1ST CONSTITUTION BANCORP
Form 10-Q
November 14, 2011

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011
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 Number: 000-32891

1ST CONSTITUTION BANCORP
(Exact Name of Registrant as Specified in Its Charter)

New Jersey (State of Other Jurisdiction of Incorporation or Organization)	22-3665653 (I.R.S. Employer Identification No.)
2650 Route 130, P.O. Box 634, Cranbury, NJ (Address of Principal Executive Offices)	08512 (Zip Code)

(609) 655-4500
(Issuer's Telephone Number, Including Area Code)

(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 x No o

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 x No o

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. (Check one):

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

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

As of November 12, 2011, there were 4,804,707 shares of the registrant’s common stock, no par value, outstanding.

1ST CONSTITUTION BANCORP

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

1st Constitution Bancorp and Subsidiaries
Consolidated Balance Sheets
(Unaudited)

	September 30, 2011	December 31, 2010
ASSETS		
CASH AND DUE FROM BANKS	$14,432,669	$17,699,103
FEDERAL FUNDS SOLD / SHORT-TERM INVESTMENTS	11,404	11,398
Total cash and cash equivalents	14,444,073	17,710,501
INVESTMENT SECURITIES:		
Available for sale, at fair value	96,309,859	85,470,993
Held to maturity (fair value of $158,148,341 and $81,712,004 at September 30, 2011 and December 31, 2010, respectively)	152,474,688	81,889,895
Total securities	248,784,547	167,360,888
LOANS HELD FOR SALE	9,848,248	21,219,230
LOANS	426,435,830	411,987,339
Less- Allowance for loan losses	(5,508,337)	(5,762,712)
Net loans	420,927,493	406,224,627
PREMISES AND EQUIPMENT, net	10,590,834	6,148,626
ACCRUED INTEREST RECEIVABLE	2,464,715	2,405,741
BANK-OWNED LIFE INSURANCE	11,774,282	11,474,643
OTHER REAL ESTATE OWNED	10,999,359	4,850,818
OTHER ASSETS	12,627,013	7,000,155
Total assets	$742,460,564	$644,395,229
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Deposits		
Non-interest bearing	$156,822,951	$92,023,123
Interest bearing	488,581,902	451,712,026
Total deposits	645,404,853	543,735,149
BORROWINGS	19,000,000	25,900,000
REDEEMABLE SUBORDINATED DEBENTURES	18,557,000	18,557,000
ACCRUED INTEREST PAYABLE	1,100,956	1,434,338

ACCRUED EXPENSES AND OTHER LIABILITIES	4,146,305	5,087,586
Total liabilities	688,209,114	594,714,073
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS’ EQUITY:		
Common stock, no par value; 30,000,000 shares authorized; 4,814,635 and 4,811,294 shares issued and 4,804,807 and 4,803,459 shares outstanding as of September 30, 2011 and December 31, 2010, respectively	39,194,613	38,899,855
Retained earnings	13,573,839	10,741,779
Treasury Stock, at cost, 9,828 shares at September 30, 2011and 8,885 shares at December 31, 2010, respectively	(69,814)	(58,652)
Accumulated other comprehensive income	1,552,812	98,174
Total shareholders’ equity	54,251,450	49,681,156
Total liabilities and shareholders’ equity	$742,460,564	$644,395,229

See accompanying notes to consolidated financial statements.

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1st Constitution Bancorp and Subsidiaries
Consolidated Statements of Income
(Unaudited)

	Three months ended September30,		Nine months ended September 30,	
INTEREST INCOME	2011	2010	2011	2010
Loans, including fees	$ 5,632,351	$ 6,349,180	$ 16,153,997	$ 17,414,422
Securities				
Taxable	1,366,274	1,229,394	4,154,352	3,843,035
Tax-exempt	433,497	106,841	1,070,297	321,012
Federal funds sold and short-term investments	43,524	4,659	115,634	37,278
Total interest income	7,475,646	7,690,074	21,494,280	21,615,747
INTEREST EXPENSE				
Deposits	1,437,263	1,567,786	4,365,667	5,129,799
Borrowings	104,849	309,476	315,481	853,898
Redeemable subordinated debentures	88,063	269,565	589,497	801,255
Total interest expense	1,630,175	2,146,827	5,270,645	6,784,952
Net interest income	5,845,471	5,543,247	16,223,635	14,830,795
Provision for loan losses	608,332	875,000	1,283,330	1,725,000
Net interest income after provision for loan losses	5,237,139	4,668,247	14,940,305	13,105,795
NON-INTEREST INCOME				
Service charges on deposit accounts	237,716	185,242	648,456	550,270
Gain on sales of loans	508,359	416,754	1,356,741	1,129,875
Income on bank-owned life insurance	100,980	102,791	299,639	304,486
Other income	382,209	291,910	1,089,488	967,932
Total non-interest income	1,229,264	996,697	3,394,324	2,952,563
NON-INTEREST EXPENSE				
Salaries and employee benefits	2,892,901	2,532,427	8,313,513	7,326,361
Occupancy expense	628,652	499,745	1,776,359	1,398,510
Data processing expenses	295,739	284,554	912,988	815,752
FDIC insurance expenses	29,805	94,034	503,810	589,285
Other operating expenses	909,370	961,537	3,068,414	2,655,425
Total non-interest expenses	4,756,467	4,372,297	14,575,084	12,785,333
Income before income taxes	1,709,936	1,292,647	3,759,545	3,273,025
INCOME TAXES	496,658	411,048	927,485	896,609
Net income	1,213,278	881,599	2,832,060	2,376,416
Dividends on preferred stock and accretion	0	176,984	0	530,952
Net income available to common shareholders	$ 1,213,278	$ 704,615	$ 2,832,060	$ 1,845,464
NET INCOME PER COMMON SHARE				
Basic	$ 0.25	$ 0.15	$ 0.59	$ 0.39
Diluted	$ 0.25	$ 0.15	$ 0.58	$ 0.38

See accompanying notes to consolidated financial statements.

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1st Constitution Bancorp and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
For the Nine Months Ended September 30, 2011 and 2010
(Unaudited)

	Preferred Stock	Common Stock	Retained Earnings	Treasury Stock	Accumulat Other Comprehens Income (Loss)
BALANCE, January 1, 2010	$11,473,262	$36,774,621	$10,307,331	$(73,492)	$(1,080,66
Issuance of vested shares under employee benefit program		148,660		2,096	
Share-based compensation		46,329			
Dividends on preferred stock			(450,000)		
Accretion of discount on preferred stock	80,951		(80,951)		
Comprehensive Income:					
Net Income for the nine months ended September 30, 2010			2,376,416		
Minimum pension liability, net of tax					205,532
Unrealized gain on securities available for sale, net of tax					971,120
Unrealized gain on interest rate swap contract, net of tax					211,592
Comprehensive Income					
Balance, September 30, 2010	$11,554,213	$36,969,610	$12,152,796	$(71.396)	$307,575
Balance, January 1, 2011	$0	$38,899,855	$10,741,779	$(58,652)	$98,174
Exercise of stock options (1,651 shares) and issuance of vested shares under employee benefit programs		252,959		11,598	
Share-based compensation		41,799			
Treasury stock purchased (2,594 shares)				(22,760)	
Comprehensive Income:					
Net Income for the nine months ended September 30, 2011			2,832,060		
Minimum pension liability, net of tax					5,778
Unrealized gain on securities available for sale, net of tax					1,237,29
Unrealized gain on interest rate swap contract,					211,562

net of tax					
Comprehensive Income					
Balance, September 30, 2011	$0	$39,194,613	$13,573,839	$(69,814)	$1,552,81

See accompanying notes to consolidated financial statements.

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1st Constitution Bancorp and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended September 30, 2011	2010
OPERATING ACTIVITIES:		
Net income	$ 2,832,060	$ 2,376,416
Adjustments to reconcile net income to net cash provided by operating activities-		
Provision for loan losses	1,283,330	1,725,000
Provision for loss on other real estate owned	147,178	0
Depreciation and amortization	782,492	454,760
Net amortization of premiums and discounts on securities	1,206,566	733,173
Gains on sales of loans held for sale	(1,356,741)	(1,129,875)
Gains on sales of other real estate owned	0	(62,584)
Originations of loans held for sale	(83,022,941)	(99,507,515)
Proceeds from sales of loans held for sale	95,750,664	104,470,891
Income on Bank – owned life insurance	(299,639)	(304,486)
Share-based compensation expense	290,226	171,329
(Increase) in accrued interest receivable	(55,960)	(64,791)
(Increase) decrease in other assets	(1,503,659)	922.877
Decrease in accrued interest payable	(426,497)	(491,704)
Decrease in accrued expenses and other liabilities	(897,336)	(1,201,221)
Net cash provided by operating activities	14,729,743	8,092,270
INVESTING ACTIVITIES:		
Purchases of securities -		
Available for sale	(69,849,189)	(35,226,910)
Held to maturity	(97,428,222)	(85,955,664)
Proceeds from maturities and repayments of securities -		
Available for sale	60,565,434	129,995,205
Held to maturity	25,956,446	23,666,230
Net (increase) in loans	(22,796,648)	(64,624,145)
Purchase of bank-owned life insurance	0	(750,000)
Capital expenditures	(481,538)	(1,686,463)
Additional investment in other real estate owned	(560,433)	(107,395)
Proceeds from sales of other real estate owned	1,937,103	1,725,757
Cash consideration received in connection with acquisition of branches	101,539,588	0
Net cash (used in) investing activities	(1,117,459)	(32,963,385)
FINANCING ACTIVITIES:		
Exercise of stock options and issuance of vested shares	264,557	150,756
Purchase of Treasury Stock	(22,760)	0
Dividend paid on preferred stock	0	(450,000)
Net (decrease) in demand, savings and time deposits	(10,220,509)	(34,302,125)
Net (decrease) increase in borrowings	(6,900,000)	47,600,000

Net cash (used in) provided by financing activities	(16,878,712)	12,998,631
(Decrease) in cash and cash equivalents	(3,266,428)	(11,872,484)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	17,710,501	25,854,285
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 14,444,073	$ 13,981,801
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for -		
Interest	$ 5,697,142	$ 7,276,656
Income taxes	1,424,256	1,660,000
Non-cash investing activities		
Real estate acquired in full satisfaction of loans in foreclosure	$ 7,672,389	$ 1,947,146

See accompanying notes to consolidated financial statements.

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1st Constitution Bancorp and Subsidiaries
Notes To Consolidated Financial Statements
September 30, 2011 (Unaudited)

(1) Summary of Significant Accounting Policies

The accompanying unaudited Consolidated Financial Statements include 1ST Constitution Bancorp (the "Company"), its wholly-owned subsidiary, 1ST Constitution Bank (the "Bank"), and the Bank's wholly-owned subsidiaries, 1ST Constitution Investment Company of Delaware, Inc., 1ST Constitution Investment Company of New Jersey, Inc., FCB Assets Holdings, Inc., 1ST Constitution Title Agency, LLC, Riverside Lofts, LLC and 249 New York Avenue, LLC. 1ST Constitution Capital Trust II, a subsidiary of the Company, is not included in the Company's consolidated financial statements, as it is a variable interest entity and the Company is not the primary beneficiary. All significant intercompany accounts and transactions have been eliminated in consolidation and certain prior period amounts have been reclassified to conform to current year presentation. The accounting and reporting policies of the Company and its subsidiaries conform to accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") including the instructions to Form 10-Q and Article 8 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to such rules and regulations. These Consolidated Financial Statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Form 10-K for the year ended December 31, 2010, filed with the SEC on March 23, 2011.

In the opinion of the Company, all adjustments (consisting only of normal recurring accruals) which are necessary for a fair presentation of the operating results for the interim periods have been included. The results of operations for periods of less than a year are not necessarily indicative of results for the full year.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of September 30, 2011 for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through the date these financial statements were issued.

(2) Acquisition of Unaffiliated Branches

On March 25, 2011, the Bank acquired certain deposit and other liabilities, real estate and related assets of the Rocky Hill, Hillsborough and Hopewell, New Jersey branch banking offices from another financial institution for a purchase price of $9.85 million (the "March 2011 Acquisition"). The March 2011 Acquisition was completed pursuant to the terms and conditions of the Branch Purchase and Assumption Agreement and Agreement for Purchase dated as of December 30, 2010, which was previously disclosed on a Current Report on Form 8-K filed by the Company with the SEC on January 3, 2011.

The Company accounted for this transaction using applicable accounting guidance regarding business combinations. The fair value of savings and transaction deposit accounts acquired was assumed to approximate the carrying value as these accounts have no stated maturity and are payable on demand. A core deposit intangible was ascribed to the value of non-maturity deposits based upon an independent third party evaluation which was prepared using the actual characteristics of the deposits and assumptions we believe to be reasonable. Certificates of deposit accounts were valued utilizing a discounted cash flows analysis based upon the underlying accounts' contractual maturities and interest rates. The present value of the projected cash flow was then determined using discount rates based upon certificate of deposit interest rates available in the marketplace for accounts with similar terms. The fair value of the three branch buildings was determined via appraisals performed by qualified independent third party appraisers. The fair value of loans acquired, all of which were performing, was assumed to approximate amortized cost based upon the small size and nature of those loans. The fair value amounts stated above are preliminary estimates and are subject to adjustment but are not expected to be materially different than those disclosed.

As a result of the March 2011 Acquisition, the three branches became branches of the Bank. Included in the March 2011 Acquisition were the assumption of deposit liabilities of $111.9 million, primarily consisting of demand deposits, and the acquisition of cash of approximately $101.5 million, fixed assets of approximately $4.6 million, which includes, without limitation, ownership of the real estate and improvements upon which the branches are situated, and loans of $862,000. The Bank recorded goodwill of approximately $3.2 million and a core deposit intangible asset of approximately $1.7 million as a result of the March 2011 Acquisition.

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(3) Net Income Per Common Share

Basic net income per common share is calculated by dividing net income less dividends and discount accretion on preferred stock by the weighted average number of common shares outstanding during each period.

Diluted net income per common share is calculated by dividing net income less dividends and discount accretion on preferred stock by the weighted average number of common shares outstanding, as adjusted for the assumed exercise of potential common stock options and unvested restricted stock awards (as defined below), using the treasury stock method. All share information has been adjusted for the effect of a 5% common stock dividend declared December 16, 2010 and paid on February 2, 2011 to shareholders of record on January 18, 2011.

The following tables illustrate the reconciliation of the numerators and denominators of the basic and diluted earnings per common share (EPS) calculations. Dilutive securities in the tables below exclude common stock options and warrants with exercise prices that exceed the average market price of the Company's common stock during the periods presented. Inclusion of these common stock options and warrants would be anti-dilutive to the diluted earnings per common share calculation.

	Three Months Ended September 30, 2011		
	Income	Weighted-average shares	Per share Amount
Basic EPS			
Net income	$1,213,278		
Preferred stock dividends and accretion	0		
Income available to common shareholders	1,213,278	4,805,226	$0.25
Effect of dilutive securities			
Stock options and unvested stock awards		36,450	
Diluted EPS			
Income available to common shareholders plus assumed conversion	$1,213,278	4,841,676	$0.25

	Three Months Ended September 30, 2010		
	Income	Weighted-average shares	Per share Amount
Basic EPS			
Net income	$ 881,599		
Preferred stock dividends and accretion	(176,984)		
Income available to common shareholders	704,615	4,797,871	$ 0.15
Effect of dilutive securities			
Stock options and unvested stock awards		28,059	
Diluted EPS			
Net income available to common shareholders	$ 704,615	4,825,930	$ 0.15

plus assumed conversion

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	Nine Months Ended September 30, 2011		
	Income	Weighted-average shares	Per share Amount
Basic EPS			
Net income	$ 2,832,060		
Preferred stock dividends and accretion	0		
Income available to common shareholders	2,832,060	4,803,860	$ 0.59
Effect of dilutive securities			
Stock options and unvested stock awards		50,376	
Diluted EPS			
Income available to common shareholders plus assumed conversion	$ 2,832,060	4,854,236	$ 0.58

	Nine Months Ended September 30, 2010		
	Income	Weighted-average shares	Per share Amount
Basic EPS			
Net income	$ 2,376,416		
Preferred stock dividends and accretion	(530,952)		
Income available to common shareholders	1,845,464	4,768,222	$ 0.39
Effect of dilutive securities			
Stock options and unvested stock awards		31,355	
Diluted EPS			
Net income available to common shareholders plus assumed conversion	$ 1845,464	4,799,577	$ 0.38

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(4) Investment Securities

Amortized cost, gross unrealized gains and losses, and the estimated fair value by security type are as follows:

September 30, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale-				
U. S. Treasury securities and obligations of U.S. Government sponsored corporations ("GSE") and agencies	$ 19,411,139	$ 126,745	$ 0	$ 19,537,884
Residential collateralized mortgage obligations – GSE	14,560,991	558,878	0	15,119,869
Residential collateralized mortgage obligations – non-GSE	4,513,524	144,031	(21,988)	4,635,567
Residential mortgage backed securities – GSE	44,191,658	2,447,199	0	46,638,857
Obligations of State and Political subdivisions	5,373,801	336,167	(7,300)	5,702,668
Trust preferred debt securities – single issuer	2,462,506	0	(558,484)	1,904,022
Corporate Debt Securities	1,456,906	0	(5,014)	1,451,892
Restricted stock	1,294,100	0	0	1,294,100
Mutual fund	25,000	0	0	25,000
	$ 93,289,625	$ 3,613,020	$ (592,786)	$ 96,309,859

September 30, 2011	Amortized Cost	Other-Than-Temporary Impairment Recognized In Accumulated Other Comprehensive Income	Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held to maturity-						
U. S. Treasury securities and obligations of U.S. Government sponsored corporations ("GSE") and agencies	$15,330,542	$0	$15,330,542	$94,335	$0	$15,424,877
Residential collateralized Mortgage obligations – GSE	25,597,921	0	25,597,921	1,379,960	0	26,977,881
Residential collateralized Mortgage obligations - non-GSE	14,774,297	0	14,774,297	890,025	0	15,664,322

Residential mortgage backed securities – GSE	22,113,205	0	22,113,205	1,004,323	0	23,117,528
Obligations of State and Political subdivisions	47,899,790	0	47,899,790	2,615,491	(3,676)	50,511,605
Trust preferred debt securities – pooled	644,406	(500,944)	143,462	0	(137,433)	6,029
Corporate debt securities	26,615,471	0	26,615,471	62,753	(232,125)	26,446,099
	$152,975,632	$(500,944)	$152,474,688	$6,046,887	$(373,234)	$158,148,341

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December 31, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale-				
U. S. Treasury securities and obligations of U.S. Government sponsored corporations ("GSE") and agencies	$ 34,299,374	$ 60,189	$ 0	$ 34,359,563
Residential collateralized mortgage obligations- GSE	18,653,850	483,908	0	19,137,758
Residential collateralized mortgage obligations- non GSE	5,677,577	113,496	(29,751)	5,761,322
Residential mortgage backed securities – GSE	16,963,589	1,206,146	0	18,169,735
Obligations of State and Political subdivisions	3,110,145	23,768	(112,485)	3,021,428
Trust preferred debt securities	2,460,380	0	(602,877)	1,857,503
Corporate debt securities	1,495,438	4,973	(1,827)	1,498,584
Restricted stock	1,640,100	0	0	1,640,100
Mutual fund	25,000	0	0	25,000
	$ 84,325,453	$ 1,892,480	$ (746,940)	$ 85,470,993

December 31, 2010	Amortized Cost	Other-Than-Temporary Impairment Recognized In Accumulated Other Comprehensive Income	Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held to maturity-						
U. S. Treasury securities and obligations of U.S. Government sponsored corporations ("GSE") and agencies	$23,170,741	$0	$23,170,741	$93,600	$(50,721)	$23,213,620
Residential collateralized mortgage obligations – GSE	2,520,690	0	2,520,690	84,253	0	2,604,943
Residential mortgage backed securities – GSE	9,344,517	0	9,344,517	131,443	(41,711)	9,434,249
Obligations of State and Political subdivisions	19,467,404	0	19,467,404	245,290	(352,534)	19,360,160
Trust preferred debt securities – pooled	642,478	(500,944)	141,534	0	(137,361)	4,173
Corporate debt securities	27,245,009	0	27,245,009	67,696	(217,846)	27,094,859

	$82,390,839	$(500,944)	$81,889,895	$622,282	$(800,173)	$81,712,004

Restricted stock at September 30, 2011 and December 31, 2010 consisted of $1,279,100 and $1,625,100, respectively, of Federal Home Loan Bank of New York stock and $15,000 of Atlantic Central Bankers Bank stock.

The amortized cost and estimated fair value of investment securities at September 30, 2011, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Restricted stock is included in “Available for sale - Due in one year or less.”

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	Amortized Cost	Fair Value
Available for sale-		
Due in one year or less	$ 1,827,359	$ 1,827,325
Due after one year through five years	14,613,469	14,743,167
Due after five years through ten years	12,428,148	12,920,977
Due after ten years	64,420,649	66,818,390
Total	$ 93,289,625	$ 96,309,859
	Carrying Value	Fair Value
Held to maturity-		
Due in one year or less	$ 9,850,114	$ 9,840,283
Due after one year through five years	35,910,049	35,918,321
Due after five years through ten years	30,893,457	32,262,029
Due after ten years	75,821,068	80,127,708
Total	$ 152,474,688	$ 158,148,341

Gross unrealized losses on securities and the estimated fair value of the related securities aggregated by security category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2011 and December 31, 2010 are as follows:

September 30, 2011		Less than 12 months		12 months or longer		Total	
	Number of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealiz Losses
Residential collateralized mortgage obligations – non-GSE	1	$ 0	$ 0	$ 286,821	$ (21,988)	$ 286,821	$ (21,9
Obligations of State and Political Subdivisions	6	1,825,663	(10,976)	0	0	1,825,663	(10,9
Trust preferred debt securities – single issuer	4	0	0	1,904,022	(558,484)	1,904,022	(558,4
Trust preferred debt securities – single issuer – pooled	1	0	0	6,029	(638,377)	6,029	(638,3
Corporate Debt Securities	34	18,525,292	(237,139)	0	0	18,525,292	(237,1
Total temporarily impaired securities	46	$ 20,350,955	$ (248,115)	$ 2,196,872	$ (1,218,849)	$ 22,547,827	$ (1,466,9

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December 31, 2010		Less than 12 months		12 months or longer		Total	
	Number of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government sponsored corporations and agencies	6	$5,120,020	$(50,721)	$-	$-	$5,120,020	$(50,721
Residential collateralized mortgage Obligations – Non-GSE	2	2,035,105	(21,478)	372,747	(8,273)	2,407,852	(29,751
Residential mortgage backed securities GSE	4	4,393,707	(41,711)	-	-	4,393,707	(41,711
Obligations of State and Political Subdivisions	31	11,124,090	(378,918)	927,538	(86,101)	12,051,628	(465,019
Trust preferred debt securities – Single issuer	4	0	0	1,857,503	(602,877)	1,857,503	(602,877
Trust preferred debt securities – Pooled	1	0	0	4,173	(638,305)	4,173	(638,305
Corporate debt securities	45	24,917,591	(219,673)	0	0	24,917,591	(219,673
Total temporarily impaired securities	93	$47,590,513	$(712,501)	$3,161,961	$(1,335,556)	$50,752,474	$(2,048,05

Residential collateralized mortgage obligations: The unrealized losses on investments in residential collateralized residential mortgage obligations were caused by interest rate increases. The contractual cash flows of these securities are guaranteed by the issuer, which are generally government or government sponsored agencies. It is expected that the securities would not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

Obligations of State and Political Subdivisions: The unrealized losses or investments in these securities were caused by interest rate increases. It is expected that the securities would not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

Corporate debt securities: The unrealized losses on investments in corporate debt securities were caused by interest rate increases. None of the corporate issuers have defaulted on interest payments. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

Trust preferred debt securities – single issuer: The investments in these securities with unrealized losses are comprised of four corporate trust preferred securities that mature in 2027, all of which were single-issuer securities. The contractual terms of the trust preferred securities do not allow the issuer to settle the securities at a price less than the face value of the trust preferred securities, which is greater than the amortized cost of the trust preferred securities. None of the corporate issuers have defaulted on interest payments. Because the decline in fair value is attributable to widening of interest rate spreads and the lack of an active trading market for these securities and to a lesser degree market concerns on the issuers' credit quality, and because the Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

Trust preferred debt security – pooled: This trust preferred debt security was issued by a two issuer pool (Preferred Term Securities XXV, Ltd. co-issued by Keefe, Bruyette and Woods, Inc. and First Tennessee ("PreTSL XXV")), consisting primarily of financial institution holding companies. During 2009, the Company recognized an other-than-temporary impairment charge of $864,727, of which $363,783 was determined to be a credit loss and charged to operations and $500,944 was recognized in other comprehensive income (loss) component of shareholders' equity.

The primary factor used to determine the credit portion of the impairment loss to be recognized in the income statement for this security was the discounted present value of projected cash flow where that present value of cash flow was less than the amortized cost basis of the security. The present value of cash flow was developed using a model that considered performing collateral ratios, the level of subordination to senior tranches of the security, credit ratings of and projected credit defaults in the underlying collateral.

On a quarterly basis, management evaluates this security to determine if any additional other-than-temporary impairment. As of September 30, 2011, our evaluation was as follows:

a. We obtained the PRETSL XXV Depository Institutions Issuer List as of September 30, 2011 from the FTN Financial Corp. ("FTN") website and reviewed the financial ratios and capital levels of each individual financial institution issuer.

b. We sorted the financial institutions on the issuer list to develop three "buckets" (or categories) for further deferred/default analysis based upon the indicated "Texas Ratio." The Texas Ratio is calculated by dividing the institution's Non-Performing Assets plus loans 90 days past due by the combined total of Tangible Equity plus the Allowance for Loan Losses. The three buckets consisted of those institutions with a Texas Ratio of:

(1) Above 100;

(2) 75 to 100; and

(3) Below 75.

c. We then applied the following asset specific deferral/default assumptions to each of these buckets:

(1) Above 100 - 100% default; 0% recovery;

(2) 75 to 100 – 100% deferred; 15% recovery at 2 years from initial date of deferral; and

(3) Below 75 – no deferral/default.

d. We then ran a cash flow projection to analyze the impact of future deferral/default activity by applying the following assumption on those institutions in bucket (3) of our analysis:

- Defaults at 75 basis points applied annually; 15% recovery with a 2-year lag from the initial date of deferral.

Our rationale for these metrics is as follows: (1) The FDIC lists the number of bank failures each year from 1934 – 2008. Comparing bank failures to the number of FDIC institutions produces an annual average default rate of 36 basis points. Given the continuing uncertain economic environment, we believe double this amount, or 75 basis points, to be an appropriate measurement for defaults; and (2) Standard & Poor's published "Global Methodology for Rating Trust Preferred/Hybrid Securities Revised" on November 21, 2008. This analysis uses a recovery assumption of 15%, which we also deem an appropriate measurement.

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Our position is that it is appropriate to apply this future default factor in our analysis as it is not realistic to assume no adverse conditions will occur over the remaining 26-year stated maturity of this pooled security even though the individual institutions are currently performing according to terms.

e. This September 30, 2011 projection of future cash flows produced as present value factor that exceeded the carrying value of the pooled trust preferred security; therefore, management concluded that no other-than-temporary impairment issues were present at September 30, 2011.

Any one or more factors, or combinations thereof, could cause management to conclude in future reporting periods that an unrealized loss that exists with respect to PRETSL XXV constitutes an additional credit impairment. These factors include, but are not limited to, failure to make interest payments, an increase in the severity of the unrealized loss, an increase in the continuous duration of the unrealized loss without an impairment in value or changes in market conditions and/or industry or issuer specific factors that would render management unable to forecast a full recovery in value. In addition, the fair value of trust preferred securities could decline if the overall economy and the financial condition of the issuers continue to deteriorate and there remains limited liquidity for this security.

The following table sets forth information with respect to this security at September 30, 2011:

										Excess Subordination (2)	
Security	Class	Amortized Cost	Fair Value	Unrealized Gain (Loss)	Percent of Underlying Collateral Performing	Percent of Underlying Collateral In Deferral (1)	Percent of Underlying Collateral In Default (1)	Expected Deferrals and Defaults as a % of Remaining Performing Collateral	Moody's S&P / Ratings	Amount	% Curr Perfor Colla
PRETSL XXV	B-1	$644,406	$6,029	($638,377)	65.9%	19.3%	14.8%	17.5%	C/ NR	$93,500,000	16.(

Notes to table above:

(1) This percentage represents the amount of specific deferrals / defaults that have occurred, plus those that are known for the following quarters to the total amount of original collateral. Fewer deferrals / defaults produce a lower percentage.

(2) "Excess subordination" amount is the additional defaults / deferrals necessary in the next reporting period to deplete the entire credit enhancement (excess interest and over-collateralization) beneath our tranche within each pool to the point that would cause a "break in yield". This amount assumes that all currently performing collateral continues to perform. A break in yield means that our security would not be expected to receive all the contractual cash flows (principal and interest) by maturity. The "percent of underlying collateral performing" is the ratio of the "excess subordination amount" to current performing collateral - a higher percentage means there is more excess subordination to absorb additional defaults / deferrals, and the better our security is protected from loss.

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The following table presents a cumulative roll forward of the amount of other-than-temporary impairment related to credit losses, all of which relate to PRETSL XXV, which have been recognized in earnings for debt securities held to maturity and not intended to be sold.

(in thousands)	Three and nine months ended September 30, 2011	Three and nine months ended September 30, 2010
Balance at beginning of period	$ 364	$ 364
Change during the period	-	-
Balance at end of period	$ 364	$ 364

(5) Loans and Allowance for Loan Losses

The Company's primary lending emphasis is the origination of commercial and commercial real estate loans and mortgage warehouse lines of credit. Based on the composition of the loan portfolio, the inherent primary risks are deteriorating credit quality, a decline in the economy, and a decline in New Jersey real estate market values. Any one, or a combination, of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

The following table provides an aging of the loan portfolio by loan class at September 30, 2011:

	30-59 Days	60-89 Days	Greater than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days Accruing	Non-accrual Loans
Commercial								
Construction	$0	$0	$3,023,329	$3,023,329	$49,818,686	$52,842,015	$0	$3,023,329
Commercial Business	270,862	44,966	393,421	709,249	50,800,694	51,509,943	0	472,984
Commercial Real Estate	993,835	0	451,088	1,444,923	98,456,026	99,900,949	0	1,395,154
Mortgage Warehouse Lines	0	0	0	0	196,255,583	196,255,583	0	0
Residential Real Estate	0	0	518,694	518,694	11,444,265	11,962,959	0	518,694
Consumer								
Loans to Individuals	0	0	77,858	77,858	12,718,243	12,796,101	0	77,858
Other	0	0	0	0	237,724	237,724	0	0
Deferred Loan Fees	0	0	0	0	930,556	930,556	0	0
Total	$1,264,697	$44,966	$4,464,390	$5,774,053	$420,661,777	$426,435,830	$0	$5,488,019

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The following table provides an aging of the loan portfolio by loan class at December 31, 2010:

	30-59 Days	60-89 Days	Greater than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days Accruing	Non-accrual Loans
Commercial								
Construction	$0	$0	$6,569,296	$6,569,296	$61,321,407	$67,890,703	$0	$6,569,296
Commercial Business	113,801	60,526	605,208	779,335	53,953,637	54,733,172	0	750,623
Commercial Real Estate	3,179,541	0	1,411,390	4,590,931	90,686,883	95,277,814	0	1,411,390
Mortgage Warehouse Lines	0	0	0	0	169,575,899	169,575,899	0	0
Residential Real Estate	173,708	0	0	173,708	10,261,330	10,435,038	0	0
Consumer								
Loans to Individuals	0	0	77,858	77,858	13,271,178	13,349,036	0	77,858
Other	0	0	0	0	181,924	181,924	0	0
Deferred Loan Fees	0	0	0	0	543,753	543,753	0	0
Total	$3,467,050	$60,526	$8,663,752	$12,191,328	$399,796,011	$411,987,339	$0	$8,809,167

Management reviews the adequacy of the allowance on at least a quarterly basis to ensure that the provision for loan losses has been charged against earnings in an amount necessary to maintain the allowance at a level that is adequate based on management's assessment of probable estimated losses. The Company's methodology for assessing the adequacy of the allowance for loan losses consists of several key elements. These elements include a specific reserve for impaired loans, an allocated reserve, and an unallocated portion.

The Company consistently applies the following comprehensive methodology. During the quarterly review of the allowance for loan losses, the Company considers a variety of factors that include:

- General economic conditions.
- Trends in charge-offs.
- Trends and levels of delinquent loans.
- Trends and levels of non-performing loans, including loans over 90 days delinquent.
- Trends in volume and terms of loans.
- Levels of allowance for specific classified loans.
- Credit concentrations.

The methodology includes the segregation of the loan portfolio into loan types with a further segregation into risk rating categories, such as special mention, substandard, doubtful, and loss. This allows for an allocation of the allowance for loan losses by loan type; however, the allowance is available to absorb any loan loss without restriction. Larger balance, non-homogeneous loans representing significant individual credit exposures are evaluated individually through the internal loan review process. It is this process that produces the watch list. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated. Based on these reviews, an estimate of probable losses for the individual larger-balance loans are determined, whenever possible, and used to establish specific loan loss reserves. In general, for non-homogeneous loans not individually assessed, and for homogeneous groups, such as residential mortgages and consumer credits, the loans are collectively evaluated based on delinquency status, loan type, and historical losses. These loan groups are then internally risk rated.

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The watch list includes loans that are assigned a rating of special mention, substandard, doubtful and loss. Loans classified special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans rated as doubtful in whole, or in part, are placed in non-accrual status. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses.

The specific reserve for impaired loans is established for specific loans which have been identified by management as being impaired. These impaired loans are assigned a substandard or doubtful risk rating grade because the loan has not performed according to payment terms and there is reason to believe that repayment of the loan principal in whole is unlikely. The specific portion of the allowance is the total amount of potential unconfirmed losses for these individual impaired loans. To assist in determining the fair value of loan collateral, the Company often utilizes independent third party qualified appraisal firms which in turn employ their own criteria and assumptions that may include occupancy rates, rental rates, and property expenses, among others.

The second category of reserves consists of the allocated portion of the allowance. The allocated portion of the allowance is determined by taking pools of loans outstanding that have similar characteristics and applying historical loss experience for each pool. This estimate represents the potential unconfirmed losses within the portfolio. Individual loan pools are created for commercial and commercial real estate loans, construction loans, and various types of loans to individuals. The historical estimation for each loan pool is then adjusted to account for current conditions, current loan portfolio performance, loan policy or management changes, or any other factor which may cause future losses to deviate from historical levels.

The Company also maintains an unallocated allowance. The unallocated allowance is used to cover any factors or conditions which may cause a potential loan loss but are not specifically identifiable. It is prudent to maintain an unallocated portion of the allowance because no matter how detailed an analysis of potential loan losses is performed, these estimates by definition lack precision. Management must make estimates using assumptions and information that is often subjective and changing rapidly.

The following discusses the risk characteristics of each of our loan portfolio segments, commercial and consumer.

Commercial

The Company's primary lending emphasis is the origination of commercial and commercial real estate loans and mortgage warehouse lines of credit. Based on the composition of the loan portfolio, the inherent primary risks are deteriorating credit quality, a decline in the economy, and a decline in New Jersey real estate market values. Any one, or a combination, of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

Consumer

The Company's loan portfolio consumer segment is comprised of residential real estate loans, home equity loans and other loans to individuals. Individual loan pools are created for the various types of loans to individuals.

In general, for homogeneous groups, such as residential mortgages and consumer credits, the loans are collectively evaluated based on delinquency status, loan type, and industry historical losses. These loan groups are then internally risk rated.

The Company considers the following credit quality indicators in assessing the risk in the loan portfolio:

- Consumer credit scores
- Internal credit risk grades
- Loan-to-value ratios

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- Collateral
- Collection experience

The Company's internal credit risk grades are based on the definitions currently utilized by the banking regulatory agencies. The grades assigned and definitions are as follows, and loans graded excellent, above average, good and watch list are treated as "pass" for grading purposes:

1. Excellent - Loans that are based upon cash collateral held at the Bank and adequately margined. Loans that are based upon "blue chip" stocks listed on the major exchanges and adequately margined.

2. Above Average - Loans to companies whose balance sheets show excellent liquidity and long-term debt is on well-spread schedules of repayment easily covered by cash flow. Such companies have been consistently profitable and have diversification in their product lines or sources of revenue. The continuation of profitable operations for the foreseeable future is likely. Management is comprised of a mix of ages, experience, and backgrounds and management succession is in place. Sources of raw materials and service companies, the source of revenue is abundant. Future needs have been planned for. Character and ability of individuals or company principals are excellent. Loans to individuals supported by high net worths and liquid assets.

3. Good - Loans to companies whose balance sheets show good liquidity and cash flow adequate to meet maturities of long-term debt with a comfortable margin. Such company has established a profitable record over a number of years, and there has been growth in net worth. Operating ratios are in line with those of the industry, and expenses are in proper relationship to the volume of business done and the profits achieved. Management is well-balanced and competent in their responsibilities. Economic environment is favorable; however, competition is strong. The prospects for growth are good. Loans in this category do not meet the collateral requirements of loans in categories 1 and 2 above. Loans to individuals supported by good net worths but whose supporting assets are illiquid.

3w. Watch List - Included in this category are loans evidencing problems identified by Bank management requiring closer supervision. Such problem has not developed to the point which requires a Special Mention rating. This category also covers situations where the Bank does not have adequate current information upon which credit quality can be determined. The account officer has the obligation to correct these deficiencies within 30 days after the time of notification.

4. Special Mention - Loans or borrowing relationships that require more than the usual amount of attention by Bank management. Industry conditions may be adverse or weak. The borrower's ability to meet current payment schedules may be questionable, even though interest and principal are being paid as agreed. Heavy reliance has been placed on the collateral. Profits, if any, are interspersed with losses. Management is "one man" or weak or incompetent or there is no plan for management succession. Expectations of a loan loss are not immediate; however, if present trends continue, a loan loss could be expected.

5. Substandard - Loans in this category possess weaknesses that jeopardize the ultimate collection of total outstanding loans. These weaknesses require close supervision by Bank management. Current financial statements are unavailable and the loan is inadequately protected by the collateral pledged. This category will normally include loans that have been classified as substandard by the regulators.

6. Doubtful - Loans with weaknesses inherent in the substandard classification and where collection or liquidation in full is highly questionable. It is likely that the loan will not be collected in full and the Bank will suffer some loss which is not quantifiable at the time of review.

7. Loss - Loans considered uncollectable and of such little value that their continuance as an active asset is not warranted. Loans in this category should immediately be eliminated from the Bank's loan loss reserve. Any accrued interest should immediately be backed out of income.

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The following table provides a breakdown of the loan portfolio by credit quality indictor at September 30, 2011.

Commercial Credit Exposure - By Internally Assigned Grade	Construction	Commercial Business	Commercial Real Estate	Mortgage Warehouse Lines	Residential Real Estate
Grade:					
Pass	$48,819,609	$48,859,185	$85,120,202	$196,255,583	$11,444,265
Special Mention	4,999,077	1,774,088	10,565,697	0	0
Substandard	2,819,758	854,187	3,614,548	0	518,694
Doubtful	203,571	22,483	600,502	0	0
Total	$52,842,015	$51,509,943	$99,900,949	$196,255,583	$11,962,959

Consumer Credit Exposure - By Payment Activity	Loans To Individuals	Other
Performing	$12,718,243	$237,724
Nonperforming	77,858	0
Total	$12,796,101	$237,724

The following table provides a breakdown of the loan portfolio by credit quality indictor at December 31, 2010.

Commercial Credit Exposure - By Internally Assigned Grade	Construction	Commercial Business	Commercial Real Estate	Mortgage Warehouse Lines	Residential Real Estate
Grade:					
Pass	$52,445,421	$52,587,444	$85,122,509	$169,575,899	$10,435,038
Special Mention	4,482,569	433,377	3,668,243	0	0
Substandard	10,962,713	1,499,461	5,823,312	0	0
Doubtful	0	212,890	663,750	0	0
Total	$67,890,703	$54,733,172	$95,277,814	$169,575,899	$10,435,038

Consumer Credit Exposure - By Payment Activity	Loans To Individuals	Other
Performing	$13,271,178	$181,924
Nonperforming	77,858	0
Total	$13,349,036	$181,924

Impaired Loans Disclosures

Loans are considered to be impaired when, based on current information and events, it is determined that the Company will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. When a loan is placed on non-accrual status, it is also considered to be impaired. Loans are placed on non-accrual status when: (1) the full collection of interest or principal becomes uncertain; or (2) they are contractually past due 90 days or more as to interest or principal payments unless both well secured and in the process of collection.

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The following tables summarize the distribution of the allowance for loan losses and loans receivable by loan class and impairment method at September 30, 2011 and December 31, 2010:

Period-End Balances By Impairment Method – September 30, 2011	Construction	Commercial Business	Commercial Real Estate	Mortgage Warehouse	Residential Real Estate	Consumer	Other
Allowance for loan losses:							
Ending Balance	$1,697,326	$754,182	$1,640,153	$883,150	$86,007	$187,913	$2,211
Ending Balance							
Individually evaluated for impairment	705,568	87,570	210,811	0	11,619	77,858	0
Collectively evaluated for impairment	991,758	666,612	1,429,342	883,150	74,388	110,055	2,211
Loans receivables:							
Ending Balance	$52,842,015	$51,509,943	$99,900,949	$196,255,583	$11,962,959	$12,796,101	$237,724
Individually evaluated for impairment	3,023,329	557,001	1,395,155	0	518,694	77,858	0
Collectively evaluated for impairment	49,818,686	50,952,942	98,505,794	196,255,583	11,444,265	12,718,243	237,724

Period-End Balances By Impairment Method – December 31, 2010	Construction	Commercial Business	Commercial Real Estate	Mortgage Warehouse	Residential Real Estate	Consumer	Other
Allowance for loan losses:							
Ending Balance	$1,744,068	$971,994	$1,723,865	$763,092	$67,828	$192,457	$1,910
Ending Balance							
Individually evaluated for impairment	45,000	180,525	271,382	0	0	77,858	0
Collectively evaluated for impairment	1,699,068	791,469	1,452,483	763,092	67,828	114,599	1,910
Loans receivables:							
Ending Balance	$67,890,703	$54,733,172	$95,277,814	$169,575,899	$10,435,038	$13,349,036	$181,924
Individually evaluated for impairment	6,569,296	750,623	1,411,390	0	0	77,858	0
Collectively evaluated for impairment	63,748,566	51,555,390	93,866,424	169,575,899	10,435,038	13,271,178	181,924

The allowance for loan loss by loan class at both September 30, 2011 and December 31, 2010, and related activity for the nine months ended September 30, 2011, are as follows:

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	Construction	Commercial Business	Commercial Real Estate	Mortgage Warehouse	Residential Real Estate	Consumer	Other	Unallocate
Balance - December 31, 2010	$1,744,068	$971,994	$1,723,865	$763,092	$67,828	$192,457	$1,910	$297,498
Provision charged to operations	1,183,736	(55,760)	(318,432)	(344,826)	9,777	(1,990)	571	(73,078
Loans charged off	(366,587)	(46,319)	-	-	-	-	-	-
Recoveries of loans charged off	-	239	-	-	-	-	-	-
Balance - March 31, 2011	$2,561,217	$870,154	$1,405,433	$418,266	$77,605	$190,467	$2,481	$224,420
Provision charged to operations	52,940	48,806	215,679	110,442	(370)	(3,016)	(28)	(149,45
Loans charged off	(158,900)	-	-	-	-	-	-	-
Recoveries of loans charged off	-	3,438	-	-	-	-	-	-
Balance - June 30, 2011	$2,455,257	$922,398	$1,621,112	$528,708	$77,235	$187,451	$2,453	$74,967
Provision charged to operations	29,559	13,870	19,041	354,442	8,772	462	(242)	182,428
Loans charged off	(793,967)	(182,343)	0	0	0	0	0	0
Recoveries of loans charged off	6,478	256	0	0	0	0	0	0
Balance – September 30, 2011	$1,697,327	$754,181	$1,640,153	$883,150	$86,007	$187,913	$2,211	$257,395

When a loan is identified as impaired, the measurement of impairment is based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole remaining source of repayment for the loan is the liquidation of the collateral. In such cases, the current fair value of the collateral less selling costs is used. If the value of the impaired loan is less than the recorded investment in the loan, the impairment is recognized through an allowance estimate or a charge to the allowance.

Impaired Loans Receivables (By Class) – September 30, 2011

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Year to Date Average Recorded Investment	Year to Date Interest Income Recognized
With no related allowance:					
Commercial					
Construction	$140,408	$277,758	$0	$ 1,080,462	$ 0
Commercial Business	100,064	123,194	0	235,059	0
Commercial Real Estate	258,435	258,435	0	325,338	0
Mortgage Warehouse Lines	0	0	0	0	0
Subtotal	498,907	659,387	0	1,640,859	0
Residential Real Estate	0	0	0	0	0
Consumer					
Loans to Individuals	0	0	0	0	0
Other	0	0	0	0	0
	498,907	659,387	0	1,640,859	0

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With an allowance:					
Commercial					
Construction	2,882,921	2,901,921	705,568	3,080,016	0
Commercial Business	456,937	456,937	87,570	613,043	5,071
Commercial Real Estate	1,136,720	1,136,720	210,811	1,077,913	0
Mortgage Warehouse Lines	0	0	0	0	0
Subtotal	4,476,578	4,495,578	1,003,949	4,770,972	5,071
Residential Real Estate	518,694	518,694	11,619	461,468	0
Consumer					
Loans to Individuals	77,858	77,858	77,858	77,858	0
Other	0	0	0	0	0
Subtotal	77,858	77,858	77,858	77,858	0
With an allowance:	5,073,130	5,092,130	1,093,426	5,310,298	0
Total:					
Commercial	4,975,485	5,154,965	1,003,949	6,411,831	5,071
Residential Real Estate	518,694	518,694	11,619	461,468	0
Consumer	77,858	77,858	77,858	77,858	0
Total	$5,572,037	$5,751,517	$1,093,426	$6,951,157	$5,071

Impaired Loans Receivables (By Class) – December 31, 2010

	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance:			
Commercial			
Construction	$ 4,409,296	$ 4,453,796	$ --
Commercial Business	385,370	394,654	--
Commercial Real Estate	554,986	554,986	--
Mortgage Warehouse Lines	--	--	--
	5,349,652	5,403,436	--
Residential Real Estate	--	--	--
Consumer			
Loans to Individuals	--	--	--
Other	--	--	--
	--	--	--
	5,349,652	5,403,436	--

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With an allowance:			
Commercial			
Construction	2,160,000	2,160,000	45,000
Commercial Business	365,253	365,253	180,525
Commercial Real Estate	856,404	856,404	271,382
Mortgage Warehouse Lines	--	--	--
	3,381,657	3,381,657	496,907
Residential Real Estate	--	--	--
Consumer			
Loans to Individuals	77,858	77,858	77,858
Other	--	--	--
	77,858	77,858	77,858
	3,459,515	3,459,515	574,765
Total:			
Commercial	8,731,309	8,785,093	496,907
Residential Real Estate	--	--	--
Consumer	77,858	77,858	77,858
	$ 8,809,167	$ 8,862,951	$ 574,765

In the normal course of business, the Bank many consider modifying loan terms for various reasons. These reasons may include as a retention strategy to compete in the current interest rate environment or to re-amortize or extend a loan term to better match the loan's payment stream with the borrower's cash flows. A modified loan would be considered to be a troubled debt restructuring ("TDR") if the Bank grants a concession to a borrower and has determined that the borrower is troubled (i.e. experiencing financial difficulties).

If the Bank restructures a loan to a troubled borrower, the loan terms (i.e. interest rate, payment, amortization period, maturity date) may modified in various ways to enable the borrower to cover the modified debt service payments based on current financials and cash flow adequacy. If a borrower's hardship is thought to be temporary, then modified terms may only be offered for that time period. Where possible, the Bank would attempt to obtain additional collateral and/or secondary payment sources at the time of the restructure in order to put the Bank in the best possible position if the borrower is not able to meet the modified terms. The Bank will not offer modified terms if it believes that modifying the loan terms will only delay an inevitable permanent default.

The Bank adopted Accounting Standards Update ("ASU") No. 2011-02 on July 1, 2011. ASU No. 2011-02 provides additional guidance to creditors for evaluating whether a modification or restructuring of a receivable is a troubled debt restructuring. In evaluating whether a restructuring constitutes a troubled debt restructuring, ASU No. 2011-02 requires that a creditor must separately conclude that the restructuring constitutes a concession and the borrower is experiencing financial difficulties. As a result of our adoption of ASU No. 2011-02, we reassessed the terms and conditions to customers on all modifications granted retrospective to January 1, 2011 and determined that no such loans were troubled debt restructurings. We do not have any loans classified as restructured as of September 30, 2011.

(6) Share-Based Compensation

The Company establishes fair value for its equity awards to determine its cost and recognizes the related expense for stock options over the vesting period using the straight-line method. The grant date fair value for stock options is calculated using the Black-Scholes option valuation model.

The Company's stock-based incentive plans (the "Stock Plans") authorize the issuance of an aggregate of 1,236,375 shares of Company common stock pursuant to awards that may be granted in the form of stock options to purchase common stock ("Options") and awards of shares of common stock ("Stock Awards"). The purpose of the Stock Plans is to attract and retain personnel for positions of substantial responsibility and to provide additional incentive to certain officers, directors, employees and other persons to promote the success of the Company. Under the Stock Plans, options have a term of ten years after the date of grant, subject to earlier termination in certain circumstances. Options are granted with an exercise price at the then fair market value of the Company's common stock. As of September 30, 2011, there were 144,066 shares of common stock (as adjusted for the 5% stock dividend declared December 16, 2010 and paid February 2, 2011 to shareholders of record on January 18, 2011) available for future grants under the Stock Plans.

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Stock-based compensation expense related to Options was $41,799 and $46,329 for the nine months ended September 30, 2011 and 2010, respectively.

Transactions under the Stock Plans during the nine months ended September 30, 2011 are summarized as follows:

Stock Options	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at January 1, 2011	156,244	$ 10.74		
Granted	55,767	7.60		
Exercised	(1,709)	5.85		
Forfeited	-	-		
Expired	-	-		
Outstanding at September 30, 2011	210,302	$ 9.95	5.9	$12,383
Exercisable at September 30, 2011	145,870	$ 10.72	4.7	$12,383

The total intrinsic value (market value on date of exercise less grant price) of options exercised during the nine months ended September 30, 2011 was $4,491.

The fair value of each option and the significant weighted average assumptions used to calculate the fair value of the options granted for the nine months ended September 30, 2011 are as follows:

	Jan. 2011	Sept. 2011
Fair value of options granted	$ 3.24	$ 2.36
Risk-free rate of return	1.99 %	0.90 %
Expected option life in years	7	7
Expected volatility	33.02 %	31.48 %
Expected dividends (1)	-	-

(1) To date, the Company has not paid cash dividends on its common stock.

As of September 30, 2011, there was approximately $199,083 of unrecognized compensation cost related to non-vested stock options based compensation arrangements granted under the Stock Plans. That cost is expected to be recognized during calendar years 2012, 2013, 2014 and 2015.

The following table summarizes non-vested restricted shares for the nine months ended September 30, 2011 (as adjusted to reflect the 5% stock dividend declared in December 2010).

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Non-vested shares	Number of Shares	Average Grant Date Fair Value
Non-vested at January 1, 2011	109,518	$ 7.70
Granted	57,955	7.41
Vested	(29,166)	11.23
Forfeited	(3,782)	8.15
Non-vested at June 30, 2011	134,525	$ 6.80

The value of restricted shares is based upon the closing price of the common stock on the date of grant. The shares generally vest over a four year service period with compensation expense recognized on a straight-line basis.

Stock based compensation expense related to stock grants was $248,427 and $125,000 for the nine months ended September 30, 2011 and 2010.

As of September 30, 2011, there was approximately $845,565 of unrecognized compensation cost related to non-vested stock grants that will be recognized during calendar years 2012, 2013, 2014 and 2015.

(7) Benefit Plans

The Company has a 401(k) plan which covers substantially all employees with six months or more of service. The Company's contributions to the 401(k) plan are expensed as incurred.

The Company also provides retirement benefits to certain employees under supplemental executive retirement plans (the "SERPs"). The SERPs are unfunded and the Company accrues actuarial determined benefit costs over the estimated service period of the employees in the SERPs. The Company recognizes the over funded or under funded status of a defined benefit post-retirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur, through comprehensive income.

The components of net periodic expense for the Company's SERPs for the three months and nine months ended September 30, 2011 and 2010 are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Service cost	$68,425	$56,514	$205,275	$169,542
Interest cost	57,057	48,435	171,171	145,305
Actuarial (gain) loss recognized	(2,062)	38,517	(6,186)	115,551
Prior service cost recognized	19,859	24,858	59,577	74,574
	$143,279	$168,324	$429,837	$504,972

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(8) Other Comprehensive Income and Accumulated Other Comprehensive Income

The components of accumulated other comprehensive income and their related income tax effects were as follows:

	September 30, 2011	December 31, 2010
Unrealized holding gains on securities available for sale	$ 3,020,234	$ 1,145,540
Related income tax effect	(1,026,879)	(389,483)
	1,993,355	756,057
Unrealized impairment loss on held to maturity security	(500,944)	(500,944)
Related income tax effect	170,321	170,321
	(330,623)	(330,623)
Unrealized loss on interest rate swap contract	0	(353,552)
Related income tax effect	0	141,990
	0	(211,562)
Pension liability	(181,881)	(191,539)
Related income tax effect	71,961	75,841
	(109,920)	(115,698)
Accumulated other comprehensive income	$ 1,552,812	$ 98,174

The components of other comprehensive income and their related income tax effects for the three and nine month periods ended September 30, 2011 and 2010 are as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
Unrealized holding gain on securities available for sale	$633,337	$ 70,364	$1,874,694	$ 1,471,395
Related income tax effect	(215,335)	(23,926)	(637,396)	(500,275)
	418,002	46,438	1,237,298	971,120
Unrealized gain on interest rate swap contract	0	114,192 (48,452)	353,552	357,035
Related income tax effect	0	65,740	(141,990)	(145,443)
	0		211,562	211,592
Pension liability amortization	3,220	113,922	9,658	341,767
Related income tax effect	(1,295)	(45,771)	(3,880)	(136,235)
	1,925	68,151	5,778	205,532
Other comprehensive income	$419,927	$ 180,329	$1,454,638	$ 1,388,244

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(9) Recent Accounting Pronouncements

ASU 2011-08 (Testing Goodwill for Impairment)

In September, 2011, the FASB issued Accounting Standards Update (ASU) 2011-08, Testing Goodwill for Impairment. The purpose of this ASU is to simplify how entities test goodwill for impairment by adding a new first step to the preexisting goodwill impairment test under ASC Topic 350, Intangibles-Goodwill and other. This amendment gives the entity the option to first assess a variety of qualitative factors such as economic conditions, cash flows, and competition to determine whether it was more likely than not that the fair value of goodwill has fallen below its carrying value. If the entity determines that it is not likely that the fair value has fallen below its carrying value, then the entity will not have to complete the original two-step test under Topic 350. The amendments in this ASU are effective for impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The Company is evaluating the impact of this ASU on its consolidated financial statements.

ASU 2011-05 (Presentation of Comprehensive Income)

The provisions of this ASU amend FASB ASC Topic 220, Comprehensive Income, to facilitate the continued alignment of U.S. GAAP with International Accounting Standards. The ASU prohibits the presentation of the components of comprehensive income in the statement of shareholders' equity. Reporting entities are allowed to present either: a statement of comprehensive income, which reports both net income and other comprehensive income; or separate, but consecutive, statements of net income and other comprehensive income. Under previous GAAP, all three presentations were acceptable. Regardless of the presentation selected, the reporting entity is required to present all reclassifications between other comprehensive and net income on the face of the new statement or statements. The provisions of this ASU are effective for fiscal years and interim periods beginning after December 31, 2011 for public entities. As the two remaining options for presentation existed prior to the issuance of this ASU, early adoption is permitted.

ASU 2011-04 (Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs)

This ASU amends FASB ASC Topic 820, Fair Value Measurements, to bring U.S. GAAP for fair value measurements in line with International Accounting Standards. The ASU clarifies existing guidance for items such as: the application of the highest and best use concept to non-financial assets and liabilities; the application of fair value measurement to financial instruments classified in a reporting entity's shareholders' equity; and disclosure requirements regarding quantitative information about unobservable inputs used in the fair value measurements of level 3 assets. The ASU also creates an exception to Topic 820 for entities which carry financial instruments within a portfolio or group, under which the entity is now permitted to base the price used for fair valuation upon a price that would be received to sell the net asset position or transfer a net liability position in an orderly transaction. The ASU also allows for the application of premiums and discounts in a fair value measurement if the financial instrument is categorized in level 2 or 3 of the fair value hierarchy. Lastly, the ASU contains new disclosure requirements regarding fair value amounts categorized as level 3 in the fair value hierarchy such as: disclosure of the valuation process used; effects of and relationships between unobservable inputs; usage of nonfinancial assets for purposes other than their highest and best use when that is the basis of the disclosed fair value; and categorization by level of items disclosed at fair value, but not measured at fair value for financial statement purposes. For public entities, this ASU is effective for interim and annual periods beginning after December 15, 2011. Early adoption is not permitted. It is anticipated that adoption of this ASU will not affect the Company's consolidated financial position or results of operations.

ASU 2011-02 (A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring)

The FASB has issued this ASU to clarify the accounting principles applied to loan modifications, as defined by FASB ASC Subtopic 310-40, Receivables – Troubled Debt Restructurings by Creditors. The ASU clarifies guidance on a creditor's evaluation of whether or not a concession has been granted, with an emphasis on evaluating all aspects of the modification rather than a focus on specific criteria, such as the effective interest rate test, to determine a concession. The ASU goes on to provide guidance on specific types of modifications such as changes in the interest rate of the borrowing, and insignificant delays in payments, as well as guidance on the creditor's evaluation of whether or not a debtor is experiencing financial difficulties. For public entities, the amendments in the ASU are effective for the first interim or annual periods beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. The entity should also disclose information required by ASU 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, which had previously been deferred by ASU 2011-01, Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in ASU No. 2010-20, for interim and annual periods beginning on or after June 15, 2011. Early adoption is permitted. The adoption of this ASU did not materially affect the Company's consolidated financial position or results of operations.

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ASU 2010-08 (When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts)

In December 2010, the FASB issued ASU No. 2010-28, When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts ("ASU 2010-28"). For reporting units with zero or negative carrying amounts, ASU 2010-28 adds a requirement to Step 1 of the goodwill impairment test that any adverse qualitative factors should be considered in determining whether it is more likely than not that goodwill impairment exists. If it is more likely than not that goodwill impairment exists, the second step of the goodwill impairment test shall be performed. For public entities, the amended guidance was effective for fiscal years, and interim periods within those years, beginning after December 15, 2010, with early adoption not permitted. The adoption of this guidance did not affect the Company's consolidated financial position or results of operations.

(10) Fair Value Disclosures

U.S. GAAP has established a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset's 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 instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Company's financial assets and financial liabilities carried at fair value.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and counterparty creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Company's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective value or reflective of future values. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

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Securities Available for Sale. Securities classified as available for sale are reported at fair value utilizing Level 2 Inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. 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 prepayments speeds, credit information and the security's terms and conditions, among other things.

Impaired loans. Loans included in the following table are those which the Company has measured and recognized impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third party appraisals of the properties, or discounted cash flows based on the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value consists of the loan balances less specific valuation allowances.

Other Real Estate Owned. Foreclosed properties are adjusted to fair value less estimated selling costs at the time of foreclosure in preparation for transfer from portfolio loans to other real estate owned ("OREO"), establishing a new accounting basis. The Company subsequently adjusts the fair value on the OREO utilizing Level 3 inputs on a non-recurring basis to reflect partial write-downs based on the observable market price, current appraised value of the asset or other estimates of fair value.

Derivatives – Interest Rate Swap. Derivatives are reported at fair value utilizing Level 2 Inputs. The Company obtains dealer quotations to value its interest rate swap.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

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	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
September 30, 2011:				
Securities available for sale:				
U. S. Treasury securities and obligations of U.S. Government sponsored corporations ("GSE") and agencies	-	$ 19,537,884	-	$ 19,537,884
Residential collateralized mortgage obligations- GSE	-	15,119,869	-	15,119,869
Residential collateralized mortgage obligations - non GSE	-	4,635,567	-	4,635,567
Residential mortgage backed securities – GSE	-	46,638,857	-	46,638,857
Obligations of State and Political subdivisions	-	5,702,668	-	5,702,668
Trust preferred debt securities – single issuer	-	1,904,022	-	1,904,022
Corporate debt securities	-	1,451,892	-	1,451,892
Restricted stock	-	1,294,100	-	1,294,100
Mutual fund	-	25,000	-	25,000
Derivative liabilities	-	--	-	
December 31, 2010:				
Securities available for sale:				
U. S. Treasury securities and obligations of U.S. Government sponsored corporations ("GSE") and agencies	-	$ 34,359,563	-	$ 34,359,563
Residential collateralized mortgage obligations- GSE	-	19,137,758	-	19,137,758
Residential collateralized mortgage obligations - non GSE	-	5,761,322	-	5,761,322
Residential mortgage backed securities – GSE	-	18,169,735	-	18,169,735
Obligations of State and Political subdivisions	-	3,021,428	-	3,021,428
Trust preferred debt securities – single issuer	-	1,857,503	-	1,857,503
Corporate debt securities	-	1,498,584	-	1,498,584
Restricted stock	-	1,640,100	-	1,640,100
Mutual fund	-	25,000	-	25,000
Derivative liabilities	-	(353,552)	-	(353,552)

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets and financial liabilities measured at fair value on a non-recurring basis at September 30, 2011 and December 31, 2010 are as follows:

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
September 30, 2011:				
Impaired loans	-	-	$ 3,979,704	$ 3,979,704
Other real estate owned	-	-	945,020	945,020
December 31, 2010:				
Impaired loans	-	-	$ 2,884,750	$ 2,884,750
Other real estate owned	-	-	243,023	243,023

Impaired loans measured at fair value and included in the above table, consisted of 12 loans having an aggregate recorded investment of $5,073,130 and specific loan loss allowances of $1,093,426 at September 30, 2011 and seven loans at December 31, 2010, having an aggregate recorded investment of $3,459,515 and specific loan loss allowances of $574,765.

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The fair value of other real estate owned was determined using appraisals, which may be discounted based on management's review and changes in market conditions.

The following is a summary of fair value versus the carrying value of all the Company's financial instruments. For the Company and the Bank, as for most financial institutions, the bulk of its assets and liabilities are considered financial instruments. Many of the financial instruments lack an available trading market as characterized by a willing buyer and willing seller engaging in an exchange transaction. Therefore, significant estimations and present value calculations were used for the purpose of this note. Changes in assumptions could significantly affect these estimates.

Estimated fair values have been determined by using the best available data and an estimation methodology suitable for each category of financial instruments as follows:

Cash and Cash Equivalents, Accrued Interest Receivable and Accrued Interest Payable (Carried at Cost). The carrying amounts reported in the balance sheet for cash and cash equivalents, accrued interest receivable and accrued interest payable approximate fair value.

Securities Held to Maturity (Carried at Amortized Cost). The fair values of securities held to maturity are determined in the same manner as for securities available for sale.

Loans Held For Sale (Carried at Lower of Aggregated Cost or Fair Value). The fair values of loans held for sale are determined, when possible, using quoted secondary market prices. If no such quoted market prices exist, fair values are determined using quoted prices for similar loans, adjusted for the specific attributes of the loans.

Gross Loans Receivable (Carried at Cost). The fair values of loans, excluding impaired loans subject to specific loss reserves, are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying values.

Deposit Liabilities (Carried at Cost). The fair values disclosed for demand deposits (e.g., interest and non-interest demand and savings accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Borrowings and Subordinated Debentures (Carried at Cost). The carrying amounts of short-term borrowings approximate their fair values. The fair values of long-term FHLB advances and subordinated debentures are estimated using discounted cash flow analysis, based on quoted or estimated interest rates for new borrowings with similar credit risk characteristics, terms and remaining maturity.

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The estimated fair values, and the recorded book balances, were as follows:

	September 30, 2011		December 31, 2010	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Cash and cash equivalents	$ 14,444,073	$ 14,444,073	17,710,501	$ $17,710,501
Securities available for sale	96,309,859	96,309,859	85,470,993	85,470,993
Securities held to maturity	152,474,688	158,148,341	81,889,895	81,712,003
Loans held for sale	9,848,248	9,848,248	21,219,230	21,219,230
Gross loans	426,435,830	426,426,000	411,987,339	410,144,000
Accrued interest receivable	2,464,715	2,464,715	2,405,741	2,405,741
Deposits	(645,404,853)	(647,336,000)	(543,735,149)	(545,225,000)
Other borrowings	(19,000,00)	(20,889,000)	(25,900,000)	(27,979,000)
Redeemable subordinated debentures	(18,557,000)	(18,557,000)	(18,557,000)	(18,557,000)
Interest rate swap contract	-	-	(353,552)	(353,552)
Accrued interest payable	(1,100,956)	(1,100,956)	(1,434,338)	(1,434,338)

Loan commitments and standby letters of credit as of September 30, 2011 and December 31, 2010 are based on fees charged for similar agreements; accordingly, the estimated fair value of loan commitments and standby letters of credit is nominal.

(11) Derivative Financial Instruments

The use of derivative financial instruments creates exposure to credit risk. This credit risk relates to losses that would be recognized if the counterparts fail to perform their obligations under the contracts. As part of the Company’s interest rate risk management process, the Company entered into an interest rate derivative contract effective November 27, 2007. Interest rate derivative contracts are typically used to limit the variability of the Company’s net interest income that could result due to shifts in interest rates. This derivative interest rate contract was an interest rate swap used to modify the repricing characteristics of a specific liability. This contract matured on June 15, 2011 and was not renewed by the Company. At December 31, 2010, the Company’s position in derivative contracts consisted entirely of this interest rate swap.

Maturity	Hedged Liability	Notional Amounts	Swap Fixed Interest Rates	Swap Variable Interest Rates
June 15, 2011	Subordinated Debenture	$18,000,000	5.87%	3 month LIBOR plus 165 basis points

During 2006, the Company issued trust preferred securities to fund loan growth and generate liquidity. In conjunction with the trust preferred securities issuance, the Company entered into a $18.0 million pay fixed swap designated as fair value hedges that was used to convert floating rate quarterly interest payments indexed to three month LIBOR, based on common notional amounts and maturity dates. The pay fixed swap changed the repricing characteristics of the quarterly interest payments from floating rate to fixed rate. The fair value of the pay fixed swap outstanding at December 31, 2010 was ($353,552), and was recorded in other liabilities in the consolidated balance sheet, with the change in fair value, net of deferred taxes, recorded through Other Comprehensive Income.

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

The purpose of this discussion and analysis of the operating results and financial condition at September 30, 2011 is intended to help readers analyze the accompanying financial statements, notes and other supplemental information contained in this document. Results of operations for the three month and nine month periods ended September 30, 2011 are not necessarily indicative of results to be attained for any other period.

This discussion and analysis should be read in conjunction with the Consolidated Financial Statements, notes and tables included elsewhere in this report and Part II, Item 7 of the Company's Form 10-K (Management's Discussion and Analysis of Financial Condition and Results of Operations) for the year ended December 31, 2010, as filed with the Securities and Exchange Commission (the "SEC") on March 23, 2011.

General

Throughout the following sections, the "Company" refers to 1st Constitution Bancorp and, as the context requires, its wholly-owned subsidiary, 1st Constitution Bank (the "Bank") and the Bank's wholly-owned subsidiaries, 1st Constitution Investment Company of Delaware, Inc., 1st Constitution Investment Company of New Jersey, Inc., FCB Assets Holdings, Inc., 1st Constitution Title Agency, LLC, Riverside Lofts, LLC and 249 New York Avenue, LLC. 1st Constitution Capital Trust II ("Trust II"), a subsidiary of the Company, is not included in the Company's consolidated financial statements as it is a variable interest entity and the Company is not the primary beneficiary.

The Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company was organized under the laws of the State of New Jersey in February 1999 for the purpose of acquiring all of the issued and outstanding stock of the Bank, a full service commercial bank which began operations in August 1989, and thereby enabling the Bank to operate within a bank holding company structure. The Company became an active bank holding company on July 1, 1999. The Bank is a wholly-owned subsidiary of the Company. Other than its ownership interest in the Bank, the Company currently conducts no other significant business activities.

The Bank operates fourteen branches, and manages an investment portfolio through its subsidiaries, 1st Constitution Investment Company of Delaware, Inc. and 1st Constitution Investment Company of New Jersey, Inc. FCB Assets Holdings, Inc., a subsidiary of the Bank, is used by the Bank to manage and dispose of repossessed real estate.

Trust II, a subsidiary of the Company, was created in May 2006 to issue trust preferred securities to assist the Company to raise additional regulatory capital.

Forward-Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward looking statements. When used in this and in future filings by the Company with the SEC, in the Company's press releases and in oral statements made with the approval of an authorized executive officer of the Company, the words or phrases "will," "will likely result," "could," "anticipates," "believes," "continues," "expects," "plans," "will continue," "is anticipated," "estimated," "project" or "outlo expressions (including confirmations by an authorized executive officer of the Company of any such expressions made by a third party with respect to the Company) are intended to identify forward-looking statements. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, each of which speak only as of the date made. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected.

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Factors that may cause actual results to differ from those results expressed or implied, include, but are not limited to, those listed under “Business”, “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in the Company’s Annual Report on Form 10-K filed with the SEC on March 23, 2011 and in other filings made by the Company with the SEC, such as the overall economy and the interest rate environment; the ability of customers to repay their obligations; the adequacy of the allowance for loan losses; competition; significant changes in accounting, tax or regulatory practices and requirements; certain interest rate risks; risks associated with investments in mortgage-backed securities; and risks associated with speculative construction lending. Although management has taken certain steps to mitigate any negative effect of the aforementioned items, significant unfavorable changes could severely impact the assumptions used and could have an adverse effect on profitability. The Company undertakes no obligation to publicly revise any forward-looking statements to reflect anticipated or unanticipated events or circumstances occurring after the date of such statements, except as required by law.

Recent Developments

On March 25, 2011, the Bank acquired certain deposit and other liabilities, real estate and related assets of the Rocky Hill, Hillsborough and Hopewell, New Jersey branch banking offices from another financial institution for a purchase price of $9.85 million (the “March 2011 Acquisition”). The March 2011 Acquisition was completed pursuant to the terms and conditions of the Branch Purchase and Assumption Agreement and Agreement for Purchase dated as of December 30, 2010, which was previously disclosed on a Current Report on Form 8-K filed by the Company with the SEC on January 3, 2011.

As a result of the March 2011 Acquisition, the three branches became branches of the Bank. Included in the March 2011 Acquisition were the assumption of deposit liabilities of $111.9 million, primarily consisting of demand deposits, and the acquisition of cash of approximately $101.5 million, fixed assets of approximately $4.6 million, which includes, without limitation, ownership of the real estate and improvements upon which the branches are situated, and loans of $862,000. The Bank recorded goodwill of approximately $3.2 million and a core deposit intangible asset of approximately $1.7 million as a result of the March 2011 Acquisition.

RESULTS OF OPERATIONS

Three Months Ended September 30, 2011 Compared to the Three Months Ended September 30, 2010

Summary

The Company realized net income of $1,213,278 for the three months ended September 30, 2011, an increase of $331,679, or 37.6%, from the $881,599 reported for the three months ended September 30, 2010. The increase is due primarily to increases in net interest income after provision for loan losses and noninterest income and a lower provision for loan losses in the 2011 period which, in total, offset an increase in non-interest expenses for the three months ended September 30, 2011 compared to the same period in 2010. Net income per diluted common share was $0.25 for the three months ended September 30, 2011 compared to net income per diluted common share of $0.15 for the three months ended September 30, 2010. Net income available to common shareholders increased from $704,615 for the three months ended September 30, 2010 to $1,213,278 for the three months ended September 30, 2011. Net income available to common shareholders for the three months ended September 30, 2010 reflected an aggregate of $176,984 attributable to dividends and discount accretion related to the preferred stock issued to the United States Department of the Treasury (the “Treasury”) under the TARP Capital Purchase Program in December 2008. On October 27, 2010, the Company repurchased from the Treasury all of the outstanding shares of the Company’s preferred stock issued to the Treasury for an aggregate purchase price (including accrued and unpaid dividends) of $12,120,000. All prior year share information has been adjusted for the effect of a 5% stock dividend declared on December 16, 2010 and paid on February 2, 2011 to shareholders of record on January 18, 2011.

Key performance ratios improved for the three months ended September 30, 2011 compared to the three months ended September 30, 2010 due to higher net income for the 2011 period. Return on average assets and return on average equity were 0.65% and 9.14% for the three months ended September 30, 2011 compared to 0.51% and 5.82%, respectively, for the three months ended September 30, 2010.

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The Bank's results of operations depend primarily on net interest income, which is primarily affected by the market interest rate environment, the shape of the U.S. Treasury yield curve, and the difference between the yield on interest-earning assets and the rate paid on interest-bearing liabilities. Other factors that may affect the Bank's operating results are general and local economic and competitive conditions, government policies and actions of regulatory authorities. The net interest margin on a tax-equivalent basis for the three months ended September 30, 2011 was 3.49% as compared to the 3.42% net interest margin recorded for the three months ended September 30, 2010, an increase of 7 basis points. The Company will continue to closely monitor the mix of earning assets and funding sources to maximize net interest income during this challenging interest rate environment.

Earnings Analysis

Net Interest Income

Net interest income, the Company's largest and most significant component of operating income, is the difference between interest and fees earned on loans and other earning assets, and interest paid on deposits and borrowed funds. This component represented 82.6% of the Company's net revenues for the three month period ended September 30, 2011 and 84.8% of net revenues for the three-month period ended September 30, 2010. Net interest income also depends upon the relative amount of average interest-earning assets, average interest-bearing liabilities, and the interest rate earned or paid on them, respectively.

The Company's net interest income increased by $302,224, or 5.5%, to $5,845,471 for the three months ended September 30, 2011 from the $5,543,247 reported for the three months ended September 30, 2010. The increase in net interest income was primarily attributable to lower rates paid on interest-bearing liabilities during the current period. The average rate paid on interest-bearing liabilities for the three months ended September 30, 2011 was 1.22%, a reduction of 40 basis points compared to 1.62% paid for the three months ended September 30, 2010.

Average interest earning assets increased by $38,911,333, or 6.0%, to $688,407,360 for the three month period ended September 30, 2011 from $649,496,027 for the three month period ended September 30, 2010. However, the overall yield on interest earning assets, on a tax-equivalent basis, decreased 30 basis points to 4.43% for the three month period ended September 30, 2011 when compared to 4.73% for the three month period ended September 30, 2010.

Average interest bearing liabilities increased by $2,743,281, or 13.5%, to $528,744,576 for the three month period ended September 30, 2011 from $526,001,295 for the three month period ended September 30, 2010. Overall, the cost of total interest bearing liabilities decreased 40 basis points to 1.22% for the three months ended September 30, 2011 compared to 1.62% for the three months ended September 30, 2010.

The net interest margin (on a tax-equivalent basis), which is net interest income divided by average interest earning assets, was 3.49% for the three months ended September 30, 2011 compared to 3.42% the three months ended September 30, 2010.

Provision for Loan Losses

Management considers a complete review of the following specific factors in determining the provisions for loan losses: historical losses by loan category, non-accrual loans, and problem loans as identified through internal classifications, collateral values, and the growth and size of the loan portfolio. In addition to these factors, management takes into consideration current economic conditions and local real estate market conditions. Using this evaluation process, the Company's provision for loan losses was $608,332 for the three months ended September 30, 2011 and $875,000 for the three months ended September 30, 2010. The reduced provision was the result of the risk profile of the loan portfolio being reduced by a change in its composition via a $15,048,688 reduction in higher risk construction loans, and non-performing loans decreasing by $3,321,148 since December 31, 2010.

Non-Interest Income

Total non-interest income for the three months ended September 30, 2011 was $1,229,264, an increase of $232,567, or 23.3%, over non-interest income of $996,697 for the three months ended September 30, 2010. A significant portion of the increase in total non-interest income and its major components when compared with non-interest expense for the prior period is attributable to the March 2011 Acquisition.

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Service charges on deposit accounts represent a consistent source of non-interest income. Service charge revenues increased to $237,716 for the three months ended September 30, 2011 from $185,242 for the three months ended September 30, 2010. This increase is primarily the result of the increase in the number of deposit accounts subject to service charges due to the March 2011 Acquisition.

Gain on sales of loans held for sale increased by $91,605, or 22.0%, to $508,359 for the three months ended September 30, 2011 when compared to $416,754 for the three months ended September 30, 2010. The Bank sells both residential mortgage loans and Small Business Administration loans in the secondary market. During the second quarter of 2011, the Bank revised its pricing on mortgage loan sales and now requires a 160 basis points return on sale transactions compared to the 110 basis points return requirement that existed in the year ended December 31, 2010.

Non-interest income also includes income from bank-owned life insurance (“BOLI”), which amounted to $100,980 for the three months ended September 30, 2011 compared to $102,791 for the three months ended September 30, 2010, a decrease of $1,811 for the third quarter of 2011 as compared to the third quarter of 2010. The Bank purchased tax-free BOLI assets to partially offset the cost of employee benefit plans and reduced the Company’s overall effective tax rate.

The Bank also generates non-interest income from a variety of fee-based services. These include safe deposit box rental, wire transfer service fees and Automated Teller Machine fees for non-Bank customers. Customer demand for these services, including at the three branches acquired in March 2011, contributed to the other income component of non-interest income amounting to $382,209 for the three months ended September 30, 2011, compared to $291,910 for the three months ended September 30, 2010, an increase of $90,299 for the third quarter of 2011 as compared to the third quarter of 2010.

Non-Interest Expense

Non-interest expenses increased by $384,170, or 8.8%, to $4,756,467 for the three months ended September 30, 2011 from $4,372,297 for the three months ended September 30, 2010. The March 2011 Acquisition was the primary cause for this current period increase in total noninterest expense and each of its major components when compared with noninterest expense for the prior period.

The following table presents the major components of non-interest expenses for the three months ended September 30, 2011 and 2010.

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Non-interest Expenses

	Three months ended September 30,	
	2011	2010
Salaries and employee benefits	$ 2,892,901	$ 2,532,427
Occupancy expenses	628,652	499,745
Data processing services	295,739	284,554
Equipment expense	199,563	176,262
Marketing	54,662	31,791
Regulatory, professional and other fees	215,138	300,316
Office expense	178,343	153,159
FDIC insurance expense	29,805	94,034
Directors' fees	18,500	21,500
Other real estate owned expenses	106,278	56,279
Amortization of intangible assets	76,170	9,178
Other expenses	60,716	213,052
	$ 4,756,467	$ 4,372,297

Salaries and employee benefits, which represent the largest portion of non-interest expenses, increased by $360,474, or 14.2%, to $2,892,901 for the three months ended September 30, 2011 compared to $2,532,427 for the three months ended September 30, 2010. The increase in salaries and employee benefits for the three months ended September 30, 2011 was a result of an increase in the number of employees, regular merit increases and increased health care costs. Staffing levels overall increased to 145 full-time equivalent employees at September 30, 2011 as compared to 134 full-time equivalent employees at September 30, 2010. The number of full-time equivalent employees at September 30, 2011 includes 13 full-time equivalent employees added as a result of the March 2011 Acquisition.

Occupancy expenses increased by $128,907, or 25.8%, to $628,652 for the three months ended September 30, 2011 compared to $499,745 for the three months ended September 30, 2010. In addition to the operating costs of the three new branches, the increase in expense was primarily attributable to increased depreciation, property taxes and maintenance costs in maintaining the Bank's branch properties.

The cost of data processing services increased by $11,185, or 3.9%, to $295,739 for the three months ended September 30, 2011 from $284,554 for the three months ended September 30, 2010, as additional expenses were incurred to convert and maintain the three new branch offices acquired in the March 2011 Acquisition to the Bank's data systems.

Equipment expense increased by $23,301, or 15.8%, to $199,563 for the three months ended September 30, 2011 from $176,262 for the three months ended September 30, 2010 primarily due to an increase in the number of maintenance contracts on equipment in the three new acquired branches as compared with the prior year period.

Marketing expense increased by $22,871, or 71.9%, to $54,662 for the three months ended September 30, 2011 compared to $31,791 for the three months ended September 30, 2010, as the Bank resumed the use of radio broadcast media in promoting products and services during 2011.

Regulatory, professional and other fees decreased by $85,178 for the three months ended September 30, 2011 to $215,138 compared to $300,316 for the three months ended September 30, 2010. Legal and consulting fees were incurred during the three month period ended September 30, 2010 in connection with the analysis and planning stages of the March 2011 Acquisition.

Office expense increased by $25,184, or 16.4%, to $178,343 for the three months ended September 30, 2011 from $153,159 for the three months ended September 30, 2010 primarily due to increases in office supplies and telephone expenses for the three newly acquired branch offices in the 2011 period.

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FDIC insurance expense decreased to $29,805 for the three months ended September 30, 2011 compared to $94,034 for the three months ended September 30, 2010 as a result of the impact of the recently effective Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"). The Dodd-Frank Act changed the base for FDIC deposit insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a financial institution, rather than on deposits.

Other real estate owned expenses increased by $49,999, to $106,278 for the three months ended September 30, 2011 compared to $56,279 for the three months ended September 30, 2010, as the Company incurred maintenance expenses on more properties during the third quarter of 2011 than during the third quarter of 2010.

Amortization of intangible assets expense increased to $76,170 for the three months ended September 30, 2011 compared to $9,178 for the three months ended September 30, 2010, as the expenses for the current period includes amortization of the $1.7 million core deposit intangible asset resulting from the March 2011 Acquisition.

All other expenses decreased by $152,336, to $60,716 for the three months ended September 30, 2011 compared to $213,052 for the three months ended September 30, 2010. Included in this component is the credit recorded to defer the direct costs of originating loans as required under generally accepted accounting principles. During the third quarter of 2011, the increased activity in the Mortgage Warehouse lines was such that direct origination costs were deferred on 2,679 new loans originated during the quarter as compared to 1,763 new loans during the comparable period of 2010.

An important financial services industry productivity measure is the efficiency ratio. The efficiency ratio is calculated by dividing total operating expenses by net interest income plus non-interest income. An increase in the efficiency ratio indicates that more resources are being utilized to generate the same or greater volume of income, while a decrease would indicate a more efficient allocation of resources. The Company's efficiency ratio increased to 67.2% for the three months ended September 30, 2011, compared to 66.9% for the three months ended September 30, 2010.

Income Taxes

Income tax expense increased by $85,610 to $496,658 for the three months ended September 30, 2011 from $411,048 for the three months ended September 30, 2010. The increase was primarily due to an increased level of pretax income for the third quarter of 2011 as compared to the third quarter of 2010.

Nine Months Ended September 30, 2011 Compared to the Nine Months Ended September 30, 2010

Summary

The Company realized net income of $2,832,060 for the nine months ended September 30, 2011, an increase of 19.2% from the $2,376,416 reported for the nine months ended September 30, 2010. The increase is due primarily to increases in net interest income after provision for loan losses and noninterest income and a lower provision for loan losses in the 2011 period which, in total, offset an increase in noninterest expenses for the nine months ended September 30, 2011 compared to the same period in 2010. Net income available to common shareholders for the nine months ended September 30, 2011 increased to $2,832,060 from $1,845,464 for the nine months ended September 30, 2010 principally for the reasons indicated above. Net income available to common shareholders for the nine months ended September 30, 2010 also reflected an aggregate of $530,952 attributable to dividends and discount accretion related to the preferred stock issued to the United States Department of Treasury (the "Treasury") under the TARP Capital Purchase Program in December 2008. On October 27, 2010, the Company repurchased from the Treasury all of the outstanding shares of the Company's preferred stock issued to the Treasury for an aggregate purchase price (including accrued and unpaid dividends) of $12,120,000.

Diluted net income per common share was $0.58 for the nine months ended September 30, 2011 compared to diluted net income per common share of $0.38 for the nine months ended September 30, 2010. All prior year share information has been adjusted for the effect of a 5% stock dividend declared on December 16, 2010, and paid on February 2, 2011 to shareholders of record on January 18, 2011.

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Key performance ratios improved for the nine months ended September 30, 2011 as compared to the nine months ended September 30, 2010 due to higher net income for the 2011 period. Return on average assets and return on average equity were 0.53% and 7.43% for the nine months ended September 30, 2011 compared to 0.48% and 5.40%, respectively, for the nine months ended September 30, 2010.

The Bank's results of operations depend primarily on net interest income, which is primarily affected by the market interest rate environment, the shape of the U.S. Treasury yield curve, and the difference between the yield on interest-earning assets and the rate paid on interest-bearing liabilities. Other factors that may affect the Bank's operating results are general and local economic and competitive conditions, government policies and actions of regulatory authorities. The net interest margin for the nine months ended September 30, 2011 was 3.44% as compared to the 3.18% net interest margin recorded for the nine months ended September 30, 2010, an increase of 26 basis points. The Company continues to closely monitor the mix of earning assets and funding sources to maximize net interest income during this challenging interest rate environment.

Earnings Analysis

Net Interest Income

Net interest income, the Company's largest and most significant component of operating income, is the difference between interest and fees earned on loans and other earning assets, and interest paid on deposits and borrowed funds. This component represented 82.7% of the Company's net revenues for the nine month period ended September 30, 2011 and 83.4% of net revenues for the nine-month period ended September 30, 2010. Net interest income also depends upon the relative amount of interest-earning assets, interest-bearing liabilities, and the interest rate earned or paid on them.

The following table sets forth the Company's consolidated average balances of assets, liabilities and shareholders' equity as well as interest income and expense on related items, and the Company's average yield or rate for the nine month periods ended September 30, 2011 and 2010, respectively. The average rates are derived by dividing interest income and expense by the average balance of assets and liabilities, respectively.

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Average Balance Sheets with Resultant Interest and Rates

(yields on a tax-equivalent basis)	Nine months ended Sept. 30, 2011			Nine months ended Sept. 30, 2010		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
Assets:						
Federal Funds Sold/Short-Term Investments	$ 56,991,124	$ 115,634	0.27%	$ 20,372,193	$ 37,278	0.24%
Investment Securities:						
Taxable	204,200,184	4,154,352	2.72%	208,285,561	3,843,035	2.47%
Tax-exempt	42,721,991	1,584,040	4.96%	11,067,976	475,098	5.74%
Total	246,922,175	5,738,392	3.11%	219,353,537	4,318,133	2.63%
Loan Portfolio:						
Construction	62,875,175	2,970,476	6.32%	72,139,313	3,358,463	6.22%
Residential real estate	10,858,304	533,740	6.57%	11,041,367	483,930	5.86%
Home Equity	12,290,937	527,882	5.74%	13,688,792	598,498	5.85%
Commercial and commercial real estate	132,440,731	7,529,942	7.60%	139,894,364	7,742,564	7.40%
Mortgage warehouse lines	105,876,852	3,913,791	4.94%	123,355,017	4,465,835	4.84%
Installment	443,537	23,107	6.97%	550,213	31,148	7.57%
All Other Loans	22,375,013	655,059	3.91%	29,064,357	733,985	3.38%
Total	347,160,549	16,153,997	6.22%	389,733,423	17,414,422	5.97%
Total Interest-Earning Assets	651,073,848	22,008,023	4.52%	629,459,153	21,769,833	4.62%
Allowance for Loan Losses	(5,969,108)			(4,972,160)		
Cash and Due From Bank	21,523,149			9,135,919		
Other Assets	42,225,020			29,175,788		
Total Assets	$ 708,852,909			$ 662,798,700		
Interest-Bearing Liabilities:						
Money Market and NOW Accounts	$ 165,857,287	$ 1,324,442	1.07%	$ 117,938,902	$ 1,287,427	1.46%
Savings Accounts	178,820,407	1,074,145	0.80%	177,675,049	1,501,080	1.13%
Certificates of Deposit	156,192,797	1,967,080	1.68%	162,795,637	2,341,292	1.92%
Other Borrowed Funds	11,317,033	315,481	3.73%	35,397,949	853,898	3.23%

Trust Preferred Securities	18,557,000	589,497	4.25%	18,557,000	801,255	5.77%
Total Interest-Bearing Liabilities	530,744,524	5,270,645	1.33%	512,364,537	6,784,952	1.77%
Net Interest Spread			3.19%			2.85%
Demand Deposits	118,142,996			84,035,263		
Other Liabilities	9,025,774			7,546,612		
Total Liabilities	657,913,294			603,946,412		
Shareholders' Equity	50,939,615			58,852,288		
Total Liabilities and Shareholders' Equity	$ 708,852,909			$ 662,798,700		
Net Interest Margin		$ 16,737,378	3.44%		$ 14,984,881	3.18%

The Company's net interest income increased by $1,392,840, or 9.4%, to $16,223,635 for the nine months ended September 30, 2011 from the $14,830,795 reported for the nine months ended September 30, 2010. The increase in net interest income was attributable to an increased investment portfolio volume combined with lower rates paid on interest-bearing liabilities volume, which was more than sufficient to offset the reduced volume of the loan portfolio.

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Average interest earning assets increased by $21,614,695, or 3.4%, to $651,073,848 for the nine month period ended September 30, 2011 from $629,459,153 for the nine month period ended September 30, 2010. The average investment securities portfolio increased by $27,568,638, or 12.6%, to $246,922,175 for the nine month period ended September 30, 2011 compared to $219,353,537 for the nine month period ended September 30, 2010, as funds were invested during the 2011 period in low risk U.S. Treasury securities, U.S. Government sponsored agency bonds and obligations of states and political subdivisions rather than being invested in the relatively higher risk loan portfolio. The average loan portfolio decreased by $42,572,874, or 10.9%, to $347,160,549 for the nine month period ended September 30, 2011 compared to $389,733,423 for the nine month period ended September 30, 2010. The overall risk profile of the loan portfolio was reduced by a change in its composition via a reduction in average construction loans of $9,264,138, or 12.8%, to $62,875,175 for the nine month period ended September 30, 2011 compared to $72,139,313 for the nine month period ended September 30, 2010, as the current adverse economic conditions have resulted in depreciation of collateral values securing these loans. Overall, the yield on interest earning assets, on a tax-equivalent basis, decreased 10 basis points to 4.52% for the nine month period ended September 30, 2011 when compared to 4.62% for the nine month period ended September 30, 2010.

Average interest bearing liabilities increased by $18,379,987, or 3.6%, to $530,744,524 for the nine month period ended September 30, 2011 from $512,364,537 for the nine month period ended September 30, 2010. Overall, the cost of total interest bearing liabilities decreased 44 basis points to 1.33% for the nine months ended September 30, 2011 compared to 1.77% for the nine months ended September 30, 2010.

The net interest margin (on a tax-equivalent basis), which is net interest income divided by average interest earning assets, was 3.44% for the nine months ended September 30, 2011 compared to 3.18% the nine months ended September 30, 2010.

Provision for Loan Losses

Management considers a complete review of the following specific factors in determining the provisions for loan losses: historical losses by loan category, non-accrual loans, and problem loans as identified through internal classifications, collateral values, and the growth and size of the loan portfolio. In addition to these factors, management takes into consideration current economic conditions and local real estate market conditions. Using this evaluation process, the Company’s provision for loan losses was $1,283,330 for the nine months ended September 30, 2011 and $1,725,000 for the nine months ended September 30, 2010. The reduced provision was the result the risk profile of the loan portfolio being reduced by a change in its composition via a $15,048,688 reduction in higher risk construction loans, and non-performing loans decreasing by $3,321,148 since December 31, 2010.

Non-Interest Income

Total non-interest income for the nine months ended September 30, 2011 was $3,394,324, an increase of $441,761, or 15.0%, over non-interest income of $2,952,563 for the nine months ended September 30, 2010. A significant portion of the increase in total non-interest income and its major components when compared with non-interest expense for the prior period is attributable to the March 2011 Acquisition.

Service charges on deposit accounts represent a significant source of non-interest income. Service charges on deposit accounts revenues increased by $98,186, or 17.8%, to $648,456 for the nine months ended September 30, 2011 from the $550,270 for the nine months ended September 30, 2010. This increase was primarily the result of an increase in the number of deposit accounts subject to service charges due to the March 2011 Acquisition, which was completed on March 25, 2011.

Gain on sales of loans increased by $226,866, or 20.1%, to $1,356,741 for the nine months ended September 30, 2011 when compared to $1,129,875 for the nine months ended September 30, 2010. The Bank sells both residential mortgage loans and SBA loans in the secondary market. Although the absolute volume of sales declined for the nine month period ended September 30, 2011 compared to the nine month period ended September 30, 2010, the Bank's pricing on these transactions was revised in the second quarter of 2011 such that the Bank earned a 160 basis points return on sales compared to a return of 110 basis points in the year ended December 31, 2010.

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on-interest income also includes income from bank-owned life insurance ("BOLI"), which amounted to $299,639 for the nine months ended September 30, 2011 compared to $304,486 for the nine months ended September 30, 2010. The Bank purchased tax-free BOLI assets to partially offset the cost of employee benefit plans and reduced the Company's overall effective tax rate.

The Bank also generates non-interest income from a variety of fee-based services. These include safe deposit box rental, wire transfer service fees and Automated Teller Machine fees for non-Bank customers. Customer demand for these services, including at the three new branches acquired earlier this year, contributed to the other income component of non-interest income amounting to $1,089,488 for the nine months ended September 30, 2011, compared to $967,932 for the nine months ended September 30, 2010.

Non-Interest Expense

Non-interest expenses increased by $1,789,751, or 14.0%, to $14,575,084 for the nine months ended September 30, 2011 from $12,785,333 for the nine months ended September 30, 2010. The March 2011 Acquisition was the primary cause for this current period increase in total noninterest expense and each of its major components when compared with the prior period noninterest expense. The following table presents the major components of non-interest expenses for the nine months ended September 30, 2011 and 2010.

Non-interest Expenses	Nine months ended September 30, 2011	2010
Salaries and employee benefits	$ 8,313,513	$ 7,326,361
Occupancy expenses	1,776,359	1,398,510
Data processing services	912,988	815,752
Equipment expense	564,733	496,143
Marketing	134,650	97,914
Regulatory, professional and other fees	699,373	741,456
Office expense	550,483	502,942
FDIC insurance expense	503,810	589,285
Directors' fees	67,500	75,000
Other real estate owned expenses	415,630	102,516
Amortization of intangible assets	143,162	27,534
All other expenses	492,883	611,920
	$ 14,575,084	$ 12,785,333

Salaries and employee benefits, which represent the largest portion of non-interest expenses, increased by $987,152, or 13.5%, to $8,313,513 for the nine months ended September 30, 2011 compared to $7,326,361 for the nine months ended September 30, 2010. The increase in salaries and employee benefits for the nine months ended September 30, 2011 was a result of an increase in the number of employees, regular merit increases and increased health care costs. Staffing levels overall increased to 145 full-time equivalent employees at September 30, 2011 as compared to 134 full-time equivalent employees at September 30, 2010. The number of full-time equivalent employees at September 30, 2011 includes 13 full-time equivalent employees added as a result of the March 2011 Acquisition.

Occupancy expenses increased by $377,849, or 27.0%, to $1,776,359 for the nine months ended September 30, 2011 compared to $1,398,510 for the nine months ended September 30, 2010. In addition to the operating costs of the three new branches, the increase in expense was primarily attributable to increased depreciation, property taxes and maintenance costs in maintaining the Bank's branch properties. In addition, the Bank's Lawrenceville, New Jersey branch office opened in May 2010 and nine months of operating expenses for this branch office are included in 2011 whereas 2010 includes only five months of expenses.

The cost of data processing services increased by $97,236, or 11.9%, to $912,988 for the nine months ended September 30, 2011 from $815,752 for the nine months ended September 30, 2010, as additional expenses were incurred to convert and maintain the three new branch offices acquired in the March 2011 Acquisition to the Bank's data systems.

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Equipment expense increased by $68,590, or 13.8%, to $564,733 for the nine months ended September 30, 2011 compared to $496,143 for the nine months ended September 30, 2010 primarily due to increased costs associated with the number of maintenance contracts on equipment in the three newly acquired branch offices as compared with the prior period.

Office expenses increased by $47,541, or 9.5%, to $550,483 for the nine months ended September 30, 2011 compared to $502,942 for the nine months ended September 30, 2010. The increase in expense was primarily attributable to the March 2011 Acquisition.

FDIC insurance expense decreased to $503,810 for the nine months ended September 30, 2011 compared to $589,285 for the nine months ended September 30, 2010 as a result of the impact of the recently effective Dodd-Frank Act.

Other real estate owned expenses increased by $313,114, to $415,630 for the nine months ended September 30, 2011 compared to $102,516 for the nine months ended September 30, 2010 as the Company recorded $147,178 in loss provisions during 2011 and incurred maintenance costs on more properties held as other real estate during the first nine months of 2011 as compared to the first nine months of 2010.

Amortization of intangible assets expense increased to $143,162 for the nine months ended September 30, 2011 compared to $27,534 for the nine months ended September 30, 2010, as the expense for the current period includes amortization of the $1.7 million core deposit intangible asset resulting from the March 2011 Acquisition.

All other expenses decreased by $119,037, to $492,883 for the nine months ended September 30, 2011 compared to $611,920 for the nine months ended September 30, 2010. Current year decreases occurred in correspondent bank fees, maintenance agreements and ATM operating expenses. All other expenses are comprised of a variety of operating expenses and fees as well as expenses associated with lending activities.

An important financial services industry productivity measure is the efficiency ratio. The efficiency ratio is calculated by dividing total operating expenses by net interest income plus non-interest income. An increase in the efficiency ratio indicates that more resources are being utilized to generate the same or greater volume of income, while a decrease would indicate a more efficient allocation of resources. The Company’s efficiency ratio increased to 74.3% for the nine months ended Sept 30, 2011, compared to 71.9% for the nine months ended September 30, 2010.

Income Taxes

The Company had income tax expense of $927,485 for the nine months ended Sept 30, 2011 compared to income tax expense of $896,609 for the nine months ended September 30, 2010. The increase in the income tax expense for the 2011 period was primarily due to the higher level of taxable income for the first nine months of 2011 as compared to the first nine months of 2010.

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Financial Condition

September 30, 2011 Compared with December 31, 2010

Total consolidated assets at September 30, 2011 were $742,460,564, representing an increase of $98,065,335, or 15.2%, from total consolidated assets of $644,395,229 at December 31, 2010. The increase in assets was primarily attributable to the March 2011 Acquisition, which was completed on March 25, 2011 and resulted in three former Amboy Bank branch banking offices becoming branches of the Bank. Included in the March 2011 Acquisition were the assumption of deposit liabilities of $111.9 million, primarily consisting of demand deposits, and the acquisition of cash of approximately $101.5 million, fixed assets of approximately $4.6 million, which includes, without limitation, ownership of the real estate and improvements upon which the branches are situated, and loans of $862,000. The Bank recorded goodwill of approximately $3.2 million and a core deposit intangible asset of approximately $1.7 million as a result of the March 2011 Acquisition.

Cash and Cash Equivalents

Cash and cash equivalents at September 30, 2011 totaled $14,444,073 compared to $17,710,501 at December 31, 2010. Cash and cash equivalents at September 30, 2011 consisted of cash and due from banks of $14,432,669 and Federal funds sold/short term investments of $11,404. The corresponding balances at December 31, 2010 were $17,699,103 and $11,398, respectively. To the extent that the Bank does not utilize funds for loan originations or securities purchases, the cash inflows accumulate in cash and cash equivalents.

Loans Held for Sale

Loans held for sale at September 30, 2011 amounted to $9,848,248 compared to $21,219,230 at December 31, 2010. The primary cause for this decrease was a high volume of sales of existing loans held for sale combined with a lower volume of mortgage loan refinance activity during the first nine months of 2011 compared with the level of activity during the last nine months of 2010. The amount of loans originated for sale was $83,022,941 for the first nine months of 2011 compared with $99,507,515 for the first nine months of 2010.

Investment Securities

Investment securities represented 33.5% of total assets at September 30, 2011 and 26.0% at December 31, 2010. Total investment securities increased $81,423,659, or 48.7%, to $248,784,547 at September 30, 2011 from $167,360,888 at December 31, 2010. Purchases of investments totaled $167,277,411 during the nine months ended September 30, 2011, which exceeded proceeds from calls and repayments totaling $86,521,880 during the period.

Securities available for sale are investments that may be sold in response to changing market and interest rate conditions or for other business purposes. Activity in this portfolio is undertaken primarily to manage liquidity and interest rate risk and to take advantage of market conditions that create more economically attractive returns. At September 30, 2011, securities available for sale totaled $96,309,859, which is an increase of $10,838,866, or 12.7 %, from securities available for sale totaling $85,470,993 at December 31, 2010.

At September 30, 2011, the securities available for sale portfolio had net unrealized gains of $3,020,234, compared to net unrealized gains of $1,145,540 at December 31, 2010. These unrealized gains are reflected, net of tax, in shareholders' equity as a component of accumulated other comprehensive income.

Securities held to maturity, which are carried at amortized historical cost, are investments for which there is the positive intent and ability to hold to maturity. At September 30, 2011, securities held to maturity were $152,474,688, an increase of $70,584,793, or 86.2 %, from $81,889,895 at December 31, 2010. The fair value of the held to maturity portfolio at September 30, 2010 was $158,148,341.

Due to the continued uncertain economic environment that includes historically low levels of market interest rates, proceeds from maturities and prepayments of securities during the first nine months of 2011 were reinvested primarily in the low risk tax-exempt obligations of states and political subdivision bonds (with credit support) component of the Bank's held to maturity portfolio. It is management's intention to hold these tax-exempt securities to their maturity.

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Loans

The Company's primary lending emphasis is the origination of commercial and commercial real estate loans and mortgage warehouse lines of credit. Based on the composition of our loan portfolio, the inherent primary risks are deteriorating credit quality, a decline in the economy, and a decline in New Jersey real estate market values. Any one, or a combination, of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

The following table sets forth the classification of loans by major category at September 30, 2011 and December 31, 2010.

Loan Portfolio Composition	September 30, 2011		December 31, 2010	
Component	Amount	% of total	Amount	% of total
Construction loans	$52,842,015	12%	$67,890,703	16%
Residential real estate loans	11,962,959	3%	10,435,038	3%
Commercial business	51,509,943	12%	54,733,172	13%
Commercial real estate	99,900,949	23%	95,277,814	23%
Mortgage warehouse lines	196,255,583	46%	169,575,899	41%
Loans to individuals	12,796,101	3%	13,349,036	3%
Deferred loan fees and costs	930,556	0%	543,753	0%
All other loans	237,724	0%	181,924	0%
	$426,435,830	100%	$411,987,339	100%

The loan portfolio increased by $14,448,491, or 3.5%, to $426,435,830 at September 30, 2011, compared to $411,987,339 at December 31, 2010. The mortgage warehouse lines portfolio increased by $26,679,684, or 15.7 %, to $196,255,583 at September 30, 2011 compared to $169,575,899 at December 31, 2010. This component's increase at September 30, 2011 compared to December 31, 2010 was principally the result of a lower level of market interest rates during the 2011 third quarter that resulted in another wave of mortgage refinance activity as homeowners sought to refinance existing mortgages at the lower current market rates.

The Bank's Mortgage Warehouse Funding Group offers a revolving line of credit that is available to licensed mortgage banking companies (the "Warehouse Line of Credit") and that we believe has been successful from inception in 2008. The Warehouse Line of Credit is used by mortgage bankers to originate one-to-four family residential mortgage loans that are pre-sold to the secondary mortgage market, which includes state and national banks, national mortgage banking firms, insurance companies and government-sponsored enterprises, including the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and others. On average, an advance under the Warehouse Line of Credit remains outstanding for a period of less than 30 days, with repayment coming directly from the sale of the loan into the secondary mortgage market. Interest (the spread between our borrowing cost and the rate charged to the client) and a transaction fee are collected by the Bank at the time of repayment. Additionally, customers of the Warehouse Line of Credit are required to maintain deposit relationships with the Bank that, on average, represent 10% to 15% of the loan balances.

A significant portion of our loan portfolio consists of the mortgage warehouse lines of credit. Risks associated with these loans include, without limitation, credit risks relating to the mortgage bankers that borrow from us, the risk of intentional misrepresentation or fraud by any of such mortgage bankers, changes in the market value of mortgage loans originated by the mortgage banker, the sale of which is the expected source of repayment of the borrowings under a warehouse line of credit, due to changes in interest rates during the time in warehouse, or unsalable or impaired mortgage loans so originated, which could lead to decreased collateral value and the failure of a purchaser of the mortgage loan to purchase the loan from the mortgage banker.

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The impact of interest rates on our mortgage warehouse business can be significant. Changes in interest rates can impact the number of residential mortgages originated and initially funded under mortgage warehouse lines of credit and thus our mortgage warehouse related revenues. A decline in mortgage rates generally increases the demand for mortgage loans. Conversely, in a constant or increasing rate environment, we would expect fewer loans to be originated. Although we use models to assess the impact of interest rates on mortgage related revenues, the estimates of net income produced by these models are dependent on estimates and assumptions of future loan demand, prepayment speeds and other factors which may overstate or understate actual subsequent experience. Further, the concentration of our loan portfolio on loans originated through our mortgage warehouse business increases the risk associated with our loan portfolio because of the concentration of loans in a single line of business, namely one-to-four family residential mortgage lending, and in a particular segment of that business, namely mortgage warehouse lending.

The ability of the Company to enter into larger loan relationships and management's philosophy of relationship banking are key factors in the Company's strategy for loan growth. The ultimate collectability of the loan portfolio and recovery of the carrying amount of real estate are subject to changes in the economic environment and real estate market in the Company's market region.

Non-Performing Assets

Non-performing assets consist of non-performing loans and other real estate owned. Non-performing loans are composed of (1) loans on a non-accrual basis, (2) loans which are contractually past due 90 days or more as to interest and principal payments but have not been classified as non-accrual, and (3) loans whose terms have been restructured to provide a reduction or deferral of interest and/or principal because of a deterioration in the financial position of the borrower.

The Bank's policy with regard to non-accrual loans is that generally, loans are placed on a non-accrual status when they are 90 days past due, unless these loans are well secured and in the process of collection or, regardless of the past due status of the loan, when management determines that the complete recovery of principal or interest is in doubt. Consumer loans are generally charged off after they become 120 days past due. Subsequent payments on loans in non-accrual status are credited to income only if collection of principal is not in doubt.

Non-performing loans decreased by $3,321,148 to $5,488,019 at September 30, 2011 from $8,809,167 at December 31, 2010. The major segments of non-accrual loans consist of commercial loans, commercial real estate loans and SBA loans, which are in the process of collection and residential real estate which is either in foreclosure or under contract to close after September 30, 2011. The table below sets forth non-performing assets and risk elements in the Bank's portfolio for the periods indicated.

As the table demonstrates, non-performing loans to total loans decreased to 1.29% at September 30, 2011 from 2.14% at December 31, 2010. Loan quality is still considered to be sound. This was accomplished through quality loan underwriting, a proactive approach to loan monitoring and aggressive workout strategies.

Non-Performing Assets and Loans	September 30, 2011	December 31, 2010
Non-Performing loans:		
Loans 90 days or more past due and still accruing	$ 0	$ 0
Non-accrual loans	5,488,019	8,809,167
Total non-performing loans	5,488,019	8,809,167
Other real estate owned	10,999,359	4,850,818

Total non-performing assets	$ 16,487,378	$ 13,659,985
Non-performing loans to total loans	1.29%	2.14%
Non-performing loans to total loans excluding mortgage warehouse lines	2.38%	3.63%
Non-performing assets to total assets	2.22%	2.12%
Non-performing assets to total assets excluding mortgage warehouse lines	3.02%	2.88%

Non-performing assets increased by $2,827,393 to $16,487,378 at September 30, 2011 from $13,659,985 at December 31, 2010. Other real estate owned increased by $6,148,541 to $10,999,359 at September 30, 2011 from $4,850,818 at December 31, 2010. Since December 31, 2010, the Bank has added $8,232,822 to other real estate owned and sold and transferred out of other real estate owned properties totaling approximately $1,937,103. In addition, during the nine months ended Sept 30, 2011, the Bank recorded a provision for loss on other real estate owned of $147,178.

Non-performing assets represented 2.22% of total assets at September 30, 2011 and 2.12% of total assets at December 31, 2010.

The Bank had no loans classified as restructured loans at September 30, 2011 or December 31, 2010.

Management takes a proactive approach in addressing delinquent loans. The Company's President meets weekly with all loan officers to review the status of credits past-due 10 days or more. An action plan is discussed for delinquent loans to determine the steps necessary to induce the borrower to cure the delinquency and restore the loan to a current status. Also, delinquency notices are system generated when loans are five days past-due and again at 15 days past-due.

In most cases, the Company's collateral is real estate and when the collateral is foreclosed upon, the real estate is carried at the lower of fair market value less the estimated selling costs or the initially recorded amount. The amount, if any, by which the recorded amount of the loan exceeds the fair market value of the collateral is a loss which is charged to the allowance for loan losses at the time of foreclosure or repossession. Resolution of a past-due loan can be delayed if the borrower files a bankruptcy petition because a collection action cannot be continued unless the Company first obtains relief from the automatic stay provided by the bankruptcy code.

Allowance for Loan Losses and Related Provision

The allowance for loan losses is maintained at a level sufficient to absorb estimated credit losses in the loan portfolio as of the date of the financial statements. The allowance for loan losses is a valuation reserve available for losses incurred or inherent in the loan portfolio and other extensions of credit. The determination of the adequacy of the allowance for loan losses is a critical accounting policy of the Company.

The Company's primary lending emphasis is the origination of commercial and commercial real estate loans and mortgage warehouse lines of credit. Based on the composition of the loan portfolio, the inherent primary risks are deteriorating credit quality, a decline in the economy, and a decline in New Jersey real estate market values. Any one, or a combination, of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

All, or part, of the principal balance of commercial and commercial real estate loans, and construction loans are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there is an amount deemed uncollectible. Because all identified losses are immediately charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

Management reviews the adequacy of the allowance on at least a quarterly basis to ensure that the provision for loan losses has been charged against earnings in an amount necessary to maintain the allowance at a level that is adequate based on management's assessment of probable estimated losses. The Company's methodology for assessing the adequacy of the allowance for loan losses consists of several key elements. These elements may include a specific reserve for doubtful or high risk loans, an allocated reserve, and an unallocated portion.

The Company consistently applies the following comprehensive methodology. During the quarterly review of the allowance for loan losses, the Company considers a variety of factors that include:

- General economic conditions.

- Trends in charge-offs.
- Trends and levels of delinquent loans.
- Trends and levels of non-performing loans, including loans over 90 days delinquent.
- Trends in volume and terms of loans.
- Levels of allowance for specific classified loans.
- Credit concentrations.

The methodology includes the segregation of the loan portfolio into loan types with a further segregation into risk rating categories. This allows for an allocation of the allowance for loan losses by loan type; however, the allowance is available to absorb any loan loss without restriction. Larger balance, non-homogeneous loans representing significant individual credit exposures are evaluated individually through the internal loan review process. It is this process that produces the watch list. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated. Based on these reviews, an estimate of probable losses for the individual larger-balance loans are determined, whenever possible, and used to establish loan loss reserves. In general, for non-homogeneous loans not individually assessed, and for homogeneous loans, such as residential mortgages and consumer credits, the loans are collectively evaluated based on delinquency status, loan type, and historical losses. These loan groups are then internally risk rated.

The watch list includes loans that are assigned a rating of special mention, substandard, doubtful and loss. Loans classified special mentions have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans rated as doubtful in whole, or in part, are placed in non-accrual status. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses.

The specific reserve for impaired loans is established for specific loans which have been identified by management as being high risk loan assets. These impaired loans are assigned a doubtful risk rating grade because the loan has not performed according to payment terms and there is reason to believe that repayment of the loan principal in whole, or part, is unlikely. The specific portion of the allowance is the total amount of potential unconfirmed losses for these individual doubtful loans. To assist in determining the fair value of loan collateral, the Company often utilizes independent third party qualified appraisal firms which in turn employ their own criteria and assumptions that may include occupancy rates, rental rates, and property expenses, among others.

The second category of reserves consists of the allocated portion of the allowance. The allocated portion of the allowance is determined by taking pools of loans outstanding that have similar characteristics and applying historical loss experience for each pool. This estimate represents the potential unconfirmed losses within the portfolio. Individual loan pools are created for commercial and commercial real estate loans, construction loans, and various types of loans to individuals. The historical estimation for each loan pool is then adjusted to account for current conditions, current loan portfolio performance, loan policy or management changes, or any other factor which may cause future losses to deviate from historical levels.

The Company also maintains an unallocated allowance. The unallocated allowance is used to cover any factors or conditions which may cause a potential loan loss but are not specifically identifiable. It is prudent to maintain an unallocated portion of the allowance because no matter how detailed an analysis of potential loan losses is performed, these estimates by definition lack precision. Management must make estimates using assumptions and information that is often subjective and changing rapidly.

Loans are placed in a non-accrual status when the ultimate collectability of principal or interest in whole, or part, is in doubt. Past-due loans contractually past-due 90 days or more for either principal or interest are also placed in non-accrual status unless they are both well secured and in the process of collection. Impaired loans are evaluated individually.

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The following table presents, for the periods indicated, an analysis of the allowance for loan losses and other related data.

Allowance for Loan Losses

	September 30, 2011	December 31, 2010	September 30, 2010
Balance, beginning of period	$5,762,712	$4,505,387	$4,505,387
Provision charged to operating expenses	1,283,330	2,325,000	1,725,000
Loans charged off :			
Construction loans	(1,319,455)	(450,000)	-
Residential real estate loans	-	-	-
Commercial and commercial real estate	(228,662)	(609,468)	(497,259)
Loans to individuals		(22,087)	(18,671)
Lease financing	-	-	(792)
All other loans	-	-	-
	(1,548,117)	(1,081,555)	(516,722)
Recoveries:			
Construction loans	6,478	-	-
Residential real estate loans	-	-	-
Commercial and commercial real estate	3,934	13,880	12,467
Loans to individuals	-	-	-
Lease financing	-	-	-
All other loans	-	-	-
	10,412	13,880	12,467
Net (charge offs) / recoveries	(1,537,705)	(1,067,675)	(504,255)
Balance, end of period	$5,508,337	$5,762,712	$5,726,132
Loans :			
At period end	$426,435,830	$411,987,339	$442,118,479
Average during the period	336,544,655	387,575,677	376,195,664
Net charge offs to average loans outstanding (annualized)	(0.61%)	(0.28%)	(0.18%)
Allowance for loan losses to :			
Total loans at period end	1.29%	1.40%	1.30%
Total loans at period end excluding mortgage warehouse lines	2.39%	2.38%	2.32%
Non-performing loans	100.37%	65.42%	64.45%

The Company's provision for loan losses was $1,283,330 for the nine months ended September 30, 2011 and $1,725,000 for the nine months ended September 30, 2010. While the risk profile of the loan portfolio was reduced by a $15,048,688 decrease in the construction loan portfolio at September 30, 2011 compared to the December 31, 2010 balance, the continuing adverse economic conditions that resulted in depreciation of collateral values securing construction and commercial loans necessitated the recorded provision. Also, management replenished the reserves to compensate for the current period net charge-offs. Net charge offs/recoveries amounted to a net charge-off of $1,537,706 for the nine months ended September 30, 2011.

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At September 30, 2011, the allowance for loan losses was $5,508,337 compared to $5,762,712 at December 31, 2010, a decrease of $254,375. The ratio of the allowance for loan losses to total loans at September 30, 2011 and December 31, 2010 was 1.29% and 1.40%, respectively. The allowance for loan losses as a percentage of non-performing loans was 65.42% at December 31, 2010, compared to 100.37% at September 30, 2011. Management believes the quality of the loan portfolio remains sound considering the economic climate and economy in the State of New Jersey and that the allowance for loan losses is adequate in relation to credit risk exposure levels.

Deposits

Deposits, which include demand deposits (interest bearing and non-interest bearing), savings deposits and time deposits, are a fundamental and cost-effective source of funding. The flow of deposits is influenced significantly by general economic conditions, changes in market interest rates and competition. The Bank offers a variety of products designed to attract and retain customers, with the Bank's primary focus being on building and expanding long-term relationships.

The following table summarizes deposits at September 30, 2011 and December 31, 2010.

	September 30, 2011	December 31, 2010
Demand		
Non-interest bearing	$ 156,822,951	$ 92,023,123
Interest bearing	158,777,333	129,869,045
Savings	180,952,975	165,388,564
Time	148,851,594	156,454,417
	$ 645,404,853	$ 543,735,149

At September 30, 2011, total deposits were $645,404,853, an increase of $101,669,704, or 18.7%, from $543,735,149 at December 31, 2010. The current period increase was due to the March 2011 Acquisition, in which the Bank assumed deposit liabilities of $111.9 million.

Borrowings

Borrowings are mainly comprised of Federal Home Loan Bank ("FHLB") borrowings and overnight funds purchased. These borrowings are primarily used to fund asset growth not supported by deposit generation. The balance of borrowings was $19,000,000 at September 30, 2011, consisting of FHLB long-term borrowings of $10,000,000 and overnight funds purchased of $9,000,000, and $25,900,000 at December 31, 2010, consisting of long-term FHLB borrowings of $10,000,000 and overnight funds purchased of $15,900,000.

The Bank has a fixed rate convertible advance from the FHLB in the amount of $10,000,000 that bears interest at the rate of 4.08%. This advance may be called by the FHLB quarterly at the option of the FHLB if rates rise and the rate earned by the FHLB is no longer a "market" rate. This advance is fully secured by marketable securities.

Shareholders' Equity and Dividends

Shareholders' equity increased by $4,570,294, or 9.2%, to $54,251,450 at September 30, 2011, from $49,681,156 at December 31, 2010. Tangible book value per common share was $10.15 at September 30, 2011 and $10.22 at December 31, 2010. The ratio of shareholders' equity to total assets was 7.31% and 7.71% at September 30, 2011 and December 31, 2010, respectively. The increase in shareholders' equity was primarily the result of net income available to common shareholders of $2,832,060 for the nine months ended September 30, 2011.

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In lieu of cash dividends to common shareholders, the Company (and its predecessor the Bank) has declared a stock dividend every year since 1992 and has paid such dividends every year since 1993. 5% stock dividends were declared in 2010 and 2009 and paid in 2011 and 2010, respectively.

The Company's common stock is quoted on the Nasdaq Global Market under the symbol "FCCY".

In 2005, the Company's board of directors authorized a common stock repurchase program that allows for the repurchase of a limited number of the Company's shares at management's discretion on the open market. The Company undertook this repurchase program in order to increase shareholder value. Disclosure of repurchases of Company shares, if any, made during the quarter ended September 30, 2011 is set forth under Part II, Item 2 of this report, "Unregistered Sales of Equity Securities and Use of Proceeds."

Actual capital amounts and ratios for the Company and the Bank as of September 30, 2011 and December 31, 2010 are as follows:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2011						
Company						
Total Capital to Risk Weighted Assets	$ 70,714,473	13.33%	$ 42,431,040	>8%	N/A	N/A
Tier 1 Capital to Risk Weighted Assets	64,754,782	12.21%	21,215,520	>4%	N/A	N/A
Tier 1 Capital to Average Assets	64,754,782	8.87%	29,213,334	>4%	N/A	N/A
Bank						
Total Capital to Risk Weighted Assets	$ 67,808,846	12.78%	$ 42,431,040	>8%	$ 53,038,800	>10%
Tier 1 Capital to Risk Weighted Assets	62,300,509	11.75%	21,215,520	>4%	31,823,280	>6%
Tier 1 Capital to Average Assets	62,300,509	8.57%	29,071,820	>4%	36,339,775	>5%
As of December 31, 2010						
Company						
Total Capital to Risk Weighted Assets	$ 72,736,033	14.43%	$ 40,335,354	>8%	N/A	N/A
Tier 1 Capital to Risk Weighted Assets	65,484,454	12.99%	20,167,677	>4%	N/A	N/A
Tier 1 Capital to Average Assets	65,484,454	9.63%	27,196,758	>4%	N/A	N/A
Bank						
Total Capital to Risk Weighted Assets	$ 70,084,660	15.46%	$ 40,272,800	>8%	$ 50,341,000	>10%
Tier 1 Capital to Risk Weighted Assets	64,321,948	14.37%	20,136,400	>4%	30,204,600	>6%
Tier 1 Capital to Average Assets	64,321,948	11.10%	27,054,854	>4%	33,818,567	>5%

The minimum regulatory capital requirements for financial institutions require institutions to have a Tier 1 capital to average assets ratio of 4.0%, a Tier 1 capital to risk weighted assets ratio of 4.0% and a total capital to risk weighted assets ratio of 8.0%. To be considered "well capitalized," an institution must have a minimum Tier 1 leverage ratio of 5.0%. At September 30, 2011, the ratios of the Company exceeded the ratios required to be considered well capitalized. It is management's goal to monitor and maintain adequate capital levels to continue to support asset growth and continue its status as a well capitalized institution.

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Liquidity

At September 30, 2011, the amount of liquid assets remained at a level management deemed adequate to ensure that contractual liabilities, depositors' withdrawal requirements, and other operational and customer credit needs could be satisfied.

Liquidity management refers to the Company's ability to support asset growth while satisfying the borrowing needs and deposit withdrawal requirements of customers. In addition to maintaining liquid assets, factors such as capital position, profitability, asset quality and availability of funding affect a bank's ability to meet its liquidity needs. On the asset side, liquid funds are maintained in the form of cash and cash equivalents, Federal funds sold, investment securities held to maturity maturing within one year, securities available for sale and loans held for sale. Additional asset-based liquidity is derived from scheduled loan repayments as well as investment repayments of principal and interest from mortgage-backed securities. On the liability side, the primary source of liquidity is the ability to generate core deposits. Short-term borrowings are used as supplemental funding sources when growth in the core deposit base does not keep pace with that of earnings assets.

The Bank has established a borrowing relationship with the FHLB which further supports and enhances liquidity. During 2010, FHLB replaced its Overnight Line of Credit and One-Month Overnight Re-pricing Line of Credit facilities available to member banks with a fully secured line of up to 50 percent of a bank's quarter-end total assets. Under the terms of this facility, the Bank's total credit exposure to FHLB cannot exceed 50 percent, or $364,715,278, of its total assets at June 30, 2011. In addition, the aggregate outstanding principal amount of the Bank's advances, letters of credit, the dollar amount of the FHLB's minimum collateral requirement for off-balance sheet financial contracts and advance commitments cannot exceed 30 percent of the Bank's total assets, unless the Bank obtains approval from FHLB's Board of Directors or its Executive Committee. These limits are further restricted by a member's ability to provide eligible collateral to support its obligations to FHLB as well as the ability to meet the FHLB's stock requirement. The Bank also maintains an unsecured federal funds line of $20,000,000 with a correspondent bank.

The Consolidated Statements of Cash Flows present the changes in cash from operating, investing and financing activities. At September 30, 2011, the balance of cash and cash equivalents was $14,444,073.

Net cash provided by operating activities totaled $14,729,743 for the nine months ended September 30, 2011 compared to net cash provided by operations of $8,092,270 for the nine months ended September 30, 2010. The primary source of funds is net income from operations adjusted for activity related to loans originated for sale, the provision for loan losses, depreciation expenses, and net amortization of premiums on securities.

Net cash used in investing activities totaled $1,117,459 for the nine months ended September 30, 2011 compared to $32,963,385 for the nine months ended September 30, 2010. The primary cause of the difference for the 2011 period compared to the 2010 period resulted from $101,539,588 in cash and cash equivalents acquired in the March 2011 Acquisition.

Net cash used in financing activities totaled $16,878,712 for the nine months ended September 30, 2011 compared to net cash provided by financing activities of $12,998,631 for the nine months ended September 30, 2011. The cash used in the 2011 period resulted primarily from a decrease in demand, savings and time deposits and repayment of borrowed funds.

The securities portfolios are also a source of liquidity, providing cash flows from maturities and periodic repayments of principal. For the nine months ended September 30, 2011, prepayments and maturities of investment securities totaled $86,521,880. Another source of liquidity is the loan portfolio, which provides a flow of payments and maturities.

Interest Rate Sensitivity Analysis

The largest component of the Company’s total income is net interest income, and the majority of the Company’s financial instruments are composed of interest rate-sensitive assets and liabilities with various terms and maturities. The primary objective of management is to maximize net interest income while minimizing interest rate risk. Interest rate risk is derived from timing differences in the re-pricing of assets and liabilities, loan prepayments, deposit withdrawals, and differences in lending and funding rates. Management actively seeks to monitor and control the mix of interest rate-sensitive assets and interest rate-sensitive liabilities.

The Company continually evaluates interest rate risk management opportunities, including the use of derivative financial instruments. Management believes that hedging instruments currently available are not cost-effective, and therefore, has focused its efforts on increasing the Bank's spread by attracting lower-cost retail deposits.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not required.

Item 4. Controls and Procedures.

The Company has established disclosure controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms and is accumulated and communicated to management, including the principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure.

The Company's principal executive officer and principal financial officer, with the assistance of other members of the Company's management, have evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this quarterly report. Based upon such evaluation, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures are effective as of the end of the period covered by this quarterly report.

The Company's principal executive officer and principal financial officer have also concluded that there was no change in the Company's internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) that occurred during the quarter ended September 30, 2011 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1A. Risk Factors.

Except as set forth below, there were no material changes to the Company's risk factors as discussed in Item 1A. Risk Factors, in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 23, 2011:

Add the following risk factor:

Our mortgage warehouse lending business represents a significant portion of our overall lending activity and is subject to numerous risks.

Our primary lending emphasis is the origination of commercial and commercial real estate loans and mortgage warehouse lines of credit. Based on the composition of our loan portfolio, the inherent primary risks are deteriorating credit quality, a decline in the economy, and a decline in New Jersey real estate market values. Any one, or a combination, of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

A significant portion of our loan portfolio consists of the mortgage warehouse lines of credit. Risks associated with these loans include, without limitation, (i) credit risks relating to the mortgage bankers that borrow from us, (ii) the risk of intentional misrepresentation or fraud by any of such mortgage bankers, (iii) changes in the market value of mortgage loans originated by the mortgage banker, the sale of which is the expected source of repayment of the borrowings under a warehouse line of credit, due to changes in interest rates during the time in warehouse, or (iv) unsalable or impaired mortgage loans so originated, which could lead to decreased collateral value and the failure of a purchaser of the mortgage loan to purchase the loan from the mortgage banker.

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The impact of interest rates on our mortgage warehouse business can be significant. Changes in interest rates can impact the number of residential mortgages originated and initially funded under mortgage warehouse lines of credit and thus our mortgage warehouse related revenues. A decline in mortgage rates generally increases the demand for mortgage loans. Conversely, in a constant or increasing rate environment, we would expect fewer loans to be originated. Although we use models to assess the impact of interest rates on mortgage related revenues, the estimates of net income produced by these models are dependent on estimates and assumptions of future loan demand, prepayment speeds and other factors which may overstate or understate actual subsequent experience. Further, the concentration of our loan portfolio on loans originated through our mortgage warehouse business increases the risk associated with our loan portfolio because of the concentration of loans in a single line of business, namely one-to-four family residential mortgage lending, and in a particular segment of that business, namely mortgage warehouse lending.

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

Issuer Purchases of Equity Securities

On July 21, 2005, the board of directors authorized a stock repurchase program under which the Company may repurchase in open market or privately negotiated transactions up to 5% of its common shares outstanding at that date. The Company undertook this repurchase program in order to increase shareholder value. The following table provides common stock repurchases made by or on behalf of the Company during the three months ended September 30, 2011, if any.

Issuer Purchases of Equity Securities (1)

Period		Total Number of Shares Purchased (2)	Average Price Paid Per Share (2)	Total Number of Shares Purchased As Part of Publicly Announced Plan or Program	Maximum Number of Shares That May Yet be Purchased Under the Plan or Program
Beginning	Ending				
July 1, 2011	July 31, 2011	-	-	-	170,222
August 1, 2011	August 31, 2011	943	$7.85	-	170,222
September 1, 2011	September 30, 2011	-	-	-	170,222
	Total	943	$7.85	-	170,222

(1) The Company's common stock repurchase program covers a maximum of 195,076 shares of common stock of the Company, representing 5% of the outstanding common stock of the Company on July 21, 2005, as adjusted for the subsequent common stock dividends.

(2) Represents shares of common stock repurchased from certain employees of the Company.

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Item 6. Exhibits.

31.1	*	Certification of Robert F. Mangano, principal executive officer of the Company, pursuant to Securities Exchange Act Rule 13a-14(a)
31.2	*	Certification of Joseph M. Reardon, principal financial officer of the Company, pursuant to Securities Exchange Act Rule 13a-14(a)
32	*	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, signed by Robert F. Mangano, principal executive officer of the Company, and Joseph M. Reardon, principal financial officer of the Company
101.INS	*	XBRL Instance DocumentX
101.SCH	*	XBRL Taxonomy Extension Schema DocumentX
101.CAL	*	XBRL Taxonomy Extension Calculation Linkbase DocumentX
101.DEF	*	XBRL Taxonomy Extension Definition Linkbase Document X
101.LAB	*	XBRL Taxonomy Extension Label Linkbase DocumentX
101.PRE	*	XBRL Taxonomy Extension Presentation Linkbase DocumentX

* Filed herewith.

X These interactive data files are being furnished as part of this Quarterly Report, and in accordance with Rule 402 of Regulation S-T, shall not be deemed filed for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under those sections.

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SIGNATURES

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

1ST CONSTITUTION BANCORP

Date: November 14, 2011	By:	/s/ ROBERT F. MANGANO Robert F. Mangano President and Chief Executive Officer (Principal Executive Officer)
Date: November 14, 2011	By:	/s/ JOSEPH M. REARDON Joseph M. Reardon Senior Vice President and Treasurer (Principal Financial and Accounting Officer)

st expense over the expected remaining lives of the ABS using the interest method.

Fixed Assets

Fixed assets represent furniture and fixtures, computer and office equipment, certain software costs and leasehold improvements, which are stated at cost less accumulated depreciation and amortization. Depreciation is computed on the straight-line basis over the estimated useful lives of the respective assets, ranging from three to five years.

Leasehold improvements are capitalized and amortized over the shorter of the respective lease terms or the estimated useful lives of the improvements.

The Company capitalizes certain costs of computer software developed or obtained for internal use and amortizes the amount over the estimated useful life of the software, generally not exceeding three years.

Purchased Management Contract

Purchased management contract relates to the CLO contract the Company purchased from Princeton Advisory Group, Inc. on September 8, 2010 and was included in other assets on the Consolidated Statements of Financial Condition at December 31, 2010. The purchased management contract is amortized over its estimated life. The Company tests the purchased management contract for impairment whenever events or changes in circumstances suggest that the asset's carrying value may not be fully recoverable. An impairment loss, calculated as the difference between the estimated fair value and the carrying value of the asset, is recognized if the sum of the estimated undiscounted cash flows relating to the asset is less than the corresponding carrying value. The CLO initiated liquidation proceedings in December 2011, which was completed in July 2012.

Income Taxes

The Company recognizes deferred tax assets and liabilities in accordance with ASC 740, Income Taxes, and are determined based upon the temporary differences between the financial reporting and tax basis of the Company's assets and liabilities using the tax rates and laws in effect when the differences are expected to reverse. Valuation allowances are established when necessary to reduce the deferred tax assets when it is more likely than not that a portion or all of the deferred tax assets will not be realized.

The Company's policy for recording interest and penalties associated with the tax audits or unrecognized tax benefits, if any, is to record such items as a component of income before taxes. Penalties, if incurred, would be recorded in "administration" and interest paid or received would be recorded in "interest and dividend expense" in the Consolidated Statements of Operations.

Stock-Based Compensation

The Company recognizes compensation cost for stock-based awards at their fair value on the date of grant and records compensation expense over the service period for awards expected to vest. Such grants are recognized as expense, net of estimated forfeitures.

Stock-based compensation includes restricted stock units and stock options granted under the Company's 2007 Equity Incentive Plan, and stock options granted under the Company's 2004 Equity Incentive Plan.

In accordance with generally accepted valuation practices for stock-based awards issued as compensation, the Company uses the Black-Scholes option-pricing model to calculate the fair value of option awards, although such models were originally developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions. The Black-Scholes model requires subjective assumptions regarding variables such as future stock price volatility, dividend yield and expected time to exercise, which greatly affect the calculated values.

The fair value of restricted stock units ("RSUs") is determined based on the closing price of the underlying stock on the grant date, discounted for future dividends not expected to be paid on unvested units during the vesting period. If applicable, a liquidity discount for post-vesting transfer restrictions is also applied.

Treasury Stock

The Company accounts for treasury stock under the cost method, using an average cost flow assumption, and includes treasury stock as a component of shareholders' equity.

Reclassification

Certain balances from prior years have been reclassified in order to conform to the current year presentation. The reclassifications had no impact on the Company’s financial position, net income or cash flows.

3. Recent Accounting Pronouncements

Accounting Standards Update (“ASU”) 2011-05: Presentation of Other Comprehensive Income was issued to increase the prominence of other comprehensive income in financial statements, by eliminating the option to report other comprehensive income in the statement of changes in stockholder's equity. The standard requires comprehensive income to be reported in either a single statement that presents the components of net income, the components of other comprehensive income, and total comprehensive income, or in two consecutive statements. The standard also required separate line items on the income statement for reclassification adjustments of items out of accumulated other comprehensive income into net income. This standard was scheduled to be effective for periods starting after December 15, 2011. However, ASU 2011-12: Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income deferred the effective date of the requirement to present separate line items on the income statement for reclassification adjustments of items out of accumulated other comprehensive income into net income. The Company adopted ASU 2011-05 effective January 1, 2012, which resulted in the disclosure of other comprehensive income as a stand alone statement outside the statement of changes in stockholder's equity.

ASU 2011-04: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in GAAP and International Financial Reporting Standards ("IFRS") gives fair value the same meaning between GAAP and IFRS, and improves consistency of disclosures relating to fair value. As a result of this standard, an entity is required to add more robust disclosures for fair value measurements categorized within Level 3 of the fair value hierarchy. The Company adopted ASU 2011-04 effective January 1, 2012, which resulted in additional disclosures within Note 4.

ASU 2011-11: Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities requires disclosures about financial instruments and derivative instruments that are either offset or subject to an enforceable master netting arrangement or similar agreement to enable financial statement users to understand the effect of those arrangements on the entity's financial position. The Company believes that the adoption of ASU No 2011-11 on January 1, 2013 will not have a material impact on its financial statement disclosures.

4. Fair Value Measurements

The following tables provide fair value information related to the Company's financial instruments at December 31, 2012 and 2011:

(In thousands)	At December 31, 2012 Carrying Value	At December 31, 2012 Fair Value	At December 31, 2011 Carrying Value	At December 31, 2011 Fair Value
Assets:				
Cash and cash equivalents	$ 67,075	67,075	$ 70,363	70,363
Marketable securities owned	14,347	14,347	24,309	24,309
Other investments	81,161	80,945	51,706	51,517
Loans held for sale	3,134	3,134	2,957	2,979
Small business loans	38,934	38,934	7,692	7,692
Loans collateralizing asset-backed securities issued, net of allowance for loan losses	401,003	412,029	410,770	420,155
Long term receivable	1,342	1,647	-	-
Total assets:	$ 606,996	$ 618,111	$ 567,797	$ 577,015
Liabilities:				
Marketable securities sold, but not yet purchased	$ 11,567	$ 11,567	$ 10,921	$ 10,921
Asset-backed securities issued	415,456	404,341	381,556	375,902
Note payable	10,486	10,486	19,222	19,222
Line of credit	28,227	28,227	-	-
Total liabilities:	$ 465,736	$ 454,621	$ 411,699	$ 406,045

The levels for the Company's financial instruments carried at fair value on a recurring basis are described in the tables below. The levels for other financial instruments are as follows:

- Cash and cash equivalents were identified as Level 1 assets at both December 31, 2011 and December 31, 2012.
- Loans held for sale were identified as Level 2 assets at both December 31, 2011 and December 31, 2012.
- Loans collateralizing asset-backed securities issued included $405.4 million identified as Level 2 assets and $14.8 million identified as Level 3 assets at December 31, 2011. At December 31, 2012, loans collateralizing asset-backed securities issued were comprised of $406.3 million identified as Level 2 assets and $5.7 million identified as Level 3 assets.
- Long term receivable was identified as Level 3 assets at both December 31, 2011 and December 31, 2012.
- Asset-backed securities issued are identified as Level 2 assets at both December 31, 2011 and December 31, 2012.
- Note payable was identified as Level 2 assets at both December 31, 2011 and December 31, 2012.
- Line of credit was identified as Level 2 assets at both December 31, 2011 and December 31, 2012.

Recurring Fair Value Measurement

The following tables provide information related to the Company's assets and liabilities carried at fair value on a recurring basis at December 31, 2012 and 2011:

(In thousands)	December 31, 2012			
	Level 1	Level 2	Level 3	Total
Marketable securities owned	$14,347	$-	$-	$14,347
Small business loans	-	3,487	35,447	38,934
Other investments:				
Investments in hedge funds managed by HCS	-	27,907	-	27,907
Investments in funds of funds managed by HCS	-	-	109	109
Total investment in funds managed by HCS	-	27,907	109	28,016
Limited partner investment in private equity fund	-	-	2,332	2,332
Warrants and other held at JMPS	-	-	413	413
Warrants and equity securities held at HCC	-	-	2,577	2,577
Equity securities in HGC, HGC II and JMP Capital	865	230	41,075	42,170
Forward purchase contract	-	-	5,437	5,437
Total other investments	865	28,137	51,943	80,945
Total assets:	$15,212	$31,624	$87,390	$134,226
Marketable securities sold, but not yet purchased	11,567	-	-	11,567
Total liabilities:	$11,567	$-	$-	$11,567

(In thousands)	December 31, 2011			
	Level 1	Level 2	Level 3	Total
Marketable securities owned	$24,309	$-	$-	$24,309
Small business loans	-	3,790	3,902	7,692
Other investments:				
Investments in hedge funds managed by HCS	-	24,072	-	24,072
Investments in funds of funds managed by HCS	-	-	102	102
Total investment in funds managed by HCS	-	24,072	102	24,174
Limited partner investment in private equity fund	-	-	2,585	2,585
Warrants and other	-	-	617	617
Equity securities in HGC and JMP Capital	3,426	-	20,707	24,133
Interest rate cap	8	-	-	8
Total other investments	3,434	24,072	24,011	51,517
Total assets:	$27,743	$27,862	$27,913	$83,518
Marketable securities sold, but not yet purchased	10,921	-	-	10,921
Total liabilities:	$10,921	$-	$-	$10,921

The following tables provide a reconciliation of the beginning and ending balances for the assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2012 and 2011:

(In thousands)	Balance as of December 31, 2011	Purchases	Sales	Total gains (losses) - realized and unrealized included in earnings (1)	Transfers in/(out) of Level 3	Balance as of December 31, 2012	Unrealized gains/(losses) included in earnings related to assets still held at reporting date
Investments in funds of funds managed by HCS	$ 102	$ -	$ -	$ 7	$ -	$ 109	$ 7
Limited partner investment in private equity fund	2,585	25	(49)	(229)	-	2,332	(229)
Warrants and other held at JMPS	617	20	-	(224)	-	413	(112)
Warrants and equity held at HCC	-	946	-	1,631	-	2,577	1,631

Small business loans	3,902	34,823	(3,673)	395	-	35,447	217
Equity securities held by HGC, HGC II and JMP Capital	20,707	20,000	-	1,581	(1,213)	41,075	1,581
Forward Purchase Contract	-	5,000	-	437	-	5,437	437
Total Level 3 assets	$ 27,913	$ 60,814	$ (3,722)	$ 3,598	$ (1,213)	$ 87,390	$ 3,095

(1) No Level 3 asset gains (losses) are included in other comprehensive income. All realized and unrealized gains (losses) related to Level 3 assets are included in earnings.

(In thousands)	Balance as of December 31, 2010	Purchases	Sales	Total gains (losses) - realized and unrealized included in earnings (1)	Transfers in/(out) of Level 3	Balance as of December 31, 2011	Unrealized gains/(losses) included in earnings related to assets still held at reporting date
Investments in funds of funds managed by HCS	$ 102	$ -	$ -	$ -	$ -	$ 102	$ -
Limited partner investment in private equity fund	3,063	32	(157)	(353)	-	2,585	(353)
Warrants and Other	532	17	-	67	-	616	67
Small business loans	-	3,927	-	(25)	-	3,902	(25)
Equity securities held by HGC and JMP Capital	11,245	15,184	(1,651)	53	(4,123)	20,708	553
Total Level 3 assets	$ 14,942	$ 19,160	$ (1,808)	$ (258)	$ (4,123)	$ 27,913	$ 242

(1) No Level 3 asset gains (losses) are included in other comprehensive income. All realized and unrealized gains (losses) related to Level 3 assets are included in earnings.

Purchases and sales of Level 3 assets shown above were recorded at fair value at the date of the transaction.

Total gains and losses included in earnings represent the total gains and/or losses (realized and unrealized) recorded for the Level 3 assets and are reported in Principal Transactions in the accompanying Consolidated Statements of Operations.

Transfers between levels of the fair value hierarchy result from changes in the observability of fair value inputs used in determining fair values for different types of financial assets and are recognized at the beginning of the reporting period in which the event or change in circumstances that caused the transfer occurs.

There were no transfers in/out of Level 1 during the year ended December 31, 2012. Transfers into Level 2 from Level 3 were $1.2 million during the year ended December 31, 2012. These transfers were a result of the initial public offerings of two investments in HGC. One investment was subsequently transferred into Level 1 from Level 2 during the year ended December 31, 2012, reflecting the fair value measurement of the investment being based on quoted market prices without further adjustment.

There were two transfers into Level 2 from Level 3 of $4.1 million for the year ended December 31, 2011, which were a result of the initial public offerings of two investments in HGC. These $4.1 million in investments were subsequently transferred into Level 1 from Level 2 during the year ended December 31, 2011, reflecting the fair value measurement of these investments being based on quoted market prices without further adjustment.

The amount of unrealized gains and losses included in earnings attributable to the change in unrealized gains and losses relating to Level 3 assets still held at the end of the period are reported in Principal Transactions in the accompanying Consolidated Statements of Operations.

Included in other investments are investments in partnerships in which one of the Company's subsidiaries is the investment manager and general partner. The Company accounts for these investments using the equity method as described in Note 2 - Summary of Significant Accounting Policies. The Company's proportionate share of those investments is included in the tables above. In addition, other investments include warrants and investments in funds managed by third parties. The investments in private investment funds managed by third parties are generally not redeemable at the option of the Company. As of December 31, 2012, the Company had unfunded investment commitments of $0.1 million related to private investment funds managed by third parties.

The Company used the following valuation techniques with unobservable inputs when estimating the fair value of the Level 3 assets:

Dollars in thousands		Fair Value at December 31, 2012	Valuation Technique	Unobservable Input	Range (Weighted Average)			
Investments in Funds of Funds managed by HCS (1)	$	109	Net Asset Value	N/A	N/A			
Limited Partner in Private Equity Fund (1)	$	2,332	Net Asset Value	N/A	N/A			
Warrants and Other held at JMPS	$	413	Black-Scholes Option Model	Annualized volatility of credit	16.2%	-	28.9%	(16.8%)
Warrants and equity held at HCC	$	2,577	Market comparable companies	EBITDA multiples	3.8x	-	9.3x	(8.5x)
			Income	Weighted average cost of capital	10.0%	-	18.0%	(15.6%)

Small Business Loans	$	35,447	Bond yield	Risk adjusted discount factor	8.5%	-	16.2%	(13.2%)
			Market comparable companies	EBITDA multiples	3.8x	-	9.3x	(8.5x)
			Income	Weighted average cost of capital	10.0%	-	18.0%	(15.6%)
				Expected principal recovery	0.0%	-	100.0%	(100.0%)
Equity securities in HGC and JMP Capital	$	41,075	Market comparable companies	Revenue multiples	2.1x	-	7.3x	(3.5x)
				EBITDA multiples	8.8x	-	22.9x	(15.8x)
				Discount for lack of marketability	30%	-	40%	(34%)
			Market transactions	Revenue multiples	3.2x	-	11.7x	(5.2x)
				EBITDA multiples	11.7x	-	19.8x	(15.4x)
				Control premium		25%		
Forward purchase contract	$	5,437	Market comparable companies	Revenue multiples	6.7x	-	8.1x	(7.3x)
				Billing multiples	6.0x	-	7.2x	(6.5x)
				Discount for lack of marketability		30%		
			Market transactions	Revenue multiples		6.3x		
				Control premium		25%		

(1) The Company uses the reported net asset value per share as a practical expedient to estimate the fair value of the general partner investment in funds of funds and limited partner investment in mortgage and private equity funds.

The significant unobservable input used in the fair value measurement of the warrants held at JMPS is the annualized volatility of credit. Significant increases in the rate would result in a significantly higher fair value measurement.

The significant unobservable input used in the fair value measurement of the warrants and equity held at HCC are EBITDA multiples and weighted average cost of capital. Significant increases in the multiples in isolation would result in a significantly higher fair value measurement. Increases in the discounts in isolation would result in decreases to the fair value measurement.

The significant unobservable input used in the fair value measurement of the small business loans held are risk adjusted discount factors, EBITDA multiples, weighted average cost of capital and expected principal recoveries. Significant increases in the multiples and expected principal recovery rates in isolation would result in a significantly higher fair value measurement. Increases in the discounts in isolation would result in decreases to the fair value measurement.

The significant unobservable inputs used in the fair value measurement of the equity securities and the forward contract in HGC and JMP Capital are Revenue, EBITDA and Billing multiples, discount for lack of marketability, and control premiums. Significant increases in the multiples in isolation would result in a significantly higher fair value measurement. Increases in the discounts and premium in isolation would result in decreases to the fair value measurement.

Nonrecurring Fair Value Measurements

The following tables provide information related to the Company's assets carried at fair value on a non-recurring basis at December 31, 2012 and 2011:

	Fair Value		Gains (Losses) Year Ended	
(In thousands)	December 31, 2012	December 31, 2011	December 31, 2012	December 31, 2011
Assets:				
Nonaccrual loans	$ 5,716	$ 14,769	$ (2,022)	$ (1,695)
Loans held for sale	3,134	2,957	164	(282)
Total assets:	$ 8,850	$ 17,726	$ (1,858)	$ (1,977)

Small Business Loans

Small business loans represent the secured subordinated debt extended by HCC to small to mid-sized companies. At inception, the loans were carried at the principal amount outstanding net of deferred fees, deferred costs and the allowance for loan losses. Net deferred fees or costs are recognized as an adjustment to interest income over the contractual life of the loans using the interest method. Any discount from the principal amount of purchased loans was accreted into interest income as a yield adjustment over the contractual life of the loan using the interest method. An allowance for credit losses was established based on continuing review and the quarterly evaluation of the Company's loan portfolio.

Due to its adoption of investment company accounting in preparation for its pending initial public offering as a BDC, HCC was required to change certain accounting principles which it had been permitted to employ historically. These changes have been retrospectively applied and as of September 30, 2012, HCC reports all investments, including debt investments, at market value or, in the absence of a readily available market value, at fair value, with unrealized gains and losses revorded in Gain on sale, payoff and mark-to-market on the Consolidated Statements of Operations. The Company recorded unrealized gains of $0.4 million and a loss of $23 thousand relating to the fair value adjustment of small business loans in 2012 and 2011, respectively.

Investments at Cost

On February 11, 2010, the Company made a $1.5 million investment in Class D Preferred Units of Sanctuary Wealth Services LLC ("Sanctuary"). Sanctuary provides a turnkey platform that will allow independent wealth advisors to establish an independent advisory business without the high startup costs and regulatory hurdles. The Class D Preferred Units entitle the Company to receive a preferred dividend with units that are convertible into equity of Sanctuary at the option of the Company prior to the maturity date, which is three years from the investment date. The Company carries its investment in Sanctuary at cost within other investments on the Consolidated Statements of Financial Condition and evaluates the investment for impairment on a quarterly basis. During the fourth quarter of 2010, the Company determined that its investment in Sanctuary was fully impaired and recorded an impairment loss of $1.5 million, which was included in Principal Transactions on the Consolidated Statements of Operations.

During the years ended December 31, 2010 and 2011, the Company invested $0.8 million and $0.3 million, respectively, in a commercial mortgage originator for the commencement of a commercial loan origination program. The Company carried its investment at cost within other investments on the Consolidated Statements of Financial Condition and evaluated the investment for impairment on a quarterly basis. In the fourth quarter of 2010 and the first quarter of 2011, the Company determined its investment in the entity was impaired and recorded an impairment loss of $0.8 million and $0.3 million, respectively. In the fourth quarter of 2011, the private commercial mortgage originator was dissolved.

Derivative Financial Instruments

On May 29, 2010, the Company entered into an interest rate cap with City National Bank (the “Lender”) to effectively lock in or fix the interest rate on its revolving line of credit and term loan from July 1, 2010 through maturity. The interest rate cap will allow the Company to receive payments from the Lender in the event that LIBOR plus 2.25% exceeds 3.75%, limiting the interest rate on the outstanding balance of the line of credit and term loan to such rate. On July 1, 2010, the Company designated the interest rate cap as a cash flow hedge of the interest rate risk of a total of $27.1 million of outstanding borrowings with the Lender as of that date. The notional principal amount of the cap was $10.5 million at December 31, 2012. See Note 7 for the information pertaining to the Company's borrowing from the Lender.

The interest rate cap is recorded at fair value in other investments on the Consolidated Statements of Financial Condition, with unrealized gains and losses recorded as other comprehensive income. For the year ended December 31, 2012, the Company recorded $7,851 of other comprehensive loss representing unrealized loss on the interest rate cap. In addition, during the year ended December 31, 2012, $54,696 was reclassified from accumulated other comprehensive income into interest expense as amortization of the interest cap.

The Company entered into a forward purchase contract to secure the acquisition of shares of a privately-held company. The contract incorporates downside protection for up to two years, for a cost basis of $5.0 million. In January 2012, the Company exchanged $5.0 million for physical custody of the shares. For one year beginning December 1, 2012, the Company may, at its discretion, become the beneficial and record holder of the shares. If the Company has not yet exercised its option at December 1, 2013, the shares will be assigned automatically to the Company. This contract is recorded in Other Investments in the Consolidated Statements of Financial Condition at fair value. The Company records changes in the fair value of this forward contract as unrealized gain or loss in Principal Transactions. For the year ended December 31, 2012, the Company recorded $0.4 million unrealized gain. Once the shares are in the Company's name, the shares will be accounted for as equity securities, remaining in Other Investments in the Consolidated Statements of Financial Condition.

5. Loans Collateralizing Asset-backed Securities Issued and Loans Held for Sale

Loans collateralizing asset-backed securities issued and loans held for sale are commercial loans securitized and owned by Cratos CLO. The loans consist of those loans within the CLO securitization structure at the acquisition date of Cratos and loans purchased by the CLO subsequent to the Cratos acquisition date. The following table presents the components of loans collateralizing asset-backed securities issued and loans held for sale as of December 31, 2012 and 2011:

(In thousands)	As of December 31, 2012		2011	
	Loans Collateralizing Asset-backed Securities	Loans Held for Sale	Loans Collateralizing Asset-backed Securities	Loans Held for Sale
Outstanding principal	$414,000	$4,686	$436,954	$4,686
Allowance for loan losses	(3,127)	-	(4,199)	-
Liquidity discount	(3,052)	(1,279)	(14,459)	(1,279)
Credit discount	-	-	(1,335)	-
Deferred loan fees, net	(6,818)	(156)	(6,191)	(168)
Valuation allowance	N/A	(117)	N/A	(282)
Total loans, net	$401,003	$3,134	$410,770	$2,957

Loans recorded upon the acquisition of Cratos at fair value reflect a liquidity discount and a credit discount. In addition, most loans purchased subsequent to the acquisition were purchased at a discount to their principal value, reflecting deferred loan fees. The table below summarizes the activity in the loan principal, allowance for loan losses, liquidity discount, credit discount, deferred loan fees, and the carrying value for the impaired and non-impaired loans as of and for the year ended December 31, 2012:

(In thousands)	Year Ended December 31, 2012					
	Principal	Allowance for Loan Losses	Liquidity Discount	Credit Discount	Deferred Loan Fees	Carrying Value, Net

Impaired Loans						
Balance at beginning of period	$ 10,538	$ (2,277)	$ (5,924)	$ (1,335)	$ (54)	$ 948
Purchases / funding	5	-	-	-	-	5
Repayments	(179)	-	-	-	-	(179)
Accretion of discount	-	-	172	-	13	185
Provision for loan losses	-	(2,022)	-	-	-	(2,022)
Sales and payoff	(3,197)	1,525	735	937	-	-
Write-off / restructuring	(7,167)	1,752	5,017	398	41	41
Transfers to/from non-impaired loans, net	3,517	-	(720)	-	(16)	2,781
Balance at end of period	$ 3,517	$ (1,022)	$ (720)	$ -	$ (16)	$ 1,759
Non-impaired Loans						
Balance at beginning of period	$ 426,416	$ (1,922)	$ (8,535)	$ -	$ (6,137)	$ 409,822
Purchases / funding	207,964	-	-	-	(5,342)	202,622
Repayments	(39,204)	-	-	-	-	(39,204)
Accretion of discount	-	-	4,519	-	2,130	6,649
Provision for loan losses	-	(183)	-	-	-	(183)
Sales and payoff	(181,176)	-	964	-	2,531	(177,681)
Transfers to/from impaired loans, net	(3,517)	-	720	-	16	(2,781)
Balance at end of period	$ 410,483	$ (2,105)	$ (2,332)	$ -	$ (6,802)	$ 399,244

The table below summarizes the activity in the loan principal, allowance for loan losses, liquidity discount, credit discount, deferred loan fees, and the carrying value for the impaired non-impaired loans as of and for the year ended December 31, 2011:

(In thousands)	Year Ended December 31, 2011					
	Principal	Allowance for Loan Losses	Liquidity Discount	Credit Discount	Deferred Loan Fees	Carrying Value, Net
Impaired Loans						
Balance at beginning of period	$ 13,867	$ (582)	$ (2,557)	$ (8,558)	$ -	$ 2,170
Purchases / funding	19	-	-	-	-	19
Repayments	(286)	-	26	-	-	(260)
Accretion of discount	-	-	99	-	-	99
Sales and payoff	(10,011)	-	660	7,223	-	(2,128)
Write-off / restructuring	-	(1,695)	-	-	-	(1,695)
Transfers to/from non-impaired loans, net	6,949	-	(4,152)	-	(54)	2,743
Balance at end of period	$ 10,538	$ (2,277)	$ (5,924)	$ (1,335)	$ (54)	$ 948
Non-impaired Loans						
Balance at beginning of period	$ 439,491	$ (1,410)	$ (33,037)	$ -	$ (6,451)	$ 398,593
Purchases / funding	250,103	-	-	-	(4,215)	245,888
Repayments	(28,215)	-	-	-	-	(28,215)
Accretion of discount	-	-	8,609	-	1,617	10,226
Provision for loan losses	-	(512)	-	-	-	(512)
Sales and payoff	(223,328)	-	10,449	-	2,683	(210,196)
Transfers to/from impaired loans, net	(6,949)	-	4,152	-	54	(2,743)
Transfers to loans held for sale (1)	(4,686)	-	1,292	-	175	(3,219)
Balance at end of period	$ 426,416	$ (1,922)	$ (8,535)	$ -	$ (6,137)	$ 409,822

(1) During the year ended December 31, 2011, one of the loans collateralizing ABS issued was reclassified as a loan held for sale reflecting management's intention to sell. The loan is carried at lower of cost or market and had the principal amount of $4.7 million, liquidity discount of $1.3 million and deferred loan fees of $0.2 million at December 31, 2011.

Allowance for Loan Losses

The Company recorded specific reserves of $2.0 million and $1.7 million on impaired loans and general reserves of $0.2 million and $0.5 million on non-impaired loans during the years ended December 31, 2012 and 2011, respectively. A summary of the activity in the allowance for loan losses for the years ended December 31, 2012 and 2011 is as follows:

(In thousands)	Year Ended December 31,		
	2012	2011	2010

Balance at beginning of period	$(4,199)	$(1,992)	(1,994)
Provision for loan losses:			
Specific reserve	(2,022)	(1,695)	-
General reserve	(183)	(512)	(997)
Reversal due to sale, payoff or restructure of loans	3,277	-	999
Balance at end of period	$(3,127)	$(4,199)	(1,992)

Impaired Loans

A loan is considered to be impaired when, based on current information, it is probable that the Company will be unable to collect all amounts due in accordance with the contractual terms of the original loan agreement, including scheduled principal and interest payments. As of December 31, 2012 and 2011, $2.8 million and $3.2 million of recorded investment amount of loans collateralizing asset-backed securities issued were individually evaluated for impairment, respectively. The remaining $401.3 million and $411.7 million of recorded investment amount of loans collateralizing asset-backed securities issued were collectively evaluated for impairment, as of December 31, 2012 and 2011, respectively. The entire $3.1 million and $3.0 million of recorded investment amount of loans held for sale were individually evaluated for impairment, as of December 31, 2012 and 2011. All impaired loans are classified as cash flow loans.

The table below presents certain information pertaining to the impaired loans as of and for the years ended December 31, 2012 and 2011:

(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
2012					
Impaired loans with an allowance recorded	$ 2,781	$ 3,517	$ 1,022	$ 4,743	$ 162
Impaired loans with no related allowance recorded	-	-	-	-	-
	$ 2,781	$ 3,517	$ 1,022	$ 4,743	$ 162
2011					
Impaired loans with an allowance recorded	$ 3,223	$ 10,538	$ 2,277	$ 3,430	$ 201
Impaired loans with no related allowance recorded	-	-	-	-	-
	$ 3,223	$ 10,538	$ 2,277	$ 3,430	$ 201

Non-Accrual, Past Due Loans and Restructured Loans

As of December 31, 2012 and 2011, the Company classified its loans as either Cash Flow loans or Enterprise Value loans. The classification is based upon whether the underwriting was based on the cash earnings or EBITDA of the borrower ("Cash Flow"), or on the market value of the borrower, including its intellectual property ("Enterprise Value"). At December 31, 2012, one Cash Flow loan with the aggregate principal amount of $3.5 million and recorded aggregate investment amount of $2.8 million was on non-accrual status. The Company recognized $0.2 million of interest income for three non-accrual status loans with an average recorded loan balance of $4.7 million that were on non-accrual status during the year ended December 31, 2012. The Company recognized $0.2 million of interest income for four non-accrual status loans with an average recorded loan balance of $3.4 million that were on non-accrual status during the year ended December 31, 2011.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. At December 31, 2011, one non-accrual loan in the amount of $2.7 million was over 90 days past due. No other loans were past due at December 31, 2012 or 2011.

At December 31, 2011, the Company's impaired loans included two Cash Flow loans, with an aggregate recorded investment balance of $0.6 million, whose terms were modified in a troubled debt restructuring ("TDR"). Concessions for these TDRs included a below market interest rate or receipt of equity interest in the debtor as compensation for reducing the loan principal balance. During the year ended December 31, 2012, one loan previously modified in a TDR was further restructured. An additional $1.0 million specific reserve was recorded for this loan earlier in the year. At the time of the modification, the loan was fully impaired. Concessions for this TDR included a below market interest rate and a reduction in the loan principal balance. Neither of the loans have had payment defaults since their respective most recent restructuring. At December 31, 2012, the impaired loans included two Cash Flow loans modified in a TDR, with an aggregate recorded investment balance of $2.0 million. At December 31, 2012 and 2011, there were no remaining commitments to lend funds to debtors whose terms have been modified in a TDR.

Credit Quality of Loans

The Company’s management, at least on a quarterly basis, reviews each loan and evaluates the credit quality of the loan. The review primarily includes the following credit quality indicators with regard to each loan: 1) Moody's rating, 2) current internal rating and 3) performance. The tables below present, by credit quality indicator, the Company's recorded investment in loans collateralizing asset-backed securities issued at December 31, 2012 and 2011:

(In thousands)	Cash Flow (CF) December 31,		Enterprise Value (EV) December 31,		Total Loans Collateralizing Asset-Backed Securities Issued December 31,		Held for Sale - Cash Flow (CF) December 31,	
	2012	2011	2012	2011	2012	2011	2012	2011
Moody's rating:								
Baa1 - Baa3	$ 5,883	$ 4,951	$ -	$ -	$ 5,883	$ 4,951	$ -	$ -
Ba1 - Ba3	129,796	131,743	-	-	129,796	131,743	-	-
B1 - B3	263,390	271,770	-	1,958	263,390	273,728	-	-
Caa1 - Caa3	5,061	4,546	-	-	5,061	4,546	3,134	2,957
Total:	$ 404,130	$ 413,010	$ -	$ 1,958	$ 404,130	$ 414,968	$ 3,134	$ 2,957
Internal rating:								

2		$ 392,208	$ 397,033	$ -	$ 1,958	$ 392,208	$ 398,991	$ -	$ -
3		11,922	12,754	-	-	11,922	12,754	-	-
4	(1)	-	3,223	-	-	-	3,223	3,134	2,957
Total:		$ 404,130	$ 413,010	$ -	$ 1,958	$ 404,130	$ 414,968	$ 3,134	$ 2,957
Performance:									
Performing		$ 401,349	$ 409,787	$ -	$ 1,958	$ 401,349	$ 411,745	$ 3,134	$ 2,957
Non-performing		2,781	3,223	-	-	2,781	3,223	-	-
Total:		$ 404,130	$ 413,010	$ -	$ 1,958	$ 404,130	$ 414,968	$ 3,134	$ 2,957

(1) Loans with an internal rating of 4 or below are designated as loans on non-accrual status.

The Company determined the fair value of loans collateralizing asset-backed securities to be $412.0 million and $420.1 million as of December 31, 2012 and 2011, respectively; primarily using the average market bid and ask quotation obtained from a loan pricing service. Such loans are identified as Level 2 assets. When average market bid and ask quotations were not available, the loans are identified as Level 3 assets. The fair value of these Level 3 loans are calculated internally based on their performance. This analysis incorporates comparable loans traded in the marketplace, the obligor's industry, future business prospects, capital structure, and expected credit losses. Significant declines in the performance of the loan would result in decreases to the fair value measurement.

The fair value of the loan held for sale was determined to be $3.1 million and $3.0 million as of December 31, 2012 and 2011, using similar methodology. Based on the fair value methodology, the Company has identified the loan held for sale as a Level 2 asset.

6. Fixed Assets

At December 31, 2012 and 2011, fixed assets consisted of the following:

(In thousands)	As of December 31,	
	2012	2011
Furniture and fixtures	$ 2,053	$ 1,946
Computer and office equipment	4,757	4,776
Leasehold improvements	4,205	3,266
Software	576	606
Less: accumulated depreciation	(8,928)	(8,309)
Total fixed assets, net	$ 2,663	$ 2,285

Depreciation expense for the years ended December 31, 2012, 2011 and 2010 was $0.9 million, $0.7 million and $0.6 million, respectively.

7. Note Payable and Line of Credit

Note payable consists of term loans and revolving lines of credit related to the Company's Credit Agreement with City National Bank ("CNB"), as defined below.

On October 11, 2012, JMP Group LLC, a wholly-owned subsidiary of the Company, entered into an Amendment, which amends certain provisions of the Credit Agreement, dated as of August 3, 2006, by and between JMP Group LLC and the Lender, as amended by Amendment Number One to Credit Agreement, dated as of December 17, 2007, Amendment Number Two to Credit Agreement, dated as of March 25, 2008, Amendment Number Three to Credit Agreement (the "Third Amendment"), dated as of December 31, 2008, Amendment Number Four to Credit Agreement and Waiver, dated as of January 28, 2010, Amendment Number Five (the "Fifth Amendment"), dated as of April 8, 2011 (collectively, the "Credit Agreement"), Amendment Number Six (the "Sixth Amendment"), dated as of August 24, 2011.

The Sixth Amendment provided a line of credit of up to $30.0 million to the extent the aggregate outstanding balance of all facilities do not exceed $55.0 million. The Amendment dated October 11, 2012 increased the allowable aggregate outstanding balance of all facilities from $55.0 million to $58.0 million. The unused portion of the line bears interest at the rate of 0.25% per annum, paid quarterly. The line of credit will remain available through August 24, 2013. On such date, any outstanding amounts convert to a term loan. The term loan will be repaid in quarterly installments of 3.75% of funded debt for the first two years, 5.00% of funded debt for the next two years, and the remainder due at maturity on August 24, 2017. The Sixth Amendment also permits additional investments. The Company anticipates that the proceeds will be used to fund certain commitments to HCC, to repurchase Company stock and other permitted investments, and for other general working capital purposes. The Company's outstanding balance on this line of credit was $28.2 million and zero as of December 31, 2012 and 2011, respectively.

Under the Fifth Amendment, JMP Securities entered into a $20.0 million revolving line of credit with the Lender to be used for regulatory capital purposes during its securities underwriting activities. The unused portion of the line bears interest at the rate of 0.25% per annum, paid monthly. Draws on the revolving line of credit bear interest at the rate of prime and are available through April 8, 2012 on which date, if there is an existing outstanding amount, it converts to a loan that matures on April 8, 2013. The Amendment dated October 11, 2012 reduced the revolving subordinated line of credit from $20.0 million to $10.0 million. There was no borrowing on this line of credit as of December 31, 2012.

Pursuant to the Amendment dated October 11, 2012, CNB also agreed to extend a $15.0 million term loan on or prior to March 31, 2013. This term loan would be repaid in quarterly installments of $1.2 million beginning March 31, 2014 and continuing through September 30, 2016, with a final payment of approximately $1.3 million on December 31, 2016.

The Third Amendment converted the Company’s outstanding revolving loans of $8.7 million into a single term loan as of December 31, 2008. The term loan is being repaid in equal quarterly payments of $0.4 million, which commenced on March 31, 2009 and continues through December 31, 2013 and bears interest at LIBOR plus 2.25%. The outstanding balance on this term loan was $1.7 million as of December 31, 2012.

The Third Amendment also provided that of the original $30.0 million revolving line of credit, $21.0 million remained available under the revolving portion of the Credit Agreement and the annual interest rate provisions of the Credit Agreement were increased from the prime rate minus 1.25% to the prime rate and from LIBOR plus 1.25% to LIBOR plus 2.25%. The Lender agreed to continue to provide revolving loans of up to $21.0 million through December 31, 2010, on which date the then existing revolving loans convert into term loans. On December 31, 2010, pursuant to the provisions of the Third Amendment, the outstanding revolving loan of $21.0 million was converted into a single term loan that will fully mature on January 1, 2014. As of December 31, 2010, the revolving line of credit was no longer available for future use. This term loan is being repaid in equal quarterly payments of $1.8 million, which commenced on April 1, 2011 and continues through January 1, 2014. The outstanding balance on this term loan was $8.8 million as of December 31, 2012.

The term loans had an aggregate outstanding principal amount of $10.5 million and $19.2 million at December 31, 2012 and 2011, respectively. The following table shows the repayment schedules for the principal portion of the term loans at December 31, 2012:

(In thousands)	December 31, 2012
2013	8,736
2014	1,750
	$ 10,486

The Credit Agreement contains financial and other covenants, including, but not limited to, limitations on debt, liens and investments, as well as the maintenance of certain financial covenants. A violation of any one of these covenants could result in a default under the Credit Agreement, which would permit the bank to terminate our note and require the immediate repayment of any outstanding principal and interest. The Third Amendment modified the financial covenants in the Credit Agreement to remove both the minimum requirement of Net Income (as defined in the Credit Agreement) and the minimum requirement of EBITDA (as defined in the Credit Agreement). The Third Amendment also removed the Fixed Charge Coverage Ratio (as defined in the Credit Agreement) and added a new financial covenant regarding the Company’s liquidity. The Sixth Amendment added back the Fixed Charge Coverage Ratio requirement and introduced certain leverage ratio requirements. At December 31, 2012, the Company was in compliance with the loan covenants. The term loans are collateralized by a pledge of the Company’s assets, including its interests in each of JMP Securities and HCS.

On May 29, 2010 the Company entered into an interest rate cap with the Lender to effectively lock in or fix the interest rate on its revolving line of credit and term loan from July 1, 2010 through maturity. The interest rate cap will allow the Company to receive payments from the counterparty in the event that LIBOR plus 2.25% exceeds 3.75%, limiting the interest rate on the outstanding balance of the term loan to such rate. The cap had an initial notional principal amount of $27.1 million, indexed to LIBOR and amortizes in accordance with the amortization of the revolving line of credit and term loan. The notional principal amount of the cap was $10.5 million at December 31, 2012. See Note 4 for additional information on the interest rate cap.

8. Asset-backed Securities Issued

On May 17, 2007, Cratos CLO completed a $500.0 million aggregate principal amount of notes (the “Notes”) on-balance sheet debt securitization and obtained $455.0 million of third-party financing. The Notes will be repaid from the cash flows generated by the loan portfolio owned by the CLO. The Notes were issued in seven separate classes as set forth in the table below. The Company owns approximately 94.0% of the unsecured subordinated notes and $13.8 million of Class C, D and E notes. These unsecured subordinated notes and the Class C, D and E notes owned by the Company are eliminated upon consolidation of JMP Credit, and therefore, are not reflected on the Company’s Consolidated Statement of Financial Condition at December 31, 2012 and 2011.

(In millions)	As of December 31, 2012					
	Notes Originally Issued	Outstanding Principal Balance	Liquidity Discount	Net Outstanding Balance	Interest Rate Spread to LIBOR	Ratings (Moody's /S&P) (1)
Class A Senior Secured Floating Rate Revolving Notes due 2021	$ 326.0	$ 315.8	$ (5.5)	$ 310.3	0.26% - 0.29%	Aaa/AAA
	30.0	30.0	(1.4)	28.6	0.50%	Aaa/AAA

Class B Senior Secured Floating Rate Notes due 2021						
Class C Senior Secured Deferrable Floating Rate Notes due 2021	35.0	35.0	(3.3)	31.7	1.10%	Aa3/AA+
Class D Secured Deferrable Floating Rate Notes due 2021	34.0	34.0	(3.3)	30.7	2.40%	A3/A-
Class E Secured Deferrable Floating Rate Notes due 2021	30.0	30.0	(3.2)	26.8	5.00%	Ba2/BB
Total secured notes sold to investors	$ 455.0	$ 444.8	$ (16.7)	$ 428.1		
Unsecured subordinated notes due 2021	45.0	45.0	(39.9)	5.1		
Total notes for the CLO I offering	$ 500.0	$ 489.8	$ (56.6)	$ 433.2		
Consolidation elimination	N/A	(58.8)	41.1	(17.7)		
Total asset-backed securities issued	N/A	$ 431.0	$ (15.5)	$ 415.5		

(1) These ratings are unaudited and were the current ratings as of December 31, 2012 and are subject to change from time to time.

(In millions)	As of December 31, 2011					
	Notes Originally Issued	Outstanding Principal Balance	Liquidity Discount	Net Outstanding Balance	Interest Rate Spread to LIBOR	Ratings (Moody's /S&P) (1)
Class A Senior Secured Floating Rate Revolving Notes due 2021	$ 326.0	$ 315.8	$ (17.6)	$ 298.2	0.26% - 0.29%	Aaa/AAA
Class B Senior Secured Floating Rate Notes due 2021	30.0	30.0	(4.4)	25.6	0.50%	Aaa/AA+
Class C Senior Secured Deferrable Floating Rate Notes due 2021	35.0	35.0	(10.5)	24.5	1.10%	Aa3/AA-
Class D Secured Deferrable Floating Rate Notes due 2021	34.0	34.0	(10.5)	23.5	2.40%	A3/BBB+
Class E Secured Deferrable Floating Rate Notes due 2021	30.0	30.0	(10.0)	20.0	5.00%	Ba2/BB-
Total secured notes sold to investors	$ 455.0	$ 444.8	$ (53.0)	$ 391.8		
	45.0	45.0	(39.9)	5.1		

Unsecured subordinated notes due 2021				
Total notes for the CLO I offering	$ 500.0	$ 489.8	$ (92.9)	$ 396.9
Consolidation elimination	N/A	(58.8)	43.5	(15.3)
Total asset-backed securities issued	N/A	$ 431.0	$ (49.4)	$ 381.6

(1) These ratings are unaudited and were the current ratings as of December 31, 2011 and are subject to change from time to time.

The secured notes and subordinated notes are limited recourse obligations payable solely from cash flows of the CLO loan portfolio and related collection and payment accounts pledged as security. Payment on the Class A-1 notes rank equal, or pari passu, in right of payment with payments on the Class A-2 notes and payment on the Class A-1 and Class A-2 notes rank senior in right of payment to the other secured notes and the subordinated notes. Payment on the Class B, Class C, Class D and Class E notes generally rank subordinate in right of payment to any other class of notes which has an earlier alphabetical designation. The subordinated notes are subordinated in right of payment to all other classes of notes and will not accrue interest. Interest on the secured notes is payable quarterly at a per annum rate equal to LIBOR plus the applicable spread set forth in the table above. Payment of interest on the Class C, Class D and Class E notes is payable only to the extent proceeds are available therefore under the applicable payment priority provisions. As of December 31, 2012, all interest on the secured notes was current. To the extent proceeds are not readily available, interest on the Class C, Class D and Class E notes will be deferred. The CLO is also required to pay a commitment fee of 0.18% on the unused portion of the funding commitments of the Class A-1 notes. As of December 31, 2012, all of the Class A-1 notes were drawn. The secured notes are secured by the CLO loan portfolio and the funds on deposit in various related collection and payment accounts. The terms of the debt securitization subject the loans included in the CLO loan portfolio to a number of collateral quality, portfolio profile, interest coverage and over-collateralization tests. Total interest expense related to the asset-backed securities issued for the years ended December 31, 2012 and 2011 was $39.1 million and $34.9 million, respectively, which comprised cash coupon of $5.2 million and $4.6 million, respectively, and liquidity discount amortization of $33.9 million and $30.2 million, respectively. As of December 31, 2012 and December 31, 2011, accrued interest payable on the Notes was $0.5 million and $0.6 million, respectively.

The Notes recorded upon the acquisition of Cratos at fair value reflect a liquidity discount. The activity in the note principal and liquidity discount for the years ended December 31, 2012 and 2011 comprised the following:

(In thousands)	Year Ended December 31, 2012		
	Principal	Liquidity Discount	Net
Balance at beginning of period	$ 431,003	$ (49,447)	$ 381,556
Amortization of discount	-	33,899	33,899
Balance at end of period	$ 431,003	$ (15,548)	$ 415,455

(In thousands)	Year Ended December 31, 2011		
	Principal	Liquidity Discount	Net
Balance at beginning of period	$ 431,003	$ (79,681)	$ 351,322
Amortization of discount	-	30,234	30,234
Balance at end of period	$ 431,003	$ (49,447)	$ 381,556

The Company determined the fair value of asset-backed securities issued to be $404.3 million and $375.9 million as of December 31, 2012 and 2011, respectively, based upon pricing from published market research for equivalent-rated CLO notes. Based on the fair value methodology, the Company has identified the asset backed securities issued as Level 2 liabilities.

9. Stockholders’ Equity

Common Stock

The Company’s board of directors declared a quarterly cash dividend of $0.03 per share of common stock in March 2012, $0.035 per share of common stock in May, July and October 2012. Those dividends were paid in March, June, August and November 2012 for the fourth quarter of 2011, the first, second and third quarter of 2012, respectively. The Company does not pay dividends on unvested shares of restricted stock.

Stock Repurchase Program

In each of August and November 2007, the Company’s board of directors authorized a 1.5 million share repurchase program, both of which were fully executed as of January 18, 2008. On March 10, 2008, the Company's board of directors authorized the repurchase of an additional 2.0 million shares during the subsequent eighteen months, the repurchase of an additional 0.5 million shares during the subsequent twelve months on March 3, 2009, the repurchase of an additional 1.0 million shares during the subsequent eighteen months on May 4, 2010, the repurchase of an additional 0.5 million shares during the subsequent twelve months on May 3, 2011, the repurchase of an additional 1.0 million shares during the subsequent eighteen months on November 1, 2011, and the repurchase of an additional 0.5 million shares during the subsequent fourteen months on October 30, 2012. During the years ended December 31, 2012 and 2011, the Company repurchased 858,137 and 860,778 shares, respectively, of the Company’s common stock at an average price of $6.58 per share and $7.38 per share, respectively, for an aggregate purchase price of $5.7 million and $6.4 million, respectively. Of the total shares repurchased during the years ended December 31, 2012 and 2011, 603,328 shares and 406,163 shares, respectively, were deemed to have been repurchased in connection with employee stock plans, whereby the Company’s shares were issued on a net basis to employees for the payment of applicable statutory withholding taxes and therefore such withheld shares are deemed to be purchased by the Company. As of December 31, 2012, 750,901 shares remain available to be repurchased under the repurchase program.

The timing and amount of any future open market stock repurchases will be determined by JMP management based on its evaluation of market conditions, the relative attractiveness of other capital deployment activities, regulatory considerations and other factors. Any open market stock repurchase activities will be conducted in compliance with the safe harbor provisions of Rule 10b-18 of the Securities Exchange Act of 1934, as amended, or in privately negotiated transactions. Repurchases of common stock may also be made under an effective Rule 10b5-1 plan which permits common stock to be repurchased when the Company may otherwise be prohibited from doing so under insider trading laws. This repurchase program may be suspended or discontinued at any time.

10. Stock-Based Compensation

On March 26, 2007, the board of directors adopted the JMP Group Inc. 2007 Equity Incentive Plan (“JMP Group 2007 Plan”), which was approved by the stockholders on April 12, 2007. The board reauthorized this plan and it was approved by our stockholders on June 6, 2011. JMP Group Inc. authorized the issuance of 4,000,000 shares of its common stock under this Plan. This amount is increased by any shares JMP Group Inc. purchases on the open market, or through any share repurchase or share exchange program, as well as any shares that may be returned to the JMP Group 2007 Plan or the JMP Group LLC 2004 Equity Incentive Plan (“JMP Group 2004 Plan”) as a result of forfeiture, termination or expiration of awards; not to exceed a maximum aggregate number of shares of 2,960,000 shares under the JMP Group 2004 Plan. The Company will issue shares upon exercises or vesting from authorized but unissued shares or from treasury stock.

Stock Options

Prior to the Company's initial public offering, JMP Group LLC, then a multi-member Delaware limited liability company, issued options to purchase its membership interests to certain employees. In connection with the Company's initial public offering and related reorganization of JMP Group LLC, all outstanding options to purchase membership interests in JMP Group LLC were exchanged into options to purchase the Company’s common stock.

The following table summarizes the stock option activity for the years ended December 31, 2012, 2011 and 2010:

	Year Ended December 31,					
	2012		2011		2010	
	Shares Subject to Option	Weighted Average Exercise Price	Shares Subject to Option	Weighted Average Exercise Price	Shares Subject to Option	Weighted Average Exercise Price
Balance, beginning of year	1,704,665	$ 11.20	1,800,565	$ 11.23	1,938,315	$ 11.28
Granted	0	0.00	0	0.00	0	0.00
Exercised	0	0.00	0	0.00	0	0.00
Forfeited	0	0.00	0	0.00	0	0.00
Expired	(95,775)	12.43	(95,900)	11.82	(137,750)	12.00
Balance, end of period	1,608,890	$ 11.12	1,704,665	$ 11.20	1,800,565	$ 11.23
Options exercisable at end of period	1,608,890	$ 11.12	1,704,665	$ 11.20	1,800,565	$ 11.23

The following table summarizes the stock options outstanding as well as stock options vested and exercisable as of December 31, 2012 and 2011:

	December 31, 2012							
	Options Outstanding				Options Vested and Exercisable			
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Aggregate Intrinsic Value	Number Exercisable	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Aggregate Intrinsic Value
$10.00 - $12.50	1,608,890	2.06	$ 11.12	$ -	1,608,890	2.06	$ 11.12	-

	December 31, 2011							
	Options Outstanding				Options Vested and Exercisable			
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Aggregate Intrinsic Value	Number Exercisable	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Aggregate Intrinsic Value
$10.00 - $12.50	1,704,665	3.00	$ 11.20	$ -	1,704,665	3.00	$ 11.20	-

The Company recognizes stock-based compensation expense for stock options over the graded vesting period of the options using the accelerated attribution method. The Company recognized compensation expense related to stock options of zero for the years ended December 31, 2012 and 2011, and $3,231 for the year ended December 31, 2010.

As of December 31, 2012 and 2011, there was no unrecognized compensation expense related to stock options.

There were no stock options exercised during the years ended December 31, 2012, 2011 and 2010. As a result, the Company did not recognize any current income tax benefits from exercise of stock options during these periods.

Restricted Stock Units

In 2010, the Company issued 1,014,034 RSUs under the JMP Group 2007 Plan, which was comprised of 886,761 performance-based RSUs granted on February 4, 2010 to certain employees and the Company's independent directors for long term incentive purposes (the "2010 performance-based RSUs"), 63,433 RSUs granted to certain new employees and 63,840 RSUs granted to the Company's independent directors. The 2010 performance-based RSUs have Company performance-based vesting conditions and vest if and to the extent the Company performance target set for such RSUs is met during any of the years ending December 31, 2010, 2011 or 2012. In the fourth quarter of 2010, the vesting of approximately 56.3% of the 2010 performance-based RSUs became probable based on the Company's operating results for the year 2010, and the Company recognized $3.8 million of compensation expense for such RSUs in the quarter. In the fourth quarter of 2011, the vesting of the remaining 2010 performance-based RSUs became probable based on the Company's operating results for the year 2011, and the Company recognized $2.8 million of compensation expense for such RSUs in the quarter. The vesting of approximately 0.2 million shares, net of applicable withholding tax, in the first quarter of 2012, related to the 2010 performance-based RSUs. The 2010 performance-based RSUs were subject to post-vesting transfer restrictions until December 31, 2012, and therefore, the fair value of such RSUs included a liquidity discount of 10% for the post-vesting transfer restrictions. The RSUs granted to certain new employees and the Company's independent directors had required service periods ranging from one to three years.

In 2010, the Company also granted 131,341 restricted shares to certain employees as a part of the 2009 annual compensation program. These shares vested immediately with a two-year restricted period during which the holders were subject to non-competition, non-solicitation and certain other covenants.

In 2011, the Company issued 1,073,583 RSUs under the JMP Group 2007 Plan, which was comprised of 921,876 performance-based RSUs granted on January 31, 2011 to certain employees for long term incentive purposes (the "2011 performance-based RSUs"), 144,505 RSUs granted to certain new employees and 7,202 RSUs granted to the Company's independent directors. The 2011 performance-based RSUs have Company performance-based vesting conditions and vest if the Company performance target set for such RSUs is met during any of the years ending December 31, 2011, 2012 or 2013. In the fourth quarter of 2011, the vesting of all of the 2011 performance-based RSUs became probable based on the Company's operating results for the year 2011, and the Company recognized $6.1 million of compensation expense for such RSUs in the quarter. In the first quarter of 2012, approximately 0.5 million shares, net of applicable withholding tax, and related to the 2011 performance-based RSUs, vested. The 2011 performance-based RSUs are subject to post-vesting transfer restrictions until December 31, 2013, and therefore, the fair value of such RSUs included a liquidity discount of 15% for the post-vesting restrictions. The RSUs granted to certain new employees and the Company's independent directors had vesting periods ranging from one to three years.

In 2011, the Company also granted 42,869 restricted shares to certain employees as a part of the 2010 annual compensation program. These shares vested immediately with a two-year restricted period during which the holders are subject to non-competition, non-solicitation and certain other covenants.

In February 2012, the Company granted 910,000 RSUs to certain employees for long term incentive purposes. These units have Company performance-based and employee service-based vesting conditions and will vest when both conditions are met. In the fourth quarter of 2012, the vesting of these RSUs became probable based on the Company's operating results for the year 2012, and the Company recognized $1.8 million of compensation expense for such RSUs in the quarter. The remaining compensation expense related to these RSUs will be recognized over the remaining vesting period of two years.

The following table summarizes the RSU activity for the years ended December 31, 2012, 2011 and 2010:

	Year Ended December 31,					
	2012		2011		2010	
	Restricted Stock Units	Weighted Average Grant Date Fair Value	Restricted Stock Units	Weighted Average Grant Date Fair Value	Restricted Stock Units	Weighted Average Grant Date Fair Value
Balance, beginning of year	1,634,268	$ 7.42	1,630,026	$ 8.52	1,392,551	$ 9.59
Granted	952,597	7.29	1,073,583	7.43	1,014,034	7.82
Vested	(1,456,540)	7.00	(1,039,082)	9.14	(641,124)	9.82
Forfeited	(109,943)	6.89	(30,259)	8.11	(135,435)	8.10
Balance, end of period	1,020,382	$ 7.27	1,634,268	$ 7.42	1,630,026	$ 8.52

The aggregate fair value of RSUs vested during the years ended December 31, 2012, 2011 and 2010 were $10.2 million, $8.4 million and $4.6 million, respectively. The income tax benefits realized from the vested RSUs were $3.7 million, $3.0 million and $2.7 million, respectively.

The Company recognizes compensation expense over a graded vesting period using the accelerated attribution method. For the years ended December 31, 2012, 2011 and 2010, the Company recorded compensation expense related to RSUs of $2.5 million, $10.3 million, and $7.6 million respectively. Included in these amounts were expenses related to RSUs awarded in connection with the initial public offering of zero, $0.8 million and $2.6 million for the years ended December 31, 2012, 2011 and 2010, respectively. The remaining expenses related to RSUs awarded after the initial public offering. For the year ended December 31, 2012, the compensation expense related to RSUs awarded after the initial public offering included $1.8 million recognized on the probable vesting of the performance-based RSUs granted in February 2012, described above. For the year ended December 31, 2011, the compensation expense related to RSUs awarded after the initial public offering included $8.9 million recognized on the probable vesting of 100.0% and 43.7% of the 2011 and 2010 performance-based RSUs, respectively, described above. For the year ended December 31, 2010, the compensation expense related to RSUs awarded after the initial public offering included $3.8 million recognized on the probable vesting of 56.3% of the 2010 performance-based RSUs granted on February 4, 2010 described above.

For the years ended December 31, 2012, 2011 and 2010, the Company recognized income tax benefits of $0.9 million, $4.2 million and $3.1 million, respectively, related to the compensation expense recognized for RSUs. As of December 31, 2012 and 2011, there was $4.8 million and $1.1 million, respectively, of unrecognized compensation expense related to RSUs expected to be recognized over a weighted average period of 1.87 years and 1.84 years, respectively.

11. Net Income (Loss) per Share of Common Stock

Basic net income (loss) per share for the Company is calculated by dividing net income (loss) by the weighted average number of common shares outstanding for the reporting period. Diluted net income (loss) per share is calculated by adjusting the weighted average number of outstanding shares to reflect the potential dilutive impact as if all potentially dilutive stock options or RSUs were exercised or converted under the treasury stock method. However, for periods that the Company has a net loss the effect of outstanding stock options or RSUs is anti-dilutive and, accordingly, is excluded from the calculation of diluted loss per share.

The computations of basic and diluted net (loss) income per share and basic and diluted net income (loss) per unit for the years ended December 31, 2012, 2011 and 2010 are shown in the table below:

(In thousands, except per share data)	Year Ended December 31,		
	2012	2011	2010
Numerator:			
Net income (loss) attributable to JMP Group, Inc	$ 2,757	$ (2,456)	$ 9,603
Denominator:			
Basic weighted average shares outstanding	22,582	22,118	21,646
Effect of potential dilutive securities:			
Restricted stock units	324	-	750
Diluted weighted average shares outstanding	22,906	22,118	22,396
Net income (loss) per share			
Basic	$ 0.12	$ (0.11)	$ 0.44
Diluted	$ 0.12	$ (0.11)	$ 0.43

Weighted average stock options to purchase 1,642,841, 1,755,131 and 1,857,083 shares of common stock for the years ended December 31, 2012, 2011 and 2010 were anti-dilutive and, therefore, were not included in the computation of diluted weighted-average common shares outstanding.

Weighted average restricted stock units for zero, 71,883 and 6,293 shares of common stock for the years ended December 31, 2012, 2011 and 2010 were anti-dilutive and, therefore, were not included in the computation of diluted weighted-average common shares outstanding.

12. Employee Benefits

All salaried employees of the Company are eligible to participate in the JMP Group 401(k) Plan after three months of employment. Participants may contribute up to the limits set by the United States Internal Revenue Service. There were no contributions by the Company during the years ended December 31, 2012, 2011 and 2010.

13. Income Taxes

The components of the Company's income tax expense (benefit) for the years ended December 31, 2012, 2011 and 2010 are as follows:

(In thousands)	Year Ended December 31, 2012	2011	2010
Federal	$ 2,714	$ 3,725	$ 1,432
State	(791)	278	1,005
Total current income tax expense	1,923	4,003	2,437
Federal	(814)	(4,795)	5,409
State	472	(840)	731
Total deferred income tax expense (benefit)	(342)	(5,635)	6,140
Total income tax expense (benefit)	$ 1,581	$ (1,632)	$ 8,577

A reconciliation of the statutory U.S. federal income tax rate to the effective tax rate for the years ended December 31, 2012, 2011 and 2010 is as follows:

	Year Ended December 31,					
	2012		2011		2010	
Tax at federal statutory tax rate	34.00	%	35.00	%	35.00	%
State income tax, net of federal tax benefit (1)	6.67	%	19.76	%	4.75	%
Change in New York valuation (1)	-3.70	%	-14.01	%	1.00	%
Adjustment for permanent items (HGC, HGC II and HCC non-controlling interest) (2)	-17.55	%	-6.89	%	-2.75	%
Adjustment for other permanent items	0.20	%	-2.72	%	0.67	%
Rate before one-time events	19.62	%	31.14	%	38.67	%
Deferred tax asset written off related to options and RSUs	0.31	%	-3.48	%	0.00	%
Adjustment for prior year taxes	-1.15	%	5.95	%	-0.73	%
Separate Georgia tax return for JMP Credit	0.00	%	0.00	%	3.92	%
California state enterprise zone tax credit	-2.20	%	4.83	%	-1.04	%
New York state tax amendment	0.00	%	0.00	%	0.06	%
Effective tax rate	16.58	%	38.44	%	40.88	%

(1) In 2012, the Company revised the tax rate used in the calculation of the current and deferred state taxes to reflect its current filing status with the State and City of New York. As discussed in Note 2, the Company's 2012 net state tax benefit of $322 thousand includes tax benefit of $106 thousand that resulted from the application of the revised state tax rate to 2011.

(2) HGC, HGC II and HCC are consolidated for financial reporting purposes but not for tax purposes.

The 21.86% decrease in the effective tax rate for the year ended December 31, 2012 compared to the same period in 2011 was primarily attributable to the income associated with HGC, HGC II and HCC which are consolidated for financial reporting purposes but not for tax purposes.

As of December 31, 2012 and 2011, the components of deferred tax assets and liabilities are as follows:

(In thousands)	As of December 31,					
		2012			2011	
Deferred tax assets:						
Accrued compensation and related expenses	$	5,829		$	9,678	
Equity based compensation		2,010			5,266	
Reserves and allowances		3,661			3,457	
New York net operating loss		715			685	
Interest in HCC (1)		-			43	
Interest on loans on non-accrual status		-			214	
Liquidity discount at JMP Credit		1,537			6,016	
Other		604			1,337	
Total deferred tax assets		14,356			26,696	
Deferred tax liabilities:						
Investment in partnerships		(1,608	)		(683	)
Repurchase of asset-backed securities issued		(1,600	)		(1,647	)
Liquidity discount at JMP Credit		(5,747	)		(19,138	)
Depreciation and amortization		(262	)		(118	)

Net unrealized capital gains		(473)		(624)
Interest in HCC (1)		(188)		-
Total deferred tax liabilities		(9,878)		(22,210)
Net deferred tax asset before valuation allowance		4,478		4,486
Valuation allowance		(1,166)		(1,516)
Net deferred tax assets	$	3,312	$	2,970

(1) HCC was consolidated for financial reporting purposes but not consolidated for tax reporting purposes.

As of December 31, 2012, JMP Group Inc has a New York State and City net operating loss ("NOL") carry forward of approximately $35.4 million, which expires between 2029 and 2032. The NOL has a full valuation allowance against it.

With the exception of the New York State and City deferred tax asset, the Company has determined that a valuation allowance against any other deferred tax assets was not necessary as of December 31, 2012, 2011 and 2010. Management believes that that the deferred tax assets will, more-likely-than-not, be realized based on taxes paid in prior years and future reversing taxable temporary differences. The Company has analyzed the filing positions in its Federal and state income tax returns for all open tax years, which are 2010 and 2011 for federal income tax purposes and 2008 through 2011 for California income tax purposes. The Company is not currently under examination in any tax jurisdictions and does not anticipate any tax adjustments that will result in a material adverse effect on the Company’s financial condition, results of operations, or cash flow within the next twelve months. Therefore, no liabilities for uncertain income tax positions have been recorded.

14. Commitments and Contingencies

The Company leases office space in California, Illinois, Georgia, Massachusetts, Minnesota, New York and Pennsylvania under various operating leases. Rental expense for the years ended December 31, 2012, 2011 and 2010 was $3.4 million, $2.9 million and $2.7 million, respectively. The Company recorded sublease income of $0.2 million, $0.6 million, and $0.5 million for the years ended December 31, 2012, 2011 and 2010.

The California, Illinois, Minnesota and New York leases included a period of free rent at the start of the lease. Rent expense is recognized over the entire lease period uniformly net of the free rent savings. The aggregate minimum future commitments of these leases are:

(In thousands)	December 31, 2012
2013	$ 3,498
2014	3,388
2015	3,356
2016	3,307
2017	3,271
Thereafter	2,926
	$ 19,746

In connection with its underwriting activities, JMP Securities enters into firm commitments for the purchase of securities in return for a fee. These commitments require JMP Securities to purchase securities at a specified price. Securities underwriting exposes JMP Securities to market and credit risk, primarily in the event that, for any reason, securities purchased by JMP Securities cannot be distributed at anticipated price levels. At December 31, 2012 and 2011, JMP Securities had no open underwriting commitments.

The marketable securities owned and the restricted cash as well as the cash held by the clearing broker may be used to maintain margin requirements. At December 31, 2012 and 2011, the Company had $150,000 and $255,336 of cash on deposit with JMP Securities' clearing broker. Furthermore, the marketable securities owned may be hypothecated or borrowed by the clearing broker.

Unfunded commitments are agreements to lend to a borrower, provided that all conditions have been met. As of December 31, 2012 and 2011, the Company had unfunded commitments of $18.6 million and $3.2 million in the Corporate Credit segment, respectively.

15. Regulatory Requirements

JMP Securities is subject to the SEC's Uniform Net Capital Rule (Rule 15c3-1), which requires the maintenance of minimum net capital, as defined, and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1. JMP Securities had net capital of $36.7 million and $38.0 million, which were $35.7 million and $37.0 million in excess of the required net capital of $1.0 million at December 31, 2012 and 2011, respectively. JMP Securities' ratio of aggregate indebtedness to net capital was 0.17 to 1 and 0.26 to 1 at December 31, 2012 and 2011, respectively.

Since all customer transactions are cleared through another broker-dealer on a fully disclosed basis, JMP Securities is not required to maintain a separate bank account for the exclusive benefit of customers in accordance with Rule 15c3-3 under the Exchange Act.

16. Related Party Transactions

The Company earns base management fees and incentive fees from serving as investment advisor for various entities, including corporations, partnerships and offshore investment companies. The Company also owns an investment in most of these entities. As of December 31, 2012 and 2011, the aggregate fair value of the Company's investments in these entities was $28.0 million and $34.5 million, respectively, which consisted of investments in hedge funds of $27.9 million and $24.1 million, respectively, general partner investments in hedge funds of funds of $0.1 million for each year, and an investment in NYMT common stock of zero and $10.3 million, respectively. Base management fees earned from these entities were $9.4 million, $9.7 million and $8.8 million for the years ended December 31, 2012, 2011 and 2010, respectively. Also, the Company earned incentive fees of $6.3 million, $10.1 million and, $2.9 million from these entities for the years ended December 31, 2012, 2011 and 2010, respectively. As of December 31, 2012 and 2011, the Company had incentive fees receivable from these entities of $2.9 million and $2.1 million, respectively.

17. Guarantees

JMP Securities has agreed to indemnify its clearing broker for losses that the clearing broker may sustain from the accounts of customers introduced by JMP Securities. Should a customer not fulfill its obligation on a transaction, JMP Securities may be required to buy or sell securities at prevailing market prices in the future on behalf of its customer. JMP Securities' obligation under the indemnification has no maximum amount. All unsettled trades at December 31, 2012 had settled with no resulting material liability to the Company. For the years ended December 31, 2012, 2011 and 2010, the Company had no material loss due to counterparty failure, and has no obligations outstanding under the indemnification arrangement as of December 31, 2012.

The Company is engaged in various investment banking and brokerage activities whose counterparties primarily include broker-dealers, banks and other financial institutions. In the event counterparties do not fulfill their obligations, the Company may be exposed to risk. The risk of default depends on the creditworthiness of the counterparty or issuer of the instrument. It is the Company’s policy to review, as necessary, the credit standing of each counterparty with which it conducts business.

18. Litigation

The Company is involved in a number of judicial, regulatory and arbitration matters arising in connection with our business. The outcome of matters the Company has been and currently is involved in cannot be determined at this time, and the results cannot be predicted with certainty. There can be no assurance that these matters will not have a material adverse effect on our results of operations in any future period and a significant judgment could have a material adverse impact on our financial condition, results of operations and cash flows. The Company may in the future become involved in additional litigation in the ordinary course of our business, including litigation that could be material to our business.

The Company reviews the need for any loss contingency reserves and establish reserves when, in the opinion of management, it is probable that a matter would result in liability and the amount of loss, if any, can be reasonably estimated. Generally, given the inherent difficulty of predicting the outcome of matters the Company is involved in, particularly cases in which claimants seek substantial or indeterminate damages, it is not possible to determine whether a liability has been incurred or to reasonably estimate the ultimate or minimum amount of that liability until the case is close to resolution. For these matters, no reserve is established until such time, other than for reasonably estimable legal fees and expenses. Management, after consultation with legal counsel, believes that the currently known actions or threats will not result in any material adverse effect on the Company’s financial condition, results of operations or cash flows.

19. Financial Instruments with Off-Balance Sheet Risk, Credit Risk or Market Risk

The majority of the Company’s transactions, and consequently the concentration of its credit exposure, is with its clearing broker. The clearing broker is also a significant source of short-term financing for the Company, which is collateralized by cash and securities owned by the Company and held by the clearing broker. The Company’s securities owned may be pledged by the clearing broker. The receivable from the clearing broker represents amounts receivable in connection with the trading of proprietary positions.

The Company is also exposed to credit risk from other brokers, dealers and other financial institutions with which it transacts business. In the event that counterparties do not fulfill their obligations, the Company may be exposed to credit risk.

The Company’s trading activities include providing securities brokerage services to institutional clients. To facilitate these customer transactions, the Company purchases proprietary securities positions (“long positions”) in equity securities. The Company also enters into transactions to sell securities not yet purchased (“short positions”), which are recorded as liabilities on the Consolidated Statements of Financial Condition. The Company is exposed to market risk on these long and short securities positions as a result of decreases in market value of long positions and increases in market value of short positions. Short positions create a liability to purchase the security in the market at prevailing prices. Such transactions result in off-balance sheet market risk as the Company’s ultimate obligation to satisfy the sale of securities sold, but not yet purchased may exceed the amount recorded in the Consolidated Statements of Financial Condition. To mitigate the risk of losses, these securities positions are marked to market daily and are monitored by management to assure compliance with limits established by the Company.

The Company is also exposed to credit risk through its subsidiary, HCC. HCC's investment portfolio consists primarily of loans to private small to mid-size companies. Many of these companies may experience variation in operating results. Many of these companies do business in regulated industries and could be affected by changes in government regulations. To mitigate the credit risk, HCC generally seeks a first or second priority security interest in all of the portfolio company's tangible and intangible assets as collateral for our debt investment, subject in some cases to permitted exceptions. Although HCC does not intend to operate as an asset-based lender, the estimated liquidation value of the assets, if any, collateralizing the debt securities that are held is evaluated as a potential source of repayment. HCC evaluates both tangible assets, such as accounts receivable, inventory and equipment, and intangible assets, such as intellectual property, customer lists, networks and databases.

In connection with the Cratos CLO, the Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include unfunded commitments to lend and standby letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheet of the Company.

Unfunded commitments are agreements to lend to a borrower, provided that all conditions have been met. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since certain commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each borrower’s creditworthiness on a case by case basis.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance by a borrower to a third party. The Company’s exposure to credit loss in the event of nonperformance by the other party to the financial instrument for standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on balance sheet instruments. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to borrowers. In its Corporate Credit segment, the Company had unfunded commitments of $18.6 million and standby letters of credit of $1.0 million at December 31, 2012. As of December 31, 2011, the Company had unfunded commitments of $3.2 million and standby letters of credit of $0.2 million in the Corporate Credit segment.

20. Business Segments

The Company’s business results are categorized into the following four business segments: Broker-Dealer, Asset Management, Corporate Credit and Corporate. The Broker-Dealer segment includes a broad range of services, such as underwriting and acting as a placement agent for public and private capital markets raising transactions and financial advisory services in M&A, restructuring and other strategic transactions. The Broker-Dealer segment also includes institutional brokerage services and equity research services to our institutional investor clients. The Asset Management segment includes the management of a broad range of pooled investment vehicles, including the Company’s hedge funds, hedge funds of funds, as well as the Company’s principal investments in public and private securities. The Corporate Credit segment includes the management of collateralized loan obligations, small business loans and certain principal investments through JMP Capital and HCC. The Corporate segment includes revenues and expenses related to JMP Group Inc., the holding company, and JMP Group LLC, and is mainly comprised of corporate overhead expenses and interest expense related to the Company's credit facility with City National Bank.

The accounting policies of the segments are consistent with those described in the Significant Accounting Policies in Note 2.

Management uses Adjusted Operating Net Income as a key metric when evaluating the performance of its segments. This measure adjusts the Company's net income as follows: (i) reverses stock-based compensation expense related to equity awards granted both at the time of JMP Group's May 2007 initial public offering and thereafter, (ii) recognizes 100% of the cost of deferred compensation in the period for which such compensation was awarded, instead of recognizing such cost over the vesting period as required under GAAP, (iii) excludes the net amortization of liquidity discounts on loans held and asset-backed securities issued by JMP Credit Corporation, (iv) excludes amortization expense related to an intangible asset, (v) reverses net unrealized gains and losses on strategic equity investments and warrants, (vi) excludes unrealized mark-to-market gains or losses on the investment portfolio at HCC, (vii) excludes a bargain purchase gain resulting from the acquisition of Cratos Capital Partners by JMP Credit Corporation, (viii) includes a non-recurring expense of $450,000 in connection with the proposed initial public offering of HCC through Harvest Capital Credit Corporation, which has filed a registration statement on Form N-2 with the SEC, and (ix) excludes gains or losses recognized by JMP Credit Corporation due to the sale or payoff of loans originally included in the portfolio acquired by JMP Group in April 2009. These charges may otherwise obscure the company's operating income and complicate an assessment of the company's core business activities. The operating pre-tax net income facilitates a meaningful comparison of the segment's results in a given period to those in prior and future periods. The revenues and expenses are presented on a basis that deconsolidates the investment funds Harvest manages.

The Company’s segment information for the years ended December 31, 2012, 2011 and 2010 was prepared using the following methodology:

- Revenues and expenses directly associated with each segment are included in determining segment operating income.
- Revenues and expenses not directly associated with a specific segment are allocated based on the most relevant measures applicable, including revenues, headcount and other factors.
- Each segment’s operating expenses include: a) compensation and benefits expenses that are incurred directly in support of the segments and b) other operating expenses, which include expenses for premises and occupancy, professional fees, travel and entertainment, communications and information services, equipment and indirect support costs (including compensation and other operating expenses related thereto) for administrative services.

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Segment Operating Results

Management believes that the following information provides a reasonable representation of each segment's contribution to revenues, income and assets:

(In thousands)	Year Ended December 31,		
	2012	2011	2010
Broker-Dealer			
Non-interest revenues	$73,451	$73,810	$76,496
Net Interest Income	53	174	68
Total net revenues after provision for loan losses	$73,504	$73,984	$76,564
Non-interest expenses	66,716	70,953	71,618
Segment operating pre-tax net income	$6,788	$3,031	$4,946
Segment assets	$66,611	$69,922	$75,148
Asset Management			
Non-interest revenues	$25,781	$23,809	$15,343
Net Interest Income	157	254	42
Total net revenues after provision for loan losses	$25,938	$24,063	$15,385
Non-interest expenses	19,454	19,634	12,784
Non-controlling interest	1	-	-
Segment operating pre-tax net income	$6,483	$4,429	$2,601
Segment assets	$57,420	$91,181	$81,396
Corporate Credit			
Non-interest revenues	$2,278	$3,726	$1,386
Net Interest Income	18,748	21,347	21,472
Provision for loan losses	(185)	(512)	(997)
Total net revenues after provision for loan losses	$20,841	$24,561	$21,861
Non-interest expenses	(3,414)	1,368	1,749
Non-controlling interest	670	590	1,390
Segment operating pre-tax net income	$23,585	$22,603	$18,722
Segment assets	$520,174	$486,281	$459,071
Corporate			
Non-interest revenues	$2,428	$367	$1,415
Net Interest Income	357	(446)	(220)
Provision for loan losses	-	478	(330)
Total net revenues after provision for loan losses	$2,785	$399	$865
Non-interest expenses	12,719	8,787	12,230
Segment operating pre-tax net (loss)	$(9,934)	$(8,388)	$(11,365)
Segment assets	$159,233	$133,391	$142,391
Eliminations			
Non-interest revenues	$(543)	$(584)	$(623)
Total net revenues after provision for loan losses	$(543)	$(584)	$(623)
Non-interest expenses	(543)	(563)	(623)
Segment operating pre-tax net (loss)	$-	$(21)	$-
Segment assets	$(93,576)	$(120,112)	$(120,141)
Total Segments			
Non-interest revenues	$103,395	$101,128	$94,017
Net Interest Income	19,315	21,329	21,362
Provision for loan losses	(185)	(34)	(1,327)

Total net revenues after provision for loan losses	$122,525	$122,423	$114,052
Non-interest expenses	94,932	100,179	97,758
Non-controlling interest	671	590	1,390
Segment operating pre-tax net income	$26,922	$21,654	$14,904
Total assets	$709,862	$660,663	$637,865

The following tables reconcile the total segments to consolidated net income before income tax expense and total assets as of and for the years ended December 31, 2012, 2011 and 2010.

(In thousands)	As of and Year Ended December 31, 2012			
	Total Segments	Consolidation Adjustments and Reconciling Items		JMP Consolidated
Non-interest revenues	$ 103,395	$ 6,707	(a)	$ 110,102
Net Interest Income	19,315	(26,410)	(b)	(7,095)
Provision for loan losses	(185)	(2,021)		(2,206)
Total net revenues after provision for loan losses	$ 122,525	$ (21,724)		$ 100,801
Non-interest expenses	94,932	(3,544)	(c)	91,388
Noncontrolling interest	671	4,456		5,127
Operating pre-tax net income (loss)	$ 26,922	$ (22,636)	(d)	$ 4,286
Total assets	$ 709,862	$ -		$ 709,862

(In thousands)	As of and Year Ended December 31, 2011			
	Total Segments	Consolidation Adjustments and Reconciling Items		JMP Consolidated
Non-interest revenues	$ 101,128	$ 14,666	(a)	$ 115,794
Net Interest Income	21,329	(23,720)	(b)	(2,391)
Provision for loan losses	(34)	(1,694)		(1,728)
Total net revenues after provision for loan losses	$ 122,423	$ (10,748)		$ 111,675
Non-interest expenses	100,179	15,620	(c)	115,799
Noncontrolling interest	590	(685)		(95)
Operating pre-tax net income (loss)	$ 21,654	$ (25,683)	(d)	$ (4,029)
Total assets	$ 660,663	$ -		$ 660,663

(In thousands)	As of and Year Ended December 31, 2010			
	Total Segments	Consolidation Adjustments and Reconciling Items		JMP Consolidated
Non-interest revenues	$ 94,017	$ 40,549	(a)	$ 134,566
Net Interest Income	21,362	(9,885)	(b)	11,477
Provision for loan losses	(1,327)	-		(1,327)
Total net revenues after provision for loan losses	$ 114,052	$ 30,664		$ 144,716
Non-interest expenses	97,758	25,971	(c)	123,729
Noncontrolling interest	1,390	1,417		2,807
Operating pre-tax net income (loss)	$ 14,904	$ 3,276	(d)	$ 18,180
Total assets	$ 637,865	$ -		$ 637,865

(a) Non-interest revenue adjustments is comprised of loan sale gains, mark-to-market gains/losses, strategic equity investments and warrants, and fund-related revenues recognized upon consolidation of certain Harvest Funds.
(b) The Net Interest Income adjustment is comprised of the non-cash net amortization of liquidity discounts at JMP Credit, due to scheduled contractual repayments, and amortization expense related to an intangible asset.
(c) Non-interest expense adjustments relate to reversals of stock-based compensation and exclusion of fund-related expenses recognized upon consolidation of certain Harvest Funds.
(d) Reconciling operating pre-tax net income to Consolidated Net Income before income tax expense in the Consolidated Statements of Operations consists of the following:

(In thousands)	Year Ended December 31, 2012	2011	2010
Total Segments adjusted operating pre-tax net income	$ 26,922	$ 21,654	$ 14,905
Adjustments:			
Compensation expense - IPO-related RSUs	-	778	2,576
Compensation expense - post-IPO RSUs	2,492	9,526	4,998
Deferred compensation program accounting adjustment	(6,985)	-	-
HCC IPO administrative expense	(450)	-	-
Net unrealized loss/ (gain) on strategic equity investments and warrants.	527	(441)	(757)
Net amortization of liquidity discounts on loans and asset-backed securities issued	29,208	23,522	9,783
Amortization of intangible asset	-	200	100
Unrealized mark-to-market (gain)/loss - HCC	(627)	16	-
Gain on loan portfolio acquired	(1,581)	(7,861)	(19,975)
Total Consolidation Adjustments and Reconciling Items	22,584	25,742	(3,275)
Consolidated pre-tax net income (loss) attributable to JMP Group Inc.	$ 4,338	$ (4,088)	$ 18,180
Income tax expense (benefit)	1,581	(1,632)	8,577
Consolidated Net Income (Loss) attributable to JMP Group Inc.	$ 2,757	$ (2,456)	$ 9,603

21. Summarized financial information for equity method investments

The tables below present summarized financial information of the hedge funds which the Company accounts for under the equity method. The financial information below represents 100% of the net assets, net realized and unrealized gains (losses) and net investment income (loss) of such hedge funds as of the dates and for the periods indicated.

(In thousands)	As of December 31, 2012 Net Assets	2011 Net Assets
Harvest Opportunity Partners II	$ 84,852	$ 74,953
Harvest Small Cap Partners	288,391	324,453
Harvest Franchise Fund	84,192	-
Harvest Agriculture Select	18,162	12,149
Harvest Technology Partners	32,689	24,571
Harvest Diversified Partners	23,598	23,637

(In thousands)	Year Ended December 31, 2012		2011		2010	
	Net Realized and Unrealized Gains (Losses)	Net Investment Income (Loss)	Net Realized and Unrealized Gains (Losses)	Net Investment Income (Loss)	Net Realized and Unrealized Gains (Losses)	Net Investment Income (Loss)

Harvest Opportunity Partners II	$ 11,752	$ (1,300)	$ 2,100	$ (1,661)	$ 5,210	$ (1,349)
Harvest Small Cap Partners	42,478	(21,096)	63,139	(19,588)	1,927	(11,940)
Harvest Franchise Fund	(7,267)	(215)	-	-	-	-
Harvest Agriculture Select	3,172	(298)	(158)	(308)	123	(236)
Harvest Technology Partners	(577)	(1,032)	2,149	(722)	713	(586)
Harvest Global Select Partners	-	-	-	-	739	(99)
Harvest Diversified Partners	2,626	(417)	1,071	(726)	2,296	(665)

22. Subsequent Events

In January 2013, the Company raised approximately $46.0 million from the sale of 8.00% Senior Notes. The notes will mature on January 15, 2023, and may be redeemed in whole or in part at any time or from time to time at the company's option on or after January 15, 2016, at a redemption price equal to the principal amount redeemed plus accrued and unpaid interest. The notes will bear interest at a rate of 8.00% per year, payable quarterly on January 15, April 15, July 15 and October 15 of each year, beginning on April 15, 2013.

On February 11, 2013, the Company granted approximately 560,000 RSUs and stock options to purchase approximately 1.5 million shares of the Company's common stock to certain employees for long-term incentive purposes. Such RSUs have a required service period of two years and will vest on December 31, 2015. Such stock options have a Company performance-based condition and a three-year service condition and will vest when both of the conditions are met.

On March 5, 2013, the Company's board of directors declared a cash dividend of $0.035 per share of common stock for the fourth quarter of 2012 to be paid on April 5, 2013, to common stockholders of record on March 22, 2013.

23. Selected Quarterly Financial Data (Unaudited)

The following represents the Company's unaudited quarterly results for the years ended December 31, 2012 and 2011. These quarterly results were prepared in accordance with GAAP and reflect all adjustments that are in the opinion of management, necessary for a fair statement of the results.

The quarterly financial data reflect the revisions attributed to the retrospective application of investment company accounting for HCC, as discussed in Note 2 - Summary of Significant Accounting Policies. The revisions resulted in increases to total net revenues after provision for loan losses of $193 thousand, $340 thousand, $371 thousand, and $179 thousand for the quarters ended December 31, 2011, March 31, 2012, June 30, 2012, and September 30, 2012, respectively. The revisions resulted in increases to net income (loss) attributable to JMP Group, Inc. of $56 thousand, $86 thousand, $80 thousand, and $49 thousand for the quarters ended December 31, 2011, March 31, 2012, June 30, 2012, and September 30, 2012, respectively.

JMP Group Inc.
Selected Consolidated Financial Data

(In thousands, except per share data)	Three Months Ended December 31, 2012	September 30, 2012	June 30, 2012	March 31, 2012
Total net revenues after provision for loan losses	$ 23,926	$ 18,310	$ 26,988	$ 31,698
Non-interest expenses:				
Compensation and benefits	10,582	17,358	16,704	21,771
Other expenses	7,035	6,278	5,984	5,676
Total non-interest expenses	17,617	23,636	22,688	27,447
Income (loss) before income tax expense	6,309	(5,326)	4,300	4,251
Income tax expense (benefit)	3,004	(884)	(920)	381
Net income (loss)	3,305	(4,442)	5,220	3,870
Less: Net (loss) income attributable to the non-controlling interest	(2,184)	(2,817)	6,765	3,432
Net income (loss) attributable to JMP Group Inc.	5,489	(1,625)	(1,545)	438
Net income attributable to JMP Group Inc. per common share:				
Basic	$ 0.24	$ (0.07)	$ (0.07)	$ 0.02
Diluted	$ 0.24	$ (0.07)	$ (0.07)	$ 0.02

JMP Group Inc.Selected
Consolidated Financial Data

(In thousands, except per share data)	Three Months Ended December 31, 2011	September 30, 2011	June 30, 2011	March 31, 2011

Total net revenues after provision for loan losses	$19,816	$17,375	$31,461	$42,902
Non-interest expenses:				
Compensation and benefits	22,799	15,970	22,017	28,231
Other expenses	6,573	7,518	6,597	6,094
Total non-interest expenses	29,372	23,488	28,614	34,325
Income (loss) before income tax expense	(9,556)	(6,113)	2,847	8,577
Income tax expense (benefit)	(3,986)	(1,410)	1,281	2,483
Net income (loss)	(5,570)	(4,703)	1,566	6,094
Less: Net (loss) income attributable to the non-controlling interest	318	(3,080)	49	2,556
Net income (loss) attributable to JMP Group Inc.	(5,888)	(1,623)	1,517	3,538
Net income attributable to JMP Group Inc. per common share:				
Basic	$(0.27)	$(0.07)	$0.07	$0.16
Diluted	$(0.26)	$(0.07)	$0.07	$0.15

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Our management, with the participation of the Chairman and Chief Executive Officer and the Chief Financial Officer (our principal executive officer and principal financial officer, respectively), has evaluated our disclosure controls and procedures as of the end of the year covered by this report.

Based on that evaluation, our Chairman and Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the year covered by this report, our disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by us in the reports filed or submitted by us under the Securities Exchange Act of 1934, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by us in such reports is accumulated and communicated to our management, including the Chairman and Chief Executive Officer and the Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

There was no change in our internal control over financial reporting that occurred during the three months ended December 31, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Our management report on internal control over financial reporting is contained in Part II, Item 8 of this annual report on Form 10-K and is incorporated herein by reference.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this item will be contained in the sections of our Proxy Statement for the 2013 Annual Meeting of Stockholders, captioned “Board of Directors,” “Compensation of Directors,” and “Section 16(a) Beneficial Ownership Reporting Compliance,” which is incorporated herein by reference.

Item 11. Executive Compensation

Information with respect to this item will be contained in the sections of our Proxy Statement for the 2013 Annual Meeting of Stockholders, captioned “Executive Compensation” which is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information with respect to this item will be contained in the sections of our Proxy Statement for the 2013 Annual Meeting of Stockholders, captioned “Ownership of Certain Beneficial Owners and Management” and “Equity Compensation Plan Information” which is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Information with respect to this item will be contained in the sections of our Proxy Statement for the 2013 Annual Meeting of Stockholders, captioned “Related Party Transactions” and “Director Independence” which is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

Information with respect to this item will be contained in the sections of our Proxy Statement for the 2013 Annual Meeting of Stockholders, captioned “Fees Paid to Independent Registered Public Accounting Firm” which is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) Documents filed as part of this Form 10-K:

1. Consolidated Financial Statements

The consolidated financial statements required to be filed in the Form 10-K are listed below. The required financial statements appear on pages 65 through 71 herein.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

2. Financial Statement Schedules

Separate financial statement schedules have been omitted either because they are not applicable or because the required information is included in the consolidated financial statements.

3. Exhibits

See the Exhibit Index beginning on page 108 for a list of the exhibits being filed or furnished with or incorporated by reference into this Annual Report on Form 10-K.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: March 8, 2013

JMP Group Inc.
Registrant

By: / S / JOSEPH A. JOLSON
Joseph A. Jolson
Chairman and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Date: March 8, 2013

Signature	Title
/ S / JOSEPH A. JOLSON Joseph A. Jolson	Director, Chairman and Chief Executive Officer (principal executive officer)
/ S / RAYMOND S. JACKSON Raymond S. Jackson	Chief Financial Officer (principal financial and accounting officer)
/ S / CRAIG R. JOHNSON Craig R. Johnson	Director
/ S / DAVID M. DIPIETRO David M. DiPietro	Director
/ S / KENNETH M. KARMIN Kenneth M. Karmin	Director
/ S / MARK L. LEHMANN Mark L. Lehmann	Director
/ S / H. MARK LUNENBURG H. Mark Lunenburg	Director
/ S / JONATHAN M. ORSZAG	Director

Jonathan M. Orszag	
/ S / CARTER D. MACK Carter D. Mack	Director
/ S / GLENN H. TONGUE Glenn H. Tongue	Director

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EXHIBIT INDEX

Exhibit Number	Description
2.1	Reorganization and Exchange Agreement (incorporated by reference to Exhibit 2.1 to the Registrant's registration statement on Form S-1/A (No. 333-140689) filed on May 8, 2007).
2.2	Cratos Purchase Agreement dated March 31, 2009 (incorporated by reference to Exhibit to the Registrant's quarterly report with respect to the quarter ended June 30, 2009 on Form 10-Q filed on August 6, 2009).
3.1	Fourth Amended and Restated Certificate of Incorporation of JMP Group Inc. (incorporated by reference to Exhibit 3.1 to the Registrant's quarterly report with respect to the quarter ended March 31, 2007 on Form 10-Q filed on June 21, 2007).
3.2	Amended and Restated Bylaws of JMP Group Inc. (incorporated by reference to Exhibit 3.2 to the Registrant's quarterly report with respect to the quarter ended March 31, 2007 on Form 10-Q filed on June 21, 2007).
4.1	Form of Certificate Representing Shares of Common Stock (incorporated by reference to Exhibit 4.1 to the Registrant's registration statement on Form S-1/A (No. 333-140689) filed on April 19, 2007).
4.2	Indenture dated as of January 24, 2013, between JMP Group Inc. and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Registrant's current report on Form 8-K filed on January 25, 2013).
4.3	First Supplemental Indenture dated as of January 25, 2013, between JMP Group Inc. and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.2 to the Registrant's current report on Form 8-K filed on January 25, 2013).
4.4	Form of 8.00% Senior Nate due 2023 (included as Exhibit A to Exhibit 4.3 above).
10.1	Amendment Number Three to Credit Agreement, dated As of December 31, 2008 (incorporated by reference to Exhibit 10.1 to the Registrant's current report on Form 8-K filed on January 7, 2009).
10.1.1	Form of Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 10.1.1 to the Registrant's registration statement on Form S-1/A (No. 333-140689) filed on May 8, 2007).
10.2	Form of Partners' Exchange Agreement (incorporated by reference to Exhibit 10.2 to the Registrant's registration statement on Form S-1/A (No. 333-140689) filed on May 8, 2007).

10.3	Credit Agreement Dated August 3, 2006 (incorporated by reference to Exhibit 10.3 to the Registrant’s registration statement on Form S-1/A (No. 333-140689) filed on March 27, 2007).
10.5	Form of Indemnification Agreement (incorporated by reference to Exhibit 10.5 to the Registrant’s registration statement on Form S-1/A (No. 333-140689) filed on March 27, 2007).
10.8	Lease Agreement, Dated December 18, 2003 (incorporated by reference to Exhibit 10.8 to the Registrant’s registration statement on Form S-1 (No. 333-140689) filed on February 14, 2007).
10.8.1	First Amendment Letter to Lease Dated May 10, 2004 (incorporated by reference to Exhibit 10.8.1 to the Registrant’s registration statement on Form S-1/A (No. 333-140689) filed on April 19, 2007).
10.9	Sublease, Dated December 18, 2003 (incorporated by reference to Exhibit 10.9 to the Registrant’s registration statement on Form S-1 (No. 333-140689) filed on February 14, 2007).
10.9.1	Consent to Sublease, Dated December 18, 2003 (incorporated by reference to Exhibit 10.9.1 to the Registrant’s registration statement on Form S-1 (No. 333-140689) filed on February 14, 2007).
10.9.2	Letter Amendment to Consent to Sublease, Dated May 10, 2004 (incorporated by reference to Exhibit 10.9.2 to the Registrant’s registration statement on Form S-1 (No. 333-140689) filed on February 14, 2007).
10.10	JMP Group Inc. 2007 Senior Executive Bonus Plan (incorporated by reference to Exhibit 10.10 to the Registrant’s registration statement on Form S-1/A (No. 333-140689) filed on April 19, 2007).
10.11	JMP Group LLC 2004 Equity Incentive Plan (incorporated by reference to Exhibit 10.11 to the Registrant’s registration statement on Form S-1/A (No. 333-140689) filed on May 8, 2007).
10.12	Form of Stock Pledge Agreement (incorporated by reference to Exhibit 10.12 to the Registrant’s registration statement on Form S-1/A (No. 333-140689) filed on May 8, 2007).
10.13	JMP Group 2007 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to the Registrant's registration statement on Form S-1/A (No. 333-140689) filed on April 19, 2007).

Exhibit Number	Description
10.13.1	Notice of Restricted Stock Unit Agreement (Principal Portion of Award) (incorporated by reference to Exhibit 10.13.1 to the Registrant's quarterly report with respect to the quarter ended March 31, 2008 on Form 10-Q filed May 9, 2008).
10.13.2	Notice of Restricted Stock Unit Agreement (Discount Portion of Award) (incorporated by reference to Exhibit 10.13.2 to the Registrant's quarterly report with respect to the quarter ended March 31, 2008 on Form 10-Q filed May 9, 2008).
10.13.3	Notice of Restricted Stock Unit Agreement (Four-Year Cliff) (incorporated by reference to Exhibit 10.13.3 to the Registrant's quarterly report with respect to the quarter ended March 31, 2008 on Form 10-Q filed May 9, 2008).
10.13.4	Form of 2008 Compensation Program Election Form and Participation Agreement (incorporated by reference to Exhibit 10.13.4 to the Registrant's Current Report on Form 8-K filed February 5, 2009).
10.13.5	Form of Restricted Stock Bonus Award Agreement (incorporated by reference to Exhibit 10.13.4 to the Registrant's Current Report on Form 8-K filed February 5, 2009).
10.15	Amendment Number Two to Credit Agreement (CNB) (incorporated by reference to Exhibit 10.15 to the Registrant's quarterly report with respect to the quarter ended March 31, 2008 on Form 10-Q filed May 9, 2008).
10.16	Amendment Number One to Credit Agreement (CNB) (incorporated by reference to Exhibit 10.16 to the Registrant's annual report on Form 10-K filed on March 9, 2010).
10.17	Summary of Compensation Arrangements with Executive Officers, Dated March 3, 2009 (incorporated by reference to Exhibit 10.1 to the Registrant's quarterly report on Form 10-Q filed on May 8, 2009).
10.18	Summary of Performance Goals under the 2007 Senior Executive Bonus Plan (incorporated by reference to Exhibit 10.1 to the Registrant's quarterly report on Form 10-Q filed on August 10, 2007).
10.19	Form of Tax Identification Agreement (incorporated by reference to Exhibit 10.7 to the Registrant's registration statement on Form S-1/A (No. 333-140689) filed May 8, 2007).
10.20	Form of Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 10.13.6 to the Registrant's quarterly report on Form 10-Q filed on May 6, 2010).

10.20.1	Amendment Number Four to Credit Agreement, Dated January 28, 2010 (incorporated by reference to Exhibit 10.17 to the Registrant’s quarterly report on Form 10-Q filed on May 6, 2010).
10.20.2	Amendment Number Five to Credit Agreement, dated as of April 8, 2011 (incorporated by reference to Exhibit 10.20.2 to the Registrant's quarterly report on Form 10-Q filed on August 4, 2011).
10.20.3	Amendment Number Six to Credit Agreement, dated as of August 24, 2011 (incorporated by reference to the Registrant's current report on Form 8-K filed on August 25, 2011).
10.20.4	Amended and Restated Credit Agreement, dated October 11, 2012 (incorporated by reference to Exhibit 10.20.4 to the Registrant's quarterly report on Form 10-Q filed on November 1, 2012).
10.20.5	Amendment Number Two to Revolving Note and Cash Subordination Agreement & Revolving Note, dated October 11, 2012 (incorporated by reference to Exhibit 10.20.5 to the Registrant's quarterly report on Form 10-Q filed on November 1, 2012).
10.21	Amended Form of Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 10.21 to the Registrant's quarterly report on Form 10-Q filed on August 2, 2012).
21*	List of subsidiaries of JMP Group Inc.
23.1*	Consent of PricewaterhouseCoopers LLP
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101*	The following materials from the Registrant’s Annual Report on Form 10-K for the year ended December 31, 2012, formatted in Extensible Business Reporting Language (XBRL), include: (i) the Consolidated Statements of Income, (ii) the Consolidated Balance Sheets, (iii) the Consolidated Statements of Stockholders' Equity, (iv) the Consolidated Statements of Cash Flows, and (v) related notes.

* Filed herewith

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