Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2011

FIRST PACTRUST BANCORP, INC.

(Exact name of registrant as specified in its charter)

000-49806

(Commission File Number)

Maryland

(State of incorporation)

04-3639825

(IRS Employer Identification No.)

610 Bay Boulevard, Chula Vista, California

(Address of Principal Executive Offices)

91910

(ZIP Code)

(619) 691-1519

(Registrant s telephone number, including area code)

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

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

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

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

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

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

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

Table of Contents

FIRST PACTRUST BANCORP, INC.

Form 10-Q Quarterly Report

Index

Table of Contents

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

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

Table of Contents

ITEM 1 FINANCIAL STATEMENTS

First PacTrust Bancorp, Inc.

Consolidated Statements of Financial Condition

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

(Unaudited)

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

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

See accompanying notes to consolidated financial statements.

4

Table of Contents

First PacTrust Bancorp, Inc.

Consolidated Statements of Income and Comprehensive Income/(Loss)

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

(Unaudited)

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

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

See accompanying notes to consolidated financial statements.

Table of Contents

First PacTrust Bancorp, Inc.

Consolidated Statements of Shareholder s Equity

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

(Unaudited)

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

Total comprehensive income/(loss)	(230)

See accompanying notes to consolidated financial statements.

Table of Contents

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

See accompanying notes to consolidated financial statements.

Table of Contents

First PacTrust Bancorp, Inc.

Consolidated Statements of Cash Flows

(In thousands of dollars)

(Unaudited)

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

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

See accompanying notes to consolidated financial statements.

Table of Contents

FIRST PACTRUST BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011

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

NOTE 1 BASIS OF PRESENTATION

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

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

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

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

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

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

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

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

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

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

In April 2011, the FASB issued ASU 2011-02 A Creditor s Determination of Whether a Restructuring Is a Troubled Debt Restructuring. The amendments in ASU 2011-02 provide additional guidance to assist creditors in determining whether a restructuring of a receivable meets the criteria to be considered a troubled debt restructuring. ASU 2011-02 also implements the disclosure requirements regarding troubled debt restructurings set forth in ASU 2010-20. ASU 2011-02 is effective for interim or

13

Table of Contents

annual periods beginning after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. The adoption of ASU 2011-02 resulted in additional disclosures regarding troubled debt restructurings included in the Company s consolidated financial statements.

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

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

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

NOTE 3 EMPLOYEE STOCK COMPENSATION

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

Recognition and Retention Plan

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

Table of Contents

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

Nonvested shares	Shares	Weighted-Average Grant-Date Fair-Value
Nonvested at July 1, 2011	11,078	$ 17.49
Granted		
Vested		