

CHICOPEE BANCORP, INC.
Form 10-Q
November 04, 2011

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

FORM 10-Q

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

For the quarterly period ended September 30, 2011

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: 000-51996

CHICOPEE BANCORP, INC.

(Exact name of registrant as specified in its charter)

Massachusetts 20-4840562
(State or other jurisdiction of incorporation or (I.R.S. Employer Identification No.)
organization)

70 Center Street, Chicopee, Massachusetts 01013
(Address of principal executive offices) (Zip Code)

(413) 594-6692
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large Accelerated Filer Accelerated Filer

Non-Accelerated Filer []

Smaller Reporting Company []

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

As of November 4, 2011, there were 5,739,903 shares of the Registrant's Common Stock outstanding.

CHICOPEE BANCORP, INC.
 FORM 10-Q
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CHICOPEE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Dollars In Thousands)

| Assets | September 30, 2011 (Unaudited) | December 31, 2010 |
|---|--------------------------------------|----------------------|
| Cash and due from banks | \$9,333 | \$6,903 |
| Federal funds sold | 38,509 | 28,970 |
| Total cash and cash equivalents | 47,842 | 35,873 |
| Securities available-for-sale, at fair value | 548 | 362 |
| Securities held-to-maturity, at cost (fair value \$62,616 and \$69,912 at September 30, 2011 and December 31, 2010, respectively) | 62,479 | 69,713 |
| Federal Home Loan Bank stock, at cost | 4,489 | 4,489 |
| Loans, net of allowance for loan losses (\$4,322 at September 30, 2011 and \$4,431 at December 31, 2010) | 442,589 | 430,307 |
| Loans held for sale | 988 | 1,888 |
| Other real estate owned | 1,055 | 286 |
| Mortgage servicing rights | 341 | 306 |
| Bank owned life insurance | 13,328 | 13,032 |
| Premises and equipment, net | 10,025 | 10,340 |
| Accrued interest and dividends receivable | 1,721 | 1,897 |
| Deferred income tax asset | 2,508 | 2,469 |
| FDIC prepaid insurance | 947 | 1,361 |
| Other assets | 1,537 | 1,381 |
| Total assets | \$590,397 | \$573,704 |
| Liabilities and Stockholders' Equity | | |
| Deposits | | |
| Non-interest-bearing | \$57,579 | \$48,302 |
| Interest-bearing | 358,778 | 343,635 |
| Total deposits | 416,357 | 391,937 |
| Securities sold under agreements to repurchase | 21,239 | 17,972 |
| Federal Home Loan Bank of Boston advances | 62,142 | 71,615 |
| Accrued expenses and other liabilities | 541 | 298 |
| Total liabilities | 500,279 | 481,822 |
| Stockholders' equity | | |
| Common stock (no par value, 20,000,000 shares authorized, 7,439,368 | | |

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| | | |
|--|-----------|-----------|
| shares issued at September 30, 2011 and December 31, 2010) | 72,479 | 72,479 |
| Treasury stock, at cost (1,689,661 shares at September 30, 2011 and 1,427,390 shares at December 31, 2010) | (22,007) | (18,295) |
| Additional paid-in-capital | 2,643 | 2,255 |
| Unearned compensation (restricted stock awards) | (740) | (1,431) |
| Unearned compensation (Employee Stock Ownership Plan) | (4,240) | (4,463) |
| Retained earnings | 42,029 | 41,308 |
| Accumulated other comprehensive (loss) income | (46) | 29 |
| Total stockholders' equity | 90,118 | 91,882 |
| Total liabilities and stockholders' equity | \$590,397 | \$573,704 |

See accompanying notes to unaudited consolidated financial statements.

CHICOPEE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands, Except for Number of Shares and Per Share Amounts)
(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|--------------|------------------------------------|---------------|
| | 2011 | 2010 | 2011 | 2010 |
| Interest and dividend income: | | | | |
| Loans, including fees | \$5,801 | \$5,862 | \$17,478 | \$17,714 |
| Interest and dividends on securities | 425 | 337 | 1,195 | 941 |
| Other interest-earning assets | 6 | 10 | 27 | 21 |
| Total interest and dividend income | 6,232 | 6,209 | 18,700 | 18,676 |
| Interest expense: | | | | |
| Deposits | 1,292 | 1,516 | 4,017 | 4,467 |
| Securities sold under agreements to repurchase | 8 | 10 | 27 | 55 |
| Other borrowed funds | 414 | 500 | 1,283 | 1,543 |
| Total interest expense | 1,714 | 2,026 | 5,327 | 6,065 |
| Net interest income | 4,518 | 4,183 | 13,373 | 12,611 |
| Provision for loan losses | 223 | 376 | 575 | 761 |
| Net interest income after provision for loan losses | 4,295 | 3,807 | 12,798 | 11,850 |
| Non-interest income: | | | | |
| Service charges, fees and commissions | 549 | 426 | 1,459 | 1,282 |
| Loan sales and servicing, net | 51 | 86 | 250 | 237 |
| Net gain on sales of securities available-for-sale | - | - | 12 | - |
| Gain on acquisition of real estate | 32 | - | 32 | - |
| Loss on sale of other real estate owned | (36) | (15) | (99) | (23) |
| Other than temporary impairment charge | - | - | - | (13) |
| Income from bank owned life insurance | 101 | 106 | 296 | 318 |
| Total non-interest income | 697 | 603 | 1,950 | 1,801 |
| Non-interest expenses: | | | | |
| Salaries and employee benefits | 2,719 | 2,484 | 8,217 | 7,728 |
| Occupancy expenses | 358 | 362 | 1,189 | 1,189 |
| Furniture and equipment | 271 | 209 | 782 | 764 |
| FDIC insurance assessment | 145 | 105 | 414 | 418 |
| Data processing | 299 | 338 | 879 | 903 |
| Professional fees | 129 | 158 | 422 | 416 |
| Advertising | 160 | 131 | 413 | 384 |
| Stationery, supplies and postage | 104 | 79 | 280 | 234 |
| Other non-interest expense | 476 | 460 | 1,485 | 1,445 |
| Total non-interest expenses | 4,661 | 4,326 | 14,081 | 13,481 |
| Income before income taxes | 331 | 84 | 667 | 170 |

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| | | | | | | | | |
|---|-----------|---|-----------|---|-----------|---|-----------|---|
| Income tax benefit | (40 |) | (99 |) | (54 |) | (90 |) |
| Net income | \$371 | | \$183 | | \$721 | | \$260 | |
| Earnings per share: (1) | | | | | | | | |
| Basic | \$0.07 | | \$0.03 | | \$0.13 | | \$0.05 | |
| Diluted | \$0.07 | | \$0.03 | | \$0.13 | | \$0.05 | |
| Adjusted weighted average shares outstanding: | | | | | | | | |
| Basic | 5,305,372 | | 5,685,598 | | 5,368,144 | | 5,710,883 | |
| Diluted | 5,321,435 | | 5,685,598 | | 5,396,608 | | 5,718,995 | |

(1) Common stock equivalents are excluded from the computation of diluted net income per share for the three and nine months ended September 30, 2011 and September 30, 2010, since the inclusion of such equivalents would be anti-dilutive.

See accompanying notes to unaudited consolidated financial statements.

CHICOPEE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Nine Months Ended September 30, 2011 and 2010
(Dollars In Thousands)
(Unaudited)

| | Common Stock | Treasury Stock | Additional Paid-in Capital | Unearned Compensation (restricted stock awards) | Unearned Compensation (Employee Stock Ownership Plan) | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total |
|---|-----------------|-------------------|----------------------------------|---|--|----------------------|---|-----------|
| Balance at December 31, 2010 | \$ 72,479 | \$ (18,295) | \$ 2,255 | \$ (1,431) | \$ (4,463) | \$ 41,308 | \$ 29 | \$ 91,882 |
| Comprehensive income: | | | | | | | | |
| Net income | - | - | - | - | - | 721 | - | 721 |
| Change in net unrealized gain on securities available-for-sale (net of deferred income taxes of \$40) | - | - | - | - | - | - | (75) | (75) |
| Total comprehensive income | | | | | | | | 646 |
| Treasury stock purchased (262,271 shares) | - | (3,712) | - | - | - | - | - | (3,712) |
| Change in unearned compensation: | | | | | | | | |
| Stock option expense | - | - | 308 | - | - | - | - | 308 |
| Restricted stock award expense | - | - | - | 691 | - | - | - | 691 |
| Common stock held by ESOP committed to be released | - | - | 80 | - | 223 | - | - | 303 |
| Balance at September 30, 2011 | \$ 72,479 | \$ (22,007) | \$ 2,643 | \$ (740) | \$ (4,240) | \$ 42,029 | \$ (46) | \$ 90,118 |
| | \$ 72,479 | \$ (13,951) | \$ 1,765 | \$ (2,269) | \$ (4,761) | \$ 40,843 | \$ 66 | \$ 94,172 |

Balance at
December 31, 2009

Comprehensive
income:

| | | | | | | | | |
|------------|---|---|---|---|---|-----|---|-----|
| Net income | - | - | - | - | - | 260 | - | 260 |
|------------|---|---|---|---|---|-----|---|-----|

Change in net
unrealized gain on
securities
available-for-sale
(net of deferred
income taxes of \$3)

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| - | - | - | - | - | - | - | 5 | 5 |
|---|---|---|---|---|---|---|---|---|

Total
comprehensive
income

| |
|-----|
| 265 |
|-----|

Treasury stock
purchased (155,207
shares)

| | | | | | | | | |
|---|----------|---|---|---|---|---|---|----------|
| - | (1,763) | - | - | - | - | - | - | (1,763) |
|---|----------|---|---|---|---|---|---|----------|

Change in unearned
compensation:

Stock option
expense

| | | | | | | | | |
|---|---|-----|---|---|---|---|---|-----|
| - | - | 316 | - | - | - | - | - | 316 |
|---|---|-----|---|---|---|---|---|-----|

Restricted stock
award expense

| | | | | | | | | |
|---|---|---|-----|---|---|---|---|-----|
| - | - | - | 627 | - | - | - | - | 627 |
|---|---|---|-----|---|---|---|---|-----|

Common stock held
by ESOP
committed to
be released

| | | | | | | | | |
|---|---|----|---|-----|---|---|---|-----|
| - | - | 45 | - | 223 | - | - | - | 268 |
|---|---|----|---|-----|---|---|---|-----|

Balance at

| | | | | | | | | |
|--------------------|-----------|-------------|----------|-------------|-------------|-----------|-------|-----------|
| September 30, 2010 | \$ 72,479 | \$ (15,714) | \$ 2,126 | \$ (1,642) | \$ (4,538) | \$ 41,103 | \$ 71 | \$ 93,885 |
|--------------------|-----------|-------------|----------|-------------|-------------|-----------|-------|-----------|

CHICOPEE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

Nine Months Ended
September 30,
2011 2010
(In thousands)

| | | |
|---|----------|----------|
| Cash flows from operating activities: | | |
| Net income | \$721 | \$260 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 734 | 752 |
| Provision for loan losses | 575 | 761 |
| Increase in cash surrender value of life insurance | (296) | (318) |
| Realized gain on sale of securities available-for-sale, net | (12) | - |
| Realized gain on sales of mortgage loans | (107) | (118) |
| Increase in other assets | (193) | (266) |
| Decrease (increase) in accrued interest and dividends receivable | 176 | (39) |
| Decrease in FDIC prepaid insurance | 413 | 428 |
| Net change in loans originated for resale | 900 | (638) |
| Net loss on sale of other real estate owned | 99 | 23 |
| Increase in other liabilities | 241 | 52 |
| Other than temporary impairment charge | - | 13 |
| Change in unearned compensation | 1,302 | 1,211 |
| Net cash provided by operating activities | 4,553 | 2,121 |
| Cash flows from investing activities: | | |
| Additions to premises and equipment | (318) | (336) |
| Loan originations and principal collections, net | (13,942) | (8,767) |
| Proceeds from sale of other real estate owned | 217 | 193 |
| Proceeds from sale of securities available-for-sale | 17 | - |
| Purchases of securities available-for-sale | (304) | - |
| Purchases of securities held-to-maturity | (69,658) | (73,925) |
| Maturities of securities held-to-maturity | 75,333 | 74,590 |
| Proceeds from principal paydowns of securities held-to-maturity | 1,568 | 1,265 |
| Purchase of FHLB stock | - | (183) |
| Net cash used by investing activities | (7,087) | (7,163) |
| Cash flows from financing activities: | | |
| Net increase in deposits | 24,420 | 16,648 |
| Net increase (decrease) in securities sold under agreements to repurchase | 3,268 | (2,358) |
| Proceeds from long-term FHLB advances | - | 24,500 |
| Payments on long-term FHLB advances | (9,473) | (13,396) |
| Stock purchased for treasury | (3,712) | (1,763) |
| Net cash provided by financing activities | 14,503 | 23,631 |
| Net increase in cash and cash equivalents | 11,969 | 18,589 |

| | | |
|--|----------|----------|
| Cash and cash equivalents at beginning of year | 35,873 | 20,075 |
| Cash and cash equivalents at end of period | \$47,842 | \$38,664 |

Supplemental cash flow information:

| | | |
|---|---------|---------|
| Interest paid on deposits | \$4,017 | \$4,467 |
| Interest paid on borrowings | 1,310 | 1,616 |
| Income taxes paid | 120 | 212 |
| Transfers from loans to other real estate owned | 1,085 | 421 |

See accompanying notes to unaudited consolidated financial statements.

CHICOPEE BANCORP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements
At and for the Three and Nine Months Ended September 30, 2011 and 2010

1. Basis of Presentation

Chicopee Bancorp, Inc. (the "Corporation") has no significant assets other than all of the outstanding shares of its wholly-owned subsidiaries, Chicopee Savings Bank (the "Bank") and Chicopee Funding Corporation (collectively, the "Company"). The Corporation was formed on March 14, 2006 and became the holding company for the Bank upon completion of the Bank's conversion from a mutual savings bank to a stock savings bank. The conversion of the Bank was completed on July 19, 2006. The accounts of the Bank include its wholly-owned subsidiaries and a 99% owned subsidiary. The consolidated financial statements of the Company as of September 30, 2011 and for the periods ended September 30, 2011 and 2010 included herein are unaudited. In the opinion of management, all adjustments, consisting only of normal recurring adjustments necessary for a fair presentation of the financial condition, results of operations, changes in stockholders' equity and cash flows, as of and for the periods covered herein, have been made. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2010 included in the Company's Annual Report on Form 10-K.

The results for the three and nine month interim periods ended September 30, 2011 are not necessarily indicative of the operating results for a full year.

2. Earnings Per Share

Basic earnings per share represents income available to common stockholders divided by the adjusted weighted-average number of common shares outstanding during the period. The adjusted outstanding common shares equals the gross number of common shares issued less average treasury shares, unallocated shares of the Chicopee Savings Bank Employee Stock Ownership Plan ("ESOP"), and average dilutive restricted stock awards under the 2007 Equity Incentive Plan. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company relate to outstanding stock options and certain stock awards and are determined using the treasury stock method.

Earnings per share is computed as follows:

| | Three Months Ended September | | Nine Months Ended September | |
|---|---------------------------------|--------------|--------------------------------|--------------|
| | 2011 | 2010 | 2011 | 2010 |
| Net income (in thousands) | \$371 | \$183 | \$721 | \$260 |
| Weighted average number of common shares issued | 7,439,368 | 7,439,368 | 7,439,368 | 7,439,368 |
| Less: average number of treasury shares | (1,617,796) | (1,144,317) | (1,526,242) | (1,090,696) |
| Less: average number of unallocated ESOP shares | (446,363) | (476,120) | (446,363) | (476,120) |
| Less: average number of dilutive restricted stock awards | (69,837) | (133,333) | (98,619) | (161,669) |
| Adjusted weighted average number of common shares outstanding | 5,305,372 | 5,685,598 | 5,368,144 | 5,710,883 |
| Plus: dilutive outstanding restricted stock awards | 16,063 | - | 28,464 | 8,112 |

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| | | | | |
|---|-----------|-----------|-----------|-----------|
| Plus: dilutive outstanding stock options | - | - | - | - |
| Weighted average number of diluted shares outstanding | 5,321,435 | 5,685,598 | 5,396,608 | 5,718,995 |
| Earnings per share: | | | | |
| Basic- common stock | \$0.07 | \$0.03 | \$0.13 | \$0.05 |
| Basic- unvested share-based payment awards | \$0.07 | \$0.03 | \$0.13 | \$0.05 |
| Diluted- common stock | \$0.07 | \$0.03 | \$0.13 | \$0.05 |
| Diluted- unvested share-based payment awards | \$0.07 | \$0.03 | \$0.13 | \$0.05 |

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There were 556,198 and 598,834 stock options that were not included in the calculation of diluted earnings per share for the three and nine months ended September 30, 2011 and 2010, respectively, because their effect was anti-dilutive.

3. Equity Incentive Plan

Stock Options

Under the Company's 2007 Equity Incentive Plan (the "Plan") approved by the Company's stockholders at the annual meeting of the Company's stockholders on May 30, 2007, the Company may grant options to directors, officers and employees for up to 743,936 shares of common stock. Both incentive stock options and non-qualified stock options may be granted under the Plan. The exercise price for each option is equal to the market price of the Company's stock on the date of grant and the maximum term of each option is ten years. The stock options vest over five years in five equal installments on each anniversary of the date of grant.

The Company recognizes compensation expense over the vesting period, based on the grant-date fair value of the options granted. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions for options granted during the years ended December 31, 2010 and 2009, and the nine months ended September 30, 2011:

| | Nine Months Ended September 30, 2011 | Year Ended December 31, 2010 | Year Ended December 31, 2009 |
|-------------------------|---|------------------------------------|------------------------------------|
| Expected dividend yield | 2.00% | 2.00% | 2.00% |
| Expected term | 6.5 years | 6.5 years | 6.5 years |
| Expected volatility | 25.02% | 25.89% | 25.89% |
| Risk-free interest rate | 2.92% | 2.95% | 2.95% |

Expected volatility is based on the historical volatility of the Company's stock and other factors. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. The Company uses historical data, such as option exercise and employee termination rates, to calculate the expected option life.

A summary of options under the Plan as of September 30, 2011, and changes during the nine months then ended, is as follows:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value (000's) |
|-----------------------------------|---------------------|---------------------------------------|---|--|
| Outstanding at December 31, 2010 | 591,334 | \$ 14.21 | 6.48 | \$ 8,403 |
| Granted | 16,000 | 14.10 | 9.35 | - |
| Exercised | 2,300 | 11.20 | 7.39 | - |
| Forfeited or expired | 48,836 | 14.04 | 6.44 | - |
| Outstanding at September 30, 2011 | 556,198 | \$ 14.23 | 6.57 | \$ 7,917 |

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| | | | | | | |
|-----------------------------------|---------|----|-------|------|----|-------|
| Exercisable at September 30, 2011 | 423,157 | \$ | 14.28 | 5.67 | \$ | 6,041 |
| Exercisable at September 30, 2010 | 350,398 | \$ | 14.28 | 6.52 | \$ | 5,004 |

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The Company granted 16,000 stock options in the nine months ended September 30, 2011 with a fair value of \$3.41. The weighted-average grant-date fair value of options granted during 2009 and 2008 was \$3.07 and \$2.37, respectively. There were no options granted during 2010. The weighted average grant-date fair value of the options outstanding and exercisable at September 30, 2011 was \$3.88 and \$3.91, respectively. For the nine months ended September 30, 2011 and 2010, share based compensation expense applicable to options granted under the Plan was \$308,000 and \$316,000 and the related tax benefit was \$66,000 and \$64,000, respectively. During the quarter ended September 30, 2011, 2,000 stock options with an exercise price of \$11.02 per share, and 300 stock options with an exercise price of \$12.41 were exercised. As of September 30, 2011, unrecognized stock-based compensation expense related to non-vested options amounted to \$415,000. This amount is expected to be recognized over a period of 1.39 years.

Stock Awards

Under the Company's 2007 Equity Incentive Plan, the Company may grant stock awards to its directors, officers and employees for up to 297,574 shares of common stock. The stock awards vest 20% per year beginning on the first anniversary of the date of grant. The fair market value of the stock awards, based on the market price at the date of grant, is recorded as unearned compensation. Unearned compensation is amortized over the applicable vesting period. The weighted-average grant-date fair value of stock awards as of September 30, 2011 is \$14.29. The Company recorded compensation cost related to stock awards of approximately \$691,000 and \$627,000 in the nine months ended September 30, 2011 and 2010, respectively. Stock awards with a fair value of \$651,000, and \$777,000 have vested during the years ended December 31, 2010 and 2009, respectively. No stock awards were granted prior to July 1, 2007. The Company granted 2,000 stock awards in the nine months ended September 30, 2011 with a grant price of \$14.29. As of September 30, 2011, unrecognized stock-based compensation expense related to non-vested restricted stock awards amounted to \$652,000. This amount is expected to be recognized over a period of 0.96 years.

A summary of the status of the Company's stock awards as of September 30, 2011, and changes during the nine months ended September 30, 2011, is as follows:

| Nonvested Shares | Number of Shares | Weighted Average Grant-Date Fair Value |
|-------------------------------|---------------------|---|
| Balance at December 31, 2010 | 117,386 | \$ 14.29 |
| Granted | 2,000 | 14.29 |
| Vested | 64,040 | 14.29 |
| Forfeited | - | - |
| Balance at September 30, 2011 | 55,346 | \$ 14.29 |

4. Recent Accounting Pronouncements (Applicable to the Company)

In January 2010, Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2010-06, Fair Value Measurements and Disclosures: Improving Disclosures about Fair Value Measurements, to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires new disclosures regarding transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a rollforward of activities, separately reporting purchases, sales, issuance, and settlements, for assets and liabilities measured using

significant unobservable inputs (Level 3 fair value measurements). The guidance is effective for annual reporting periods that begin after December 15, 2009, and for interim periods within those annual reporting periods except for the changes to the disclosure of rollforward activities for any Level 3 fair value measurements, which are effective for annual reporting periods that begin after December 15, 2010, and for interim periods within those annual reporting periods. Other than requiring additional disclosures, adoption of this new guidance did not have a material impact on the Company's consolidated financial statements.

In July 2010, the FASB issued ASU No. 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. This ASU is intended to provide additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of its allowance for credit losses. The guidance is effective for interim and annual reporting periods ending after December 15, 2010. Other than requiring additional disclosures, adoption of this new guidance did not have a material impact on the Company's consolidated financial statements.

In April 2011, the FASB issued ASU No. 2011-03, Transfer and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements. This ASU removes from the assessment of effective control the criterion relating to the transferor's ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. The guidance is effective for first interim and annual reporting periods ending after December 15, 2011. The Company believes the adoption of this new guidance will not have a material effect on the Company's consolidated financial statements.

In April 2011, the FASB issued ASU No. 2011-02, A Creditor's Determination of whether a Restructuring Is a Troubled Debt Restructuring. The new guidance clarifies when a loan modification or restructuring is considered a troubled debt restructuring ("TDR") in order to address current diversity in practice and lead to more consistent application of accounting principles generally accepted in the United States of America. In evaluating whether a restructuring constitutes a TDR, a creditor must separately conclude that the restructuring constitutes a concession and the debtor is experiencing financial difficulties. Additionally, the guidance clarifies that a creditor is precluded from using the effective interest rate test in the debtor's guidance on restructuring of payables when evaluating whether a restructuring constitutes a TDR. The guidance is effective for interim and annual reporting periods beginning on or after June 15, 2011.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS. This ASU clarifies how to measure fair value, but does not require additional fair value measurement and is not intended to affect current valuation practices outside of financial reporting. However, additional information and disclosure will be required for transfers between Level 1 and Level 2, the sensitivity of a fair value measurement categorized as Level 3, and the categorization of items that are not measured at fair value by level of the fair value hierarchy. The guidance is effective during interim and annual reporting periods beginning after December 15, 2011. The Company is currently evaluating the impact of the clarifications provided in ASU No. 2011-04 on the Company's consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. This ASU will, "require that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income." This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company believes the adoption of this new guidance will not have a material effect on the Company's consolidated financial statements.

Reclassification

Certain amounts in the 2010 financial statements have been reclassified to conform to the current period's presentation. These reclassifications had no effect on the net income previously reported.

5. Comprehensive Income or Loss

Accounting principles generally require recognized revenue, expenses, gains, and losses to be included in net income or loss. Certain changes in assets and liabilities, such as the after-tax effect of unrealized gains and losses on securities available-for-sale, are not reflected in the statement of operations, but the cumulative effect of such items from period-to-period is reflected as a separate component of the equity section of the statement of financial condition (accumulated other comprehensive income or loss). Other comprehensive income or loss, along with net income or loss, comprises the Company's total comprehensive income or loss.

Comprehensive income is comprised of the following:

| | Three Months Ended September 30, | |
|---|-------------------------------------|--------|
| | 2011 | 2010 |
| | (In Thousands) | |
| Net income | \$ 371 | \$ 183 |
| Other comprehensive income, net of tax: | | |
| Unrealized holding (loss) gain on available-for-sale securities arising during the period | (84) | 11 |
| Tax effect | 29 | (4) |
| Other comprehensive (loss) income, net of tax | (55) | 7 |
| Total comprehensive income | \$ 316 | \$ 190 |

| | Nine Months Ended September 30, | |
|--|------------------------------------|--------|
| | 2011 | 2010 |
| | (In Thousands) | |
| Net income | \$ 721 | \$ 260 |
| Other comprehensive income, net of tax: | | |
| Unrealized holding losses on available-for-sale securities arising during the period | (103) | (5) |
| Other than temporary impairment charge, included in net income | - | 13 |
| Reclassification adjustment for gain on sale of securities available-for-sale included in net income | (12) | - |
| Tax effect | 40 | (3) |
| Other comprehensive loss (income), net of tax | (75) | 5 |
| Total comprehensive income | \$ 646 | \$ 265 |

6. Investment Securities

The following table sets forth, at the dates indicated, information regarding the amortized cost and fair values, with gross unrealized gains and losses of the Company's investment securities:

| | September 30, 2011 | | | |
|---|--------------------|------------|------------|-----------|
| | Amortized | Gross | Gross | Fair |
| | Cost | Unrealized | Unrealized | Value |
| | | Gains | Losses | |
| | (In Thousands) | | | |
| Securities available-for-sale | | | | |
| Marketable equity securities ¹ | \$ 618 | \$ 17 | \$ (87) | \$ 548 |
| Total securities available-for-sale | \$ 618 | \$ 17 | \$ (87) | \$ 548 |
| Securities held-to-maturity | | | | |
| Debt securities of U.S. Government | | | | |
| sponsored enterprises | \$ 981 | \$ - | \$ - | \$ 981 |
| U.S. Treasury securities | 23,997 | - | (1) | 23,996 |
| Corporate and industrial revenue bonds | 31,952 | - | - | 31,952 |
| Certificates of deposit | 3,000 | - | - | 3,000 |
| Collateralized mortgage obligations | 2,549 | 138 | - | 2,687 |
| Total securities held-to-maturity | \$ 62,479 | \$ 138 | \$ (1) | \$ 62,616 |
| | | | | |
| | December 31, 2010 | | | |
| | Amortized | Gross | Gross | Fair |
| | Cost | Unrealized | Unrealized | Value |
| | | Gains | Losses | |
| | (In Thousands) | | | |
| Securities available-for-sale | | | | |
| Marketable equity securities ¹ | \$ 319 | \$ 43 | \$ - | \$ 362 |
| Total securities available-for-sale | \$ 319 | \$ 43 | \$ - | \$ 362 |
| Securities held-to-maturity | | | | |
| U.S. Treasury securities | \$ 30,817 | \$ - | \$ (1) | \$ 30,816 |
| Corporate and industrial revenue bonds | 23,348 | - | - | 23,348 |
| Certificates of deposit | 11,725 | - | - | 11,725 |
| Collateralized mortgage obligations | 3,823 | 200 | - | 4,023 |
| Total securities held-to-maturity | \$ 69,713 | \$ 200 | \$ (1) | \$ 69,912 |

¹ Does not include investments in FHLB-Boston stock of \$4.5 million and Banker's Bank stock of \$183,000 respectively, at September 30, 2011 and December 31, 2010.

At September 30, 2011 and December 31, 2010, securities with a carrying value of \$22.3 million and \$25.9 million, respectively, were pledged as collateral to support securities sold under agreements to repurchase.

The amortized cost and estimated fair value of debt securities by contractual maturity at September 30, 2011 are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without prepayment penalties. The collateralized mortgage obligations are allocated to maturity categories according to final maturity date.

| | Held-to-Maturity | |
|--------------------|------------------|------------|
| | Amortized Cost | Fair Value |
| | (In Thousands) | |
| Within 1 year | \$ 27,978 | \$ 27,976 |
| From 1 to 5 years | 3,243 | 3,243 |
| From 5 to 10 years | 10,849 | 10,988 |
| Over 10 years | 20,409 | 20,409 |
| | \$ 62,479 | \$ 62,616 |

Unrealized Losses on Investment Securities

Management conducts, at least on a monthly basis, a review of its investment portfolio including available-for-sale and held-to-maturity (“HTM”) securities to determine if the value of any security has declined below its cost or amortized cost and whether such security is other-than-temporarily impaired (“OTTI”). Securities are evaluated individually based on guidelines established by the FASB and the internal policy of the Company and include but are not limited to: (1) intent and ability of the Company to retain the investment for a period of time sufficient to allow for the anticipated recovery in market value; (2) percentage and length of time which an issue is below book value; (3) financial condition and near-term prospects of the issuer; (4) whether the debtor is current on contractually obligated interest and principal payments; (5) the volatility of the market price of the security; and (6) any other information and observable data considered relevant in determining whether other-than-temporary impairment has occurred, including the expectation of receipt of all principal and interest due.

During the year ended December 31, 2010, management determined that one equity security issued by a company in the financial industry had other-than-temporary impairment for which a charge was recorded in the amount of \$13,000. For the nine months ended September 30, 2011, management determined that there were no securities other-than-temporarily impaired.

The following table presents the fair value of investments with continuous unrealized losses as of September 30, 2011 and December 31, 2010:

| | Less Than Twelve Months | | September 30, 2011 Twelve Months and Over (In Thousands) | | Total | |
|---------------------------------------|-------------------------|-------------------------|---|-------------------------|------------|-------------------------|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Marketable equity securities | \$ 472 | \$ (87) | \$ - | \$ - | \$ 472 | \$ (87) |
| U.S. Treasury securities | 5,997 | (1) | - | - | 5,997 | (1) |
| Total temporarily impaired securities | \$ 6,469 | \$ (88) | \$ - | \$ - | \$ 6,469 | \$ (88) |

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| | Less Than Twelve Months | | Twelve Months and Over (In Thousands) | | Total | |
|---------------------------------------|-------------------------|-------------------------|--|-------------------------|------------|-------------------------|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| U.S. Treasury securities | \$ 17,995 | \$ (1) | \$ - | \$ - | \$ 17,995 | \$ (1) |
| Total temporarily impaired securities | \$ 17,995 | \$ (1) | \$ - | \$ - | \$ 17,995 | \$ (1) |

U.S. Treasury Securities

Unrealized losses within the U.S. Treasury securities category at September 30, 2011, related to two U.S. Treasury securities of which all had losses for less than 12 months. At December 31, 2010, all had unrealized losses for less than 12 months. Management deemed these losses to be immaterial.

Collateralized Mortgage Obligations

As of September 30, 2011 and December 31, 2010, there were no unrealized losses within the CMO portfolio. The portfolio ended the quarter with an unrealized gain of \$138,000 compared to an unrealized gain of \$200,000 at December 31, 2010.

Management reviews these securities on a regular basis for OTTI and considers if the issuer is an agency sponsored by the U.S. Government and whether downgrades by rating agencies have occurred. The Company reviews its CMO portfolio for OTTI similar to its OTTI analysis for its other securities, whereby it considers the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, whether the debtors are current on contractually obligated interest and principal payments, the volatility of the market price of the security, and the Company's intent and ability to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value or until maturity. The Company has the ability and intent to hold these securities until maturity.

As of September 30, 2011, the Company has 15 CMO bonds, or 21 individual issues, with an aggregate book value of \$2.5 million, which included five bonds, or six individual issues, with FICO scores less than 650. This risk is mitigated by loan-to-value ratios of less than 65%. The total exposure of these five bonds to the Company is \$4,800. Since the purchase of these bonds, interest payments have been current and the Company expects to receive all principal and interest due.

These 15 CMO bonds have been substantially paid down with an average current factor of 13.0%, and are backed by well seasoned loans of an earlier vintage, which have not been significantly affected by high delinquency levels or vulnerable to lower collateral coverage as seen in later issued pools. All such CMOs are paying according to their contractual terms and are expected to continue to pay their contractual cash flows.

The Company's remaining 10 CMO bonds are all investment grade and classified as HTM. All of these securities were issued by government sponsored agencies and are all collateralized primarily by AA+ rated Federal Home Loan Mortgage Corporation ("FHLMC") and Federal National Mortgage Association ("FNMA") mortgage loans and, to the best of the Company's knowledge, are not collateralized by sub-prime or Alt-A loans. FHLMC and FNMA guarantees the contractual cash flows of these CMOs. The loans collateralizing such CMOs consist of fixed-rate, 15-year loans, originated in early 2003 and 2004, with average FICO scores between 727 and 766, and average LTV of 60%.

Based on management's analysis, which included the above indicators, the Company has determined that no OTTI exists within the CMO portfolio as of September 30, 2011.

Marketable Equity Securities

Unrealized losses within the marketable equity securities category at September 30, 2011 related to eight securities issued by two companies in the financial industry. In reviewing the marketable securities for OTTI, it was determined that the eight securities did not fail the Company's OTTI test. Three securities issued by one company were in a loss position for four consecutive months and five securities issued by one company were in an unrealized gain position after acquisition with the exception of the stock price at the end of the third quarter. During the third quarter of 2011, none of the eight securities had losses for more than 12 months.

As of December 31, 2010, there were no unrealized losses within the equities portfolio.

Federal Home Loan Bank (“FHLB”) stock and Federal Reserve Bank stock have also been evaluated for impairment. FHLB stock is a non-marketable equity security and therefore is reported at cost, which equals par value. Shares held in excess of the minimum required amount are generally redeemable at par value. However, in the first quarter of 2009 the FHLB announced a moratorium on such redemptions in order to preserve its capital in response to current market conditions and declining retained earnings. The minimum required shares are redeemable, subject to certain limitations, five years following termination of FHLB membership. The Company has no intention of terminating its FHLB membership. For the nine months ended September 30, 2011, the Company received \$10,000 in dividend income from its FHLB stock investment.

The Company periodically evaluates its investment in FHLB stock for impairment based on, among other things, the capital adequacy of the FHLB and its overall financial condition. No impairment losses have been recorded through September 30, 2011.

7. Loans and Allowance for Loan Losses

At September 30, 2011, the Company's net loan portfolio was \$442.6 million, or 75.0% of total assets, compared to \$430.3 million or 75.0% of total assets, at December 31, 2010. The following table sets forth the composition of the Company's loan portfolio in dollar amounts and as a percentage of the respective portfolio.

| | September 30, 2011 | | December 31, 2010 | |
|-------------------------------------|--------------------|---|-------------------|---------------------|
| | Amount | Percent of Total (Dollars In Thousands) | Amount | Percent of Total |
| Real estate loans: | | | | |
| Residential ¹ | \$ 123,955 | 27.8 % | \$ 132,670 | 30.6 % |
| Home equity | 30,246 | 6.8 % | 29,933 | 6.9 % |
| Commercial | 173,297 | 38.9 % | 162,107 | 37.4 % |
| Total | 327,498 | 73.5 % | 324,710 | 74.9 % |
| Construction-residential | 4,828 | 1.1 % | 6,428 | 1.5 % |
| Construction-commercial | 28,781 | 6.4 % | 26,643 | 6.1 % |
| Total construction | 33,609 | 7.5 % | 33,071 | 7.6 % |
| Total real estate loans | 361,107 | 81.0 % | 357,781 | 82.5 % |
| Consumer loans | 2,538 | 0.5 % | 3,165 | 0.7 % |
| Commercial loans | 82,333 | 18.5 % | 72,847 | 16.8 % |
| Total loans | 445,978 | 100.0 % | 433,793 | 100.0 % |
| Net deferred loan origination costs | 933 | | 945 | |
| Allowance for loan losses | (4,322) | | (4,431) | |
| Loans, net | \$442,589 | | \$430,307 | |

¹ Excludes loans held for sale of \$988,000 and \$1.9 million at September 30, 2011 and December 31, 2010, respectively.

The Company has transferred a portion of its originated commercial real estate and commercial loans to participating lenders. The amounts transferred have been accounted for as sales and therefore not included in the Company's consolidated statements of financial condition. The Company and participating lenders share proportionally, based on participating agreements, any gains or losses the may result from the borrowers lack of compliance with the terms of the loan. The Company continues to service the loans on behalf of the participating lenders. At September 30, 2011 and December 31, 2010, the Company was servicing loans for participating lenders totaling \$9.4 million and \$11.8 million, respectively.

In accordance with the Company's asset/liability management strategy and in an effort to reduce interest rate risk, the Company continues to sell fixed rate, low coupon residential real estate loans to the secondary market. The unpaid principal balance of mortgages that are serviced for others was \$78.4 million and \$75.8 million at September 30, 2011 and December 31, 2010, respectively. Servicing rights will continue to be retained on all loans written and sold in the secondary market.

Risk Characteristics

Residential Real Estate Loans enable the borrower to purchase or refinance existing homes, most of which serve as the primary residence of the owner. Repayment is dependent on the credit quality of the borrower. Factors attributable to failure of repayment may include a weakened economy and/or unemployment, as well as possible personal considerations. While we anticipate adjustable-rate mortgages will better offset the potential adverse effects of an increase in interest rates as compared to fixed-rate mortgages, the increased mortgage payments required of adjustable-rate loan borrowers in a rising interest rate environment could cause an increase in delinquencies and defaults. The marketability of the underlying property also may be adversely affected in a high interest rate environment.

Commercial Real Estate Loans are secured by commercial real estate and residential investment real estate and generally have larger balances and involve a greater degree of risk than one- to four-family residential mortgage loans. Risk in commercial real estate and residential investment lending are borrower's creditworthiness and the feasibility and cash flow potential of the project. Payments on loans secured by income properties often depend on successful operation and management of the properties. As a result, repayment of such loans may be subject to a greater extent than residential real estate loans to adverse conditions in the real estate market or the economy.

Construction Loans are generally considered to involve a higher degree of risk of loss than long-term financing on improved, occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the property's value at completion of construction and the estimated cost (including interest) of construction.

Commercial and Industrial Loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. Further, any collateral securing such loans may depreciate over time, may be difficult to appraise and may fluctuate in value.

Consumer and Home Equity Loans may entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by assets that depreciate rapidly. In such cases, repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan and the remaining deficiency often does not warrant further substantial collection efforts against the borrower. In addition, consumer loan collections depend on the borrower's continuing financial stability, and therefore are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans.

Credit Quality

To evaluate the risk in the loan portfolio, internal credit risk ratings are used for the following loan classes: commercial real estate, commercial construction and commercial & industrial. The risks evaluated in determining an adequate credit risk rating, include the financial strength of the borrower and the collateral securing the loan. Commercial loans are rated from one through nine. Credit risk ratings one through five are considered pass ratings. Classified assets include credit risk ratings of special mention through loss. At least quarterly, classified assets are reviewed by management and by an independent third party. Credit risk ratings are updated as soon as information is obtained that indicates a change in the credit risk rating may be warranted.

The following describes the credit risk ratings:

Special Mention. Assets that do not currently expose the Company to sufficient risk to warrant classification in one of the following categories but possess potential weaknesses.

Substandard. Assets that have one or more defined weaknesses and are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Non-accruing loans are typically classified as substandard.

Doubtful. Assets that have the weaknesses of substandard assets with the additional characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss.

Loss. Assets rated in this category are considered uncollectible and are charged off against the allowance for loan losses.

Residential real estate and residential construction loans are categorized into pass and substandard risk ratings. Substandard residential loans are loans that are on nonaccrual status and are individually evaluated for impairment.

Consumer loans are considered nonperforming when they are 90 days past due or have not returned to accrual status. Consumer loans are not individually evaluated for impairment.

Home equity loans are considered nonperforming when they are 90 days past due or have not returned to accrual status. Each nonperforming home equity loan is individually evaluated for impairment.

The following table presents an analysis of total loans segregated by risk rating and class as of September 30, 2011:

| | Commercial Credit Risk Exposure | | | Total |
|------------------------|---------------------------------|-------------------------|------------------------|------------|
| | Commercial | Commercial Construction | Commercial Real Estate | |
| | (In Thousands) | | | |
| Pass | \$ 77,253 | \$ 16,243 | \$ 163,222 | \$ 256,718 |
| Special mention | 2,699 | 12,319 | 6,226 | 21,244 |
| Substandard | 2,381 | 219 | 3,849 | 6,449 |
| Doubtful | - | - | - | - |
| Loss | - | - | - | - |
| Total commercial loans | \$ 82,333 | \$ 28,781 | \$ 173,297 | \$ 284,411 |

| | Residential Credit Risk Exposure | | Total |
|--------------------------------|----------------------------------|--------------------------|------------|
| | Residential Real Estate | Residential Construction | |
| | (In Thousands) | | |
| Pass | \$ 122,123 | \$ 4,828 | \$ 126,951 |
| Substandard (also, nonaccrual) | 1,832 | - | 1,832 |
| Total residential loans | \$ 123,955 | \$ 4,828 | \$ 128,783 |

| | Consumer Credit Risk Exposure | | Total |
|----------------------------|-------------------------------|-------------|-----------|
| | Consumer | Home Equity | |
| | (In Thousands) | | |
| Performing | \$ 2,474 | \$ 30,205 | \$ 32,679 |
| Nonperforming (nonaccrual) | 64 | 41 | 105 |
| Total consumer loans | \$ 2,538 | \$ 30,246 | \$ 32,784 |

The following table presents an analysis of total loans segregated by risk rating and class as of December 31, 2010:

| | Commercial Credit Risk Exposure | | | Total |
|------------------------|---------------------------------|----------------------------|---------------------------|------------|
| | Commercial | Commercial Construction | Commercial Real Estate | |
| | (In Thousands) | | | |
| Pass | \$ 68,048 | \$ 10,484 | \$ 152,062 | \$ 230,594 |
| Special mention | 1,516 | 11,856 | 6,090 | 19,462 |
| Substandard | 3,283 | 4,303 | 3,955 | 11,541 |
| Doubtful | - | - | - | - |
| Loss | - | - | - | - |
| Total commercial loans | \$ 72,847 | \$ 26,643 | \$ 162,107 | \$ 261,597 |

| | Residential Credit Risk Exposure | | Total |
|--------------------------------|----------------------------------|-----------------------------|------------|
| | Residential Real Estate | Residential Construction | |
| | (In Thousands) | | |
| Pass | \$ 129,341 | \$ 6,112 | \$ 135,453 |
| Substandard (also, nonaccrual) | 3,329 | 316 | 3,645 |
| Total residential loans | \$ 132,670 | \$ 6,428 | \$ 139,098 |

| | Consumer Credit Risk Exposure | | Total |
|----------------------------|-------------------------------|----------------|-----------|
| | Consumer | Home Equity | |
| | (In Thousands) | | |
| Performing | \$ 3,093 | \$ 29,729 | \$ 32,822 |
| Nonperforming (nonaccrual) | 72 | 204 | 276 |
| Total consumer loans | \$ 3,165 | \$ 29,933 | \$ 33,098 |

Allowance for loan losses

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

Management believes the allowance for loan losses requires the most significant estimates and assumptions used in the preparation of the consolidated financial statements. The allowance for loan losses is based on management's evaluation of the level of the allowance required in relation to the probable loss exposure in the loan portfolio. The allowance for loan losses is evaluated on a regular basis by management. Qualitative factors, or risks considered in evaluating the adequacy of the allowance for loan losses for all loan classes include historical loss experience; levels and trends in delinquencies, nonaccrual loans, impaired loans and net charge offs; the character and size of the loan portfolio; effects of any changes in underwriting policies; experience of management and staff; current economic conditions and their effect on borrowers; effects of changes in credit concentrations, and management's estimation of probable losses. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard, or special mention. For all classes of loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

The following table sets forth activity in the Company's allowance for loan losses for the periods presented:

| | For the Three Months Ended September 30, | |
|---|---|----------|
| | 2011 | 2010 |
| (In Thousands) | | |
| Allowance for loan losses at beginning of the period: | \$ 4,465 | \$ 4,123 |
| Provision for loan losses | 223 | 376 |
| Recoveries | 3 | 7 |
| Loans charged-off | (369) | (239) |
| Allowance for loan losses, end of period: | \$ 4,322 | \$ 4,267 |

| | For the Nine Months Ended September 30, | |
|---|--|----------|
| | 2011 | 2010 |
| (In Thousands) | | |
| Allowance for loan losses at beginning of the year: | \$ 4,431 | \$ 4,077 |
| Provision for loan losses | 575 | 761 |
| Recoveries | 13 | 19 |
| Loans charged-off | (697) | (590) |
| Allowance for loan losses, end of period: | \$ 4,322 | \$ 4,267 |

There were no changes in the allowance for loan losses methodology during the nine months ended September 30, 2011. The following table presents the allowance for loan losses and select loan information for the three months ended September 30, 2011:

| | Residential | | Commercial | | Commercial | Consumer Loans | Home Equity | Total |
|---|----------------|-----------------------------|----------------|----------------------------|------------|-------------------|----------------|----------|
| | Real Estate | Residential Construction | Real Estate | Commercial Construction | | | | |
| Allowance for loan losses | (In Thousands) | | | | | | | |
| Balance as of June 30, 2011 | \$ 416 | \$ 102 | \$ 1,879 | \$ 419 | \$ 1,483 | \$ 49 | \$ 117 | \$ 4,465 |
| Provision (reduction) for loan losses | 46 | 8 | 18 | 69 | 55 | 10 | 17 | 223 |
| Recoveries | - | - | - | - | - | 3 | - | 3 |
| Loans Charged off | (38) | (34) | - | - | (282) | (15) | - | (369) |
| Balance as of September 30, 2011 | \$ 424 | \$ 76 | \$ 1,897 | \$ 488 | \$ 1,256 | \$ 47 | \$ 134 | \$ 4,322 |

The following table presents the allowance for loan losses and select loan information as of and for the nine months ended September 30, 2011:

| | Residential Real Estate | Residential Construction | Commercial Real Estate | Commercial Construction | Commercial Commercial | Consumer Loans | Home Equity | Total |
|--|-------------------------------|-----------------------------|---------------------------|----------------------------|--------------------------|-------------------|----------------|-----------|
| Allowance for loan losses | (In Thousands) | | | | | | | |
| Balance as of December 31, 2010 | \$513 | \$ 148 | \$ 1,783 | \$ 402 | \$ 1,429 | \$ 28 | \$ 128 | \$4,431 |
| Provision (reduction) for loan losses | (2) | 4 | 277 | 86 | 141 | 57 | 12 | 575 |
| Recoveries | - | - | - | - | - | 13 | - | 13 |
| Loans Charged off | (87) | (76) | (163) | - | (314) | (51) | (6) | (697) |
| Balance as of September 30, 2011 | \$424 | \$ 76 | \$ 1,897 | \$ 488 | \$ 1,256 | \$ 47 | \$ 134 | \$4,322 |
| Allowance for loan losses ending balance | | | | | | | | |
| Collectively evaluated for impairment | \$342 | \$ 76 | \$ 1,817 | \$ 466 | \$ 1,090 | \$ 47 | \$ 121 | \$3,959 |
| Individually evaluated for impairment | 82 | - | 80 | 22 | 166 | - | 13 | 363 |
| | \$424 | \$ 76 | \$ 1,897 | \$ 488 | \$ 1,256 | \$ 47 | \$ 134 | \$4,322 |
| Total loans ending balance | | | | | | | | |
| Collectively evaluated for impairment | \$122,123 | \$ 4,828 | \$ 169,767 | \$ 28,562 | \$ 80,151 | \$ 2,538 | \$ 30,205 | \$438,174 |
| Individually evaluated for impairment | 1,832 | - | 3,530 | 219 | 2,182 | - | 41 | 7,804 |
| | \$123,955 | \$ 4,828 | \$ 173,297 | \$ 28,781 | \$ 82,333 | \$ 2,538 | \$ 30,246 | \$445,978 |

The following table presents the allowance for loan losses and select loan information as of December 31, 2010:

| | Residential Real Estate | Residential Construction | Commercial Real Estate | Commercial Construction | Commercial Commercial | Consumer Loans | Home Equity | Total |
|--|-------------------------------|-----------------------------|------------------------------|----------------------------|--------------------------|-------------------|----------------|-------|
| | (In Thousands) | | | | | | | |

| | | | | | | | | |
|--|------------|----------|------------|-----------|-----------|----------|-----------|------------|
| Allowance for loan losses ending balance | | | | | | | | |
| Collectively evaluated for impairment | \$ 349 | \$ 86 | \$ 1,632 | \$ 374 | \$ 1,016 | \$ 28 | \$ 128 | \$ 3,613 |
| Individually evaluated for impairment | 164 | 62 | 151 | 28 | 413 | - | - | 818 |
| | \$ 513 | \$ 148 | \$ 1,783 | \$ 402 | \$ 1,429 | \$ 28 | \$ 128 | \$ 4,431 |
| Total loans ending balance | | | | | | | | |
| Collectively evaluated for impairment | \$ 129,342 | \$ 6,112 | \$ 158,437 | \$ 24,915 | \$ 69,601 | \$ 3,165 | \$ 29,729 | \$ 421,301 |
| Individually evaluated for impairment | 3,328 | 316 | 3,670 | 1,728 | 3,246 | - | 204 | 12,492 |
| | \$ 132,670 | \$ 6,428 | \$ 162,107 | \$ 26,643 | \$ 72,847 | \$ 3,165 | \$ 29,933 | \$ 433,793 |

Impairment

Loans considered for impairment include all loan classes of commercial and residential, as well as home equity loans. The classes are considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

The Company may periodically agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring (“TDR”). All TDR’s are initially classified as impaired.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer loans for impairment evaluation, except for home equity loans.

The following table presents a summary of information pertaining to impaired loans by class for the three months ended September 30, 2011:

| | Recorded Investment | Unpaid Balance | Average Recorded Investment (In Thousands) | Related Allowance | Interest Income Recognized |
|---------------------------|------------------------|-------------------|---|----------------------|----------------------------------|
| With no related allowance | | | | | |
| Residential real estate | \$1,449 | \$1,449 | \$1,740 | \$- | \$13 |
| Residential construction | - | - | - | - | - |
| Commercial real estate | 3,046 | 3,371 | 2,749 | - | 54 |
| Commercial construction | - | - | - | - | - |
| Commercial | 1,001 | 1,001 | 991 | - | 5 |
| Consumer | - | - | - | - | - |
| Home equity | 6 | 6 | 53 | - | - |
| With an allowance | | | | | |
| Residential real estate | \$382 | \$382 | \$349 | \$82 | \$- |
| Residential construction | - | - | 23 | - | - |
| Commercial real estate | 484 | 484 | 627 | 80 | 3 |
| Commercial construction | 219 | 219 | 220 | 22 | 2 |
| Commercial | 1,182 | 1,182 | 1,989 | 166 | 9 |
| Consumer | - | - | - | - | - |
| Home equity | 35 | 35 | 18 | 13 | - |
| Total | | | | | |
| Residential real estate | \$1,832 | \$1,832 | \$2,089 | \$82 | \$13 |
| Residential construction | - | - | 23 | - | - |
| Commercial real estate | 3,530 | 3,855 | 3,376 | 80 | 57 |
| Commercial construction | 219 | 219 | 220 | 22 | 2 |
| Commercial | 2,182 | 2,182 | 2,980 | 166 | 14 |
| Consumer | - | - | - | - | - |
| Home equity | 41 | 41 | 71 | 13 | - |

No additional funds are committed to be advanced in connection with impaired loans.

The following table presents a summary of information pertaining to impaired loans by class for the nine months ended September 30, 2011:

| | Recorded Investment | Unpaid Balance | Average Recorded Investment (In Thousands) | Related Allowance | Interest Income Recognized |
|---------------------------|------------------------|-------------------|---|----------------------|----------------------------------|
| With no related allowance | | | | | |
| Residential real estate | \$1,449 | \$1,449 | \$1,989 | \$- | \$37 |
| Residential construction | - | - | 24 | - | - |
| Commercial real estate | 3,046 | 3,371 | 2,531 | - | 125 |
| Commercial construction | - | - | 750 | - | - |
| Commercial | 1,001 | 1,001 | 919 | - | 32 |
| Consumer | - | - | - | - | - |
| Home equity | 6 | 6 | 106 | - | - |
| With an allowance | | | | | |
| Residential real estate | \$382 | \$382 | \$586 | \$82 | \$- |
| Residential construction | - | - | 121 | - | - |
| Commercial real estate | 484 | 484 | 870 | 80 | 19 |
| Commercial construction | 219 | 219 | 223 | 22 | 10 |
| Commercial | 1,182 | 1,182 | 2,260 | 166 | 38 |
| Consumer | - | - | - | - | - |
| Home equity | 35 | 35 | 8 | 13 | 2 |
| Total | | | | | |
| Residential real estate | \$1,832 | \$1,832 | \$2,575 | \$82 | \$37 |
| Residential construction | - | - | 145 | - | - |
| Commercial real estate | 3,530 | 3,855 | 3,401 | 80 | 144 |
| Commercial construction | 219 | 219 | 973 | 22 | 10 |
| Commercial | 2,182 | 2,182 | 3,179 | 166 | 70 |
| Consumer | - | - | - | - | - |
| Home equity | 41 | 41 | 114 | 13 | 2 |

No additional funds are committed to be advanced in connection with impaired loans.

The following table presents a summary of information pertaining to impaired loans by class as of December 31, 2010:

| | Recorded Investment | Unpaid Balance | Average Recorded Investment (In Thousands) | Related Allowance | Interest Income Recognized |
|----------------------------------|------------------------|-------------------|---|----------------------|----------------------------------|
| With no related allowance | | | | | |
| Residential real estate | \$2,274 | \$2,274 | \$1,948 | \$- | \$33 |
| Residential construction | 97 | 97 | 179 | - | - |
| Commercial real estate | 2,341 | 2,666 | 1,262 | - | 26 |
| Commercial construction | 1,500 | 1,500 | 1,499 | - | 50 |
| Commercial | 384 | 384 | 1,199 | - | 10 |
| Consumer | - | - | - | - | - |
| Home equity | 204 | 204 | 150 | - | 4 |
| With an allowance | | | | | |
| Residential real estate | \$1,054 | \$1,054 | \$835 | \$164 | \$22 |
| Residential construction | 219 | 219 | 81 | 62 | - |
| Commercial real estate | 1,329 | 1,329 | 1,244 | 151 | 47 |
| Commercial construction | 228 | 228 | 563 | 28 | 16 |
| Commercial | 2,862 | 2,862 | 2,481 | 413 | 129 |
| Consumer | - | - | - | - | - |
| Home equity | - | - | 7 | - | - |
| Total | | | | | |
| Residential real estate | \$3,328 | \$3,328 | \$2,783 | \$164 | \$55 |
| Residential construction | 316 | 316 | 260 | 62 | - |
| Commercial real estate | 3,670 | 3,995 | 2,506 | 151 | 73 |
| Commercial construction | 1,728 | 1,728 | 2,062 | 28 | 66 |
| Commercial | 3,246 | 3,246 | 3,680 | 413 | 139 |
| Consumer | - | - | - | - | - |
| Home equity | 204 | 204 | 157 | - | 4 |

No additional funds are committed to be advanced in connection with impaired loans.

Delinquency and nonaccrual

All loan classes past due greater than 30 days are considered delinquent. The Company calculates the number of days past due based on a 30 day month. Management continuously monitors delinquency and nonaccrual levels and trends.

It is the policy of the Company to discontinue the accrual of interest on all loan classes when principal or interest payments are delinquent 90 days or more. The accrual of interest is also discontinued for impaired loans that are delinquent 90 days or more or at management's discretion.

All interest accrued, but not collected, for all loan classes, including impaired loans that are placed on nonaccrual or charged off, is reversed against interest income. Interest recognized on these loans is limited to interest payments

received until qualifying for return to accrual. All loan classes are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The following table presents an aging analysis of past due loans as of September 30, 2011:

| | 31-59 Days Past Due | 60-89 Days Past Due | Greater than 90 days | Total Past Due | Current | Total Loans |
|--------------------------|---------------------------|---------------------------|----------------------------|-------------------|------------|----------------|
| (In Thousands) | | | | | | |
| Residential real estate | \$ 2,960 | \$ 566 | \$ 1,165 | \$ 4,691 | \$ 119,264 | \$ 123,955 |
| Residential construction | - | - | - | - | 4,828 | 4,828 |
| Commercial real estate | 1,066 | 965 | 380 | 2,411 | 170,886 | 173,297 |
| Commercial construction | - | - | - | - | 28,781 | 28,781 |
| Commercial | 1,260 | 32 | 1,033 | 2,325 | 80,008 | 82,333 |
| Consumer | 129 | 17 | 37 | 183 | 2,355 | 2,538 |
| Home equity | 387 | - | 41 | 428 | 29,818 | 30,246 |
| Total | \$ 5,802 | \$ 1,580 | \$ 2,656 | \$ 10,038 | \$ 435,940 | \$ 445,978 |

The following table presents an aging analysis of past due loans as of December 31, 2010:

| | 31-59 Days Past Due | 60-89 Days Past Due | Greater than 90 days | Total Past Due | Current | Total Loans |
|--------------------------|---------------------------|---------------------------|----------------------------|-------------------|------------|----------------|
| (In Thousands) | | | | | | |
| Residential real estate | \$ 964 | \$ 622 | \$ 2,356 | \$ 3,942 | \$ 128,728 | \$ 132,670 |
| Residential construction | - | - | 316 | 316 | 6,112 | 6,428 |
| Commercial real estate | 340 | 33 | 758 | 1,131 | 160,976 | 162,107 |
| Commercial construction | - | - | - | - | 26,643 | 26,643 |
| Commercial | 105 | 401 | 258 | 764 | 72,083 | 72,847 |
| Consumer | 92 | 3 | 68 | 163 | 3,002 | 3,165 |
| Home equity | 107 | 6 | 117 | 230 | 29,703 | 29,933 |
| Total | \$ 1,608 | \$ 1,065 | \$ 3,873 | \$ 6,546 | \$ 427,247 | \$ 433,793 |

Any loan with a payment more than 30 days past due will be considered delinquent.

The following table presents nonaccrual loans as of September 30, 2011 and December 31, 2010:

| | September 30, 2011 | December 31, 2010 |
|--|------------------------|----------------------|
| | (Dollars In Thousands) | |

Nonaccrual loans:

| | | |
|-------------------------|----------|----------|
| Residential real estate | \$ 1,832 | \$ 3,329 |
| Construction | - | 316 |
| Commercial real estate | 380 | 2,158 |
| Commercial | 1,633 | 391 |
| Home equity | 41 | 204 |
| Consumer | 64 | 72 |
| Total nonaccrual loans | \$ 3,950 | \$ 6,470 |

Troubled Debt Restructurings

The following table sets forth information regarding TDR's at the dates indicated:

| For the Three Months Ended September 30, 2011 | Number of Modifications | Recorded Investment Pre-Modification (In Thousands) | Recorded Investment Post-Modification |
|--|----------------------------|--|---|
| Residential real estate | - | \$ - | \$ - |
| Residential construction | - | - | - |
| Commercial real estate | 1 | 380 | 380 |
| Commercial construction | - | - | - |
| Commercial | - | - | - |
| Consumer | - | - | - |
| Home equity | - | - | - |
| Total | 1 | \$ 380 | \$ 380 |

| For the Nine Months Ended September 30, 2011 | Number of Modifications | Recorded Investment Pre-Modification (In Thousands) | Recorded Investment Post-Modification |
|---|----------------------------|--|---|
| Residential real estate | 1 | \$ 253 | \$ 253 |
| Residential construction | - | - | - |
| Commercial real estate | 6 | 2,755 | 2,430 |
| Commercial construction | - | - | - |
| Commercial | 1 | 134 | 134 |
| Consumer | - | - | - |
| Home equity | - | - | - |
| Total | 8 | \$ 3,142 | \$ 2,817 |

The TDR totals include eight troubled debt restructurings consisting of one nonperforming commercial and industrial loan totaling \$134,000, six commercial real estate loans totaling \$2.4 million and one residential real estate loan totaling \$253,000. As of September 30, 2011, all restructured loans were performing to their modified terms. Management reviews TDR's on a loan by loan basis and applies specific reserves to loan balances in excess of collateral values if sufficient borrower cash flows cannot be identified. The modifications did not result in a reduction of the recorded investment and were primarily the result of rate concessions and extensions of time.

8. Fair Value Measurements

ASC Topic 820, Fair Value Measurements and Disclosures, provides a framework for measuring fair value under U.S. generally accepted accounting principles ("GAAP").

The Company groups its financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the observability of the assumptions used to determine fair value:

Level 1 – Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury Notes and U.S. Government and agency mortgage-backed securities that are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 – Valuations for assets and liabilities with inputs that are observable either directly or indirectly for substantially the full term or valuations obtained from third party pricing services based on quoted market prices for comparable assets or liabilities. Level 2 also includes assets and liabilities traded in inactive markets.

There were no transfers of assets and liabilities between Level 1 and Level 2 during the three and nine months ended September 30, 2011.

Level 3 – Valuations for assets and liabilities with inputs that are unobservable, which are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and are not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets and liabilities. There were no level 3 valuations as of September 30, 2011 or December 31, 2010.

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

| | September 30, 2011 (Dollars In Thousands) | Fair Value Measurements Using | | |
|-------------------------------------|---|--|---|--|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets | | | | |
| Securities available-for-sale | | | | |
| Equity securities by industry type: | | | | |
| Financial | \$ 548 | \$ 548 | \$- | \$- |
| Total equity securities | \$ 548 | \$ 548 | \$- | \$- |

| | December 31, 2010 (Dollars In Thousands) | Fair Value Measurements Using | | |
|-------------------------------------|--|--|---|--|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets | | | | |
| Securities available-for-sale | | | | |
| Equity securities by industry type: | | | | |
| Financial | \$ 362 | \$ 362 | \$- | \$- |
| Total equity securities | \$ 362 | \$ 362 | \$- | \$- |

The valuation approach used to value the securities available-for-sale was the market approach. Also, the Company may be required, from time to time, to measure certain other financial assets on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting or write-downs of individual assets. The following table summarizes the fair value hierarchy used to determine each adjustment and the carrying value of the related individual assets:

| | September 30, 2011 | Fair Value Measurements Using | | |
|--|-----------------------|--|---|--|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) (Dollars In Thousands) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets | | | | |
| Impaired loans with a valuation allowance, net | \$1,939 | \$- | \$1,939 | \$- |
| Other real estate owned | 1,055 | - | 1,055 | - |
| Loans held for sale | 988 | - | 988 | - |
| Mortgage servicing rights | 355 | - | 355 | - |

| | December 31, 2010 | Fair Value Measurements Using | | |
|--|----------------------|--|---|--|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) (Dollars In Thousands) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets | | | | |
| Impaired loans with a valuation allowance, net | \$4,874 | \$- | \$4,874 | \$- |
| Other real estate owned | 286 | - | 286 | - |
| Loans held for sale | 1,888 | - | 1,888 | - |
| Mortgage servicing rights | 455 | - | 455 | - |

A valuation reserve, for the above impaired loans, of \$363,000 and \$818,000 as of September 30, 2011 and December 31, 2010, respectively, was included in the allowance for loan losses. The amount of impaired loans represents the carrying value, net of the related allowance for loan losses on impaired loans for which adjustments are based on the appraised value of the collateral which is based on the market approach of valuation.

Real estate acquired through foreclosure (“OREO”). OREO is recorded at fair value less costs to sell. The Company acquires property through foreclosure or acceptance of a deed in lieu-of-foreclosure as OREO. The valuation of this property is accounted for individually based on its net realizable value on the date of acquisition. At the acquisition date, if the net realizable value of the property is less than the book value of the loan, a charge or reduction in the allowance for loan losses is recorded. If the value of the property becomes subsequently impaired, as determined by an appraisal or an evaluation in accordance with the Company’s appraisal policy, the decline is recorded by a charge against current earnings. Upon acquisition of a property, a current appraisal or broker’s opinion must substantiate market value for the property. As such, the Company records other real estate owned as nonrecurring Level 2.

ASC Topic 825, Fair Value Measurements and Disclosures, requires disclosures of fair value information about financial instruments, whether or not recognized in the balance sheet, if the fair values can be reasonably determined. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques using observable inputs when available. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

Cash and cash equivalents. The carrying amounts of cash and short-term instruments approximate fair values.

Securities. Fair values for securities, excluding Federal Home Loan Bank stock, are based on quoted market prices. The carrying value of Federal Home Loan Bank stock approximates fair value based on the redemption provisions of the Federal Home Loan Bank.

Loans receivable. For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Mortgage loans held for sale. Loans held for sale are recorded at the lower of carrying value or market value. The fair value of mortgage loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, the Company classifies mortgage loans held for sale as nonrecurring Level 2.

Mortgage servicing rights. Mortgage servicing rights are recognized when they are acquired through the sale of loans, and are reported in other assets. They are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Management uses an independent firm which specializes in the valuation of mortgage servicing rights to determine the fair value. The Company uses the amortization method for financial reporting. As such, the Company classifies mortgage servicing rights as nonrecurring Level 2.

Deposit liabilities and mortgagors' escrow accounts. The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregate expected monthly maturities on time deposits.

Securities sold under agreements to repurchase. The carrying amounts of borrowings under repurchase agreements maturing within ninety days approximate their fair values.

Advances from Federal Home Loan Bank. The fair values of these borrowings are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Accrued interest and dividends. The carrying amounts of accrued interest and dividends approximate fair value.

Off-balance sheet instruments. The Company's off-balance-sheet instruments consist of loan commitments. Fair values for loan commitments have not been presented as the future revenue derived from such financial instruments is not significant.

The carrying amounts and estimated fair values of the Company's financial instruments are as follows:

| | September 30, 2011 | | December 31, 2010 | |
|---|--------------------|------------|-------------------|------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial assets: | | | | |
| Cash and cash equivalents | \$47,842 | \$47,842 | \$35,873 | \$35,873 |
| Securities available-for-sale | 548 | 548 | 362 | 362 |
| Securities held-to-maturity | 62,479 | 62,616 | 69,713 | 69,912 |
| Federal Home Loan Bank stock | 4,489 | 4,489 | 4,489 | 4,489 |
| Loans, net | 442,589 | 440,863 | 430,307 | 426,024 |
| Loans held for sale | 988 | 988 | 1,888 | 1,888 |
| Accrued interest and dividends receivable | 1,721 | 1,721 | 1,897 | 1,897 |
| Mortgage servicing rights | 341 | 355 | 306 | 455 |
| Financial liabilities: | | | | |
| Deposits | \$416,357 | \$417,809 | \$391,937 | \$390,951 |
| Repurchase agreements | 21,239 | 21,239 | 17,972 | 17,972 |
| Advances from Federal Home Loan Bank | 62,142 | 64,506 | 71,615 | 73,241 |
| Accrued interest payable | 133 | 133 | 162 | 162 |

9. Common Stock

On November 19, 2010 the Company announced that its Board of Directors authorized a fifth stock repurchase program (the "Fifth Stock Repurchase Program") for the purchase of up to 303,004 shares of the Company's common stock, or approximately 5% of its outstanding common stock. The repurchase under the Fifth Stock Repurchase Program will be conducted solely through a Rule 10b5-1 repurchase plan with Stifel, Nicolaus & Company, Inc. Repurchased shares will be held in treasury. This plan will continue until it is completed or terminated by the Board of Directors.

10. Subsequent Events

Subsequent events represent events or transactions occurring after the balance sheet date but before the financial statements are issued or are available to be issued. Financial statements are considered "issued" when they are widely distributed to shareholders and others for general use and reliance in a form and format that complies with GAAP. Financial statements are considered "available to be issued" when they are complete in form and format that complies with GAAP and all approvals necessary for their issuance have been obtained.

The Company is an SEC filer and management has evaluated subsequent events through the date that the financial statements were issued.

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

The following analysis discusses changes in the financial condition and results of operations of the Company at and for the three and nine months ended September 30, 2011 and 2010, and should be read in conjunction with the Company's Unaudited Consolidated Financial Statements and the notes thereto, appearing in Part I, Item 1 of this document.

Forward-Looking Statements

This Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and is including this statement for purposes of these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are generally identified by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project" or similar expressions. The Company's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations of the Company include, but are not limited to: changes in interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company's market area and accounting principles and guidelines. Additional factors are discussed in the Company's 2010 Annual Report on Form 10-K under "Item 1A-Risk Factors" and in "Part II. Item 1A. Risk Factors" of this 10-Q. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

Except as required by law, the Company does not undertake – and specifically disclaims any obligation – to publicly release the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

General

Chicopee Savings Bank is a community-oriented financial institution dedicated to serving the financial services needs of consumers and businesses within its market area. We attract deposits from the general public and use such funds to originate primarily one- to four-family residential real estate loans, commercial real estate loans, commercial loans, multi-family loans, construction loans and consumer loans. At September 30, 2011, we operated out of our main office, lending and operations center, and seven branch offices located in Chicopee, Ludlow, South Hadley, Ware, and West Springfield. All of our offices are located in western Massachusetts.

CRITICAL ACCOUNTING POLICIES

Management's discussion and analysis of the Company's financial condition is based on the consolidated financial statements which are prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of such financial statements requires Management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, Management evaluates its estimates, including those related to the allowance for loan losses, other-than-temporary impairment on securities, the valuation of mortgage servicing rights, and the valuation of other real estate owned. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis in making judgments about the carrying values of assets that are not readily apparent from other sources. Actual results could differ from the amount derived from Management's estimates and assumptions under different assumptions or conditions. Additional accounting policies are more fully described in Note 1 in the "Notes to Consolidated Financial Statements"

presented in our 2010 Annual Report on Form 10-K. A brief description of our current accounting policies involving significant management judgment follows.

Allowance for Loan Losses. Management believes the allowance for loan losses requires the most significant estimates and assumptions used in the preparation of the consolidated financial statements. The allowance for loan losses is based on Management's evaluation of the level of the allowance required in relation to the probable losses inherent in the loan portfolio. Management believes the allowance for loan losses is a significant estimate and therefore regularly evaluates it for adequacy by taking into consideration factors such as: levels and historical trends in delinquencies, impaired loans, non-accruing loans, charge-offs and recoveries, and classified assets; trends in the volume and terms of the loans; effects of any change in underwriting policies, procedures, and practices; experience, ability, and depth of management staff; national and local economic trends and conditions; trends and conditions in the industries in which borrowers operate; and effects of changes in credit concentrations. The use of different estimates or assumptions could produce different provisions for loan losses.

Other-Than-Temporary Impairment of Securities. One of the significant estimates related to investment securities is the evaluation of other-than-temporary impairments. The evaluation of securities for other-than-temporary impairments is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in the fair value of investments should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuer's financial condition and/or future prospects, the effects of changes in interest rates or credit spreads and the expected recovery period of unrealized losses. Securities that are in an unrealized loss position are reviewed at least quarterly to determine if other-than-temporary impairment is present based on certain quantitative and qualitative factors and measures. The primary factors considered in evaluating whether a decline in value of securities is other-than-temporary include: (a) the length of time and extent to which the fair value has been less than cost or amortized cost and the expected recovery period of the security, (b) the financial condition, credit rating and future prospects of the issuer, (c) whether the debtor is current on contractually obligated interest and principal payments, (d) the volatility of the securities market price, (e) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for recovery, which may be at maturity and (f) any other information and observable data considered relevant in determining whether other-than-temporary impairment has occurred, including the expectation of receipt of all principal and interest due.

Mortgage Servicing Rights. The valuation of mortgage servicing rights is a critical accounting policy which requires significant estimates and assumptions. The Company often sells mortgage loans it originates and retains the ongoing servicing of such loans, receiving a fee for these services, generally 1% of the outstanding balance of the loan per annum. Mortgage servicing rights are recognized when they are acquired through the sale of loans, and are reported in other assets. They are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Management uses an independent firm which specializes in the valuation of mortgage servicing rights to determine the fair value. The Company uses the amortization method for financial reporting. The most important assumption is the anticipated loan prepayment rate, and increases in prepayment speeds result in lower valuations of mortgage servicing rights. Management evaluates for impairment based upon the fair value of the rights, which can vary depending upon current interest rates and prepayment expectations, as compared to amortized cost. The use of different assumptions could produce a different valuation. All of the assumptions are based on standards the Company believes would be utilized by market participants in valuing mortgage servicing rights and are consistently derived and/or benchmarked against independent public sources.

Valuation of Other Real Estate Owned ("OREO"). Periodically, we acquire property through foreclosure or acceptance of a deed in lieu-of-foreclosure as OREO. OREO is recorded at fair value less costs to sell. The valuation of this property is accounted for individually based on its net realizable value on the date of acquisition. At the acquisition date, if the net realizable value of the property is less than the book value of the loan, a charge or reduction in the allowance for loan losses is recorded. If the value of the property becomes subsequently impaired, as determined by an appraisal or an evaluation in accordance with our appraisal policy, we will record the decline by a charge against current earnings. Upon acquisition of a property, a current appraisal or broker's opinion must substantiate market value

for the property.

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Comparison of Financial Condition at September 30, 2011 and December 31, 2010

The Company's assets increased \$16.7 million, or 2.9%, to \$590.4 million at September 30, 2011 compared to \$573.7 million at December 31, 2010, primarily due to increases in net loans of \$12.3 million, or 2.9%, to \$442.6 million and an increase of \$12.0 million, or 33.4%, in cash and cash equivalents, partially offset by a decrease in securities held-to-maturity of \$7.2 million or 10.4%.

The Company's net loan portfolio increased \$12.3 million, or 2.9%, during the first nine months of 2011 primarily due to the increases in commercial and industrial loans of \$9.5 million, or 13.0%, and commercial real estate loans of \$11.2 million, or 6.9%, partially offset by decreases in residential construction loans of \$1.6 million, or 24.9%, and residential real estate loans of \$8.7 million, or 6.6%, from \$132.7 million at December 31, 2010 to \$124.0 million at September 30, 2011. The construction portfolio continues to decrease as borrowers complete existing construction projects and the demand for new construction loans decreases. The decrease in one-to four-family residential loans was primarily due to prepayments and refinancing activity attributed to the decline in interest rates to historically low levels. In accordance with the asset/liability management strategy and in a continued effort to reduce interest rate risk, the Company continues to sell substantially all fixed rate, low coupon residential real estate loans that we originate to the secondary market.

The investment securities portfolio, including held-to-maturity and available-for-sale securities, decreased \$7.1 million, or 10.1%, to \$63.1 million at September 30, 2011 from \$70.0 million at December 31, 2010. The decrease in investments was primarily due to the decrease of \$8.7 million, or 74.4%, in certificates of deposit held for investment, a decrease in U. S. Treasury securities of \$6.8 million, or 22.1% and a decrease of \$1.3 million, or 33.3%, in collateralized mortgage obligations, partially offset by an increase of \$8.6 million, or 36.9%, in tax-exempt industrial revenue bonds.

Total deposits increased \$24.4 million, or 6.2%, to \$416.4 million at September 30, 2011 from \$391.9 million at December 31, 2010. Money market accounts increased \$11.5 million, or 17.3%, to \$77.7 million, regular savings accounts increased \$2.8 million, or 6.4%, to \$47.1 million, demand accounts increased \$9.3 million, or 19.2%, to \$57.6 million and NOW accounts increased \$6.6 million, or 45.4%, to \$21.2 million. These increases were offset by a decrease in certificates of deposit of \$5.8 million, or 2.7%, to \$212.8 million. The decrease in certificates of deposits was mainly attributed to the strategic run-off of high cost accounts as a result of management's focus to lower the cost of deposits and allow higher cost, short-term time deposits to mature without renewals. The \$5.8 million decrease in certificates of deposit was offset by the \$30.2 million, or 17.4%, increase in low cost relationship focused transaction and savings accounts.

Stockholders' equity decreased \$1.8 million, or 1.9%, to \$90.1 million at September 30, 2011 from \$91.9 million at December 31, 2010. The decrease in stockholders equity was primarily due to the repurchase of the Company's stock at a cost of \$3.7 million, partially offset by stock-based compensation of \$914,000, an increase in additional paid in capital of \$388,000 and net income of \$721,000. In the first three quarters of 2011, pursuant to the Company's fifth Stock Repurchase Program announced on November 19, 2010, the Company repurchased 245,100 shares of Company stock for \$3.5 million, at an average price of \$14.14 per share. In addition, the Company purchased 19,471 shares of Company stock, at an average price of \$14.25 per share in connection with the vesting of the restricted stock grants as part of the Company's 2007 Equity Incentive Plan. The Company purchased these shares from the employee plan participants for settlement of tax withholding obligations.

Allowance for Loan Losses

| | At or for the Nine Months Ended September 30, | | | |
|---|--|--------|------|--------|
| | 2011 | | 2010 | |
| | (Dollars In Thousands) | | | |
| Allowance for loan losses at beginning of year, December 31 | \$ | 4,431 | \$ | 4,077 |
| Charged-off loans: | | | | |
| Residential real estate | | (87) | | (131) |
| Construction | | (76) | | (94) |
| Commercial real estate | | (163) | | (7) |
| Commercial | | (314) | | (266) |
| Home equity | | (6) | | - |
| Consumer | | (51) | | (92) |
| Total charged-off loans | | (697) | | (590) |
| Recoveries on loans previously charged-off: | | | | |
| Residential real estate | | - | | - |
| Construction | | - | | - |
| Commercial real estate | | - | | - |
| Commercial | | - | | - |
| Home equity | | - | | - |
| Consumer | | 13 | | 19 |
| Total recoveries | | 13 | | 19 |
| Net loan charge-offs | | (684) | | (571) |
| Provision for loan losses | | 575 | | 761 |
| Allowance for loan losses, end of period | \$ | 4,322 | \$ | 4,267 |
| Ratios: | | | | |
| Net loan charge-offs to total average loans | | 0.15 | % | 0.13 |
| Allowance for loan losses to total loans (1) | | 0.97 | % | 0.98 |
| Allowance for loan losses to nonperforming loans (2) | | 109.42 | % | 70.60 |
| Recoveries to charge-offs | | 1.87 | % | 3.22 |

(1) Total loans includes net loans plus the allowance for loan losses.

(2) Nonperforming loans consist of all loans 90 days or more past due or other loans which have been identified by the Company as presenting uncertainty with respect to the collectability of interest or principal.

Analysis and Determination of the Allowance for Loan Losses. The allowance for loan losses is a valuation allowance for probable credit losses inherent in the loan portfolio. Management evaluates the need to establish allowances against losses on loans on a quarterly basis. When additional allowances are necessary, a provision for loan losses is charged to earnings. The allowance for loan losses is maintained at an amount that management considers appropriate to cover inherent probable losses in the loan portfolio.

Our methodology for assessing the appropriateness of the allowance for loan losses consists of: (1) a specific allowance on identified problem loans; and (2) a general valuation allowance on the remainder of the loan portfolio. Although we determine the amount of each element of the allowance separately, the entire allowance for loan losses is available for the entire portfolio. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

Specific Allowance Required for Identified Problem Loans. We establish an allowance on certain identified problem loans based on such factors as: (1) the strength of the customer's personal or business cash flows; (2) the availability of other sources of repayment; (3) the amount due or past due; (4) the type and value of collateral; (5) the strength of our collateral position; (6) the estimated cost to sell the collateral; and (7) the borrower's effort to cure the delinquency.

General Valuation Allowance on the Remainder of the Loan Portfolio. We establish a general allowance for loans that are not delinquent to recognize the probable losses associated with lending activities. This general valuation allowance is determined by segregating the loans by loan category and assigning percentages to each category. The percentages are adjusted for significant factors that, in management's judgment, affect the collectability of the portfolio as of the evaluation date. These significant factors include: levels and historical trends in delinquencies, impaired loans, nonaccrual loans, charge-offs, recoveries, and classified assets; trends in the volume and terms of loans; effects of any change in underwriting, policies, procedures, and practices; experience, ability, and depth of management and staff; national and local economic trends and conditions; trends and conditions in the industries in which borrowers operate; effects of changes in credit concentrations. The applied loss factors are reevaluated quarterly to ensure their relevance in the current economic environment.

We identify loans that may need to be charged off as a loss by reviewing all delinquent loans, classified loans and other loans for which management may have concerns about collectability. For individually reviewed loans, the borrower's inability to make payments under the terms of the loan or a shortfall in the fair value of the collateral if the loan is collateral dependent would result in our allocating a portion of the allowance to the loan that was impaired.

The allowance for loan losses is based on management's estimate of the amount required to reflect the potential inherent losses in the loan portfolio, based on circumstances and conditions known or anticipated at each reporting date. There are inherent uncertainties with respect to the collectability of the Company's loans and it is reasonably possible that actual loss experience in the near term may differ from the amounts reflected in this report.

At September 30, 2011, the allowance for loan losses represented 0.97% of total loans and 109.4% of nonperforming loans. The allowance for loan losses decreased \$109,000 from \$4.4 million at December 31, 2010 to \$4.3 million at September 30, 2011, due to a provision for loan losses of \$575,000 offset by net charge-offs of \$684,000. The provision for loan losses for the nine months ended September 30, 2011 reflects management's assessment of several factors. In particular, nonaccrual loans decreased \$2.5 million, or 38.9%, to \$4.0 million at September 30, 2011 from \$6.5 million at December 31, 2010. In addition, management assessed the continued growth of the loan portfolio, particularly the increases in commercial real estate loans and commercial business loans.

Nonperforming Assets

The following table sets forth information regarding nonaccrual loans, real estate owned, and restructured loans at the dates indicated.

| | September 30, 2011 | December 31, 2010 |
|------------------------------|------------------------|----------------------|
| | (Dollars In Thousands) | |
| Nonaccrual loans: | | |
| Residential real estate | \$ 1,832 | \$ 3,329 |
| Construction | - | 316 |
| Commercial real estate | 380 | 2,158 |
| Commercial | 1,633 | 391 |
| Home equity | 41 | 204 |
| Consumer (1) | 64 | 72 |
| Total nonaccrual loans | 3,950 | 6,470 |
| Other real estate owned, net | 1,055 | 286 |
| Total nonperforming assets | \$ 5,005 | \$ 6,756 |
| Ratios: | | |

| | | | | |
|--|------|---|------|---|
| Total nonperforming loans as a percentage of total loans (2) | 0.89 | % | 1.49 | % |
| Total nonperforming assets as a percentage of total assets (3) | 0.85 | % | 1.18 | % |

- (1) Consumer loans include home equity loans.
- (2) Total loans equals net loans plus the allowance for loan losses.
- (3) Nonperforming assets consist of nonperforming loans and other real estate owned. Nonperforming loans consist of all loans 90 days or more past due and other loans which have been identified by the Company as presenting uncertainty with respect to the collectability of interest or principal. At September 30, 2011, the Company had three troubled debt restructurings included in nonperforming loans of \$768,000. The two restructured loans continue to be reported on nonaccrual but have been performing as modified.

Loans are placed on nonaccrual status either when reasonable doubt exists as to the timely collection of principal and interest or when a loan becomes 90 days past due unless an evaluation clearly indicates that the loan is well-secured and in the process of collection. There were no loans that were over 90 days delinquent and still accruing interest.

As of September 30, 2011, nonperforming loans decreased \$2.5 million, or 38.9%, to \$4.0 million compared to \$6.5 million as of December 31, 2010. The decrease in nonperforming loans is primarily due to the decrease in nonperforming residential real estate loans of \$1.5 million, or 45.0%, a decrease of \$1.8 million, or 82.4%, in nonperforming commercial real estate loans, a decrease of \$316,000, or 100.0%, in nonperforming construction loans, a decrease of \$163,000, or 79.9%, in nonperforming home equity loans and a decrease of \$8,000, or 11.1%, in nonperforming consumer loans. These decreases were offset by an increase of \$1.2 million, or 317.7%, in nonperforming commercial and industrial loans. Loans that are less than 90 days past due and were previously on nonaccrual continue to be on nonaccrual status until the borrower can demonstrate their ability to make payments according to their loan terms. The following loan classes were not accruing interest as of September 30, 2011: 15 residential real estate loans with a principal balance of \$1.8 million, two commercial real estate loans with a principal balance of \$380,000, 23 commercial loans with a principal balance of \$1.6 million, four consumer loans with a principal balance of \$64,000 and two home equity loan with a principal balance of \$41,000.

Deposits

The following table sets forth the Company's deposit accounts at the dates indicated:

| | September 30, 2011 | | December 31, 2010 | |
|-------------------------------|--------------------|---|-------------------|---------------------------------|
| | Balance | Percent of Total Deposits (Dollars In Thousands) | Balance | Percent of Total Deposits |
| Demand deposits | \$57,579 | 13.8 % | \$48,302 | 12.3 % |
| NOW accounts | 21,193 | 5.1 % | 14,572 | 3.7 % |
| Savings accounts | 47,055 | 11.3 % | 44,215 | 11.3 % |
| Money market deposit accounts | 77,697 | 18.7 % | 66,218 | 16.9 % |
| Total transaction accounts | 203,524 | 48.9 % | 173,307 | 44.2 % |
| Certificates of deposit | 212,833 | 51.1 % | 218,630 | 55.8 % |
| Total deposits | \$416,357 | 100.0 % | \$391,937 | 100.0 % |

Total deposits increased \$24.4 million, or 6.2%, to \$416.4 million at September 30, 2011 from \$391.9 million at December 31, 2010. Money market accounts increased \$11.5 million, or 17.3%, to \$77.7 million, regular savings

accounts increased \$2.8 million, or 6.4%, to \$47.1 million, demand accounts increased \$9.3 million, or 19.2%, to \$57.6 million and NOW accounts increased \$6.6 million, or 45.4%, to \$21.2 million. These increases were offset by a decrease in certificates of deposit of \$5.8 million, or 2.7%, to \$212.8 million. The decrease in certificates of deposits was mainly attributed to the strategic run-off of high cost accounts as a result of management's focus to lower the cost of deposits and allow higher cost, short-term time deposits to mature without renewals. The \$5.8 million decrease in certificates of deposit was offset by the \$30.2 million, or 17.4%, increase in low cost relationship focused transaction and savings accounts.

Borrowings

The following sets forth information concerning our borrowings for the periods indicated.

| | September 30, 2011 | December 31, 2010 |
|--|-----------------------|----------------------|
| | (In Thousands) | |
| Maximum amount of advances outstanding at any month-end during the period: | | |
| FHLB Advances | \$70,564 | \$80,907 |
| Securities sold under agreements to repurchase | 24,560 | 29,639 |
| Average advances outstanding during the period: | | |
| FHLB Advances | \$66,304 | \$74,775 |
| Securities sold under agreements to repurchase | 17,655 | 18,703 |
| Weighted average interest rate during the period: | | |
| FHLB Advances | 2.59% | 2.70% |
| Securities sold under agreements to repurchase | 0.21% | 0.36% |
| Balance outstanding at end of period: | | |
| FHLB Advances | \$62,142 | \$71,615 |
| Securities sold under agreements to repurchase | 21,239 | 17,972 |
| Weighted average interest rate at end of period: | | |
| FHLB Advances | 2.48% | 2.54% |
| Securities sold under agreements to repurchase | 0.20% | 0.25% |

We utilize borrowings from a variety of sources to supplement our supply of funds for loans and investments. FHLB advances decreased \$9.5 million, or 13.2%, from \$71.6 million at December 31, 2010 to \$62.1 million at September 30, 2011 due to payments on long-term advances of \$9.5 million. Securities sold under agreements to repurchase increased \$3.3 million, or 18.2%, primarily due to customer activity.

During the quarter ended September 30, 2011, the Company restructured \$6.7 million in FHLB advances in order to lower the cost of borrowing and to increase the time until maturity. In executing this restructuring of FHLB advances, the Company incurred a prepayment penalty, which was blended with the effective rate and will be amortized over the life of the restructured advances. This restructuring did not meet the 10 percent cash flow test and is not required to be accounted for as a debt extinguishment. The new effective interest rate was determined based on the carrying amount of the original advance, adjusted for the present value of the new advance and the prepayment penalty. From time to time, management may use borrowed money to engage in various leverage strategies to increase income as opportunities arise.

Comparison of Operating Results for the Three Months Ended September 30, 2011 and 2010

General

The Company reported net income of \$371,000, or \$0.07 earnings per share, for the three months ended September 30, 2011, an increase of \$188,000, or 102.7%, compared to net income of \$183,000, or \$0.03 earnings per share, for the same period in 2010. The increase in net income was due to an increase in net interest income of \$335,000, or 8.0%, a decrease in the provision for loan losses of \$153,000, or 40.7%, and an increase in non-interest income of \$94,000, or 15.6%, partially offset by an increase in non-interest expense of \$335,000, or 7.7%.

Analysis of Net Interest Income

Net interest income represents the difference between income on interest-earning assets and expense on interest-bearing liabilities. Net interest income depends on the relative amounts of interest-earning assets and interest-bearing liabilities and the interest rate earned or paid on them.

The following table sets forth average balances, interest income and expense and yields earned or rates paid on the major categories of assets and liabilities for the periods indicated. The average yields and costs are derived by dividing interest income or expense by the average balance of interest-earning assets or interest-bearing liabilities, respectively. The yields and costs are annualized. Average balances are derived from average daily balances. The yields and costs include fees which are considered adjustments to yields. Loan interest and yield data does not include any accrued interest from non-accruing loans.

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| | For the Three Months Ended September 30, | | | | | | | |
|---|--|----------|---|--|--------------------|----------|---------------------------|---|
| | 2011 | | | | 2010 | | | |
| | Average Balance | Interest | Average Yield/ Rate (Dollars In Thousands) | | Average Balance | Interest | Average Yield/ Rate | |
| Interest-earning assets: | | | | | | | | |
| Investment securities (1) | \$ 67,731 | \$ 684 | 4.01 % | | \$ 62,210 | \$ 523 | 3.34 | % |
| Loans: | | | | | | | | |
| Residential real estate loans | 153,195 | 1,915 | 4.96 % | | 158,230 | 2,118 | 5.31 | % |
| Commercial real estate loans | 179,341 | 2,615 | 5.78 % | | 166,885 | 2,446 | 5.81 | % |
| Consumer loans | 32,440 | 373 | 4.56 % | | 33,737 | 404 | 4.75 | % |
| Commercial loans | 84,764 | 898 | 4.20 % | | 76,375 | 894 | 4.64 | % |
| Loans, net (2) | 449,740 | 5,801 | 5.12 % | | 435,227 | 5,862 | 5.34 | % |
| Other | 11,804 | 6 | 0.20 % | | 21,176 | 10 | 0.19 | % |
| Total interest-earning assets | 529,275 | \$ 6,491 | 4.87 % | | 518,613 | \$ 6,395 | 4.89 | % |
| Noninterest-earning assets | 44,768 | | | | 40,967 | | | |
| Total assets | \$ 574,043 | | | | \$ 559,580 | | | |
| Interest-bearing liabilities: | | | | | | | | |
| Deposits: | | | | | | | | |
| Money market accounts | \$ 77,729 | \$ 71 | 0.36 % | | \$ 59,559 | \$ 106 | 0.70 | % |
| Savings accounts (3) | 46,853 | 12 | 0.10 % | | 44,135 | 28 | 0.25 | % |
| NOW, ATS, and other transaction accounts | 19,612 | 26 | 0.53 % | | 16,097 | 9 | 0.23 | % |
| Certificates of deposit | 209,393 | 1,183 | 2.24 % | | 212,667 | 1,373 | 2.56 | % |
| Total interest-bearing deposits | 353,587 | 1,292 | 1.45 % | | 332,458 | 1,516 | 1.81 | % |
| FHLB advances | 63,146 | 414 | 2.60 % | | 75,851 | 500 | 2.62 | % |
| Securities sold under agreement to repurchase | 15,467 | 8 | 0.21 % | | 15,277 | 10 | 0.26 | % |
| Total interest-bearing borrowings | 78,613 | 422 | 2.13 % | | 91,128 | 510 | 2.22 | % |
| Total interest-bearing liabilities | 432,200 | 1,714 | 1.57 % | | 423,586 | 2,026 | 1.90 | % |
| Demand deposits | 50,358 | | | | 40,666 | | | |
| Other noninterest-bearing liabilities | 443 | | | | 301 | | | |
| Total liabilities | 483,001 | | | | 464,553 | | | |
| Total stockholders' equity | 91,042 | | | | 95,027 | | | |

| | | | | | | |
|---|------------|----------|----------|------------|----------|----------|
| Total liabilities and stockholders' equity | \$ 574,043 | | | \$ 559,580 | | |
| Net interest-earning assets | \$ 97,075 | | | \$ 95,027 | | |
| Tax equivalent net interest income/ interest rate spread (4) | | 4,777 | 3.30 % | | 4,369 | 2.99 % |
| Tax equivalent net interest income as a percentage of interest-earning assets | | | 3.58 % | | | 3.34 % |
| Ratio of interest-earning assets to interest-bearing liabilities | | | 122.46 % | | | 122.43 % |
| Less: tax equivalent adjustment (1) | | (259) | | | (186) | |
| Net interest income as reported on statement of operations | | \$ 4,518 | | | \$ 4,183 | |

(1) Municipal securities income and net interest income are presented on a tax equivalent basis using a tax rate of 41%. The tax equivalent adjustment is deducted from the tax equivalent net interest income to agree to the amount reported on the statement of operations. See 'Explanation of Use of Non-GAAP Financial Measurements'.

(2) Loans, net excludes loans held for sale.

(3) Savings accounts include mortgagors' escrow deposits.

(4) Tax equivalent interest rate spread represents the difference between the weighted average yield on interest-earning assets and the weighted average cost of interest-bearing liabilities.

The following table presents the extent to which changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected the Company's tax equivalent interest income and interest expense during the periods indicated. Information is provided in each category with respect to: (i) changes attributable to changes in volume (changes in volume multiplied by prior rate); (ii) changes attributable to changes in rate (changes in rate multiplied by prior volume); and (iii) the net change. The changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

| | Three Months Ended September 30, 2011 compared to 2010 | | |
|---|---|----------------|---------|
| | Increase (Decrease) | | |
| | Volume | Due to Rate | Net |
| | (Dollars In Thousands) | | |
| Interest-earning assets: | | | |
| Investment securities (1) | \$51 | \$110 | \$161 |
| Loans: | | | |
| Residential real estate loans | (66) | (137) | (203) |
| Commercial real estate loans | 182 | (13) | 169 |
| Consumer loans | (15) | (16) | (31) |
| Commercial loans | 92 | (88) | 4 |
| Total loans | 193 | (254) | (61) |
| Other | (5) | 1 | (4) |
| Total interest-earning assets | \$239 | \$(143) | \$96 |
| Interest-bearing liabilities: | | | |
| Deposits: | | | |
| Money market accounts | \$25 | \$(60) | \$(35) |
| Savings accounts (2) | 2 | (18) | (16) |
| NOW, ATS, and other transaction accounts | 2 | 15 | 17 |
| Certificates of deposit | (21) | (169) | (190) |
| Total deposits | 8 | (232) | (224) |
| FHLB advances | (83) | (3) | (86) |
| Securities sold under agreement to repurchase | - | (2) | (2) |
| Total interest-bearing borrowings | (83) | (5) | (88) |
| Total interest-bearing liabilities | (75) | (237) | (312) |
| Increase in net interest income (3) | \$314 | \$94 | \$408 |

- (1) The changes in state and municipal income are reflected on a tax equivalent basis using a tax rate of 41%.
- (2) Includes interest on mortgagors' escrow deposits.
- (3) The changes in net interest income are reflected on a tax equivalent basis and thus do not correspond to the statement of operations.

Net interest income, on a tax equivalent basis, increased \$408,000, or 9.3%, to \$4.8 million for the three months ended September 30, 2011, primarily due to the decrease in the cost of interest bearing liabilities outweighing the decrease in the yield on average interest-earning assets. Net interest margin, on a tax equivalent basis, increased 24 basis points from 3.34% for the three months ended September 30, 2010 to 3.58% for the three months ended September 30, 2011.

Interest and dividend income, on a tax equivalent basis, increased \$96,000, or 1.5%, to \$6.5 million for the three months ended September 30, 2011. Average interest-earning assets increased \$10.7 million, or 2.1%, from \$518.6 million at September 30, 2010 to \$529.3 million at September 30, 2011. Average loans increased \$14.5 million, or 3.3%, primarily due to strong commercial originations. Average investment securities increased \$5.5 million, or 8.9%, for the period and tax equivalent investment securities interest income increased \$161,000, or 30.8%, primarily due to the increase in tax-exempt industrial revenue bond income. The yield on average interest-earning assets decreased 2 basis points to 4.87% for the three months ended September 30, 2011, primarily as a result of lower market rates of interest.

Total interest expense decreased \$312,000, or 15.4%, to \$1.7 million for the three months ended September 30, 2011 from \$2.0 million for the three months ended September 30, 2010, due to lowering deposit costs by \$224,000, or 14.8% and a decrease in cost of borrowings of \$88,000 or 17.3%. Average interest-bearing liabilities increased \$8.6 million, or 2.0% to \$432.2 million for the three months ended September 30, 2011 from \$423.6 million for the three months ended September 30, 2010. Rates paid on average interest-bearing liabilities declined 33 basis points from 1.90% for the three months ended September 30, 2010 to 1.57% for the three months ended September 30, 2011. The lower interest rate environment led to a decrease in rates paid for certificates of deposit and money market accounts of 32 and 34 basis points, respectively.

Provision for Loan Losses

The provision for loan losses for the three months ended September 30, 2011 was \$223,000 compared \$376,000 for the three months ended September 30, 2010. The decrease in the provision for loan losses was due to a \$130,000 decrease in charge offs for the three months ended September 30, 2011 compared to the same period in 2010. Nonperforming loans decreased by \$2.0 million from \$6.0 million for the three months ended September 30, 2010 to \$4.0 million for the three months ended September 30, 2011 but decreased by \$2.5 million from December 31, 2010.

Non-interest Income

Non-interest income for the three months ended September 30, 2011 increased \$94,000, or 15.6%, from \$603,000 for the three months ended September 30, 2010 to \$697,000 for the three months ended September 30, 2011. Service charges, fees and commissions increased \$123,000, or 28.9%, primarily due to the seasonal increase in deposit account service charges related to a commercial account. These increases were partially offset by a decrease in net loan sales and servicing of \$35,000, or 40.7%, due to lower volume of loan sales in 2011.

Non-interest Expenses

Non-interest expense increased \$335,000, or 7.7%, for the three months ended September 30, 2011 compared to the three months ended September 30, 2010. Non-interest expense increased primarily due to an increase in salaries and employee benefits of \$235,000, or 9.5%, an increase in furniture and fixtures of \$62,000, or 29.7%, an increase in FDIC insurance of \$40,000, or 38.1%, and an increase of \$70,000, or 10.5%, in other non-interest expenses. These increases were partially offset by a decrease in data processing of \$39,000, or 11.5%, and decrease in professional fees of \$29,000, or 18.4%.

Comparison of Operating Results for the Nine Months Ended September 30, 2011 and 2010

General

For the nine months ended September 30, 2011, the Company reported net income of \$721,000, or \$0.13 per share, an increase of \$461,000, or 177.3%, as compared to net income of \$260,000, or \$0.05 earnings per share, for the same period in 2010. The increase in net income for the nine months ended September 30, 2011 was primarily due to the increase in net interest income of \$762,000, or 6.0%, an increase in non-interest income of \$149,000, or 8.3%, and a decrease in the provision for loan losses of \$186,000, or 24.4%, partially offset by an increase in non-interest expense of \$600,000, or 4.5%.

Analysis of Net Interest Income

Net interest income represents the difference between income on interest-earning assets and expense on interest-bearing liabilities. Net interest income depends on the relative amounts of interest-earning assets and

interest-bearing liabilities and the interest rate earned or paid on them.

The following table sets forth average balances, interest income and expense and yields earned or rates paid on the major categories of assets and liabilities for the periods indicated. The average yields and costs are derived by dividing interest income or expense by the average balance of interest-earning assets or interest-bearing liabilities, respectively. The yields and costs are annualized. Average balances are derived from average daily balances. The yields and costs include fees which are considered adjustments to yields. Loan interest and yield data does not include any accrued interest from non-accruing loans.

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For the Nine Months Ended September 30,

| | 2011 | | | | 2010 | | | |
|---|------------------------|----------|---------------------------|---|--------------------|----------|---------------------------|---|
| | Average Balance | Interest | Average Yield/ Rate | | Average Balance | Interest | Average Yield/ Rate | |
| | (Dollars In Thousands) | | | | | | | |
| Interest-earning assets: | | | | | | | | |
| Investment securities (1) | \$ 68,427 | \$ 1,875 | 3.66 | % | \$ 63,883 | \$ 1,438 | 3.01 | % |
| Loans: | | | | | | | | |
| Residential real estate | | | | | | | | |
| loans | 154,491 | 5,922 | 5.13 | % | 160,442 | 6,566 | 5.47 | % |
| Commercial real estate | | | | | | | | |
| loans | 178,383 | 7,762 | 5.82 | % | 165,107 | 7,343 | 5.95 | % |
| Consumer loans | 32,271 | 1,111 | 4.60 | % | 33,831 | 1,235 | 4.88 | % |
| Commercial loans | 81,704 | 2,683 | 4.39 | % | 74,246 | 2,570 | 4.63 | % |
| Loans, net (2) | 446,849 | 17,478 | 5.23 | % | 433,626 | 17,714 | 5.46 | % |
| Other | 18,484 | 27 | 0.20 | % | 14,841 | 21 | 0.19 | % |
| Total interest-earning assets | 533,760 | 19,380 | 4.85 | % | 512,350 | 19,173 | 5.00 | % |
| Noninterest-earning assets | | | | | | | | |
| | 42,147 | | | | 40,240 | | | |
| Total assets | \$ 575,907 | | | | \$ 552,590 | | | |
| Interest-bearing liabilities: | | | | | | | | |
| Deposits: | | | | | | | | |
| Money market accounts | \$ 73,905 | \$ 198 | 0.36 | % | \$ 59,284 | \$ 329 | 0.74 | % |
| Savings accounts (3) | 46,461 | 36 | 0.10 | % | 44,228 | 83 | 0.25 | % |
| NOW, ATS, and other transaction accounts | 17,064 | 42 | 0.33 | % | 17,412 | 29 | 0.22 | % |
| Certificates of deposit | 213,407 | 3,741 | 2.34 | % | 202,827 | 4,026 | 2.65 | % |
| Total interest-bearing deposits | 350,837 | 4,017 | 1.53 | % | 323,751 | 4,467 | 1.84 | % |
| FHLB advances | 66,304 | 1,283 | 2.59 | % | 75,485 | 1,543 | 2.73 | % |
| Securities sold under agreement to repurchase | | | | | | | | |
| | 17,655 | 27 | 0.20 | % | 18,446 | 55 | 0.40 | % |
| Total interest-bearing borrowings | 83,959 | 1,310 | 2.09 | % | 93,931 | 1,598 | 2.27 | % |
| Total interest-bearing liabilities | 434,796 | 5,327 | 1.64 | % | 417,682 | 6,065 | 1.94 | % |
| Demand deposits | | | | | | | | |
| | 48,922 | | | | 39,545 | | | |
| Other noninterest-bearing liabilities | | | | | | | | |
| | 308 | | | | 240 | | | |
| Total liabilities | 484,026 | | | | 457,467 | | | |
| Total stockholders' equity | | | | | | | | |
| | 91,881 | | | | 95,123 | | | |

| | | | | | | |
|---|------------|-----------|----------|------------|-----------|----------|
| Total liabilities and stockholders' equity | \$ 575,907 | | | \$ 552,590 | | |
| Net interest-earning assets | \$ 98,964 | | | \$ 94,668 | | |
| Tax equivalent net interest income/ interest rate spread (4) | | 14,053 | 3.21 % | | 13,108 | 3.06 % |
| Tax equivalent net interest income as a percentage of interest-earning assets | | | 3.52 % | | | 3.42 % |
| Ratio of interest-earning assets to interest-bearing liabilities | | | 122.76 % | | | 122.66 % |
| Less: tax equivalent adjustment (1) | | (680) | | | (497) | |
| Net interest income as reported on statement of operations | | \$ 13,373 | | | \$ 12,611 | |

(1) Municipal securities income and net interest income are presented on a tax equivalent basis using a tax rate of 41%. The tax equivalent adjustment is deducted from the tax equivalent net interest income to agree to the amount reported on the statement of operations. See 'Explanation of Use of Non-GAAP Financial Measurements'.

(2) Loans, net excludes loans held for sale

(3) Savings accounts include mortgagors' escrow deposits.

(4) Tax equivalent interest rate spread represents the difference between the weighted average yield on interest-earning assets and the weighted average cost of interest-bearing liabilities.

The following table presents the extent to which changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected the Company's tax equivalent interest income and interest expense during the periods indicated. Information is provided in each category with respect to: (i) changes attributable to changes in volume (changes in volume multiplied by prior rate); (ii) changes attributable to changes in rate (changes in rate multiplied by prior volume); and (iii) the net change. The changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

| | Nine Months Ended September 30, 2011 compared to 2010 Increase (Decrease) | | |
|---|---|----------|----------|
| | Due to Volume | Rate | Net |
| | (Dollars In Thousands) | | |
| Interest-earning assets: | | | |
| Investment securities (1) | \$148 | \$289 | \$437 |
| Loans: | | | |
| Residential real estate loans | (238) | (406) | (644) |
| Commercial real estate loans | 497 | (78) | 419 |
| Consumer loans | (55) | (69) | (124) |
| Commercial loans | 193 | (80) | 113 |
| Total loans | 397 | (633) | (236) |
| Other | 6 | - | 6 |
| Total interest-earning assets | \$551 | \$(344) | \$207 |
| Interest-bearing liabilities: | | | |
| Deposits: | | | |
| Money market accounts | \$31 | \$(162) | \$(131) |
| Savings accounts (2) | 1 | (48) | (47) |
| NOW, ATS, and other transaction accounts | - | 13 | 13 |
| Certificates of deposit | 104 | (389) | (285) |
| Total deposits | 136 | (586) | (450) |
| FHLB advances | (180) | (80) | (260) |
| Securities sold under agreement to repurchase | (3) | (25) | (28) |
| Total interest-bearing borrowings | (183) | (105) | (288) |
| Total interest-bearing liabilities | (47) | (691) | (738) |
| Increase in net interest income (3) | \$598 | \$347 | \$945 |

- (1) The changes in state and municipal income are reflected on a tax equivalent basis using a tax rate of 41%.
- (2) Includes interest on mortgagors' escrow deposits.
- (3) The changes in net interest income are reflected on a tax equivalent basis and thus do not correspond to the statement of operations.

Net interest income, on a tax equivalent basis, increased \$945,000 or 7.2%, to \$14.1 million for the nine months ended September 30, 2011, primarily due to the decrease in the cost of interest bearing liabilities outweighing the decrease in the yield on average interest-earning assets. Net interest margin, on a tax equivalent basis, increased 10 basis points from 3.42% for the nine months ended September 30, 2010 to 3.52% for the nine months ended September 30, 2011.

Interest and dividend income, on a tax equivalent basis, increased \$207,000, or 1.1%, to \$19.4 million for the nine months ended September 30, 2011, compared to \$19.2 million for the same period last year. Average interest-earning assets increased \$21.4 million, or 4.2%, from \$512.3 million for the nine months ended September 30, 2010 to \$533.8 million for the nine months ended September 30, 2011. Average loans increased \$13.2 million, or 3.1%, primarily due to strong commercial originations. Average investment securities increased \$4.5 million, or 7.1%, for the period and tax equivalent investment securities interest income increased \$437,000, or 30.4%, primarily due to the increase in tax-exempt industrial revenue bond income. The yield on average interest-earning assets decreased 15 basis points to 4.85% for the nine months ended September 30, 2011, due to lower market rates of interest.

Total interest expense decreased \$738,000, or 12.2%, to \$5.3 million for the nine months ended September 30, 2011 from \$6.1 million for the same period in 2010, due to lowering deposit costs by \$450,000, or 10.0%, and borrowing costs by \$288,000, or 18.0%. Average interest-bearing liabilities increased \$17.1 million, or 4.1%, to \$434.8 million for the nine months ended September 30, 2011 from \$417.7 million for nine months ended September 30, 2010, reflecting increases in deposits of \$27.1 million, or 8.4%. Rates paid on average interest-bearing liabilities declined 30 basis points from 1.94% for the nine months ended September 30, 2010 to 1.64% for the nine months ended September 30, 2011, reflecting the lower interest rates paid on deposits and borrowings. The lower interest rate environment led to a decrease in rates paid on certificates of deposit and money market accounts of 31 and 38 basis points, respectively.

Provision for Loan Losses

The provision for loan losses for the nine months ended September 30, 2011 was \$575,000 compared to \$761,000 for the nine months ended September 30, 2010. The decrease in the provision for loan losses was primarily due to the \$2.5 million, or 38.9%, decrease in non performing loans from \$6.5 million at December 31, 2010 to \$4.0 million at September 30, 2011.

Non-interest Income

Non-interest income for the nine months ended September 30, 2011 increased \$149,000, or 8.3%, from \$1.8 million for the nine months ended September 30, 2010 to \$2.0 million for the nine months ended September 30, 2011. Income from customer service charges, fees and commissions increased \$177,000, or 13.8%, due to the seasonal activity of a commercial account, and income from net loan sales and servicing increased by \$13,000, or 5.5%. These increases were partially offset by a loss on the sale of other real estate owned ("OREO") of \$99,000 and a decrease in income from bank owned life insurance of \$22,000, or 6.9%.

Non-interest Expenses

Non-interest expense increased \$600,000, or 4.5%, from \$13.5 million for the nine months ended September 30, 2010 to \$14.1 million for the nine months ended September 30, 2011. The increase was primarily due to the \$489,000, or 6.3%, increase in salaries and employee benefits as a result of higher benefit costs, normal salary increases and \$130,000 in costs associated with the retirement of one of our senior officers on March 31, 2011, a non-recurring expense. Stationary supplies and postage increased \$46,000, or 19.7%, other non-interest expense increased \$89,000, or 1.6%. These increases were partially offset by a \$24,000, or 2.7%, decrease in data processing costs.

Explanation of Use of Non-GAAP Financial Measurements

We believe that it is common practice in the banking industry to present interest income and related yield information on tax exempt securities on a tax-equivalent basis and that such information is useful to investors because it facilitates comparisons among financial institutions. However, the adjustment of interest income and yields on tax exempt

securities to a tax equivalent amount may be considered to include financial information that is not in compliance with U.S. generally accepted accounting principles (“GAAP”). A reconciliation from GAAP to non-GAAP is provided below.

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|--|-------------------------------------|------------------|--------------------------------|------------------|------------------------------------|------------------|--------------------------------|------------------|
| | 2011 (Dollars in Thousands) | | 2010 (Dollars in Thousands) | | 2011 (Dollars in Thousands) | | 2010 (Dollars in Thousands) | |
| | Interest | Average Yield | Interest | Average Yield | Interest | Average Yield | Interest | Average Yield |
| Investment securities (no tax adjustment) | \$ 425 | 2.49 % | \$ 337 | 2.15 % | \$ 1,195 | 2.33 % | \$ 941 | 1.97 % |
| Tax equivalent adjustment (1) | 259 | | 186 | | 680 | | 497 | |
| Investment securities (tax equivalent basis) | \$ 684 | 4.01 % | \$ 523 | 3.34 % | \$ 1,875 | 3.66 % | \$ 1,438 | 3.01 % |
| Net interest income (no tax adjustment) | \$ 4,518 | | \$ 4,183 | | \$ 13,373 | | \$ 12,611 | |
| Tax equivalent adjustment (1) | 259 | | 186 | | 680 | | 497 | |
| Net interest income (tax equivalent basis) | \$ 4,777 | | \$ 4,369 | | \$ 14,053 | | \$ 13,108 | |
| Interest rate spread (no tax adjustment) | | 3.10 % | | 2.85 % | | 3.05 % | | 2.93 % |
| Net interest margin (no tax adjustment) | | 3.39 % | | 3.20 % | | 3.35 % | | 3.29 % |

(1) The tax equivalent adjustment is based on a combined federal and state tax rate of 41% for all periods presented.

Liquidity Management

Liquidity is the ability to meet current and future financial obligations of a short-term nature. Our primary sources of funds consist of deposit inflows, loan repayments, maturities and sales of securities, borrowings from the Federal Home Loan Bank of Boston and securities sold under agreements to repurchase. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. Prepayment rates can have a significant impact on interest income. Because of the large percentage of loans we hold, rising or falling interest rates have a significant impact on the prepayment speeds of our earning assets that, in turn, affect the rate sensitivity position. When interest rates rise, prepayments tend to slow. When interest rates fall, prepayments tend to rise. Our asset sensitivity would be reduced if prepayments slow and vice versa. While we believe these assumptions to be reasonable, there can be no assurance that assumed prepayment rates will approximate actual loan repayment activity. Our short-term securities are primarily consisted of U.S. Treasury and government agencies, which we use primarily for the collateral purposes for sweep accounts maintained by commercial customers. The balances of these securities fluctuate as the aggregate balance of our sweep accounts fluctuate.

We regularly adjust our investments in liquid assets based upon our assessment of: (1) expected loan demands; (2) expected deposit flows; (3) yields available on interest-earning deposits and securities; and (4) the objectives of our asset/liability management policy.

Our most liquid assets are cash and cash equivalents. The levels of these assets depend on our operating, financing, lending and investing activities during any given period. At September 30, 2011, total cash and cash equivalents totaled \$47.8 million, net of reserve requirements. Securities classified as available-for-sale whose market value exceeds our cost, which provides additional sources of liquidity, totaled \$76,000 at September 30, 2011. Other liquid assets as of September 30, 2011 include: U.S. Treasury securities and collateralized mortgage, net of pledged securities, totaled \$5.3 million, and certificates of deposit of \$3.0 million. At September 30, 2011, the Company had an over collateralized securities pledging position of \$1.0 million.

In addition, at September 30, 2011, we had the ability to borrow a total of approximately \$77.6 million from the Federal Home Loan Bank of Boston. On September 30, 2011, we had \$62.5 million of borrowings outstanding. We have the ability to increase our borrowing capacity with the FHLB by pledging additional loans. We have received approval from the Federal Reserve Bank to access its discount window. The Company's unused borrowing capacity with the Federal Reserve Bank was approximately \$48.4 million at September 30, 2011. In addition, we had the following available lines of credit to use as contingency funding sources: \$3.0 million with Bankers Bank, N.E. and available Fed Funds to purchase of \$3.0 million.

Certificates of deposit due within one year of September 30, 2011 totaled \$103.7 million, or 48.7%, of our certificates of deposit. If these maturing deposits do not remain with us, we will be required to seek other sources of funds, including other certificates of deposit and borrowings. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit due on or before September 30, 2012. We believe, however, based on past experience that a significant portion of our certificates of deposit will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

Capital Management

We are subject to various regulatory capital requirements administered by the Federal Deposit Insurance Corporation, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. At September 30, 2011, the Company exceeded all of its regulatory capital requirements. The Company is considered “well capitalized” under regulatory guidelines. The Company is subject to the Federal Reserve Board’s capital adequacy guidelines for bank holding companies (on a consolidated basis) substantially similar to those of the Federal Deposit Insurance Corporation. The Company exceeded these requirements at September 30, 2011.

The Company’s and Bank’s actual capital amounts and ratios as of September 30, 2011 and December 31, 2010 are presented in the following table:

| | Actual | | Minimum for Capital Adequacy Purposes | | Minimum to be Well Capitalized Under Prompt Corrective Action Provisions | |
|--|-----------|--------|---------------------------------------|-------|--|--------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of September 30, 2011 | | | | | | |
| Total Capital to Risk Weighted Assets | | | | | | |
| Company | \$ 93,381 | 19.5 % | \$ 38,304 | 8.0 % | N/A | N/A |
| Bank | \$ 80,736 | 16.9 % | \$ 38,211 | 8.0 % | \$ 47,764 | 10.0 % |
| Tier 1 Capital to Risk Weighted Assets | | | | | | |
| Company | \$ 89,060 | 18.6 % | \$ 19,152 | 4.0 % | N/A | N/A |
| Bank | \$ 76,415 | 16.0 % | \$ 19,106 | 4.0 % | \$ 28,658 | 6.0 % |
| Tier 1 Capital to Average Assets | | | | | | |
| Company | \$ 89,060 | 15.5 % | \$ 22,922 | 4.0 % | N/A | N/A |
| Bank | \$ 76,415 | 13.4 % | \$ 22,876 | 4.0 % | \$ 28,595 | 5.0 % |

| | Actual | | Minimum for Capital Adequacy Purposes | | Minimum to be Well Capitalized Under Prompt Corrective Action Provisions | |
|--|-----------|--------|---------------------------------------|-------|--|--------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of December 31, 2010: | | | | | | |
| Total Capital to Risk Weighted Assets | | | | | | |
| Company | \$ 95,199 | 20.7 % | \$ 36,861 | 8.0 % | N/A | N/A |
| Bank | \$ 78,687 | 17.1 % | \$ 36,786 | 8.0 % | \$ 45,982 | 10.0 % |
| Tier 1 Capital to Risk Weighted Assets | | | | | | |
| Company | \$ 90,749 | 19.7 % | \$ 18,430 | 4.0 % | N/A | N/A |
| Bank | \$ 74,237 | 16.1 % | \$ 18,393 | 4.0 % | \$ 27,589 | 6.0 % |
| Tier 1 Capital to Average Assets | | | | | | |
| Company | \$ 90,749 | 16.1 % | \$ 22,590 | 4.0 % | N/A | N/A |
| Bank | \$ 74,237 | 13.2 % | \$ 22,532 | 4.0 % | \$ 28,164 | 5.0 % |

Restrictions on Dividends

Dividends from Chicopee Bancorp, Inc. may depend, in part, upon receipt of dividends from the Bank. The subsidiary may pay dividends to its parent out of so much of its net income as the Bank's directors deem appropriate, subject to the limitation that the total of all dividends declared by the Bank in any calendar year may not exceed the total of its net income of that year combined with its retained net income of the preceding two years and subject to minimum regulatory capital requirements. The approval of the Massachusetts Commissioner of Banks is required if the total of all dividends declared in any calendar year exceeds the total of its net profits for that year combined with its retained net profits of the preceding two years. Net profits for this purpose means the remainder of all earnings from current operations plus actual recoveries on loans and investments and other assets after deducting from the total thereof all current operating expenses, actual losses, accrued dividends on preferred stock, if any and all federal and state taxes.

There were no dividends from the Bancorp for the nine months ended September 30, 2011.

Off-Balance Sheet Arrangements

In the normal course of operations, we engage in a variety of financial transactions that, in accordance with U.S. generally accepted accounting principles, are not recorded in our financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments, letters of credit and lines of credit. We currently have no plans to engage in hedging activities in the future.

Credit-related financial instruments

The Company is a party to credit related 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 commitments to extend credit, standby letters of credit, and various financial instruments with off-balance-sheet risk. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

The following financial instruments were outstanding whose contract amounts represent credit risk:

| | September 30, 2011 | December 31, 2010 |
|---|-----------------------|----------------------|
| Commitments to grant loans | \$ 25,752 | \$ 18,945 |
| Unfunded commitments for construction loans | 12,623 | 7,140 |
| Unfunded commitments under lines of credit | 73,339 | 75,924 |
| Standby letters of credit | 1,988 | 2,301 |

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Company, is based on management's credit evaluation of the customer. Collateral held varies but may include cash, securities, accounts receivable, inventory, property, plant and equipment, and real estate.

Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are uncollateralized, usually do not contain a specified maturity date, and may not be drawn upon to the total extent to which the Company is committed.

"Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others", requires certain disclosures and liability recognition for the fair value at issuance of guarantees that fall within its scope. The Company does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. The Company has issued conditional commitments in the form of standby letters of credit to guarantee payment on behalf of a customer and guarantee the performance of a customer to a third party. Standby letters of credit generally arise in connection with lending relationships. The credit risk involved in issuing these instruments is essentially the same as that involved in extending loans to customers. Contingent obligations under standby letters of credit totaled \$1,988 at September 30, 2011 and \$2,301 at December 31, 2010, respectively, and represent the maximum potential future payments the Company could be required to make. Typically, these instruments have terms of 12 months or less and expire unused; therefore, the total amounts do not necessarily represent future cash requirements. Each customer is evaluated individually for creditworthiness under the same underwriting standards used for commitments to extend credit and on-balance sheet instruments. The Company's policies governing loan collateral apply to standby letters of credit at the time of credit extension. Loan-to-value ratios are generally consistent with loan-to-value requirements for other commercial loans secured by similar types of collateral. The fair value of the Company's standby letters of credit at September 30, 2011 and December 31, 2010 was insignificant.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Qualitative Aspects of Market Risk

We manage the interest rate sensitivity of our interest-bearing liabilities and interest-earning assets in an effort to minimize the adverse effects of changes in the interest rate environment. Deposit accounts typically react more quickly to changes in market interest rates than mortgage loans because of the shorter maturities of deposits. As a result, sharp increases in interest rates may adversely affect our earnings while decreases in interest rates may beneficially affect our earnings. To reduce the potential volatility of our earnings, we have sought to improve the match between asset and liability maturities and rates, while maintaining an acceptable interest rate spread. Our strategy for managing interest rate risk emphasizes: adjusting the maturities of borrowings; adjusting the investment portfolio mix and duration; increasing our focus on shorter-term, adjustable-rate commercial and multi-family lending; selling fixed-rate mortgage loans; and periodically selling available-for-sale securities. We currently do not participate in hedging programs, interest rate swaps or other activities involving the use of derivative financial instruments.

We have an Asset/Liability Committee, which includes members of management, to communicate, coordinate and control all aspects involving asset/liability management. The committee reports to the Board of Directors of the Bank quarterly and establishes and monitors the volume, maturities, pricing and mix of assets and funding sources with the objective of managing assets and funding sources to provide results that are consistent with liquidity, growth, risk limits and profitability goals.

Quantitative Aspects of Market Risk

We analyze our interest rate sensitivity to manage the risk associated with interest rate movements through the use of interest income simulation. The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are “interest rate sensitive.” An asset or liability is said to be “interest rate sensitive” within a specific time period if it will mature or reprice within that time period.

Our goal is to manage asset and liability positions to moderate the effects of interest rate fluctuations on net interest income. Interest income simulations are completed quarterly and presented to the Asset/Liability Committee and Board of Directors of the Bank. The simulations provide an estimate of the impact of changes in interest rates on net interest income under a range of assumptions. The numerous assumptions used in the simulation process are reviewed by the Asset/Liability Committee and the Board of Directors of the Bank on a quarterly basis. Changes to these assumptions can significantly affect the results of the simulation. The simulation incorporates assumptions regarding the potential timing in the repricing of certain assets and liabilities when market rates change and the changes in spreads between different market rates. The simulation analysis incorporates management’s current assessment of the risk that pricing margins will change adversely over time due to competition or other factors.

Simulation analysis is only an estimate of our interest rate risk exposure at a particular point in time. We continually review the potential effect changes in interest rates could have on the repayment of rate sensitive assets and funding requirements of rate sensitive liabilities.

The table below sets forth an approximation of our exposure as a percentage of estimated net interest income for the next 12 month period using interest income simulation. The simulation uses projected repricing of assets and liabilities at September 30, 2011 on the basis of contractual maturities, anticipated repayments and scheduled rate adjustments. Prepayment rates can have a significant impact on interest income simulation. Because of the large percentage of loans we hold, rising or falling interest rates have a significant impact on the prepayment speeds of our earning assets that, in turn, affect the rate sensitivity position. When interest rates rise, prepayments tend to

slow. When interest rates fall, prepayments tend to rise. Our asset sensitivity would be reduced if prepayments slow and vice versa. While we believe such assumptions to be reasonable, there can be no assurance that assumed prepayment rates will approximate future mortgage-backed security and loan repayment activity.

The following table reflects changes in estimated net interest income for the Company at September 30, 2011 through September 30, 2012:

| Changes In Interest Rates (Basis Points) | Percentage Change in Estimated Net Interest Income Over Twelve Months |
|---|---|
| Up 500 - 24 Months | 2.0% |
| UP 400 - 24 Months | 2.0% |
| UP 300 - 12 Months | 3.0% |
| UP 200 - 12 Months | 4.0% |
| Base | 0.0% |
| Down 100 Basis Points | 0.0% |

As indicated in the table above the result of a 200 basis point instantaneous increase in interest rates is estimated to increase net interest income by 4.0% and 3.0% for a 300 basis point increase over a 12-month horizon, when compared to the flat rate scenario. A 400 and 500 basis point increase in interest rates over a 24-month period is estimated to increase net interest income by 2.0% in the first 12-months.

Item 4. Controls and Procedures

The Company's management, including the Company's principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the "Exchange Act"). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (the "SEC") (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

There have been no changes in the Company's internal control over financial reporting during the quarter ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

The Company is not involved in any pending legal proceedings other than routine legal proceedings occurring in the ordinary course of business. Such routine legal proceedings, in the aggregate, are believed by management to be immaterial to the financial condition and results of operations of the Company.

Item 1A. Risk Factors.

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2010, which could materially affect our business, financial condition or future results. Additional risks not presently known to us, or that we currently deem immaterial, may also adversely affect our business, financial condition or results of operations. At September 30, 2011, the risk factors for the Company have not changed materially from those reported in our 2010 Annual Report on Form 10-K. However, the risks described in our 2010 Annual Report on Form 10-K are not the only risks that we face.

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

(a) Unregistered Sales of Equity Securities – Not applicable

(b) Use of Proceeds – Not applicable

(c) Repurchase of Our Equity Securities –

On November 19, 2010, the Company announced that its Board of Directors authorized a fifth repurchase program for the repurchase of 303,004, or 5.0%, of the common stock outstanding, in open market purchases or through a 10b5-1 plan. Purchases are made from time to time at the discretion of the Company. Repurchased shares will be held in treasury. This plan will continue until it is completed or terminated by the Board of Directors. During the third quarter, the Company repurchased 103,000 shares of Company stock, at an average price of \$14.12 per share. In the first three quarters of 2011, the Company repurchased 245,100 shares of Company stock for \$3.5 million, at an average price of \$14.14 per share. In addition, in the third quarter of 2011, the Company repurchased 16,300 shares of Company stock, at an average price of \$14.25 per share, in connection with the vesting of the restricted stock grants as part of company's 2007 Equity Incentive Plan. The Company purchased these shares from the employee plan participants for settlement of tax withholding obligations. Repurchases made in the third quarter of 2011 were as follows:

| Period | (a) Total Number of Shares (or Units) Purchased | (b) Average Price Paid Per Share (or Unit) | (c) | (d) |
|----------------------|---|--|---|--|
| | | | Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs |
| July 1-31, 2011 | 25,400 | \$ 14.48 | 215,600 | 87,404 |
| August 1-31, 2011 | 67,000 | 14.04 | 282,600 | 20,404 |
| September 1-30, 2011 | 10,600 | 13.69 | 293,200 | 296,804 |
| Total | 103,000 | \$ 14.12 | | |

In addition, on September 30, 2011, the Company announced that its Board of Directors authorized a sixth stock repurchase program (the "Stock Repurchase Program") for the purchase of up to 287,000, or 5.0%, of the company's outstanding common stock. The Company will commence its sixth stock repurchase program immediately upon the completion of its fifth repurchase program. Any repurchases under the Stock Repurchase Program will be made through open market purchase transactions from time to time or through a Rule 10b5-1 plan. The amount and exact timing of any repurchases will depend on market conditions and other factors, at the discretion of management of the Company, and it is intended that the Stock Repurchase Program will complete all repurchases within twelve months after its commencement. There is no assurance that the Company will repurchase shares during any period.

Item 3. Defaults Upon Senior Securities.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

3.1 Articles of Incorporation of Chicopee Bancorp, Inc. (1)

3.2 Bylaws of Chicopee Bancorp, Inc. (2)

4.0 Stock Certificate of Chicopee Bancorp, Inc. (1)

31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer

31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer

32.0 Section 1350 Certification

101.0 The following financial information from Chicopee Bancorp Inc.'s Quarterly Report on Form 10-Q for the three and nine months ended September 30, 2011, formatted in XBRL (Extensible Business Reporting Language) includes: (i) the Consolidated Balance Sheets as of September 30, 2011 and December 31, 2010, (ii) the Consolidated Statements of Earnings for each of the three and nine month periods ended September 30, 2011 and 2010, (iii) the Consolidated Statements of Cash Flows for each of the nine month periods ended September 30, 2011 and 2010, (iv) the Consolidated Statements of Changes in Shareholders' Equity for the nine month periods ended September 30, 2011 and 2010, Consolidated Statements of Comprehensive Income for each of the three and nine month periods ended September 30, 2011 and 2010, and (v) the Notes to Consolidated Financial Statements, tagged in summary and detail.

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- (1) Incorporated herein by reference to the Exhibits to the Company's Registration Statement on Form S-1 (File No. 333-132512), as amended, initially filed with the Securities and Exchange Commission on March 17, 2006.
- (2) Incorporated herein by reference to Exhibit 3.2 to the Company's 8-K (File No. 000-51996) filed with the Securities and Exchange Commission on August 1, 2007.

SIGNATURES

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

CHICOPEE BANCORP, INC.

Dated: November 4, 2011

By: /s/ William J. Wagner
William J. Wagner
Chairman of the Board, President and
Chief Executive Officer
(principal executive officer)

Dated: November 4, 2011

By: /s/ Guida R. Sajdak
Guida R. Sajdak
Senior Vice President,
Chief Financial Officer and Treasurer
(principal financial and chief accounting officer)