FIRST NATIONAL COMMUNITY BANCORP INC
Form 10-Q
August 24, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2012

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File No. 000-53869

FIRST NATIONAL COMMUNITY BANCORP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania (State or Other Jurisdiction of Incorporation or Organization)	**23-2900790** (I.R.S. Employer Identification No.)
102 E. Drinker St., Dunmore, PA (Address of Principal Executive Offices)	**18512** (Zip Code)

Registrant s telephone number, including area code **(570) 346-7667**

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

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 o NO x

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

Large Accelerated Filer o	Accelerated Filer o
Non-Accelerated Filer x	Smaller reporting company o

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

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

Common Stock, $1.25 par value	**16,442,119 shares**
(Title of Class)	(Outstanding at August 20, 2012)

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Part I - Financial Information

Item 1 - Financial Statements

FIRST NATIONAL COMMUNITY BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(unaudited)

(in thousands, except share data)	**June 30, 2012**	**December 31, 2011**
Assets		
Cash and cash equivalents:		
Cash and due from banks	$ 22,363	$ 18,956
Interest-bearing deposits in other banks	70,397	149,690
Total cash and cash equivalents	92,760	168,646
Securities		
Available-for-sale, at fair value	186,807	185,475
Held-to-maturity, at amortized cost (fair value $2,388 and $2,245)	2,145	2,094
Stock in Federal Home Loan Bank of Pittsburgh, at cost	7,580	8,399
Loans held for sale		94
Loans, net of allowance for loan and lease losses of $19,600 and $20,834	603,053	659,044
Bank premises and equipment, net	19,340	18,846
Accrued interest receivable	2,308	2,552
Refundable federal income taxes	11,612	11,612
Intangible assets	715	797
Bank-owned life insurance	27,122	26,769
Other real estate owned	5,302	6,958
Other assets	9,001	11,353
Total Assets	$ 967,745	$ 1,102,639
Liabilities		
Deposits:		
Demand	$ 139,447	$ 134,016
Interest-bearing demand	259,154	326,899
Savings	90,596	87,712
Time ($100,000 and over)	159,401	199,790
Other time	188,101	208,719
Total deposits	836,699	957,136
Borrowed funds:		
FHLB advances	36,001	48,261
Subordinated debentures	25,000	25,000
Junior subordinated debentures	10,310	10,310
Total borrowed funds	71,311	83,571
Accrued interest payable	5,288	4,301
Other liabilities	13,136	17,706
Total liabilities	926,434	1,062,714

Shareholders Equity				
Common Shares ($1.25 par)				
Authorized: 50,000,000 shares as of June 30, 2012 and December 31, 2011				
Issued and outstanding: 16,442,119 shares as of June 30, 2012 and 16,442,119 shares as of December 31, 2011		20,552		20,552
Additional paid-in capital		61,557		61,557
Accumulated deficit		(40,349)		(38,217)
Accumulated other comprehensive loss				
Unrealized holding gain on available-for-sale securities, net of taxes		3,870		497
Unrealized non-credit holding loss on OTTI available-for-sale securities, net		(4,319)		(4,464)
Total accumulated other comprehensive loss, net of taxes		(449)		(3,967)
Total shareholders equity		41,311		39,925
Total Liabilities and Shareholders Equity	$	967,745	$	1,102,639

The accompanying notes to consolidated financial statements are an integral part of these statements.

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FIRST NATIONAL COMMUNITY BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands, except share data)	**2012**	**2011**	**2012**	**2011**
Interest income				
Interest and fees on loans	$ 7,529	$ 8,943	$ 15,318	$ 18,036
Interest and dividends on securities				
U.S. government agencies	476	827	1,231	1,749
State and political subdivisions, tax-free	1,007	1,406	1,963	2,816
State and political subdivisions, taxable	95	13	249	26
Other securities	273	58	307	102
Total interest and dividends on securities	1,851	2,304	3,750	4,693
Interest on interest-bearing deposits and federal funds sold	44	36	100	62
Total interest income	9,424	11,283	19,168	22,791
Interest expense				
Deposits				
Interest-bearing demand	157	539	340	1,151
Savings	44	87	90	182
Time ($100,000 and over)	385	664	800	1,362
Other time	791	1,167	1,679	2,408
Total interest on deposits	1,377	2,457	2,909	5,103
Interest on borrowed funds				
Interest on FHLB advances	340	797	754	1,666
Interest on subordinated debentures	569	569	1,138	1,131
Interest on junior subordinated debentures	57	51	115	102
Total interest on borrowed funds	966	1,417	2,007	2,899
Total interest expense	2,343	3,874	4,916	8,002
Net interest income before (credit) provision for loan and lease losses	7,081	7,409	14,252	14,789
(Credit) provision for loan and lease losses	(280)	765	(416)	2,509
Net interest income after (credit) provision for loan and lease losses	7,361	6,644	14,668	12,280
Non-interest income				
Deposit service charges	756	783	1,493	1,510
Net gain on the sale of securities		2,302	8	2,302
Gross other-than-temporary impairment (OTTI) gains (losses)	(117)	(479)	57	(209)
Portion of (gain) loss recognized in OCI (before taxes)	21	130	(153)	(140)
Other-than-temporary-impairment losses recognized in earnings	(96)	(349)	(96)	(349)
Net gain on the sale of loans held for sale	247	123	490	298
Net gain on the sale of other real estate owned	145	23	154	2,567
Net gain on the sale of other assets		19		20
Loan-related fees	125	182	249	359
Income on bank-owned life insurance	168	199	353	395
Other	199	175	343	337
Total non-interest income	1,544	3,457	2,994	7,439
Non-interest expense				

Salaries and employee benefits	3,621	3,459	7,259	6,855
Occupancy expense	501	821	1,099	1,498
Equipment expense	446	409	866	794
Advertising expense	140	182	288	343
Data processing expense	596	518	1,070	1,019
FDIC assessment	603	587	1,203	1,376
Bank shares tax	275	276	551	552
Expense of other real estate	226	121	404	688
Provision (credit) for off-balance sheet commitments	252	43	187	(191)
Legal expense	839	1,103	1,760	1,401
Professional fees	1,004	1,206	2,535	3,445
Insurance expenses	247	98	485	197
Other operating expenses	1,122	1,089	2,087	2,079
Total non-interest expense	9,872	9,912	19,794	20,056
Income (loss) before income taxes	(967)	189	(2,132)	(337)
Provision for income taxes				
Net Income (loss)	$ (967)	$ 189	$ (2,132)	$ (337)
Earnings (Loss) Per Share				
Basic	$ (0.06)	$ 0.01	$ (0.13)	$ (0.02)
Diluted	$ (0.06)	$ 0.01	$ (0.13)	$ (0.02)
Cash Dividends Declared Per Common Share	$	$	$	$
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:				
Basic	16,442,119	16,440,190	16,442,119	16,437,491
Diluted	16,442,119	16,440,190	16,442,119	16,437,491

The accompanying notes to consolidated financial statements are an integral part of these statements.

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FIRST NATIONAL COMMUNITY BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
	(In thousands)		(In thousands)	
Net income (loss)	$ (967)	$ 189	$ (2,132)	$ (337)
Other comprehensive income:				
Unrealized gains on securities available for sale	1,458	6,609	5,298	9,109
Tax expense	(496)	(2,247)	(1,800)	(3,097)
Net of tax amount	962	4,362	3,498	6,012
Non-credit related (gains) losses on OTTI securities not expected to be sold	117	479	(57)	209
Tax expense	(40)	(163)	19	(71)
Net of tax amount	77	316	(38)	138
Reclassification adjustment for losses included in net loss	96	(1,953)	88	(1,953)
Tax benefit	(33)	664	(30)	664
Net of tax amount	63	(1,289)	58	(1,289)
Total other comprehensive income	1,102	3,389	3,518	4,861
Total comprehensive income	$ 135	$ 3,578	$ 1,386	$ 4,524

The accompanying notes to consolidated financial statements are an integral part of these statements.

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FIRST NATIONAL COMMUNITY BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

For the Six Months Ended June 30, 2012 and 2011

(Unaudited)

(in thousands, except share data)	Number of Common Shares	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Comprehensive Loss	Total Shareholders Equity
BALANCES, DECEMBER 31, 2010	16,433,020	$ 20,541	$ 61,539	$ (37,882)	$ (12,143)	$ 32,055
Net loss for the period				(337)		(337)
Other comprehensive income, net of tax of $2,504					4,861	4,861
Proceeds from the issuance of common shares through dividend reinvestment plan	8,299	10	17			27
Balances, June 30, 2011	16,441,319	$ 20,551	$ 61,556	$ (38,219)	$ (7,282)	$ 36,606
BALANCES, DECEMBER 31, 2011	16,442,119	$ 20,552	$ 61,557	$ (38,217)	$ (3,967)	$ 39,925
Net loss for the period				(2,132)		(2,132)
Other comprehensive income, net of tax of $1,811					3,518	3,518
Balances, June 30, 2012	16,442,119	$ 20,552	$ 61,557	$ (40,349)	$ (449)	$ 41,311

The accompanying notes to consolidated financial statements are an integral part of these statements.

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FIRST NATIONAL COMMUNITY BANCORP, INC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(in thousands)	Six months ended June 30, 2012	2011
Cash Flows from Operating Activities:		
Net loss	$ (2,132)	$ (337)
Adjustments to Reconcile Net loss to Net Cash (Used in) Provided by Operating Activities:		
Investment securities accretion, net	(830)	(754)
Equity in trust	(2)	(1)
Depreciation and amortization	619	750
(Credit) provision for loan and lease losses	(416)	2,509
Provision (credit) for off balance sheet commitments	187	(191)
Net gain on sale of investment securities	(8)	(2,302)
Other-than temporary impairment losses	96	349
Net gain on the sale of loans held for sale	(490)	(298)
Net gain on the sale of other real estate owned	(154)	(2,567)
(Recoveries) write-down of other real estate owned	(20)	266
Gain on the sale of other assets		(20)
Bank owned life insurance income	(353)	(395)
Proceeds from the sale of loans held for sale	17,117	15,512
Funds used to originate loans held for sale	(16,541)	(13,460)
Increase in interest payable	987	669
Increase in other liabilities	363	378
Decrease in interest receivable	244	319
Increase in refundable federal income taxes		(2)
Decrease in prepaid expenses and other assets	493	4,388
Net Cash (Used in) Provided by Operating Activities	(840)	4,813
Cash Flows from Investing Activities:		
Investment Securities:		
Proceeds from maturities, calls and principal payments	19,381	14,869
Proceeds from sales		16,103
Purchases	(19,811)	
Purchases of Federal Reserve Bank stock	(90)	
Redemption of FHLB stock	819	1,005
Net decrease in loans to customers	56,195	26,899
Proceeds from the sale of other real estate owned	2,336	6,101
Purchases of bank premises and equipment	(1,179)	(517)
Proceeds from the sale of bank premises and equipment		32
Net Cash Provided by Investing Activities	57,651	64,492
Cash Flows from Financing Activities:		
Net decrease in demand deposits, money market demand, interest-bearing demand accounts, and savings accounts	(59,430)	(19,346)
Net decrease in time deposits	(61,007)	(30,388)
Proceeds from FHLB advances	15,737	97,947
Repayment of FHLB advances	(27,997)	(134,006)
Repayment of other borrowed funds		(227)
Proceeds from issuance of common shares - dividend reinvestment plan		27

Net Cash Used in Financing Activities		(132,697)		(85,993)
Net Decrease in Cash and Cash Equivalents		(75,886)		(16,688)
Cash & Cash Equivalents at Beginning of Period		168,646		74,505
Cash & Cash Equivalents at End of Period	$	92,760	$	57,817
Supplemental Cash Flow Information				
Cash paid during the period for:				
Interest	$	3,929	$	7,333
Income Taxes		25		25
Other transactions:				
Principal balance of loans transferred to OREO		506		2,356
Transfer from loans held for sale to other assets				830
Transfer from loans held for sale to loans		94		1,803
Settlement of security settled on trade date		5,120		

The accompanying notes to consolidated financial statements are an integral part of these statements.

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FIRST NATIONAL COMMUNITY BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Notes to Consolidated Financial Statements

Note 1. Basis of Presentation

The consolidated financial statements are comprised of First National Community Bancorp, Inc. and its wholly owned subsidiary, First National Community Bank (the Bank) as well as the Bank s wholly-owned subsidiaries, (collectively the Company). All inter-company transactions and balances have been eliminated. The accounting and reporting policies of the Company conform to U.S. Generally Accepted Accounting Principles (GAAP) and general practices within the financial services industry. In the opinion of management, all adjustments necessary to a fair presentation of the results for the quarterly period ended June 30, 2012 have been included.

In preparing these consolidated financial statements, management has made estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated statements of financial condition and results of operations for the periods indicated. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to change are the allowance for loan and lease losses (ALLL), security valuations, the evaluation of deferred income taxes, and the impairment of securities and other real estate owned (OREO). The current economic environment has increased the degree of uncertainty inherent in these material estimates.

These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s December 31, 2011 audited financial statements filed on Form 10-K and the Company s March 31, 2012 unaudited financial statements filed on Form 10-Q.

Note 2. New Authoritative Accounting Guidance

Accounting Standards Update (ASU) No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS , an update to ASC Topic 820 - Fair Value Measurement, results in common fair value measurement and disclosure requirements in U.S. GAAP and IFRS. The amendments in ASU No. 2011-04 include clarifications about the application of existing fair value measurement requirements and changes to principles for measuring fair value. ASU No. 2011-04 also requires additional disclosures about fair value measurements. ASU No. 2011-04 is required to be applied prospectively and is effective for interim and annual periods beginning after December 15, 2011. The Company adopted this new guidance for the quarter ended March 31, 2012. The adoption of this guidance did not have a material impact on the Company s consolidated financial statements; however, the adoption did have an impact on the Company s fair value disclosures. See Note 7 for the disclosures required by the adoption of this new guidance.

ASU No. 2011-05, Presentation of Comprehensive Income, an update to ASC Topic 220 - Comprehensive Income, was issued to improve the comparability, consistency and transparency of financial reporting. The amendment provides the entity an option to present the total of comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments do not change the items that must be reported in other comprehensive income. ASU No. 2011-05 is required to be applied retrospectively and is effective for interim and annual periods beginning after December 15, 2011. The Company adopted this new guidance for the quarter ended March 31, 2012. Upon adoption of this new guidance the Company presents comprehensive income in a separate Statement of Comprehensive Income.

ASU No. 2011-12 Comprehensive Income (Topic 220) - Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update 2011-05 was issued in December 2011. This update defers only those changes in ASU No. 2011-05 that relate to the presentation of reclassification adjustments, the paragraphs in this update supersede certain pending paragraphs in ASU No. 2011-05. All other requirements in ASU No. 2011-05 are not affected by this update, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and were adopted for the quarter ended March 31, 2012.

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Standards to be Adopted In Future Periods

ASU No. 2011-11, Balance Sheet (Topic 210) - Disclosures about Offsetting Assets and Liabilities was issued in December 2011. The objective of this update is to provide enhanced disclosures that will enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on an entity s financial position. This includes the effect or potential effect of rights of setoff associated with an entity s recognized assets and recognized liabilities within the scope of this update. The amendments require enhanced disclosures by requiring improved information about financial instruments and derivative instruments that are either (1) offset in accordance with either ASC 210-20-45 or ASC 815-10-45 or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with either ASC 210-20-45 or ASC 815-10-45. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The adoption of ASU 2011-11 is not expected to have a material impact on the Company s consolidated financial statements.

Reclassification of Prior Year Financial Statements

Certain reclassifications have been made to the prior year s consolidated financial statements to conform to the current year s presentation. Such reclassifications had no impact on results of operations.

Note 3. Regulatory Matters

The Bank is under a Consent Order (the Order) from the Office of the Comptroller of the Currency (OCC) dated September 1, 2010. The Company is also subject to a written Agreement (the Agreement) with the Federal Reserve Bank of Philadelphia (the Reserve Bank) dated November 24, 2010.

OCC Consent Order. The Bank, pursuant to a Stipulation and Consent to the Issuance of a Consent Order dated September 1, 2010 without admitting or denying any wrongdoing, consented and agreed to the issuance of the Order by the OCC, the Bank s primary regulator. The Order requires the Bank to undertake certain actions within designated timeframes, and to operate in compliance with the provisions thereof during its term. The Order is based on the results of an examination of the Bank as of March 31, 2009. Since the examination, management has engaged in discussions with the OCC and has taken steps to improve the condition, policies and procedures of the Bank. Compliance with the Order is to be monitored by a committee (the Committee) of at least three directors, none of whom is an employee or controlling shareholder of the Bank or its affiliates or a family member of any such person. The Committee is required to submit written progress reports on a monthly basis and the Agreement requires the Bank to make periodic reports and filings with the OCC. The members of the Committee are John P. Moses, Joseph Coccia, Joseph J. Gentile and Thomas J. Melone. The material provisions of the Order are as follows:

(i) By October 31, 2010, the Board of Directors of the Bank (the Board) is required to adopt and implement a three-year strategic plan which must be submitted to the OCC for review and prior determination of no supervisory objection; the strategic plan must establish objectives for the Bank s overall risk profile, earnings performance, growth, balance sheet mix, off-balance sheet activities, liability structure, capital adequacy, reduction in the volume of nonperforming assets, product line development, and market segments that the Bank intends to promote or develop, and is to include strategies to achieve those objectives; if the strategic plan involves the sale or merger of the Bank, it must address the timeline and steps to be followed to provide for a definitive agreement within 90 days after the receipt of a determination of no supervisory objection;

(ii) by October 31, 2010, the Board is required to adopt and implement a three year capital plan, which must be submitted to the OCC for review and prior determination of no supervisory objection;

(iii) by November 30, 2010, the Bank is required to achieve and thereafter maintain a total risk-based capital equal to at least 13% of risk-weighted assets and a Tier 1 capital equal to at least 9% of adjusted total assets;

(iv) the Bank may not pay any dividend or capital distribution unless it is in compliance with the higher capital requirements required by the Order, the Capital Plan, applicable legal requirements and, then only after receiving a determination of no supervisory objection from the OCC;

(v) by November 15, 2010, the Committee must review the Board and the Board s committee structure; by November 30, 2010, the Board must prepare or cause to be prepared an assessment of the capabilities of the Bank s executive officers to perform their past and current duties, including those required to respond to the most recent examination report, and to perform annual performance appraisals of each officer;

(vi) by October 31, 2010, the Board must adopt, implement and thereafter ensure compliance with a comprehensive conflict of interest policy applicable to the Bank s and the Company s directors, executive officers, principal shareholders and their affiliates and such

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person s immediate family members and their related interests, employees, and by November 30, 2010, conduct a review of existing relationships with such persons to identify those, if any, not in compliance with the policy; and review all subsequent proposed transactions with such persons or modifications of transactions;

(vii) by October 31, 2010, the Board must develop, implement and ensure adherence to policies and procedures for Bank Secrecy Act (BSA) compliance; and account opening and monitoring procedures compliance;

(viii) by October 31, 2010, the Board must ensure the BSA audit function is supported by an adequately staffed department or third party firm; adopt, implement and ensure compliance with an independent BSA audit; and assess the capabilities of the BSA officer and supporting staff to perform present and anticipated duties;

(ix) by October 31, 2010, the Board is required to adopt, implement and ensure adherence to a written credit policy, including specified features, to improve the Bank s loan portfolio management;

(x) the Board is required to take certain actions to resolve certain credit and collateral exceptions;

(xi) by October 31, 2010, the Board is required to establish an effective, independent and ongoing loan review system to review, at least quarterly, the Bank s loan and lease portfolios to assure the timely identification and categorization of problem credits; by October 31, 2010, to adopt and adhere to a program for the maintenance of an adequate ALLL, and to review the adequacy of the Bank s ALLL at least quarterly;

(xii) by October 31, 2010, the Board must adopt and the Bank implement and adhere to a program to protect the Bank s interest in criticized assets; and the Bank may only extend additional credit (including renewals) to a borrower whose loans are criticized under specified circumstances;

(xiii) by October 31, 2010, the Board must adopt and ensure adherence to action plans for each piece of other real estate owned;

(xiv) by November 30, 2010, the Board is required to develop, implement and ensure adherence to a policy for effective monitoring and management of concentrations of credit;

(xv) by October 31, 2010, the Board must revise and implement the Bank s other than temporary impairment policy;

(xvi) by October 31, 2010, the Board must take action to maintain adequate sources of stable funding and liquidity and a contingency funding plan; by October 31, 2010, the Board is required to adopt, implement and ensure compliance with an independent, internal audit program; and

(xvii) take actions to correct cited violations of law; and adopt procedures to prevent future violations and address compliance management.

Federal Reserve Agreement. On November 24, 2010, the Company entered into the Agreement with the Reserve Bank. The Agreement requires the Company to undertake certain actions within designated timeframes, and to operate in compliance with the provisions thereof during its term. The material provisions of the Agreement include the following:

(i) the Company s Board must 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 ensure that the Bank complies with its Consent Order entered into with the OCC;

(ii) the Company may not declare or pay any dividends without the prior written approval of the Reserve Bank and the Director of the Division of Banking Supervision and Regulation (the Director) of the Federal Reserve Board;

(iii) the Company may not take dividends or other payments representing a reduction of the Bank s capital without the prior written approval of the Reserve Bank;

(iv) the Company and its nonbank subsidiary may not make any payment of interest, principal or other amounts on the Company s subordinated debentures or trust preferred securities without the prior written approval of the Reserve Bank and the Director;

(v) the Company may not make any payment of interest, principal or other amounts on debt owed to insiders of the Company without the prior written approval of the Reserve Bank and Director;

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(vi) the Company and its nonbank subsidiary may not incur, increase or guarantee any debt without the prior written approval of the Reserve Bank;

(vii) the Company may not purchase or redeem any shares of its stock without the prior written approval of the Reserve Bank;

(viii) the Company must submit to the Reserve Bank, by January 23, 2011, an acceptable written plan to maintain sufficient capital at the Company on a consolidated basis. Thereafter, the Company must notify the Reserve Bank within 45 days of the end of any quarter in which the Company s capital ratios fall below the approved capital plan s minimum ratios, and submit an acceptable written plan to increase the Company s capital ratios above the capital plan s minimums;

(ix) the Company must immediately take all actions necessary to ensure that: (1) each regulatory report accurately reflects the Company s condition on the date for which it is filed and all material transactions between the Company and its subsidiaries; (2) each such report is prepared in accordance with its instructions; and (3) all records indicating how the report was prepared are maintained for supervisory review;

(x) the Company must submit to the Reserve Bank, by January 23, 2011, acceptable written procedures to strengthen and maintain internal controls to ensure all required regulatory reports and notices filed with the Board of Governors are accurate and filed in accordance with the instructions for preparation;

(xi) the Company must submit to the Reserve Bank, by January 8, 2011, a cash flow projection for 2011, reflecting the Company s planned sources and uses of cash, and submit a cash flow projection for each subsequent calendar year at least one month prior to the beginning of such year;

(xii) the Company must comply with: (1) the notice provisions of Section 32 of the FDI Act and Subpart H of Regulation Y in appointing any new director or senior executive officer or changing the duties of any senior executive officer; and (2) the restrictions on indemnification and severance payments of Section 18(k) of the FDI Act and Part 359 of the FDIC s regulations; and

(xiii) the Board must submit written progress reports within 30 days of the end of each calendar quarter.

During the six months ended June 30, 2012, and the year ended December 31, 2011, the Company incurred approximately $288 thousand and $1.0 million, respectively, of expenses related to entering into and complying with these regulatory agreements, consisting primarily of professional and consulting fees. In addition, the Order and the Agreement place restrictions on the Company s ability to borrow funds and to pay interest and dividends to its security holders. In the future, the Company expects to continue to experience increased costs related to compliance with these regulatory agreements, primarily as a result of increased head count and also expects to face certain restrictions on its operations for as long as it continues to operate under the Order and the Agreement. The Company expects, however, that future compliance expenses will decrease from the 2011 level, because the majority of the expenses incurred to date are related to development and implementation of processes and policies that, once those policies and processes are finalized and implemented, are not expected to recur.

The Order and Agreement have not and are not expected to have an impact on the Company s ability to attract and maintain deposits or the Company s cost of funds. In order to meet the increased capital requirements imposed under the Order and the Agreement, however, unless the Company is able to raise additional capital, the Company could be limited in the aggregate amount of loans it can have outstanding, which may constrain loan growth. While it is not anticipated that the Order and the Agreement will have an immediate impact on the Company s net interest margin, the overall cost of compliance with the Order and the Agreement will continue to impact profitability at least through the end of 2012.

Banking regulations also limit the amount of dividends that may be paid without prior approval of the Bank s regulatory agency. At August 24, 2012, the Company and the Bank are restricted from paying any dividends, without regulatory approval.

The Company is 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 adverse effect on the Company s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices must be met. 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 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).

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In accordance with the Order, the Bank is required to achieve and thereafter maintain a total risk-based capital equal to at least 13% of risk-weighted assets and a Tier 1 capital equal to at least 9% of adjusted total assets. At June 30, 2012, the Bank did not meet these requirements. The minimum capital requirements under the Order take precedence over the standard regulatory capital adequacy definitions described in the tables below. The Company s and the Bank s actual capital positions and ratios at June 30, 2012 and December 31, 2011 are presented in the following table:

CAPITAL ANALYSIS

(In thousands)	**June 30, 2012**	**December 31, 2011**
Company		
Tier I Capital:		
Total Tier I Capital	$ 51,028	$ 53,059
Tier II Capital:		
Subordinated notes	25,000	25,000
Allowable portion of allowance for loan losses	9,609	9,823
Total Tier II Capital	34,609	34,823
Total Risk-Based Capital	85,637	87,882
Total Risk Weighted Assets	$ 758,116	$ 774,452
Bank		
Tier I Capital:		
Total Tier I Capital	$ 80,194	$ 80,976
Tier II Capital:		
Allowable portion of allowance for loan losses	9,604	9,819
Total Tier II Capital	9,604	9,819
Total Risk-Based Capital	89,798	90,795
Total Risk Weighted Assets	$ 757,758	$ 774,097

	Actual		**For Capital Adequacy Purposes**		**To Be Well Capitalized Under Prompt Corrective Action Provision**	
At June 30, 2012	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Total Capital (to Risk Weighted Assets)						
Company	$ 85,637	11.30%	$ >60,649	>8.00%	N/A	N/A
Bank	$ 89,798	11.85%	$ >60,621	>8.00%	$ >75,776	>10.00%
Tier I Capital (to Risk Weighted Assets)						
Company	$ 51,028	6.73%	$ >30,325	>4.00%	N/A	N/A
Bank	$ 80,194	10.58%	$ >30,310	>4.00%	$ >45,465	>6.00%
Tier I Capital (to Average Assets)						
Company	$ 51,028	5.02%	$ >40,657	>4.00%	N/A	N/A
Bank	$ 80,194	7.89%	$ >40,643	>4.00%	$ >50,804	>5.00%

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At December 31, 2011	Actual Amount		Ratio	For Capital Adequacy Purposes Amount		Ratio	To Be Well Capitalized Under Prompt Corrective Action Provision Amount		Ratio
Total Capital (to Risk Weighted Assets)									
Company	$	87,882	11.35%	$	>61,956	>8.00%		N/A	N/A
Bank	$	90,795	11.73%	$	>61,928	>8.00%	$	>77,410	>10.00%
Tier I Capital (to Risk Weighted Assets)									
Company	$	53,059	6.85%	$	>30,978	>4.00%		N/A	N/A
Bank	$	80,976	10.46%	$	>30,964	>4.00%	$	>46,446	>6.00%
Tier I Capital (to Average Assets)									
Company	$	53,059	4.72%	$	>44,992	>4.00%		N/A	N/A
Bank	$	80,976	7.20%	$	>44,978	>4.00%	$	>56,227	>5.00%

Note 4. Loans

Loans receivable, net, consists of the following at June 30, 2012 and December 31, 2011:

(In thousands)		June 30, 2012		December 31, 2011
Residential real estate	$	86,361	$	80,056
Commercial real estate		249,079		256,508
Construction, land acquisition and development		30,312		33,450
Commercial and industrial loans		124,375		174,233
Consumer loans		110,119		111,778
State and political subdivisions		22,179		23,496
Total loans, gross		622,425		679,521
Unearned discount		(130)		(159)
Net deferred loan fees and costs		358		516
Allowance for loan and lease losses		(19,600)		(20,834)
Loans, net	$	603,053	$	659,044

The Company has granted loans, letters of credit and lines of credit to certain executive officers and directors of the Company as well as to certain related parties of executive officers and directors. See Note 9 to these consolidated financial statements for more information about related party transactions.

The Company originates one-to-four family mortgage loans primarily for sale in the secondary market. During the three and six month period ended June 30, 2012, the Company sold $8.2 and $16.7 million, respectively, of one-to-four family mortgages. The Company retains servicing rights on these mortgages.

The Company had $0 and $94 thousand in loans held-for-sale at June 30, 2012 and December 31, 2011, respectively. All loans held for sale are one-to-four family residential mortgage 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-burden ratios.

See Note 2 to the Company s consolidated financial statements included in the 2011 Form 10-K for the risk characteristics related to the Company s loan segments.

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The Company provides for loan losses based on the consistent application of its documented ALLL methodology. Loan losses are charged to the ALLL and recoveries are credited to it. Additions to the ALLL are provided by charges against income based on various factors which, in management s judgment, deserve current recognition of estimated probable losses. Loan losses are charged-off in the period the loans, or portions thereof, are deemed uncollectible. Generally, the Company will record a loan charge-off (including a partial charge-off) to reduce a loan to the estimated recoverable amount based on our methodology detailed below. The Company regularly reviews the loan portfolio and makes adjustments for loan losses in order to maintain the ALLL in accordance with U.S. GAAP. The ALLL consists primarily of the following two components:

(1) Specific allowances are established for impaired loans (defined by the Company as all loans with an outstanding balance greater than $100,000 rated doubtful or substandard and on non-accrual status and all TDRs). The amount of impairment provided for as an allowance is represented by the deficiency, if any, between the carrying value of the loan and either (a) the present value of expected future cash flows discounted at the loan s effective interest rate, (b) the loan s observable market price, or (c) the fair value of the underlying collateral, less estimated costs to sell, for collateral dependent loans. Impaired loans that have no impairment losses are not considered for general valuation allowances described below. If the Company determines that collection of the impairment amount is remote, the Company will record a charge-off.

(2) General allowances are established for loan losses on a portfolio basis for loans that do not meet the definition of impaired. The Company divides its portfolio into loan segments, with loans exhibiting similar characteristics. These segments are further disaggregated into classes. Loans rated special mention or substandard and accruing which are embedded in these loan segments are then separated from these loan segments. These loans are then subject to an analysis placing increased emphasis on the credit risk associated with these specific loans. The Company applies an estimated loss rate to each loan group. The loss rates applied are primarily based on the Company s own historical loss experience based on the loss rate for each group of loans with similar risk characteristics in its portfolio. In addition management evaluates and applies certain qualitative or environmental factors that are likely to cause estimated credit losses associated with the Company s existing portfolio that may differ from historical experience, which are discussed below. This evaluation is inherently subjective, as it requires material estimates that may be susceptible to significant revisions based upon changes in economic and real estate market conditions. Actual loan losses may be significantly more than the ALLL that is established, which could have a material negative effect on the Company s financial results.

In underwriting a loan secured by real property (unless exempt based on legal requirements), the Company requires an appraisal of the property by an independent licensed appraiser approved by the Company s Board of Directors. The appraisal is either reviewed internally or by an independent third party hired by the Company. Generally, management obtains updated appraisals when a loan is deemed impaired. These appraisals may be more limited than those prepared for the underwriting of a new loan. In addition, when the Company acquires OREO upon foreclosure, it generally obtains a current appraisal to substantiate the net carrying value of the asset.

Management makes adjustments for loan losses based on its evaluation of several qualitative and environmental factors, including but not limited to:

- Changes in national, local, and business economic conditions and developments, including the condition of various market segments;
- Changes in the nature and volume of the Company s loan portfolio;
- Changes in the Company s lending policies and procedures, including underwriting standards, collection, charge-off and recovery practices and results;

- Changes in the experience, ability and depth of the Company s lending management and staff;

- Changes in the quality of the Company s loan review system and the degree of oversight by the Company s Board of Directors;

- Changes in the trend of the volume and severity of past due and classified loans, including trends in the volume of non-accrual loans, troubled debt restructurings and other loan modifications;

- The existence and effect of any concentrations of credit and changes in the level of such concentrations;

- The effect of external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the Company s current loan portfolio; and

- Analysis of its customers credit quality.

Management evaluates the ALLL based on the combined total of the impaired and general components. Generally, when the loan portfolio increases, absent other factors, the Company s ALLL methodology results in a higher dollar amount of estimated probable losses. Conversely, when the loan portfolio decreases, absent other factors, the Company s ALLL methodology results in a lower dollar amount of estimated probable losses.

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Each quarter, management evaluates the ALLL and adjusts the ALLL as appropriate through a provision for loan losses. While the Company uses the best information available to make evaluations, future adjustments to the ALLL may be necessary if conditions differ substantially from the information used in making the evaluations. In addition, as an integral part of its examination process, the Office of the Comptroller of the Currency periodically reviews the Company s ALLL. The OCC may require the Company to adjust the ALLL based on its analysis of information available to it at the time of its examination.

The following tables set forth activity in the ALLL, by loan type, for the three and six months June 30, 2012.

	Real Estate			**Commercial & Industrial**		**Consumer**			
(in thousands)	**Residential Real Estate**	**Commercial Real Estate**	**Construction, Land Acquisition and Development**	**Solid Waste Landfills**	**Other**	**Indirect Auto**	**Installment HELOC**	**State and Political Subdivisions**	**Total**
Three Months Ended June 30, 2012:									
Allowance for loan losses:									
Beginning Balance, April 1, 2012	$ 1,799	$ 10,741	$ 2,845	$ 16	$ 3,389	$ 733	$ 724	$ 417	$ 20,664
Charge-offs	(131)	(742)			(101)	(133)	(37)		(1,144)
Recoveries	15	13	234		57	40	1		360
Provisions (credits)	322	(220)	(1,414)	(16)	713	258	38	39	(280)
Ending Balance, June 30, 2012	$ 2,005	$ 9,792	$ 1,665	$	$ 4,058	$ 898	$ 726	$ 456	$ 19,600
Three Months Ended June 30, 2011:									
Allowance for loan losses:									
Beginning Balance, April 1, 2011	$ 2,241	$ 10,860	$ 4,623	$ 16	$ 4,643	$ 581	$ 576	$ 690	$ 24,230
Charge-offs	(145)	(1,376)			(15)	(104)	(13)		(1,653)
Recoveries	7	11	117		173	51			359
Provisions (credits)	135	2,091	(1,077)		(126)	37	44	(339)	765
Ending Balance, June 30, 2011	$ 2,238	$ 11,586	$ 3,663	$ 16	$ 4,675	$ 565	$ 607	$ 351	$ 23,701
Six Months Ended June 30, 2012:									
Allowance for loan losses:									
Beginning Balance, January 1, 2012	$ 1,823	$ 11,151	$ 2,590	$ 16	$ 3,276	$ 802	$ 724	$ 452	$ 20,834
Charge-offs	(443)	(896)			(150)	(156)	(93)		(1,738)
Recoveries	34	330	255		182	108	11		920
Provisions (credits)	591	(793)	(1,180)	(16)	750	144	84	4	(416)
Ending Balance, June 30, 2012	$ 2,005	$ 9,792	$ 1,665	$	$ 4,058	$ 898	$ 726	$ 456	$ 19,600
Six Months Ended June 30, 2011:									
Allowance for loan losses:									
	$ 2,176	$ 9,640	$ 4,170	$ 11	$ 4,839	$ 597	$ 576	$ 566	$ 22,575

Beginning Balance, January 1, 2011									
Charge-offs	(281)	(1,833)	(6)		(124)	(232)	(105)		(2,581)
Recoveries	14	24	823		247	89	1		1,198
Provisions (credits)	329	3,755	(1,324)	5	(287)	111	135	(215)	2,509
Ending Balance, June 30, 2011	$ 2,238	$ 11,586	$ 3,663	$ 16	$ 4,675	$ 565	$ 607	$ 351	$ 23,701

The following tables represent the allocation of the allowance for loan losses and the related loan by loan portfolio segment disaggregated based on the impairment methodology at June 30, 2012 and December 31, 2011:

	Real Estate			**Commercial & Industrial**		**Consumer**			
(in thousands)	**Residential Real Estate**	**Commercial Real Estate**	**Construction, Land Acquisition and Development**	**Solid Waste Landfills**	**Other**	**Indirect Auto**	**Installment/ HELOC**	**State and Political Subdivisions**	**Total**
June 30, 2012									
Allowance for loan losses:									
Individually evaluated for impairment	$ 62	$ 214	$ 3	$	$	$	$	$	$ 279
Collectively evaluated for impairment	1,943	9,578	1,662		4,058	898	726	456	19,321
Total	$ 2,005	$ 9,792	$ 1,665	$	$ 4,058	$ 898	$ 726	$ 456	$ 19,600
Loans receivable:									
Individually evaluated for impairment	$ 3,000	$ 13,303	$ 2,855	$	$ 3,286	$	$ 31	$ 175	$ 22,650
Collectively evaluated for impairment	83,361	235,776	27,457		121,089	70,198	39,890	22,004	599,775
Total	$ 86,361	$ 249,079	$ 30,312	$	$ 124,375	$ 70,198	$ 39,921	$ 22,179	$ 622,425
December 31, 2011									
Allowance for loan losses:									
Individually evaluated for impairment	$ 65	$ 545	$ 91	$	$	$	$	$	$ 701
Collectively evaluated for impairment	1,758	10,606	2,499	16	3,276	802	724	452	20,133
Total	$ 1,823	$ 11,151	$ 2,590	$ 16	$ 3,276	$ 802	$ 724	$ 452	$ 20,834
Loans receivable:									
Individually evaluated for impairment	$ 3,615	$ 13,012	$ 2,979	$	$ 4,066	$	$ 31	$	$ 23,703
Collectively evaluated for impairment	76,441	243,496	30,471	42,270	127,897	63,722	48,025	23,496	655,818
Total	$ 80,056	$ 256,508	$ 33,450	$ 42,270	$ 131,963	$ 63,722	$ 48,056	$ 23,496	$ 679,521

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Credit Quality Indicators   Commercial Loans

The Company continuously monitors the credit quality of its commercial loan receivables. Credit quality is monitored by reviewing certain credit quality indicators. Management has determined that internally assigned credit risk ratings by loan type are the key credit quality indicators that best help management monitor the credit quality of the Company s loan receivables.

The Bank s commercial loan classification and credit grading processes are part of the lending, underwriting, and credit administration functions to ensure an ongoing assessment of credit quality. Accurate and timely loan classification or credit grading is a critical component of loan portfolio management. Loan officers are required to review their loan portfolio risk ratings regularly for accuracy. The loan review function uses the same risk rating system in the loan review process. This allows an independent third party to assess the quality of the portfolio and compare the accuracy of ratings with the loan officer s and management s assessment.

A formal loan classification and credit grading system reflects the risk of default and credit losses. The Company maintains a written description of the risk ratings that includes a discussion of the factors used to assign appropriate classifications of credit grades to loans. The process identifies groups of loans that warrant the special attention of management. The risk grade groupings provide a mechanism to identify risk within the loan portfolio and provide management and the Board with periodic reports by risk category. The credit risk ratings play an important role in the establishment and evaluation of ALLL. After determining the historical loss factor which is adjusted for qualitative and environmental factors for each portfolio segment, segment balances collectively evaluated for impairment are multiplied by the general reserve loss factor for the respective portfolio segments in order to determine the general reserve. Loans that have an internal credit rating of special mention or substandard follow the same process: however, the qualitative and environmental factors are further adjusted for the increased risk.

The Company utilizes a loan rating system that that assigns a degree of risk to commercial loans based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors. Management analyzes these non-homogeneous loans individually based on credit risk and probability of collection for each type of class. Commercial loans include commercial indirect auto loans which are not individually risk rated. These loans are monitored on a pool basis due to their homogeneous nature as described in   Credit Quality Indicators   Other Loans   below. The grading system contains the following basic risk categories:

1. Minimal Risk
2. Above Average Credit Quality
3. Average Risk
4. Acceptable Risk
5. Pass - Watch
6. Special Mention
7. Substandard - Accruing

8. Substandard - Non-Accrual

9. Doubtful

10. Loss

This analysis is performed on a quarterly basis using the following definitions for risk ratings:

Pass - Assets rated 1 through 5 are considered pass ratings. These assets show no current or potential problems and are considered fully collectible. All such loans are considered collectively for ALLL calculation purposes.

Special Mention Assets classified as special mention do not currently expose the Company to a sufficient degree of risk to warrant an adverse classification but do possess credit deficiencies or potential weaknesses deserving close attention. Special Mention assets have a potential weakness or pose an unwarranted financial risk which, if not corrected, could weaken the asset and increase risk in the future.

Substandard - Assets classified as substandard 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.

Doubtful - 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 highly questionable and improbable based on current circumstances.

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Loss - Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets is not warranted.

The following table details the recorded investment in loans receivable by the aforementioned class of loan and credit quality indicator at June 30, 2012 and December 31, 2011:

Commercial Credit Quality Indicators

June 30, 2012

(in thousands)	Residential Real Estate	Real Estate Commercial Real Estate	Construction, Land Acquisition & Development	Commercial & Industrial	Consumer Installment / HELOC	State and Political Subdivisions	Total
Internal Risk Rating							
Pass	$ 18,657	$ 202,418	$ 18,200	$ 105,071	$ 3,448	$ 22,004	$ 369,798
Special Mention	467	7,686	6,216	5,821			20,190
Substandard	2,730	38,975	3,446	7,299	145	175	52,770
Doubtful							
Loss							
Total Loans Receivable	$ 21,854	$ 249,079	$ 27,862	$ 118,191	$ 3,593	$ 22,179	$ 442,758

Commercial Credit Quality Indicators

December 31, 2011

	Real Estate			Commercial & Industrial				
(in thousands)	Residential Real Estate	Commercial Real Estate	Construction, Land Acquisition and Development	Solid Waste Landfills	Other	Consumer Installment/ HELOC	State and Political Subdivisions	Total
Internal Risk Rating								
Pass	$ 19,267	$ 198,730	$ 15,924	$ 42,270	$ 117,104	$ 2,489	$ 23,464	$ 419,248
Special Mention	313	12,908	256		3,690	288		17,455
Substandard	3,906	44,870	14,090		5,532	144	32	68,574
Doubtful								
Loss								
Total Loans Receivable	$ 23,486	$ 256,508	$ 30,270	$ 42,270	$ 126,326	$ 2,921	$ 23,496	$ 505,277

Credit Quality Indicators Other Loans

Residential, consumer and commercial and consumer indirect auto loans are monitored on a pool basis due to their homogeneous nature. Loans that are delinquent 90 days or more are considered non-accrual. The Company utilizes accruing versus non-accruing status as the credit quality indicator for these loan pools. The following table presents the recorded investment in residential, consumer and indirect auto loans based on payment activity as of June 30, 2012 and December 31, 2011.

	June 30, 2012			December 31, 2011		
(in thousands)	**Performing Loans**	**Non-accrual Loans**	**Total**	**Performing Loans**	**Non-accrual Loans**	**Total**
Construction, Land Acquisition and Development - Residential	$ 2,450	$	$ 2,450	$ 3,180	$	$ 3,180
Residential Real Estate	62,859	1,648	64,507	55,112	1,458	56,570
Indirect Auto - Consumer	70,178	19	70,197	63,718	4	63,722
Indirect Auto - Commercial	6,184		6,184	5,637		5,637
Installment/HELOC	36,113	216	$ 36,329	45,103	32	45,135
Total	$ 177,784	$ 1,883	$ 179,667	$ 172,750	$ 1,494	$ 174,244

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 investment in these non-accrual loans was $19.2 million and $19.9 million at June 30, 2012 and December 31, 2011, respectively. Generally, loans are placed on non-accruing status when they become 90 days or more delinquent, and remain on non-accrual status until they are brought current, have six months of performance under the loan

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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 fewer than 90 days delinquent and still be on a non-accruing status. Loans past due 90 days or more and still accruing interest were $23 thousand and $5 thousand at June 30, 2012 and December 31, 2011, respectively, and consisted of loans that are well secured and are in the process of renewal.

The following tables set forth the detail, and delinquency status, of past due and non-accrual loans at June 30, 2012 and December 31, 2011:

Performing and Non-Performing Loan Delinquency Status

June 30, 2012

	Performing (Accruing) Loans				
(in thousands)	**0-29 Days Past Due**	**30-59 Days Past Due**	**60-89 Days Past Due**	**>/= 90 Days Past Due**	**Total Performing Loans**
Real Estate					
Residential Real Estate	$ 82,089	$ 366	$ 206	$	$ 82,661
Commercial Real Estate	238,492	77	1,191		239,760
Construction, Land Acquisition & Development	28,035	31			28,066
Total Real Estate	348,616	474	1,397		350,487
Commercial and Industrial	120,555	326	25	23	120,929
Consumer					
Indirect Auto	69,362	724	93		70,179
Installment/HELOC	39,520	89	1		39,610
Total Consumer	108,882	813	94		109,789
State and Political Subdivisions	22,004				22,004
Totals	$ 600,057	$ 1,613	$ 1,516	$ 23	$ 603,209

	Non-Accruing Loans				
	0-29 Days Past Due	**30-59 Days Past Due**	**60-89 Days Past Due**	**>/= 90 Days Past Due**	**Total**
Real Estate					
Residential Real Estate	$ 250	$ 264	$ 164	$ 3,022	$ 3,700
Commercial Real Estate	463	83		8,773	9,319
Construction, Land Acquisition and Development				2,246	2,246
Total Real Estate	713	347	164	14,041	15,265
Commercial and Industrial	3,315	86	1	44	3,446
Consumer					
Indirect Auto	5		13	1	19
Installment/HELOC	48	57	24	182	311
Total Consumer	53	57	37	183	330

State and Political Subdivisions	175				175
Total Non-accruing loans	$ 4,256	$ 490	$ 202	$ 14,268	$ 19,216
Total loans receivable	$ 604,313	$ 2,103	$ 1,718	$ 14,291	$ 622,425

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Performing and Non-Performing Loan Delinquency Status

December 31, 2011

	Performing (Accruing) Loans				
(in thousands)	0-29 Days Past Due	30-59 Days Past Due	60-89 Days Past Due	>/= 90 Days Past Due	Total Performing Loans
Real Estate					
Residential Real Estate	$ 74,379	$ 1,293	$ 248	$	$ 75,920
Commercial Real Estate	243,873	2,381	1,235		247,489
Construction, Land Acquisition and Development	30,945	241			31,186
Total Real Estate	349,197	3,915	1,483		354,595
Commercial and Industrial					
Solid Waste Landfills	42,270				42,270
Other	126,774	667	91	5	127,537
Total Commercial and Industrial	169,044	667	91	5	169,807
Consumer					
Indirect Auto	62,753	845	120		63,718
Installment/HELOC	47,617	244	163		48,024
Total Consumer	110,370	1,089	283		111,742
State and Political Subdivisions	23,464				23,464
Totals	$ 652,075	$ 5,671	$ 1,857	$ 5	$ 659,608

	Non-Performing Loans				
	0-29 Days Past Due	30-59 Days Past Due	60-89 Days Past Due	>/= 90 Days Past Due	Total Non-accrual Loans
Real Estate					
Residential Real Estate	$ 1,994	$ 964	$ 94	$ 1,084	$ 4,136
Commercial Real Estate	291	220		8,508	9,019
Construction, Land Acquisition & Development	426			1,838	2,264
Total Real Estate	2,711	1,184	94	11,430	15,419
Commercial and Industrial					
Solid Waste Landfills					
Other	4,114	4	126	182	4,426
Total Commercial and Industrial	4,114	4	126	182	4,426
Consumer					
Indirect Auto				4	4
Installment/HELOC				32	32
Total Consumer				36	36
State and Political Subdivisions				32	32

Total Non-accruing loans	$	6,825	$	1,188	$	220	$	11,680	$	19,913
Total loans receivable	$	658,900	$	6,859	$	2,077	$	11,685	$	679,521

The total recorded investment in impaired loans, which consists of non-accrual loans greater than $100,000 and performing TDRs, amounted to $22.7 million and $23.7 million at June 30, 2012 and December 31, 2011, respectively. The related allowance on impaired loans was $0.3 million and $0.7 million at June 30, 2012 and December 2011, respectively.

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The following table provides an analysis of our impaired loans at June 30, 2012 and December 31, 2011:

Impaired Loans

June 30, 2012

(in thousands)		Recorded Investment		Unpaid Principal Balance		Related Allowance
With No Allowance Recorded:						
Residential Real Estate	$	1,211	$	1,299	$	
Commercial Real Estate		2,287		2,744		
Construction, Land Acquisition and Development		2,460		5,860		
Total Real Estate		5,958		9,903		
Commercial and Industrial		3,286		4,152		
Consumer						
Indirect Auto						
Installment/HELOC		31		35		
Total Consumer		31		35		
State and Political Subdivisions		175		177		
Total With No Allowance Recorded	**$**	**9,450**	**$**	**14,267**	**$**	
With a Related Allowance Recorded:						
Residential Real Estate	$	1,789	$	2,443	$	62
Commercial Real Estate		11,016		13,311		214
Construction, Land Acquisition and Development		395		395		3
Total Real Estate		13,200		16,149		279
Commercial and Industrial						
Consumer						
Indirect Auto						
Installment/HELOC						
Total Consumer						
State and Political Subdivisions						
Total with Related Allowance	**$**	**13,200**	**$**	**16,149**	**$**	**279**
Total of impaired loans						
Residential Real Estate	$	3,000	$	3,742	$	62
Commercial Real Estate		13,303		16,055		214
Construction, Land Acquisition & Development		2,855		6,255		3
Total Real Estate		19,158		26,052		279
Commercial and Industrial		3,286		4,152		
Consumer						
Indirect Auto						

Installment/HELOC		31		35		
Total Consumer		31		35		
State and Political Subdivisions		175		177		
Total Impaired Loans (1)	**$**	**22,650**	**$**	**30,416**	**$**	**279**

(1) Non-accrual loans with outstanding balances of less than $100,000 are not considered for individual impairment evaluation and are accordingly not included in the table above. However, these loans are included as homogenous pools in the general allowance calculation under ASC Topic 310. Total non-accrual loans with individual balances of less than $100 thousand equaled $2.1 million at June 30, 2012.

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Impaired Loans

December 31, 2011

(in thousands)		Recorded Investment		Unpaid Principal Balance		Related Allowance
With No Allowance Recorded:						
Residential Real Estate	$	961	$	1,097	$	
Commercial Real Estate		725		815		
Construction, Land Acquisition & Development		2,058		5,387		
Commercial and Industrial						
Solid Waste Landfills						
Other		4,066		4,601		
Total Commercial and Industrial		4,066		4,601		
Consumer						
Indirect Auto						
Installment/HELOC		31		35		
Total Consumer		31		35		
State and Political Subdivisions						
Total With No Allowance Recorded	**$**	**7,841**	**$**	**11,935**	**$**	
With a Related Allowance Recorded:						
Residential Real Estate	$	2,654	$	3,274	$	65
Commercial Real Estate		12,287		14,187		545
Construction, Land Acquisition & Development		921		984		91
Commercial and Industrial						
Solid Waste Landfills						
Other						
Total Commercial and Industrial						
Consumer						
Indirect Auto						
Installment/HELOC						
Total Consumer						
State and Political Subdivisions						
Total with Related Allowance	**$**	**15,862**	**$**	**18,445**	**$**	**701**
Total of impaired loans						
Residential Real Estate	$	3,615	$	4,371	$	65
Commercial Real Estate		13,012		15,002		545
Construction, Land Acquisition and Development		2,979		6,371		91
Total Real Estate		19,606		25,744		701
Commercial and Industrial						
Solid Waste Landfills						
Other		4,066		4,601		
Total Commercial and Industrial		4,066		4,601		
Consumer						

Indirect Auto			
Installment/HELOC	31	35	
Total Consumer	31	35	
State and Political Subdivisions			
Total Impaired Loans (1)	**$ 23,703**	**$ 30,380**	**$ 701**

(1) Nonaccrual loans with outstanding balances of less than $100 thousand are not considered for individual impairment evaluation and are accordingly not included in the table above. However, these loans are evaluated collectively as homogenous pools in the general allowance calculation under ASC Topic 310. Total non-accrual loans with individual balances of less than $100 thousand equaled $1.9 million at December 31, 2011.

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The following table presents by loan portfolio class, the average balance and interest income recognized on impaired loans for the three months ended June 30, 2012 and 2011:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2012		2011		2012		2011	
	Average Balance	Interest Income (1)	Average Balance	Interest Income (1)	Average Balance	Interest Income (1)	Average Balance	Interest Income (1)
	(in thousands)				(in thousands)			
Residential Real Estate	$ 3,046	$ 3	$ 3,034	$ 1	$ 3,235	$ 6	$ 2,998	$ 3
Commercial Real Estate	13,078	69	14,128	21	13,056	139	12,578	41
Construction, Land Acquisition & Development	2,911	10	6,507	14	2,934	22	8,126	16
Total Real Estate	19,035	82	23,669	36	19,225	167	23,702	60
Commercial and Industrial								
Solid Waste Landfills								
Other	3,481		5,076	4	3,676		5,393	9
Total Commercial and Industrial	3,481		5,076	4	3,676		5,393	9
Consumer								
Indirect Auto								
Installment/HELOC	31		130		31		130	
Total Consumer	31		130		31		130	
State and Political Subdivisions	88				58			
Total Impaired Loans	**$ 22,635**	**$ 82**	**$ 28,875**	**$ 40**	**$ 22,990**	**$ 167**	**$ 29,225**	**$ 69**

(1) Interest income represents income recognized on performing TDRs.

The additional interest income that would have been earned on non-accrual and restructured loans in accordance with their original terms approximated $430 thousand and $835 thousand for the three and six months ended June 30, 2012, respectively, and $684 thousand and $1.4 million for the three and six months ended June 30, 2011, respectively.

Troubled Debt Restructured Loans

The book balance of troubled debt restructured loans (TDRs) at June 30, 2012 and December 31, 2011 was $9.7 million and $10.8 million, respectively. The balances at June 30, 2012 included approximately $4.2 million of TDRs in non-accrual status and $5.5 million of TDRs in accrual status compared to $5.1 million of TDRs in non-accrual status and $5.7 million of TDRs in accrual status at December 31, 2011. Approximately $67 thousand and $185 thousand in specific reserves have been established for these loans as of June 30, 2012 and December 31, 2011, respectively.

The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan, an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan. Non-accruing restructured loans remain in non-accrual status until there has been a period of sustained repayment performance for a reasonable period, usually six months. In some instances, where the Company modifies a loan that is delinquent but not on non-accrual status, the restructured loan remains on accrual status provided the repayment performance remains in accordance with the modified terms.

The following tables show the pre- and post- modification recorded investment in loans modified as TDRs by portfolio segment and class of financing receivable during the three and six months ended June 30, 2012 and 2011:

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(In Thousands)	Three Months Ended June 30, 2012 Number of Contracts	Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investments	Three Months Ended June 30, 2011 Number of Contracts	Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investments
Troubled Debt Restructuring						
Residential Real Estate		$	$	1	$ 18	$ 18
Construction, Land Acquisition & Development				4	820	820
Total New Troubled Debt Restructuring		$	$	5	$ 838	$ 838

(In Thousands)	Six Months Ended June 30, 2012 Number of Contracts	Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investments	Six Months Ended June 30, 2011 Number of Contracts	Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investments
Troubled Debt Restructuring						
Residential Real Estate		$	$	2	$ 193	$ 73
Construction, Land Acquisition & Development	1	39	39	5	903	903
Total New Troubled Debt Restructuring	1	$ 39	$ 39	7	$ 1,096	$ 976

The TDRs described above did not have any impact on the allowance for loan losses but resulted in a charge off of $120 thousand during the six months ended June 30, 2011.

The following table shows the types of modifications made during the three months ended June 30, 2012 and 2011:

(In thousands)	Three months ended June 30, 2012 Residential Real Estate	Commercial Real Estate	Construction Land Acquisition & Development	Total	Three months ended June 30, 2011 Residential Real Estate	Commercial Real Estate	Construction Land Acquisition & Development	Total
Type of modification								
Extension of Term	$	$	$	$	$ 18	$	$ 820	$ 838
Extension of Term and Principal Forgiveness								
Total TDRs	$	$	$	$	$ 18	$	$ 820	$ 838

(In thousands)	Six months ended June 30, 2012 Residential Real Estate	Commercial Real Estate	Construction, Land Acquisition & Development	Total	Six months ended June 30, 2012 Residential Real Estate	Commercial Real Estate	Construction, Land Acquisition & Development	Total
Type of modification								
Extension of Term	$	$	$	$	$ 18	$	$ 903	$ 921

Extension of Term and Principal Forgiveness			39	39	55			55
	$	$	$ 39	$ 39	$ 73	$	$ 903	$ 976

The following table summarizes TDRs which have re-defaulted (defined as past due 90 days) during the three and six months ended June 30, 2012 and 2011 that were restructured within the last twelve months prior to such re-default:

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	Three Months Ended June 30, 2012			Three Months Ended June 30, 2011		
(In Thousands)	**Number of Contracts**	**Recorded Investment**		**Number of Contracts**	**Recorded Investment**	
Contruction, Land Acquistion and Development	1	$	408		$	

	Six Months Ended June 30, 2012			Six Months Ended June 30, 2011		
(In Thousands)	**Number of Contracts**	**Recorded Investment**		**Number of Contracts**	**Recorded Investment**	
Commercial Real Estate		$		1	$	145
Contruction, Land Acquistion and Development	1		408			
Total	1	$	408	1	$	145

Note 5. Other Real Estate Owned

The following schedule reflects a breakdown of OREO for the periods reviewed.

(in thousands)		**June 30, 2012**		**December 31, 2011**
Land/Lots	$	3,339	$	4,443
Commercial Real Estate		1,696		1,695
Residential Real Estate		267		820
Total	$	5,302	$	6,958

The following schedule reflects the activity in OREO for the six months ended June 30, 2012 and 2011:

	June 30,			
(in thousands)		**2012**		**2011**
Balance, beginning of year	$	6,958	$	9,633
Additions		506		2,356
Write-downs / recoveries		20		(266)
Carrying value of OREO sold		(2,182)		(3,534)
Balance, end of year	$	5,302	$	8,189

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The following table details the components of net expense of OREO for the six months ended June 30, 2012 and 2011:

(in thousands)	Six Months Ended June 30, 2012	2011
Insurance	$ 39	$ 8
Legal fees	30	82
Maintenance	29	1
Income from the operation of foreclosed properties	(10)	(6)
Professional Fees	78	56
Real estate taxes	204	183
Utilities	9	16
Other	45	82
Impairment charges (recoveries)	(20)	266
Total	$ 404	$ 688

Note 6. Securities

Securities have been classified in the consolidated financial statements according to management s intent. The amortized cost, gross unrealized gains and losses, and the fair value of the Company s securities available-for-sale at June 30, 2012 and at December 31, 2011 are as follows:

June 30, 2012 (in thousands)	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Obligations of U.S. government agencies	$ 1,832	$ 106	$	$ 1,938
Obligations of state and political subdivisions	95,754	6,113	1,471	100,396
Collateralized mortgage obligations:				
Government sponsored agency	5,856	339	7	6,188
Private Label	44,187	94	395	43,886
Residential mortgage-backed securities:				
Government sponsored agency	27,949	1,208		29,157
Pooled Trust Preferred Senior Class	3,812		2,142	1,670
Pooled Trust Preferred Mezzanine Class	6,589		4,402	2,187
Corporate debt securities	500		120	380
Equity securities	1,010		5	1,005
Total available-for-sale securities	$ 187,489	$ 7,860	$ 8,542	$ 186,807

December 31, 2011 (in thousands)	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Obligations of U.S. government agencies	$ 7,893	$ 155	$	$ 8,048
Obligations of state and political subdivisions	96,392	3,767	3,998	96,161
Collateralized mortgage obligations:				
Government sponsored agency	8,093	380	5	8,468
Private label	36,607	13	364	36,256
Residential mortgage-backed securities				

Government sponsored agency	30,426	967		31,393
Pooled Trust Preferred Senior Class	3,833		2,229	1,604
Pooled Trust Preferred Mezzanine Class	6,732		4,535	2,197
Corporate debt securities	500		158	342
Equity securities	1,010		4	1,006
Total available-for-sale securities	$ 191,486	$ 5,282	$ 11,293	$ 185,475

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The amortized cost, gross unrealized gains or losses, and the fair value of the Company s securities held-to-maturity at June 30, 2012 and December 31, 2011 are as follows:

(in thousands)	Amortized cost	Gross unrealized holding Gains	Gross unrealized holding losses	Fair value
June 30, 2012				
Obligations of state and political subdivisions	$ 2,145	$ 243	$	$ 2,388
December 31, 2011				
Obligations of state and political subdivisions	$ 2,094	$ 151	$	$ 2,245

At June 30, 2012 and December 31, 2011, securities with a carrying amount of $182.6 million and $150.8 million, respectively, were pledged as collateral to secure public deposits and for other purposes.

The following table shows the approximate fair value of the Company s debt securities at June 30, 2012 using contractual maturities. Expected maturities will differ from contractual maturity because issuers may have the right to call or prepay obligations with or without call or prepayment 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.

	Available-for-sale		Held-to-maturity	
(In thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Amounts maturing in:				
One Year or Less	$	$	$	$
One Year through Five Years	1,445	1,387		
After Five Years through Ten Years	25,104	26,530	2,145	2,388
After Ten Years	81,938	78,654		
Collateralized mortgage obligations	50,043	50,074		
Mortgage-backed securities	27,949	29,157		
Total	$ 186,479	$ 185,802	$ 2,145	$ 2,388

Gross proceeds from the sale of securities for the three and six months ended June 30, 2012 and 2011 were $0 and $16.1 million, respectively with the gross realized gains being $0 and $2.3 million, respectively, and there were no securities sold at a realized loss during the three months ended June 30, 2012 and 2011. The Company recognized gains of $8 thousand and $0 on securities called during the six months ended June 30, 2012 and 2011, respectively. The Company did not recognize any gains on securities called during the three months ended June 30, 2012 and 2011.

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The tables below indicates the length of time that individual securities held-to-maturity and available-for-sale have been in a continuous unrealized loss position at June 30, 2012 and December 31, 2011:

	Less than 12 Months		12 Months or Greater		Total	
June 30, 2012 (in thousands)	**Fair Value**	**Gross Unrealized Losses**	**Fair Value**	**Gross Unrealized Losses**	**Fair Value**	**Gross Unrealized Losses**
Obligations of U.S. government agencies	$	$	$	$	$	$
Obligations of state and political subdivisions	10,349	162	14,418	1,309	24,767	1,471
Collateralized mortgage obligations						
Government sponsored agency	911	7			911	7
Private label	32,409	395			32,409	395
Residential mortgage-backed securities						
Government sponsored agency						
Pooled Trust Preferred Senior Class			1,670	2,142	1,670	2,142
Pooled Trust Preferred Mezzanine Class			2,187	4,402	2,187	4,402
Corporate debt securities			380	120	380	120
Equity Securities	995	5			995	5
	$ 44,664	$ 569	$ 18,655	$ 7,973	$ 63,319	$ 8,542

	Less than 12 Months		12 Months or Greater		Total	
December 31, 2011 (in thousands)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Gross Unrealized Losses**
Obligations of U.S. government agencies	$	$	$	$	$	$
Obligations of state and political subdivisions	11,129	241	25,910	3,757	37,039	3,998
Collateralized mortgage obligations						
Government sponsored agency	1,028	5			1,028	5
Private label	30,459	364			30,459	364
Residential mortgage-backed securities						
Government sponsored agency						
Pooled Trust Preferred Senior Class			1,604	2,229	1,604	2,229
Pooled Trust Preferred Mezzanine Class			2,197	4,535	2,197	4,535
Corporate debt securities			342	158	342	158
Equity Securities	996	4			996	4
	$ 43,612	$ 614	$ 30,053	$ 10,679	$ 73,665	$ 11,293

At June 30, 2012, excluding pooled trust preferred securities (PreTSLs), 75 of the Company s debt securities holdings having unrealized losses have depreciated 3.3% from their amortized cost basis. These securities are guaranteed by either the U.S. Government, government sponsored agencies, other governments or corporations, and all are considered investment grade. Seventy-four percent (74%) of the Company s investment in obligations of state and political subdivisions are also guaranteed by underlying insurance which further secures the safety of principal. These unrealized losses relate principally to current interest rates for similar types of securities. The Company does not intend to sell these securities and does not anticipate that it will be required to sell these securities before the full recovery of principal and interest due, which may be at maturity. Therefore, the Company did not consider the carrying value of these securities to be other-than-temporarily impaired (OTTI) at June 30, 2012.

At June 30, 2012, four of the Company s PreTSLs having realized cumulative OTTI losses of $8.7 million and unrealized losses of $6.5 million have depreciated 63% and 82% from their current amortized cost and face values, respectively.

On a quarterly basis, the Company evaluates its investment securities for OTTI. Unrealized losses on securities are considered to be other-than-temporarily-impaired when the Company believes the security s impairment is due to factors that could include the issuer s inability to pay interest or dividends, its potential for default, and/or other factors. When a held-to-maturity or available-for-sale debt security is assessed for OTTI, the Company must first consider (a) whether management intends to sell the security and (b) whether it is more likely than not that the Company will be required to sell the security prior to recovery of its amortized cost basis. If one of these circumstances applies to a security, an OTTI loss is recognized in the statement of operations equal to the full amount of the

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decline in fair value below amortized cost. If neither of these circumstances applies to a security, but the Company does not expect to recover the entire amortized cost basis, an OTTI loss has occurred that must be separated into two categories: (a) the amount related to credit loss and (b) the amount related to other factors (such as market risk). In assessing the level of OTTI attributable to credit loss, the Company compares the present value of cash flows expected to be collected with the amortized cost basis of the security. As discussed previously, the portion of the total OTTI related to credit loss is recognized in earnings, while the amount related to other factors is recognized in other comprehensive income. The total OTTI loss is presented in the statement of operations, less the portion recognized in other comprehensive income. When a debt security becomes other-than-temporarily impaired, its amortized cost basis is reduced to reflect the portion of the total impairment related to credit loss.

To determine whether a security s impairment is other-than-temporary, the Company considers factors that include:

- the causes of the decline in fair value, such as credit problems, interest rate fluctuations, or market volatility;
- the severity and duration of the decline;
- the Company s ability and intent to hold equity security investments until they recover in value, as well as the likelihood of such a recovery in the near term;
- the Company s intent to sell security investments, or if it is more likely than not that the Company will be required to sell such securities before recovery of their individual amortized cost basis less any current period credit loss.

For debt securities that the Company does not intend to sell, or will not be required to sell, the primary consideration in determining whether impairment is other-than-temporary is whether or not the Company expects to receive all contractual cash flows.

Based on the Company s evaluation at June 30, 2012, the Company has determined that the decreases in estimated fair value of the securities it holds in its portfolio are temporary with the exception of four PreTSLs. The Company s estimate of projected discounted cash flows it expects to receive was less than the securities carrying value resulting in a credit-related impairment charge of $96 thousand to earnings for the three and six months ended June 30, 2012.

OTTI of Pooled Trust Preferred Collateralized Debt Obligations:

At June 30, 2012, the amortized cost of the Company s PreTSLs totaled $10.4 million with an estimated fair value of $3.9 million and is comprised of four securities each of which is collateralized by debt issued by bank holding companies and insurance companies. The Company holds one senior tranche and three mezzanine tranches and all possess credit ratings below investment grade. At the time of initial issue, no more than 5% of any pooled security consisted of a security issued by any one institution. At June 30, 2012, three of these securities had no excess subordination and one had excess subordination which was 16.1% of the current performing collateral. Excess subordination is the amount by which the underlying performing collateral exceeds the outstanding bonds in the current class plus all senior classes. It can also be referred to as credit enhancement. As deferrals and defaults of underlying issuers occur, the excess subordination is reduced or eliminated, increasing the risk of the security experiencing principal or interest shortfalls. Conversely, subordination can be increased as collateral transitions from non-performing to performing. The coverage ratio, or overcollateralization, of a specific security measures the rate of performing collateral to a given class of notes. It is calculated by dividing the performing collateral in a transaction by the current balance of the class of notes plus all classes senior to that class.

The following table presents information about the Company s collateral and subordination for its PreTSLs at June 30, 2012:

Security	Performing Collateral	Bonds Outstanding (in thousands)	Excess/ (Insufficient) Collateral	Coverage Ratio	Excess Subordination	Current Number of Performing Issuers	Actual Deferrals / Defaults as a % of Current Collateral	Expected Future Default Rate
PreTSL IX	$ 287,880	$ 301,221	$ (13,341)	95.57%	N/A	33	31.80%	1.61%
PreTSL XI	388,465	436,572	(48,107)	88.98%	N/A	43	32.30%	1.70%
PreTSL XIX	470,831	533,230	(62,399)	88.30%	N/A	48	27.60%	1.44%
PreTSL XXVI	638,500	549,974	88,526	116.10%	16.10%	53	29.40%	1.46%

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The following list details information for each of the Company s PreTSLs at June 30, 2012:

Security	Class	Amortized Cost	Fair Value	Unrealized Gain/Loss	Moody s / Fitch Ratings	Credit Impairment Quarter to Date	Credit Impairment Year to Date	Cumulative Credit Impairment
PreTSL IX	Mezzanine	$ 1,126	$ 395	$ (731)	Ca/C	$ 96	$ 96	$ 1,776
PreTSL XI	Mezzanine	1,549	688	(861)	Ca/C			3,426
PreTSL XIX	Mezzanine	3,913	1,105	(2,808)	Ca/CC			3,262
PreTSL XXVI	Senior	3,813	1,669	(2,144)	B1/CCC			251
Total		$ 10,401	$ 3,857	$ (6,544)		$ 96	$ 96	$ 8,715

The Company s PreTSLs are measured for OTTI by determining whether an adverse change in estimated cash flows has occurred. The Company uses a third-party service provider to perform this analysis. Determining whether there has been an adverse change in estimated cash flows from the cash flows previously projected involves comparing the present value of remaining cash flows previously projected against the present value of the cash flows estimated at June 30, 2012. The Company considers the discounted cash flow analysis to be our primary evidence when determining whether credit related OTTI exists.

Results of a discounted cash flow test are significantly affected by variables such as the estimate of the probability of default, discount rates, prepayment rates and the creditworthiness of the underlying issuers. The following provides additional information for each of these variables:

- Probability of Default An issuer level approach is used to analyze each security and default and recovery assumptions are based on the credit quality of the underlying issuers (generally, bank holding companies or insurance companies). Each bank issuer is evaluated based upon an examination of the trends in its earnings, net interest margin, operating efficiency, liquidity, capital position, level of nonperforming loans to total loans, apparent sufficiency of loan loss reserves, Texas ratio and whether the bank received TARP monies. From this information, each issuer bank that is currently performing is assigned a category of Good, Average, Weak, or Troubled. Default rates are then assigned based upon the historical performance of each category. Additionally, because the information available to the Company regarding the underlying insurance company issuers is more limited than for bank issuers, rather than performing an analysis of each issuer s results and assigning insurance company issuers to these same categories, the Company uses the Moody s one year long-term default rate assumption for insurance companies. The historical default rates used in this analysis are:

Default Rate

Category	Year 1	Year 2	Year 3	Thereafter
Good	0.50%	0.60%	0.60%	0.40%
Average	1.80%	2.30%	2.30%	1.50%
Insurance	1.00%	1.20%	1.20%	0.80%
Weak	5.80%	7.20%	7.20%	4.80%
Troubled	9.70%	12.20%	12.20%	8.10%

Each issuer in the collateral pool is assigned a probability of default for each year until maturity. Banks currently in default or deferring interest payments thus far are assumed to default immediately. A zero percent projected recovery rate is applied to defaults and deferrals. The probability of default is updated quarterly based upon changes in the creditworthiness of each underlying issuer. Timing of defaults and deferrals has a substantial impact on each valuation. As a result of this analysis, each issuer is assigned an expected default rate specific to that issuer.

- Estimates of Future Cash Flows While understanding the composition and characteristics of each bank issuer is important in evaluating the security, certain issuers have a disproportionate impact (both positive and negative) based upon other attributes, such as the interest rate payable by each issuer. Each credit is assessed independently, and the timing and nature of each issuer s performance is assessed. Once assessed, the expected performance of each issuer is applied to a structural cash flow model. Due to the complexity of these transactions, the expected performance of each unique issuer requires an adherence to the governing documents of the securitization to derive a cash flow. A model produced by a third party is utilized to assist in determining cash flows. Utilization of third party cash flow modeling to derive cash flows from assumptions is a market convention for these types of securities.

- Discount Rate The Company is discounting projected cash flows based upon its discount margin defined at the time of purchase, which constitutes a spread over 3-month LIBOR plus credit premium, consistent with our pre-purchase yield.

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- Prepayment Rate   Lack of liquidity in the market for PreTSL securities, credit rating downgrades and market uncertainties related to the financial industry are factors contributing to the impairment of these securities. During the early years of PreTSL securities, prepayments were common as issuers were able to refinance into lower cost borrowings. Since the middle of 2007, however, this option has all but disappeared. However, recently the Company has observed an increase in prepayments by bank issuers with over $15 billion in total assets. As part of the Dodd Frank banking reform act, banks with over $15 billion in total assets will have their ability to include trust preferred securities they have issued as Tier 1 Capital phased out over a three year period beginning in 2013. As a result, the Company has changed its prepayment assumptions so that 50% of issuers with total assets over $15 billion prepay in 2013, 25% in 2014 and 25% in 2015. In addition, the Company has also assumed a 1% prepayment assumption for the issuers below $15 billion in total assets based on the prepayments it has observed recently. As a result of this change in prepayment assumption, the Company recognized a $96 thousand charge to earnings for OTTI for PreTSL IX in the quarter ended June 30, 2012. Credit losses increase as a result of an increase in the prepayment assumption because prepayments reduce the amount of excess spread that would be available to absorb expected losses. Excess spread is the difference between the interest received from the issuers that collateralize a PreTSL and the interest paid on the securities issued by PreTSL.

- Credit Analysis   A quarterly credit evaluation is performed for each of the securities. While the underlying core component of these securities are the credit characteristics of the underlying   issuers , typically banks, other characteristics of the securities and issuers are evaluated and stressed to determine cash flow. These include but are not limited to the interest rate payable by each issuer, certain derivative contracts, default timing, and interest rate volatility. Issuer level credit considers all evidence available to us and includes the nature of the issuer s business, its years of operating history, corporate structure, loan composition, loan concentrations, deposit mix, asset growth rates, geographic footprint and local environment. Depending upon the security, and its place in the capital structure, certain analytical assumptions are isolated with greater scrutiny. The core analysis for each specific issuer focuses on profitability, return on assets, shareholders   equity, net interest margin, credit quality ratios, operating efficiency, capital adequacy and liquidity.

The Company has evaluated its PreTSLs considering all available evidence, including information received after the statement of financial condition date but before the filing date, and determined that the estimated projected cash flows are less than the securities   carrying value, resulting in impairment charges to earnings of $96 thousand for the three and six months ended June 30, 2012.

The table below provides a cumulative roll forward of credit losses recognized:

Rollforward of Cumulative Credit Loss

(in thousands)	**2012**	**2011**
Beginning Balance January 1	$ 8,619	$ 22,598
Credit losses on debt securities for which OTTI was not previously recognized		
Additional credit losses on debt securities for which OTTI was previously recognized	96	349
Less: Sale of PreTSLs for which OTTI was previously recognized		(14,777)
Ending Balance, June 30	$ 8,715	$ 8,170

Investments in FHLB and FRB stock, which have limited marketability, are carried at cost and totaled $8.9 million and $9.7 million at June 30, 2012 and December 31, 2011, respectively. FRB stock of $1.4 million and $1.3 million is included in Other Assets at June 30, 2012 and December 31, 2011, respectively. Management noted no indicators of impairment for the FHLB of Pittsburgh and FRB of Philadelphia at June 30, 2012.

Note 7. Fair Value Measurements

In determining fair value, the Company uses various valuation approaches, including market, income and cost approaches. Accounting standards establish a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability, which are developed based on market data obtained from sources independent of the Company. Unobservable inputs reflects the Company s assumptions about the assumptions the market participants would use in pricing an asset or liability, which are developed based on the best information available in the circumstances.

The fair value hierarchy gives the highest priority to unadjusted quoted market prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The fair value hierarchy is broken down into three levels based on the reliability of inputs as follows:

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- Level 1 valuation is based upon unadjusted quoted market prices for identical instruments traded in active markets.

- Level 2 valuation is based upon quoted market prices for similar instruments traded in active markets, quoted market prices for identical or similar instruments traded in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by market data.

- Level 3 valuation is derived from other valuation methodologies including discounted cash flow models and similar techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in determining fair value.

An asset or liability s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

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

Cash, Short-term Investments, Accrued Interest Receivable and Accrued Interest Payable

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

Securities

The estimated fair values of available for sale equity securities are determined by obtaining quoted prices on nationally recognized exchanges (Level 1 inputs). The estimated fair values for the Company s investments in obligations of U.S. government agencies, obligations of state and political subdivisions, government sponsored agency collateralized mortgage obligations, government sponsored agency residential mortgage backed securities, and corporate debt securities are obtained by the Company from a nationally-recognized pricing service. This pricing service develops estimated fair values by analyzing like securities and applying available market information through processes such as benchmark curves, benchmarking of like securities, sector groupings and matrix pricing (Level 2 inputs), to prepare valuations. Matrix pricing is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities relationship to other benchmark quoted securities.The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond s terms and conditions, among other things and are based on market data obtained from sources independent from the Company. The Level 2 investments in the Company s portfolio are priced using those inputs that, based on the analysis prepared by the pricing service, reflect the assumptions that market participants would use to price the assets. The Company has determined that the Level 2 designation is appropriate for these securities because, as with most fixed-income securities, those in the Company s portfolio are not exchange-traded, and such non-exchange-traded fixed income securities are typically priced by correlation to observed market data. The Company has reviewed the pricing service s methodology to confirm its understanding that such methodology results in a valuation based on quoted market prices for similar instruments traded in active markets, quoted markets for identical or similar instruments traded in markets that are not active and model-based valuation techniques for which the significant assumptions can be corroborated by market data as appropriate to a Level 2 designation.

For those securities, for which the inputs used by an independent pricing service were derived from unobservable market information, the Company evaluated the appropriateness and quality of each price. The Company reviewed the volume and level of activity for all classes of securities and attempted to identify transactions which may not be orderly or reflective of a significant level of activity and volume. For securities meeting these criteria, the quoted prices received from either market participants or an independent pricing service may be adjusted, as necessary, to estimate fair value (fair values based on Level 3 inputs). If applicable, the adjustment to fair value was derived based on present value cash flow model projections prepared by the Company or obtained from third party providers utilizing assumptions similar to those incorporated by market participants. The estimated fair value of the PreTSLs and the private label collateralized mortgage obligations (PLCMOs) in the Company s securities portfolio are obtained from third-party service providers that prepared the valuation using a discounted cash flow approach with inputs derived from unobservable market information (Level 3 inputs). The valuation of PreTSLs is further described below and in Note 6 of these financial statements.

At June 30, 2012, the Company owned four PreTSLs having an amortized cost of $10.4 million. The market for these securities at June 30, 2012 is not active and markets for similar securities are also not active. PreTSLs were historically priced using Level 2 inputs. However, the decline in the level of observable inputs and market activity in this class of investments by the measurement date has been significant and resulted in unreliable external pricing. Broker pricing and bid/ask spreads, when available, vary widely. The once active market has become comparatively inactive. As such, the valuation of these investments is now determined using Level 3

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inputs. The Company obtained the valuations from a third-party service provider that prepared the valuations using a discounted cash flows approach. The Company takes measures to validate the service provider s analysis and is actively involved in the valuation process, including reviewing and verifying the assumptions used in the valuation calculations. The difference between the discounted cash flow calculations for the purpose of estimating OTTI credit losses, described in Note 6, and the calculations used for fair value relates only to the discount rate used.

Results of a discounted cash flow test are significantly affected by variables such as the estimate of the probability of default, estimates of future cash flows, discount rates, prepayment rates and the creditworthiness of the underlying issuers. Refer to the discussion of these variables in Note 6. The Company considers these inputs to be unobservable Level 3 inputs because they are based on the Company s estimates about the assumptions market participants would use in pricing this type of asset and developed based on the best information available in the circumstances rather than on observable inputs. The Company continues to monitor the market for PreTSLs to assess the market activity and the availability of observable inputs and will continue to apply these controls and procedures to the valuations received from its third party service provider for the period it continues to use an outside valuation service. As it relates to fair value measurements, once each issuer is categorized and the forecasted default rates have been applied, the expected cash flows are modeled using the variables described above. The Company then applies a 10% discount rate to PreTSL XXVI, a 12% discount rate to PreTSL XIX and a 15% discount rate to PreTSLs IX and XI to the expected cash flows to estimate fair value.

Changes to prepayment, default and discount rate assumptions will result in changes to the forecast cash flows and therefore changes to the fair values of the PreTSLs. An increase in prepayment assumptions increases the valuation of PreTSL XXVI and decrease the valuation of the remaining PreTSLs. The Company expects that an increase in default rates will decrease the fair value of the Company s PreTSLs and a decrease in default rates will increase the fair value of these securities. The Company expects that an increase in discount rates will decrease the fair value of these securities and a decrease in discount rates will increase the fair value of these securities. The Company does not believe these unobservable inputs to be interrelated.

At June 30, 2012, the Company owned investment grade PLCMOs, having an amortized cost of $44.2 million. PLCMOs are securitized products where payments from residential mortgage loans are pooled together and passed on to different classes of owners in various tranches. The markets for such securities are generally characterized by a limited number of new issuances, a significant reduction in trading volumes and wide bid-ask spreads, all driven by the lack of market participants. Although estimated prices can generally be obtained for such securities, the level of market observable assumptions used is severely limited in the valuation. Specifically, market assumptions regarding credit adjusted cash flows and liquidity influences on discount rates were difficult to observe at the individual security level. Because of the inactivity in the markets and the lack of observable valuation inputs, the PLCMOs were valued by a third party specialist using a discounted cash flow approach and proprietary pricing model. The model uses inputs such as estimated prepayment speeds, losses, recoveries, default rates that are implied by the underlying performance of collateral in the structure or similar structures, and discount rates that are implied by market prices for similar securities and collateral structure types. The following table presents quantitative information about Level 3 inputs used to measure the fair value of these securities at June 30, 2012:

Security Type	**Valuation Technique**	**Unobservable Input**	**Range**	**Weighted Average**
Private Label CMOs	Discounted cash flow	Prepayment rate	5.20 - 37.18%	11.04%
		Default rate	0.50 - 14.88%	6.99%
		Loss severity	24.20 - 77.35%	55.43%
		Discount Rate	3.50 - 5.50%	4.00%

Changes to prepayment, default, loss severity, and discount rate assumptions will result in changes to the forecast cash flows and therefore changes to their fair values. An increase in prepayment assumptions increases the valuation of those securities owned at a discount and decreases those owned at a premium. The Company expects that an increase in default rates will decrease the fair value of the Company s

PLCMOs and a decrease in default rates will increase the fair value of the securities. The Company expects that an increase in loss severity will decrease the fair value of these securities and a decrease in loss severity will increase the fair value of the Company s PLCMOs. The Company expects that an increase in discount rates will decrease the fair value of these securities and a decrease in discount rates will increase the fair value of these securities. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for loss severity and a directionally opposite change in the assumption used for prepayment rates.

At June 30, 2012, the Company owned three securities issued by state and political subdivisions having an amortized cost of $2.6 million that are valued using Level 3 inputs. Two of these securities, with an amortized cost of $1.2 million, had their ratings withdrawn by nationally recognized credit rating agencies. The third security with an amortized cost of $1.4 million and fair value of $1.4 million was downgraded by several nationally recognized credit rating agencies during 2010. As a result of the ratings withdrawals and downgrade, the market for these securities at June 30, 2012 was no longer active. These securities were historically priced using Level 2 inputs. The credit ratings withdrawal and downgrade have resulted in a decline in the level of significant other observable inputs for these investment securities at the measurement date. Broker pricing and bid/ask spreads are very limited for these securities. The first two securities were valued based on similar nonrated Pennsylvania Sewer bonds adjusted for coupon and maturity. For the third security, the Company obtained a bid indication from a third-party municipal trading desk to determine the fair value of this security.

Loans

For non-impaired loans and non-collateral dependent impaired loans, fair values are estimated by discounting the projected future cash flows using market discount rates that reflect the credit, liquidity, and interest rate risk inherent in the loan. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. The estimated fair value of collateral dependent impaired loans is based on the appraised loan value or other reasonable offers less estimated costs to sell. The Company does not record loans at fair value on a recurring basis. However from time to time, a loan is considered impaired and an allowance for credit losses is established. The specific reserves for collateral dependent impaired loans are based on the fair value of the collateral less estimated costs to sell. The fair value of the collateral is based on appraisals. In some cases, adjustments are made to the appraised values due to various factors including age of the appraisal, age of comparables included in the appraisal, and known changes in the market and in the collateral. When significant adjustments are based on unobservable inputs, the resulting fair value measurement is categorized as a Level 3 measurement. See also Note 4   Loans.

Loans Held For Sale

Fair values of mortgage loans held for sale are based on commitments on hand from investors or prevailing market prices.

Mortgage Servicing Rights

The fair value of mortgage servicing rights is estimated using a discounted cash flow model that applies current estimated prepayments derived from the mortgage-backed securities market and utilizes a current market discount rate for observable credit spreads. The Bank does not record mortgage servicing rights at fair value on a recurring basis.

Federal Home Loan Bank (FHLB   ) and Federal Reserve Bank (FRB   ) Stock

Ownership in equity securities of FHLB of Pittsburgh and the FRB is restricted and there is no established market for their resale. The carrying amount is a reasonable estimate of fair value.

Deposits

The fair value of demand deposits, savings deposits, and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated based on discounted cash flows using FHLB advance rates currently offered for similar remaining maturities.

Borrowed funds

The Bank uses discounted cash flows using rates currently available for debt with similar terms and remaining maturities to estimate fair value.

Commitments to extend credit and standby letters of credit

The fair value of commitments to extend credit and standby letters of credit are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of off-balance- sheet commitments is insignificant and therefore not included in the table for non-recurring assets and liabilities.

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Assets measured at fair value on a recurring basis

The following tables detail the financial asset amounts that are carried at fair value and measured at fair value on a recurring basis at June 30, 2012 and December 31, 2011 and indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine the fair value:

Fair Value Measurements at June 30, 2012

(in thousands)	Fair value	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Available-for-sale securities:				
Obligations of U.S. government agencies	$ 1,938	$	$ 1,938	$
Obligations of state and political subdivisions	100,396		97,803	2,593
Government sponsored agency CMOs	6,188		6,188	
Private label CMOs	43,886			43,886
Residential mortgage backed securities	29,157		29,157	
Pooled trust preferred senior class	1,670			1,670
Pooled trust preferred mezzanine class	2,187			2,187
Corporate debt securities	380		380	
Equity securities	1,005	1,005		
Total securities available-for-sale	$ 186,807	$ 1,005	$ 135,466	$ 50,336

Fair Value Measurements at December 31, 2011

		Fair value measurements at December 31, 2011		
(in thousands)	Fair value	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Available-for-sale securities:				
Obligations of U.S. government agencies	$ 8,048	$	$ 8,048	$
Obligations of state and political subdivisions	96,161		93,350	2,811
Government sponsored agency CMOs	8,468		8,468	
Private label CMOs	36,256			36,256
Residential mortgage-backed securities	31,393		31,393	
Pooled trust preferred Senior Class	1,604			1,604
Pooled trust preferred Mezzanine Class	2,197			2,197
Corporate debt securities	342		342	
Equity securities	1,006	1,006		
Total securities available-for-sale	$ 185,475	$ 1,006	$ 141,601	$ 42,868

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The tables below present a reconciliation and statement of operations classifications of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the six month periods ended June 30, 2012 and 2011:

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

(in thousands)	PreTSLs	State and Political Subdivisions	Private Label CMOs	Total
Balance at December 31, 2011	$ 3,801	$ 2,811	$ 36,256	$ 42,868
Amortization			(246)	(246)
Accretion			61	61
Paydowns	(69)	(270)	(6,927)	(7,266)
Purchases			14,691	14,691
Total gains or losses (realized/unrealized):				
Included in earnings	(96)			(96)
Included in other comprehensive income	221	52	51	324
Balance at June 30, 2012	$ 3,857	$ 2,593	$ 43,886	$ 50,336

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

(in thousands)	PreTSLs	State and Political Subdivisions	Total
Balance at December 31, 2010	$ 3,069	$ 2,245	$ 5,314
Accretion	6		6
Paydowns		(260)	(260)
Sales	(19)		(19)
Total gains or losses (realized/unrealized):			
Included in earnings	(349)		(349)
Included in other comprehensive income	134		134
Balance at June 30, 2011	$ 2,841	$ 1,985	$ 4,826

There were no transfers between levels within the fair value hierarchy during the period ended June 30, 2012.

Assets measured at fair value on a non-recurring basis

Assets measured at fair value on a non-recurring basis are summarized below:

	Fair Value Measurements at June 30, 2012			Fair Value Measurements at December 31, 2011		
(in thousands)	**Quoted Prices in Active Markets for Identical Assets (Level I)**	**Significant Other Observable Inputs (Level II)**	**Unobservable Inputs (Level III)**	**Quoted Prices in Active Markets for Identical Assets (Level I)**	**Significant Other Observable Inputs (Level II)**	**Unobservable Inputs (Level III)**
Collateral-dependent impaired loans (1)			$ 12,368			$ 12,555
Other real estate owned			364			5,212

(1) Represents carrying value and related write-downs for which adjustments are based on appraised value. Management makes adjustments to the appraised values as necessary to consider declines in real estate values since the time of the appraisal. Such adjustments are based on management s knowledge of the local real estate markets.

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Collateral dependent impaired loans are classified as Level 3 assets and the estimated fair value of the collateral is based on independent appraisals of the underlying collateral, which generally include various Level 3 inputs which are not identifiable. Appraisals are adjusted by management for estimated costs to sell, which equals 10%, and is recorded through a valuation allowance. When the measure of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through a valuation allowance or is charged-off. The amount shown is the balance of impaired loans, net of any charge-offs and the related allowance for loan losses.

Other real estate owned properties are recorded at the fair value based on independent appraisals, which generally include various Level 3 inputs which are not identifiable, less the estimated cost to sell at the date of foreclosure. Subsequent to foreclosure, the balance might be subject to additional write-downs. It is the Company s policy to obtain certified external appraisals of real estate collateral underlying impaired loans, including OREO, and it estimates fair value using those appraisals. Other valuation sources may be used, including broker price opinions, letters of intent and executed sale agreements. The amounts in the table above represent the value of OREO properties at June 30, 2012 and December 31, 2011 that were subject to additional write-downs subsequent to foreclosure.

The Company discloses fair value information about financial instruments, whether or not recognized in the Statement of Financial Condition, for which it is practicable to estimate that value. The following estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, management judgment is required to interpret data and develop fair value estimates. Accordingly, the estimates below are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The estimated fair values of the Company s financial instruments are as follows:

	Fair Value	June 30, 2012		December 31, 2011	
(in thousands)	**Measurement**	**Carrying Value**	**Fair Value**	**Carrying Value**	**Fair Value**
Financial assets					
Cash and short term investments	Level 1	$ 92,760	$ 92,760	$ 168,646	$ 168,646
Securities	See previous table	188,952	189,195	187,569	187,720
FHLB and FRB Stock	Level 2	8,930	8,930	9,659	9,659
Loans, net	Level 3				