SI Financial Group, Inc.
Form 10-Q
May 11, 2011

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

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2011

OR

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

For the Transition Period from to

Commission File Number: 0-54241

SI FINANCIAL GROUP, INC.
(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	80-0643149 (I.R.S. Employer Identification No.)
803 Main Street, Willimantic, Connecticut (Address of principal executive offices)	06226 (Zip Code)

(860) 423-4581
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section

232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

Large Accelerated Filer o	Accelerated Filer o
Non-Accelerated Filer x	Smaller Reporting Company o

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

As of May 2, 2011, there were 10,576,302 shares of the registrant’s common stock outstanding.

SI FINANCIAL GROUP, INC.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements.

SI FINANCIAL GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share Amounts / Unaudited)

	March 31, 2011	December 31, 2010
ASSETS:		
Cash and due from banks:		
Noninterest-bearing	$11,984	$ 11,204
Interest-bearing	2,852	2,287
Federal funds sold	34,700	64,830
Total cash and cash equivalents	49,536	78,321
Trading securities, at fair value	269	248
Available for sale securities, at fair value	217,204	180,036
Loans held for sale	1,776	7,371
Loans receivable (net of allowance for loan losses of $4,563 at March 31, 2011 and $4,799 at December 31, 2010)	608,506	606,214
Federal Home Loan Bank stock, at cost	8,388	8,388
Bank-owned life insurance	8,796	9,024
Premises and equipment, net	12,521	12,123
Goodwill and other intangibles	4,121	4,126
Accrued interest receivable	3,357	3,113
Deferred tax asset, net	5,417	5,729
Other real estate owned, net	830	1,285
Prepaid FDIC deposit insurance assessment	2,350	2,576
Other assets	6,360	7,855
Total assets	$929,431	$ 926,409
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Liabilities:		
Deposits:		
Noninterest-bearing	$67,049	$ 66,845
Interest-bearing	604,325	593,869
Total deposits	671,374	660,714
Mortgagors' and investors' escrow accounts	1,791	3,425
Federal Home Loan Bank advances	109,169	114,169
Junior subordinated debt owed to unconsolidated trust	8,248	8,248
Stock offering escrow	-	48,325
Accrued expenses and other liabilities	9,914	10,424
Total liabilities	800,496	845,305
Shareholders' Equity:		
Preferred stock ($.01 par value; 1,000,000 shares authorized; none issued)	-	-
	106	126

Common stock ($.01 par value; 35,000,000 and 75,000,000 shares authorized; 10,576,849 and 12,563,750 shares issued; 10,576,302 and 11,777,496 shares outstanding at March 31, 2011 and December 31, 2010, respectively)		
Additional paid-in-capital	94,518	52,198
Unallocated common shares held by ESOP	(5,928)	(2,907)
Unearned restricted shares	(23)	(25)
Retained earnings	40,770	40,859
Accumulated other comprehensive loss	(503)	(1,108)
Treasury stock, at cost (547 and 786,254 shares at March 31, 2011 and December 31, 2010, respectively)	(5)	(8,039)
Total shareholders' equity	128,935	81,104
Total liabilities and shareholders' equity	$929,431	$ 926,409

See accompanying notes to unaudited interim consolidated financial statements.

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SI FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF INCOME
(In Thousands, Except Per Share Amounts / Unaudited)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Interest and dividend income:		
Loans, including fees	$7,908	$8,411
Securities:		
Taxable interest	1,561	1,755
Tax-exempt interest	1	15
Dividends	20	5
Other	30	23
Total interest and dividend income	9,520	10,209
Interest expense:		
Deposits	1,897	2,664
Federal Home Loan Bank advances	1,012	1,076
Subordinated debt	83	39
Total interest expense	2,992	3,779
Net interest income	6,528	6,430
Provision for loan losses	210	170
Net interest income after provision for loan losses	6,318	6,260
Noninterest income:		
Total other-than-temporary impairment losses on securities	-	(378)
Portion of losses recognized in other comprehensive income	-	207
Net impairment losses recognized in earnings	-	(171)
Service fees	1,180	1,259
Wealth management fees	1,066	1,019
Increase in cash surrender value of bank-owned life insurance	72	71
Net gain on sale of securities	35	267
Mortgage banking fees	169	130
Net gain in fair value on trading securities and derivatives	27	-
Net loss on disposal of equipment	(7)	-
Other	107	38
Total noninterest income	2,649	2,613
Noninterest expenses:		
Salaries and employee benefits	4,144	4,141
Occupancy and equipment	1,535	1,421
Computer and electronic banking services	956	941
Outside professional services	267	249
Marketing and advertising	160	182
Supplies	135	141

FDIC deposit insurance and regulatory assessments	305	339
Contribution to SI Financial Group Foundation	500	-
Other	711	723
Total noninterest expenses	8,713	8,137
Income before income tax provision	254	736
Income tax provision	45	243
Net income	$209	$493
Net income per share:		
Basic	$0.02	$0.05
Diluted	$0.02	$0.05

See accompanying notes to unaudited interim consolidated financial statements.

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SI FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE THREE MONTHS ENDED MARCH 31, 2011
(In Thousands, Except Share Amounts / Unaudited)

	Common Stock Shares	Common Stock Dollars	Additional Paid-in Capital	Unallocated Common Shares Held by ESOP	Unearned Restricted Shares	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Shareholders' Equity
Balance at December 31, 2010	12,563,750	$ 126	$ 52,198	$ (2,907)	$ (25)	$ 40,859	$ (1,108)	$ (8,039)	$ 81,104
Exchange of common stock pursuant to reorganization and concurrent second-step stock offering	(1,986,901)	(20)	42,306	-	-	-	-	8,039	50,325
Comprehensive income:									
Net income	-	-	-	-	-	209	-	-	209
Net unrealized gain on available for sale securities, net of reclassification adjustment and tax effects	-	-	-	-	-	-	556	-	556
Net unrealized gain on interest-rate swap derivative	-	-	-	-	-	-	49	-	49
Total comprehensive income									814
Cash dividends declared ($0.03 per share)	-	-	-	-	-	(298)	-	-	(298)
Equity incentive plan shares earned	-	-	18	-	2	-	-	-	20
Shares purchased for ESOP pursuant to reorganization (392,670 shares)	-	-	-	(3,141)	-	-	-	-	(3,141)
	-	-	(6)	120	-	-	-	-	114

Allocation of 12,159 ESOP shares									
Tax benefit from share-based compensation	-	-	2	-	-	-	-	-	2
Treasury stock purchased (547 shares)	-	-	-	-	-	-	-	(5)	(5)
Balance at March 31, 2011	10,576,849	$ 106	$ 94,518	$ (5,928)	$ (23)	$ 40,770	$ (503)	$ (5)	$ 128,935

See accompanying notes to unaudited interim consolidated financial statements.

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SI FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands / Unaudited)

	Three Months Ended March 31, 2011	2010
Cash flows from operating activities:		
Net income	$209	$493
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	210	170
Employee stock ownership plan expense	114	45
Equity incentive plan expense	20	155
Excess tax benefit from share-based compensation	(2)	(2)
Amortization of investment premiums and discounts, net	103	54
Amortization of loan premiums and discounts, net	204	154
Depreciation and amortization of premises and equipment	461	475
Amortization of core deposit intangible	5	8
Net gain on sale of securities	(35)	(267)
Net gain on trading securities	(21)	-
Deferred income tax benefit	-	(43)
Loans originated for sale	(14,249)	(9,280)
Proceeds from sale of loans held for sale	19,785	7,624
Net gain on sale of loans	(124)	(67)
Net loss on disposal of equipment	7	-
Net loss on sales or write-downs of other real estate owned	62	34
Increase in cash surrender value of bank-owned life insurance	(72)	(71)
Gain on bank-owned life insurance proceeds	(120)	-
Other-than-temporary impairment losses on securities	-	171
Change in operating assets and liabilities:		
Accrued interest receivable	(244)	(31)
Other assets	1,134	(2,114)
Accrued expenses and other liabilities	(614)	431
Net cash provided by (used in) operating activities	6,833	(2,061)
Cash flows from investing activities:		
Purchases of available for sale securities	(47,374)	(26,764)
Proceeds from sales of available for sale securities	1,065	9,071
Proceeds from maturities of and principal repayments on available for sale securities	9,917	15,313
Net decrease in loans	14,633	12,978
Purchases of loans	(17,419)	(7,296)
Proceeds from sale of other real estate owned	473	443
Purchases of premises and equipment	(866)	(126)
Proceeds from bank-owned life insurance	600	-
Net cash (used in) provided by investing activities	(38,971)	3,619
Cash flows from financing activities:		
Net increase in deposits	10,660	10,983

Net decrease in mortgagors' and investors' escrow accounts	(1,634)	(1,701)
Proceeds from Federal Home Loan Bank advances	14,000	7,386
Repayments of Federal Home Loan Bank advances	(19,000)	(9,386)
Net proceeds from common stock offering	2,769	-
Excess tax benefit from share-based compensation	2	2
Purchase of shares by ESOP pursuant to reorganization	(3,141)	-
Cash dividends on common stock	(298)	-
Treasury stock purchased	(5)	(3)
Net cash provided by financing activities	3,353	7,281

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SI FINANCIAL GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Concluded)
(In Thousands / Unaudited)

	Three Months Ended March 31,	
	2011	2010
Net change in cash and cash equivalents	(28,785)	8,839
Cash and cash equivalents at beginning of period	78,321	24,204
Cash and cash equivalents at end of period	$49,536	$33,043
Supplemental cash flow information:		
Interest paid	$3,009	$3,784
Income taxes paid, net	-	1
Transfer of stock offering escrow for issuance of common shares	47,556	-
Transfer of loans to other real estate owned	80	1,003
Due from broker	-	2,160

See accompanying notes to unaudited interim consolidated financial statements.

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SI FINANCIAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2011 AND 2010 AND DECEMBER 31, 2010

NOTE 1. NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business
SI Financial Group, Inc. (the "Company") is the holding company for Savings Institute Bank and Trust Company (the "Bank"). Established in 1842, the Bank is a community-oriented financial institution headquartered in Willimantic, Connecticut. The Bank provides a variety of financial services to individuals, businesses and municipalities through its twenty-one offices in eastern Connecticut. Its primary products include savings, checking and certificate of deposit accounts, residential and commercial mortgage loans, commercial business loans and consumer loans. In addition, wealth management services, which include trust, financial planning, life insurance and investment services, are offered to individuals and businesses through the Bank's Connecticut offices. SI Trust Servicing, a third-party provider of trust outsourcing services for community banks, expands the wealth management products offered by the Bank, and offers trust services to other community banks. The Company does not conduct any material business other than owning all of the stock of the Bank and making payments on the subordinated debentures held by the Company.

Effective January 12, 2011, the Company completed its public stock offering and the concurrent conversion of the Bank from the mutual holding company form of organization to the stock form of organization (the "Conversion"). A total of 6,544,493 shares of common stock were sold in the subscription and community offerings at $8.00 per share, including 392,670 shares purchased by the Bank's Employee Stock Ownership Plan ("ESOP"). Additional shares totaling 4,032,356 were issued in exchange for shares of the former SI Financial Group, Inc., at an exchange ratio of 0.8981. Shares outstanding after the stock offering and the exchange total 10,576,849. Net proceeds received from the reorganization and stock offering totaled $50.3 million, net of costs of $2.0 million. Net income per share and the weighted average shares outstanding for the three months ended March 31, 2010 have been restated to reflect the Conversion.

Principles of Consolidation
The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, the Bank, and the Bank's wholly-owned subsidiaries, 803 Financial Corp., SI Mortgage Company and SI Realty Company, Inc. All significant intercompany accounts and transactions have been eliminated.

Basis of Financial Statement Presentation
The interim consolidated financial statements and related notes have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information, with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X of the Securities and Exchange Commission ("SEC") and general practices within the banking industry. Accordingly, certain information and footnote disclosures required by GAAP for complete financial statements have been omitted. Information in the accompanying interim consolidated financial statements and notes to the financial statements of the Company as of March 31, 2011 and for the three months ended March 31, 2011 and 2010 is unaudited. These unaudited interim consolidated financial statements and related notes should be read in conjunction with the audited financial statements of the Company and the accompanying notes for the year ended December 31, 2010 contained in the Company's Form 10-K.

Interim financial statements are subject to possible adjustment in connection with the annual audit of the Company for the year ending December 31, 2011. In the opinion of management, the accompanying unaudited interim consolidated financial statements reflect all of the adjustments, consisting only of normal and recurring adjustments, necessary for a fair presentation of the financial condition, results of operations and cash flows as of and for the period covered herein. The results of operations for the three months ended March 31, 2011 are not necessarily indicative of the operating results for the year ending December 31, 2011.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities, as of the date of the balance sheets and reported amounts of revenues and expenses for the periods presented. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, other-than-temporary impairment (“OTTI”) of securities, deferred income taxes and the impairment of long-lived assets.

Reclassifications
Certain amounts in the Company's 2010 consolidated financial statements have been reclassified to conform to the 2011 presentation. Such reclassifications had no effect on net income.

Loans Receivable
Loans receivable are stated at current unpaid principal balances, net of the allowance for loan losses and deferred loan origination fees and costs. Management has the ability and intent to hold its loans receivable for the foreseeable future or until maturity or pay-off.

A loan is impaired when it is probable the Company will be unable to collect all contractual principal and interest payments due in accordance with the terms of the loan agreement. Impairment is measured on a loan by loan basis for residential and commercial mortgage loans and commercial business loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer loans for impairment disclosures, unless such loans are subject to a troubled debt restructuring agreement.

The Company periodically may agree to modify the contractual terms of loans. When a loan is modified and concessions have been made to the original contractual terms, such as reductions of interest rates or deferral of interest or principal payments, due to the borrower's financial condition, the modification is considered a troubled debt restructuring ("TDR"). All TDRs are initially classified as impaired.

Management considers all nonaccrual loans and TDRs to be impaired. In most cases, loan payments less than 90 days past due are considered minor collection delays and the related loans are generally not considered impaired.

Allowance for Loan Losses
The allowance for loan losses, a material estimate which could change significantly in the near-term, is established through a provision for loan losses charged to earnings to account for losses that are inherent in the loan portfolio and estimated to occur, and is maintained at a level that management considers adequate to absorb losses in the loan portfolio. Loan losses are charged against the allowance for loan losses when management believes that the uncollectibility of the principal loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance for loan losses when received. In the determination of the allowance for loan losses, management may obtain independent appraisals for significant properties, if necessary.

Management's judgment in determining the adequacy of the allowance is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for loan losses is evaluated on a monthly basis by management and is based on the evaluation of the known and inherent risk characteristics and size and composition of the loan portfolio, the assessment of current economic and real estate market conditions, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, historical loan loss experience and evaluations of loans and other relevant factors.

The allowance for loan losses consists of the following key elements:

- Specific allowance for identified impaired loans. For such loans that are identified as impaired, an allowance is established when the present value of expected cash flows (or collateral value or observable market price if the loan is collateral dependent) of the impaired loan is lower than the carrying value of that loan.

- General valuation allowance. The general component represents a valuation allowance on the remainder of the loan portfolio, after excluding impaired loans. For this portion of the allowance, loans are segregated by category and assigned an allowance percentage based on historical loan loss experience adjusted for qualitative factors stratified by the following loan segments: residential one- to four-family, multi-family and commercial real estate, construction, commercial business and consumer. Management uses a rolling average of historical losses based on the time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels/trends in delinquencies; level of charge-offs and nonperforming loans; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; experience/ability and depth of lending management and staff and national and local economic trends and conditions.

The qualitative factors are determined based on the various risk characteristics for each loan segment. Risk characteristics relevant to each portfolio segment are as follows:

Residential – 1 to 4 Family – The Company does not originate conventional loans with loan-to-value ratios exceeding 95% and generally originates loans with loan-to-value ratios in excess of 80% only when secured by first liens on owner-occupied one- to four-family residences. All loans in this segment are collateralized by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality of this segment.

Multi-family and Commercial Real Estate – Loans in this segment are originated for the purpose of acquiring, developing, improving or refinancing multi-family and commercial real estate where the property is the primary collateral securing the loan, and the income generated from the property is the primary repayment source. The underlying cash flows generated by the properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates, which in turn, will have an effect on the credit quality in this segment. Payments on loans secured by income-producing properties often depend on the successful operation and management of the properties. Management continually monitors the cash flows of these loans.

Construction – This segment includes loans to individuals, and to a lesser extent builders, to finance the construction of residential dwellings. The Bank also originates construction loans for commercial development projects. Upon the completion of construction, the loan generally converts to a permanent mortgage loan. Credit risk is affected by cost overruns, time to sell at an adequate price and market conditions.

Commercial Business – Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. A weakened economy and reduced viability of the industry in which the customer operates will have a negative impact on the credit quality in this segment.

Consumer – Loans in this segment primarily include home equity lines of credit, and, to a lesser extent, loans secured by marketable securities, passbook or certificate accounts, motorcycles, automobiles and recreational vehicles, as well as unsecured loans. 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.

- Unallocated allowance. 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.

In computing the allowance for loan losses, we do not assign a general valuation allowance to the USDA and SBA loans that we purchase as such loans are fully guaranteed. These loans are included in commercial business loans.

The majority of the Company's loans are collateralized by real estate located in eastern Connecticut. Accordingly, the collateral value of a substantial portion of the Company's loan portfolio and real estate acquired through foreclosure is susceptible to changes in market conditions.

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Although management believes that it uses the best information available to establish the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary and the Company's results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while management believes it has established the allowance for loan losses in conformity with U.S. generally accepted accounting principles, the regulatory agencies, in reviewing the loan portfolio, may request us to increase our allowance for loan losses based on judgments different from ours. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, the existing allowance for loan losses may not be adequate or increases may be necessary should the quality of any loans deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses would adversely affect the Company's financial condition and results of operations.

Interest and Fees on Loans

Interest on loans is accrued and included in net interest income based on contractual rates applied to principal amounts outstanding. Accrual of interest is discontinued when loan payments are 90 days or more past due, based on contractual terms, or when, in the judgment of management, collectibility of the loan or loan interest becomes uncertain. Subsequent recognition of income occurs only to the extent payment is received subject to management's assessment of the collectibility of the remaining interest and principal. A nonaccrual loan is restored to accrual status when it is no longer delinquent and collectibility of interest and principal is no longer in doubt. Interest collected on nonaccrual loans and impaired loans is recognized only to the extent cash payments are received, and may be recorded as a reduction to principal if the collectibility of the principal balance of the loan is unlikely.

Loan origination fees and direct loan origination costs are deferred, and the net amount is recognized as an adjustment of the related loan's yield utilizing the interest method over the contractual life of the loan.

Recent Accounting Pronouncements

Fair Value Measurement Disclosures – In January 2010, the Financial Accounting Standards Board ("FASB") amended its standards related to the disclosure of fair value measurements to require: (1) separate disclosure of significant amounts transferred in and out of Levels 1 and 2 fair value measurement categories, (2) a reconciliation of activity in the Level 3 fair value measurement category to present separately information relating to purchases, sales, issuances and settlements, (3) greater disaggregation of the assets and liabilities for which fair value measurements are presented and (4) expanded disclosure of the valuation techniques and inputs used to measure assets and liabilities in Levels 2 and 3 fair value measurement categories. The Company adopted these amendments effective January 1, 2010, with the exception of the requirement related to the reconciliation of activity in Level 3 fair value measurement category, which was adopted effective January 1, 2011. The adoption of these amendments did not have a material impact on the Company's consolidated financial statements.

Scope Exception Related to Embedded Credit Derivatives – In March 2010, the FASB amended its standards related to derivatives and hedging to clarify that the only form of an embedded credit derivative that is exempt from embedded derivative bifurcation requirements are those that relate to the subordination of one financial instrument to another. As a result, entities that have contracts containing an embedded credit derivative feature in a form other than such subordination may need to separately account for the embedded credit derivative feature. Upon initially adopting the amendments of this update, an entity may elect the fair value option for any investment in a beneficial interest in a securitized financial asset. The provisions of the update became effective on July 1, 2010. The Company recorded a cumulative effect adjustment for a change in accounting principle as a reduction to retained earnings and an increase in accumulated other comprehensive income of $652,000 related to the adoption of this update for the year ended December 31, 2010. See Note 3 for related disclosures.

Credit Quality of Financing Receivables and the Allowance for Credit Losses – In July 2010, the FASB issued guidance requiring additional disclosures that facilitate financial statement users' evaluation of: (1) the nature of credit risk inherent in the entity's portfolio of financing receivables, (2) how that risk is analyzed and assessed in arriving at the allowance for credit losses and (3) the changes and reasons for those changes in the allowance for credit losses. For public entities, the disclosures as of the end of a reporting period were effective for interim and annual reporting periods ending on or after December 15, 2010 and the disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The adoption of this amendment had a significant impact on the Company's disclosures. See Note 4 for additional disclosures.

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A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring – In April 2011, the FASB issued additional guidance to creditors in evaluating whether a modification or restructuring of a loan is a troubled debt restructuring to limit diversity in the application GAAP which could adversely affect comparability of financial statements. The update provides guidance on (1) how to determine whether a creditor has granted a concession and (2) whether a borrower is experiencing financial difficulty. For public entities, the amendments are effective for the first interim or annual period beginning on or after June 15, 2011 and should be applied retrospectively to restructurings occurring on or after the beginning of the annual period of adoption. This amendment is not expected to have a significant impact on the Company's consolidated financial statements.

Reconsideration of Effective Control for Repurchase Agreements – In April 2011, the FASB issued guidance which affects all entities that enter into agreements to transfer financial assets that both entitle and obligate the transferor to repurchase or redeem the financial assets before their maturity. The amendment removes from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. The amendment is effective for the first interim or annual period beginning on or after December 15, 2011 and should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. This amendment is not expected to have a significant impact on the Company's consolidated financial statements.

NOTE 2. NET INCOME PER SHARE

Basic net income per share is calculated by dividing the net income available to common shareholders by the weighted average number of common shares outstanding during the period. Unvested restricted shares are considered outstanding in the computation of basic net income per share since the shares participate in dividends and the rights to the dividends are non-forfeitable. Diluted net income per share is computed in a manner similar to basic net income per share except that the weighted average number of common shares outstanding is increased to include the incremental common shares (as computed using the treasury stock method) that would have been outstanding if all potentially dilutive common stock equivalents were issued during the period. The Company's common stock equivalents relate solely to stock options. Treasury shares and unallocated common shares held by the Bank's ESOP are not deemed outstanding for net income per share calculations.

Anti-dilutive shares are common stock equivalents with weighted average exercise prices in excess of the weighted average market value for the periods presented. The Company had anti-dilutive common shares outstanding of 416,677 and 423,589 for the three months ended March 31, 2011 and 2010, respectively. For the three months ended March 31, 2010, all common stock equivalents were anti-dilutive and were not included in the computation of diluted income per share.

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SI FINANCIAL GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2011 AND 2010 AND DECEMBER 31, 2010

The computation of net income per share is as follows:

	Three Months Ended March 31,	
	2011	2010
	(In Thousands, Except Share Amounts)	
Net income	$209	$493
Weighted average common shares outstanding: (1)		
Basic	10,114,324	10,297,874
Effect of dilutive stock options	18,751	-
Diluted	10,133,075	10,297,874
Net income per share: (1)		
Basic	$0.02	$0.05
Diluted	$0.02	$0.05

(1) The number of shares outstanding for the three months ended March 31, 2011 has been adjusted to reflect that on January 12, 2011, each outstanding share was converted to 0.8981 shares of Company common stock in connection with the Conversion. For comparison purposes, the weighted average shares outstanding and resulting net income per share for the three months ended March 31, 2010 have been restated to reflect the Conversion.

NOTE 3. SECURITIES

Trading securities:
During the third quarter of 2010, the Company elected to record two collateralized debt obligations at fair value, previously reported as available for sale securities, and reclassified them to trading securities in accordance with applicable guidance. These securities had amortized costs and fair values of $269,000 and $248,000 at March 31, 2011 and December 31, 2010, respectively. Cumulative unrealized losses at the date of election totaling $652,000 were reclassified from accumulated other comprehensive loss to retained earnings as a cumulative effect adjustment resulting from a change in accounting principle. The Company does not purchase securities with the intent of selling them in the near term, thus there are no other securities in the trading portfolio. For the three months ended March 31, 2011, the net gain in fair value on trading securities held at the reporting date was $21,000, and is included in net gain in fair value on trading securities and derivatives on the statements of income.

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

	March 31, 2011			
	Amortized Cost (1)	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Debt securities:				
U.S. Government and agency obligations	$35,963	$195	$(130)	$36,028
Government-sponsored enterprises	36,082	209	(260)	36,031
Mortgage-backed securities:(2)				
Agency - residential	100,703	2,874	(258)	103,319
Non-agency - residential	10,177	244	(634)	9,787
Non-agency - HELOC	3,638	-	(398)	3,240
Corporate debt securities	15,047	262	(19)	15,290
Collateralized debt obligations	6,458	-	(2,998)	3,460
Obligations of state and political subdivisions	6,644	120	(50)	6,714
Tax-exempt securities	140	3	-	143
Foreign government securities	75	-	-	75
Total debt securities	214,927	3,907	(4,747)	214,087
Equity securities:				
Equity securities - financial services	1,288	116	(2)	1,402
Equity securities - other	1,696	37	(18)	1,715
Total equity securities	2,984	153	(20)	3,117
Total available for sale securities	$217,911	$4,060	$(4,767)	$217,204

(1)Net of OTTI write-downs recognized in earnings.
(2)Agency securities refer to debt obligations issued or guaranteed by government corporations or government-sponsored enterprises (“GSEs”). Non-agency securities, or private-label securities, are the sole obligation of their issuer and are not guaranteed by one of the GSEs or the U.S. Government.

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	December 31, 2010			
	Amortized Cost (1)	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
Debt securities:				
U.S. Government and agency obligations	$23,399	$197	$(13)	$23,583
Government-sponsored enterprises	29,912	283	(202)	29,993
Mortgage-backed securities:(2)				
Agency - residential	84,408	3,132	(170)	87,370
Non-agency - residential	11,039	127	(711)	10,455
Non-agency - HELOC	3,797	-	(598)	3,199
Corporate debt securities	14,502	252	(37)	14,717
Collateralized debt obligations	6,466	-	(3,934)	2,532
Obligations of state and political subdivisions	6,800	157	(52)	6,905
Tax-exempt securities	140	4	-	144
Foreign government securities	100	-	-	100
Total debt securities	180,563	4,152	(5,717)	178,998
Equity securities:				
Equity securities - financial services	1,024	27	(13)	1,038
Total available for sale securities	$181,587	$4,179	$(5,730)	$180,036

(1) Net of OTTI write-downs recognized in earnings.
(2) Agency securities refer to debt obligations issued or guaranteed by government corporations or government-sponsored enterprises ("GSEs"). Non-agency securities, or private-label securities, are the sole obligation of their issuer and are not guaranteed by one of the GSEs or the U.S. Government.

The amortized cost and fair value of debt securities by contractual maturities at March 31, 2011 are presented below. Actual maturities of mortgage-backed securities may differ from contractual maturities because the mortgages underlying the securities may be called or repaid without any penalties. Because mortgage-backed securities are not due at a single maturity date, they are not included in the maturity categories in the following maturity summary.

	Amortized Cost	Fair Value
	(In Thousands)	
Within 1 year	$ 7,067	$ 7,148
After 1 but within 5 years	43,457	43,622
After 5 but within 10 years	14,220	14,231
After 10 years	35,665	32,740
	100,409	97,741
Mortgage-backed securities	114,518	116,346
Total debt securities	$ 214,927	$ 214,087

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The following is a summary of realized gains and losses on the sale of securities for the three months ended March 31, 2011 and 2010:

	Three Months Ended March 31,	
	2011	2010
	(In Thousands)	
Gross gains on sales	$ 35	$ 485
Gross losses on sales	-	(218)
Net gain on sale of securities	$ 35	$ 267

Proceeds from the sale of available for sale securities were $1.1 million and $9.1 million for the three months ended March 31, 2011 and March 31, 2010, respectively.

The following tables present information pertaining to securities with gross unrealized losses at March 31, 2011 and December 31, 2010, aggregated by investment category and length of time the individual securities have been in a continuous unrealized loss position.

	Less Than 12 Months		12 Months Or More		Total	
March 31, 2011:	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In Thousands)					
U.S. Government and agency obligations	$14,627	$124	$753	$6	$15,380	$130
Government-sponsored enterprises	19,767	260	-	-	19,767	260
Mortgage-backed securities:						
Agency - residential	26,211	234	1,062	24	27,273	258
Non-agency - residential	384	8	6,078	626	6,462	634
Non-agency - HELOC	-	-	3,240	398	3,240	398
Corporate debt securities	2,727	19	-	-	2,727	19
Collateralized debt obligations	45	42	3,415	2,956	3,460	2,998
Obligations of state and political subdivisions	1,495	50	-	-	1,495	50
Equity securities - financial services	108	2	-	-	108	2
Equity securities - other	608	18	-	-	608	18
Total	$65,972	$757	$14,548	$4,010	$80,520	$4,767

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	Less Than 12 Months		12 Months Or More		Total	
December 31, 2010:	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(In Thousands)			
U.S. Government and agency obligations	$2,053	$4	$858	$9	$2,911	$13
Government-sponsored enterprises	16,636	202	-	-	16,636	202
Mortgage-backed securities:						
Agency - residential	15,881	170	-	-	15,881	170
Non-agency - residential	2,805	9	6,512	702	9,317	711
Non-agency - HELOC	-	-	3,198	598	3,198	598
Corporate debt securities	3,667	37	-	-	3,667	37
Collateralized debt obligations	28	60	2,504	3,874	2,532	3,934
Obligations of state and political subdivisions	1,493	52	-	-	1,493	52
Equity securities - financial services	-	-	747	13	747	13
Total	$42,563	$534	$13,819	$5,196	$56,382	$5,730

At March 31, 2011, fifty-four debt securities with gross unrealized losses had aggregate depreciation of 5.61% of the Company's amortized cost basis. The majority of the unrealized losses related to the Company's non-agency mortgage-backed securities and collateralized debt obligations as discussed below. The Company did not recognize net impairment losses on securities for the three months ended March 31, 2011. For the three months ended March 31, 2010, the Company recognized net impairment losses of $171,000 on investments deemed other-than-temporarily impaired. The following summarizes, by security type, the basis for management's determination during the preparation of the financial statements of whether the applicable investments within the Company's securities portfolio were other-than-temporarily impaired at March 31, 2011.

Debt Securities:
U.S. Government and Agency Obligations and Government-Sponsored Enterprises. The unrealized losses on the Company's U.S. Government and agency obligations and government-sponsored enterprises related primarily to a widening of the rate spread to comparable treasury securities. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the decline in market value is attributable to changes in interest rates and not credit quality and because the Company does not intend to sell these securities and it is not more likely than not that the Company will be required to sell the securities before their anticipated recovery, which may be maturity, the Company does not consider these securities to be other-than-temporarily impaired at March 31, 2011.

Mortgage-backed Securities – Agency - Residential. The unrealized losses on the Company's agency–residential mortgage-backed securities were caused by increases in the rate spread to comparable treasury securities. The Company does not expect these securities to settle at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before the recovery of their amortized cost basis, which may be at maturity, the Company does not consider these investments to be other-than-temporarily impaired at March 31, 2011.

Mortgage-backed Securities - Non-agency - Residential. The unrealized losses on the Company's non-agency-residential mortgage-backed securities are primarily due to the fact that these securities continue to trade well below historic levels, particularly those backed by jumbo or hybrid loan collateral. In particular, four non-agency mortgage-backed securities displayed market pricing significantly below book value or were rated below investment grade at March 31, 2011. At March 31, 2011, management evaluated credit rating details for the tranche owned, as well as credit information on subordinate tranches, potential future credit losses and loss analyses. Additionally, management reviewed reports prepared by an independent third party for certain non-agency mortgage-backed securities. The Company previously recorded OTTI losses on one of the non-agency mortgage-backed securities totaling $1.1 million related to credit. The Company did not record any further impairment losses at March 31, 2011 because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity. See the table of non-agency mortgage-backed securities rated below investment grade as of March 31, 2011 for more details.

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Mortgage-backed Securities - Non-agency - HELOC. The unrealized loss on the Company's non-agency - HELOC mortgage-backed security is related to one security whose market has been illiquid. This security is collateralized by home equity lines of credit secured by first and second liens and insured by Financial Security Assurance. At March 31, 2011, management evaluated credit rating details, collateral support and loss analyses. All of the unrealized losses on this security relate to factors other than credit. Because the Company does not intend to sell this security and it is not more likely than not that the Company will be required to sell this security before the recovery of its amortized cost basis, which may be at maturity, the Company did not record an impairment loss at March 31, 2011.

Collateralized Debt Obligations. The unrealized losses on the Company's collateralized debt obligations related to investments in pooled trust preferred securities ("PTPS"). The PTPS market continues to experience significant declines in market value as a result of market saturation. Transactions for PTPS have been limited and have occurred primarily as a result of distressed or forced liquidation sales.

Management evaluated current credit ratings, credit support and stress testing for future defaults related to the Company's PTPS. Management also reviewed analytics provided by the trustee and independent OTTI review and associated cash flow analyses performed by an independent third party. The unrealized losses on the Company's PTPS investments were caused by a lack of liquidity, credit downgrades and decreasing credit support. The increased number of bank and insurance company failures has decreased the level of credit support for these investments. A number of lower tranche income issues have foregone payments or have received payment in kind through increased principal allocations. The Company previously recorded OTTI losses on three PTPS investments totaling $1.2 million related to credit factors. At March 31, 2011, based on the existing credit profile, management does not believe that these investments will suffer from any further credit-related losses. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity, the Company did not record additional impairment losses at March 31, 2011. See the table of collateralized debt obligations rated below investment grade as of March 31, 2011for more details.

Equity Securities:
The Company's investments in marketable equity securities consist of common and preferred stock of companies in the financial services sector and common stock of companies in various other industries. Management evaluated the near-term prospects of the issuers and the Company's ability and intent to hold the investments for a reasonable period of time sufficient for an anticipated recovery of fair value. Although certain issuers have shown declines in earnings as a result of the weakened economy, no credit issues have been identified that cause management to believe that the declines in market value are other-than-temporary at March 31, 2011.

For debt securities with OTTI losses, the Company estimated the portion of loss attributable to credit using a discounted cash flow model in accordance with applicable guidance. Significant inputs for the non-agency mortgage-backed securities included the estimated cash flows of the underlying collateral based on key assumptions, such as default rate, loss severity and prepayment rate. Assumptions used can vary widely from loan to loan, and are influenced by such factors as loan interest rate, geographical location of the borrower, borrower characteristics and collateral type. Significant inputs for the collateralized debt obligations included estimated cash flows and prospective deferrals, defaults and recoveries based on the underlying seniority status and subordination structure of the pooled trust preferred debt tranche at the time of measurement. Prospective deferral, default and recovery estimates affecting projected cash flows were based on an analysis of the underlying financial condition of the individual issuers, with consideration of the account's capital adequacy, credit quality, lending concentrations and other factors. All cash flow estimates were based on the securities' tranche structure and contractual rate and maturity terms. The Company utilized the services of an independent third-party valuation firm to obtain information about the structure in order to determine how the underlying collateral cash flows will be distributed to each security issued from the structure. The present value of the expected cash flows was compared to the Company's holdings to determine the credit-related impairment loss, if any.

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To the extent that continued changes in interest rates, credit movements and other factors that influence fair value of investments occur, the Company may be required to record additional impairment charges for OTTI in future periods.

The following table details the Company's non-agency mortgage-backed security holdings that are rated below investment grade as of March 31, 2011 (dollars in thousands).

Security	Class (1)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Lowest Credit Rating (2)	Total Credit-Related OTTI (3)	Credit Support Coverage Ratios (4)
MBS 1	SSNR, AS	$ 2,690	$ -	$ 448	$ 2,242	CCC	$ -	0.51
MBS 2	SSUP, AS	216	211	-	427	CC	1,059	0.00
MBS 3	PT, AS	393	-	9	384	CC	-	0.78
MBS 4	CSTR	4,013	-	177	3,836	BB-	-	2.80
		$ 7,312	$ 211	$ 634	$ 6,889		$ 1,059	

(1)Class definitions: PT – Pass Through, AS – Accelerated, SSNR – Super Senior, SSUP – Senior Support and CSTR – Collateral Strip Interest.
(2)The Company utilized credit ratings provided by Moody's, S&P and Fitch in its evaluation of issuers.
(3)The OTTI amounts provided in the table represent cumulative credit loss amounts through March 31, 2011.
(4)The credit support coverage ratio, which is the ratio that determines the multiple of credit support, is based on assumptions for the performance of loans within the delinquency pipeline. The assumptions used are: current collateral support/((60 day delinquencies x .60) + (90 day delinquencies x .70) + (foreclosures x 1.00) + (other real estate x 1.00)) x .40 for loss severity.

The following table details the Company's collateralized debt obligations that are rated below investment grade as of March 31, 2011 (dollars in thousands).

Security	Class	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Lowest Credit Rating (1)	Total Credit-Related OTTI (2)	% of Current Performing Collateral Coverage
CDO 1	B1	$ 1,000	$ -	$ 776	$ 224	CCC-	$ -	110.6
CDO 2	B3	1,000	-	770	230	CCC-	-	110.6
CDO 3	MEZ	88	-	42	46	CC	34	124.0
CDO 4 (3)	B	269	-	-	269	CC	377	104.9
CDO 5 (3)	C	-	-	-	-	C	809	71.6

CDO 6	A2	2,637	-	913	1,724	CCC-	-	105.8
CDO 7	A1	1,733	-	497	1,236	CCC	-	139.3
		$ 6,727	$ -	$ 2,998	$ 3,729		$ 1,220	

(1)The Company utilized credit ratings provided by Moody's, S&P and Fitch in its evaluation of issuers.
(2)The OTTI amounts provided in the table represent cumulative credit loss amounts through March 31, 2011.
(3)These securities were transferred from available for sale to trading securities during the quarter ended September 30, 2010.

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The following table presents a roll-forward of the balance of credit losses on the Company's debt securities for which a portion of OTTI was recognized in other comprehensive income for the three months ended March 31, 2011.

	Three Months Ended March 31, 2011 (In Thousands)
Balance at January 1, 2011	$ 1,093
Amounts related to credit for which OTTI losses were not previously recognized	-
Additional credit losses for which OTTI losses were previously recognized	-
Balance at March 31, 2011	$ 1,093

NOTE 4. LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

The composition of the Company's loan portfolio at March 31, 2011 and December 31, 2010 is as follows:

	March 31, 2011	December 31, 2010
	(In Thousands)	
Real estate loans:		
Residential - 1 to 4 family	$ 265,306	$ 270,923
Multi-family and commercial	155,594	160,015
Construction	6,877	6,952
Total real estate loans	427,777	437,890
Commercial business loans:		
SBA & USDA guaranteed	130,355	116,492
Other	24,271	26,310
Total commercial business loans	154,626	142,802
Consumer loans:		
Home equity	25,972	25,533
Other	3,044	3,167
Total consumer loans	29,016	28,700
Total loans	611,419	609,392
Deferred loan origination costs, net of fees	1,650	1,621
Allowance for loan losses	(4,563)	(4,799)
Loans receivable, net	$ 608,506	$ 606,214

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Allowance for Loan Losses

The following table summarizes the changes in the allowance for loan losses by portfolio segment for the three months ended March 31, 2011 and 2010:

March 31, 2011	Residential - 1 to 4 Family	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
	(In Thousands)					
Balance at beginning of period	$915	$ 2,700	$ 64	$ 790	$330	$4,799
Provision for loan losses	81	(70)	109	(15)	105	210
Loans charged-off	(289)	(32)	(83)	(31)	(14)	(449)
Recoveries of loans previously charged-off	-	-	-	3	-	3
Balance at end of period	$707	$ 2,598	$ 90	$ 747	$421	$4,563

March 31, 2010	Residential - 1 to 4 Family	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
	(In Thousands)					
Balance at beginning of period	$1,028	$ 2,443	$ 221	$ 906	$293	$4,891
Provision for loan losses	(20)	191	(25)	11	13	170
Loans charged-off	(44)	(222)	-	-	(4)	(270)
Recoveries of loans previously charged-off	1	-	-	-	1	2
Balance at end of period	$965	$ 2,412	$ 196	$ 917	$303	$4,793

Further information pertaining to the allowance for loan losses at March 31, 2011 and December 31, 2010 is as follows:

March 31, 2011	Residential - 1 to 4 Family	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
	(In Thousands)					
Allowance for loans individually evaluated for impairment	$20	$ 234	$ -	$ 5	$-	$259

Allowance for loans collectively evaluated for impairment	687	2,364	90	742	421	4,304
Total loan loss allowance	$707	$ 2,598	$ 90	$ 747	$421	$4,563
Loans individually evaluated for impairment	$4,946	$ 6,829	$ -	$ 52	$50	$11,877
Loans collectively evaluated for impairment	260,360	148,765	6,877	154,574	28,966	599,542
Total loans	$265,306	$ 155,594	$ 6,877	$ 154,626	$29,016	$611,419

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	December 31, 2010					
	Residential - 1 to 4 Family	Multi-family and Commercial	Construction	Commercial Business	Consumer	Total
	(In Thousands)					
Allowance for loans individually evaluated for impairment	$212	$ 290	$ -	$ -	$ -	$502
Allowance for loans collectively evaluated for impairment	703	2,410	64	790	330	4,297
Total loan loss allowance	$915	$ 2,700	$ 64	$ 790	$330	$4,799
Loans individually evaluated for impairment	$3,768	$ 6,169	$ 82	$ 116	$51	$10,186
Loans collectively evaluated for impairment	267,155	153,846	6,870	142,686	28,649	599,206
Total loans	$270,923	$ 160,015	$ 6,952	$ 142,802	$28,700	$609,392

Impaired and Nonaccrual Loans

The following represents an aging of loans at March 31, 2011 and December 31, 2010:

	March 31, 2011						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total 30 Days or More Past Due	Current	Total Loans	Past Due 90 Days or More and Accruing
	(In Thousands)						
Real Estate:							
Residential - 1 to 4 family	$2,882	$306	$3,034	$6,222	$259,084	$265,306	$ -
Multi-family and commercial	858	-	29	887	154,707	155,594	-
Construction	-	-	-	-	6,877	6,877	-
Commercial Business:							
SBA & USDA guaranteed	15,144	-	350	15,494	114,861	130,355	350
Other	-	-	46	46	24,225	24,271	-
Consumer:							

Home equity	284	-	50	334	25,638	25,972	-
Other	10	2	-	12	3,032	3,044	-
Total	$19,178	$308	$3,509	$22,995	$588,424	$611,419	$350

	December 31, 2010						
	30-59 Days Past Due (In Thousands)	60-89 Days Past Due	Greater Than 90 Days Past Due	Total 30 Days or More Past Due	Current	Total Loans	Past Due 90 Days or More and Accruing
Real Estate:							
Residential - 1 to 4 family	$2,387	$1,291	$2,364	$6,042	$264,881	$270,923	$-
Multi-family and commercial	597	-	44	641	159,374	160,015	-
Construction	-	-	82	82	6,870	6,952	-
Commercial Business:							
SBA & USDA guaranteed	10,718	-	-	10,718	105,774	116,492	-
Other	-	-	46	46	26,264	26,310	-
Consumer:							
Home equity	25	50	-	75	25,458	25,533	-
Other	10	1	-	11	3,156	3,167	-
Total	$13,737	$1,342	$2,536	$17,615	$591,777	$609,392	$-

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The Company reviews and establishes, if necessary, an allowance for certain impaired loans for the amount by which the present value of expected cash flows (or fair value of collateral or observable market value) are lower than the carrying value of the loan. For the periods presented, the Company concluded that certain impaired loans required no valuation allowance as a result of management's measurement of impairment. No additional funds are committed to be advanced to those borrowers whose loans are impaired.

The following is a summary of impaired and nonaccrual loans at March 31, 2011 and December 31, 2010:

March 31, 2011	Recorded Investment	Unpaid Principal Balance	Related Allowance	Total Nonaccrual Loans
	(In Thousands)			
Impaired loans without valuation allowance:				
Real Estate:				
Residential - 1 to 4 family	$4,761	$4,761	$-	$3,894
Multi-family and commercial	2,200	2,215	-	1,084
Commercial business	47	163	-	47
Consumer	50	50	-	50
Total	7,058	7,189	-	5,075
Impaired loans with valuation allowance:				
Real Estate:				
Residential - 1 to 4 family	185	185	20	185
Multi-family and commercial	4,629	4,629	234	908
Commercial business	5	5	5	5
Total	4,819	4,819	259	1,098
Total impaired loans	$11,877	$12,008	$259	$6,173

December 31, 2010	Recorded Investment	Unpaid Principal Balance	Related Allowance	Total Nonaccrual Loans
	(In Thousands)			
Impaired loans without valuation allowance:				
Real Estate:				
Residential - 1 to 4 family	$3,212	$3,212	$-	$2,345
Multi-family and commercial	1,513	1,513	-	853
Construction	82	990	-	82
Commercial business	116	201	-	116
Consumer	51	51	-	51
Total	4,974	5,967	-	3,447
Impaired loans with valuation allowance:				
Real Estate:				
Residential - 1 to 4 family	556	556	212	556

Multi-family and commercial	4,656	4,656	290	922
Total	5,212	5,212	502	1,478
Total impaired loans	$10,186	$11,179	$502	$4,925

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Additional information related to impaired loans is as follows:

	Three Months Ended March 31, 2011		
	Average Recorded Investment in Impaired Loans	Interest Income Recognized on Impaired Loans	Cash Interest Income Received on Impaired Loans
Real Estate:			
Residential - 1 to 4 family	$3,449	$-	$38
Multi-family and commercial	4,522	13	96
Construction	241	73	-
Commercial business	168	-	-
Total	$8,380	$86	$134

	Three Months Ended March 31, 2010		
	Average Recorded Investment in Impaired Loans	Interest Income Recognized on Impaired Loans	Cash Interest Income Received on Impaired Loans
Real Estate:			
Residential - 1 to 4 family	$3,250	$1	$13
Multi-family and commercial	1,263	39	39
Construction	2,207	-	-
Commercial business	130	-	1
Total	$6,850	$40	$53

Credit Quality Information
The Company utilizes an eight grade internal loan rating system for all loans in the portfolio, with the exception of its purchased Small Business Administration ("SBA") and United States Department of Agriculture ("USDA") commercial business loans that are fully guaranteed by the U.S. government, as follows:

- Pass (Ratings 1-4): Loans in these categories are considered low to average risk.

- Special Mention (Rating 5): Loans in this category are starting to show signs of potential weakness and are being closely monitored by management.

- Substandard (Rating 6): Generally, a loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligors and/or the collateral pledged. There is a distinct possibility that the Company will sustain some loss if the weakness is not corrected.

- Doubtful (Rating 7): Loans classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable.

- Loss (Rating 8): Loans in this category are considered uncollectible and of such little value that their continuance as loans is not warranted.

Management periodically reviews the ratings described above and the Company's internal audit function reviews components of the credit files, including the assigned risk ratings, of certain commercial loans as part of its loan review. Management incorporates these results into its audit process.

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The following table presents the Company's loans by risk rating at March 31, 2011 and December 31, 2010:

	Real Estate Loans			Commercial Business		Consumer		
March 31, 2011	Residential - 1 to 4 Family	Multi-family and Commercial	Construction	SBA & USDA	Other	Home Equity	Other	Total Loans
				(In Thousands)				
Not Rated	$-	$ -	$ -	$130,355	$-	$-	$-	$130,355
Pass	260,232	126,578	6,349	-	18,128	25,862	3,044	440,193
Special Mention	830	18,906	528	-	2,348	-	-	22,612
Substandard	4,244	10,110	-	-	3,764	110	-	18,228
Doubtful	-	-	-	-	31	-	-	31
Loss	-	-	-	-	-	-	-	-
Total	$265,306	$ 155,594	$ 6,877	$130,355	$24,271	$25,972	$3,044	$611,419

	Real Estate Loans			Commercial Business		Consumer		
December 31, 2010	Residential - 1 to 4 Family	Multi-family and Commercial	Construction	SBA & USDA	Other	Home Equity	Other	Total Loans
				(In Thousands)				
Not Rated	$-	$ -	$ -	$116,492	$-	$-	$-	$116,492
Pass	267,023	134,484	6,504	-	20,105	25,483	3,166	456,765
Special Mention	834	16,260	366	-	2,896	-	-	20,356
Substandard	3,066	9,271	82	-	3,239	50	1	15,709
Doubtful	-	-	-	-	70	-	-	70
Loss	-	-	-	-	-	-	-	-
Total	$270,923	$ 160,015	$ 6,952	$116,492	$26,310	$25,533	$3,167	$609,392

NOTE 5. PREMISES AND EQUIPMENT

Premises and equipment at March 31, 2011 and December 31, 2010 are summarized as follows:

	March 31, 2011	December 31, 2010
	(In Thousands)	
Land	$ 2,098	$ 2,098
Buildings	6,086	6,077
Leasehold improvements	7,787	7,786
Furniture and equipment	11,964	11,388
Construction in process	-	21

		27,935		27,370
Accumulated depreciation and amortization		(15,414)		(15,247)
Premises and equipment, net	$	12,521	$	12,123

At December 31, 2010, construction in process related to incidental branch improvements.

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NOTE 6. ACCUMULATED OTHER COMPREHENSIVE LOSS

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities are reported as a separate component of shareholders' equity on the balance sheet, such items, along with net income are components of comprehensive income.

Components of other comprehensive income for the three months ended March 31, 2011 are as follows:

	March 31, 2011		
	Before Tax Amount	Tax Effects (In Thousands)	Net of Tax Amount
Securities:			
Unrealized holding gains on available for sale securities	$758	$(259)	$499
Noncredit portion of OTTI on available for sale securities	121	(41)	80
Reclassification adjustment for gains realized in net income	(35)	12	(23)
Unrealized holding gains on available for sale securities, net of taxes	844	(288)	556
Derivative instrument:			
Change in fair value of effective cash flow hedging derivative	74	(25)	49
Other comprehensive income	$918	$(313)	$605

The components of accumulated other comprehensive loss included in shareholders' equity are as follows:

	March 31, 2011		
	Before Tax Amount	Tax Effects (In Thousands)	Net of Tax Amount
Net unrealized losses on available for sale securities	$(876)	$297	$(579)
Noncredit portion of OTTI on available for sale securities	169	(57)	112
Net unrealized loss on effective cash flow hedging derivative	(55)	19	(36)
Accumulated other comprehensive loss	$(762)	$259	$(503)

	December 31, 2010		
	Before Tax Amount	Tax Effects (In Thousands)	Net of Tax Amount
Net unrealized losses on available for sale securities	$(1,599)	$544	$(1,055)
Noncredit portion of OTTI on available for sale securities	48	(16)	32
Net unrealized loss on effective cash flow hedging derivative	(129)	44	(85)
Accumulated other comprehensive loss	$(1,680)	$572	$(1,108)

NOTE 7. REGULATORY CAPITAL

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

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Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier I capital (as defined) to total assets (as defined). As of March 31, 2011 and December 31, 2010, the Bank met the conditions to be classified as "well capitalized" under the regulatory framework for prompt corrective action. There are no conditions or events since then that management believes have changed the Bank's regulatory category. As a savings and loan holding company regulated by the Office of Thrift Supervision (the "OTS"), the Company is not subject to any separate regulatory capital requirements.

The following is a summary of the Bank's regulatory capital amounts and ratios as of March 31, 2011 and December 31, 2010.

March 31, 2011	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
(Dollars in Thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Risk-based Capital Ratio	$103,590	21.77 %	$38,067	8.00 %	$47,584	10.00 %
Tier I Risk-based Capital Ratio	98,974	20.80	19,033	4.00	28,550	6.00
Tier I Capital Ratio	98,974	10.91	36,287	4.00	45,359	5.00
Tangible Equity Ratio	98,974	10.91	13,608	1.50	N/A	N/A

December 31, 2010	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
(Dollars in Thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Risk-based Capital Ratio	$75,823	15.34 %	$39,543	8.00 %	$49,428	10.00 %
Tier I Risk-based Capital Ratio	71,173	14.40	19,770	4.00	29,655	6.00
Tier I Capital Ratio	71,173	7.81	36,452	4.00	45,565	5.00
Tangible Equity Ratio	71,173	7.81	13,670	1.50	N/A	N/A

NOTE 8. FAIR VALUE OF ASSETS AND LIABILITIES

Fair Value Hierarchy
The Company groups its assets and liabilities in three levels based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1: Valuation is based on quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2: Valuation is based on observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using unobservable inputs to pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

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Determination of Fair Value

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in 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. 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 of its financial instruments:

- Cash and cash equivalents. The carrying amounts of cash and short-term instruments approximate the fair values based on the short-term nature of the assets.

- Trading securities. The Company holds two securities designated as trading securities. The determination of the fair value for these securities is determined based on a discounted cash flow methodology. Certain inputs to the fair value calculation are unobservable and management determined that since an orderly and active market for these securities did not exist, the securities meet the definition of Level 3 securities.

- Securities available for sale. Included in the available for sale category are both debt and equity securities. The securities measured at fair value in Level 1 are based on quoted market prices in an active exchange market. Securities measured at fair value in Level 2 are based on pricing models that consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes, credit spreads and new issue data. The Company utilizes Interactive Data Corporation ("IDC"), a third-party, nationally-recognized pricing service to estimate fair value measurements for the majority of its portfolio. The pricing service evaluates each asset class based on relevant market information considering observable data but these prices do not represent binding quotes. The fair value prices on all investments are reviewed for reasonableness by management. Securities measured at fair value in Level 3 include collateralized debt obligations that are backed by trust preferred securities issued by banks, thrifts and insurance companies. Management determined that an orderly and active market for these securities and similar securities did not exist based on a significant reduction in trading volume and widening spreads relative to historical levels. The Company estimates future cash flows discounted using a rate management believes is representative of current market conditions. Factors in determining the discount rate include the current level of deferrals and/or defaults, changes in credit rating and the financial condition of the debtors within the underlying securities, broker quotes for securities with similar structure and credit risk, interest rate movements and pricing for new issuances.

- Federal Home Loan Bank stock. The carrying value of Federal Home Loan Bank ("FHLB") stock approximates fair value based on the redemption provisions of the FHLB.

- Loans held for sale. The fair value of loans held for sale is estimated using quoted market prices.

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Loans receivable. For variable rate loans which reprice frequently and have no significant change in credit risk, fair values are based on carrying values. The fair value of fixed-rate loans are estimated by discounting the future cash flows using the rates at the end of the period in which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

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- Accrued interest receivable. The carrying amount of accrued interest approximates fair value.

- Deposits. The fair value of demand deposits, negotiable orders of withdrawal, regular savings, certain money market deposits and mortgagors' and investors' escrow accounts is the amount payable on demand at the reporting date. The fair value of certificates of deposit and other time deposits is estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities to a schedule of aggregated expected maturities on such deposits.

- Federal Home Loan Bank advances. The fair value of the advances is estimated using a discounted cash flow calculation that applies current FHLB interest rates for advances of similar maturity to a schedule of maturities of such advances.

- Junior subordinated debt owed to unconsolidated trust. Rates currently available for debt with similar terms and remaining maturities are used to estimate fair value of existing debt.

- Interest rate swap agreement. The fair value of the Company's interest rate swap is obtained from a third-party pricing service and is determined using a discounted cash flow analysis on the expected cash flows of the derivative. The pricing analysis is based on observable inputs for the contractual term of the derivative, including the period to maturity and interest rate curves.