolidated financial statements have been prepared in accordance with GAAP. In preparing the Corporation's financial statements management makes estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses. Management believes that the most significant subjective judgments that it makes include the following:

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### **Allowance for Loan Losses**

The allowance for loan losses is an estimate of the losses that may be sustained in our loan portfolio. The allowance is based on two basic principles of accounting: (i) FASB ASC 450-10, which requires that losses be accrued when they are probable of occurring and can be estimated, and (ii) FASB ASC 310-10, which requires that losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance. An allowance for loan losses is established through a provision for loan losses based upon industry standards, known risk characteristics, management's evaluation of the risk inherent in the loan portfolio, and changes in the nature and volume of loan activity. Such evaluation considers, among other factors, the estimated market value of the underlying collateral and current economic conditions. For further information about our practices with respect to allowance for loan losses, please see Note 4 to the consolidated financial statements.

### **Other Than Temporary Impairment of Securities**

Securities in the Corporation's securities portfolio are classified as either available-for-sale or held-to-maturity. At March 31, 2012 there were no non-agency mortgage backed securities or trust preferred securities in the portfolio. The estimated fair value of the portfolio fluctuates due to changes in market interest rates and other factors. Changes in estimated fair value are recorded in shareholders' equity as a component of other comprehensive income. Securities are monitored to determine whether a decline in their value is other than temporary. Management evaluates the securities portfolio on a quarterly basis to determine the collectability of amounts due per the contractual terms of each security. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to net income is recognized. At March 31, 2012 there were no securities with other than temporary impairment.

### **Income Taxes**

The Corporation uses the liability method of accounting for income taxes. This method results in the recognition of deferred tax assets and liabilities that are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The deferred provision for income taxes is the result of the net change in the deferred tax asset and deferred tax liability balances during the year. This amount combined with the current taxes payable or refundable results in the income tax expense for the current year. The Corporation's evaluation of the deductibility or taxability of items included in the Corporation's tax returns has not resulted in the identification of any material, uncertain tax positions.

### **Fair Value**



Fair values of financial instruments are estimated using relevant market information and other assumptions. 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. The fair value estimates of existing on and off-balance sheet financial instruments do not include the value of anticipated future business or the values of assets and liabilities not considered financial instruments. For additional information about our financial assets carried at fair value, please see Note 9 to the consolidated financial statements.

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## **FINANCIAL CONDITION**

### **Executive Summary**

At March 31, 2012, the Corporation's assets totaled \$804.8 million, compared to \$809.8 million at December 31, 2011, a decrease of \$5.0 million. The decrease in assets is attributable mainly to a decrease in loans held for sale of \$19.6 million which was offset by an increase in investment securities of \$17.3 million. Another primary cause of the decline in assets was the payoff of a \$30.0 million senior unsecured note issued under the Temporary Liquidity Guarantee Program, which was substantially offset by an increase in deposits of \$22.2 million. Notwithstanding these changes, our core commercial bank continues to grow at a steady pace. Loans held for investment totaled \$573.3 million at March 31, 2012 compared to \$569.4 million at year end 2011, an increase of \$3.9 million. The increase in loans is attributable to a \$6.5 million increase in commercial loans that was partially offset by a \$2.9 million decrease in real estate construction loans. At March 31, 2012, loans secured by real estate collateral comprised 75.3% of our total loan portfolio, with loans secured by commercial real estate contributing 48.2% of our total loan portfolio, loans secured by residential real estate contributing 22.4% and real estate construction loans contributing 4.7%. Loans held for sale totaled \$75.6 million at March 31, 2012, compared to \$95.1 million at December 31, 2011. Loans held for sale fluctuates with the volume of loans originated during any given month and the length of time the loans are held prior to selling them in the secondary market. Deposits totaled \$667.2 million at March 31, 2012, compared to \$645.0 million at December 31, 2011. Noninterest-bearing deposits increased \$23.0 million from December 31, 2011 to March 31, 2012, which was the primary contributor for the increase in deposit accounts.

Net income for the first quarter of 2012 totaled \$3.4 million compared to \$2.3 million for the same period in 2011. Earnings per diluted share were \$0.33 for the first quarter of 2012, compared to \$0.22 per diluted share in the same period of 2011. The increase in earnings is primarily due to a \$520 thousand decrease in interest expense, due to the low rate environment and favorable changes in deposit mix, and a \$789 thousand increase in interest and fee income on loans.

Non-performing assets ("NPA") totaled \$5.4 million, or 0.66%, of total assets at March 31, 2012, down from \$6.7 million, or 0.83%, of total assets at December 31, 2011. NPA are comprised solely of non-accrual loans at March 31, 2012.

We believe the economic recovery is continuing to strengthen and the labor market is improving. The unemployment rate for Fairfax County, Virginia at the end of March 2012 was 4.1% compared to 5.6% for the state of Virginia and 8.2% for the nation. The median sales price of new single family homes that sold through February 2012 was \$1,075,900, an increase of 22.5% compared to the 2011 median of \$878,000. The volume of homes in the United States entering the foreclosure process is down more than 30% from a year ago while reported foreclosures in Fairfax County were down 15.8% for the same period. The Federal Open Market Committee announced at the March 2012 meeting that the target rate for federal funds will remain at 0 to 25 basis points, with expectation that economic

conditions will warrant this range through at least 2014. The historically low interest rate environment continues to impact yields of variable loans and the securities portfolio. Despite the low rate environment, the Corporation's net interest margin increased from the first quarter of 2011 to the first quarter of 2012.

We are continuing to focus on credit quality and we believe that we are well positioned for expanding our core commercial banking business and strategic initiatives as the economy cycles into recovery.

### **Securities**

The Corporation's securities portfolio is comprised of U.S. government agency securities, mortgage backed securities, taxable municipal securities, corporate bonds, and a CRA mutual fund. The portfolio does not have any non-agency mortgage backed securities or trust preferred securities.

At March 31, 2012 the fair value of the securities portfolio totaled \$103.0 million, compared to \$85.8 million at December 31, 2011. Included in the fair value totals are held-to-maturity securities with an amortized cost of \$65.0 million and \$40.0 million at March 31, 2012 and December 31, 2011, respectively. Securities classified as available-for-sale are accounted for at fair market value with unrealized gains and losses recorded directly to a separate component of shareholders' equity, net of associated tax effect while held-to-maturity securities are carried at amortized cost. Investment securities are used to provide liquidity, to generate income, and to temporarily supplement loan growth as needed.

### **Restricted Stock**

Restricted stock consists of FHLB stock and FRB stock. These stocks are classified as restricted stocks because their ownership is restricted to certain types of entities and they lack a market. Restricted stock is carried at cost on the Corporation's financial statements. Dividends are paid semi-annually on FRB stock and the FHLB has declared quarterly dividends for each quarter in 2011.

### **Loans**

The loan portfolio constitutes the largest component of earning assets and is comprised of commercial real estate – owner occupied, commercial real estate – non-owner occupied, residential real estate, commercial, real estate construction, and consumer loans. All lending activities of the Bank and its subsidiaries are subject to the regulations and supervision of the Comptroller. The loan portfolio does not have any pay option adjustable rate mortgages, loans with teaser rates or subprime loans or any other loans considered “high risk loans”. Loans totaled \$573.3 million at March 31, 2012 compared to \$569.4 million at December 31, 2011, an increase of \$3.9 million. Owner occupied commercial real estate loans decreased \$1.4 million, non-owner occupied commercial real estate loans increased \$1.2 million, residential real estate loans saw minimal increase and real estate construction loans decreased \$2.9 million. Additionally, commercial loans increased \$6.5 million and consumer loans increased \$502 thousand. The overall increase in loans reflects a continued improvement in loan demand by local businesses, as seen through the increase in commercial segments of the loan portfolio, and is principally due to improvement in economic conditions in Northern Virginia. Please see Note 4 to the consolidated financial statements for a table that summarizes the composition of the Corporation's loan portfolio. The following is a summary of the loan portfolio at March 31, 2012.

**Commercial Real Estate Loans – Owner Occupied:** This category of loans represented the largest segment of the loan portfolio and was comprised of owner occupied loans secured by the commercial property, totaling \$170.2, million representing 29.69% of the loan portfolio at March 31, 2012. Commercial real estate loans are secured by the subject property and underwritten to policy standards. Policy standards approved by the Board of Directors from time to time set forth, among other considerations, loan-to-value limits, cash flow coverage ratios, and the general creditworthiness of the obligors.

**Commercial Real Estate Loans – Non-Owner Occupied:** This category of loans represented the fourth largest segment of the loan portfolio and was comprised of loans secured by income producing commercial property, totaling \$106.2 million and representing 18.52% of the loan portfolio at March 31, 2012. Commercial real estate loans are secured by the subject property and underwritten to policy standards as listed above.

Residential Real Estate Loans: This category represented the third largest segment of the loan portfolio and included loans secured by first or second mortgages on one to four family residential properties. This segment totaled \$128.5 million and comprised 22.42% of the loan portfolio as of March 31, 2012. Of this amount, the following sub-categories existed as a percentage of the whole residential real estate loan portfolio as of March 31, 2012: home equity lines of credit, 18.3%; first trust mortgage loans, 69.0%; and junior trust loans, 12.7%.

Home equity lines of credit are extended to borrowers in our target market. Real estate equity is often the largest component of consumer wealth in our marketplace. Once approved, this consumer finance tool allows the borrowers to access the equity in their homes or investment properties and use the proceeds for virtually any purpose. Home equity lines of credit are most frequently secured by a second lien on residential property. The proceeds of first trust mortgage loans are used to acquire or refinance the primary financing on owner occupied and residential investment properties. Junior trust loans are loans to consumers wherein the proceeds have been used for a stated consumer purpose. Examples of consumer purposes are education, refinancing debt, or purchasing consumer goods. The loans are generally extended in a single disbursement and repaid over a specified period of time. Loans in the residential real estate portfolio are underwritten to standards within a traditional consumer framework that is periodically reviewed and updated by management and the Board of Directors and takes into consideration repayment source and capacity, value of the underlying property, credit history, savings pattern, and stability.

**Loans (continued)**

**Commercial Loans:** Commercial Loans represented the second largest segment of the loan portfolio, totaling \$138.3 million and representing 24.12% of the loan portfolio as of March 31, 2012. These loans are made to businesses or individuals within our target market for business purposes. Typically the loan proceeds are used to support working capital and the acquisition of fixed assets of an operating business. We underwrite these loans based upon our assessment of the obligor(s)' ability to generate operating cash flows in the future necessary to repay the loan. To address the risks associated with the uncertainties of future cash flows, these loans are generally well secured by assets owned by the business or its principal shareholders/owners and the principal shareholders/owners are typically required to guarantee the loan.

**Real Estate Construction Loans:** Real estate construction loans, also known as construction and land development loans represented the fifth largest segment of the loan portfolio and totaled \$26.8 million and represented 4.68% of the loan portfolio as of March 31, 2012. These loans generally fall into one of three categories: first, loans to individuals that are ultimately used to acquire property and construct an owner occupied residence; second, loans to builders for the purpose of acquiring property and constructing homes for sale to consumers; and third, loans to developers for the purpose of acquiring land that is developed into finished lots for the ultimate construction of residential or commercial buildings. Loans of these types are generally secured by the subject property within limits established by the Board of Directors based upon an assessment of market conditions and updated from time to time. The loans typically carry recourse to principal owners. In addition to the repayment risk associated with loans to individuals and businesses, loans in this category carry construction completion risk. To address this additional risk, loans of this type are subject to additional administration procedures designed to verify and ensure progress of the project in accordance with allocated funding, project specifications and time frames.

**Consumer Loans:** Consumer loans, which was the smallest segment of the loan portfolio, totaled \$3.3 million and represented 0.57% of the loan portfolio as of March 31, 2012. Most loans in this category are well secured with assets other than real estate, such as marketable securities or automobiles. Very few consumer loans are unsecured. As a matter of operation, management discourages unsecured lending. Loans in this category are underwritten to standards within a traditional consumer framework that is periodically reviewed and updated by management and the Board of Directors and takes into consideration repayment capacity, collateral value, savings pattern, credit history and stability.

**Loans Held for Sale ("LHFS")**

LHFS are residential mortgage loans originated by the mortgage division of the Bank to consumers and underwritten in accordance with standards set forth by an institutional investor to whom we expect to sell the loans for a profit. Loan proceeds are used for the purchase or refinance of the property securing the loan. Loans are sold with the servicing released to the investor. At March 31, 2012, LHFS at fair value totaled \$75.6 million compared to \$95.1

million at December 31, 2011.

The LHFS loans are closed by the Bank and held on average fifteen to thirty days pending their sale primarily to mortgage banking subsidiaries of large financial institutions. The Bank is also approved to sell loans directly to Fannie Mae and Freddie Mac and is able to securitize loans that are insured by the Federal Housing Administration. During the first quarter of 2012 we originated \$256.9 million of loans processed in this manner, compared to \$278.1 million in the fourth quarter of 2011 and \$122.2 million for the first quarter of 2011. Loans are sold without recourse and subject to industry standard representations and warranties that may require the repurchase by the Bank of loans previously sold. The repurchase risks associated with this activity center around early payment defaults and borrower fraud.

### **Brokered Loans**

Brokered loans are underwritten and closed by a third party lender. The Bank is paid a fee for procuring and packaging brokered loans. We have historically brokered loans that do not conform to the products offered by the Bank. As of April 1, 2011 we began a phase out of brokering loans as a result of new disclosure and compensation regulations. This phase out is evidenced when comparing the first three months of 2012 to the same period for 2011. Brokered loans accounted for 0.16%, or \$424 thousand, of the total loan volume for the first three months of 2012 compared to 12.3%, or \$17.2 million, for the same period of 2011. The change pertaining to brokered loans has not had a material impact on our business.

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**Allowance for Loan Losses**

The allowance for loan losses totaled \$11.9 million at March 31, 2012 compared to \$11.7 million at December 31, 2011. The allowance for loan losses was equivalent to 2.08% of total loans held for investment at March 31, 2012 compared to 2.06% at December 31, 2011. Adequacy of the allowance is assessed and increased by provisions for loan losses charged to expense no less than quarterly. Charge-offs are taken when a loan is identified as uncollectible. For additional information about the allowance for loan losses, please see Note 4 to the consolidated financial statements.

**Non-performing Assets**

At March 31, 2012 and December 31, 2011, the Bank had non-performing assets totaling \$5.4 million and \$6.7 million, respectively. Non-performing assets consist of non-accrual and restructured loans. All non-performing loans are carried at the expected liquidation value of the underlying collateral.

The following table is a summary of our non-performing assets at March 31, 2012 and December 31, 2011.

	March 31, 2012	December 31, 2011	
Non-accrual loans :			(In Thousands)
Commercial real estate - owner occupied	\$1,714	\$ 2,694	
Commercial real estate - non-owner occupied	317	321	
Residential real estate	2,089	2,249	
Commercial	1,230	1,439	
Total non-accrual loans	\$5,350	\$ 6,703	
Restructured loans included above in non-accrual loans	\$1,375	\$ 1,428	
Ratio of non-performing assets to:			
Total loans plus OREO	0.93 %	1.18 %	
Total Assets	0.66 %	0.83 %	

At March 31, 2012 and December 31, 2011 the Bank had no loans past due 90 days or more and still accruing interest.



## **Deposits**

Deposits are the primary sources of funding loan growth. At March 31, 2012, deposits totaled \$667.2 million compared to \$645.0 million on December 31, 2011, an increase of \$22.2 million. Savings and interest-bearing deposits increased \$11.4 million from December 31, 2011 and totaled \$193.4 million at March 31, 2012 as compared to \$182.0 million at December 31, 2011. Time deposits decreased \$12.2 million from \$349.1 million at December 31, 2011 to \$336.9 million at March 31, 2012. Noninterest-bearing deposits increased \$23.0 million from \$113.9 million at December 31, 2011 to \$136.9 million at March 31, 2012. The growth in noninterest-bearing accounts is attributable to new accounts opened during the first quarter of 2012 and balance fluctuations of existing commercial accounts. The overall increase in deposits allowed the Corporation to decrease its borrowings which, coupled with other factors, contributed to the increase in net interest margin.

## **Shareholders' Equity**

Shareholders' equity totaled \$85.6 million at March 31, 2012 compared to \$82.8 million at December 31, 2011. The increase in shareholders' equity is due mainly to retained earnings net of dividends paid. Banking regulators have defined minimum regulatory capital ratios that the Corporation and the Bank are required to maintain. These risk based capital guidelines take into consideration risk factors, as defined by the banking regulators, associated with various categories of assets, both on and off the balance sheet. Both the Corporation and Bank are classified as well capitalized, which is the highest rating.

**Shareholders' Equity (continued)**

The following table outlines the regulatory components of the Corporation's capital and risk based capital ratios.

**Risk Based Capital Analysis**

	March 31, 2012	December 31, 2011				
	(In Thousands)					
Tier 1 Capital:						
Common stock	\$8,541	\$8,511				
Capital surplus	16,613	16,716				
Retained earnings	60,434	57,529				
Less: Net unrealized loss on equity securities	(4 )	(2 )				
Subordinated debentures	6,000	6,000				
Less: Dissallowed servicing assets	(99 )	(110 )				
Total Tier 1 capital	91,485	88,644				
Allowance for loan losses	8,210	7,788				
	8,210	7,788				
Total risk based capital	\$99,695	\$96,432				
Risk weighted assets	\$652,704	\$618,746				
Quarterly average assets	\$827,179	\$821,995				
Capital Ratios:					Regulatory Minimum	
Tier 1 risk based capital ratio	14.02 %	14.33 %			4.00 %	
Total risk based capital ratio	15.27 %	15.59 %			8.00 %	
Leverage ratio	11.06 %	10.78 %			4.00 %	

**RESULTS OF OPERATIONS****Summary**

Net income for the first quarter of 2012 totaled \$3.4 million or \$0.33 diluted earnings per share. This compares with \$2.3 million or \$0.22 diluted earnings per share for the same quarter in 2011. The increase in net income for the three

months ended March 31, 2012 as compared to the same period in 2011 is attributable to the increase in core earnings from the banking segment as well as increased earnings from the mortgage banking segment.

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**Net Interest Income**

Net interest income, the principal source of earnings, is the amount of income generated by earning assets (primarily loans and investment securities) less the interest expense incurred on interest-bearing liabilities (primarily deposits) used to fund earning assets. Net interest income before the provision for loan losses totaled \$7.9 million for the three months ended March 31, 2012 compared to \$6.6 million for the same period in 2011. The increase in net interest income is primarily due to lower funding costs and changes in the composition of earning assets. The annualized yield on earning assets remained stable at 4.65% for the quarter ended March 31, 2012 when compared to 4.64% for the quarter ended March 31, 2011. The stability in the annualized yield on earning assets is primarily attributable to a \$73.4 million increase in average loans held for investment, which more than offset a decrease in the rate earned by the loan portfolio from 6.09% for the quarter ended March 31, 2011 to 5.50% for the same period in 2012. The cost of interest-bearing deposits and borrowings decreased from 1.33% for the quarter ended March 31, 2011 to 0.97% for the quarter ended March 31, 2012. Net interest margin was 3.91% for the quarter ended March 31, 2012 compared to 3.55% for the same period in 2011.

**Volume and Rate Analysis**

The following table presents the dollar amount of changes in interest income and interest expense for each category of interest earning assets and interest-bearing liabilities.

	Three Months Ended March 31, 2012 compared to 2011 Change Due To:		
	Increase		
	/		
	(Decrease)	Volume	Rate
	(In Thousands)		
<b>Interest Earning Assets:</b>			
Securities	\$16	\$(152 )	\$168
Loans held for sale	501	544	(43 )
Loans	288	1,053	(765)
Interest-bearing deposits	(24 )	(19 )	(5 )
Total increase (decrease) in interest income	781	1,426	(645)
<b>Interest-Bearing Liabilities:</b>			
Interest-bearing demand deposits	24	34	(10 )
Money market deposit accounts	(48 )	9	(57 )
Savings accounts	-	-	-
Time deposits	(214 )	96	(310)

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Total interest-bearing deposits	(238 )	139	(377)
FHLB Advances	(11 )	(11 )	-
Securities sold under agreements to repurchase	(8 )	(3 )	(5 )
Other short-term borrowings	(49 )	(25 )	(24 )
Long-term borrowings	(21 )	(20 )	(1 )
Senior unsecured term note	(197 )	(123 )	(74 )
Subordinated debentures	4	-	4
Total decrease in interest expense	(520 )	(43 )	(477)
Increase (decrease) in net interest income	\$1,301	\$1,469	\$(168)

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**Average Balances, Net Interest Income, Yields Earned and Rates Paid**

The following table presents for the periods indicated the total dollar amount of interest income from average interest-earning assets and the resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed in dollars and rates.

Yield on Average Earning Assets and Rates on Average Interest-Bearing Liabilities

Three Month Period Ended  
March 31, 2012                      March 31, 2011

	Average	Income /	Yield /	Average	Income /	Yield /
	Balance	Expense	Rate	Balance	Expense	Rate

(Dollars In Thousands)

## Assets:

## Interest earning assets:

Securities, at amortized cost <sup>(1)</sup>	\$ 106,487	\$ 649	2.44 %	\$ 135,281	\$ 633	1.87 %
Loans held for sale	79,575	850	4.27 %	29,021	349	4.81 %
Loans <sup>(2)</sup>	568,351	7,821	5.50 %	494,920	7,533	6.09 %
Interest-bearing balances and federal funds sold	50,471	31	0.25 %	80,250	55	0.27 %
Total interest earning assets	804,884	9,351	4.65 %	739,472	8,570	4.64 %
Non-interest earning assets:						
Cash and due from banks	8,966			12,180		
Premises, land, and equipment	8,641			8,927		
Other assets	16,754			13,798		
Less: allowance for loan losses	(11,807 )			(10,597 )		
Total non-interest earning assets	22,554			24,308		
Total Assets	\$ 827,438			\$ 763,780		

## Liabilities and Shareholders' Equity:

## Interest-bearing deposits:

Interest-bearing demand deposits	\$ 62,243	\$ 51	0.33 %	\$ 23,425	\$ 27	0.46 %
Money market deposit accounts	130,362	146	0.45 %	124,176	194	0.62 %
Savings accounts	2,557	1	0.16 %	2,905	1	0.14 %
Time deposits	362,867	1,075	1.19 %	336,279	1,289	1.53 %
Total interest-bearing deposits	558,029	1,273	0.91 %	486,785	1,511	1.24 %
Borrowings:						
FHLB Advances	1,203	4	1.33 %	4,523	15	1.33 %
Securities sold under agreements to repurchase and federal fund purchased	28,426	10	0.14 %	36,064	18	0.20 %
Other short-term borrowings	-	-	0.00 %	32,115	49	0.61 %

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FHLB long-term borrowings	4,750	41	3.45 %	7,018	62	3.53 %
Senior unsecured term note	14,505	98	2.70 %	29,999	295	3.93 %
Subordinated Debentures	6,186	57	3.69 %	6,186	53	3.43 %
Total borrowings	55,070	210	1.53 %	115,905	492	1.70 %
Total interest-bearing liabilities	613,099	1,483	0.97 %	602,690	2,003	1.33 %
Noninterest-bearing liabilities:						
Demand deposits	112,298			80,181		
Other liabilities	16,240			7,921		
Total liabilities	741,637			690,792		
Shareholders' Equity	85,801			72,988		
Total Liabilities and Shareholders' Equity:	\$827,438			\$763,780		
Interest spread <sup>(3)</sup>			3.68 %			3.31 %
Net interest margin <sup>(4)*</sup>		\$ 7,868	3.91 %		\$ 6,567	3.55 %

(1) Includes restricted stock.

(2) Loans placed on nonaccrual status are included in loan balances.

(3) Interest spread is the average yield earned on earning assets, less the average rate incurred on interest-bearing liabilities.

(4) Net interest margin is net interest income, expressed as a percentage of average earning assets.

**Noninterest Income**

Noninterest income consists of revenue generated from financial services and activities other than lending and investing. The mortgage segment provides the most significant contributions to noninterest income. Total noninterest income was \$12.1 million for the first quarter of 2012 compared to \$5.8 million for the same period in 2011. Gains on the sale of loans originated by the Banks's mortgage segment are the largest component of noninterest income. Gains on the sale of loans totaled \$10.9 million for the three month period ended March 31, 2012, compared to \$5.5 million for the same period of 2011. Gains on the sale of loans fluctuate with the volume of mortgage loans originated. During the three months ended March 31, 2012, the Bank's mortgage segment originated \$257.3 million in mortgage and brokered loans, up from \$139.4 million for the same period in 2011.

For the three months ended March 31, 2012, other income reflected a gain of \$973 thousand as a result of a \$542 thousand gain relating to derivatives and hedging activities associated with loans held for sale.

**Noninterest Expense**

Noninterest expense totaled \$13.8 million for the three months ended March 31, 2012, compared to \$8.6 million for the same period in 2011, an increase of \$5.2 million. Salaries and employee benefits totaled \$8.3 million for the three months ended March 31, 2012, compared to \$5.4 million for the same period last year. The increase in salary and employee benefits is attributable mainly to new hires for the banking and mortgage segments as well as the wealth management division. Other operating expenses totaled \$4.8 million for the three months ended March 31, 2012, compared to \$2.6 million for the same period in 2011. Management fee expense for the Bank's mortgage division increased \$997 thousand in the first quarter of 2012 from the first quarter of 2011 due to the increase in mortgage division production. Advertising and promotional expense increased \$347 thousand for the three months ended March 31, 2012, compared to the same period in 2011. Other expense increased \$435 thousand for the three months ended March 31, 2012, compared to the same period in 2011 due mainly to an increase in branch reserves of \$258 thousand.

The table below provides the composition of other operating expenses.

	Three Months Ended March 31, 2012    2011 (In Thousands)	
Management fees	\$1,244	\$247



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Advertising and promotional	792	445
Investor fees	328	199
Provision for losses on mortgage loans sold	258	126
Business and franchise tax	175	156
Data processing	165	126
Accounting and auditing	153	151
Consulting fees	108	93
Credit report	87	61
Publication and subscription	70	26
FDIC insurance	65	201
Stock option expense	65	60
Education and training	64	30
Legal fees	63	26
Office supplies-stationary print	62	40
SBA guarantee fee	59	18
Director fees	50	48
Telephone	46	57
Verification Fees	45	37
Regulatory examinations	43	47
Other settlement fees	37	18
Postage	36	33
Other	763	328
	\$4,778	\$2,573

## **Liquidity Management**

Liquidity is the ability of the Corporation to meet current and future cash flow requirements. The liquidity of a financial institution reflects its ability to convert assets into cash or cash equivalents without significant loss and to raise additional funds by increasing liabilities. Liquidity management involves maintaining the Corporation's ability to meet the daily cash flow requirements of both depositors and borrowers. Management monitors liquidity through a regular review of asset and liability maturities, funding sources, and loan and deposit forecasts.

Asset and liability management functions not only serve to assure adequate liquidity in order to meet the needs of the Corporation's customers, but also to maintain an appropriate balance between interest sensitive assets and interest sensitive liabilities so that the Corporation can earn an appropriate return for its shareholders.

The asset portion of the balance sheet provides liquidity primarily through loan principal repayments and maturities of investment securities. Other short-term investments such as federal funds sold and interest-bearing deposits with other banks provide an additional source of liquidity funding. At March 31, 2012, overnight interest-bearing balances totaled \$30.0 million while securities available-for-sale totaled \$38.2 million.

The Bank proactively manages a portfolio of short-term time deposits issued to local municipalities and wholesale depositors in order to fund loans held for sale and short-term investments. As of March 31, 2012, the portfolio of CDARS and wholesale time deposits totaled \$206.4 million compared to \$222.6 million and \$145.6 million at December 31, 2011 and March 31, 2011, respectively.

The liability portion of the balance sheet provides liquidity through various interest-bearing and noninterest-bearing deposit accounts, federal funds purchased, securities sold under agreement to repurchase and other short-term borrowings. At March 31, 2012, the Bank had a line of credit with the FHLB totaling \$242.6 million and had outstanding \$4.3 million in term loans at fixed rates ranging from 2.93% to 4.97% leaving \$238.3 million available on the line. In addition to the line of credit at the FHLB, the Bank issues repurchase agreements. In the first quarter of 2012, the Bank paid off the senior unsecured term note guaranteed by the FDIC under the Temporary Liquidity Guarantee program of \$30.0 million issued in February 2009. In the first quarter of 2011, the Bank also issued commercial paper to corporate clients as an overnight investment vehicle. With the repeal of Regulation D that went into effect in the third quarter of 2011, the Bank discontinued issuing commercial paper and replaced it with a commercial interest-bearing deposit account. This change was primarily responsible for the elimination of any balance in other short-term borrowings as reflected in the table below. As of March 31, 2012, outstanding repurchase agreements totaled \$31.3 million. The interest rates on these instruments are variable and subject to change daily. The Bank also maintains federal funds lines of credit with its correspondent banks and, at March 31, 2012, these lines totaled \$60.4 million and were available as an additional funding source. The Corporation also has \$6.2 million in subordinated debentures to support the capital needs of the Bank.



**Liquidity Management (continued)**

The following table presents the composition of borrowings at March 31, 2012 and December 31, 2011.

**Borrowed Funds Distribution**

	As of March 31, 2012	As of December 31, 2011		
	(Dollars In Thousands)			
Borrowings:				
FHLB advances	\$1,000	\$ -		
FHLB long-term borrowings	3,268	4,821		
Securities sold under agreements to repurchase and federal funds purchased	31,343	29,904		
Subordinated debentures	6,186	6,186		
Senior unsecured term note	-	30,000		
Total at period end	\$41,797	\$ 70,911		
	As of March 31, 2012	As of December 31, 2011		
	(Dollars In Thousands)			
Borrowings:				
Average Balances				
FHLB advances	\$1,203	\$ 8,458		
FHLB long-term borrowings	4,750	6,196		
Securities sold under agreements to repurchase and federal funds purchased	28,426	36,612		
Other short-term borrowings	-	20,681		
Subordinated debentures	6,186	6,186		
Senior unsecured term note	14,505	30,081		
Total average balance	\$55,070	\$ 108,214		
Average rate paid on all borrowed funds	1.53	%	1.71	%

Management believes the Corporation is well positioned with liquid assets, the ability to generate liquidity through liability funding and the availability of borrowed funds, to meet the liquidity needs of depositors and customers' borrowing needs.

### **Contractual Obligations**

There have been no material changes outside the ordinary course of business to the contractual obligations disclosed in the

Corporation's Annual Report on Form 10-K for the fiscal year ended December 31, 2011.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The Corporation's market risk is composed primarily of interest rate risk. The Funds Management Committee is responsible for reviewing the interest rate sensitivity position and establishes policies to monitor and coordinate the Corporation's sources, uses and pricing of funds.

### **Interest Rate Sensitivity Management**

The Corporation uses a simulation model to analyze, manage and formulate operating strategies that address net interest income sensitivity to movements in interest rates. The simulation model projects net interest income based on various interest rate scenarios over a twelve month period. The model is based on the actual maturity and re-pricing characteristics of rate sensitive assets and liabilities. The model incorporates certain assumptions which management believes to be reasonable regarding the impact of changing interest rates and the prepayment assumption of certain assets and liabilities. The table

**Interest Rate Sensitivity Management (continued)**

below reflects the outcome of these analyses at March 31, 2012 and December 31, 2011, assuming budgeted growth in the balance sheet. According to the model run for the three month period ended March 31, 2012, and projecting forward over a twelve month period, an immediate 100 basis point increase in interest rates would result in an increase in net interest income of 4.90%. Modeling for an immediate 100 basis point decrease in interest rates has been suspended due to the current rate environment. While management carefully monitors the exposure to changes in interest rates and takes actions as warranted to mitigate any adverse impact, there can be no assurance about the actual effect of interest rate changes on net interest income.

The following table reflects the Corporation's earnings sensitivity profile.

Increase in Federal Funds Target Rate	Hypothetical Percentage Change in Earnings March 31, 2012	Hypothetical Percentage Change in Earnings December 31, 2011
3.00%	15.49%	15.41%
2.00%	10.45%	10.22%
1.00%	4.90%	4.98%

The Corporation's net interest income and the fair value of its financial instruments are influenced by changes in the level of interest rates. The Corporation manages its exposure to fluctuations in interest rates through policies established by its Funds Management Committee. The Funds Management Committee meets periodically and has responsibility for formulating and implementing strategies to improve balance sheet positioning and earnings and reviewing interest rate sensitivity.

The Bank is party to mortgage rate lock commitments to fund mortgage loans at interest rates previously agreed to, and locked by both the Bank and the borrower for specified periods of time. When the borrower locks its interest rate, the Bank effectively extends a put option to the borrower, whereby the borrower is not obligated to enter into the loan agreement, but the Bank must honor the interest rate for the specified time period. The Bank is exposed to interest rate risk during the accumulation of interest rate lock commitments and loans prior to sale. The Bank utilizes either a best efforts forward sale commitment or a mandatory forward sale commitment to economically hedge the changes in fair value of the loan due to changes in market interest rates. Failure to effectively monitor, manage and hedge the interest rate risk associated with the mandatory commitments subjects the Bank to potentially significant market risk.

Throughout the lock period, the changes in the market value of interest rate lock commitments, best efforts, and mandatory forward sale commitments are recorded as unrealized gains and losses and are included in the statement of operations in other income. The Bank's management has made complex judgments in the recognition of gains and

losses in connection with this activity. The Bank utilizes a third party and its proprietary simulation model to assist in identifying and managing the risk associated with this activity.

**Item 4. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

The Corporation's management evaluated, with the participation of the Chief Executive Officer and Chief Financial Officer, the effectiveness of the Corporation's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act") as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Corporation's disclosure controls and procedures are effective as of the end of the period covered by this report to ensure that information required to be disclosed

**Evaluation of Disclosure Controls and Procedures (continued)**

in the reports that the Corporation files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Corporation's management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that the Corporation's disclosure controls and procedures will detect or uncover every situation involving the failure of persons within the Corporation to disclose material information required to be set forth in the Corporation's periodic and current reports.

**Changes in Internal Control over Financial Reporting**

The Corporation's management is also responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). No changes in the Corporation's internal control over financial reporting occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings**

The Corporation, and the Bank are from time to time parties to legal proceedings arising in the ordinary course of business. Management is of the opinion that these legal proceedings will not have a material adverse effect on the Corporation's financial condition or results of operations. From time to time the Bank and the Corporation may initiate legal actions against borrowers in connection with collecting defaulted loans. Such actions are not considered material by management unless otherwise disclosed.

Prior to discontinuing the operations of the Mortgage Corporation, a subpoena dated May 3, 2011 was received from the United States Attorney's Office (the "U.S. Attorney's Office") for the Southern District of New York. Correspondence accompanying the subpoena indicated that the U.S. Attorney's Office is investigating potential violations by the Mortgage Corporation of the statutes, regulations, and rules governing the Federal Housing Administration's direct endorsement lender program and potential violations of sections 215, 656, 657, 1005, 1006, 1007, 1014, or 1344 of Title 18 or section 287, 1001, 1032, 1341, or 1343 of Title 18 affecting a federally insured financial institution in contemplation of a possible civil proceeding under 12 U.S.C. Section 1833a.



The subpoena requires the Mortgage Corporation, through the Bank since the activities of the Mortgage Corporation have been transitioned into an operating division of the Bank, to produce certain documents and designate a knowledgeable witness to testify with respect to the matters set forth above. The Corporation and its subsidiaries intend to cooperate fully with this investigation.

The Corporation cannot determine the outcome of this investigation or any related civil proceeding. In addition, the Corporation cannot predict how long the investigation will take or whether it or any of its subsidiaries will be required to take any additional actions.

**Item 1A. Risk Factors**

There have been no material changes in the risk factors faced by the Corporation from those disclosed in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2011.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table details the Corporation's purchases of its common stock during the first quarter of 2012 pursuant to a Share Repurchase Program announced on March 20, 2007. On June 22, 2010 the number of shares authorized for repurchase under the share repurchase program was increased from 2,500,000 to 3,500,000. The Share Repurchase Program does not have an expiration date.

Period	Issuer Purchases of Equity Securities			
	(a) Total Number of Shares Purchased	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plan	(d) Maximum Number of Shares that may yet be Purchased Under the Plan
January 1 - January 31, 2012	-	\$ -	-	904,535
February 1 - February 29, 2012	49,800	10.25	49,800	854,735
March 1 - March 31, 2012	24,500	10.40	24,500	830,235
	74,300	\$ 10.30	74,300	830,235

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

Exhibit No.	Description
3.1	Amended and Restated Articles of Incorporation of Access National Corporation (incorporated by reference to Exhibit 3.1 to Form 8-K filed July 18, 2006 (file number 000-49929))
3.1.1	Articles of Amendment to Amended and Restated Articles of Incorporation of Access National Corporation (incorporated by reference to Exhibit 3.1.1 to Form 10-Q filed August 15, 2011 (file number 000-49929))
3.2	Amended and Restated Bylaws of Access National Corporation (incorporated by reference to Exhibit 3.2 to Form 8-K filed October 24, 2007 (file number 000-49929))
4.0	Certain instruments relating to long-term debt as to which the total amount of securities authorized thereunder does not exceed 10% of Access National Corporation's total assets have been omitted in accordance with Item 601(b)(4)(iii) of Regulation S-K. The registrant will furnish a copy of any such instrument to the Securities and Exchange Commission upon its request.
31.1*	CEO Certification Pursuant to Rule 13a-14(a)
31.2*	CFO Certification Pursuant to Rule 13a-14(a)
32*	

CEO/CFO Certification Pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350)

101\* The following materials from Access National Corporation's Quarterly Report on Form 10-Q for the quarter ended March 31, 2012 formatted in XBRL (Extensible Business Reporting Language), furnished herewith: (i) Consolidated Balance Sheets (unaudited), (ii) Consolidated Statements of Income (unaudited), (iii) Consolidated Statements of Comprehensive Income (unaudited), (iv) Consolidated Statements of Changes in Shareholders' Equity (unaudited), (v) Consolidated Statements of Cash Flows (unaudited), and (vi) Notes to Consolidated Financial Statements (unaudited).

\* filed herewith



SIGNATURES

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

Access National Corporation  
(Registrant)

Date: May 14, 2012 By: /s/ Michael W. Clarke  
Michael W. Clarke  
President and Chief  
Executive Officer  
(Principal Executive  
Officer)

Date: May 14, 2012 By: /s/ Charles Wimer  
Charles Wimer  
Executive Vice  
President and Chief  
Financial Officer  
(Principal Financial &  
Accounting Officer)