

PATRIOT NATIONAL BANCORP INC

Form 10-Q

November 10, 2011

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
QUARTERLY REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarter Ended September 30, 2011
Commission file number 000-29599
PATRIOT NATIONAL BANCORP, INC.
(Exact name of registrant as specified in its charter)**

Connecticut
(State of incorporation) 06-1559137
(I.R.S. Employer Identification Number)
900 Bedford Street, Stamford, Connecticut 06901
(Address of principal executive offices)
(203) 324-7500
(Registrant's telephone number)

Check whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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 in Rule 12b-2 of the Exchange Act:

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer 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

State the number of shares outstanding of each of the registrant's classes of common equity, as of the latest practicable date.

Common stock, \$0.01 par value per share, 38,362,727 shares outstanding as of the close of business October 31, 2011.

Table of Contents

	Page
<u>Part I FINANCIAL INFORMATION</u>	
<u>Item 1. Consolidated Financial Statements</u>	3
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	39
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	53
<u>Item 4. Controls and Procedures</u>	54
<u>Item 5. Other Information</u>	55
<u>Part II OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	56
<u>Item 1A. Risk Factors</u>	56
<u>Item 6. Exhibits</u>	56
<u>Exhibit 10(a)(20)</u>	
<u>Exhibit 31.1</u>	
<u>Exhibit 31.2</u>	
<u>Exhibit 32</u>	
<u>EX-101 INSTANCE DOCUMENT</u>	
<u>EX-101 SCHEMA DOCUMENT</u>	
<u>EX-101 CALCULATION LINKBASE DOCUMENT</u>	
<u>EX-101 LABELS LINKBASE DOCUMENT</u>	
<u>EX-101 PRESENTATION LINKBASE DOCUMENT</u>	
<u>EX-101 DEFINITION LINKBASE DOCUMENT</u>	

Table of Contents**PART I FINANCIAL INFORMATION****Item 1: Consolidated Financial Statements****PATRIOT NATIONAL BANCORP, INC.****CONSOLIDATED BALANCE SHEETS**

	September 30, 2011 (Unaudited)	December 31, 2010
ASSETS		
Cash and due from banks:		
Noninterest bearing deposits and cash	\$ 9,497,603	\$ 4,613,211
Interest bearing deposits	30,484,856	131,711,047
Federal funds sold		10,000,000
Short-term investments	3,206,016	453,400
Total cash and cash equivalents	43,188,475	146,777,658
Securities:		
Available for sale securities, at fair value (Note 2)	88,529,050	40,564,700
Other Investments	3,500,000	3,500,000
Federal Reserve Bank stock, at cost	1,707,000	1,192,000
Federal Home Loan Bank stock, at cost	4,508,300	4,508,300
Total securities	98,244,350	49,765,000
Loans receivable (net of allowance for loan losses: 2011: \$11,157,678; 2010: \$15,374,101) (Note 3)	453,133,275	534,531,213
Loans held for sale	250,000	
Accrued interest and dividends receivable	2,320,572	2,512,186
Premises and equipment, net	4,180,814	5,270,312
Cash surrender value of life insurance	20,839,710	20,348,332
Other real estate owned	4,731,890	16,408,787
Deferred tax asset (Note 9)		
Other assets	1,537,619	8,711,366
Total assets	\$ 628,426,705	\$ 784,324,854
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities		
Deposits (Note 4):		
Noninterest bearing deposits	\$ 56,699,418	\$ 51,058,373
Interest bearing deposits	451,023,611	595,750,456
Total deposits	507,723,029	646,808,829
Borrowings:		
Repurchase agreements	7,000,000	7,000,000
Federal Home Loan Bank borrowings	50,000,000	50,000,000

Total borrowings	57,000,000	57,000,000
Junior subordinated debt owed to unconsolidated trust	8,248,000	8,248,000
Accrued expenses and other liabilities	4,785,687	5,095,837
Total liabilities	577,756,716	717,152,666
Commitments (Note 7)		
Shareholders equity		
Preferred stock, no par value; 1,000,000 shares authorized, no shares issued and outstanding		
Common stock, \$.01 par value, 100,000,000 shares authorized; 38,374,432 shares issued; 38,362,727 shares outstanding	383,744	383,744
Additional paid-in capital	105,050,433	105,050,433
Accumulated deficit	(55,301,852)	(39,399,345)
Less: Treasury stock, at cost: 2011 and 2010, 11,705 shares	(160,025)	(160,025)
Accumulated other comprehensive income	697,689	1,297,381
Total shareholders equity	50,669,989	67,172,188
Total liabilities and shareholders equity	\$ 628,426,705	\$ 784,324,854

See Accompanying Notes to Consolidated Financial Statements.

Table of Contents
PATRIOT NATIONAL BANCORP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Interest and Dividend Income				
Interest and fees on loans	\$ 6,184,920	\$ 7,977,476	\$ 19,680,074	\$ 26,011,835
Interest on investment securities	664,661	369,169	1,425,582	1,236,019
Dividends on investment securities	56,462	66,403	207,091	202,109
Interest on federal funds sold	464	4,428	6,875	12,275
Other interest income	1,485	51,436	121,738	104,706
Total interest and dividend income	6,907,992	8,468,912	21,441,360	27,566,944
Interest Expense				
Interest on deposits	1,384,540	2,765,030	4,803,634	8,830,894
Interest on Federal Home Loan Bank borrowings	428,183	428,183	1,270,587	1,270,587
Interest on subordinated debt	70,929	76,411	212,546	216,775
Interest on other borrowings	77,772	77,773	230,781	230,781
Total interest expense	1,961,424	3,347,397	6,517,548	10,549,037
Net interest income	4,946,568	5,121,515	14,923,812	17,017,907
Provision for Loan Losses		5,025,000	8,464,427	6,264,000
Net interest income after provision for loan losses	4,946,568	96,515	6,459,385	10,753,907
Non-interest Income				
Mortgage brokerage referral fees	13,500	22,465	28,110	76,139
Loan application, inspection & processing fees	20,656	21,947	61,421	115,448
Deposit fees and service charges	207,200	322,943	736,140	850,661
Gains on sale of loans			79,729	
Gains on sale of investment securities	779,685		779,685	
Earnings on cash surrender value of life insurance	170,133	161,014	491,378	429,848
Other income	90,306	108,727	398,180	264,096
Total non-interest income	1,281,480	637,096	2,574,643	1,736,192
Non-interest Expenses				
Salaries and benefits	2,840,195	3,192,396	9,244,021	9,745,036
Occupancy and equipment expense	1,038,883	1,371,108	3,685,276	4,207,405
Data processing	315,912	369,736	979,721	884,290
Advertising and promotional expenses	91,786	61,415	521,541	216,093
Professional and other outside services	545,612	566,204	2,662,277	2,508,648

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Loan administration and processing expenses	88,373	41,460	173,591	217,676
Regulatory assessments	431,786	689,510	1,671,530	2,074,151
Insurance expense	227,173	194,399	686,584	598,798
Other real estate operations	(26,250)	454,608	1,018,707	1,760,235
Material and communications	163,240	195,900	527,493	597,763
Restructuring charges and asset disposals (Note 11)			2,986,441	
Other operating expenses	255,879	387,455	779,353	777,327
Total non-interest expenses	5,972,589	7,524,191	24,936,535	23,587,422
Income (loss) before income taxes	255,459	(6,790,580)	(15,902,507)	(11,097,323)
Provision for Income Taxes				225,000
Net income (loss)	\$ 255,459	\$ (6,790,580)	\$ (15,902,507)	\$ (11,322,323)
Basic and diluted income (loss) per share (Note 5)	\$ 0.01	\$ (1.43)	\$ (0.41)	\$ (2.38)

See Accompanying Notes to Consolidated Financial Statements.

Table of Contents

PATRIOT NATIONAL BANCORP, INC
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
(Unaudited)

	Number of Shares	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive Income	Total
Nine months ended September 30, 2010							
Balance at December 31, 2009	4,762,727	\$ 9,548,864	\$ 49,651,534	\$ (24,000,400)	\$ (160,025)	\$ 821,337	\$ 35,861,310
Comprehensive loss							
Net loss				(11,322,323)			(11,322,323)
Unrealized holding gain on available for sale securities, net of taxes (Note 6)						626,012	626,012
Total comprehensive loss							(10,696,311)
Balance, September 30, 2010	4,762,727	\$ 9,548,864	\$ 49,651,534	\$ (35,322,723)	\$ (160,025)	\$ 1,447,349	\$ 25,164,999
Nine months ended September 30, 2011							
Balance at December 31, 2010	38,362,727	\$ 383,744	\$ 105,050,433	\$ (39,399,345)	\$ (160,025)	\$ 1,297,381	\$ 67,172,188
Comprehensive loss							

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Net loss	(15,902,507)	(15,902,507)
Unrealized holding loss on available for sale securities, net of taxes (Note 6)		(599,692) (599,692)
Total comprehensive loss		(16,502,199)

Balance, September 30, 2011	38,362,727	\$ 383,744	\$ 105,050,433	\$ (55,301,852)	\$ (160,025)	\$ 697,689	\$ 50,669,989
-----------------------------	------------	------------	----------------	-----------------	--------------	------------	---------------

See Accompanying Notes to Consolidated Financial Statements.

Table of Contents
PATRIOT NATIONAL BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30,	
	2011	2010
Cash Flows from Operating Activities:		
Net loss	\$ (15,902,507)	\$ (11,322,323)
Adjustments to reconcile net loss to net cash used in operating activities:		
Restructuring charges and asset disposals	1,094,094	
Amortization and accretion of investment premiums and discounts, net	234,525	318,842
Amortization and accretion of purchase loan premiums and discounts, net	7,542	7,477
Provision for loan losses	8,464,427	6,264,000
Gain on sales of investments	(779,685)	
Gain on sale of loans	(79,729)	
Amortization of core deposit intangible	11,259	11,925
Earnings on cash surrender value of life insurance	(491,378)	(429,848)
Depreciation and amortization	974,798	1,131,641
Loss on disposal of fixed assets	2,624	
Loss on sale of other real estate owned	58,215	173,289
Impairment writedown on other real estate owned	165,764	961,497
Changes in assets and liabilities:		
Decrease (increase) in deferred loan costs	34,092	(237,165)
Decrease in accrued interest and dividends receivable	191,614	488,000
Decrease in other assets	7,162,488	500,942
Decrease in cash surrender value of life insurance		58,416
(Decrease) increase in accrued expenses and other liabilities	(466,973)	2,037,258
Net cash provided by (used in) operating activities	681,170	(36,049)
Cash Flows from Investing Activities:		
Purchases of available for sale securities	(65,459,630)	(15,162,500)
Purchases of other investments		(500,000)
Principal repayments on available for sale securities	7,316,078	5,819,337
Proceeds from redemptions of available for sale securities		10,000,000
Proceeds from sales of available for sale securities	9,757,118	
Purchases of Federal Reserve Bank Stock	(1,174,100)	
Redemptions of Federal Reserve Bank Stock	659,100	605,450
Proceeds from sale of loans	55,089,794	
Net decrease in loans	13,849,922	61,993,858
Purchase of other real estate owned	(481,165)	
Proceeds from sale of other real estate owned	15,715,973	11,423,343
Capital improvements of other real estate owned		(271,493)
Purchase of bank premises and equipment	(457,643)	(158,167)
Net cash provided by investing activities	34,815,447	73,749,828
Cash Flows from Financing Activities:		

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Net decrease in demand, savings and money market deposits	(25,697,339)	(22,942,716)
Net decrease in time certificates of deposits	(113,388,461)	(47,424,309)
Net cash used in financing activities	(139,085,800)	(70,367,025)
Net (decrease) increase in cash and cash equivalents	(103,589,183)	3,346,754
Cash and Cash Equivalents:		
Beginning	146,777,658	107,799,432
Ending	\$ 43,188,475	\$ 111,146,186

Table of Contents**PATRIOT NATIONAL BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS ,Continued
(Unaudited)**

	Nine Months Ended September 30,	
	2011	2010
Supplemental Disclosures of Cash Flow Information		
Interest paid	\$ 6,319,721	\$ 10,374,774
Income taxes paid	\$ 10,534	\$ 2,080
Supplemental disclosures of noncash investing and financing activities:		
Unrealized holding (loss) gain on available for sale securities arising during the period	\$ (967,244)	\$ 1,009,749
Transfer of loans to other real estate owned	\$ 3,781,890	\$ 556,600
Transfer of loans to held for sale	\$ 250,000	\$
See Accompanying Notes to Consolidated Financial Statements.		

Table of Contents**PATRIOT NATIONAL BANCORP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)****Note 1: Basis of Financial Statement Presentation**

The Consolidated Balance Sheet at December 31, 2010 has been derived from the audited financial statements of Patriot National Bancorp, Inc. (Bancorp or the Company) at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

The accompanying unaudited financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The accompanying consolidated financial statements and related notes should be read in conjunction with the audited financial statements of Bancorp and notes thereto for the year ended December 31, 2010.

The information furnished reflects, in the opinion of management, all normal recurring adjustments necessary for a fair presentation of the results for the interim periods presented. The results of operations for the nine months September 30, 2011 are not necessarily indicative of the results of operations that may be expected for the remainder of 2011.

Note 2: Investment Securities

The amortized cost, gross unrealized gains, gross unrealized losses and approximate fair values of available-for-sale securities at September 30, 2011 and December 31, 2010 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2011:				
U. S. Government agency mortgage-backed securities	\$ 70,131,473	\$ 1,519,219	\$ (5,694)	\$ 71,644,998
U. S. Government agency bonds	5,000,000	36,100		5,036,100
Corporate bonds	12,272,271	212,749	(637,068)	11,847,952
	\$ 87,403,744	\$ 1,768,068	\$ (642,762)	\$ 88,529,050
December 31, 2010:				
U. S. Government agency mortgage-backed securities	\$ 36,572,430	\$ 900,286	\$ (838)	\$ 37,471,878
Auction rate preferred equity securities	1,899,720	1,193,102		3,092,822
	\$ 38,472,150	\$ 2,093,388	\$ (838)	\$ 40,564,700

Table of Contents

The following table presents the gross unrealized loss and fair value of Bancorp's available-for-sale securities, aggregated by the length of time the individual securities have been in a continuous loss position, at September 30, 2011 and December 31, 2010:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
September 30, 2011:						
Corporate bonds	\$ 5,362,932	\$ (637,068)	\$	\$	\$ 5,362,932	\$ (637,068)
U. S. Government mortgage - backed securities	\$ 4,662,632	\$ (5,040)	\$ 68,702	\$ (654)	\$ 4,731,334	\$ (5,694)
Totals	\$ 10,025,564	\$ (642,108)	\$ 68,702	\$ (654)	\$ 10,094,266	\$ (642,762)
December 31, 2010:						
U. S. Government mortgage - backed securities	\$ 86,375	\$ (838)	\$	\$	\$ 86,375	\$ (838)
Totals	\$ 86,375	\$ (838)	\$	\$	\$ 86,375	\$ (838)

At September 30, 2011, 7 securities had unrealized holding losses with aggregate depreciation of 5.99% from the amortized cost. There was one security with unrealized losses greater than 5% of amortized cost. At December 31, 2010, two securities had unrealized losses with aggregate depreciation of 1.0% from the amortized cost. There were no securities with unrealized losses greater than 5% of amortized cost.

Bancorp performs a quarterly analysis of those securities that are in an unrealized loss position to determine if those losses qualify as other-than-temporary impairments. This analysis considers the following criteria in its determination: the ability of the issuer to meet its obligations, an impairment due to a deterioration in credit, management's plans and ability to maintain its investment in the security, the length of time and the amount by which the security has been in a loss position, the interest rate environment, the general economic environment and prospects or projections for improvement or deterioration.

Management believes that none of the unrealized losses on available-for-sale securities noted above are other than temporary due to the fact that they relate to interest rate changes on mortgage-backed securities issued by U.S. Government agencies, and generally weak economic news and global concerns regarding the financial services industry that is impacting the corporate bonds. Management considers the issuers of the mortgage-backed securities, as well as the corporate bonds, to be financially sound, and the Company expects to receive all contractual principal and interest related to these investments. Because the Company does not intend to sell the investments, and it is not more-likely-than-not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at September 30, 2011.

Table of Contents

The amortized cost and fair value of available-for-sale debt securities at September 30, 2011, by contractual maturity, are presented below. Actual maturities of mortgage-backed securities may differ from contractual maturities because the mortgages underlying the securities may be repaid without any penalties. Because mortgage-backed securities are not due at a single maturity date, they are not included in the maturity categories in the following maturity summary:

	Amortized Cost	Fair Value
Maturity:		
> 10 years	\$	\$
Corporate bonds < 5 years	3,272,271	3,465,040
Corporate bonds 5 to 10 years	9,000,000	8,382,912
U. S. Government bonds 5 to 10 years	5,000,000	5,036,100
Mortgage-backed securities	70,131,473	71,644,998
Total	\$ 87,403,744	\$ 88,529,050

Note 3: Loans Receivable and Allowance for Loan Losses

A summary of the Company's loan portfolio at September 30, 2011 and December 31, 2010 is as follows:

	September 30, 2011	December 31, 2010
Real Estate		
Commercial	\$ 210,128,617	\$ 228,842,489
Residential	151,147,445	187,058,318
Construction	12,857,291	63,889,083
Construction to permanent	10,864,395	10,331,043
Commercial	28,553,155	14,573,790
Consumer home equity	48,225,020	42,884,962
Consumer installment	2,163,798	1,932,763
Total Loans	463,939,721	549,512,448
Premiums on purchased loans	234,884	242,426
Net deferred costs	116,348	150,440
Allowance for loan losses	(11,157,678)	(15,374,101)
Loans receivable, net	\$ 453,133,275	\$ 534,531,213

The changes in the allowance for loan losses for the periods shown are as follows:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2011	2010	2011	2010
Balance, beginning of period	\$ 11,399,727	\$ 13,989,069	\$ 15,374,101	\$ 15,794,118
Provision for loan losses		5,025,000	8,464,427	6,264,000
Loans charged-off	(217,788)	(1,917,286)	(7,405,926)	(5,094,670)
Recoveries of loans previously charged-off	16,086	53,345	779,736	186,680
Transferred to loans held-for-sale	(40,347)		(6,054,660)	
Balance, end of period	\$ 11,157,678	\$ 17,150,128	\$ 11,157,678	\$ 17,150,128

Table of Contents

At September 30, 2011 and December 31, 2010, the unpaid balances of loans delinquent 90 days or more and still accruing interest were \$5.8 million and \$3.4 million, respectively. At September 30, 2011, this was comprised of seven loans. Six of the loans totaling \$5.3 million are past their maturity dates but are current for payment and are well secured. One loan is delinquent 60 days as for payment, is past maturity, but is well secured and in the process of collection. The Company has agreed to forbear from pursuing its remedies while the borrowers arrange refinancing from other financial institutions.

The unpaid principal balances of loans on nonaccrual status and considered impaired were \$21.8 million at September 30, 2011 and \$89.1 million at December 31, 2010. On March 24, 2011, the Company completed the sale of certain non-performing assets that included 21 non-accruing loans with an aggregate net book value of \$52.4 million (net of related specific reserves) and 4 other real estate owned (OREO) properties with an aggregate carrying value of \$14.4 million. The sale of \$66.8 million of non-performing assets was consummated for a cash purchase price of \$60,602,036 which represented 90.7% of the Bank's net book value for these assets.

If non-accrual loans had been performing in accordance with their contractual terms, the Company would have recorded approximately \$0.4 million of additional income during the quarter ended September 30, 2011 and \$1.9 million during the quarter ended September 30, 2010. If non-accrual loans had been performing in accordance with their contractual terms, the Company would have recorded approximately \$1.9 million of additional income for the nine months ended September 30, 2011 and \$5.3 million during the nine months ended September 30, 2010.

For the three months ended September 30, 2011 and 2010, the interest collected and recognized as income on impaired loans was approximately \$4,000 and \$362,000, respectively. For the nine months ended September 30, 2011 and 2010, the interest income collected and recognized on impaired loans was approximately \$465,000 and \$1,641,000 respectively. The average recorded investment in impaired loans for the three and nine months ended September 30, 2011 was \$40.4 million and \$54.0 million respectively.

At September 30, 2011, there were 13 loans totaling \$27.7 million that were considered troubled debt restructurings, all of which are included in impaired loans, as compared to December 31, 2010 when there were 19 loans totaling \$38.0 million, all of which were included in impaired loans. At September 30, 2011, 6 of the 13 loans aggregating \$16.1 million were accruing loans and 7 loans aggregating \$11.6 million were non-accruing loans.

The Company's lending activities are conducted principally in Fairfield and New Haven Counties in Connecticut and Westchester County, New York City and Long Island, New York. The Company originates commercial real estate loans, commercial business loans and a variety of consumer loans. In addition, the Company had originated loans for the construction of residential homes, residential developments and for land development projects. A moratorium on all new construction loans was instituted by management in July 2008. All residential and commercial mortgage loans are collateralized primarily by first or second mortgages on real estate. The ability and willingness of borrowers to satisfy their loan obligations is dependent in large part upon the status of the regional economy and regional real estate market. Accordingly, the ultimate collectability of a substantial portion of the loan portfolio and the recovery of a substantial portion of any resulting real estate acquired is susceptible to changes in market conditions.

The Company has established credit policies applicable to each type of lending activity in which it engages, evaluates the creditworthiness of each customer and, in most cases, extends credit of up to 75% of the market value of the collateral at the date of the credit extension depending on the Company's evaluation of the borrower's creditworthiness and type of collateral. In the case of construction loans, the maximum loan-to-value was 65% of the as completed market value. The market value of collateral is monitored on an ongoing basis and additional collateral is obtained when warranted. Real estate is the primary form of collateral. Other important forms of collateral are accounts receivable, inventory, other business assets, marketable securities and time deposits. While collateral provides assurance as a secondary source of repayment, the Company ordinarily requires the primary source of repayment to be based on the borrower's ability to generate continuing cash flows on all loans not related to construction.

Table of Contents

Risk characteristics of the Company's portfolio classes include the following:

Commercial Real Estate Loans In underwriting commercial real estate loans, the Company evaluates both the prospective borrower's ability to make timely payments on the loan and the value of the property securing the loans. Repayment of such loans may be negatively impacted should the borrower default or should there be a substantial decline in the value of the property securing the loan or a decline in the general economic conditions. Where the owner occupies the property, the Company also evaluates the business's ability to repay the loan on a timely basis. In addition, the Company may require personal guarantees, lease assignments and/or the guarantee of the operating company when the property is owner occupied. These types of loans may involve greater risks than other types of lending, because payments on such loans are often dependent upon the successful operation of the business involved, therefore, repayment of such loans may be negatively impacted by adverse changes in economic conditions affecting the borrower's business.

Construction Loans Construction loans are short-term loans (generally up to 18 months) secured by land for both residential and commercial development. The loans are generally made for acquisition and improvements. Funds are disbursed as phases of construction are completed.

In the past, the Company funded construction of single family homes, when no contract of sale exists, based upon the experience of the builder, the financial strength of the owner, the type and location of the property and other factors. Construction loans are generally personally guaranteed by the principal(s). Repayment of such loans may be negatively impacted by the builder's inability to complete construction, by a downturn in the new construction market, by a significant increase in interest rates or by a decline in general economic conditions. The Company has had a moratorium in place since mid-2008 on new speculative construction loans.

Residential Real Estate Loans Various loans secured by residential real estate properties are offered by the Company, including 1-4 family residential mortgages, multi-family residential loans and a variety of home equity line of credit products. Repayment of such loans may be negatively impacted should the borrower default, should there be a significant decline in the value of the property securing the loan or should there be a decline in general economic conditions.

Commercial and Industrial Loans The Company's commercial and industrial loan portfolio consists primarily of commercial business loans and lines of credit to businesses and professionals. These loans are usually made to finance the purchase of inventory, new or used equipment or other short or long-term working capital purposes. These loans are generally secured by corporate assets, often with real estate as secondary collateral, but are also offered on an unsecured basis. In granting this type of loan, the Company primarily looks to the borrower's cash flow as the source of repayment with collateral and personal guarantees, where obtained, as a secondary source. Commercial loans are often larger and may involve greater risks than other type of loans offered by the Company. Payments on such loans are often dependent upon the successful operation of the underlying business involved and, therefore, repayment of such loans may be negatively impacted by adverse changes in economic conditions, management's inability to effectively manage the business, claims of others against the borrower's assets which may take priority over the Company's claims against assets, death or disability of the borrower or loss of market for the borrower's products or services.

Other Loans The Company also offers installment loans and reserve lines of credit to individuals. Repayments of such loans are often dependent on the personal income of the borrower which may be negatively impacted by adverse changes in economic conditions. The Company does not place an emphasis on originating these types of loans.

The Company does not have any lending programs commonly referred to as subprime lending. Subprime lending generally targets borrowers with weakened credit histories typically characterized by payment delinquencies, previous charge-offs, judgments, bankruptcies, or borrowers with questionable repayment capacity as evidenced by low credit scores or high debt-burdened ratios.

Table of Contents

The following table sets forth activity in our allowance for loan losses, by loan type, for the period ended September 30, 2011. The following table also details the amount of loans receivable, net, that are evaluated individually, and collectively, for impairment, and the related portion of allowance for loan losses that is allocated to each loan portfolio segment.

As ended September 30, 2011	Commercial Real		Construction to		Residential	Consumer	Unallocated
	Commercial	Estate	Construction	Permanent			
Allowance for loan losses:							
Balance	\$ 885,310	\$ 6,437,699	\$ 1,340,939	\$ 885,052	\$ 1,245,489	\$ 604,058	\$ 1,180
			(217,788)				
		14,987	499			600	
Loans held-for-sale			(40,347)				
	206,481	(118,612)	(365,592)	(1,741)	(45,348)	48,312	276,500
Loans receivable:							
Loans individually evaluated for impairment	\$ 1,091,791	\$ 6,334,074	\$ 717,711	\$ 883,311	\$ 1,200,141	\$ 652,970	\$ 277,680
Loans collectively evaluated for impairment	\$ 383,678	\$ 1,349,634	\$ 31,520	\$ 791,962	\$ 182,071	\$ 151,500	\$
Allowance for Loan Losses	\$ 1,091,791	\$ 6,334,074	\$ 717,711	\$ 883,311	\$ 1,200,141	\$ 652,970	\$ 277,680
Ending balance	\$ 28,553,155	\$ 210,128,617	\$ 12,857,291	\$ 10,864,395	\$ 151,147,445	\$ 50,388,818	\$
Loans individually evaluated for impairment	\$ 699,379	\$ 11,708,562	\$ 1,545,001	\$ 8,555,062	\$ 13,926,561	\$ 1,417,742	\$
Loans collectively evaluated for impairment	\$ 27,853,776	\$ 198,420,055	\$ 11,312,290	\$ 2,309,333	\$ 137,220,884	\$ 48,971,076	\$

Table of Contents

ended September 30, 2011	Commercial		Real		Construction			Unallocated
	Commercial	Estate	Construction	Permanent	Residential	Consumer		
Loan losses:								
Balance	\$ 441,319	\$ 7,632,355	\$ 3,478,058	\$ 491,446	\$ 2,363,838	\$ 578,612	\$ 388,473	\$
		(2,736,140)	(3,049,828)		(1,458,199)	(161,759)		
	240	18,776	461,781			298,939		
Loans held-for-sale		(963,461)	(1,409,701)		(3,681,498)			
	650,232	2,382,544	1,237,401	391,865	3,976,000	(62,822)	(110,793)	
Provision for Loan Losses	\$ 1,091,791	\$ 6,334,074	\$ 717,711	\$ 883,311	\$ 1,200,141	\$ 652,970	\$ 277,680	\$
Provision: individually evaluated for	\$ 383,678	\$ 1,349,634	\$ 31,520	\$ 791,962	\$ 182,071	\$ 151,500	\$	\$
Provision: collectively evaluated for	\$ 708,113	\$ 4,984,440	\$ 686,191	\$ 91,349	\$ 1,018,070	\$ 501,470	\$ 277,680	\$
Provision for Loan Losses	\$ 1,091,791	\$ 6,334,074	\$ 717,711	\$ 883,311	\$ 1,200,141	\$ 652,970	\$ 277,680	\$
Ending balance	\$ 28,553,155	\$ 210,128,617	\$ 12,857,291	\$ 10,864,395	\$ 151,147,445	\$ 50,388,818	\$	\$
Provision: individually evaluated for	\$ 699,379	\$ 11,708,562	\$ 1,545,001	\$ 8,555,062	\$ 13,926,561	\$ 1,417,742	\$	\$
Provision: collectively evaluated for	\$ 27,853,776	\$ 198,420,055	\$ 11,312,290	\$ 2,309,333	\$ 137,220,884	\$ 48,971,076	\$	\$

Table of Contents

The Company monitors the credit quality of its loans receivable in an ongoing manner. Credit quality is monitored by reviewing certain credit quality indicators. Management has determined that loan-to-value ratios (LTVs), (at period end) and internally assigned risk ratings are the key credit quality indicators that best help management monitor the credit quality of the Company's loans receivable. Loan-to-value ratios used by management in monitoring credit quality are based on current period loan balances and original values at time of origination (unless a current appraisal has been obtained as a result of the loan being deemed impaired or the loan is a maturing construction loan).

Appraisals on properties securing impaired loans and Other Real Estate Owned are updated annually. Additionally, appraisals on construction loans are updated four months in advance of scheduled maturity dates. We update our impairment analysis monthly based on the most recent appraisal as well as other factors (such as senior lien positions, e.g. property taxes), and we are using published information regarding actual median home sales prices in the towns/counties where our collateral is located in CT and NY.

The majority of the Company's impaired loans have been resolved through courses of action other than via bank liquidations of real estate collateral through OREO. These include normal loan payoffs, the traditional workout process, triggering personal guarantee obligations, and troubled debt restructurings. However, as loan workout efforts progress to a point where the bank's liquidation of real estate collateral is the likely outcome, the impairment analysis is updated to reflect actual recent experience with bank sales of OREO properties.

A disposition discount is built into our impairment analysis and reflected in our allowance once a property is determined to be a likely OREO (e.g. foreclosure is probable). To determine the discount we compare the actual sales prices of our OREO properties to the appraised value that was obtained as of the date when we took title to the property. The difference is the bank-owned disposition discount.

The Company has a risk rating system as part of the risk assessment of its loan portfolio. The Company's lending officers are required to assign a risk rating to each loan in their portfolio at origination. When the lender learns of important financial developments, the risk rating is reviewed accordingly, and adjusted if necessary. Similarly, the Loan Committee can adjust a risk rating. The Loan Workout Committee meets on a regular basis and reviews loans rated special mention or worse. In addition, the Company engages a third party independent loan reviewer that performs semi-annual reviews of a sample of loans, validating the Bank's risk ratings assigned to such loans. The risk ratings play an important role in the establishment of the loan loss provision and to confirm the adequacy of the allowance for loan losses.

When assigning a risk rating to a loan, management utilizes the Bank's internal nine-point risk rating system. Loans deemed to be acceptable quality are rated 1 through 5, with a rating of 1 established for loans with minimal risk and borrowers exhibiting the strongest financial condition. Loans rated 1-5 are considered Pass. Loans that are deemed to be of questionable quality are rated 6 (special mention). An asset is considered special mention when it has a potential weakness based on objective evidence, but does not currently expose the Company to sufficient risk to warrant classification in one of the following categories. Loans with adverse classifications (substandard, doubtful or loss) are rated 7, 8 or 9, respectively. An asset is considered substandard if it is not adequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets have well defined weaknesses based on objective evidence, and are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard with the 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.

Charge-off generally commences in the month that the loan is classified doubtful and is fully charged off within six months of such classification. If the account is classified loss the full balance is charged off immediately. The full balance is charged off regardless of the potential recovery from the sale of the collateral. This amount is recognized as a recovery once the collateral is sold.

In accordance with FFIEC (Federal Financial Institutions Examination Council) published policies establishing uniform criteria for the classification of retail credit based on delinquency status, Open-end credits are charged-off when 180 days delinquent and Closed-end credits are charged-off when 120 days delinquent. Typically, consumer installment loans are charged off no later than 90 days past due.

Table of Contents

The following table details the credit risk exposure of loans receivable, by loan type and credit quality indicator at September 30, 2011:

CREDIT RISK PROFILE BY CREDITWORTHINESS CATEGORY

	Commercial Real Estate		Construction		Construction to Permanent		Residential Real Estate		< 75%	>= 75%
	< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%		
54	\$ 138,358,750	\$ 6,203,715	\$	\$	\$ 600,000	\$	\$ 95,563,057	\$ 32,641,241	\$ 44,474,523	\$
75	25,926,653	4,601,276	9,594,291		1,709,333		5,318,049	2,400,000	274,390	3
88	13,821,012	21,217,211	154,396	3,108,604		8,555,062	4,111,951	11,113,147	11,294	1
17	\$ 178,106,415	\$ 32,022,202	\$ 9,748,687	\$ 3,108,604	\$ 2,309,333	\$ 8,555,062	\$ 104,993,057	\$ 46,154,388	\$ 44,760,207	\$ 4

CREDIT RISK PROFILE

	Commercial	Commercial Real Estate	Construction	Construction to Permanent	Residential Real Estate	Consumer	Totals
Performing	\$ 27,853,776	\$ 198,660,360	\$ 11,312,289	\$ 7,214,333	\$ 147,727,635	\$ 49,395,078	\$ 442,163,471
Non Performing	699,379	11,468,257	1,545,002	3,650,062	3,419,810	993,740	21,776,250
Total	\$ 28,553,155	\$ 210,128,617	\$ 12,857,291	\$ 10,864,395	\$ 151,147,445	\$ 50,388,818	\$ 463,939,721

Table of Contents

The following table details the credit risk exposure of loans receivable, by loan type and credit quality indicator at December 31, 2010:

CREDIT RISK PROFILE BY CREDITWORTHINESS CATEGORY

Commercial Real Estate		Construction		Construction to Permanent		Residential Real Estate		Consumer
< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%
\$ 124,645,152	\$ 9,449,059	\$ 1,272,028	\$ 350,000	\$	\$	\$ 91,534,348	\$ 51,996,851	\$ 35,192,214
35,253,018	4,645,738	15,059,704	4,485,209	1,709,333		2,088,700	2,907,285	3,146,244
13,792,482	41,057,040	10,712,146	32,009,996		8,621,710	18,052,003	20,479,131	99,235
\$ 173,690,652	\$ 55,151,837	\$ 27,043,878	\$ 36,845,205	\$ 1,709,333	\$ 8,621,710	\$ 111,675,051	\$ 75,383,267	\$ 38,437,693

CREDIT RISK PROFILE

	Commercial	Commercial Real Estate	Construction	Construction to Permanent	Residential Real Estate	Consumer	Totals
Performing	\$ 13,358,840	\$ 202,054,317	\$ 33,003,060	\$ 8,951,208	\$ 159,270,574	\$ 43,724,749	\$ 460,362,748
Non Performing	1,214,950	26,788,172	30,886,023	1,379,835	27,787,744	1,092,976	89,149,700
Total	\$ 14,573,790	\$ 228,842,489	\$ 63,889,083	\$ 10,331,043	\$ 187,058,318	\$ 44,817,725	\$ 549,512,448

Table of Contents

Included in loans receivable are loans for which the accrual of interest income has been discontinued due to deterioration in the financial condition of the borrowers. The recorded balance of these nonaccrual loans was \$21.8 million and \$89.1 million at September 30, 2011, and December 31, 2010 respectively. Generally, loans are placed on non-accruing status when they become 90 days or more delinquent, or earlier if deemed appropriate, and remain on non-accrual status until they are brought current, have six months of performance under the loan terms, and factors indicating reasonable doubt about the timely collection of payments no longer exist. Therefore, loans may be current in accordance with their loan terms, or may be less than 90 days delinquent and still be on a non-accruing status. Additionally, certain loans that cannot demonstrate sufficient global cash flow to continue loan payments in the future and certain trouble debt restructures (TDRs) are placed on non-accrual status.

The following table sets forth the detail, and delinquency status, of non-accrual loans and past due loans at September 30, 2011:

	Non-Accrual and Past Due Loans						Total Non- >90 Days Past Due and Accruing	Total Non- Accrual and Past Due Loans
	31-60 Days Past Due	61-90 Days Past Due	Greater Than 90 Days	Total Past Due		Current		
2011								
Commercial								
Pass	\$	\$	\$	\$	\$	\$	\$	\$
Special Mention								
Substandard		172,088	410,170	582,258	117,121	448,000	1,147,379	
Total Commercial	\$	\$ 172,088	\$ 410,170	\$ 582,258	\$ 117,121	\$ 448,000	\$ 1,147,379	
Commercial Real Estate								
Pass	\$	\$	\$	\$	\$	\$ 574,893	\$ 574,893	
Substandard	\$	\$	\$ 7,745,806	\$ 7,745,806	\$ 3,722,450	\$ 3,099,805	\$ 14,568,061	
Total Commercial Real Estate	\$	\$	\$ 7,745,806	\$ 7,745,806	\$ 3,722,450	\$ 3,674,698	\$ 15,142,954	
Construction Substandard	\$	\$	\$ 289,397	\$ 289,397	\$ 1,255,604	\$ 1,717,999	\$ 3,263,000	
Total Construction	\$	\$	\$ 289,397	\$ 289,397	\$ 1,255,604	\$ 1,717,999	\$ 3,263,000	
Construction to Permanent Substandard	\$	\$	\$ 1,127,875	\$ 1,127,875	\$ 2,522,187	\$	\$ 3,650,062	
Total Construction to Permanent	\$	\$	\$ 1,127,875	\$ 1,127,875	\$ 2,522,187	\$	\$ 3,650,062	
Residential Real Estate Substandard	\$	\$	\$ 3,419,810	\$ 3,419,810	\$	\$	\$ 3,419,810	
Total Residential Real Estate	\$	\$	\$ 3,419,810	\$ 3,419,810	\$	\$	\$ 3,419,810	

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Consumer Substandard	\$	\$	\$	993,742	\$	993,742	\$	\$	993,742				
Total Consumer	\$	\$	\$	993,742	\$	993,742	\$	\$	993,742				
Total	\$	\$	172,088	\$	13,986,800	\$	14,158,888	\$	7,617,362	\$	5,840,697	\$	27,616,947

Table of Contents

The following table sets forth the detail, and delinquency status, of non-accrual loans and past due loans at December 31, 2010:

2010	Non-Accrual and Past Due Loans						Total Non-Accrual and Past Due Loans
	31-60 Days Past Due	61-90 Days Past Due	Greater Than 90 Days	Total Past Due	Current	>90 Days Past Due and Accruing	
Commercial Special Mention Substandard	\$ 350,000	\$ 100,000	\$ 698,767	\$ 1,148,767	\$ 66,183	\$ 63,289 175,000	\$ 63,289 1,389,950
Total Commercial	\$ 350,000	\$ 100,000	\$ 698,767	\$ 1,148,767	\$ 66,183	\$ 238,289	\$ 1,453,239
Commercial Real Estate Substandard	\$ 269,672	\$ 6,449,096	\$ 13,521,123	\$ 20,239,891	\$ 6,548,281	\$	\$ 26,788,172
Total Commercial Real Estate	\$ 269,672	\$ 6,449,096	\$ 13,521,123	\$ 20,239,891	\$ 6,548,281	\$	\$ 26,788,172
Construction Substandard	\$ 1,517,943	\$ 4,059,516	\$ 13,736,985	\$ 19,314,444	\$ 11,571,579	\$ 3,135,953	\$ 34,021,976
Total Construction	\$ 1,517,943	\$ 4,059,516	\$ 13,736,985	\$ 19,314,444	\$ 11,571,579	\$ 3,135,953	\$ 34,021,976
Construction to Permanent Substandard	\$	\$	\$	\$	\$ 1,379,835	\$	\$ 1,379,835
Total Construction to Permanent	\$	\$	\$	\$	\$ 1,379,835	\$	\$ 1,379,835
Residential Real Estate Substandard	\$	\$	\$ 15,897,248	\$ 15,897,248	\$ 11,890,496	\$	\$ 27,787,744
Total Residential Real Estate	\$	\$	\$ 15,897,248	\$ 15,897,248	\$ 11,890,496	\$	\$ 27,787,744
Consumer Substandard	\$	\$	\$ 1,092,976	\$ 1,092,976	\$	\$	\$ 1,092,976

Total Consumer	\$	\$	\$ 1,092,976	\$ 1,092,976	\$	\$ 1,092,976
Total	\$ 2,137,615	\$ 10,608,612	\$ 44,947,099	\$ 57,693,326	\$ 31,456,374	\$ 3,374,242 \$ 92,523,942

These non-accrual and past due amounts included loans deemed to be impaired of \$21.8 million and \$89.1 million at September 30, 2011, and December 31, 2010, respectively. Loans past due ninety days or more and still accruing interest were approximately \$5.8 million and \$3.4 million at September 30, 2011, and December 31, 2010 respectively, and consisted of 7 loans at September 30, 2011. Six of the loans are past their maturity, but are well secured and in the process of collection. One loan is 60 days delinquent as for payment, is past maturity, but is well secured and in the process of collection.

Table of Contents

The following table sets forth the detail and delinquency status of loans receivable, by performing and non-performing loans at September 30, 2011.

2011	Performing (Accruing) Loans				Total Performing Loans	Total Non-Accrual and		Total Loans
	31-60 Days Past Due	Greater Than 60 Days	Total Past Due	Current		Past Due Loans	Total Loans	
Commercial								
Pass	\$ 18,862	\$	\$ 18,862	\$ 22,757,629	\$ 22,776,491	\$	\$	\$ 22,776,491
Special Mention				754,955	754,955			754,955
Substandard	242,868		242,868	3,631,462	3,874,330	1,147,379		5,021,709
Total								
Commercial	\$ 261,730	\$	\$ 261,730	\$ 27,144,046	\$ 27,405,776	\$ 1,147,379	\$	\$ 28,553,155
Commercial								
Real Estate								
Pass	\$ 1,918,308	\$	\$ 1,918,308	\$ 142,069,265	\$ 143,987,573	\$ 574,893	\$	\$ 144,562,466
Special Mention	400,516		400,516	30,127,412	30,527,928			30,527,928
Substandard	617,139		617,139	19,853,023	20,470,162	14,568,061		35,038,223
Total								
Commercial	\$ 2,935,963	\$	\$ 2,935,963	\$ 192,049,700	\$ 194,985,663	\$ 15,142,954	\$	\$ 210,128,617
Construction								
Pass	\$	\$	\$	\$	\$	\$	\$	\$
Special Mention				9,594,291	9,594,291			9,594,291
Substandard						3,263,000		3,263,000
Total								
Construction	\$	\$	\$	\$ 9,594,291	\$ 9,594,291	\$ 3,263,000	\$	\$ 12,857,291
Construction to								
Permanent								
Pass	\$	\$	\$	\$ 600,000	\$ 600,000	\$	\$	\$ 600,000
Special Mention				1,709,333	1,709,333			1,709,333
Substandard				4,905,000	4,905,000	3,650,062		8,555,062
Total								
Construction to	\$	\$	\$	\$ 7,214,333	\$ 7,214,333	\$ 3,650,062	\$	\$ 10,864,395
Permanent								
Residential Real								
Estate								
Pass	\$ 148,285	\$	\$ 148,285	\$ 128,056,013	\$ 128,204,298	\$	\$	\$ 128,204,298
Special Mention				7,718,049	7,718,049			7,718,049
Substandard				11,805,288	11,805,288	3,419,810		15,225,098

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Total Residential Real Estate	\$ 148,285	\$	\$ 148,285	\$ 147,579,350	\$ 147,727,635	\$ 3,419,810	\$ 151,147,445
Consumer Pass	\$	\$	\$	\$ 45,656,029	\$ 45,656,029	\$	\$ 45,656,029
Special Mention				3,303,753	3,303,753		3,303,753
Substandard				435,294	435,294	993,742	1,429,036
Total Consumer	\$	\$	\$	\$ 49,395,076	\$ 49,395,076	\$ 993,742	\$ 50,388,818
Total	\$ 3,345,978	\$	\$ 3,345,978	\$ 432,976,796	\$ 436,322,774	\$ 27,616,947	\$ 463,939,721

Table of Contents

The following table sets forth the detail and delinquency status of loans receivable, net, by performing and non-performing loans at December 31, 2010.

2010	Performing (Accruing) Loans				Total Performing Loans	Total Non-Accrual and		Total Loans
	31-60 Days Past Due	Greater Than 60 Days	Total Past Due	Current		Past Due Loans		
Commercial								
Pass	\$	\$	\$	\$ 11,481,557	\$ 11,481,557	\$	\$	\$ 11,481,557
Special Mention				822,364	822,364	63,289		885,653
Substandard				816,630	816,630	1,389,950		2,206,580
Total								
Commercial	\$	\$	\$	\$ 13,120,551	\$ 13,120,551	\$ 1,453,239		\$ 14,573,790
Commercial								
Real Estate								
Pass	\$	\$	\$	\$ 134,094,210	\$ 134,094,210	\$		\$ 134,094,210
Special Mention				39,898,756	39,898,756			39,898,756
Substandard				28,061,351	28,061,351	26,788,172		54,849,523
Total								
Commercial	\$	\$	\$	\$ 202,054,317	\$ 202,054,317	\$ 26,788,172		\$ 228,842,489
Real Estate								
Construction								
Pass	\$	\$	\$	\$ 1,622,029	\$ 1,622,029	\$		\$ 1,622,029
Special Mention				19,544,913	19,544,913			19,544,913
Substandard				8,700,165	8,700,165	34,021,976		42,722,141
Total								
Construction	\$	\$	\$	\$ 29,867,107	\$ 29,867,107	\$ 34,021,976		\$ 63,889,083
Construction to								
Permanent								
Pass	\$	\$	\$	\$	\$	\$		\$
Special Mention				1,709,333	1,709,333			1,709,333
Substandard	1,127,875		1,127,875	6,114,000	7,241,875	1,379,835		8,621,710
Total								
Construction to	\$ 1,127,875	\$	\$ 1,127,875	\$ 7,823,333	\$ 8,951,208	\$ 1,379,835		\$ 10,331,043
Permanent								
Residential Real								
Estate								
Pass	\$ 198,357	\$	\$ 198,357	\$ 143,332,842	\$ 143,531,199	\$		\$ 143,531,199
Special Mention	2,907,285		2,907,285	2,088,700	4,995,985			4,995,985
Substandard				10,743,390	10,743,390	27,787,744		38,531,134

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Total Residential Real Estate	\$ 3,105,642	\$	\$ 3,105,642	\$ 156,164,932	\$ 159,270,574	\$ 27,787,744	\$ 187,058,318
Consumer Pass	\$	\$	\$	\$ 37,109,997	\$ 37,109,997	\$	\$ 37,109,997
Special Mention	168,589		168,589	5,857,276	6,025,865		6,025,865
Substandard				588,887	588,887	1,092,976	1,681,863
Total Consumer	\$ 168,589	\$	\$ 168,589	\$ 43,556,160	\$ 43,724,749	\$ 1,092,976	\$ 44,817,725
Total	\$ 4,402,106	\$	\$ 4,402,106	\$ 452,586,400	\$ 456,988,506	\$ 92,523,942	\$ 549,512,448

Table of Contents

The following table summarizes impaired loans as of September 30, 2011:

	Recorded	Unpaid	
	Investment	Principal	Related
		Balance	Allowance
2011			
With no related allowance recorded:			
Commercial	\$ 173,208	\$ 492,972	\$
Commercial Real Estate	4,675,439	5,402,165	
Construction	1,410,001	1,414,048	
Construction to Permanent	4,905,000	4,905,000	
Residential	9,251,452	9,251,452	
Consumer	993,742	1,038,640	
Total:	\$ 21,408,842	\$ 22,504,277	\$
With an allowance recorded:			
Commercial	\$ 526,171	\$ 553,663	\$ 383,678
Commercial Real Estate	7,033,123	8,594,940	1,349,634
Construction	135,000	286,625	31,520
Construction to Permanent	3,650,062	3,761,875	791,962
Residential	4,675,109	4,675,110	182,071
Consumer	424,000	424,000	151,500
Total:	\$ 16,443,465	\$ 18,296,213	\$ 2,890,365
Commercial	\$ 699,379	\$ 1,046,635	\$ 383,678
Commercial Real Estate	11,708,562	13,997,105	1,349,634
Construction	1,545,001	1,700,673	31,520
Construction to Permanent	8,555,062	8,666,875	791,962
Residential	13,926,561	13,926,562	182,071
Consumer	1,417,742	1,462,640	151,500
Total:	\$ 37,852,307	\$ 40,800,490	\$ 2,890,365

The recorded investment of impaired loans at September 30, 2011 and December 31, 2010 was \$37.9 million and \$100.7 million respectively, with related allowances of \$2.9 million and \$6.0 million, respectively.

Included in the table above at September 30, 2011, are 21 loans with carrying balances of \$21.4 million that required no specific reserves. The allowance for loan losses is comprised of 29 non-accruing loans aggregating \$21.8 million and six accruing TDR loans aggregating \$16.1 million. Loans that did not require specific reserves at September 30, 2011 have sufficient collateral values, less costs to sell, supporting the carrying balances of the loans. In some cases, there may be no specific reserves because the Company already charged-off the specific impairment. Once a borrower is in default, the Company is under no obligation to advance additional funds on unused commitments.

Table of Contents

The following table summarizes impaired loans as of December 31, 2010:

	Recorded Investment	Unpaid Principal Balance	Related Allowance
2010			
With no related allowance recorded:			
Commercial	\$ 1,077,512	\$ 1,828,917	\$
Commercial Real Estate	12,770,033	13,052,924	
Construction	14,060,251	15,133,253	
Construction to Permanent			
Residential	24,513,106	24,737,293	
Consumer	1,516,977	1,883,585	
Total:	\$ 53,937,879	\$ 56,635,972	\$
With an allowance recorded:			
Commercial	\$ 137,438	\$ 151,633	\$ 76,045
Commercial Real Estate	15,696,205	19,509,247	2,300,199
Construction	16,825,772	19,368,468	1,895,326
Construction to Permanent	1,379,835	1,425,000	183,835
Residential	12,706,762	12,826,248	1,556,077
Consumer			
Total:	\$ 46,746,012	\$ 53,280,596	\$ 6,011,482
Commercial	\$ 1,214,950	\$ 1,980,550	\$ 76,045
Commercial Real Estate	28,466,238	32,562,171	2,300,199
Construction	30,886,023	34,501,721	1,895,326
Construction to Permanent	1,379,835	1,425,000	183,835
Residential	37,219,868	37,563,541	1,556,077
Consumer	1,516,977	1,883,585	
Total:	\$ 100,683,891	\$ 109,916,568	\$ 6,011,482

Included in the table above at December 31, 2010, are loans with carrying balances of \$53.9 million that required no specific reserves in our allowance for loan losses. Loans that did not require specific reserves at December 31, 2010 have sufficient collateral values, less costs to sell, supporting the carrying balances of the loans.

On a case-by-case basis, the Company may agree to modify the contractual terms of a borrower's loan to remain competitive and assist customers who may be experiencing financial difficulty, as well as preserve the Company's position in the loan. If the borrower is experiencing financial difficulties and a concession has been made at the time of such modification, the loan classified is a troubled debt restructured loan.

As a result of the adoption of ASU 2011-02, the Company reassessed all restructurings occurred on or after January 1, 2011 for identification as TDRs and has concluded that there were no additional TDRs identified that have not been previously disclosed.

Table of Contents

The following table presents the total troubled debt restructured loans as of September 30, 2011:

	Accrual		Non-accrual		Total	
	# of Loans	Amount	# of Loans	Amount	# of Loans	Amount
Commercial Real Estate	3	\$ 4,794,528	1	\$ 2,155,000	4	\$ 6,949,528
Residential Real Estate	3	10,506,751			3	10,506,751
Construction			1	1,255,605	1	1,255,605
Construction to permanent	1	4,905,000	3	3,650,062	4	8,555,062
Consumer home equity	1	424,000			1	424,000
Total Troubled Debt Restructurings	8	\$ 20,630,279	5	\$ 7,060,667	13	\$ 27,690,946

There were no loans modified in a troubled debt restructuring for the three months ended September 30, 2011.

The following table summarizes loans that were modified in a troubled debt restructuring during the nine months ended September 30, 2011.

	Nine months ended September 30, 2011		
	Number of Relationships	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Commercial Real Estate	2	\$ 3,579,149	\$ 3,506,461
Residential Real Estate	1	2,884,141	2,884,141
Construction to permanent	5	12,560,969	8,555,062
Total Troubled Debt Restructurings	8	\$ 19,024,259	\$ 14,945,664

The eight loans represented above have been reclassified as troubled debt restructurings during the first nine months of 2011.

Substantially all of our troubled debt restructured loan modifications involve lowering the monthly payments on such loans through either a reduction in interest rate below market rate, an extension of the term of the loan, or a combination of these two methods. These modifications rarely result in the forgiveness of principal or accrued interest. In addition, we frequently obtain additional collateral or guarantor support when modifying commercial loans. If the borrower has demonstrated performance under the previous terms and our underwriting process shows the borrower has the capacity to continue to perform under the restructured terms, the loan will continue to accrue interest. Non-accruing restructured loans may be returned to accrual status when there has been a sustained period of repayment performance (generally six consecutive months of payments) and both principal and interest are deemed collectible.

In addition to the above, during the nine months ended September 30, 2011, there was one commercial real estate loan modified on March 31, 2011 for \$3.3 million that released a guarantor having financial difficulty to allow the borrower to recapitalize and provide additional time in which to develop an exit plan to pay off the debt.

Table of Contents

During the nine months ended September 30, 2011, two of the troubled debt restructurings modified had a payment default. One default was a residential loan for \$3.5 million and is subsequently an OREO, and the other default was a commercial loan for \$1.3 million, and is currently in the foreclosure process.

All troubled debt restructurings are impaired loans, which are individually evaluated for impairment, as discussed above, and were included in the allowance for loan losses.

Note 4: Deposits

The following table is a summary of the Company's deposits at:

	September 30, 2011	December 31, 2010
Non-interest bearing	\$ 56,699,418	\$ 51,058,373
Interest bearing		
NOW	25,325,126	19,297,225
Savings	53,634,681	57,041,943
Money market	58,724,455	92,683,478
Time certificates, less than \$100,000	185,394,428	251,296,558
Time certificates, \$100,000 or more	127,944,921	175,431,252
Total interest bearing	451,023,611	595,750,456
Total Deposits	\$ 507,723,029	\$ 646,808,829

Included in time certificates are certificates of deposit through the Certificate of Deposit Account Registry Service (CDARS) network of \$1,362,540 and \$2,879,838 at September 30, 2011 and December 31, 2010, respectively. These are considered brokered deposits. Pursuant to the Agreement discussed in Note 8, the Bank's participation in the CDARS program, as an issuer of deposits to customers of other banks in the CDARS program, may not exceed 10% of total deposits.

Note 5: Income (Loss) per share

The Company is required to present basic income (loss) per share and diluted income (loss) per share in its consolidated statements of operations. Basic income (loss) per share amounts are computed by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted income (loss) per share reflects additional common shares that would have been outstanding if potentially dilutive common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. The Company is also required to provide a reconciliation of the numerator and denominator used in the computation of both basic and diluted loss per share.

Table of Contents

The following is information about the computation of loss per share for the three and nine months ended September 30, 2011 and 2010:

Three months ended September 30, 2011

	Net Income	Weighted Average Common Shares O/S	Amount
Basic and Diluted Income Per Share			
Income attributable to common shareholders	\$ 255,459	38,362,727	\$ 0.01

Three months ended September 30, 2010

	Net Loss	Weighted Average Common Shares O/S	Amount
Basic and Diluted Loss Per Share			
Loss attributable to common shareholders	\$ (6,790,580)	4,762,727	\$ (1.43)

Nine months ended September 30, 2011

	Net Loss	Weighted Average Common Shares O/S	Amount
Basic and Diluted Loss Per Share			
Loss attributable to common shareholders	\$ (15,902,507)	38,362,727	\$ (0.41)

Nine months ended September 30, 2010

	Net Loss	Weighted Average Common Shares O/S	Amount
Basic and Diluted Loss Per Share			
Loss attributable to common shareholders	\$ (11,322,323)	4,762,727	\$ (2.38)

Table of Contents**Note 6: Other Comprehensive (Loss) Income**

Other comprehensive (loss) income, which is comprised solely of the change in unrealized gains and losses on available-for-sale securities, is as follows:

	Three Months Ended September 30, 2011			Nine Months Ended September 30, 2011		
	Before Tax		Net of Tax	Before Tax		Net of Tax
	Amount	Tax Effect	Amount	Amount	Tax Effect	Amount
Unrealized holding (losses) arising during the period	\$ (646,692)	\$ 279,659	\$ (367,033)	\$ (187,559)	\$ 71,272	\$ (116,287)
Reclassification adjustment for gains recognized in income	(779,685)	296,280	(483,405)	(779,685)	296,280	(483,405)
Unrealized holding (losses) on available for sale securities, net of taxes	\$ (1,426,377)	\$ 575,939	\$ (850,438)	\$ (967,244)	\$ 367,552	\$ (599,692)

	Three Months Ended September 30, 2010			Nine Months Ended September 30, 2010		
	Before Tax		Net of Tax	Before Tax		Net of Tax
	Amount	Tax Effect	Amount	Amount	Tax Effect	Amount
Unrealized holding gains arising during the period	\$ 592,440	\$ (225,161)	\$ 367,279	\$ 1,009,749	\$ (383,737)	\$ 626,012
Reclassification adjustment for gains recognized in income						
Unrealized holding gains on available for sale securities, net of taxes	\$ 592,440	\$ (225,161)	\$ 367,279	\$ 1,009,749	\$ (383,737)	\$ 626,012

Note 7: Financial Instruments with Off-Balance Sheet Risk

In the normal course of business, the Company is a party to financial instruments with off-balance-sheet risk to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit and involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheets. The contractual amounts of these instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The contractual amounts of commitments to extend credit and standby letters of credit represent the amounts of potential accounting loss should the contracts be fully drawn upon; the customers default; and the values of any existing collateral become worthless. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments and evaluates each customer's creditworthiness on a case-by-case basis. Management believes that the Company controls the credit risk of these financial instruments through credit approvals, credit limits, monitoring procedures and the receipt of collateral as deemed necessary.

Table of Contents

Financial instruments whose contractual amounts represent credit risk at September 30, 2011 are as follows:

Commitments to extend credit:	
Future loan commitments	\$ 41,934,556
Home equity lines of credit	28,777,583
Unused lines of credit	18,597,232
Undisbursed construction loans	1,269,083
Financial standby letters of credit	532,000
	\$ 91,110,454

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 to extend credit generally have fixed expiration dates or other termination clauses, and may require payment of a fee by the borrower. Since these commitments could expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include residential and commercial property, deposits and securities.

Standby letters of credit are written commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Newly issued or modified guarantees that are not derivative contracts are recorded on the Company's consolidated balance sheet at the fair value at inception. No liability related to guarantees was required to be recorded at September 30, 2011.

Note 8: Regulatory and Operational Matters

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company's and the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). In addition, due to the Bank's asset profile and current economic conditions in its markets, the Bank's capital plan pursuant to the Agreement described below targets a minimum 9% Tier 1 leverage capital ratio.

In February 2009 the Bank entered into a formal written agreement (the Agreement) with the Office of the Comptroller of the Currency (the OCC). Under the terms of the Agreement, the Bank has appointed a Compliance Committee of outside directors and the Chief Executive Officer. The Committee must report quarterly to the Board of Directors and to the OCC on the Bank's progress in complying with the Agreement. The Agreement requires the Bank to review, adopt and implement a number of policies and programs related to credit and operational issues. The Agreement further provided for certain asset growth restrictions for a limited period of time together with limitations on the acceptance of certain brokered deposits and the extension of credit to borrowers whose loans are criticized. The Bank may pay dividends during the term of the Agreement only with prior written permission from the OCC. The Agreement also requires that the Bank develop and implement a three-year capital plan. The Bank has taken or put into process many of the steps required by the Agreement, and does not anticipate that the restrictions included within the Agreement will impair its current business plan.

Table of Contents

In June 2010 the Company entered into a formal written agreement (the Reserve Bank Agreement) with the Federal Reserve Bank of New York (the Reserve Bank). Under the terms of the Reserve Bank Agreement, the Board of Directors of the Company is required to take appropriate steps to fully utilize the Company s financial and managerial resources to serve as a source of strength to the Bank including taking steps to insure that the Bank complies with the Agreement with the OCC. The Reserve Bank Agreement requires the Company to submit, adopt and implement a capital plan that is acceptable to the Reserve Bank. The Company must also report to the Reserve Bank quarterly on the Company s progress in complying with the Reserve Bank Agreement. The Agreement further provides for certain restrictions on the payment or receipt of dividends, distributions of interest or principal on subordinate debentures or trust preferred securities and the Company s ability to incur debt or to purchase or redeem its stock without the prior written approval of the Reserve Bank. The Company has taken or put into process many of the steps required by the Reserve Bank Agreement, and does not anticipate that the restrictions included within the Reserve Bank Agreement will impair its current business plan.

The Bank and the Company continue to execute their business plan with the goal of achieving full compliance with the Agreement and the Reserve Bank Agreement noted above. The financial condition of the Company has improved with the continued reduction in non-performing assets. The operating performance has also been strengthened with the reduction in operating expenses, resulting from the closure of four branches and the elimination of selective staff positions. The net interest margin increased to 3.40% for the quarter ended September 30, 2011, compared to 2.71% for the quarter ended September 30, 2010, due to the continued deposit cost reduction and the investment of excess liquidity.

Table of Contents

The Company's and the Bank's actual capital amounts and ratios at September 30, 2011 and December 31, 2010 were:

(dollars in thousands)	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2011						
The Company:						
Total Capital (to Risk Weighted Assets)	\$ 62,986	15.82%	\$ 31,851	8.00%	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	57,930	14.55%	15,926	4.00%	N/A	N/A
Tier 1 Capital (to Average Assets)	57,930	9.25%	25,051	4.00%	N/A	N/A
The Bank:						
Total Capital (to Risk Weighted Assets)	\$ 60,715	15.27%	\$ 31,809	8.00%	\$ 39,761	10.00%
Tier 1 Capital (to Risk Weighted Assets)	55,666	14.00%	15,905	4.00%	23,857	6.00%
Tier 1 Capital (to Average Assets)	55,666	8.90%	25,018	4.00%	31,273	5.00%
December 31, 2010						
The Company:						
Total Capital (to Risk Weighted Assets)	\$ 80,358	17.08%	\$ 37,643	8.00%	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	73,822	15.69%	18,822	4.00%	N/A	N/A
Tier 1 Capital (to Average Assets)	73,822	9.16%	32,219	4.00%	N/A	N/A
The Bank:						
Total Capital (to Risk Weighted Assets)	\$ 77,705	16.54%	\$ 37,582	8.00%	\$ 46,978	10.00%
Tier 1 Capital (to Risk Weighted Assets)	71,178	15.15%	18,791	4.00%	28,187	6.00%
Tier 1 Capital (to Average Assets)	71,178	8.84%	32,203	4.00%	40,253	5.00%

Restrictions on dividends, loans and advances

The Company's ability to pay dividends is dependent on the Bank's ability to pay dividends to the Company. Pursuant to the February 9, 2009 Agreement between the Bank and the OCC, the Bank can pay dividends to the Company only pursuant to a dividend policy requiring compliance with the Bank's OCC-approved capital program, in compliance with applicable law and with the prior written determination of no supervisory objection by the Assistant Deputy Comptroller. In addition to the Agreement, certain other restrictions exist regarding the ability of the Bank to transfer

funds to the Company in the form of cash dividends, loans or advances. The approval of the OCC is required to pay dividends in excess of the Bank's earnings retained in the current year plus retained net earnings for the preceding two years. As of September 30, 2011, the Bank had an accumulated deficit; therefore, dividends may not be paid to the Company. The Bank is also prohibited from paying dividends that would reduce its capital ratios below minimum regulatory requirements.

Table of Contents

The Company's ability to pay dividends and incur debt is also restricted by the Reserve Bank Agreement. Under the terms of the Reserve Bank Agreement, the Company has agreed that it shall not declare or pay any dividends or incur, increase or guarantee any debt without the prior written approval of the Reserve Bank and the Director of the Division of Banking Supervision and Regulation (the Director) of the Board of Governors.

Loans or advances to the Company from the Bank are limited to 10% of the Bank's capital stock and surplus on a secured basis.

Recent Legislative Developments

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Act) was signed into law on July 21, 2010. The Act is a significant piece of legislation that will have a major impact on the financial services industry, including the organization, financial condition and operations of banks and bank holding companies. Management is currently evaluating the impact of the Act; however, uncertainty remains as to its operational impact, which could have a material adverse impact on the Company's business, results of operations and financial condition. Many of the provisions of the Act are aimed at financial institutions that are significantly larger than the Company and the Bank. Notwithstanding this, there are many other provisions that the Company and the Bank are subject to and will have to comply with, including any new rules applicable to the Company and the Bank promulgated by the Bureau of Consumer Financial Protection, a new regulatory body dedicated to consumer protection. As rules and regulations are promulgated by the agencies responsible for implementing and enforcing the Act, the Company and the Bank will have to address each to ensure compliance with applicable provisions of the Act and compliance costs are expected to increase.

The Dodd-Frank Act broadens the base for Federal Deposit Insurance Corporation insurance assessments. Under rules issued by the FDIC in February 2011, the base for insurance assessments changed from domestic deposits to consolidated assets less tangible equity. Assessment rates are calculated using formulas that take into account the risks of the institution being assessed. The rule was effective beginning April 1, 2011. This did not have a material impact on the Company.

On June 28, 2011, the Federal Reserve Board approved a final debit-card interchange rule. This primarily impacts larger banks and should not have a material impact on the Company.

It is difficult to predict at this time what specific impact the Dodd-Frank Act and the yet to be written implementing rules and regulations will have on the Company. The financial reform legislation and any implementing rules that are ultimately issued could have adverse implications on the financial industry, the competitive environment, and our ability to conduct business. Management will have to apply resources to ensure compliance with all applicable provisions of the Dodd-Frank Act and any implementing rules, which may increase our costs of operations and adversely impact our earnings.

Note 9: Income Taxes

The determination of the amount of deferred tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. A valuation allowance related to deferred tax assets is required when it is considered more likely than not that all or part of the benefit related to such assets will not be realized. Management has reviewed the deferred tax position of the Company at September 30, 2011. The deferred tax position has been affected by several significant transactions in the past three years. These transactions include increased provision for loan losses, the heightened levels of non-accrual loans and other-than-temporary impairment write-offs of certain investments. As a result, the Company is in a cumulative net loss position at September 30, 2011, and under the applicable accounting guidance, has concluded that it is not more-likely-than-not that the Company will be able to realize its deferred tax assets and, accordingly, has established a full valuation allowance totaling \$16.1 million against its deferred tax asset at September 30, 2011. The valuation allowance is analyzed quarterly for changes affecting the deferred tax asset. If, in the future, the Company generates taxable income on a sustained basis, management's conclusion regarding the need for a deferred tax asset valuation allowance could change, resulting in the reversal of all or a portion of the deferred tax asset valuation allowance.

Table of Contents

As measured under the rules of the Tax Reform Act of 1986, the Company has undergone a greater than 50% change of ownership in 2010. Consequently, use of the Company's net operating loss carryforward and certain built in deductions available against future taxable income in any one year is limited. The maximum amount of carryforwards available in a given year is limited to the product of the Company's fair market value on the date of ownership change and the federal long-term tax-exempt rate, plus any limited carryforward not utilized in prior years. The Company is currently analyzing the impact of its recent ownership change. There is a full valuation allowance against the deferred tax assets as the Company does not believe that it is more-likely-than-not that the Company will generate sufficient taxable income to realize the deferred tax assets. Accordingly, the Company does not believe the analysis will result in a material impact to the consolidated financial statements.

Note 10: Fair Value and Interest Rate Risk

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in certain instances, there are no quoted market prices for certain assets or liabilities. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the asset or liability.

Fair value measurements focus on exit prices in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment.

The Company's fair value measurements are classified into a fair value hierarchy based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. The three categories within the hierarchy are as follows:

Level 1 Inputs Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

Level 3 Inputs Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

Table of Contents

The fair value measurement level of an asset or liability within the fair value hierarchy is based on the lower level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

A description of the valuation methodologies used for assets and liabilities recorded at fair value, and for estimating fair value for financial and non-financial instruments not recorded at fair value, is set forth below.

Cash and due from banks, federal funds sold, short-term investments and accrued interest receivable and payable:

The carrying amount is a reasonable estimate of fair value. These financial instruments are not recorded at fair value on a recurring basis.

Available-for-Sale Securities: These financial instruments are recorded at fair value in the financial statements. Where quoted prices are available in an active market, securities are classified within Level 1 of the fair value hierarchy. If quoted prices are not available, then fair values are estimated by using pricing models (i.e., matrix pricing) or quoted prices of securities with similar characteristics and are classified within Level 2 of the fair value hierarchy. Examples of such instruments include government agency bonds and mortgage-backed securities, and money market preferred equity securities. Level 3 securities are instruments for which significant unobservable inputs are utilized. Available-for-sale Securities are recorded at fair value on a recurring basis.

Other Investments: This investment includes the Solomon Hess SBA Loan Fund, utilized for the purpose of the Bank satisfying its CRA lending requirements. As this fund operates as a private fund, shares in the Fund are not publicly traded and therefore have no readily determinable market value. Therefore, this investment is classified within Level 2 of the fair value hierarchy. An investor can have their interest in the Fund redeemed for the balance of their capital account at any quarter end assuming they give the Fund 60 days notice. The investment in this Fund is recorded at cost. The Company does not record other investments at fair value on a recurring basis.

Loans: For variable rate loans, which reprice frequently and have no significant change in credit risk, carrying values are a reasonable estimate of fair values, adjusted for credit losses inherent in the portfolios. The fair value of fixed rate loans is estimated by discounting the future cash flows using the period end rates, estimated by using local market data, at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, adjusted for credit losses inherent in the portfolios. The Company does not record loans at fair value on a recurring basis. However, from time to time, nonrecurring fair value adjustments to collateral-dependent impaired loans are recorded to reflect partial write-downs based on the observable market price or current appraised value of collateral. Fair values estimated in this manner do not fully incorporate an exit-price approach to fair value, but instead are based on a comparison to current market rates for comparable loans.

Other Real Estate Owned: The fair values of the Company's other real estate owned (OREO) properties are based on the estimated current property valuations less estimated selling costs. When the fair value is based on current observable appraised values, OREO is classified within Level 2. The Company classifies OREO within Level 3 when unobservable adjustments are made to appraised values. The Company does not record other real estate owned at fair value on a recurring basis.

Deposits: The fair value of demand deposits, regular savings and certain money market deposits is the amount payable on demand at the reporting date. The fair value of certificates of deposit and other time deposits is estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities, estimated using local market data, to a schedule of aggregated expected maturities on such deposits. The Company does not record deposits at fair value on a recurring basis.

Table of Contents

Short-term borrowings: The carrying amounts of borrowings under short-term repurchase agreements and other short-term borrowings maturing within 90 days approximate their fair values. The Company does not record short-term borrowings at fair value on a recurring basis.

Junior Subordinated Debt: Junior subordinated debt reprices quarterly and as a result the carrying amount is considered a reasonable estimate of fair value. The Company does not record junior subordinated debt at fair value on a recurring basis.

Federal Home Loan Bank Borrowings: The fair value of the advances is estimated using a discounted cash flow calculation that applies current Federal Home Loan Bank interest rates for advances of similar maturity to a schedule of maturities of such advances. The Company does not record these borrowings at fair value on a recurring basis.

Other Borrowings: The fair values of longer term borrowings and fixed rate repurchase agreements are estimated using a discounted cash flow calculation that applies current interest rates for transactions of similar maturity to a schedule of maturities of such transactions. The Company does not record these borrowings at fair value on a recurring basis.

Off-balance sheet instruments: Fair values for the Company's off-balance-sheet instruments (lending commitments) are based on interest rate changes and fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The Company does not record its off-balance-sheet instruments at fair value on a recurring basis.

The following table details the financial assets measured at fair value on a recurring basis as of September 30, 2011 and December 31, 2010, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine fair value:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of September 30, 2011
September 30, 2011				
Securities available for sale	\$	\$ 88,529,050	\$	\$ 88,529,050

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2010
December 31, 2010				
Securities available for sale	\$	\$ 40,564,700	\$	\$ 40,564,700

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

Table of Contents

The following tables reflect financial assets measured at fair value on a non-recurring basis as of September 30, 2011 and December 31, 2010, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance
September 30, 2011				
Impaired Loans ⁽¹⁾	\$	\$	\$ 16,443,466	\$ 16,443,466
Other real estate owned ⁽²⁾	\$	\$	\$ 4,731,890	\$ 4,731,890
December 31, 2010				
Impaired Loans ⁽¹⁾	\$	\$	\$ 30,999,865	\$ 30,999,865
Other real estate owned ⁽²⁾	\$	\$	\$ 10,103,199	\$ 10,103,199

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

⁽²⁾ Represents carrying value for which adjustments are based on the appraised value of the property.

The Company discloses fair value information about financial instruments, whether or not recognized in the consolidated balance sheet, for which it is practicable to estimate that value. Certain financial instruments are excluded from disclosure requirements and, accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The estimated fair value amounts have been measured as of September 30, 2011 and December 31, 2010 and have not been reevaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair value of these financial instruments subsequent to the respective reporting dates may be different than amounts reported on those dates.

The information presented should not be interpreted as an estimate of the fair value of the Company since a fair value calculation is only required for a limited portion of the Company's assets and liabilities. Due to the wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other bank holding companies may not be meaningful.

Table of Contents

The following is a summary of the carrying amounts and estimated fair values of the Company's financial instruments at September 30, 2011 and December 31, 2010 (in thousands):

	September 30, 2011		December 31, 2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial Assets:				
Cash and noninterest bearing balances due from banks	\$ 9,498	\$ 9,498	\$ 4,613	\$ 4,613
Interest-bearing deposits due from banks	30,485	30,485	131,711	131,711
Federal funds sold			10,000	10,000
Short-term investments	3,206	3,206	453	453
Other investments	3,500	3,500	3,500	3,500
Available-for-sale securities	88,529	88,529	40,565	40,565
Federal Reserve Bank stock	1,707	1,707	1,192	1,192
Federal Home Loan Bank stock	4,508	4,508	4,508	4,508
Loans receivable, net	453,133	462,915	534,531	542,360
Accrued interest receivable	2,321	2,321	2,512	2,512
Loans held for sale	250	250		
Financial Liabilities:				
Demand deposits	\$ 56,699	\$ 56,699	\$ 51,058	\$ 51,058
Savings deposits	53,635	53,635	57,042	57,042
Money market deposits	58,724	58,724	92,683	92,683
NOW accounts	25,325	25,325	19,297	19,297
Time deposits	313,339	316,900	426,728	432,466
FHLB Borrowings	50,000	52,326	50,000	51,195
Securities sold under repurchase agreements	7,000	7,788	7,000	7,796
Subordinated debentures	8,248	8,248	8,248	8,248
Accrued interest payable	927	927	729	729

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Company's financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company's overall interest rate risk.

Off-balance sheet instruments

Loan commitments on which the committed interest rate is less than the current market rate were insignificant at September 30, 2011 and December 31, 2010. The estimated fair value of fee income on letters of credit at September 30, 2011 and December 31, 2010 was insignificant.

Table of Contents**Note 11: Restructuring Charges and Asset Disposals**

Bancorp recorded restructuring charges and asset disposals of \$3.0 million for the nine months ended September 30, 2011. These costs are included in restructuring charges and asset disposals expense in the Consolidated Statements of Operations.

During 2011, Bancorp announced that it would be undertaking a series of initiatives that are designed to transform and enhance its operations. In order to strengthen Bancorp's competitive position and return it to its goal of restored health and profitability, it executed one initiative to consolidate four branch locations and vacate other office space, and a second plan to reduce workforce by approximately 10% of employees.

On March 3, 2011, Bancorp announced that it would consolidate four branches, effective June 2011, to reduce operating expenses. All customer accounts in the affected branches were transferred to nearby Patriot branches to minimize any inconvenience to customers. The consolidation of these branches resulted in an earnings charge of \$1.8 million, which is comprised of lease termination expenses of \$1.2 million, lease liabilities charges of \$0.4 million, and severance payments of \$0.2 million to affected employees. In addition, there was a \$0.6 million write-off of leasehold improvements and other fixed assets for these branches that were closed.

In order to further reduce operating expenses, Bancorp announced on May 16, 2011 that it would be executing a workforce reduction plan with employees in the back office operational areas. There were a total of eighteen employees affected by this reduction. This initiative resulted in an earnings charge of \$0.6 million, which is comprised exclusively of severance payments to affected employees.

On September 23, 2011, Bancorp subleased vacant office space at 900 Bedford Street, Stamford, CT, effective October 1, 2011 for a term of two years.

Restructuring reserves at September 30, 2011 for the restructuring activities taken in connection with these initiatives are comprised of the following:

	Expenses	Cash payments	Non-cash charges	Balance at September 30, 2011
Severance and benefit costs	\$ 756,727	\$ (556,458)	\$ (17,920)	\$ 182,349
Lease termination costs	1,659,995	(1,279,034)	(38,935)	342,026
Asset disposals	569,719		(569,719)	
Total	\$ 2,986,441	\$ (1,835,492)	\$ (626,574)	\$ 524,375

The restructuring reserves at September 30, 2011 are included in accrued expenses and other liabilities in the Consolidated Balance Sheet.

Table of Contents

Note 12: Recent Accounting Pronouncements

In February 2010, the FASB issued ASU No. 2010-06 Topic 820 *Improving Disclosures about Fair Value Measurements* which amended the existing guidance related to *Fair Value Measurements and Disclosures*. The amendments require the following new fair value disclosures:

Separate disclosure of the significant transfers into and out of Level 1 and Level 2 fair value measurements, and a description of the reasons for the transfers.

In the rollforward of activity for Level 3 fair value measurements (significant unobservable inputs), purchases, sales, issuances, and settlements should be presented separately (on a gross basis rather than as one net number).

In addition, the amendments clarify existing disclosure requirements, as follows:

Fair value measurements and disclosures should be presented for each class of assets and liabilities within a line item in the statement of financial position.

Reporting entities should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements that fall in either Level 2 or Level 3.

The new disclosures and clarifications of existing disclosures were effective for the Company beginning in the quarter ended March 31, 2010, except for the disclosures included in the roll forward of activity for Level 3 fair value measurements, for which the effective date is for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The Company adopted this guidance during the quarters ended March 31, 2010 and March 31, 2011 respectively, and has included these disclosures in these financial statements.

The FASB issued ASU No. 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* in July 2010. The amendments in this ASU apply to all entities, both public and nonpublic, with financing receivables, excluding short-term trade accounts receivable or receivables measured at fair value or lower of cost or fair value. The amendments in this ASU enhance disclosures about the credit quality of financing receivables and the allowance for credit losses. This ASU amends existing disclosure guidance to require entities to provide a greater level of disaggregated information about the credit quality of its financing receivables and its allowance for credit losses. In addition, this ASU requires entities to disclose credit quality indicators, past due information, and modifications of its financing receivables. For public entities, the 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 disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. An entity should disclose the information required by paragraphs 310-10-50-33 through 50-34, which was deferred by ASU No. 2011-01, *Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20*, for interim and annual periods beginning on or after June 15, 2011. The adoption of this guidance did not have an impact on the Company's results of operations or financial position.

In April 2011, the FASB issued ASU No. 2011-02, *A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*. The amendments in this update apply to all creditors, both public and nonpublic, that restructure receivables that fall within the scope of Subtopic 310-40, *Receivables - Troubled Debt Restructurings by Creditors*. The amendments in this ASU clarify the guidance on a creditor's evaluation of whether it has granted a concession and whether a debtor is experiencing financial difficulties. In addition, the amendments clarify that a creditor is precluded from using the effective interest rate test in the debtor's guidance on restructuring of payables when evaluating whether a restructuring constitutes a troubled debt restructuring. These amendments are effective for the first interim or annual period beginning on or after June 15, 2011. The Company adopted this guidance in the first quarter ended March 31, 2011 and the guidance did not have a material impact on the Company's results of operations or financial position.

Table of Contents

Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

SAFE HARBOR STATEMENT UNDER PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Certain statements contained in Bancorp's public reports, including this report, and in particular in Management's Discussion and Analysis of Financial Condition and Results of Operations, may be forward looking and subject to a variety of risks and uncertainties. These factors include, but are not limited to; (1) changes in prevailing interest rates which would affect the interest earned on Bancorp's interest earning assets and the interest paid on its interest bearing liabilities; (2) the timing of repricing of Bancorp's interest earning assets and interest bearing liabilities; (3) the effect of changes in governmental monetary policy; (4) the effect of changes in regulations applicable to Bancorp and the Bank and the conduct of its business; (5) changes in competition among financial service companies, including possible further encroachment of non-banks on services traditionally provided by banks; (6) the ability of competitors that are larger than Bancorp to provide products and services which it is impracticable for Bancorp to provide; (7) the state of the economy and real estate values in Bancorp's market areas, and the consequent effect on the quality of Bancorp's loans, customers, vendors and communities; (8) recent governmental initiatives that are expected to have a profound effect on the financial services industry and could dramatically change the competitive environment of Bancorp; (9) other legislative or regulatory changes, including those related to residential mortgages, changes in accounting standards, and Federal Deposit Insurance Corporation (FDIC) premiums that may adversely affect Bancorp.

Although Bancorp believes that it offers the loan and deposit products and has the resources needed for continued success, future revenues and interest spreads and yields cannot be reliably predicted. These trends may cause Bancorp to adjust its operations in the future. Because of the foregoing and other factors, recent trends should not be considered reliable indicators of future financial results or stock prices.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and to disclose contingent assets and liabilities. Actual results could differ from those estimates. Management has identified the accounting for the allowance for loan losses, the valuation of its investment securities and the valuation of deferred income tax assets, as Bancorp's most critical accounting policies and estimates in that they are important to the portrayal of Bancorp's financial condition and results. They require management's most subjective and complex judgment as a result of the need to make an estimate about the effect of matters that are inherently uncertain. These accounting policies, including the nature of the estimates and types of assumptions used, are described throughout this Management's Discussion and Analysis.

Table of Contents**Summary**

Bancorp realized net income of \$255,000 (\$0.01 basic and diluted income per share) for the quarter ended September 30, 2011, compared to a net loss of \$6.8 million (\$1.43 basic and diluted loss per share) for the quarter ended September 30, 2010. This increase in net income of \$7.0 million is primarily due to the lower level of non-performing assets, resulting in no provision for loan losses for the quarter ended September 30, 2011, compared to a \$5.0 million provision for loan losses recorded during the same period in the prior year. For the nine-month period ended September 30, 2011, Bancorp incurred a net loss of \$15.9 million (\$0.41 basic and diluted loss per share) compared to net loss of \$11.3 million (\$2.38 basic and diluted loss per share) for the nine months ended September 30, 2010. The primary reason for the increased loss in the nine-month comparison is the \$6.2 million charge on the bulk sale of non-performing assets, as discussed in Note 3, and the restructuring charges of \$3.0 million associated with the branch closings and reduction-in-force, discussed in Note 11. Bancorp's net interest income for the quarter ended September 30, 2011 was \$4.9 million compared to \$5.1 million for the quarter ended September 30, 2010. Interest income and interest expense decreased by 18% and 41%, respectively, for the quarter ended September 30, 2011 compared to the quarter ended September 30, 2010, as improvement in the net margin was offset by lower level of earning assets. Non-interest income increased \$644,000, or 101%, for the quarter ended September 30, 2011, when compared to the quarter ended September 30, 2010. For the nine months ended September 30, 2011, interest income and interest expense declined by 22% and 38% respectively, compared to the nine months ended September 30, 2010. The decline in interest income is due primarily to lower average outstanding loan balances and the lower interest rate environment. The significant decline in interest expense is primarily due to the reduction of total deposits as management lowered interest rates paid on high rate non-core deposits.

Total assets decreased \$155.9 million from \$784.3 million at December 31, 2010 to \$628.4 million at September 30, 2011. Cash and cash equivalents decreased \$103.6 million from \$146.8 million at December 31, 2010 to \$43.2 million at September 30, 2011. Available-for-sale securities increased \$47.9 million from \$40.6 million at December 31, 2010 to \$88.5 million at September 30, 2011 as overnight liquidity was invested into higher yielding instruments. The net loan portfolio decreased \$81.4 million from \$534.5 million at December 31, 2010 to \$453.1 million at September 30, 2011. This decrease is primarily a result of a \$66.8 million bulk sale of non-performing assets, comprised of \$52.4 million of non-performing loans and \$14.4 million of other real estate owned. This was the result of management's strategic plan to dramatically lower the level of non-performing assets and improve the overall credit quality, and significantly increase the level of earning assets. As a result of weak loan demand and high levels of balance sheet liquidity, the Bank continued to lower rates on deposit products. The overall cost of deposits decreased from 1.69% at September 30, 2010 to 1.24% at September 30, 2011. Deposits decreased \$139.1 million from \$646.8 million at December 31, 2010 to \$507.7 million at September 30, 2011. Borrowings remained unchanged compared to December 31, 2010.

Financial Condition***Cash and Cash Equivalents***

Cash and cash equivalents decreased \$103.6 million, or 71%, to \$43.2 million at September 30, 2011 compared to \$146.8 million at December 31, 2010. This decrease is primarily the result of using \$65.5 million in excess liquidity to purchase available for sale securities. In addition, deposit balances decreased as Bancorp strategically reduced deposit rates in order to lower its funding costs.

Table of Contents**Investments**

The following table is a summary of Bancorp's available-for-sale securities portfolio, at fair value, at the dates shown:

	September 30, 2011	December 31 2010
U. S. Government agency mortgage-backed securities	\$ 71,644,998	\$ 37,471,878
U. S. Government agency bonds	5,036,100	
Corporate bonds	11,847,952	
Auction rate preferred equity securities		3,092,822
Total Available-for-Sale Securities	\$ 88,529,050	\$ 40,564,700

Available-for-sale securities increased \$47.9 million, or 118.2%, from \$40.6 million at December 31, 2010 to \$88.5 million at September 30, 2011. This increase is primarily due to purchases of mortgage-backed securities, corporate bonds, and government agency bonds of \$48.2 million, \$12.3 million, and \$5.0 million, respectively. These were partially offset with proceeds from sales of mortgage-backed securities of \$7.1 million and auction rate preferred equity securities of \$2.6 million. In addition, there were principal pay downs of \$7.3 million on mortgage backed securities.

Loans

The following table is a summary of Bancorp's loan portfolio at the dates shown:

	September 30, 2011	December 31, 2010
Real Estate		
Commercial	\$ 210,128,617	\$ 228,842,489
Residential	151,147,445	187,058,318
Construction	12,857,291	63,889,083
Construction to permanent	10,864,395	10,331,043
Commercial	28,553,155	14,573,790
Consumer home equity	48,225,020	42,884,962
Consumer installment	2,163,798	1,932,763
Total Loans	463,939,721	549,512,448
Premiums on purchased loans	234,884	242,426
Net deferred costs	116,348	150,440
Allowance for loan losses	(11,157,678)	(15,374,101)
Loans receivable, net	\$ 453,133,275	\$ 534,531,213

Bancorp's net loan portfolio decreased \$81.4 million, or 15.2%, from \$534.5 million at December 31, 2010 to \$453.1 million at September 30, 2011. The decrease is primarily a result of a bulk sale of non-performing assets and loan payoffs, including some that were impaired and on non-accrual status. Construction loans decreased by \$50.5 million, commercial real estate loans decreased by \$18.7 million, and residential mortgages decreased by \$35.9 million. This was partially offset by increases of \$14.0 million in commercial loans and a \$5.3 million increase in consumer home equity loans. The net decrease in the portfolio also reflects net charge-offs for the nine months ended September 30, 2011 of \$6.6 million, of which specific reserves of \$3.4 million were related to loans in the bulk sale. In an effort to reduce its concentration in construction loans, Bancorp has continued its moratorium on originating new speculative construction loans.

Table of Contents

On March 24, 2011, the Bank completed the sale of certain non-performing assets that included 21 non-accruing loans with an aggregate net book value of \$52.4 million (net of related specific reserves) and 4 OREO properties with an aggregate carrying value of \$14.4 million. The sale of \$66.8 million of non-performing assets was consummated for a cash purchase price of \$60.6 million which represented 90.7% of the Bank's net book value for these assets.

At September 30, 2011, the net loan to deposit ratio was 89% and the net loan to total assets ratio was 72%. At December 31, 2010, these ratios were 83% and 68%, respectively.

Allowance for Loan Losses

The allowance for loan losses is established as probable losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect a borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for loan losses decreased by \$4.2 million from December 31, 2010 to September 30, 2011 primarily due to net charge-offs of \$6.6 million, of which \$3.4 million were specific reserves related to the bulk sale. In addition, a provision of \$8.5 million was recorded, of which \$6.0 million related to loans transferred to held-for-sale in connection with the bulk loan sale.

The allowance consists of allocated and general components. The allocated component relates to loans that are considered impaired. For such impaired loans, an allowance is established when the discounted cash flows (or observable market price or collateral value if the loan is collateral dependent) of the impaired loan is lower than the carrying value of that loan. When a loan is placed on non-accrual status the loan is considered impaired. For collateral dependent loans, the appraised value is reduced by estimated selling costs and any senior liens and the result is compared to the principal loan balance to determine the impairment amount, if any. For loans that are not collateral dependent and for which a restructure is in place, the impairment is determined by using the discounted cash flow method which takes into account the difference between the original interest rate and the restructured rate.

The general component covers all other loans, segregated generally by loan type, and is based on historical loss experience with adjustments for qualitative factors which are made after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss data. In addition, a risk rating system is utilized to evaluate the general component of the allowance for loan losses. Management assigns risk ratings to all loans assigning ratings between one and nine, with a rating of one being the least risk, and a rating of nine reflecting the most risk or a complete loss. Risk ratings are assigned based upon the recommendations of the credit analyst and the originating loan officer and confirmed by the Loan Committee at the initiation of the transactions and are reviewed and changed, when necessary, during the life of the loan. Loans assigned a risk rating of six or above are monitored more closely by the Loan Officers and Loan Workout Committee.

The allowance for loan losses reflects management's estimate of probable but unconfirmed losses inherent in the portfolio; such estimates are influenced by uncertainties in economic conditions, unfavorable information about a borrower's financial condition, delays in obtaining information, difficulty in identifying triggering events that correlate perfectly to subsequent loss rates, and risk factors that have not yet manifested themselves in loss allocation factors. Loan quality control is continually monitored by management, subject to oversight by the Board of Directors through its members who serve on the Loan Committee. Loan quality control is also reviewed by the full Board of Directors on a monthly basis and semi-annual loan reviews are performed by an independent external firm. The independent external loan review reports directly to the Audit Committee.

Table of Contents

The methodology for determining the adequacy of the allowance for loan losses has been consistently applied. Of the \$11.2 million allowance for loan losses as of September 30, 2011, \$2.9 million was attributed to collateral dependent impaired loans and \$8.3 million was the reserve attributed to performing loans. The appraised values on impaired loans that are anticipated to become OREO in the coming quarter are adjusted based upon Bancorp's recent sales experience. As of September 30, 2011, the Bank's OREO sales experience has indicated that the ultimate sales prices of the underlying collateral have been 13% less than the appraisal amounts. The appraisal adjustment percentage is reviewed quarterly for those loans anticipated to become OREO in the subsequent quarter, based on an analysis of actual variances between appraised values as of the date the loan is transferred into OREO and the actual sales prices of the OREO properties. Generally, the sales prices have usually been below the appraised values due to the fact that buyers become aware that the Bank owns those properties and, therefore, attempt to offer less than fair market value. In the future, additional revisions may be made to the methodology and assumptions based on historical information related to charge-off and recovery experience and management's evaluation of the current loan portfolio, and prevailing internal and external factors including but not limited to current economic conditions and local real estate markets. The \$8.5 million provision for the nine months ended September 30, 2011 included \$6.0 million related to loans transferred to held-for-sale in connection with the bulk loan sale and \$2.5 million was deemed necessary by management to maintain appropriate coverage after taking the net charge-offs of \$6.6 million. The ratio of allowance for loan losses to total loans as of September 30, 2011 was 2.40% as compared to 2.80% as of December 31, 2010. Management believes that the decrease is warranted based upon the significant reduction in non-performing loans and charge-offs of specific reserves related to loans in the bulk sale.

The accrual of interest on loans is discontinued at the time a loan is 90 days past due unless the loan is well-secured and in process of collection. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful. Management considers all non-accrual loans and troubled debt restructured loans to be impaired. All interest accrued but not collected for loans that are placed on nonaccrual status is reversed against interest income. The interest on these loans is accounted for on the cash-basis method until qualifying for return to accrual status. Loans may be returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured after a six month seasoning period.

In most cases, loan payments that are past due less than 90 days, based on contractual terms, are considered collection delays and the related loans are not considered to be impaired. The Bank considers consumer installment loans to be pools of smaller balance homogeneous loans, which are collectively evaluated for impairment.

Table of Contents

The changes in the allowance for loan losses for the periods shown are as follows:

<i>(Thousands of dollars)</i>	Three months ended		Nine months ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
Balance at beginning of period	\$ 11,400	\$ 13,989	\$ 15,374	\$ 15,794
Charge-offs	(218)	(1,917)	(7,406)	(5,095)
Recoveries	16	53	780	187
Net Charge-offs	(202)	(1,864)	(6,626)	(4,908)
Transferred to loans held-for-sale	(40)		(6,054)	
Provision charged to operations		5,025	8,464	6,264
Balance at end of period	\$ 11,158	\$ 17,150	\$ 11,158	\$ 17,150
Ratio of net charge-offs during the period to average loans outstanding during the period	0.04%	0.31%	1.36%	0.78%
Ratio of ALLL / Gross Loans	2.40%	2.89%	2.40%	2.89%

Based upon the overall assessment and evaluation of the loan portfolio, management believes the allowance for loan losses of \$11.2 million, at September 30, 2011, which represents 2.40% of gross loans outstanding, is adequate under prevailing economic conditions, to absorb existing losses in the loan portfolio. Bancorp has had eight consecutive quarters of decreases in non-accrual loans.

Non-Accrual, Past Due and Restructured Loans

The following table presents non-accruing loans and loans past due 90 days or more and still accruing:

<i>(Thousands of dollars)</i>	September 30, 2011	December 31, 2010
Loans past due over 90 days still accruing	\$ 5,841	\$ 3,374
Non accruing loans	21,776	89,150
Total	\$ 27,617	\$ 92,524
% of Total Loans	5.95%	16.83%
% of Total Assets	4.39%	11.80%

There are 7 loans delinquent over 90 days and still accruing which aggregate \$5.8 million. Of the 7 loans, 6 totaling \$5.3 million have matured, are current for payment and are well secured. One loan is 60 days delinquent as to payment, has matured and is well secured and in the process of collection. The bank has agreed to forbear from pursuing its remedies while the borrowers arrange refinancing from other financial institutions. Impaired loans, which are comprised of non-accruing loans and troubled debt restructured loans, decreased by \$5.0 million to \$37.9 million for the quarter ended September 30, 2011 and decreased \$62.8 million for the nine months ended September 30, 2011.

Impaired loans are attributable to the lingering effects of the downturn in the economy, which has severely impacted the real estate market and placed unprecedented stress on credit markets. Residents of Fairfield County, Connecticut, many of whom are associated with the financial services industry, have been affected by the impact of the poor economy on employment and real estate values.

Table of Contents

The \$21.8 million of non-accrual loans at September 30, 2011 is comprised of exposure to 29 loans, for which a specific reserve of \$2.6 million has been established. All of the non-accruing loans are collateral dependent and are secured by residential or commercial real estate located within the Bank's market area. In all cases, the Bank has obtained appraisal reports from independent licensed appraisal firms and discounted those values for estimated selling costs to determine estimated impairment. Of the \$21.8 million of non-accrual loans at September 30, 2011, borrowers of 7 loans with aggregate balances of \$6.4 million continue to make loan payments in accordance with contractual terms and these loans are current within one month as to payments.

Potential Problem Loans

In addition to the above, there are \$46.8 million of substandard accruing loans comprised of 36 loans and \$53.6 million of special mention loans comprised of 54 loans for which management has a concern as to the ability of the borrowers to comply with the present repayment terms. All but \$1.3 million of the substandard accruing loans and the special mention loans comprised of 3 borrowers continue to make timely payments in accordance with contractual terms and are within 30 days at September 30, 2011.

Other Real Estate Owned

The following table is a summary of Bancorp's other real estate owned at the dates shown:

	September 30, 2011	December 31, 2010
Residential construction	\$ 3,781,890	\$ 15,774,187
Land	950,000	634,600
Other real estate owned	\$ 4,731,890	\$ 16,408,787

The balance of other real estate owned at September 30, 2011 is comprised of three properties with a carrying value of \$4.7 million that was obtained through loan foreclosure proceedings. Included in the March 2011 bulk sale of non-performing assets were four OREO properties with an aggregate carrying value of \$14.4 million. Additionally, during the nine months ended September 30, 2011 two properties were added and two properties were sold.

Deferred Taxes

The determination of the amount of deferred tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. A valuation allowance related to deferred tax assets is required when it is considered more likely than not that all or part of the benefit related to such assets will not be realized. Management has reviewed the deferred tax position of Bancorp at September 30, 2011. The deferred tax position has been affected by several significant matters in the past three years. These matters include increased levels of provision for loan losses, the high levels of non-accrual loans and other-than-temporary impairment write-offs of certain investments. As a result, Bancorp is in a cumulative net loss position at September 30, 2011, and under the applicable accounting guidance, has concluded that it is not more-likely-than-not that the Company will be able to realize the deferred tax assets and accordingly has established a full valuation allowance totaling \$16.1 million against its net deferred tax asset at September 30, 2011. The valuation allowance is analyzed quarterly for changes affecting the deferred tax asset. If, in the future, Bancorp generates taxable income on a sustained basis, management's conclusion regarding the need for a deferred tax asset valuation allowance could change, resulting in the reversal of all or a portion of the deferred tax asset valuation allowance.

Table of Contents**Deposits**

The following table is a summary of the Company's deposits at the dates shown:

	September 30, 2011	December 31, 2010
Non-interest bearing	\$ 56,699,418	\$ 51,058,373
Interest bearing		
NOW	25,325,126	19,297,225
Savings	53,634,681	57,041,943
Money market	58,724,455	92,683,478
Time certificates, less than \$100,000	185,394,428	251,296,558
Time certificates, \$100,000 or more	127,944,921	175,431,252
Total interest bearing	451,023,611	595,750,456
Total Deposits	\$ 507,723,029	\$ 646,808,829

Total deposits decreased \$139.1 million, or 22%, from \$646.8 million at December 31, 2010 to \$507.7 million at September 30, 2011. Demand deposits increased \$5.6 million primarily as a result of increases in commercial and personal checking accounts of \$4.3 million and \$1.3 million respectively, and an increase in official checks of \$0.4 million. Interest bearing accounts decreased \$144.7 million. This is primarily due to decreases in certificates of deposit (CD s) of \$113.4 million, which is a result of Bancorp intentionally allowing the higher rate CD s to runoff to help reduce the cost of funds and improve the interest spread; and, decreases in money market accounts of \$34.0 million due to improved economic conditions in the overall financial markets as customers reinvested in financial instruments outside of the banking industry. A large number of our CD account holders had temporarily placed funds in money market accounts during the economic recession. These decreases were partially offset by increases in NOW accounts of \$6.0 million, of which \$5.2 million were due to Interest on Lawyer Trust Accounts (IOLTA) accounts.

Borrowings

At September 30, 2011, total borrowings were \$65.2 million and are unchanged compared to December 31, 2010. In addition to the outstanding borrowings disclosed in the consolidated balance sheet, the Bank has the ability to borrow approximately \$71.9 million in additional advances from the Federal Home Loan Bank of Boston, including a \$2.0 million overnight line of credit. The Bank has also established a line of credit at the Federal Reserve Bank.

Table of Contents

The subordinated debentures of \$8,248,000 are unsecured obligations of the Company and are subordinate and junior in right of payment to all present and future senior indebtedness of the Company. The Company has entered into a guarantee, which together with its obligations under the subordinated debentures and the declaration of trust governing the Trust, provides a full and unconditional guarantee of amounts on the capital securities. The subordinated debentures, which bear interest at three-month LIBOR plus 3.15% (3.50806% at September 30, 2011), matures on March 26, 2033. In the second quarter of 2009, the Company began deferring interest payments on the subordinated debentures as permitted under the terms of the debentures. The deferral in the third quarter of 2011 represented the tenth consecutive quarter of deferral. The Company continues to accrue and charge interest to operations. The Company may defer the payment of interest until March 2014, and all accrued interest must be paid prior to or at completion of the deferral period.

Capital

Capital decreased \$16.5 million compared to December 31, 2010 primarily as a result of the net loss of \$6.2 million on the bulk sale of non-performing assets, \$3.0 million on branch closings and reduction-in-force, and loss on continuing operations for the nine months ended September 30, 2011.

Off-Balance Sheet Arrangements

Bancorp's off-balance sheet arrangements, which primarily consist of commitments to lend, increased by \$56.1 million from \$35.0 million at December 31, 2010 to \$91.1 million at September 30, 2011, primarily due to increases of \$37.2 million in future loan commitments, \$10.9 million in unused lines of credit and \$7.6 million in home equity lines of credit as the Company continues to increase loan origination activity.

Table of Contents**Results of Operations****Interest and dividend income and expense**

The following tables present average balance sheets (daily averages), interest income, interest expense and the corresponding yields earned and rates paid for major balance sheet components:

	Three months ended September 30,					
	Average Balance	2011 Interest Income/ Expense	Average Rate	Average Balance	2010 Interest Income/ Expense	Average Rate
<i>(dollars in thousands)</i>						
Interest earning assets:						
Loans	\$ 459,943	\$ 6,185	5.38%	\$ 604,941	\$ 7,977	5.27%
Investments	102,171	721	2.82%	60,147	436	2.90%
Interest bearing deposits in banks	17,678	1	0.02%	81,891	52	0.25%
Federal funds sold	2,739	1	0.15%	10,000	4	0.16%
Total interest earning assets	582,531	6,908	4.74%	756,979	8,469	4.48%
Cash and due from banks	23,977			21,001		
Premises and equipment, net	4,088			5,639		
Allowance for loan losses	(11,385)			(14,000)		
Other assets	29,234			37,958		
Total Assets	\$ 628,445			\$ 807,577		
Interest bearing liabilities:						
Deposits	\$ 447,553	\$ 1,385	1.24%	\$ 655,696	\$ 2,765	1.69%
FHLB advances	50,000	428	3.42%	50,000	428	3.42%
Subordinated debt	8,248	71	3.44%	8,248	76	3.69%
Other borrowings	7,000	77	4.42%	7,000	78	4.46%
Total interest bearing liabilities	512,801	1,961	1.53%	720,944	3,347	1.86%
Demand deposits	57,933			50,201		
Accrued expenses and other liabilities	6,453			5,207		
Shareholders' equity	51,258			31,225		
Total liabilities and equity	\$ 628,445			\$ 807,577		
Net interest income		\$ 4,947			\$ 5,122	
Interest margin			3.40%			2.71%

Interest spread

3.21%

2.62%

Table of Contents

	Nine months ended September 30,					
	Average Balance	2011 Interest Income/ Expense	Average Rate	Average Balance	2010 Interest Income/ Expense	Average Rate
<i>(dollars in thousands)</i>						
Interest earning assets:						
Loans	\$ 488,295	\$ 19,680	5.37%	\$ 630,899	\$ 26,012	5.50%
Investments	76,443	1,632	2.85%	65,404	1,438	2.93%
Interest bearing deposits in banks	64,595	122	0.25%	55,556	105	0.25%
Federal funds sold	7,516	7	0.12%	10,000	12	0.16%
Total interest earning assets	636,849	21,441	4.49%	761,859	27,567	4.82%
Cash and due from banks	21,366			21,059		
Premises and equipment, net	4,576			5,935		
Allowance for loan losses	(12,863)			(14,965)		
Other assets	34,261			44,643		
Total Assets	\$ 684,189			\$ 818,531		
Interest bearing liabilities:						
Deposits	\$ 498,515	\$ 4,804	1.28%	\$ 665,732	\$ 8,831	1.77%
FHLB advances	50,000	1,270	3.39%	50,000	1,270	3.39%
Subordinated debt	8,248	213	3.44%	8,248	217	3.51%
Other borrowings	7,000	230	4.39%	7,000	231	4.40%
Total interest bearing liabilities	563,763	6,517	1.54%	730,980	10,549	1.92%
Demand deposits	56,636			49,590		
Accrued expenses and other liabilities	6,027			4,917		
Shareholders' equity	57,763			33,044		
Total liabilities and equity	\$ 684,189			\$ 818,531		
Net interest income		\$ 14,924			\$ 17,018	
Interest margin			3.12%			2.98%
Interest spread			2.95%			2.90%

Table of Contents

The following rate volume analysis reflects the impact that changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities had on net interest income during the periods indicated. Information is provided in each category with respect to changes attributable to changes in volume (changes in volume multiplied by prior rate), changes attributable to changes in rates (changes in rates multiplied by prior volume) and the total net change. The change resulting from the combined impact of volume and rate is allocated proportionately to the change due to volume and the change due to rate.

	Three months ended September 30, 2011 vs 2010			Nine months ended September 30, 2011 vs 2010		
	Increase (decrease) in Interest Income/Expense Due to change in:			Increase (decrease) in Interest Income/Expense Due to change in:		
	Volume	Rate	Total	Volume	Rate	Total
	<i>(dollars in thousands)</i>			<i>(dollars in thousands)</i>		
Interest earning assets:						
Loans	\$ (1,866)	\$ 74	\$ (1,792)	\$ (5,703)	\$ (629)	\$ (6,332)
Investments	297	(12)	285	234	(40)	194
Interest bearing deposits in banks	(23)	(28)	(51)	21	(4)	17
Federal funds sold	(3)		(3)	(8)	3	(5)
Total interest earning assets	(1,595)	34	(1,561)	(5,456)	(670)	(6,126)
Interest bearing liabilities:						
Deposits	\$ (751)	\$ (630)	\$ (1,381)	\$ (1,899)	\$ (2,128)	\$ (4,027)
FHLB advances						
Subordinated debt		(5)	(5)		(5)	(5)
Other borrowings						
Total interest bearing liabilities	(751)	(635)	(1,386)	(1,899)	(2,133)	(4,032)
Net interest income	\$ (844)	\$ 669	\$ (175)	\$ (3,557)	\$ 1,463	\$ (2,094)

For the quarter ended September 30, 2011, average interest earning assets decreased \$174.4 million, or 23%, to \$582.5 million from \$757.0 million for the quarter ended September 30, 2010, resulting in interest income for Bancorp of \$6.9 million compared to \$8.5 million for the same period in 2010. Interest and fees on loans decreased \$1.8 million, or 22%, from \$8.0 million for the quarter ended September 30, 2010 to \$6.2 million for the quarter ended September 30, 2011. This decrease is primarily the result of a \$145.0 million decrease in the average balance of the loan portfolio. When compared to the same period last year, interest income on investments increased by 65% due to an increase of \$42.0 million in the average balance of investments outstanding.

Total interest expense for the quarter ended September 30, 2011 of \$2.0 million represents a decrease of \$1.4 million, or 41%, compared to interest expense of \$3.3 million for the same period last year. This decrease in interest expense is the result of a decrease in both interest rates paid and in the average balances of interest-bearing liabilities. Average balances of deposit accounts decreased \$208.1 million, or 32%, which is comprised primarily of decreases in certificates of deposit and money market accounts of \$158.5 million and \$48.0 million, respectively. In addition, significantly lower interest rates contributed to a reduction of \$630,000 to the overall decrease of \$1.4 million in interest expense on deposits. Average FHLB advances remained constant at \$50 million and resulted in \$428,000 in

interest expense, which is consistent with the same period last year. Interest expense on the junior subordinated debt and borrowed funds remained relatively flat.

Table of Contents

As a result of the above, Bancorp's net interest income decreased \$175,000 or 3%, to \$4.9 million for the three months ended September 30, 2011 compared to \$5.1 million for the same period last year. The net interest margin for the three months ended September 30, 2011 was 3.40% as compared to 2.71% for the three months ended September 30, 2010 as a result of the various reasons mentioned above.

Interest and dividend income was \$21.4 million for the nine months ended September 30, 2011, which represents a decrease of \$6.1 million, or 22%, as compared to interest and dividend income of \$27.6 million for the same period last year. This decrease was due primarily to a \$142.6 million decrease in the average loan portfolio and lower interest rates, resulting in a decrease of \$6.3 million in interest and fees on loans. This was combined with a decrease in interest rates on investment securities, partially offset with an increase in average balances.

For the nine months ended September 30, 2011, total interest expense decreased \$4.0 million, or 38%, to \$6.5 million from \$10.5 million for the nine months ended September 30, 2010. This decrease in interest expense was due to the above-mentioned reasons.

As a result of the above, net interest income decreased \$2.1 million, or 12%, for the nine months ended September 30, 2011 to \$14.9 million as compared to \$17.0 million at September 30, 2010. The net interest margin for the nine months ended September 30, 2011 was 3.12% as compared to 2.98% for the nine months ended September 30, 2010.

Provision for Loan Losses

Based on management's most recent evaluation of the adequacy of the allowance for loan losses, a provision for loan losses charged to operations for the three months ended September 30, 2011 was not required, compared to \$5.0 million for the three months ended September 30, 2010. For the nine months ended September 30, 2011, the provision for loan losses charged to operations was \$8.5 million compared to \$6.3 million for the nine months ended September 30, 2010 primarily due to \$6.0 million related to loans transferred to held-for-sale in connection with the bulk loan sale and additional specific reserves for certain impaired loans.

An analysis of the changes in the allowance for loan losses is presented under Allowance for Loan Losses.

Non-interest income

Non-interest income increased \$644,000 from \$637,000 for the quarter ended September 30, 2010 to \$1.3 million for the quarter ended September 30, 2011. This is primarily due to gains on sales of investment securities of \$780,000, partially offset by lower service charges on deposit accounts of \$116,000.

For the nine months ended September 30, 2011, non-interest income increased \$838,000, or 48%, to \$2.6 million as compared to \$1.7 million for the nine months ended September 30, 2010. This is primarily due to \$780,000 in gains on the sales of investment securities, \$111,000 in interest received on federal tax refunds, an \$80,000 gain on sale of loans, and an increase of \$62,000 in earnings on the cash surrender value of life insurance. These were partially offset by lower service charges on deposit accounts, loan origination and processing fees and mortgage brokerage referral fees of \$115,000, \$54,000 and \$48,000 respectively.

Non-interest expenses

Non-interest expenses decreased \$1.5 million or 21% from \$7.5 million to \$6.0 million for the quarter ended September 30, 2011 as compared to the quarter ended September 30, 2010. This decrease was primarily due to the impact of the restructuring in the second quarter related to the branch closings and reduction in force, resulting in lower salaries and benefits and occupancy expenses of \$352,000 and 332,000 respectively. Other real estate owned expenses decreased \$481,000 due primarily to lower operating costs associated with fewer properties. Regulatory assessments decreased \$258,000 due to lower deposit balances and changes by the FDIC in their method of calculating insurance premiums.

Table of Contents

For the nine months ended September 30, 2011, non-interest expenses increased \$1.3 million, or 6%, to \$24.9 million from \$23.6 million for the same period in 2010. This increase was primarily due to \$3.0 million in restructuring charges and asset disposals related to the branch closings and reduction in force recorded in the second quarter. Advertising and promotional expenses increased \$305,000. These were partially offset by decreases in other real estate owned, occupancy expenses and salaries and benefits of \$742,000, \$522,000 and \$501,000, respectively, due to the reasons discussed above. Regulatory expenses decreased \$403,000 when compared to the same period in prior year.

Liquidity

Bancorp's liquidity ratio was 21% at September 30, 2011 compared to 20% at September 30, 2010. The liquidity ratio is defined as the percentage of liquid assets to total assets. The following categories of assets, as described in the accompanying consolidated balance sheets, are considered liquid assets: cash and due from banks, federal funds sold, short-term investments and available-for-sale securities. Liquidity is a measure of Bancorp's ability to generate adequate cash to meet financial obligations. The principal cash requirements of a financial institution are to cover downward fluctuations in deposit accounts and increases in its loan portfolio. Management believes Bancorp's short-term assets provide sufficient liquidity to cover loan demand, potential fluctuations in deposit accounts and to meet other anticipated cash operating requirements.

Capital

The following table illustrates Bancorp's regulatory capital ratios at September 30, 2011 and December 31, 2010 respectively:

	September 30, 2011	December 31, 2010
Tier 1 Leverage Capital	9.25%	9.16%
Tier 1 Risk-based Capital	14.55%	15.69%
Total Risk-based Capital	15.82%	17.08%

The following table illustrates the Bank's regulatory capital ratios at September 30, 2011 and December 31, 2010 respectively:

	September 30, 2011	December 31, 2010
Tier 1 Leverage Capital	8.90%	8.84%
Tier 1 Risk-based Capital	14.00%	15.15%
Total Risk-based Capital	15.27%	16.54%

Table of Contents**IMPACT OF INFLATION AND CHANGING PRICES**

Bancorp's consolidated financial statements have been prepared in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the general levels of inflation. Interest rates do not necessarily move in the same direction or with the same magnitude as the prices of goods and services. Notwithstanding this, inflation can directly affect the value of loan collateral, in particular, real estate. Inflation, or disinflation, could significantly affect Bancorp's earnings in future periods.

Item 3: Quantitative and Qualitative Disclosures about Market Risk

Market risk is defined as the sensitivity of income to fluctuations in interest rates, foreign exchange rates, equity prices, commodity prices and other market-driven rates or prices. Based upon the nature of Bancorp's business, the primary source of market risk is interest rate risk, which is the impact that changing interest rates have on current and future earnings. In addition, Bancorp's loan portfolio is primarily secured by real estate in the company's market area. As a result, the changes in valuation of real estate could also impact Bancorp's earnings.

Qualitative Aspects of Market Risk

Bancorp's goal is to maximize long term profitability while minimizing its exposure to interest rate fluctuations. The first priority is to structure and price Bancorp's assets and liabilities to maintain an acceptable interest rate spread while reducing the net effect of changes in interest rates. In order to accomplish this, the focus is on maintaining a proper balance between the timing and volume of assets and liabilities re-pricing within the balance sheet. One method of achieving this balance is to originate variable rate loans for the portfolio and purchase short-term investments to offset the increasing short term re-pricing of the liability side of the balance sheet. In fact, a number of the interest-bearing deposit products have no contractual maturity. Therefore, deposit balances may run off unexpectedly due to changing market conditions. Additionally, loans and investments with longer term rate adjustment frequencies are matched against longer term deposits and borrowings to lock in a desirable spread.

The exposure to interest rate risk is monitored by the Management Asset and Liability Committee consisting of senior management personnel. The Committee meets on a monthly basis, but may convene more frequently as conditions dictate. The Committee reviews the interrelationships within the balance sheet to maximize net interest income within acceptable levels of risk. This Committee reports to the Board of Directors on a monthly basis regarding its activities. In addition to the Management Asset and Liability Committee, there is a Board Asset and Liability Committee (ALCO), which meets quarterly. ALCO monitors the interest rate risk analyses, reviews investment transactions during the period and determines compliance with Bank policies.

Quantitative Aspects of Market Risk

In order to manage the risk associated with interest rate movements, management analyzes Bancorp's interest rate sensitivity position through the use of interest income simulation and GAP analysis. The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are interest sensitive. An asset or liability is said to be interest sensitive within a specific time period if it will mature or reprice within that time period.

Management's goal is to manage asset and liability positions to moderate the effects of interest rate fluctuations on net interest income. Interest income simulations are completed quarterly and presented to ALCO. The simulations provide an estimate of the impact of changes in interest rates on net interest income under a range of assumptions. Changes to these assumptions can significantly affect the results of the simulations. The simulation incorporates assumptions regarding the potential timing in the repricing of certain assets and liabilities when market rates change and the changes in spreads between different market rates.

Table of Contents

Simulation analysis is only an estimate of Bancorp's interest rate risk exposure at a particular point in time. Management regularly reviews the potential effect changes in interest rates could have on the repayment of rate sensitive assets and funding requirements of rate sensitive liabilities.

The table below sets forth examples of changes in estimated net interest income and the estimated net portfolio value based on projected scenarios of interest rate increases and decreases. The analyses indicate the rate risk embedded in Bancorp's portfolio at the dates indicated should all interest rates instantaneously rise or fall. The results of these changes are added to or subtracted from the base case; however, there are certain limitations to these types of analyses. Rate changes are rarely instantaneous and these analyses may also overstate the impact of short-term repricings. As a result of the historically low interest rate environment, the calculated effects of the 100 and 200 basis point downward shocks cannot absolutely reflect the risk to earnings and equity since the interest rates on certain balance sheet items have approached their minimums, and, therefore, it is not possible for the analyses to fully measure the entire impact of these downward shocks.

Net Interest Income and Economic Value
Summary Performance

Projected Interest Rate Scenario	September 30, 2011			September 30, 2011		
	Net Interest Income			Net Portfolio Value		
	Estimated Value	\$ Change from Base	% Change from Base	Estimated Value	\$ Change from Base	% Change from Base
+ 200	21,961	657	3.08%	46,691	(8,400)	-15.25%
+ 100	21,695	391	1.84%	50,793	(4,298)	-7.80%
BASE	21,304			55,091		
- 100	20,863	(441)	-2.07%	59,438	4,347	7.89%
- 200	20,048	(1,256)	-5.90%	64,922	9,831	17.85%

Projected Interest Rate Scenario	December 31, 2010			December 31, 2010		
	Net Interest Income			Net Portfolio Value		
	Estimated Value	\$ Change from Base	% Change from Base	Estimated Value	\$ Change from Base	% Change from Base
+ 200	26,290	110	0.42%	63,164	(4,420)	-6.54%
+ 100	26,209	29	0.11%	65,502	(2,082)	-3.08%
BASE	26,180			67,584		
- 100	25,869	(311)	-1.19%	70,228	2,644	3.91%
- 200	25,068	(1,112)	-4.25%	75,096	7,512	11.12%

Item 4: Controls and Procedures

Based on an evaluation of the effectiveness of Bancorp's disclosure controls and procedures performed by Bancorp's management, with the participation of Bancorp's Chief Executive Officer and its Chief Financial Officer as of the end of the period covered by this report, Bancorp's Chief Executive Officer and Chief Financial Officer concluded that Bancorp's disclosure controls and procedures have been effective.

Table of Contents

As used herein, "disclosure controls and procedures" means controls and other procedures of Bancorp that are designed to ensure that information required to be disclosed by Bancorp in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by Bancorp in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to Bancorp's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in Bancorp's internal controls over financial reporting identified in connection with the evaluation described in the preceding paragraph that occurred during Bancorp's fiscal quarter ended September 30, 2011 that has materially affected, or is reasonably likely to materially affect, Bancorp's internal controls over financial reporting.

Item 5: Other Information

On November 8, 2011, Bancorp and PNBK Sponsor LLC ("Sponsor") entered into a Financial Advisory Agreement. Sponsor is the manager of PNBK Holdings LLC, the owner of 87.6% of the outstanding common stock of Bancorp. Michael A. Carrazza, Chairman of the Board of Directors of Bancorp, is manager of Sponsor. Under the terms of the Financial Advisory Agreement, Sponsor shall provide Bancorp with financial advisory services, including financial analysis, capital raising and strategic initiative services. Sponsor will be reimbursed for its expenses, but will only receive compensation upon the closing of a Bancorp financial transaction, which includes the issuance of securities, merger, acquisition, divestiture, tender offer, exchange offer or recapitalization. Upon such a transaction, Sponsor will receive 3% of the first \$50 million of consideration received by Bancorp, 2% of the consideration between \$50 and \$100 million, and 1% of the excess consideration received. The Financial Advisory Agreement lasts for a term of three years and automatically renews, unless terminated by either party.

Table of Contents

PART II OTHER INFORMATION.

Item 1: Legal Proceedings

Neither Bancorp nor the Bank has any pending legal proceedings, other than ordinary routine litigation incidental to its business, to which Bancorp or the Bank is a party or any of its property is subject.

Item 1A: Risk Factors

During the three months ended September 30, 2011, there were no material changes to the risk factors relevant to Bancorp's operations, which are described in the Annual Report on Form 10-K for the year ended December 31, 2010.

Item 6: Exhibits

No.	Description
2	Agreement and Plan of Reorganization dated as of June 28, 1999 between Bancorp and the Bank (incorporated by reference to Exhibit 2 to Bancorp's Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)).
3(i)	Certificate of Incorporation of Bancorp, (incorporated by reference to Exhibit 3(i) to Bancorp's Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)).
3(i)(A)	Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. dated July 16, 2004 (incorporated by reference to Exhibit 3(i)(A) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2004 (Commission File No. 000-29599)).
3(i)(B)	Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. dated June 15, 2006 (incorporated by reference to Exhibit 3(i)(B) to Bancorp's Quarterly Report of Form 10-Q for the quarter ended September 30, 2006 (commission File No. 000-29599)).

Table of Contents

No.	Description
3(i)(C)	Certificate of Amendment to the Certificate of Incorporation of Patriot National Bancorp, Inc., filed with the Secretary of State of the State of Connecticut on October 6, 2010 (incorporated by reference to Exhibit 3.1 to Bancorp's Current Report on Form 8-K dated October 20, 2010 (Commission File No. 000-29599)).
3(i)(D)	Registration Rights Agreement, dated as of October 15, 2010, by and between Patriot National Bancorp, Inc. and PNBK Holdings LLC (incorporated by reference to Exhibit 10.1 to Bancorp's Current Report on Form 8-K dated October 20, 2010 (Commission File No. 000-29599)).
3(ii)	Amended and Restated By-laws of Bancorp (incorporated by reference to Exhibit 3(ii) to Bancorp's Current Report on Form 8-K dated November 1, 2010 (Commission File No. 000-29599)).
10(a)(1)	2001 Stock Appreciation Rights Plan of Bancorp (incorporated by reference to Exhibit 10(a)(1) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2001 (Commission File No. 000-29599)).
10(a)(5)	Employment Agreement dated as of January 1, 2008 among Patriot National Bank, Bancorp and Robert F. O'Connell (incorporated by reference to Exhibit 10(a)(5) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2007 (Commission File No. 000-29599)).
10(a)(6)	Change of Control Agreement, dated as of January 1, 2007 among Robert F. O'Connell, Patriot National Bank and Bancorp (incorporated by reference to Exhibit 10(a)(6) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2006 (Commission File No. 000-29599)).
10(a)(9)	License agreement dated July 1, 2003 between Patriot National Bank and L. Morris Glucksman (incorporated by reference to Exhibit 10(a)(9) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2003 (Commission File No. 000-29599)).

Table of Contents

No.	Description
10(a)(12)	2005 Director Stock Award Plan (incorporated by reference to Exhibit 10(a)(12) to Bancorp's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 (Commission File No. 000-295999)).
10(a)(14)	Change of Control Agreement, dated as of January 1, 2007 among Philip W. Wolford, Patriot National Bank and Bancorp (incorporated by reference to Exhibit 10(a)(14) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2006 (Commission File No. 000-295999)).
10(a)(15)	Formal Written Agreement between Patriot National Bank and the Office of the Comptroller of the Currency (incorporated by reference to Exhibit 10(a)(15) to Bancorp's Current Report on Form 8-K dated February 9, 2009 (Commission File No. 000-295999)).
10(a)(16)	Securities Purchase Agreement by and among Patriot National Bancorp, Inc., Patriot National Bank and PNBK Holdings LLC dated as of December 16, 2009 (incorporated by reference to Exhibit 10.1 to Bancorp's Current Report on Form 8-K dated December 17, 2009).
10(a)(17)	First Amendment to Securities Purchase Agreement by and among Patriot National Bancorp, Inc., Patriot National Bank and PNBK Holdings LLC dated as of May 3, 2010. (incorporated by reference to Exhibit 10(a) to Bancorp's Current Report on Form 8-K dated May 4, 2010).
10(a)(18)	Purchase and Sale Agreement, dated February 25, 2011, by and among Patriot National Bank, Pinpat Acquisition Corporation and ES Ventures One LLC (incorporated by reference to Exhibit 2.1 to Bancorp's Current Report on Form 8-K dated March 29, 2011).
10(a)(19)	Formal Written Agreement between Patriot National Bank and the Federal Reserve Bank of New York (as incorporated by reference to Exhibit 10(a)(16) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2010).
10(a)(20)	Financial Advisory Agreement, dated November 8, 2011, by and between Patriot National Bancorp, Inc. and PNBK Sponsor LLC.

Table of Contents

No.	Description
14	Code of Conduct for Senior Financial Officers (incorporated by reference to Exhibit 14 to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2004 (Commission File No. 000-29599)).
21	Subsidiaries of Bancorp (incorporated by reference to Exhibit 21 to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 1999 (Commission File No. 000-29599)).
31(1)	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31(2)	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32	Section 1350 Certifications

Table of Contents

SIGNATURES

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

Patriot National Bancorp, inc.
(Registrant)

By: /s/ Robert F. O Connell
Robert F. O Connell,
Senior Executive Vice President
Chief Financial Officer

(On behalf of the registrant and as
chief financial officer)

November 10, 2011