UNITY BANCORP INC /NJ/
Form 10-Q
November 09, 2012

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, 2012

OR

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

For the transition period from ____ to ____.

Commission File Number 1-12431

Unity Bancorp, Inc.

(Exact name of registrant as specified in its charter)

New Jersey	22-3282551
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
64 Old Highway 22, Clinton, NJ	08809
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (908) 730-7630

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, as amended, 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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act):

Large accelerated filer o Accelerated filer o Nonaccelerated filer 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

The number of shares outstanding of each of the registrant's classes of common equity stock, as of November 1, 2012 common stock, no par value: 7,506,674 shares outstanding

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PART I CONSOLIDATED FINANCIAL INFORMATION

ITEM 1 Consolidated Financial Statements (Unaudited)

Unity Bancorp, Inc.

Consolidated Balance Sheets

(Unaudited)

(In thousands)	September 30, 2012	December 31, 2011	September 30, 2011
ASSETS			
Cash and due from banks	$ 17,027	$ 17,688	$ 15,965
Federal funds sold and interest-bearing deposits	55,536	64,886	74,125
Cash and cash equivalents	72,563	82,574	90,090
Securities:			
Securities available for sale	90,852	88,765	88,083
Securities held to maturity (fair value of $16,884, $19,879 and $13,782, respectively)	15,585	18,771	12,669
Total securities	106,437	107,536	100,752
Loans:			
SBA loans held for sale	7,708	7,668	9,284
SBA loans held to maturity	59,299	64,175	66,363
SBA 504 loans	41,771	55,108	55,520
Commercial loans	306,569	283,104	284,046
Residential mortgage loans	137,192	134,090	136,942
Consumer loans	44,371	48,447	51,478
Total loans	596,910	592,592	603,633
Allowance for loan losses	(15,294)	(16,348)	(16,447)
Net loans	581,616	576,244	587,186
Premises and equipment, net	12,016	11,350	10,648
Bank owned life insurance ("BOLI")	9,327	9,107	9,033
Deferred tax assets	6,221	6,878	6,889
Federal Home Loan Bank stock	3,989	4,088	4,088
Accrued interest receivable	3,478	3,703	3,519
Other real estate owned ("OREO")	1,456	3,032	3,555
Prepaid FDIC insurance	2,079	2,545	2,653
Goodwill and other intangibles	1,518	1,530	1,533
Other assets	1,975	2,259	706
Total assets	$ 802,675	$ 810,846	$ 820,652
LIABILITIES AND SHAREHOLDERS' EQUITY			

Liabilities:			
Deposits:			
Noninterest-bearing demand deposits	$ 105,529	$ 101,193	$ 93,706
Interest-bearing demand deposits	104,469	104,749	100,807
Savings deposits	295,567	278,603	296,571
Time deposits, under $100,000	78,104	102,809	105,840
Time deposits, $100,000 and over	49,457	56,617	57,247
Total deposits	633,126	643,971	654,171
Borrowed funds	75,000	75,000	75,000
Subordinated debentures	15,465	15,465	15,465
Accrued interest payable	464	523	533
Accrued expenses and other liabilities	2,233	2,329	2,347
Total liabilities	726,288	737,288	747,516
Commitments and contingencies	-	-	-
Shareholders' equity:			
Cumulative perpetual preferred stock	19,968	19,545	19,409
Common stock	54,176	53,746	53,663
Retained earnings (deficit)	1,028	(854)	(1,056)
Accumulated other comprehensive income	1,215	1,121	1,120
Total shareholders' equity	76,387	73,558	73,136
Total liabilities and shareholders' equity	$ 802,675	$ 810,846	$ 820,652
Preferred shares	21	21	21
Issued and outstanding common shares	7,503	7,459	7,413

The accompanying notes to the Consolidated Financial Statements are an integral part of these statements.

Unity Bancorp, Inc.

Consolidated Statements of Income

(Unaudited)

(In thousands, except per share amounts)	For the three months ended September 30, 2012	2011	For the nine months ended September 30, 2012	2011
INTEREST INCOME				
Federal funds sold and interest-bearing deposits	$ 13	$ 6	$ 56	$ 26
Federal Home Loan Bank stock	50	46	144	147
Securities:				
Available for sale	656	804	2,066	2,558
Held to maturity	146	157	482	625
Total securities	802	961	2,548	3,183
Loans:				
SBA loans	881	1,243	2,652	3,671
SBA 504 loans	647	838	2,098	2,626
Commercial loans	4,313	4,417	12,707	13,304
Residential mortgage loans	1,631	1,825	4,869	5,502
Consumer loans	534	616	1,624	1,931
Total loans	8,006	8,939	23,950	27,034
Total interest income	8,871	9,952	26,698	30,390
INTEREST EXPENSE				
Interest-bearing demand deposits	108	137	368	420
Savings deposits	293	536	933	1,701
Time deposits	619	979	2,222	3,119
Borrowed funds and subordinated debentures	824	947	2,486	2,851
Total interest expense	1,844	2,599	6,009	8,091
Net interest income	7,027	7,353	20,689	22,299
Provision for loan losses	1,000	1,400	3,200	5,650
Net interest income after provision for loan losses	6,027	5,953	17,489	16,649
NONINTEREST INCOME				
Branch fee income	383	374	1,131	1,054
Service and loan fee income	366	213	954	840
Gain on sale of SBA loans held for sale, net	46	338	427	848
Gain on sale of mortgage loans, net	662	250	1,526	506
BOLI income	74	74	220	221
Net security gains	7	266	514	353
Other income	236	139	558	534
Total noninterest income	1,774	1,654	5,330	4,356
NONINTEREST EXPENSE				
Compensation and benefits	3,191	2,944	9,505	8,881
Occupancy	690	615	2,038	2,161
Processing and communications	544	549	1,631	1,593
Furniture and equipment	368	384	1,085	1,178

Professional services	196	206	598	599
Loan collection costs	182	235	453	660
OREO expenses	36	491	398	936
Deposit insurance	162	60	502	661
Advertising	181	187	630	510
Other expenses	449	430	1,319	1,328
Total noninterest expense	5,999	6,101	18,159	18,507
Income before provision for income taxes	1,802	1,506	4,660	2,498
Provision for income taxes	606	420	1,583	548
Net income	1,196	1,086	3,077	1,950
Preferred stock dividends and discount accretion	397	386	1,195	1,164
Income available to common shareholders	$ 799	$ 700	$ 1,882	$ 786
Net income per common share - Basic	$ 0.11	$ 0.09	$ 0.25	$ 0.11
Net income per common share - Diluted	$ 0.10	$ 0.09	$ 0.24	$ 0.10
Weighted average common shares outstanding - Basic	7,473	7,413	7,465	7,301
Weighted average common shares outstanding - Diluted	7,782	7,781	7,786	7,719

The accompanying notes to the Consolidated Financial Statements are an integral part of these statements.

Unity Bancorp, Inc.

Consolidated Statements of Comprehensive Income

(Unaudited)

(In thousands)	For the three months ended September 30, 2012	2011	For the nine months ended September 30, 2012	2011
Net income	$ 1,196	$ 1,086	$ 3,077	$ 1,950
Other comprehensive income, net of tax:				
Unrealized gains (losses) on securities:				
Unrealized holding gains arising during period	286	143	405	1,060
Less: Reclassification adjustment for gains included in net income	-	210	337	313
Total unrealized gains (losses) on securities	286	(67)	68	747
Unrealized gains on cash flow hedge derivatives:				
Unrealized holding gains arising during period	-	91	26	250
Total other comprehensive income	286	24	94	997
Total comprehensive income	$ 1,482	$ 1,110	$ 3,171	$ 2,947

The accompanying notes to the Consolidated Financial Statements are an integral part of these statements

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Unity Bancorp, Inc.

Consolidated Statements of Changes in Shareholders’ Equity

For the nine months ended September 30, 2012 and 2011

(Unaudited)

(In thousands)	Preferred stock	Common stock Shares	Common stock Amount	Retained earnings (deficit)	Accumulated other comprehensive income	Total shareholders' equity
Balance, December 31, 2011	$ 19,545	7,459	$ 53,746	$ (854)	$ 1,121	$ 73,558
Net income				3,077		3,077
Unrealized holding gains on securities and cash flow hedge derivatives					94	94
Accretion of discount on preferred stock	423			(423)		-
Dividends on preferred stock (5% annually)				(772)		(772)
Common stock issued and related tax effects (1)		44	430			430
Balance, September 30, 2012	$ 19,968	7,503	$ 54,176	$ 1,028	$ 1,215	$ 76,387

(In thousands)	Preferred stock	Common stock Shares	Common stock Amount	Accumulated deficit	Treasury stock	Accumulated other comprehensive income	Total shareholders' equity
Balance, December 31, 2010	$ 19,019	7,211	$ 55,884	$ (772)	$ (4,169)	$ 123	$ 70,085
Net income				1,950			1,950
Unrealized holding gains on securities and cash flow hedge derivatives						997	997
Accretion of discount on preferred stock	390			(390)			-
Dividends on preferred stock (5% annually)				(776)			(776)
Retire Treasury stock			(3,101)	(1,068)	4,169		-
Common stock issued and related tax effects (1)		202	880				880
Balance, September 30, 2011	$ 19,409	7,413	$ 53,663	$ (1,056)	$ -	$ 1,120	$ 73,136

(1) Includes the issuance of common stock under employee benefit plans, which includes nonqualified stock options and restricted stock expense related entries, employee option exercises and the tax benefit of options exercised.

The accompanying notes to the Consolidated Financial Statements are an integral part of these statements

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Unity Bancorp, Inc.

Consolidated Statements of Cash Flows

(Unaudited)

	For the nine months ended September 30,			
(In thousands)	2012		2011	
OPERATING ACTIVITIES:				
Net income	$	3,077	$	1,950
Adjustments to reconcile net income to net cash provided by operating activities:				
Provision for loan losses		3,200		5,650
Net amortization of purchase premiums and discounts on securities		638		378
Depreciation and amortization		999		785
Deferred income tax expense (benefit)		594		(4)
Net security gains		(514)		(353)
Stock compensation expense		234		145
Loss on sale of OREO		77		198
Gain on sale of mortgage loans held for sale, net		(1,526)		(506)
Gain on sale of SBA loans held for sale, net		(427)		(848)
Origination of mortgage loans held for sale		(71,568)		(29,029)
Origination of SBA loans held for sale		(4,700)		(9,977)
Proceeds from sale of mortgage loans held for sale, net		73,094		29,535
Proceeds from sale of SBA loans held for sale, net		5,087		11,938
Loss on sale or disposal of premises and equipment		23		199
Net change in other assets and liabilities		1,428		3,774
Net cash provided by operating activities		9,716		13,835
INVESTING ACTIVITIES				
Purchases of securities held to maturity		(624)		-
Purchases of securities available for sale		(32,802)		(30,264)

Maturities and principal payments on securities held to maturity		3,706		6,197
Maturities and principal payments on securities available for sale		24,172		27,485
Proceeds from sales of securities held to maturity		-		2,168
Proceeds from sales of securities available for sale		6,638		23,123
Proceeds from redemption of Federal Home Loan Bank stock		99		117
Proceeds from sale of OREO		3,525		1,526
Net decrease (increase) in loans		(11,499)		3,647
Proceeds from sale or disposal of premises and equipment		12		-
Purchases of premises and equipment		(1,493)		(725)
Net cash provided by (used in) investing activities		(8,266)		33,274
FINANCING ACTIVITIES				
Net decrease in deposits		(10,844)		(617)
Proceeds from exercise of stock options		157		446
Dividends on preferred stock		(774)		(774)
Net cash used in financing activities		(11,461)		(945)
Increase (decrease) in cash and cash equivalents		(10,011)		46,164
Cash and cash equivalents, beginning of period		82,574		43,926
Cash and cash equivalents, end of period	$	72,563	$	90,090
SUPPLEMENTAL DISCLOSURES				
Cash:				
Interest paid	$	6,068	$	8,114
Income taxes paid		939		356
Noncash investing activities:				
Transfer of loans to OREO		2,772		4,047

The accompanying notes to the Consolidated Financial Statements are an integral part of these statements

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Unity Bancorp, Inc.

Notes to the Consolidated Financial Statements (Unaudited)

September 30, 2012

NOTE 1. Significant Accounting Policies

The accompanying Consolidated Financial Statements include the accounts of Unity Bancorp, Inc. (the "Parent Company") and its wholly-owned subsidiary, Unity Bank (the "Bank" or when consolidated with the Parent Company, the "Company"), and reflect all adjustments and disclosures which are generally routine and recurring in nature, and in the opinion of management, necessary for a fair presentation of interim results. Unity Investment Services, Inc., a wholly-owned subsidiary of the Bank, is used to hold part of the Bank's investment portfolio. All significant intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications have been made to prior period amounts to conform to the current year presentation, with no impact on current earnings. The financial information has been prepared in accordance with U.S. generally accepted accounting principles and has not been audited. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and revenues and expenses during the reporting periods. Actual results could differ from those estimates. The Company has evaluated subsequent events for potential recognition and/or disclosure through the date the Consolidated Financial Statements included in this Quarterly Report on Form 10-Q were available to be issued.

Estimates that are particularly susceptible to significant changes relate to the determination of the allowance for loan losses, the valuation of deferred income tax assets and the fair value of financial instruments. Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance for loan losses may be necessary based on changes in economic conditions. The interim unaudited Consolidated Financial Statements included herein have been prepared in accordance with instructions for Form 10-Q and the rules and regulations of the Securities and Exchange Commission ("SEC") and consist of normal recurring adjustments necessary for the fair presentation of interim results. The results of operations for the nine months ended September 30, 2012 are not necessarily indicative of the results which may be expected for the entire year. As used in this Form 10-Q, "we" and "us" and "our" refer to Unity Bancorp, Inc., and its consolidated subsidiary, Unity Bank, depending on the context. Certain information and financial disclosures required by generally accepted accounting principles have been condensed or omitted from interim reporting pursuant to SEC rules. Interim financial statements should be read in conjunction with the Company's Consolidated Financial Statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

Stock Transactions

Stock Option Plans

The Company has incentive and nonqualified option plans, which allow for the grant of options to officers, employees and members of the Board of Directors. Transactions under the Company's stock option plans for the nine months ended September 30, 2012 are summarized in the following table:

	Shares	Weighted average exercise price	Weighted average remaining contractual life (in years)	Aggregate intrinsic value
Outstanding at December 31, 2011	643,206	$ 6.80	5.3	$ 517,867
Options granted	2,500	5.95		
Options exercised	(111,208)	4.99		
Options forfeited	(9,999)	6.08		
Options expired	(843)	6.93		
Outstanding at September 30, 2012	523,656	$ 7.19	5.2	$ 315,276
Exercisable at September 30, 2012	408,907	$ 7.48	4.2	$ 280,602

Grants under the Company's incentive and nonqualified option plans generally vest over 3 years and must be exercised within 10 years of the date of grant. The exercise price of each option is the market price on the date of grant. As of September 30, 2012, 1,720,529 shares have been reserved for issuance upon the exercise of options, 523,656 option grants are outstanding, and 1,063,574 option grants have been exercised, forfeited or expired, leaving 133,299 shares available for grant.

The fair values of the options granted during the nine months ended September 30, 2012 and 2011 were estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	For the nine months ended September 30, 2012	2011
Number of options granted	2,500	67,000
Weighted average exercise price	$ 5.95	$ 6.66
Weighted average fair value of options	$ 2.79	$ 3.20
Expected life in years (1)	4.72	4.62
Expected volatility (2)	56.33 %	57.69 %
Risk-free interest rate (3)	0.72 %	1.28 %
Dividend yield (4)	- %	- %

(1) The expected life of the options was estimated based on historical employee behavior and represents the period of time that options granted are expected to be outstanding.
(2) The expected volatility of the Company's stock price was based on the historical volatility over the period commensurate with the expected life of the options.
(3) The risk-free interest rate is the U.S Treasury rate commensurate with the expected life of the options on the date of grant.
(4) The expected dividend yield is the projected annual yield based on the grant date stock price.

Upon exercise, the Company issues shares from its authorized but unissued common stock to satisfy the options. The following table presents information about options exercised during nine months ended September 30, 2012 and 2011:

	For the three months ended September 30, 2012	2011	For the nine months ended September 30, 2012	2011
Number of options exercised	107,367	738	111,208	233,105
Total intrinsic value of options exercised	$ 109,896	$ 2,294	$ 115,951	$ 753,440
Cash received from options exercised	148,226	2,610	169,636	445,515
Tax deduction realized from options exercised	40,401	569	40,913	298,494

The following table summarizes information about stock options outstanding and exercisable at September 30, 2012:

	Options outstanding			Options exercisable	
Range of exercise prices	Options outstanding	Weighted average remaining contractual	Weighted average exercise price	Options exercisable	Weighted average exercise price

		life (in years)						
$	0.00 - 4.00	119,750	6.6	$	3.87	103,832	$	3.86
	4.01 - 8.00	226,158	7.0		6.52	127,327		6.54
	8.01 - 12.00	121,107	1.4		9.22	121,107		9.22
	12.01 - 16.00	56,641	3.4		12.54	56,641		12.54
	Total	523,656	5.2	$	7.19	408,907	$	7.48

Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") Topic 718, “Compensation - Stock Compensation,” requires an entity to recognize the fair value of equity awards as compensation expense over the period during which an employee is required to provide service in exchange for such an award (vesting period). Compensation expense related to stock options and the related income tax benefit for the three and nine months ended September 30, 2012 and 2011 are detailed in the following table:

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Compensation expense	$ 38,167	$ 39,716	$ 113,631	$ 85,494
Income tax benefit	11,935	15,615	40,333	32,468

As of September 30, 2012, unrecognized compensation costs related to nonvested share-based compensation arrangements granted under the Company’s stock option plans totaled approximately $231 thousand. That cost is expected to be recognized over a weighted average period of 1.9 years.

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Restricted Stock Awards

Restricted stock is issued under the stock bonus program to reward employees and directors and to retain them by distributing stock over a period of time. The following table summarizes nonvested restricted stock activity for the nine months ended September 30, 2012:

	Shares	Average grant date fair value
Nonvested restricted stock at December 31, 2011	93,684	$ 6.06
Granted	1,000	5.95
Vested	(11,534)	6.44
Forfeited	(2,000)	6.25
Nonvested restricted stock at September 30, 2012	81,150	$ 6.00

Restricted stock awards granted to date vest over a period of 4 years and are recognized as compensation to the recipient over the vesting period. The awards are recorded at fair market value at the time of grant and amortized into salary expense on a straight line basis over the vesting period. As of September 30, 2012, 221,551 shares of restricted stock were reserved for issuance, of which 46,162 shares are available for grant.

Restricted stock awards granted during the nine months ended September 30, 2012 and 2011 were as follows:

	For the nine months ended September 30,	
	2012	2011
Number of shares granted	1,000	22,500
Average grant date fair value	$ 5.95	$ 6.66

Compensation expense related to the restricted stock for the three and nine months ended September 30, 2012 and 2011 is detailed in the following table:

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Compensation expense	$ 39,301	$ 28,608	$ 120,413	$ 60,025

As of September 30, 2012, there was approximately $389 thousand of unrecognized compensation cost related to nonvested restricted stock awards granted under the Company's stock incentive plans. That cost is expected to be recognized over a weighted average period of 2.8 years.

Income Taxes

The Company follows FASB ASC Topic 740, "Income Taxes," which prescribes a threshold for the financial statement recognition of income taxes and provides criteria for the measurement of tax positions taken or expected to be taken in a tax return. ASC 740 also includes guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition of income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the enacted tax rates applicable to taxable income for the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation reserves are established against certain deferred tax assets when it is more likely than not that the deferred tax assets will not be realized. Increases or decreases in the valuation reserve are charged or credited to the income tax provision.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that ultimately would be sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. The evaluation of a tax position taken is considered by itself and not offset or aggregated with other positions. Tax positions that meet the more likely than not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

Interest and penalties associated with unrecognized tax benefits are recognized in income tax expense on the income statement.

Derivative Instruments and Hedging Activities

The Company may use derivative instruments, such as interest rate swaps, to manage interest rate risk. The Company recognizes all derivative instruments at fair value as either assets or liabilities in other assets or other liabilities. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship. For derivatives not designated as an accounting hedge, the gain or loss is recognized in trading noninterest income. The Company had no derivative instruments at September 30, 2012, and all of the Company's derivative instruments qualified as hedging instruments at December 31, 2011.

For those derivative instruments that are designated and qualify as hedging instruments, the Company must designate the hedging instrument, based on the exposure being hedged, as a fair value hedge, a cash flow hedge or a hedge of a net investment in a foreign operation. The Company does not have any fair value hedges or hedges of foreign operations.

The Company formally documents the relationship between the hedging instruments and hedged item, as well as the risk management objective and strategy before undertaking a hedge. To qualify for hedge accounting, the derivatives and hedged items must be designated as a hedge. For hedging relationships in which effectiveness is measured, the Company formally assesses both at inception and on an ongoing basis, if the derivatives are highly effective in offsetting changes in fair values or cash flows of the hedged item. If it is determined that the derivative instrument is not highly effective as a hedge, hedge accounting is discontinued.

For derivatives that are designated as cash flow hedges, the effective portion of the gain or loss on derivatives is reported as a component of other comprehensive income or loss and subsequently reclassified in interest income in the same period during which the hedged transaction affects earnings. As a result, the change in fair value of any ineffective portion of the hedging derivative is recognized immediately in earnings.

The Company will discontinue hedge accounting when it is determined that the derivative is no longer qualifying as an effective hedge; the derivative expires or is sold, terminated or exercised; or the derivative is de-designated as a fair value or cash flow hedge or it is no longer probable that the forecasted transaction will occur by the end of the originally specified time period. If the Company determines that the derivative no longer qualifies as a cash flow or fair value hedge and therefore hedge accounting is discontinued, the derivative will continue to be recorded on the balance sheet at its fair value with changes in fair value included in current earnings.

Loans Held to Maturity and Loans Held for Sale

Loans held to maturity are stated at the unpaid principal balance, net of unearned discounts and net of deferred loan origination fees and costs. Loan origination fees, net of direct loan origination costs, are deferred and are recognized over the estimated life of the related loans as an adjustment to the loan yield utilizing the level yield method.

Interest is credited to operations primarily based upon the principal amount outstanding. When management believes there is sufficient doubt as to the ultimate ability to collect interest on a loan, interest accruals are discontinued and all past due interest, previously recognized as income, is reversed and charged against current period earnings. Payments received on nonaccrual loans are applied as principal. Loans are returned to an accrual status when the ability to collect is reasonably assured and when the loan is brought current as to principal and interest.

Loans are reported as past due when either interest or principal is unpaid in the following circumstances: fixed payment loans when the borrower is in arrears for two or more monthly payments; open end credit for two or more billing cycles; and single payment notes if interest or principal remains unpaid for 30 days or more.

Loans are charged off when collection is sufficiently questionable and when the Company can no longer justify maintaining the loan as an asset on the balance sheet. Loans qualify for charge-off when, after thorough analysis, all possible sources of repayment are insufficient. These include: 1) potential future cash flows, 2) value of collateral, and/or 3) strength of co-makers and guarantors. All unsecured loans are charged off upon the establishment of the loan's nonaccrual status. Additionally, all loans classified as a loss or that portion of the loan classified as a loss is charged off. All loan charge-offs are approved by the Board of Directors.

Nonperforming loans consist of loans that are not accruing interest (nonaccrual loans) as a result of principal or interest being in default for a period of 90 days or more or when the ability to collect principal and interest according to the contractual terms is in doubt. When a loan is classified as nonaccrual, interest accruals discontinue and all past due interest previously recognized as income is reversed and charged against current period income. Generally, until the loan becomes current, any payments received from the borrower are applied to outstanding principal until such time as management determines that the financial condition of the borrower and other factors merit recognition of a portion of such payments as interest income.

The Company evaluates its loans for impairment. A loan is considered impaired when, based on current information and events; it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. The Company has defined impaired loans to be all troubled debt restructurings and nonperforming loans. Impairment is evaluated in total for smaller-balance loans of a similar nature (consumer and residential mortgage loans), and on an individual basis for other loans. Troubled debt restructurings ("TDRs") occur when a creditor, for economic or legal reasons related to a debtor's financial condition, grants a concession to the debtor that it would not otherwise consider. These concessions typically include reductions in interest rate, extending the maturity of a loan, or a combination of both. Interest income on accruing TDRs is credited to operations primarily based upon the principal amount outstanding, as stated in the paragraphs above. Impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate. Impairment can also be measured based on a loan's observable market price or the fair value of collateral, net of estimated costs to sell, if the loan is collateral dependent. If the measure of the impaired loan is less than the recorded investment in the loan, the Company establishes a valuation allowance, or adjusts existing valuation allowances, with a corresponding charge or credit to the provision for loan losses.

Loans held for sale are SBA loans and are reflected at the lower of aggregate cost or market value. The net amount of loan origination fees on loans sold is included in the carrying value and in the gain or loss on the sale.

The Company originates loans to customers under an SBA program that historically has provided for SBA guarantees of up to 90 percent of each loan. The Company generally sells the guaranteed portion of its SBA loans to a third party and retains the servicing, holding the nonguaranteed portion in its portfolio. When sales of SBA loans do occur, the premium received on the sale and the present value of future cash flows of the servicing assets are recognized in income.

Serviced loans sold to others are not included in the accompanying consolidated balance sheets. Income and fees collected for loan servicing are credited to noninterest income when earned, net of amortization on the related servicing assets.

For additional information see the section titled "Loan Portfolio" under Item 2. Management's Discussion and Analysis.

Allowance for Loan Losses and Unfunded Loan Commitments

The allowance for loan losses is maintained at a level management considers adequate to provide for probable loan losses as of the balance sheet date. The allowance is increased by provisions charged to expense and is reduced by net charge-offs.

The level of the allowance is based on management's evaluation of probable losses in the loan portfolio, after consideration of prevailing economic conditions in the Company's market area, the volume and composition of the loan portfolio, and historical loan loss experience. The allowance for loan losses consists of specific reserves for individually impaired credits and troubled debt restructurings, reserves for nonimpaired loans based on historical loss factors and reserves based on general economic factors and other qualitative risk factors such as changes in delinquency trends, industry concentrations or local/national economic trends. This risk assessment process is performed at least quarterly, and, as adjustments become necessary, they are realized in the periods in which they become known.

Although management attempts to maintain the allowance at a level deemed adequate to provide for probable losses, future additions to the allowance may be necessary based upon certain factors including changes in market conditions and underlying collateral values. In addition, various regulatory agencies periodically review the adequacy of the Company's allowance for loan losses. These agencies may require the Company to make additional provisions based on their judgments about information available to them at the time of their examination.

The Company maintains an allowance for unfunded loan commitments at a level that management believes is adequate to absorb estimated probable losses. Adjustments to the allowance are made through other expenses and applied to the allowance which is classified as other liabilities.

For additional information, see the sections titled "Asset Quality" and "Allowance for Loan Losses and Unfunded Loan Commitments" under Item 2. Management's Discussion and Analysis.

Other-Than-Temporary Impairment

The Company has a process in place to identify debt securities that could potentially incur credit impairment that is other-than-temporary. This process involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concern warrants such evaluation. This evaluation considers relevant facts and circumstances in evaluating whether a credit or interest rate-related impairment of a security is other-than-temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events and (4) for fixed maturity securities, our intent to sell a security or whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity and for equity securities, our ability and intent to hold the security for a forecasted period of time that allows for the recovery in value.

For debt securities, management assesses its intent to sell or whether it is more likely than not that it will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other-than-temporarily impaired where management has no intent to sell and the Company has no requirement to sell prior to recovery of its amortized cost basis, the amount of the impairment is separated into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and is recognized in other comprehensive income.

The present value of expected future cash flows is determined using the best estimate cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best estimate cash flows vary depending on the type of security. The asset-backed securities cash flow estimates are based on bond specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds and structural support, including subordination and guarantees. The corporate bond cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or the disposition of assets using bond specific facts and circumstances including timing, security interests and loss severity.

NOTE 2. Litigation

From time to time, the Company is subject to legal proceedings and claims in the ordinary course of business. The Company currently is not aware of any such legal proceedings or claims that it believes will have, individually or in the aggregate, a material adverse effect on the business, financial condition, or the results of operations of the Company.

NOTE 3. Net Income per Share

Basic net income per common share is calculated as net income available to common shareholders divided by the weighted average common shares outstanding during the reporting period. Net income available to common shareholders is calculated as net income less accrued dividends and discount accretion related to preferred stock.

Diluted net income per common share is computed similarly to that of basic net income per common share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if all potentially dilutive common shares, principally stock options and warrants were issued during the reporting period utilizing the Treasury stock method.

The following is a reconciliation of the calculation of basic and diluted income per share.

(In thousands, except per share amounts)	For the three months ended September 30, 2012	For the three months ended September 30, 2011	For the nine months ended September 30, 2012	For the nine months ended September 30, 2011
Net income	$ 1,196	$ 1,086	$ 3,077	$ 1,950
Less: Preferred stock dividends and discount accretion	397	386	1,195	1,164
Income available to common shareholders	$ 799	$ 700	$ 1,882	$ 786
Weighted average common shares outstanding - Basic	7,473	7,413	7,465	7,301
Plus: Potential dilutive common stock equivalents	309	368	321	418
Weighted average common shares outstanding - Diluted	7,782	7,781	7,786	7,719
Net income per common share - Basic	$ 0.11	$ 0.09	$ 0.25	$ 0.11
Net income per common share - Diluted	0.10	0.09	0.24	0.10
Stock options and common stock excluded from the income per share calculation as their effect would have been anti-dilutive	499	385	505	358

The "potential dilutive common stock equivalents" shown in the table above includes the impact of 764,778 common stock warrants issued to the U.S. Department of Treasury under the Capital Purchase Program in December 2008, utilizing the Treasury stock method. These warrants were dilutive for the three and nine months ended September 30, 2012 and 2011.

NOTE 4. Income Taxes

The Company follows FASB ASC Topic 740, “Income Taxes,” which prescribes a threshold for the financial statement recognition of income taxes and provides criteria for the measurement of tax positions taken or expected to be taken in a tax return. ASC 740 also includes guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition of income taxes.

For the quarter ended September 30, 2012, the Company reported income tax expense of $606 thousand for an effective tax rate of 33.6 percent, compared to an income tax expense of $420 thousand and effective tax rate of 27.9 percent for the prior year’s quarter. For the nine months ended September 30, 2012, the Company reported income tax expense of $1.6 million for an effective tax rate of 34.0 percent, compared to an income tax expense of $548 thousand and effective tax rate of 21.9 percent for the nine months ended September 30, 2011. The provision for income taxes for the nine months ended September 30, 2011 included the reversal of $258 thousand of a valuation reserve for deferred taxes related to the net operating loss carry-forward deferred tax asset. Excluding this valuation adjustment, our effective tax rate would have been 32.3 percent.

The Company did not recognize or accrue any interest or penalties related to income taxes during the nine months ended September 30, 2012 or 2011. The Company does not have an accrual for uncertain tax positions as of September 30, 2012 or December 31, 2011, as deductions taken and benefits accrued are based on widely understood administrative practices and procedures and are based on clear and unambiguous tax law. Tax returns for all years 2008 and thereafter are subject to future examination by tax authorities.

NOTE 5. Other Comprehensive Income (Loss)

The following table shows the changes in other comprehensive income (loss) for the three months ended September 30, 2012 and 2011:

	For the three months ended September 30,					
	2012			2011		
(In thousands)	Pre-tax	Tax	After-tax	Pre-tax	Tax	After-tax
Net unrealized gains (losses) on securities:						
Balance, beginning of period			$ 929			$ 1,237
Unrealized holding gains arising during period	$ 477	$ 191	286	$ 207	$ 64	143
Less: Reclassification adjustment for gains included in net income	-	-	-	316	106	210
Net unrealized gains (losses) on securities arising during the period	477	191	286	(109)	(42)	(67)
Balance, end of period			1,215			1,170
Net unrealized gains (losses) on cash flow hedges:						
Balance, beginning of period			$ -			$ (141)

Unrealized holding gain on cash flow hedges arising during the period	$ -	$ -	-	$ 153	$ 62	91
Balance, end of period			-			(50)
Total accumulated other comprehensive income			$ 1,215			$ 1,120

The following table shows the changes in other comprehensive income (loss) for the nine months ended September 30, 2012 and 2011:

	For the nine months ended September 30,					
	2012			2011		
(In thousands)	Pre-tax	Tax	After-tax	Pre-tax	Tax	After-tax
Net unrealized gains on securities:						
Balance, beginning of period			$ 1,147			$ 423
Unrealized holding gains arising during period	$ 622	$ 217	405	$ 1,717	$ 657	1,060
Less: Reclassification adjustment for gains included in net income	507	170	337	471	158	313
Net unrealized gains on securities arising during the period	115	47	68	1,246	499	747
Balance, end of period			1,215			1,170
Net unrealized gains (losses) on cash flow hedges:						
Balance, beginning of period			$ (26)			$ (300)
Unrealized holding gain on cash flow hedges arising during the period	$ 43	$ 17	26	$ 416	$ 166	250
Balance, end of period			-			(50)
Total accumulated other comprehensive income			$ 1,215			$ 1,120

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NOTE 6. Fair Value

Fair Value Measurement

The Company follows FASB ASC Topic 820, "Fair Value Measurement and Disclosures," which requires additional disclosures about the Company's assets and liabilities that are measured at fair value. Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. Based on these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and/or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Company utilizes techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in valuation techniques, the Company is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed as follows:

Level 1 Inputs

- Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Generally, this includes debt and equity securities and derivative contracts that are traded in an active exchange market (i.e. New York Stock Exchange), as well as certain U.S. Treasury, U.S. Government and sponsored entity agency mortgage-backed securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 Inputs

- Quoted prices for similar assets or liabilities in active markets.
- Quoted prices for identical or similar assets or liabilities in inactive markets.
- Inputs other than quoted prices that are observable, either directly or indirectly, for the term of the asset or liability (i.e., interest rates, yield curves, credit risks, prepayment speeds or volatilities) or "market corroborated inputs."
- Generally, this includes U.S. Government and sponsored entity mortgage-backed securities, corporate debt securities and derivative contracts.

Level 3 Inputs

- Prices or valuation techniques that require inputs that are both unobservable (i.e. supported by little or no market activity) and that are significant to the fair value of the assets or liabilities.
- These assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Fair Value on a Recurring Basis

The following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis:

Securities Available for Sale

The fair value of available for sale ("AFS") securities is the market value based on quoted market prices, when available, or market prices provided by recognized broker dealers (Level 1). If listed prices or quotes are not available, fair value is based upon quoted market prices for similar or identical assets or other observable inputs (Level 2) or externally developed models that use unobservable inputs due to limited or no market activity of the instrument (Level 3).

As of September 30, 2012, the fair value of the Company's AFS securities portfolio was $90.9 million. Approximately 52 percent of the portfolio was made up of residential mortgage-backed securities, which had a fair value of $47.7 million at September 30, 2012. Approximately $46.2 million of the residential mortgage-backed securities are guaranteed by the Government National Mortgage Association ("GNMA"), the Federal National Mortgage Association ("FNMA") or the Federal Home Loan Mortgage Corporation ("FHLMC"). The underlying loans for these securities are residential mortgages that are geographically dispersed throughout the United States. All AFS securities were classified as Level 2 assets at September 30, 2012. The valuation of AFS securities using Level 2 inputs was primarily determined using the market approach, which uses quoted prices for similar assets or liabilities in active markets and all other relevant information. It includes model pricing, defined as valuing securities based upon their relationship with other benchmark securities.

Interest Rate Swap Agreements

Based on the complex nature of interest rate swap agreements, the markets these instruments trade in are not as efficient and are less liquid than that of Level 1 markets. These markets do, however, have comparable, observable inputs in which an alternative pricing source values these assets or liabilities in order to arrive at a fair value. The fair values of any interest swaps are measured based on the difference between the yield on the existing swaps and the yield on current swaps in the market (i.e. The Yield Book); consequently, they are classified as Level 2 instruments.

There were no changes in the inputs or methodologies used to determine fair value during the period ended September 30, 2012, as compared to the periods ended December 31, 2011 and September 30, 2011. The tables below present the balances of assets and liabilities measured at fair value on a recurring basis as of September 30, 2012 and December 31, 2011.

	September 30, 2012			
(In thousands)	Level 1	Level 2	Level 3	Total
Financial assets:				
Securities available for sale:				
U.S. Government sponsored entities	$ -	$ 2,050	$ -	$ 2,050
State and political subdivisions	-	14,415	-	14,415
Residential mortgage-backed securities	-	47,701	-	47,701
Commercial mortgage-backed securities	-	6,158	-	6,158
Corporate and other securities	-	20,528	-	20,528
Total securities available for sale	$ -	$ 90,852	$ -	$ 90,852

	December 31, 2011			
(In thousands)	Level 1	Level 2	Level 3	Total
Financial assets:				
Securities available for sale:				
U.S. Government sponsored entities	$ -	$ 5,376	$ -	$ 5,376
State and political subdivisions	-	17,878	-	17,878
Residential mortgage-backed securities	-	57,924	-	57,924
Commercial mortgage-backed securities	-	210	-	210
Corporate and other securities	-	7,377	-	7,377
Total securities available for sale	$ -	$ 88,765	$ -	$ 88,765
Financial liabilities:				
Interest rate swap agreements	$	$ 43	$	$ 43

Fair Value on a Nonrecurring Basis

Certain assets and liabilities 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). The following is a description of the valuation methodologies used for instruments measured at fair value on a nonrecurring basis:

Other Real Estate Owned ("OREO")

The fair value was determined using appraisals, which may be discounted based on management’s review and changes in market conditions (Level 3 Inputs). All appraisals must be performed in accordance with the Uniform Standards of Professional Appraisal Practice ("USPAP"). Appraisals are certified to the Company and performed by appraisers on the Company’s approved list of appraisers. Evaluations are completed by a person independent of Company management. The content of the appraisal depends on the complexity of the property. Appraisals are completed on a “retail value” and an “as is value”.

The Company requires current real estate appraisals on all loans that become OREO or in-substance foreclosure, loans that are classified substandard, doubtful or loss, or loans that are over $100,000 and nonperforming. Prior to each balance sheet date, the Company values impaired collateral-dependent loans and OREO based upon a third party appraisal, broker's price opinion, drive by appraisal, automated valuation model, updated market evaluation, or a combination of these methods. The amount is discounted for the decline in market real estate values (for original appraisals), for any known damage or repair costs, and for selling and closing costs. The amount of the discount is dependent upon the method used to determine the original value. The original appraisal is generally used when a loan is first determined to be impaired. When applying the discount, the Company takes into consideration when the appraisal was performed, the collateral’s location, the type of collateral, any known damage to the property and the type of business. Subsequent to entering impaired status and the Company determining that there is a collateral shortfall, the Company will generally, depending on the type of collateral, order a third party appraisal, broker's price opinion, automated valuation model or updated market evaluation. Subsequent to receiving the third party results, the Company will discount the value 6-10% for selling and closing costs.

Partially charged-off loans are measured for impairment based upon an appraisal for collateral-dependant loans. When an updated appraisal is received for a nonperforming loan, the value on the appraisal is discounted in the manner discussed above. If there is a deficiency in the value after the Company applies these discounts, management applies a specific reserve and the loan remains in nonaccrual status. The receipt of an updated appraisal would not qualify as a reason to put a loan back into accruing status. The Company removes loans from nonaccrual status when the borrower makes nine months of contractual payments and demonstrates the ability to service the debt going forward. Charge-offs are determined based upon the loss that management believes the Company will incur after evaluating collateral for impairment based upon the valuation methods described above and the ability of the borrower to pay any deficiency.

Impaired Collateral-Dependent Loans

The fair value of impaired collateral-dependent loans is derived in accordance with FASB ASC Topic 310, "Receivables." Fair value is determined based on the loan's observable market price or the fair value of the collateral. The valuation allowance for impaired loans is included in the allowance for loan losses in the consolidated balance sheets. At September 30, 2012, the valuation allowance for impaired loans was $2.4 million, a decrease of $1.3 million from $3.7 million at June 30, 2012 and $2.1 million from $4.4 million at December 31, 2011.

The following tables present the assets and liabilities carried on the balance sheet by caption and by level within the hierarchy (as described above) as of September 30, 2012 and September 30, 2011 and the fair value gains (losses) recognized during the three and nine months ended September 30, 2012 and 2011:

	Fair value at September 30, 2012				Gains (losses) from fair value changes for the three months ended September 30, 2012	Gains (losses) from fair value changes for the nine months ended September 30, 2012
(In thousands)	Level 1	Level 2	Level 3	Total		
Financial assets:						
OREO	$ -	$ -	$ 269	$ 269	$ (119)	$ (863)
Impaired collateral-dependent loans	-	-	12,162	12,162	1,320	2,067

	Fair value at September 30, 2011				Losses from fair value changes for the three months ended September 30, 2011	Losses from fair value changes for the nine months ended September 30, 2011
(In thousands)	Level 1	Level 2	Level 3	Total		
Financial assets:						
OREO	$ -	$ -	$ 3,028	$ 3,028	$ (325)	$ (550)
Impaired collateral-dependent loans	-	-	13,019	13,019	(381)	(1,821)

Fair Value of Financial Instruments

FASB ASC Topic 825, “Financial Instruments,” requires the disclosure of the estimated fair value of certain financial instruments, including those financial instruments for which the Company did not elect the fair value option. These estimated fair values as of September 30, 2012 and December 31, 2011 have been determined using available market information and appropriate valuation methodologies. Considerable judgment is required to interpret market data to develop estimates of fair value. The estimates presented are not necessarily indicative of amounts the Company could realize in a current market exchange. The use of alternative market assumptions and estimation methodologies could have had a material effect on these estimates of fair value. The methodology for estimating the fair value of financial assets and liabilities that are measured on a recurring or nonrecurring basis are discussed above. The following methods and assumptions were used to estimate the fair value of other financial instruments for which it is practicable to estimate that value:

Cash and Cash Equivalents

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

Securities Held to Maturity

The fair value of held to maturity ("HTM") securities is based upon quoted market prices for similar or identical assets or other observable inputs (Level 2) or externally developed models that use unobservable inputs due to limited or no market activity of the instrument (Level 3).

SBA Loans Held for Sale

The fair value of SBA loans held for sale is estimated by using a market approach that includes significant other observable inputs.

Loans

The fair value of loans is estimated by discounting the future cash flows using current market rates that reflect the interest rate risk inherent in the loan, except for previously discussed impaired loans.

Federal Home Loan Bank Stock

Federal Home Loan Bank stock is carried at cost. Carrying value approximates fair value based on the redemption provisions of the issues.

SBA Servicing Assets

SBA servicing assets do not trade in an active, open market with readily observable prices. The Company estimates the fair value of SBA servicing assets using discounted cash flow models incorporating numerous assumptions from the perspective of a market participant including market discount rates and prepayment speeds.

Deposit Liabilities

The fair value of demand deposits and savings accounts is the amount payable on demand at the reporting date (i.e. carrying value). The fair value of fixed-maturity certificates of deposit is estimated by discounting the future cash flows using current market rates.

Borrowed Funds and Subordinated Debentures

The fair value of borrowings is estimated by discounting the projected future cash flows using current market rates.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Standby Letters of Credit

At September 30, 2012, the Bank had standby letters of credit outstanding of $1.3 million, as compared to $1.8 million at December 31, 2011. The fair value of these commitments is nominal.

The table below presents the carrying amount and estimated fair values of the Company’s financial instruments not previously presented as of September 30, 2012 and December 31, 2011:

		September 30, 2012		December 31, 2011	
(In thousands)	Fair value level	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Financial assets:					
Cash and cash equivalents	Level 1	$ 72,563	$ 72,563	$ 82,574	$ 82,574
Securities held to maturity	Level 2	15,585	16,884	18,771	19,879
SBA loans held for sale	Level 2	7,708	8,417	7,668	8,192
Loans, net of allowance for loan losses	Level 2	573,908	574,969	568,576	572,165
Federal Home Loan Bank stock	Level 2	3,989	3,989	4,088	4,088
SBA servicing assets	Level 3	391	391	418	418
Accrued interest receivable	Level 2	3,478	3,478	3,703	3,703
Financial liabilities:					

Deposits	Level 2	633,126	635,416	643,971	647,281
Borrowed funds and subordinated debentures	Level 2	90,465	100,614	90,465	102,533
Accrued interest payable	Level 2	464	464	523	523

Note 7. Securities

This table provides the major components of securities available for sale ("AFS") and held to maturity ("HTM") at amortized cost and estimated fair value at September 30, 2012 and December 31, 2011:

	September 30, 2012				December 31, 2011			
(In thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Available for sale:								
U.S. Government sponsored entities	$ 1,979	$ 71	$ -	$ 2,050	$ 5,274	$ 102	$ -	$ 5,376
State and political subdivisions	13,853	566	(4)	14,415	17,031	856	(9)	17,878
Residential mortgage-backed securities	46,137	1,700	(136)	47,701	56,546	1,655	(277)	57,924
Commercial mortgage-backed securities	6,128	41	(11)	6,158	208	2	-	210
Corporate and other securities	20,733	389	(594)	20,528	7,799	5	(427)	7,377
Total securities available for sale	$ 88,830	$ 2,767	$ (745)	$ 90,852	$ 86,858	$ 2,620	$ (713)	$ 88,765
Held to maturity:								
State and political subdivisions	$ 2,748	$ 279	$ -	$ 3,027	$ 2,992	$ 192	$ -	$ 3,184
Residential mortgage-backed securities	10,159	381	(9)	10,531	13,083	329	(31)	13,381
Commercial mortgage-backed securities	2,678	648	-	3,326	2,696	618	-	3,314
Total securities held to maturity	$ 15,585	$ 1,308	$ (9)	$ 16,884	$ 18,771	$ 1,139	$ (31)	$ 19,879

This table provides the remaining contractual maturities and yields of securities within the investment portfolios. The carrying value of securities at September 30, 2012 is primarily distributed by contractual maturity. Mortgage-backed securities and other securities, which may have principal prepayment provisions, are distributed based on contractual maturity. Expected maturities will differ materially from contractual maturities as a result of early prepayments and calls. The total weighted average yield excludes equity securities.

	Within one year		After one through five years		After five through ten years		After ten years		Total carrying value	
(In thousands)	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Available for sale at fair value:										
U.S. Government sponsored entities	$ -	- %	$ 1,160	1.40 %	$ 8	0.97 %	$ 882	3.69 %	$ 2,050	2.38 %
State and political subdivisions	-	-	148	6.50	10,077	3.02	4,190	2.42	14,415	3.26
Residential mortgage-backed securities	67	3.46	102	3.35	1,060	4.56	46,472	2.98	47,701	3.01
Commercial mortgage-backed securities	-	-	-	-	-	-	6,158	2.01	6,158	2.01
Corporate and other securities	-	-	3,359	2.55	3,769	3.73	13,400	2.15	20,528	2.51
Total securities available for sale	$ 67	3.46 %	$ 4,769	2.41 %	$ 14,914	3.31 %	$ 71,102	2.75 %	$ 90,852	2.86 %
Held to maturity at cost:										
State and political subdivisions	$ 624	0.75 %	$ -	- %	$ -	- %	$ 2,124	4.69 %	$ 2,748	3.80 %
Residential mortgage-backed securities	-	-	901	4.59	808	4.87	8,450	2.65	10,159	3.00
Commercial mortgage-backed securities	-	-	-	-	-	-	2,678	5.40	2,678	5.40
Total securities held to maturity	$ 624	0.75 %	$ 901	4.59 %	$ 808	4.87 %	$ 13,252	3.53 %	$ 15,585	3.55 %

The fair value of securities with unrealized losses by length of time that the individual securities have been in a continuous unrealized loss position at September 30, 2012 and December 31, 2011 are as follows:

	September 30, 2012						
		Less than 12 months		12 months and greater		Total	
(In thousands)	Total number in a loss position	Estimated fair value	Unrealized loss	Estimated fair value	Unrealized loss	Estimated fair value	Unrealized loss
Available for sale:							
State and political subdivisions	2	$ 779	$ (4)	$ -	$ -	$ 779	$ (4)
Residential mortgage-backed securities	6	2,637	(24)	2,212	(112)	4,849	(136)
Commercial mortgage-backed securities	4	1,527	(11)	-			