

SOUTHERN CONNECTICUT BANCORP INC  
Form 10-Q  
August 13, 2012

---

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2012

<sup>or</sup>  
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: 0-49784

Southern Connecticut Bancorp, Inc.  
(Exact Name of Registrant as Specified in Its Charter)

Connecticut  
(State or Other Jurisdiction of Incorporation  
or Organization)

06-1609692  
(I.R.S. Employer Identification No.)

215 Church Street, New Haven, Connecticut  
(Address of Principal Executive Offices)

06510  
(Zip Code)

(203) 782-1100  
(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  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 (§ 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  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 the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
(Do not check if a 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

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

Class	Outstanding as of August 13, 2012
Common Stock, \$.01 par value per share	2,772,816 shares

---

---

---

Table of Contents  
Part I – Financial Information

	Page
<u>Item 1.</u>	
<u>Financial Statements.</u>	
<u>Consolidated Balance Sheets as of June 30, 2012 and December 31, 2011 (unaudited)</u>	3
<u>Consolidated Statements of Operations for the three and six months ended June 30, 2012 and 2011 (unaudited)</u>	4
<u>Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2012 and 2011 (unaudited)</u>	5
<u>Consolidated Statements of Changes in Shareholders' Equity for the six months ended June 30, 2012 and 2011 (unaudited)</u>	6
<u>Consolidated Statements of Cash Flows for the six months ended June 30, 2012 and 2011 (unaudited)</u>	7
<u>Notes to Consolidated Financial Statements (unaudited)</u>	9
<u>Item 2.</u>	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations.</u>	26
<u>Item 3.</u>	
<u>Quantitative and Qualitative Disclosures About Market Risk.</u>	41
<u>Item 4.</u>	
<u>Controls and Procedures.</u>	41
<u>Part II - Other Information</u>	
<u>Item 1.</u>	
<u>Legal Proceedings.</u>	41
<u>Item 1A.</u>	
<u>Risk Factors.</u>	41
<u>Item 2.</u>	
<u>Unregistered Sales of Equity Securities and Use of Proceeds.</u>	41
<u>Item 3.</u>	
<u>Defaults Upon Senior Securities.</u>	41
<u>Item 4.</u>	
<u>Mine Safety Disclosures.</u>	42
<u>Item 5.</u>	
<u>Other Information.</u>	42
<u>Item 6.</u>	
<u>Exhibits.</u>	42
<u>Signatures</u>	43



## Item 1. Financial Statements.

## SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS (unaudited)

June 30, 2012 and December 31, 2011

	June 30, 2012	December 31, 2011
<b>ASSETS</b>		
Cash and due from banks	\$ 9,775,930	\$ 18,167,794
Short term investments	6,065,606	6,764,409
Cash and cash equivalents	15,841,536	24,932,203
Interest bearing certificates of deposit	655,265	99,426
Available for sale securities (at fair value)	2,249,955	3,849,847
Federal Home Loan Bank stock	60,600	66,100
Loans receivable		
Loans receivable	106,271,992	113,943,767
Allowance for loan losses	(2,185,000 )	(2,299,625 )
Loans receivable, net	104,086,992	111,644,142
Accrued interest receivable	387,912	434,302
Premises and equipment	1,921,463	2,014,665
Other real estate owned	582,911	374,211
Other assets held for sale	315,000	315,000
Other assets	1,612,351	2,240,009
Total assets	\$ 127,713,985	\$ 145,969,905
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
<b>Deposits</b>		
Noninterest bearing deposits	\$ 29,361,309	\$ 31,003,581
Interest bearing deposits	84,992,606	101,627,100
Total deposits	114,353,915	132,630,681
Repurchase agreements	172,285	68
Capital lease obligations	1,158,148	1,161,938
Accrued expenses and other liabilities	443,572	631,285
Total liabilities	116,127,920	134,423,972
<b>Commitments and Contingencies</b>		
<b>Shareholders' Equity</b>		
Preferred stock, no par value; shares authorized: 500,000; none issued	—	—
Common stock, par value \$.01; shares authorized: 5,000,000; shares issued and outstanding: 2012 2,735,359; 2011 2,697,902	27,354	26,979
Additional paid-in capital	22,708,451	22,569,489

Edgar Filing: SOUTHERN CONNECTICUT BANCORP INC - Form 10-Q

Accumulated deficit	(11,149,695 )	(11,050,382 )
Accumulated other comprehensive loss - net unrealized loss on available for sale securities	(45 )	(153 )
Total shareholders' equity	11,586,065	11,545,933
Total liabilities and shareholders' equity	\$ 127,713,985	\$ 145,969,905

See Notes to Consolidated Financial Statements

## SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

For the Three Months and Six Months Ended June 30, 2012 and 2011

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Interest Income:</b>				
Interest and fees on loans	\$1,607,230	\$1,805,410	\$3,148,400	\$3,622,756
Interest on securities	382	—	449	202
Interest on federal funds sold and short-term and other investments	9,578	26,909	26,542	44,498
<b>Total interest income</b>	<b>1,617,190</b>	<b>1,832,319</b>	<b>3,175,391</b>	<b>3,667,456</b>
<b>Interest Expense:</b>				
Interest expense on deposits	230,116	481,339	516,706	940,861
Interest expense on capital lease obligations	41,570	43,101	83,539	86,407
Interest expense on repurchase agreements and other borrowings	58	261	156	489
<b>Total interest expense</b>	<b>271,744</b>	<b>524,701</b>	<b>600,401</b>	<b>1,027,757</b>
<b>Net interest income</b>	<b>1,345,446</b>	<b>1,307,618</b>	<b>2,574,990</b>	<b>2,639,699</b>
<b>Provision (credit) for loan losses</b>	<b>180,254</b>	<b>(77,044 )</b>	<b>210,254</b>	<b>666,060</b>
<b>Net interest income after provision (credit) for loan losses</b>	<b>1,165,192</b>	<b>1,384,662</b>	<b>2,364,736</b>	<b>1,973,639</b>
<b>Noninterest Income:</b>				
Service charges and fees	81,855	93,757	156,272	194,480
Loan prepayment fees	—	—	45,207	—
Other noninterest income	53,630	29,122	110,252	63,960
<b>Total noninterest income</b>	<b>135,485</b>	<b>122,879</b>	<b>311,731</b>	<b>258,440</b>
<b>Noninterest Expenses:</b>				
Salaries and benefits	722,765	679,831	1,526,876	1,379,673
Professional services	114,919	56,137	276,538	173,563
Occupancy and equipment	136,269	160,937	295,976	342,471
Data processing and other outside services	69,737	111,983	136,561	206,007
FDIC Insurance	51,956	56,424	107,406	117,364
Directors fees	42,650	85,350	79,200	161,700
Insurance	32,427	13,261	64,854	28,261
Other operating expenses	171,633	166,829	288,369	282,806
<b>Total noninterest expenses</b>	<b>1,342,356</b>	<b>1,330,752</b>	<b>2,775,780</b>	<b>2,691,845</b>
<b>Net (loss) income</b>	<b>\$(41,679 )</b>	<b>\$176,789</b>	<b>\$(99,313 )</b>	<b>\$(459,766 )</b>
<b>Basic and diluted (loss) income per share</b>	<b>\$(0.02 )</b>	<b>\$0.07</b>	<b>\$(0.04 )</b>	<b>\$(0.17 )</b>

See Notes to Consolidated Financial Statements

4

---



## SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (unaudited)

For the Three Months and Six Months Ended June 30, 2012 and 2011

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net (loss) income	\$(41,679 )	\$176,789	\$(99,313 )	\$(459,766 )
Other comprehensive income, net of taxes:				
Net change in unrealized holding gain on available for sale securities	1,774	8	108	245
Comprehensive (loss) income	\$(39,905 )	\$176,797	\$(99,205 )	\$(459,521 )

See Notes to Consolidated Financial Statements

## SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (unaudited)

For the Six Months Ended June 30, 2012 and 2011

	Number of Common Shares	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Other Comprehensive (Loss) Income	Total
Balance, December 31, 2010	2,696,902	\$26,969	\$22,567,146	\$(8,312,465 )	\$ (274 )	\$14,281,376
Net loss	—	—	—	(459,766 )	—	(459,766 )
Other comprehensive income	—	—	—	—	245	245
Restricted stock compensation	1,000	10	2,343	—	—	2,353
Balance, June 30, 2011	2,697,902	\$26,979	\$22,569,489	\$(8,772,231 )	\$ (29 )	\$13,824,208
Balance, December 31, 2011	2,697,902	\$26,979	\$22,569,489	\$(11,050,382)	\$ (153 )	\$11,545,933
Net loss	—	—	—	(99,313 )	—	(99,313 )
Other comprehensive income	—	—	—	—	108	108
Restricted stock compensation	37,457	375	138,962	—	—	139,337
Balance, June 30, 2012	2,735,359	\$27,354	\$22,708,451	\$(11,149,695)	\$ (45 )	\$11,586,065

See Notes to Consolidated Financial Statements

## SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

For the Six Months Ended June 30, 2012 and 2011

	2012	2011
Cash Flows From Operations		
Net loss	\$(99,313 )	\$(459,766 )
Adjustments to reconcile net loss to net cash provided by operating activities:		
Amortization and accretion of premiums and discounts on investments, net	—	(4 )
Provision for loan losses	210,254	666,060
Share based compensation	139,337	2,353
Depreciation and amortization	115,901	135,604
Gain on sale of other real estate owned	(2,896 )	—
Increase in cash surrender value of life insurance	(19,980 )	(20,205 )
Changes in assets and liabilities:		
Decrease in deferred loan fees	(31,136 )	(1,074 )
Decrease in accrued interest receivable	46,390	93,245
Decrease in other assets	647,638	22,034
Decrease in accrued expenses and other liabilities	(187,713 )	(145,910 )
Net cash provided by operating activities	818,482	292,337
Cash Flows From Investing Activities		
Purchases of interest bearing certificates of deposit	(555,839 )	—
Proceeds from maturities of interest bearing certificates of deposits	—	13
Purchases of available for sale securities	(8,596,158 )	(18,399,993)
Proceeds from maturities / calls of available for sale securities	10,196,158	16,900,000
Redemptions of Federal Home Loan Bank Stock	5,500	—
Net decrease in loans receivable	6,990,584	5,156,026
Purchases of premises and equipment	(22,699 )	(8,243 )
Proceeds from the sale of other real estate owned	181,644	—
Capitalized costs related to other real estate owned	—	(7,375 )
Net cash provided by investing activities	8,199,190	3,640,428
Cash Flows From Financing Activities		
Net (decrease) increase in demand, savings and money market deposits	(5,351,116 )	3,012,423
Net (decrease) increase in certificates of deposit	(12,925,650)	2,689,646
Net increase in repurchase agreements	172,217	57,030
Principal repayments on capital lease obligations	(3,790 )	(3,415 )
Net cash (used in) provided by financing activities	(18,108,339)	5,755,684
Net (decrease) increase in cash and cash equivalents	(9,090,667 )	9,688,449
Cash and cash equivalents		
Beginning	24,932,203	20,837,760
Ending	\$15,841,536	\$30,526,209

See Notes to Consolidated Financial Statements

(Continued)



SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited), Continued  
For the Six Months Ended June 30, 2012 and 2011

	2012	2011
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	\$736,675	\$1,016,885
Supplemental Disclosures of Non-Cash Investing and Financing Activities:		
Transfer of loans receivable to other real estate owned	\$387,448	\$858,550
Unrealized holding gains on available for sale securities arising during the period	\$108	\$245

See Notes to Consolidated Financial Statements

Southern Connecticut Bancorp, Inc.  
Notes to Consolidated Financial Statements  
(Unaudited)

Note 1. Nature of Operations

Southern Connecticut Bancorp, Inc. (the “Company”) is a bank holding company headquartered in New Haven, Connecticut that was incorporated on November 8, 2000. The Company’s strategic objective is to serve as a bank holding company for a community-based commercial bank serving primarily New Haven County (the “Greater New Haven Market”). The Company owns 100% of the capital stock of The Bank of Southern Connecticut (the “Bank”), a Connecticut-chartered bank with its headquarters in New Haven, Connecticut, and 100% of the capital stock of SCB Capital, Inc. The Company and its subsidiaries focus on meeting the financial service needs of consumers and small to medium-sized businesses, professionals and professional corporations, and their owners and employees in the Greater New Haven Market.

The Bank operates branches at four locations, including downtown New Haven, the Amity/Westville section of New Haven, Branford and North Haven. The Bank’s branches have a consistent, attractive appearance. Each location has an open lobby, comfortable waiting area, offices for the branch manager and a loan officer, and a conference room. The design of the branches complements the business development strategy of the Bank, affording an appropriate space to deliver personalized banking services in professional, confidential surroundings.

The Bank focuses on serving the banking needs of small to medium-sized businesses, professionals and professional corporations, and their owners and employees in the Greater New Haven Market. The Bank’s target commercial customer has between \$1.0 and \$30.0 million in revenues, 15 to 150 employees, and borrowing needs of up to \$3.0 million. The primary focus on this commercial market makes the Bank uniquely qualified to move deftly in responding to the needs of its clients. The Bank has been successful in winning business by offering a combination of competitive pricing for its services, quick decision making processes and a high level of personalized, “high touch” customer service.

SCB Capital, Inc. operated under the name “Evergreen Financial Services” (“Evergreen”) as a licensed mortgage brokerage business through July 31, 2010. After reviewing the historical operations and results of Evergreen, and considering future prospects for the business, management determined that it was in the best interest of the Company to discontinue the mortgage brokerage operation of SCB Capital, Inc. Subsequent to July 31, 2010, the mortgage brokerage activities continued through the Bank.

Note 2. Basis of Financial Statement Presentation

The consolidated interim financial statements include the accounts of the Company and its subsidiaries. The consolidated interim financial statements and notes thereto have been prepared in conformity with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. All significant intercompany transactions have been eliminated in consolidation. Amounts in prior period financial statements are reclassified whenever necessary to conform to current period presentations. The results of operations for the three and six months ended June 30, 2012 are not necessarily indicative of the results which may be expected for the year as a whole. The accompanying consolidated financial statements and notes thereto should be read in conjunction with the audited financial statements of the Company and notes thereto as of December 31, 2011, filed with the Securities and Exchange Commission on Form 10-K on March 30, 2012. Certain amounts included in the

2011 consolidated financial statements have been reclassified to conform with the 2012 presentation. Such reclassification had no impact on net income (loss).

Note 3. Available for Sale Securities

The amortized cost, gross unrealized gains, gross unrealized losses and approximate fair values of available for sale securities at June 30, 2012 and December 31, 2011 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2012				
U.S. Treasury Bills	\$ 2,250,000	\$ —	\$ (45 )	\$ 2,249,955

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2011				
U.S. Treasury Bills	\$ 3,850,000	\$ —	\$ (153 )	\$ 3,849,847

The following table presents the Company's available for sale securities' gross unrealized losses and fair value, aggregated by the length of time the individual securities have been in a continuous loss position, at June 30, 2012 and 2011:

	Less Than 12 Months		12 Months or More		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
June 30, 2012	Value	Loss	Value	Loss	Value	Loss
U.S. Treasury Bills	\$ 2,249,955	\$ 45	\$ —	\$ —	\$ 2,249,955	\$ 45

	Less Than 12 Months		12 Months or More		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
December 31, 2011	Value	Loss	Value	Loss	Value	Loss
U.S. Treasury Bills	\$ 3,849,847	\$ 153	\$ —	\$ —	\$ 3,849,847	\$ 153

At both June 30, 2012 and December 31, 2011, the Company had one available for sale security in an unrealized loss position.

Management believes that none of the unrealized losses on available for sale securities are other than temporary because all of the unrealized losses in the Company's investment portfolio are due to market interest rate changes on debt securities issued by U.S. government agencies. Management considers the issuers of the securities to be financially sound and the Company expects to receive all contractual principal and interest related to these 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 recovery of their amortized cost basis, which may be maturity, the Company does not consider the investments to be other-than-temporarily impaired at June 30, 2012.

The amortized cost and fair value of available for sale debt securities at June 30, 2012 by contractual maturity are presented below:

	Amortized Cost	Fair Value
Maturity:		
Within one year	\$ 2,250,000	\$ 2,249,955



## Note 4. Loans Receivable and Allowance for Loan Losses

A summary of the Company's loan portfolio at June 30, 2012 and December 31, 2011 was as follows:

	2012	2011
Commercial loans secured by real estate	\$65,447,716	\$67,248,165
Commercial	25,776,880	31,719,229
Residential mortgages	12,667,316	12,565,428
Construction and land	2,276,502	2,309,600
Consumer	206,038	234,941
Total loans	106,374,452	114,077,363
Net deferred loan fees	(102,460 )	(133,596 )
Allowance for loan losses	(2,185,000 )	(2,299,625 )
Loans receivable, net	\$104,086,992	\$111,644,142

The following table details the period end loan balances and the allowance for loan losses by portfolio segment that were collectively and individually evaluated for impairment as of June 30, 2012 and December 31, 2011.

June 30, 2012	Commercial Loans Secured by Real Estate	Commercial	Residential Mortgages	Construction and Land	Consumer	Total
Period-end loan balances:						
Loans collectively evaluated for impairment	\$63,530,590	\$22,036,857	\$11,945,100	\$882,386	\$206,038	\$98,600,971
Loans individually evaluated for impairment	1,917,126	3,740,023	722,216	1,394,116	—	7,773,481
Total	\$65,447,716	\$25,776,880	\$12,667,316	\$2,276,502	\$206,038	\$106,374,452

Period-end allowance amount allocated to:						
Loans collectively evaluated for impairment	\$1,197,231	\$758,046	\$199,995	\$21,754	\$3,576	\$2,180,602
Loans individually evaluated for impairment	—	4,398	—	—	—	4,398
Balance at end of period	\$1,197,231	\$762,444	\$199,995	\$21,754	\$3,576	\$2,185,000

December 31, 2011	Commercial Loans Secured by Real Estate	Commercial	Residential Mortgages	Construction and Land	Consumer	Total
Period-end loan balances:						
Loans collectively evaluated for impairment	\$65,146,824	\$28,112,167	\$12,010,750	\$889,444	\$233,481	\$106,392,666
Loans individually evaluated for impairment	2,101,341	3,607,062	554,678	1,420,156	1,460	7,684,697
Total	\$67,248,165	\$31,719,229	\$12,565,428	\$2,309,600	\$234,941	\$114,077,363

Period-end allowance amount allocated to:						
Loans collectively evaluated for impairment	\$1,122,699	\$961,581	\$187,224	\$20,431	\$3,292	\$2,295,227
Loans individually evaluated for impairment	—	4,398	—	—	—	4,398

Loans individually evaluated for  
impairment

Balance at end of period	\$ 1,122,699	\$ 965,979	\$ 187,224	\$ 20,431	\$ 3,292	\$ 2,299,625
--------------------------	--------------	------------	------------	-----------	----------	--------------

The following table details activity in the allowance for loan losses by portfolio segment for the six months ended June 30, 2012 and 2011. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories:

June 30, 2012	Commercial Loans Secured by		Residential	Construction	Consumer	Total
	Real Estate	Commercial	Mortgages	and Land		
Balance at beginning of year	\$ 1,122,699	\$ 965,979	\$ 187,224	\$ 20,431	\$ 3,292	\$ 2,299,625
Provision for loan losses	45,418	117,266	45,963	1,323	284	210,254
Loans charged-off	—	(384,027 )	(33,192 )	—	—	(417,219 )
Recoveries of loans previously charged-off	29,114	63,226	—	—	—	92,340
Net recoveries (charge-offs)	29,114	(320,801 )	(33,192 )	—	—	(324,879 )
Balance at end of period	\$ 1,197,231	\$ 762,444	\$ 199,995	\$ 21,754	\$ 3,576	\$ 2,185,000

Period-end amount allocated  
to:

Loans collectively evaluated for impairment	\$ 1,197,231	\$ 758,046	\$ 199,995	\$ 21,754	\$ 3,576	\$ 2,180,602
Loans individually evaluated for impairment	—	4,398	—	—	—	4,398
Balance at end of period	\$ 1,197,231	\$ 762,444	\$ 199,995	\$ 21,754	\$ 3,576	\$ 2,185,000

June 30, 2011	Commercial Loans Secured by		Residential	Construction	Consumer	Total
	Real Estate	Commercial	Mortgages	and Land		
Balance at beginning of year	\$ 1,587,196	\$ 821,981	\$ 316,146	\$ 55,182	\$ 6,136	\$ 2,786,641
Provision for (credit to) loan losses	522,487	205,384	(29,414 )	(37,855 )	5,458	666,060
Loans charged-off	(1,124,269)	(156,628 )	—	—	(9,115 )	(1,290,012)
Recoveries of loans previously charged-off	—	4,104	—	—	2,156	6,260
Net charge-offs	(1,124,269)	(152,524 )	—	—	(6,959 )	(1,283,752)
Balance at end of period	\$ 985,414	\$ 874,841	\$ 286,732	\$ 17,327	\$ 4,635	\$ 2,168,949

Period-end amount allocated  
to:

Loans collectively evaluated for impairment	\$ 707,157	\$ 696,688	\$ 132,795	\$ 17,327	\$ 4,635	\$ 1,558,602
Loans individually evaluated for impairment	278,257	178,153	153,937	—	—	610,347
Balance at end of period	\$ 985,414	\$ 874,841	\$ 286,732	\$ 17,327	\$ 4,635	\$ 2,168,949

Impaired Loans. A loan is 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 for commercial and real estate loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the fair value of the collateral if the loan is collateral dependent.

The following tables relate to impaired loans as of June 30, 2012 and as of December 31, 2011:

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
June 30, 2012					
Commercial loans secured by real estate	\$ 1,888,012	\$ 1,917,126	\$ —	\$ 1,917,126	\$ —
Commercial	4,060,824	2,072,145	1,667,878	3,740,023	4,398
Construction and land	1,394,116	1,394,116	—	1,394,116	—
Residential mortgages	755,408	722,216	—	722,216	—
Consumer	—	—	—	—	—
Total	\$ 8,098,360	\$ 6,105,603	\$ 1,667,878	\$ 7,773,481	\$ 4,398

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
December 31, 2011					
Commercial loans secured by real estate	\$ 2,354,430	\$ 2,101,341	\$ —	\$ 2,101,341	\$ —
Commercial	4,664,485	1,707,720	1,899,342	3,607,062	4,398
Construction and land	1,420,156	1,420,156	—	1,420,156	—
Residential mortgages	706,472	554,678	—	554,678	—
Consumer	1,460	1,460	—	1,460	—
Total	\$ 9,147,003	\$ 5,785,355	\$ 1,899,342	\$ 7,684,697	\$ 4,398

The following tables relate to interest income recognized by class of impaired loans as of and for the six months ended June 30, 2012 and 2011:

	Six Months Ended June 30, 2012		Six Months Ended June 30, 2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Commercial loans secured by real estate	\$ 2,131,753	\$ 41,035	\$ 3,446,949	\$ 60,908
Commercial	3,733,465	38,418	1,473,522	7,766
Construction and land	1,407,061	25,205	1,000,000	—
Residential mortgages	695,715	5,168	724,848	8,186
Consumer	532	14	—	—
Total	\$ 7,968,526	\$ 109,840	\$ 6,645,319	\$ 76,860

The Company's lending activities are conducted principally in New Haven County of Connecticut. The Company grants commercial and residential real estate loans, commercial business loans and a variety of consumer loans. In addition, the Company may grant loans for the construction of residential homes, residential developments and land development projects. All residential and commercial mortgage loans are collateralized by first or second mortgages on real estate. The ability and willingness of borrowers to satisfy their loan obligations is dependent in large part upon the status of the regional economy and regional real estate market. Accordingly, the ultimate collectability of a substantial portion of the loan portfolio and the recovery of a substantial portion of any resulting real estate acquired is susceptible to changes in market conditions.

The Company has established credit policies applicable to each type of lending activity in which it engages, evaluates the creditworthiness of each customer on an individual basis and, when deemed appropriate, obtains collateral. Collateral varies by each borrower and loan type. The market value of collateral is monitored on an ongoing basis and additional collateral is obtained when warranted. Important types of collateral include business assets, real estate, commercial vehicles, equipment, automobiles, marketable securities and time deposits. While collateral provides assurance as a secondary source of repayment, the Company ordinarily requires the primary source of repayment to be based on the borrower's ability to generate continuing cash flows.

**Loan Origination/Risk Management.** Management and the Board of Directors have adopted policies and procedures which dictate the guidelines for all loan originations for the Company. All loan originations are either approved by the Board of Directors or by a management committee comprised of the CEO, the President and Chief Credit Officer and the senior loan officers of the Company. Any loans approved by the management committee are reviewed and ratified by the Board of Directors.

The Company underwrites commercial and industrial loans, loans secured by commercial real estate, loans secured by residential real estate, loans related to commercial and residential development, and loans to consumers. The principal requirement of any borrower is the demonstrated ability to service the interest and principal payments of the loan as structured.

Commercial and industrial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and generate the cash flow necessary to repay the loan as agreed with respect to principal and interest. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and require a personal

guarantee. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Like commercial and industrial loans, commercial real estate loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and generate the cash flow necessary to repay the loan as agreed with respect to principal and interest. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk rating.

While the Company does have a small number of loans to individual borrowers to finance their primary residence, the majority of the Company's loans secured by residential real estate are made in connection with a commercial loan for which residential real estate is offered as collateral. These loans are underwritten to the same standards as commercial real estate loans.

With respect to loans to developers and builders that are secured by non-owner occupied properties that the Company may originate from time to time, the Company requires the borrower to have a proven record of success, and typically requires a personal guarantee from all the principals of the project. Construction loans are underwritten utilizing independent appraisal reviews and lease rates and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the complete project.

The Company originates consumer loans on a limited basis. Applications for consumer loans are analyzed on an individual basis based on the borrower's ability to repay the loan. Where available, collateral is used to secure consumer loans.

Not less than annually, the Company utilizes an independent loan review company to review and validate the credit risk program. Results of these reviews are presented to management and reported to the Board of Directors. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

Non-Accrual and Past Due Loans. The accrual of interest on loans is discontinued at the time the loan is 90 days past due unless the loan is well-secured and in process of collection. Consumer installment loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not collected for loans that are placed on nonaccrual status or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis method until the loans qualify for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

At June 30, 2012 and December 31, 2011, the unpaid principal balances of loans placed on nonaccrual status were \$5,010,913 and \$5,785,355, respectively. At June 30, 2012, three commercial loans with an aggregate principal balance of \$1,926,498 and two commercial real estate loans with an aggregate principal balance of \$1,359,953 were considered to be troubled debt restructurings. There are no further commitments to lend funds to these borrowers. Accruing loans contractually past due 90 days or more were \$134,902 at June 30, 2012. There were no loans past due 90 days or more and still accruing interest at December 31, 2011.

Nonaccrual loans segregated by class of loans as of June 30, 2012 and December 31, 2011 were as follows:

	2012	2011
Commercial loans secured by real estate	\$ 822,436	\$ 2,101,341
Commercial	2,072,145	1,707,720
Construction and land	1,394,116	1,420,156
Residential mortgages	722,216	554,678
Consumer	—	1,460
	\$ 5,010,913	\$ 5,785,355

An age analysis of past due loans, segregated by class of loans, as of June 30, 2012 and December 31, 2011 were as follows:

	Loans 30-89 Days Past Due	Loans 90 Days or More Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
June 30, 2012	\$ 3,029,213	\$ 822,436	\$ 3,851,649	\$ 61,596,067	\$ 65,447,716	\$ —

Commercial loans secured by real estate						
Commercial	5,762	2,155,088	2,160,850	23,616,030	25,776,880	82,943
Residential mortgages	—	722,216	722,216	11,945,100	12,667,316	—
Construction and land	—	1,394,116	1,394,116	882,386	2,276,502	—
Consumer	—	51,959	51,959	154,079	206,038	51,959
	\$ 3,034,975	\$ 5,145,815	\$ 8,180,790	\$ 98,193,662	\$ 106,374,452	\$ 134,902

						Accruing Loans 90 or More Days Past Due
	Loans 30-89 Days Past Due	Loans 90 Days or More Past Due	Total Past Due Loans	Current Loans	Total Loans	
December 31, 2011						
Commercial loans secured by real estate						
Commercial	\$ 128,384	\$ 2,101,341	\$ 2,229,725	\$ 65,018,440	\$ 67,248,165	\$ —
Residential mortgages	1,052,990	1,707,720	2,760,710	28,958,519	31,719,229	—
Construction and land	211,562	554,678	766,240	11,799,188	12,565,428	—
Consumer	—	1,420,156	1,420,156	889,444	2,309,600	—
	—	1,460	1,460	233,481	234,941	—
	\$ 1,392,936	\$ 5,785,355	\$ 7,178,291	\$ 106,899,072	\$ 114,077,363	\$ —



Troubled Debt Restructurings. The recorded investment balance of TDRs, net of charge-offs, as of June 30, 2012 and December 31, 2011 was \$3,286,000 and \$3,213,000, respectively. At June 30, 2012, this recorded investment balance included \$1,095,000 for a commercial and industrial loan which returned to accrual status during the quarter ended June 30, 2012, as it had performed in accordance with the terms and conditions of its restructuring agreement for a period of one year. At both June 30, 2012 and December 31, 2011, there was a \$4,398 specific reserve related to one TDR. There were no charge-offs of TDRs during the three and six months ended June 30, 2012 and 2011. There were no additional funds committed to borrowers in TDR status at June 30, 2012.

The following table provides information on loans modified as TDRs during the six months ended June 30, 2012:

	For the Six Months Ended June 30, 2012			Coupon Rate	
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment		
Commercial	2	\$ 428,228	\$ 428,228	1.12	%

The following table provides information on how loans were modified as TDRs during the six months ended June 30, 2012:

	2012
Extended maturity	\$ 79,617
Adjusted interest rates	348,611
Total	\$ 428,228

There were no loans previously modified as a TDR for which there was a payment default during the six months ended June 30, 2012.

Credit Quality Indicators. Oversight of the credit quality of the Company's loan portfolio is managed by members of senior management and a committee of the Board of Directors. This group meets not less than monthly to review all impaired loans, any loans identified by management as potential problem loans, and all loans that are past due. The Company's loan portfolio is comprised principally of loans to commercial entities, but the Company offers consumer loans as well. The Company employs different methodologies for monitoring credit risk in commercial loans and consumer loans.

Commercial Loans. The Company employs a risk rating system to identify the level of risk inherent in commercial loans. The risk rating system assists management in monitoring and overseeing the loan portfolio by providing indications of credit trends, serving as a basis for pricing, and being a part of the quantitative determination of the allowance for loan losses.

All commercial relationships, including loans categorized as commercial and industrial loans, commercial real estate loans, commercial loans secured by residential real estate, and construction loans, are included in this risk rating system. Under the Company's internal risk rating system, the Company has risk rating categories of 0 through 5 that fall into the federal regulatory risk rating of "Pass." A risk rating of 0 is assigned to those loans that are secured by readily marketable assets (including deposits at the bank); risk ratings increase from 1 to 5 in incremental increases of risk inherent in the relationship, with a loan that is rated 5 representing moderate risk. In addition, the Company identifies criticized loans as "special mention," "substandard," "doubtful" or "loss," by employing a numerical risk rating system of 6, 7, 8 and 9, respectively, which correspond with the federal regulatory risk rating definitions of special mention, substandard, doubtful and loss, respectively.

Risk ratings assigned to loans are recommended by management and approved by the Company's loan committee. The loan officer presents a proposed risk rating based on the underlying loan and the proposal is reviewed for accuracy and confirmed by the credit department. Risk ratings take into account a variety of commonly employed financial metrics, both quantitative and qualitative, which serve to measure risk. As part of the determination, all ratings of 5 or better (which are collectively considered "Pass" ratings by the Company) require that the customers have furnished timely financial information and other data pertinent to the relationships. Cash flow is reviewed and analyzed over a period of two to five years, but particular emphasis is placed on recent data in the event of a material change in performance, particularly a downward trend. New companies are generally considered riskier than established entities and length of time in business is factored into the risk rating decision. As part of the risk rating system, the health of the overall industry in which the company operates is also considered. Risk ratings are reviewed not less than annually.

**Consumer Residential Mortgage Loans.** The Company does not assign risk ratings to consumer residential mortgage loans. Consumer residential mortgage loans are considered "Pass loans until such time that it is determined that the loan is impaired. For our consumer residential real estate loans, the Company orders an appraisal at 90 days past due. In the event there is a collateral shortfall, the Company records partial or full charge-offs of the loan balances, typically immediately.

**Consumer Loans.** The Company does not assign risk ratings to consumer loans. Consumer loans are considered "Pass" loans until such time that it is determined that the loan is impaired. In the event a consumer loan becomes impaired, the entire balance of the loan is typically charged off immediately.

The following table presents credit risk ratings by class of loan as of June 30, 2012 and December 31, 2011:

June 30, 2012 Risk Rating:	Commercial Loans Secured by		Construction and Land	Residential Mortgages	Consumer	Total
	Real Estate	Commercial				
Pass	\$52,203,513	\$19,392,802	\$882,386	\$11,945,100	\$206,038	\$84,629,839
Special Mention	9,897,872	746,979	—	—	—	10,644,851
Substandard	3,346,331	5,637,099	1,394,116	722,216	—	11,099,762
Total	\$65,447,716	\$25,776,880	\$2,276,502	\$12,667,316	\$206,038	\$106,374,452

December 31, 2011 Risk Rating:	Commercial Loans Secured by		Construction and Land	Residential Mortgages	Consumer	Total
	Real Estate	Commercial				
Pass	\$60,201,549	\$26,578,102	\$889,444	\$12,010,750	\$233,481	\$99,913,326
Special Mention	4,945,275	269,222	—	—	—	5,214,497
Substandard	2,101,341	4,871,905	1,420,156	554,678	1,460	8,949,540
Total	\$67,248,165	\$31,719,229	\$2,309,600	\$12,565,428	\$234,941	\$114,077,363

#### Note 5. Deposits

At June 30, 2012 and December 31, 2011, deposits consisted of the following:

	2012	2011
Noninterest bearing	\$ 29,361,309	\$ 31,003,581
Interest bearing:		
Checking	5,646,296	5,149,535
Money Market	43,289,095	47,728,069
Savings	3,072,105	2,838,736
Time certificates, less than \$100,000 (1)	12,033,754	19,657,059
Time certificates, \$100,000 or more (2)	20,951,356	26,253,701
Total interest bearing	84,992,606	101,627,100
Total deposits	\$ 114,353,915	\$ 132,630,681

(1) Included in time certificates of deposit, less than \$100,000, at June 30, 2012 and December 31, 2011 were brokered deposits totaling \$553,926 and \$3,976,764, respectively.

(2) Included in time certificates of deposit, \$100,000 or more, at June 30, 2012 and December 31, 2011 were brokered deposits totaling \$4,295,236 and \$5,119,113, respectively.

Brokered deposits at June 30, 2012 and December 31, 2011 were as follows:

	2012	2011
--	------	------

Bank customer time certificates of deposit placed through CDARS to ensure FDIC coverage	\$ 4,387,893	\$ 4,161,974
Time certificates of deposit purchased by the Bank through CDARS	275,117	2,180,568
Other brokered time certificates of deposit	186,152	2,753,335
Total brokered deposits	\$ 4,849,162	\$ 9,095,877

As a result of the Consent Order described in Note 13, the Bank does not intend to renew or accept brokered deposits without obtaining prior regulatory approval during the period in which the Consent Order is in place.

#### Note 6. Available Borrowings

The Bank is a member of the Federal Home Loan Bank of Boston (“FHLB”). At June 30, 2012, the Bank had the ability to borrow from the FHLB based on a certain percentage of the value of the Bank’s qualified collateral, as defined in the FHLB Statement of Products Policy, at the time of the borrowing. In accordance with an agreement with the FHLB, the qualified collateral must be free and clear of liens, pledges and encumbrances. There were no borrowings outstanding with the FHLB at June 30, 2012.

The Bank is required to maintain an investment in capital stock of the FHLB in an amount that is based on a percentage of its outstanding residential first mortgage loans. The stock is bought from and sold to the Federal Home Loan Bank based upon its \$100 par value. The stock does not have a readily determinable fair value and as such is classified as restricted stock, carried at cost and evaluated for impairment. The stock's value is determined by the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The determination of whether the par value will ultimately be recovered is influenced by criteria such as the following: (a) the significance of the decline in net assets of the FHLB as compared to the capital stock amount and the length of time this situation has persisted; (b) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to its operating performance; (c) the impact of legislative and regulatory changes on the customer base of the FHLB; and (d) the liquidity position of the FHLB.

The FHLB incurred losses in 2008 and 2009 and suspended the payment of dividends and excess stock redemptions during those years. The losses suffered during 2008 and 2009 were primarily attributable to impairment of investment securities associated with the extreme economic conditions in place during those years. The FHLB announced in February 2011 that it was profitable during 2010 and reinstated dividend payments in 2011. Management evaluated the stock and concluded that the stock was not impaired for the periods presented herein. More consideration was given to the long-term prospects for the FHLB as opposed to the recent stress caused by the current extreme economic conditions. Management also considered that the FHLB's regulatory capital ratios have increased from the prior year, liquidity appears adequate, and new shares of FHLB Stock continue to trade at the \$100 par value.

#### Note 7. Shareholders' Equity

##### Income (Loss) Per Share

The Company is required to present basic income (loss) per share and diluted income (loss) per share in its statements of operations. Basic per share amounts are computed by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted per share amounts assume exercise of all potential common stock equivalents in weighted average shares outstanding, unless the effect is antidilutive. The Company is also required to provide a reconciliation of the numerator and denominator used in the computation of both basic and diluted income (loss) per share.

The following is information about the computation of (loss) income per share for the three months and six months ended June 30, 2012 and 2011:

Three Months Ended June 30,	2012			2011		
	Net	Weighted	Amount	Net	Weighted	Amount
	Loss	Average	Per Share	Income	Average	Per Share
		Shares			Shares	
Basic (Loss) Income Per Share						
(Loss) income available to common shareholders	\$(41,679 )	2,735,359	\$(0.02 )	\$176,789	2,697,407	\$0.07
Effect of Dilutive Securities						
Warrants/Restricted Stock/Stock Options outstanding	—	—	—	—	495	—
Diluted Loss Income Per Share						
(Loss) income available to common shareholders plus assumed conversions	\$(41,679 )	2,735,359	\$(0.02 )	\$176,789	2,697,902	\$0.07

For the three months ended June 30, 2012, common stock equivalents of 74,914 shares have been excluded from the computation of net loss per share because the inclusion of such common stock equivalents is anti-dilutive.

Six Months Ended June 30,	Net Loss	2012 Weighted Average Shares	Amount Per Share	Net Loss	2011 Weighted Average Shares	Amount Per Share
<b>Basic Loss Per Share</b>						
Loss available to common shareholders	\$(99,313 )	2,723,422	\$(0.04 )	\$(459,766 )	2,697,156	\$(0.17 )
<b>Effect of Dilutive Securities</b>						
Warrants/Restricted Stock/Stock Options outstanding	—	—	—	—	—	—
<b>Diluted Loss Per Share</b>						
Loss available to common shareholders plus assumed conversions	\$(99,313 )	2,723,422	\$(0.04 )	\$(459,766 )	2,697,156	\$(0.17 )

For the six months ended June 30, 2012 and 2011, common stock equivalents of 51,040 shares and 746 shares, respectively, have been excluded from the computation of net loss per share because the inclusion of such common stock equivalents is anti-dilutive.

## Restricted stock plan

A summary of the status of the Company's nonvested restricted stock at June 30, 2012 and changes during the period then ended, is as follows:

	2012	Weighted- Average Grant-Date Fair Value
	Number of Shares	
Nonvested restricted stock at beginning of the year	—	\$ —
Granted	112,371	1.55
Vested and issued	(37,457)	1.55
Forfeited	—	—
Nonvested restricted stock at June 30, 2012	74,914	1.55

For the six months ended June 30, 2012, there were 112,371 shares of time-based restricted stock granted to senior management. During the six months ended June 30, 2012, \$139,337 of compensation cost related to restricted stock awards was recognized. As of June 30, 2012, there was \$34,835 of unrecognized compensation cost related to non-vested restricted stock awards expected to be recognized over the remaining vesting period of less than one year. Of the 112,371 shares of restricted common stock, 37,457 shares vested on February 28, 2012, 37,457 shares vested on July 1, 2012 and the remaining 37,457 shares of restricted common stock will vest on January 1, 2013.

## Note 8. Financial Instruments with Off-Balance-Sheet Risk

In the normal course of business, the Company is a party to financial instruments with off-balance sheet risk to meet the financing needs of its customers. These financial instruments include commitments to extend credit and involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the financial statements. The contractual amounts of these instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The contractual amounts of commitments to extend credit represent the amounts of potential accounting loss should the contract be fully drawn upon, the customer defaults, and the value of any existing collateral becomes worthless. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments and evaluates each customer's creditworthiness on a case-by-case basis.

The Company controls the credit risk of these financial instruments through credit approvals, credit limits, monitoring procedures and the receipt of collateral that it deems necessary.

Financial instruments whose contract amounts represent credit risk at June 30, 2012 and December 31, 2011 were as follows:

	June 30, 2012	December 31, 2011
Commitments to extend credit:		
Future loan commitments	\$ 2,860,000	\$ 1,565,000
Unused lines of credit	14,546,460	17,569,186
Financial standby letters of credit	2,279,806	3,083,828
Undisbursed construction loans	508,827	508,827

\$	20,195,093	\$	22,726,841
----	------------	----	------------

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 to extend credit generally have fixed expiration dates or other termination clauses and may require payment of a fee by the borrower. Since these commitments could expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counter-party. Collateral held varies, but may include residential and commercial property, deposits and securities.

Standby letters of credit are written commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Guarantees that are not derivative contracts have been recorded on the Company's consolidated balance sheet at their fair value at inception. The liability related to guarantees recorded at June 30, 2012 and December 31, 2011 was not significant.



## Note 9. Fair Value

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. A description of the valuation methodologies used for assets and liabilities recorded at fair value, and for estimating fair value for financial and non-financial instruments not recorded at fair value, is set forth below.

Cash and due from banks, Federal funds sold, short-term investments, interest bearing certificates of deposit, accrued interest receivable, Federal Home Loan Bank stock, accrued interest payable and repurchase agreements

The carrying amount is a reasonable estimate of fair value. The Company does not record these assets at fair value on a recurring basis. Cash and due from banks, Federal funds sold, short-term investments, interest bearing certificates of deposit, accrued interest receivable, Federal Home Loan Bank stock, accrued interest payable and repurchase agreements are classified as Level 1 within the fair value hierarchy.

### Available for sale securities

These financial instruments are recorded at fair value in the financial statements on a recurring basis. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted prices are not available, then fair values are estimated by using pricing models (i.e., matrix pricing) or quoted prices of securities with similar characteristics and are classified within Level 2 of the valuation hierarchy. Examples of such instruments include government agency bonds and mortgage-backed securities and common stock. Securities classified within level 3 of the valuation hierarchy are securities for which significant unobservable inputs are utilized. Available for sale securities are recorded at fair value on a recurring basis.

The Company's available for sale securities, comprised of U.S. Treasury securities, are classified as Level 1 in the fair value hierarchy, as quoted prices are available in an active market.

### Loans receivable

For variable rate loans that reprice frequently and have no significant change in credit risk, carrying values are a reasonable estimate of fair values, adjusted for credit losses inherent in the portfolios. The fair value of fixed rate loans is estimated by discounting the future cash flows using estimated period end market rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, adjusted for credit losses inherent in the portfolios. The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for credit losses is established. The specific reserves for collateral dependent impaired loans are based on the fair value of collateral less estimated costs to sell. The fair value of collateral is determined based on appraisals. In some cases, adjustments are made to the appraised values due to various factors including age of the appraisal, age of comparables included in the appraisal, and known changes in the market and in the collateral. When significant adjustments are based on unobservable inputs, the resulting fair value measurement is categorized as a Level 3 measurement.

At June 30, 2012 and December 31, 2011, the Company's collateral dependent loans receivable considered impaired that were newly measured for fair value purposes during such periods, were categorized as Level 3 within the fair value hierarchy, and the balances, net of related specific reserves, were \$609,149 and \$3,678,296, respectively. The remainder of the balance of loans receivable is classified as Level 2 within the fair value hierarchy.

### Servicing assets

The fair value is based on market prices for comparable servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The Company does not record these assets at fair value on a recurring basis. Servicing assets are classified as Level 2 within the fair value hierarchy.

Other assets held for sale and other real estate owned

Other assets held for sale represents real estate that is not intended for use in operations and real estate acquired through foreclosure, and are recorded at fair value on a nonrecurring basis. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company classifies the fair value measurement as Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company classifies the fair value measurement as Level 3. The Company classified the other assets held for sale and other real estate owned as Level 2 within the fair value hierarchy, as the fair value of these assets was based upon current appraisals.

## Other assets – derivative financial instruments

Derivative financial instruments represent an equity warrant asset held by the Bank which entitled the Bank to acquire stock in the issuer, a publicly traded company. The Bank held this asset for prospective investment gains. The Bank did not use it to hedge any economic risks nor does it use other derivative instruments to hedge economic risks. The equity warrant asset was recorded at fair value and classified as a derivative asset, which is a component of other assets, on the Company's consolidated balance sheet at December 31, 2011. The Company classified the other assets – derivative financial instruments as Level 2 within the fair value hierarchy.

## Interest only strips

The fair value is based on a valuation model that calculates the present value of estimated future cash flows. The Company does not record these assets at fair value on a recurring basis. Interest only strips are classified as Level 2 within the fair value hierarchy.

## Deposits

The fair value of demand deposits, savings and money market deposits is the amount payable on demand at the reporting date. The fair value of certificates of deposit is estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities, estimated using local market data, to a schedule of aggregated expected maturities on such deposits. The Company does not record deposits at fair value on a recurring basis. Demand deposits, savings and money market deposits are classified as Level 1 within the fair value hierarchy. Certificates of deposit are classified as Level 2 within the fair value hierarchy.

## Off-balance-sheet instruments

Fair values for the Company's off-balance-sheet instruments (lending commitments) are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The Company does not record its off-balance-sheet instruments at fair value on a recurring basis. Off-balance-sheet instruments are classified as Level 3 within the fair value hierarchy.

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

	Balance as of June 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Treasury Bills	\$2,249,955	\$2,249,955	\$-	\$ -
	Balance	Quoted Prices in	Significant Observable	Significant Unobservable

	as of December 31, 2011	Active Markets for Identical Assets (Level 1)	Inputs (Level 2)	Inputs (Level 3)
U.S. Treasury Bills	\$ 3,849,847	\$3,849,847	\$-	\$ -
Other Assets - derivatives	\$ 86,434	\$-	\$86,434	\$ -

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

	Balance as of June 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets held at fair value				
Impaired loans (1)	\$ 609,149	\$-	\$-	\$ 609,149

	Balance as of December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets held at fair value				
Impaired loans (1)	\$ 3,678,296	\$ -	\$-	\$ 3,678,296

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

The Company discloses fair value information about financial instruments, whether or not recognized in the statement of financial condition, for which it is practicable to estimate that value. Certain financial instruments are excluded from disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The estimated fair value amounts as of June 30, 2012 and December 31, 2011 have been measured as of their respective periods and have not been reevaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than amounts reported at such reporting dates.

The information presented should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only required for a limited portion of the Company's assets and liabilities. Due to the wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful.

The following is a summary of the recorded book balances and estimated fair values of the Company's financial instruments at June 30, 2012 and December 31, 2011:

	Fair Value Hierarachy Level	June 30, 2012		December 31, 2011	
		Recorded Book Balance	Fair Value	Recorded Book Balance	Fair Value
<b>Financial Assets:</b>					
Cash and due from banks	Level 1	\$9,775,930	\$9,775,930	\$18,167,794	\$18,167,794
Short-term investments	Level 1	6,065,606	6,065,606	6,764,409	6,764,409
Interest bearing certificates of deposit	Level 1	655,265	655,265	99,426	99,426
Available for sale securities	Level 1	2,249,955	2,249,955	3,849,847	3,849,847
Federal Home Loan Bank stock	Level 1	60,600	60,600	66,100	66,100
<b>Loans receivable, net:</b>					
Observable inputs	Level 2	99,076,079	101,265,087	106,893,215	109,691,073
Unobservable inputs	Level 3	5,010,913	5,010,913	4,750,927	4,750,927
Accrued interest receivable	Level 1	387,912	387,912	434,302	434,302
Servicing rights	Level 2	6,925	17,400	7,991	20,079
Interest only strips	Level 2	8,964	14,459	10,364	16,717
Derivative financial instruments	Level 2	-	-	86,434	86,434
<b>Financial Liabilities:</b>					
Noninterest-bearing deposits	Level 1	29,361,309	29,361,309	31,003,581	31,003,581
Interest bearing checking accounts	Level 1	5,646,296	5,646,296	5,149,535	5,149,535
Money market deposits	Level 1	43,289,095	43,289,095	47,728,069	47,728,069
Savings deposits	Level 1	3,072,105	3,072,105	2,838,736	2,838,736
Time certificates of deposits	Level 2	32,985,110	32,897,000	45,910,760	46,787,000
Repurchase agreements	Level 1	172,285	172,285	68	68
Accrued interest payable	Level 1	67,748	67,748	204,021	204,021

## Off-balance-sheet financial instruments:

Commitments to extend credit	Level 3	-	-	-	-
Standby letters of credit	Level 3	-	-	-	-

## Unrecognized financial instruments

Loan commitments on which the committed interest rate is less than the current market rate were insignificant at June 30, 2012 and December 31, 2011.

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, fair values of the Company's financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent management believes necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and by investing in securities with terms that mitigate the Company's overall interest rate risk.

## Note 10. Commitments and Contingencies

## Change in Control Agreement

Effective June 21, 2012, the Bank entered into a change in control agreement with its Senior Vice President of Retail Banking.

The agreement provides that in the event of (i) a “Change in Control” (as defined in the agreement) and (ii) the termination within twelve months of such “Change in Control” of the Senior Vice President of Retail Banking’s employment (a) for any reason other than for “Cause” (as defined in the agreement), death or “Disability” (as defined in the agreement) or (b) as result of his resignation for “Good Reason” (as defined in the agreement) following the cure period specified in the agreement, the Senior Vice President of Retail Banking will be entitled to receipt of an amount equal to one times his annual base salary immediately prior to his termination or employment or the “Change in Control,” whichever is higher. The Senior Vice President of Retail Banking will also be entitled to receipt of accrued but unpaid compensation and vacation time as well as an amount equal to one year’s medical and dental insurance premiums totaling approximately \$20,000.

The agreement further provides that notwithstanding anything to the contrary contained in the agreement, no “Change in Control” payments will be made to the Senior Vice President of Retail Banking if such payments would constitute a “golden parachute payment” under regulations promulgated by the Federal Deposit Insurance Corporation.

## Note 11. Segment Reporting

For the seven months ended July 31, 2010, the Company had three reporting segments for purposes of reporting business line results: Community Banking, Mortgage Brokerage and the Holding Company. The Community Banking segment is defined as all operating results of the Bank. The Mortgage Brokerage segment is defined as the results of Evergreen (through July 31, 2010) and subsequently, the continuation of mortgage brokerage activities through the Bank, and the Holding Company segment is defined as the results of Southern Connecticut Bancorp on an unconsolidated or standalone basis. The Company uses an internal reporting system to generate information by operating segment. Estimates and allocations are used for noninterest expenses. Effective August 1, 2010, the Company discontinued its licensed mortgage brokerage business associated with SCB Capital, Inc. Subsequent to July 31, 2010, the mortgage brokerage activities continued through the Bank.

Information about the reporting segments and reconciliation of such information to the consolidated financial statements was as follows:

	Three Months Ended June 30, 2012				Consolidated Total
	Community Banking	Mortgage Brokerage	Holding Company	Elimination Entries	
Net interest income	\$1,344,586	\$763	\$97	\$—	\$1,345,446
Provision for loan losses	180,254	—	—	—	180,254
Net interest income after provision for loan losses	1,164,332	763	97	—	1,165,192
Noninterest income	127,385	—	7,665	435	135,485
Noninterest expense	1,267,024	(379 )	75,276	435	1,342,356

Net (loss) income	24,693	1,142	(67,514 )	—	(41,679 )
Total assets as of June 30, 2012	127,084,192	44,419	11,598,657	(11,013,283)	127,713,985

23

---



Edgar Filing: SOUTHERN CONNECTICUT BANCORP INC - Form 10-Q

	Three Months Ended June 30, 2011				
	Community Banking	Mortgage Brokerage	Holding Company	Elimination Entries	Consolidated Total
Net interest income	\$1,301,097	\$5,967	\$554	\$—	\$1,307,618
Provision for loan losses	(77,044 )	—	—	—	(77,044 )
Net interest income after provision for loan losses	1,378,141	5,967	554	—	1,384,662
Noninterest income	130,149	—	6,000	—	136,149
Noninterest expense	1,314,016	485	29,521	—	1,344,022
Net (loss) income	194,274	5,482	(22,967 )	—	176,789
Total assets as of June 30, 2011	156,927,876	111,991	14,026,852	(13,459,558)	157,607,161

	Six Months Ended June 30, 2012				
	Community Banking	Mortgage Brokerage	Holding Company	Elimination Entries	Consolidated Total
Net interest income	\$2,572,499	\$2,183	\$308	\$—	\$2,574,990
Provision for loan losses	210,254	—	—	—	210,254
Net interest income after provision for loan losses	2,362,245	2,183	308	—	2,364,736
Noninterest income	294,676	—	16,620	435	311,731
Noninterest expense	2,669,230	(187 )	106,302	435	2,775,780
Net (loss) income	(12,309 )	2,370	(89,374 )	—	(99,313 )
Total assets as of June 30, 2012	127,084,192	44,419	11,598,657	(11,013,283)	127,713,985

	Six Months Ended June 30, 2011				
	Community Banking	Mortgage Brokerage	Holding Company	Elimination Entries	Consolidated Total
Net interest income	\$2,624,482	\$13,856	\$1,361	\$—	\$2,639,699
Provision for loan losses	666,060	—	—	—	666,060
Net interest income after provision for loan losses	1,958,421	13,856	1,361	—	1,973,639
Noninterest income	259,710	—	12,000	—	271,710

Noninterest expense	2,653,599	1,322	50,194	—	2,705,115
Net loss	(435,467 )	12,534	(36,833 )	—	(459,766 )
Total assets as of June 30, 2011	156,927,876	111,991	14,026,852	(13,459,558)	157,607,161

#### Note 12. Recent Accounting Pronouncements

In April 2011, the FASB amended its guidance relating to repurchase agreements. The amendments change the effective control assessment by removing the criterion that required the transferor to have the ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. Instead, the amendments focus the assessment of effective control on the transferor's rights and obligations with respect to the transferred financial assets and not whether the transferor has the practical ability to perform in accordance with those rights or obligations. The amended guidance became effective for the Company as it relates to transactions or modifications of existing transactions that occur in interim and annual periods beginning with the quarter ended March 31, 2012. These amendments did not have an impact on the Company's consolidated financial statements.

In May 2011, the FASB issued Accounting Standards Update (ASU) 2011-04, Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRs, (ASU 2011-04). ASU 2011-04 converges the fair value measurement guidance in U.S. GAAP and International Financial Reporting Standards (IFRSs). Some of the amendments clarify the application of existing fair value measurement requirements, while other amendments change a particular principle in existing guidance. In addition, ASU 2011-04 requires additional fair value disclosures. The amendments are to be applied prospectively and are effective for interim and annual periods beginning after December 15, 2011. The Company adopted the methodologies prescribed by this ASU during the quarter ended March 31, 2012. Adoption of this guidance did not have a material effect on the Company's financial statements.

In June 2011, the FASB issued new accounting guidance related to the presentation of comprehensive income that eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company adopted this guidance effective for the quarter ended March 31, 2012. The adoption of this guidance did not impact the Company's financial position, results of operations or cash flows and only impacted the presentation of other comprehensive income in the financial statements.

#### Note 13. Subsequent Events

On July 2, 2012, the Bank entered into a stipulation and consent to the Issuance of a Consent Order with the Federal Deposit Insurance Corporation ("FDIC") and the State of Connecticut Department of Banking ("Connecticut Department of Banking"). Thereafter, on July 3, 2012, the Bank entered into a Consent Order (the Consent Order) with the FDIC and the Connecticut Department of Banking.

By entering into the Consent Order, the Bank has agreed to take certain measures in a number of areas, including, without limitation, the following: (i) having and retaining qualified management and reviewing and revising its assessment of senior management; (ii) maintaining minimum specified capital levels and developing and submitting a capital plan in the event any of its capital ratios fall below such minimum specified capital levels; (iii) formulating and submitting a profit and budget plan consisting of goals and strategies consistent with sound banking practices and implementing such plan; (iv) formulating and submitting a plan to reduce classified assets and implementing such plan; (v) reviewing and improving the loan and credit risk management policies and procedures; (vi) developing and implementing action plans addressing all other recommendations identified within its most recent Report of Examination; (vii) complying with the Interagency Policy Statement on Internal Audit Function and its Outsourcing; and (viii) not accepting, renewing or rolling over any brokered deposits unless the Bank is in compliance with regulations governing the solicitation and acceptance of brokered deposits. The Consent Order also provides that the Bank will obtain prior regulatory approval before the payment of any dividends. The Bank has already adopted and implemented many of the actions prescribed in the Consent Order.

The Consent Order requires the Bank to maintain a minimum Tier 1 leverage ratio of at least 8.0%, a Tier 1 risk-based capital ratio of at least 9% and a total risk-based capital ratio of at least 10%. At June 30, 2012, the Bank's capital ratios exceeded such minimums set forth in the Consent Order. In June 2012, the Bank submitted a revised capital plan outlining its strategy for increasing its capital amounts and ratios to the Federal Deposit Insurance Corporation and the State of Connecticut Department of Banking for their approval. The capital plan included a profit and budget plan and a plan to reduce classified assets. Following receipt of regulatory approval, the Company and the Bank will seek to implement the plan to increase capital as soon as practicable. Further regulatory action is possible if the Bank does not maintain the minimum capital ratios set forth in the Consent Order.

The Bank has an Oversight Committee that is responsible for supervising the implementation of the Consent Order. The Oversight Committee meets monthly and is currently composed of the Company's Chairman of the Board, two additional directors, the Chief Executive Officer, the President and Chief Credit Officer and the Chief Financial Officer.

The Consent Order is the result of ongoing discussions between the Bank's regulatory agencies and the Bank based on a regulatory examination conducted in early 2012. The Consent Order will remain in effect until it is modified or terminated by the FDIC and the Connecticut Department of Banking. The Bank's customer deposits remain fully

insured to the highest limit set by the FDIC.

25

---

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

The following discussion and analysis is intended to assist you in understanding the financial condition and results of operations of the Company. This discussion should be read in conjunction with the accompanying unaudited financial statements as of and for the three and six months ended June 30, 2012 and 2011 together with the audited financial statements as of and for the year ended December 31, 2011, included in the Company's Form 10-K filed with the Securities and Exchange Commission on March 30, 2012.

Summary

As of June 30, 2012, the Company had \$127.7 million of total assets, \$106.3 million of gross loans receivable, and \$114.4 million of total deposits. Total equity capital at June 30, 2012 was \$11.6 million, and the Company's Tier I Leverage Capital Ratio was 8.92%.

The Company had a net loss for the quarter ended June 30, 2012 of \$42,000 (or basic and diluted loss per share of \$0.02) as compared to net income of \$177,000 (or basic and diluted income per share of \$0.07) for the second quarter of 2011. The decline in the Company's net income was largely attributable to an increase in the provision for loan losses to \$180,000 for the three months ended June 30, 2012 compared to a credit to the provision for loan losses of \$77,000 for the same period in 2011. The increase in the provision for loan losses was primarily related to an increase in net charge-offs during the second quarter of 2012 compared to the second quarter of 2011, including charge-offs against specific reserves relating to four impaired loans during the three months ended June 30, 2012. These changes, are in contrast to the credit to the provision for loan losses during the second quarter of 2011, which was primarily related to net decreases to the specific allowances on certain impaired loans resulting from payments received in excess of amounts previously estimated and the return to accrual status of one commercial real estate loan, for which a specific allowance of \$100,000 was reversed as the loan had performed for over one year and no allowance was considered necessary.

In addition to the impact of the increase in the provision for loan losses, the Company's operating results for the second quarter of 2012, when compared to the same period of 2011, were influenced by the following factors:

Net interest income increased by \$38,000 due to the combined effects of decreases in liability volumes, lower rates paid on interest bearing liabilities and an increase in yields on interest earning assets (primarily attributable to recognition of \$42,000 in interest income on one commercial and industrial loan classified as a troubled debt restructuring which returned to accrual status during the quarter ended June 30, 2012 as it had performed in accordance with the terms of its restructuring agreement for a period of one year), which were partially offset by decreases in loan volume;

Noninterest income increased by \$12,000 because of increases in other noninterest income (primarily loan fees) during the three months ended June 30, 2012 compared to the same period of 2011, which were partially offset by a decrease in service charges and fees resulting from changes in the business practices of customers of the Bank; and

Noninterest expenses increased by \$12,000 during the second quarter of 2012 compared to the same period in 2011 primarily due to increases in salaries and benefits expense, professional services fees and insurance expense, which were partially offset by decreases in directors' fees and data processing fees. The increase in salaries and benefits expense during the second quarter of 2012 when compared to the second quarter of 2011 was primarily attributable to restricted stock compensation expense recorded by the Company based upon the vesting schedule for restricted stock granted to the Chief Executive Officer under his employment agreement and restricted stock agreement executed on February 28,

2012. The increase in professional services fees was due to increased costs for internal auditing and consulting services performed during the quarter ended June 30, 2012 compared to the same period in 2011. Insurance expense increased due to increased costs in 2012 associated with insurance policies that the Company had entered into during a more favorable environment in July 2008. These unfavorable changes were partially offset by the impact of reductions in directors' fees that were approved by the Company's compensation committee effective January 1, 2012, as well as benefits the Company continued to realize during the second quarter of 2012 related to the renewal of certain data processing service contracts during the fourth quarter of 2011.

The Company had a net loss for the six months ended June 30, 2012 of \$99,000 (or basic and diluted loss per share of \$.04) as compared to a net loss of \$460,000 (or basic and diluted loss per share of \$0.17) for the six months ended June 30, 2011. The decline in the Company's net loss was largely attributable to a decrease in the provision for loan losses to \$210,000 for the six months ended June 30, 2012 compared to a provision for loan losses of \$666,000 for the same period in 2011. The decrease in the provision for loan losses during the six months ended June 30, 2012 compared to the same period in 2011 was primarily related to one commercial loan secured by real estate that was severely impacted by prevailing economic conditions in 2011.

In addition to the impact of the decrease in the provision for loan losses, the Company's operating results for the six months ended June 30, 2012, when compared to the same period of 2011, were influenced by the following factors:

Net interest income decreased by \$65,000 due to the combined effects of decreases in loan volume and lower yields on interest earning assets (primarily attributable to a decline in yields in the loan portfolio), which were partially offset by decreases in liability volumes and lower rates paid on interest bearing liabilities;

Noninterest income increased by \$54,000 because of loan prepayment fees received during the six months ended June 30, 2012 with no similar income recognized in the same period of 2011, as well as an increase in other noninterest income, which were partially offset by a decrease in service charges and fees resulting from changes in the business practices of customers of the Bank; and

Noninterest expenses increased by \$84,000 during the first six months of 2012 compared to the same period in 2011 primarily due to increases in salaries and benefits expense, professional services fees and insurance expense, which were partially offset by decreases in directors' fees and data processing fees. The increase in salaries and benefits expense during the first six months of 2012 when compared to the same period in 2011 was primarily attributable to restricted stock compensation expense recorded by the Company based upon the vesting schedule for restricted stock granted to the Chief Executive Officer under his employment agreement and restricted stock agreement executed on February 28, 2012. The increase in professional services fees was due to increased costs for loan review, internal audit and consulting services performed during the six months ended June 30, 2012, compared to the same period in 2011. Insurance expense increased due to increased costs in 2012 associated with insurance policies that the Company had entered into during a more favorable environment in July 2008. These unfavorable changes were partially offset by the impact of reductions in directors' fees that were approved by the Company's compensation committee effective January 1, 2012, as well as benefits the Company continued to realize during the first six months of 2012 related to the renewal of certain data processing service contracts during the fourth quarter of 2011.

#### Critical Accounting Policy

In the ordinary course of business, the Company has made a number of estimates and assumptions relating to reporting the results of operations and financial condition in preparing its financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ significantly from those estimates under different assumptions and conditions. The Company believes the following discussion addresses the Company's only critical accounting policy, which is the policy that is most important to the portrayal of the Company's financial condition and results of operations, and requires management's most difficult, subjective and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. The Company has reviewed this critical accounting policy and estimate with its audit committee. Refer to the discussion below under "Allowance for Loan Losses" and Note 1 to the audited financial statements as of and for the year ended December 31, 2011 included in the Company's Form 10-K filed with the Securities and Exchange Commission on March 30, 2012.

#### 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.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of allocated and general components. The allocated component relates to loans that are considered impaired. For such impaired loans, an allowance is established when the discounted cash flows (or observable market price or collateral value if the loan is collateral dependent) of the impaired loan is lower than the carrying value of that loan. The general component covers all other loans, segregated generally by loan type (and further segregated by risk rating), and is based on historical loss experience with adjustments for qualitative factors which are made after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss data.

A loan is 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 for commercial and real estate loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, 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 the subject of a restructuring agreement due to financial difficulties of the borrower.

Impaired loans also include loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection.



A modified loan is considered a troubled debt restructuring (“TDR”) when two conditions are met: (1) the borrower is experiencing documented financial difficulty and (2) concessions are made by the Company that would not otherwise be considered for a borrower with similar credit characteristics. The most common types of modifications include interest rate reductions and/or maturity extensions. Modified terms are dependent upon the financial position and needs of the individual borrower, as the Bank does not employ modification programs for temporary or trial periods. All modifications are permanent. The modified loan does not revert back to its original terms, even if the modified loan agreement is violated. The Company’s workout committee continues to monitor the modified loan and if a re-default occurs, the loan is classified as a re-defaulted TDR and collection is pursued through liquidation of collateral, from guarantors, if any, or through other legal action.

Most TDRs are placed on nonaccrual status at the time of restructuring, and continue on nonaccrual status until they have performed under the revised terms of the modified loan agreement for a minimum of six months. In certain instances, for TDRs that are on accrual status at the time the loans are restructured, the Bank may continue to classify the loans as accruing loans based upon the terms and conditions of the restructuring.

Impairment analysis is performed on a loan by loan basis for all modified commercial loans, residential mortgages and consumer loans that are deemed to be TDRs, and related charge-offs are recorded or specific reserves are established as appropriate. Commercial loans include loans categorized as commercial loans secured by real estate, commercial loans, and construction and land loans. Impairment is measured by the present value of expected future cash flows discounted at the loan’s effective interest rate. The original contractual interest rate for the loan is used as the discount rate for fixed rate loan modifications. The current rate is used as the discount rate when the loan’s interest rate floats with a specified index. A change in terms or payments would be included in the impairment calculation.

The allowances established for losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the borrower’s ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed by the credit department, in consultation with the loan officers, for all commercial loans. Specific valuation allowances are determined by analyzing the borrower’s ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower’s industry, among other things.

General valuation allowances are calculated based on the historical loss experience of specific types of loans. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool. The Company’s pools of similar loans include analogous risk-graded groups of commercial and industrial loans, commercial real estate loans, consumer real estate loans and consumer and other loans.

Due to the relatively small asset size and loans outstanding of the Company, the Company uses readily available data from the FDIC regarding the loss experience of national banks with assets between \$100 million and \$300 million and combines this data with the Company’s actual loss experience to develop average loss factors by weighting the national banks’ loss experience and the Company’s loss experience. As both the Company’s asset size and outstanding loan balance increased significantly during 2010, beginning with the quarter ended March 31, 2011, the Company determined to place greater emphasis on the Company’s loss experience and to utilize the average loss experience for the prior four years instead of the prior three years used in the Company’s calculations through December 31, 2010. The Company increased the weighting of its loss experience from 25% to 50%. The Company intends to weight the Company’s loss experience more heavily in determining the allowance for loan loss provision as the size of the Company’s loan portfolio becomes more significant. The historical loss period was extended by an additional year from the loss period utilized through December 31, 2010, which is considered more representative of average annual losses inherent in the loan portfolio.

General valuation allowances are based on general economic conditions and other qualitative risk factors, both internal and external, to the Company. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the Bank's lending management and staff; (ii) the effectiveness of the Company's loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; and (vi) the impact of national and local economic trends and conditions. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. Each component is determined to have either a high, moderate or low degree of risk. The results are then entered into a general allocation matrix to determine an appropriate general valuation allowance.

Based upon this evaluation, management believes the allowance for loan losses of \$2,185,000 or 2.06% of gross loans outstanding at June 30, 2012 is adequate, under prevailing economic conditions, to absorb losses on existing loans. At December 31, 2011, the allowance for loan losses was \$2,300,000 or 2.02% of gross loans outstanding. The decrease in the allowance was attributable to a \$115,000 decrease in the general component of the allowance. The decrease in the general component of the reserve was primarily due to a decline in loan volume during the six months ended June 30, 2012. In addition, the Company had \$417,000 in charge-offs during the six months ended June 30, 2012, of which \$384,000 was for loans that were not impaired at December 31, 2011 and \$33,000 was related to a decline in collateral for a loan impaired at December 31, 2011. The charge-offs during the first six months of 2012 primarily relate to three commercial and industrial loans and one residential loan. The Company's net loan charge-offs were adequately provided for during the six months ended June 30, 2012.

The accrual of interest on loans is discontinued at the time the loan is 90 days past due unless the loan is well-secured and in process of collection. Consumer installment loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not collected for loans that are placed on nonaccrual status or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis method until qualifying for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Management considers all non-accrual loans and troubled-debt restructured loans to be impaired. In most cases, loan payments that are past due less than 90 days and the related loans are not considered to be impaired.

#### Allowance for Loan Losses and Non-Accrual, Past Due and Restructured Loans

The changes in the allowance for loan losses for the six months ended June 30, 2012 and 2011 are as follows:

	2012	2011
Balance at beginning of year	\$2,299,625	\$2,786,641
Provision for loan losses	210,254	666,060
Recoveries of loans previously charged-off:		
Commercial	63,226	4,104
Commercial loans secured by real estate	29,114	
Consumer	—	2,156
Total recoveries	92,340	6,260
Loans charged-off:		
Commercial	(384,027 )	(134,699 )
Commercial loans secured by real estate	—	(1,146,198)
Residential mortgages	(33,192 )	—
Consumer	—	(9,115 )
Total charge-offs	(417,219 )	(1,290,012)
Balance at end of period	\$2,185,000	\$2,168,949
Net charge-offs to average loans	(0.30 )%	(1.03 )%

#### Non-Performing Assets and Potential Problem Loans

The following table represents non-performing assets and potential problem loans at June 30, 2012 and December 31, 2011:

	2012	2011
Non-accrual loans:		
Commercial loans secured by real estate	\$ 557,173	\$ 787,311
Commercial	1,813,525	1,707,720
Construction and land	1,394,116	1,420,156
Residential mortgages	722,216	554,678
Consumer	—	1,460
Total non-accrual loans	4,487,030	4,471,325

#### Troubled debt restructured (TDR) loans:

Edgar Filing: SOUTHERN CONNECTICUT BANCORP INC - Form 10-Q

Non-accrual TDR loans not included in Total non-accrual loans above:				
Commercial loans secured by real estate	265,263		1,314,030	
Commercial	258,620		1,899,342	
Accruing TDR impaired loans:				
Commercial loans secured by real estate	1,094,690		—	
Commercial	1,667,878		—	
Foreclosed assets:				
Commercial	474,948		374,211	
Residential	107,963		—	
Total non-performing assets	\$ 8,356,392		\$ 8,058,908	
Ratio of non-performing assets to:				
Total loans and foreclosed assets	7.84	%	7.05	%
Total assets	6.54	%	5.52	%
Accruing past due loans:				
30 to 89 days past due	\$3,034,976		\$1,392,936	
90 or more days past due	134,902		—	
Total accruing past due loans	\$3,169,878		\$1,392,936	
Ratio of accruing past due loans to total net loans:				
30 to 89 days past due	2.86	%	1.22	%
90 or more days past due	0.13	%	—	
Total accruing past due loans	2.98	%	1.22	%

## Recent Accounting Changes

In April 2011, the FASB amended its guidance relating to repurchase agreements. The amendments change the effective control assessment by removing the criterion that required the transferor to have the ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. Instead, the amendments focus the assessment of effective control on the transferor's rights and obligations with respect to the transferred financial assets and not whether the transferor has the practical ability to perform in accordance with those rights or obligations. The amended guidance became effective for the Company as it relates to transactions or modifications of existing transactions that occur in interim and annual periods beginning with the quarter ended March 31, 2012. These amendments did not have an impact on the Company's consolidated financial statements.

In May 2011, the FASB issued Accounting Standards Update (ASU) 2011-04, Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRs, (ASU 2011-04). ASU 2011-04 converges the fair value measurement guidance in U.S. GAAP and International Financial Reporting Standards (IFRSs). Some of the amendments clarify the application of existing fair value measurement requirements, while other amendments change a particular principle in existing guidance. In addition, ASU 2011-04 requires additional fair value disclosures. The amendments are to be applied prospectively and are effective for interim and annual periods beginning after December 15, 2011. The Company adopted the methodologies prescribed by this ASU during the quarter ended March 31, 2012. Adoption of this guidance did not have a material effect on the Company's financial statements.

In June 2011, the FASB issued new accounting guidance related to the presentation of comprehensive income that eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company adopted this guidance during the quarter ended March 31, 2012. The adoption of this guidance did not impact the Company's financial position, results of operations or cash flows and only impacted the presentation of other comprehensive income in the financial statements.

## Comparison of Financial Condition as of June 30, 2012 versus December 31, 2011

### General

The Company's total assets were \$127.7 million at June 30, 2012, a decrease of \$18.3 million over total assets of \$146.0 million at December 31, 2011. The Bank's net loans receivable decreased to \$104.1 million at June 30, 2012 from \$111.6 million at December 31, 2011, and cash and cash equivalents, including short term investments, decreased to \$15.8 million as of June 30, 2012 from \$24.9 million as of December 31, 2011. Total deposits decreased to \$114.4 million as of June 30, 2012 from \$132.6 million as of December 31, 2011. The decreases in net loans receivable and cash and cash equivalents corresponded with the decrease in deposit liabilities during the six months ended June 30, 2012.

### Short-term investments

Short-term investments, consisting of money market investments, decreased to \$6.1 million at June 30, 2012 compared to \$6.8 million at December 31, 2011.

### Investments

Available for sale securities, which consisted of U.S. Treasury Bills, decreased \$1.6 million to \$2.2 million at June 30, 2012 from \$3.8 million at December 31, 2011. The Company uses the U.S. Treasury Bills included in its available for sale securities portfolio to meet pledge requirements for public deposits and repurchase agreements. The Company classifies its securities as “available for sale” to provide greater flexibility to respond to changes in interest rates as well as future liquidity needs.

### Loans

Interest income on loans is the most important component of the Company's net interest income. The loan portfolio is the largest component of earning assets, and it, therefore, generates the largest portion of revenues. The Company's net loan portfolio was \$104.1 million at June 30, 2012 versus \$111.6 million at December 31, 2011, a decrease of \$7.5 million. The Company attributes the decline in loan balances during the first six months of 2012 to a decline in loan demand. The Bank's loans have been made to small to medium-sized businesses, primarily in the Greater New Haven Market. There are no other significant loan concentrations in the loan portfolio.

### Deposits

Total deposits were \$114.4 million at June 30, 2012, a decrease of \$18.2 million or 13.8% from total deposits of \$132.6 million at December 31, 2011. Non-interest bearing deposits were \$29.4 million at June 30, 2012, a decrease of \$1.6 million or 5.3% from \$31.0 million at December 31, 2011. Total interest bearing checking, money market and savings deposits decreased \$3.7 million or 6.7% to \$52.0 million at June 30, 2012 from \$55.7 million at December 31, 2011. Time deposits decreased \$13.0 million or 28.1% to \$32.9 million at June 30, 2012 from \$45.9 million at December 31, 2011. Included in time deposits at June 30, 2012 and December 31, 2011 were \$4.8 million and \$9.1 million, respectively, of brokered deposits. This included the Company's placement of \$4.4 million and \$4.2 million in customer deposits as of June 30, 2012 and as of December 31, 2011, respectively; and the purchase of \$300,000 and \$2.1 million in brokered certificates of deposit through the CDARS program as of June 30, 2012 and December 31, 2011, respectively. As a result of the Consent Order, the Bank does not intend to renew or accept brokered deposits without obtaining prior regulatory approval during the period in which the Consent Order is in place.

The Greater New Haven Market is highly competitive. The Bank faces competition from a large number of banks (ranging from small community banks to large international banks), credit unions, and other providers of financial services. The level of rates offered by the Bank reflects the high level of competition in the Bank's market.

### Other

Repurchase agreement balances totaled \$172,000 at June 30, 2012 as compared to less than \$100 at December 31, 2011. The increase was due to normal customer activity.

### Results of Operations: Comparison of Results for the three months and six months ended June 30, 2012 and 2011

#### General

The Company had a net loss for the quarter ended June 30, 2012 of \$42,000 (or basic and diluted loss per share of \$0.02) as compared to net income of \$177,000 (or basic and diluted income per share of \$0.07) for the second quarter of 2011. The decline in the Company's net income was largely attributable to an increase in the provision for loan losses to \$180,000 for the three months ended June 30, 2012 compared to a credit to the provision for loan losses of \$77,000 for the same period in 2011. The increase in the provision for loan losses was primarily related to an increase in net charge-offs during the second quarter of 2012 compared to the second quarter of 2011, including charge-offs against specific reserves relating to four impaired loans during the three months ended June 30, 2012. These changes are in contrast to the credit to the provision for loan losses during the second quarter of 2011, which was primarily related to net decreases to the specific allowances on certain impaired loans resulting from payments received in excess of amounts previously estimated and the return to accrual status of one commercial real estate loan, for which a specific allowance of \$100,000 was reversed as the loan had performed for over one year and no allowance was considered necessary.

In addition to the impact of the increase in the provision for loan losses, the Company's operating results for the second quarter of 2012, when compared to the same period of 2011, were influenced by the following factors:

Net interest income increased by \$38,000 due to the combined effects of decreases in liability volumes, lower rates paid on interest bearing liabilities and an increase in yields on interest earning assets (primarily attributable to recognition of \$42,000 in interest income on one commercial and industrial loan classified as a troubled debt restructuring which returned to accrual status during the quarter ended June 30, 2012 as it had performed in accordance with the terms of its restructuring agreement for a period of one year), which were partially offset by decreases in loan volume;

Noninterest income increased by \$12,000 because of increases in other noninterest income (primarily loan fees) during the three months ended June 30, 2012 compared to the same period of 2011, which were partially offset by a decrease in service charges and fees resulting from changes in the business practices of customers of the Bank; and

Noninterest expenses increased by \$12,000 during the second quarter of 2012 compared to the same period in 2011 primarily due to increases in salaries and benefits expense, professional services fees and insurance expense, which were partially offset by decreases in directors' fees and data processing fees. The increase in salaries and benefits expense during the second quarter of 2012 when compared to the second quarter of 2011 was primarily attributable to restricted stock compensation expense recorded by the Company based upon the vesting schedule for restricted stock granted to the Chief Executive Officer under his employment agreement and restricted stock agreement executed on February 28, 2012. The increase in professional services fees was due to increased costs for internal auditing and consulting services performed during the quarter ended June 30, 2012 compared to the same period in 2011. Insurance expense increased due to increased costs in 2012 associated with insurance policies that the Company had entered into during a more favorable environment in July 2008. These unfavorable changes were partially offset by the impact of reductions in directors' fees that were approved by the Company's compensation committee effective January 1, 2012, as well as benefits the Company continued to realize during the second quarter of 2012 related to the renewal of certain data processing service contracts during the fourth quarter of 2011.



The Company had a net loss for the six months ended June 30, 2012 of \$99,000 (or basic and diluted loss per share of \$.04) as compared to a net loss of \$460,000 (or basic and diluted loss per share of \$0.17) for the six months ended June 30, 2011. The decline in the Company's net loss was largely attributable to a decrease in the provision for loan losses to \$210,000 for the six months ended June 30, 2012 compared to a provision for loan losses of \$666,000 for the same period in 2011. The decrease in the provision for loan losses during the six months ended June 30, 2012 compared to the same period in 2011 was primarily related to one commercial loan secured by real estate that was severely impacted by prevailing economic conditions in 2011.

In addition to the impact of the decrease in the provision for loan losses, the Company's operating results for the six months ended June 30, 2012, when compared to the same period of 2011, were influenced by the following factors:

Net interest income decreased by \$65,000 due to the combined effects of decreases in loan volume and lower yields on interest earning assets (primarily attributable to a decline in yields in the loan portfolio), which were partially offset by decreases in liability volumes and lower rates paid on interest bearing liabilities;

Noninterest income increased by \$54,000 because of loan prepayment fees received during the six months ended June 30, 2012 with no similar income recognized in the same period of 2011, as well as an increase in other noninterest income, which were partially offset by a decrease in service charges and fees resulting from changes in the business practices of customers of the Bank; and Noninterest expenses increased by \$84,000 during the first six months of 2012 compared to the same period in 2011 primarily due to increases in salaries and benefits expense, professional services fees and insurance expense, which were partially offset by decreases in directors' fees and data processing fees. The increase in salaries and benefits expense during the first six months of 2012 when compared to the same period in 2011 was primarily attributable to restricted stock compensation expense recorded by the Company based upon the vesting schedule for restricted stock granted to the Chief Executive Officer under his employment agreement and restricted stock agreement executed on February 28, 2012. The increase in professional services fees was due to increased costs for loan review, internal audit and consulting services performed during the six months ended June 30, 2012, compared to the same period in 2011. Insurance expense increased due to increased costs in 2012 associated with insurance policies that the Company had entered into during a more favorable environment in July 2008. These unfavorable changes were partially offset by the impact of reductions in directors' fees that were approved by the Company's compensation committee effective January 1, 2012, as well as benefits the Company continued to realize during the first six months of 2012 related to the renewal of certain data processing service contracts during the fourth quarter of 2011.

#### Net Interest Income

The principal source of revenue for the Bank is net interest income. The Bank's net interest income is dependent primarily upon the difference or spread between the average yield earned on loans receivable and securities and the average rate paid on deposits and borrowings, as well as the relative amounts of such assets and liabilities. The Bank, like other banking institutions, is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different times, or on a different basis, than its interest-earning assets.

For the quarter ended June 30, 2012, net interest income was \$1,345,000 versus \$1,308,000 for the same period in 2011. The \$37,000 or 2.9% increase was the result of a \$252,000 decrease in interest expense partially offset by a \$215,000 decrease in interest income. This net increase was primarily the result of decreases in average balances on interest bearing liabilities, favorable decreases in rates on interest bearing liabilities and increased yields on interest earning assets, which were partially offset by decreased asset volumes.

The Company's average total interest earning assets were \$118.3 million during the quarter ended June 30, 2012 compared to \$134.7 million for the same period in 2011, a decrease of \$16.4 million or 12.2%. The decrease in average interest earning assets of \$16.4 million during the quarter ended June 30, 2012 was comprised of decreases in average balances of loans of \$14.3 million, decreases in average balances of short-term and other investments of \$2.0 million and a \$188,000 decrease in investments.

The yield on average interest earning assets for the quarter ended June 30, 2012 was 5.50% compared to 5.45% for the same period in 2011, an increase of 5 basis points. The increase in the yield on average interest earning assets was primarily attributable to recognition of \$42,000 in interest income on one commercial and industrial loan classified as a troubled debt restructuring, which returned to accrual status during the quarter ended June 30, 2012 as it had performed in accordance with the terms of its restructuring agreement for a period of one year. This increase was partially offset by lower yields on the Bank's loan portfolio because of the lower interest rate environment as well as an increase in non-performing loans.

The combined effects of the \$16.4 million decrease in average balances of interest earning assets and the 5 basis point increase in yield on average interest earning assets resulted in the \$215,000 decline in interest income for the quarter ended June 30, 2012 compared to the quarter ended June 30, 2011.

The average balance of the Company's interest bearing liabilities was \$87.6 million during the quarter ended June 30, 2012 compared to \$118.6 million for the quarter ended June 30, 2011, a decrease of \$31.0 million or 26.2%. The cost of average interest bearing liabilities decreased 52 basis points to 1.25% for the quarter ended June 30, 2012 compared to 1.77% for the same period in 2011 due to maturities of higher priced time deposits as well as a general decrease in market interest rates.

The combined effect of the 52 basis point decrease in cost of average interest bearing liabilities and the \$31.0 million decrease in average balances of interest bearing liabilities resulted in the \$252,000 decrease in interest expense for the quarter ended June 30, 2012 compared to the quarter ended June 30, 2011.

For the six months ended June 30, 2012, net interest income was \$2,575,000 versus \$2,640,000 for the same period in 2011. The \$65,000 or 2.5% decrease was the result of a \$492,000 decrease in interest income partially offset by a \$427,000 decrease in interest expense. This net decrease was primarily the result of decreased asset volumes, as well as lower yields on interest earning assets, which were partially offset by decreases in average balances on interest bearing liabilities and favorable decreases in rates on interest bearing liabilities.

The Company's average total interest earning assets were \$120.7 million during the six months ended June 30, 2012 compared to \$136.5 million for the same period in 2011, a decrease of \$15.8 million or 11.6%. The decrease in average interest earning assets of \$15.8 million during the six months ended June 30, 2012 was comprised of decreases in average balances of loans of \$15.0 million as well as decreases in average balances of short-term and other investments of \$1.5 million, which were partially offset by increases in investments of \$700,000.

The yield on average interest earning assets for the six months ended June 30, 2012 was 5.29% compared to 5.42% for the same period in 2011, a decrease of 13 basis points. The decrease in the yield on average interest earning assets was attributable to lower yields on the Bank's loan portfolio due to the lower interest rate environment as well as an increase in non-performing loans.

The combined effects of the \$15.8 million decrease in average balances of interest earning assets and the 13 basis point decrease in yield on average interest earning assets resulted in the \$493,000 decline in interest income for the six months ended June 30, 2012 compared to the six months ended June 30, 2011.

The average balance of the Company's interest bearing liabilities was \$92.8 million during the six months ended June 30, 2012 compared to \$115.2 million for the six months ended June 30, 2011, a decrease of \$22.4 million or 19.4%. The cost of average interest bearing liabilities decreased 50 basis points to 1.30% for the six months ended June 30, 2012 compared to 1.80% for the same period in 2011 due to maturities of higher priced time deposits as well as a general decrease in market interest rates.

The combined effect of the 50 basis point decrease in cost of average interest bearing liabilities and the \$22.4 million decrease in average balances of interest bearing liabilities resulted in the \$428,000 decrease in interest expense for the six months ended June 30, 2012 compared to the six months ended June 30, 2011.

## Average Balances, Yields, and Rates

The following table presents average balance sheets (daily averages), interest income, interest expense, and the corresponding annualized rates on interest earning assets and rates paid on interest bearing liabilities for the three months ended June 30, 2012 and 2011:

## Distribution of Assets, Liabilities and Shareholders' Equity;

## Interest Rates and Interest Differential

(Dollars in thousands)	2012			2011			Change in	
	Average Balance	Interest Income/Expense	Average Rate	Average Balance	Interest Income/Expense	Average Rate	Increases in Interest Income/Expense	in Average Balance
<b>Interest earning assets</b>								
Loans (1)	\$108,809	\$1,607	5.94 %	\$123,077	\$1,805	5.88 %	\$(198)	\$(14,268)
Short-term and other investments	6,987	10	0.58 %	8,942	27	1.21 %	(17)	(1,955)
Investments	2,535	—	0.00 %	2,723	—	0.00 %	—	(188)
<b>Total interest earning assets</b>	<b>118,331</b>	<b>1,617</b>	<b>5.50 %</b>	<b>134,742</b>	<b>1,832</b>	<b>5.45 %</b>	<b>(215)</b>	<b>(16,411)</b>
Cash and due from banks	9,339			26,005				(16,666)
Premises and equipment, net	1,950			2,124				(174)
Allowance for loan losses	(2,416)			(2,574)				158
Other	2,705			2,716				(11)
<b>Total assets</b>	<b>\$129,909</b>			<b>\$163,013</b>				<b>\$(33,104)</b>
<b>Interest bearing liabilities</b>								
Time certificates	\$35,194	149	1.70 %	\$67,329	352	2.10 %	(203)	\$(32,135)
Savings deposits	3,004	1	0.13 %	2,742	4	0.59 %	(3)	262
Money market / checking deposits	47,948	80	0.67 %	46,101	125	1.09 %	(45)	1,847
Capital lease obligations	1,159	42	14.57 %	1,167	43	14.78 %	(1)	(8)
Repurchase agreements	289	—	0.00 %	1,307	—	0.00 %	—	(1,018)
<b>Total interest bearing liabilities</b>	<b>87,594</b>	<b>272</b>	<b>1.25 %</b>	<b>118,646</b>	<b>524</b>	<b>1.77 %</b>	<b>(252)</b>	<b>(31,052)</b>
Non-interest bearing deposits	30,067			29,703				364
Accrued expenses and other liabilities	426			887				(461)
Shareholder's equity	11,822			13,777				(1,955)
<b>Total liabilities and equity</b>	<b>\$129,909</b>			<b>\$163,013</b>				<b>\$(33,104)</b>
<b>Net interest income</b>		<b>\$1,345</b>			<b>\$1,308</b>		<b>\$37</b>	
Interest spread			4.25 %			3.68 %		
Interest margin			4.57 %			3.89 %		

(1) Includes nonaccruing loans.

(2) Interest income includes loan fees, which are not material.

## Changes in Assets and Liabilities and Fluctuations in Interest Rates

The following table summarizes the variance in interest income and interest expense for the three months ended June 30, 2012 and 2011 resulting from changes in assets and liabilities and fluctuations in interest rates earned and paid. The changes in interest attributable to both rate and volume have been allocated to both rate and volume on a pro rata basis:

(Dollars in thousands)	Three Months Ended June 30, 2012 vs 2011		
	Due to Change in Average		(Decrease) Increase
	Volume	Rate	
<b>Interest earning assets</b>			
Loans	\$ (211 )	\$ 13	\$ (198 )
Short-term and other investments	(5 )	(12 )	(17 )
<b>Total interest earning assets</b>	<b>(216 )</b>	<b>1</b>	<b>(215 )</b>
<b>Interest bearing liabilities</b>			
Time certificates	(145 )	(58 )	(203 )
Savings deposits	—	(3 )	(3 )
Money market / checking deposits	5	(50 )	(45 )
Capital lease obligations	—	(1 )	(1 )
<b>Total interest bearing liabilities</b>	<b>(140 )</b>	<b>(112 )</b>	<b>(252 )</b>
<b>Net interest income</b>	<b>\$ (76 )</b>	<b>\$ 113</b>	<b>\$ 37</b>

The increase in net interest income during the second quarter of 2012 reflected a \$31.0 million decrease in average interest bearing liabilities to \$87.6 million in the second quarter of 2012 from \$118.6 million in the second quarter of 2011; favorable decreases in rates on interest bearing liabilities to 1.25% for the three months ended June 30, 2012 from 1.77% for the same period in 2011; and an increase in the yields on interest earning assets to 5.50% for the three months ended June 30, 2012 from 5.45% in the same period of 2011. The combined effects of these favorable changes were partially offset by a \$16.4 million decrease in total average interest earning asset balances to \$118.3 million for the three months ended June 30, 2012 from \$134.7 million for the same period of 2011. Interest income from interest earning assets in the second quarter of 2012 when compared to the same period in 2011 decreased by \$215,000 because of a \$216,000 decrease due to volume considerations, which was partially offset by a \$1,000 increase due to favorable changes in interest rates. Variances in the cost of interest bearing liabilities during the three months ended June 30, 2012 in comparison to the same period in 2011 were due to decreased rate considerations of \$112,000 and decreased volume considerations of \$140,000.

## Average Balances, Yields, and Rates

The following table presents average balance sheets (daily averages), interest income, interest expense, and the corresponding annualized rates on interest earning assets and rates paid on interest bearing liabilities for the six months ended June 30, 2012 and 2011.

	Distribution of Assets, Liabilities and Shareholders' Equity; Interest Rates and Interest Differential							
	2012				2011			
(Dollars in thousands)	Average Balance	Interest Income/ Expense	Average Rate	Average Balance	Interest Income/ Expense	Average Rate	Change in Interest Income/Expense	
Interest earning assets								
Loans (1)(2)	\$109,958	\$3,148	5.76 %	\$124,913	\$3,623	5.85 %	\$ (475 )	\$(14,955 )
Short-term and other investments	7,400	27	0.73 %	8,924	45	1.02 %	(18 )	(1,524 )
Investments	3,328	—	0.00 %	2,667	—	0.00 %	—	661
Total interest earning assets	120,686	3,175	5.29 %	136,504	3,668	5.42 %	(493 )	(15,818 )
Cash and due from banks	11,981			21,532				(9,551 )
Premises and equipment, net	1,974			2,155				(181 )
Allowance for loan losses	(2,384 )			(2,896 )				512
Other	3,005			2,720				285
Total assets	\$135,262			\$160,015				\$ (24,753 )
Interest bearing liabilities								
Time certificates	\$39,100	347	1.78 %	\$65,052	683	2.12 %	(336 )	\$(25,952 )
Savings deposits	2,887	2	0.14 %	2,711	9	0.67 %	(7 )	176
Money market / checking deposits	49,302	168	0.69 %	45,053	249	1.11 %	(81 )	4,249
Capital lease obligations	1,160	83	14.39 %	1,167	86	14.86 %	(3 )	(7 )
Repurchase agreements	391	—	0.00 %	1,234	1	0.16 %	(1 )	(843 )
Total interest bearing liabilities	92,840	600	1.30 %	115,217	1,028	1.80 %	(428 )	(22,377 )
Non-interest bearing deposits	30,150			29,856				294
Accrued expenses and other liabilities	500			765				(265 )
Shareholder's equity	11,772			14,177				(2,405 )
Total liabilities and equity	\$135,262			\$160,015				\$ (24,753 )
Net interest income		\$2,575			\$2,640		\$ (65 )	

Interest spread	3.99	%	3.62	%
Interest margin	4.29	%	3.90	%

- (1) Average balance includes non-accruing loans.  
(2) Interest income includes loan fees, which are not material.

## Changes in Assets and Liabilities and Fluctuations in Interest Rates

The following table summarizes the variance in interest income and interest expense for the six months ended June 30, 2012 and 2011 resulting from changes in assets and liabilities and fluctuations in interest rates earned and paid. The changes in interest attributable to both rate and volume have been allocated to both rate and volume on a pro rata basis.

(Dollars in thousands)	2012 vs 2011		(Decrease) Increase
	Due to Change in Average Volume	Rate	
<b>Interest earning assets</b>			
Loans	\$ (429 )	\$ (46 )	\$ (475 )
Short-term and other investments	(7 )	(11 )	(18 )
<b>Total interest earning assets</b>	<b>(436 )</b>	<b>(57 )</b>	<b>(493 )</b>
<b>Interest bearing liabilities</b>			
Time certificates	(240 )	(96 )	(336 )
Savings deposits	1	(8 )	(7 )
Money market / checking deposits	21	(102 )	(81 )
Capital lease obligations	(1 )	(2 )	(3 )
Repurchase agreements	(1 )	—	(1 )
<b>Total interest bearing liabilities</b>	<b>(220 )</b>	<b>(208 )</b>	<b>(428 )</b>
Net interest income	\$ (216 )	\$ 151	\$ (65 )

The decrease in net interest income during the first six months of 2012 reflected a \$15.8 million decrease in total average interest earning asset balances to \$120.7 million for the six months ended June 30, 2012 compared to \$136.5 million for the same period of 2011 and a decrease in the yields on interest earning assets to 5.29% for the six months ended June 30, 2012 from 5.42% in the same period of 2011. The combined effects of these unfavorable changes were partially offset by favorable decreases in rates on interest bearing liabilities to 1.30% for the six months ended June 30, 2012 from 1.80% for the same period in 2011 as well as a \$22.4 million decrease in average interest bearing liabilities to \$92.8 million for the first six months of 2012 from \$115.2 million for the first six months of 2011. Overall, the decrease in net interest income attributed to volume changes was \$216,000, which was partially offset by a net increase attributed to interest rate changes of \$151,000. Interest income from interest earning assets in the first six months of 2012 when compared to the same period in 2011 decreased by \$493,000 because of the combined effects of a \$57,000 decrease due to a decline in interest rates and a \$436,000 decrease due to volume considerations. Variances in the cost of interest bearing liabilities during the six months ended June 30, 2012 in comparison to the same period in 2011 were due to decreased rate considerations of \$208,000 and decreased volume considerations of \$220,000.

The Company intends for the Bank to continue to emphasize lending to small to medium-sized businesses in its market area as it maintains its strategy to increase assets under management and to improve earnings. The Bank will seek opportunities through marketing to increase its deposit base, with a primary objective of attracting core non-interest checking and related money market deposit accounts, in order to support its earning assets and through the consideration of additional branch locations and new product and service offerings.

## Provision for Loan Losses

The Bank's provision for loan losses was \$180,000 and \$210,000 for the three months and six months ended June 30, 2012, respectively, as compared to a (credit to) provision for loan losses of (\$77,000) and \$666,000, respectively, for the same periods in 2011. The increase in the provision for loan losses was primarily related to an increase in net charge-offs during the second quarter of 2012 compared to the second quarter of 2011, including charge-offs against



specific reserves relating to four impaired loans during the three months ended June 30, 2012. These changes are in contrast to the credit to the provision for loan losses during the second quarter of 2011, which was primarily related to net decreases to the specific allowances on certain impaired loans resulting from payments received in excess of amounts previously estimated and the return to accrual status of one commercial real estate loan, for which a specific allowance of \$100,000 was reversed as the loan had performed for over one year and no allowance was considered necessary.

The decrease in the provision for loan losses during the six months ended June 30, 2012 when compared to the same period in the prior year was primarily related to one commercial loan secured by real estate that was severely impacted by prevailing economic conditions in 2011.

#### Noninterest Income

Total noninterest income increased \$12,000 to \$135,000 for the three months ended June 30, 2012 from \$123,000 for the same period in 2011. This increase was primarily due to a \$24,000 improvement in loan fees and other fee income recognized in the three months ended June 30, 2012 compared to the same period in 2011, which was partially offset by a \$12,000 decrease in service charges and fees due to changes in business practices of customers of the Bank during the second quarter of 2012 as compared to the same period in 2011.

Total noninterest income increased \$54,000 to \$311,000 for the six months ended June 30, 2012 from \$258,000 for the same period in 2011. This increase was primarily due to loan prepayment fees of \$45,000 and a \$10,000 increase in fair value of a derivative financial instrument recognized during the six months ended June 30, 2012, with no such revenue in the same period in 2011, as well as a \$36,000 increase in other noninterest income for the six months ended June 30, 2012 compared to the same period of 2011. The combined effect of these favorable changes were partially offset by a \$37,000 decrease in service charges and fees due to changes in business practices of customers of the Bank during the six months ended June 30, 2012 as compared to the same period in 2011.

#### Noninterest Expense

Total noninterest expense was \$1,342,000 for the three months ended June 30, 2012 compared to \$1,330,000 for the same period in 2011, an increase of \$12,000 or 0.9%.

Salaries and benefits expense increased \$43,000 to \$723,000 for the three months ended June 30, 2012 from \$680,000 for the same period in 2011. The increase in salaries and benefits expense during the second quarter of 2012 when compared to the second quarter of 2011 was primarily attributable to restricted stock compensation expense recorded by the Company based upon the vesting schedule for restricted stock granted to the Chief Executive Officer under his employment agreement and restricted stock agreement executed on February 28, 2012.

Occupancy and equipment expense decreased by \$25,000 to \$136,000 for the three months ended June 30, 2012 from \$161,000 for the same period in 2011 primarily due to declines in asset depreciation expense and lower repairs and maintenance expenditures.

Professional services expense increased by \$59,000 to \$115,000 for the three months ended June 30, 2012 from \$56,000 for the same period in 2011 due to increased costs for internal auditing and consulting services performed during the quarter ended June 30, 2012 compared to the same period in 2011.

Fees for data processing and other outside services declined \$42,000 to \$70,000 for the quarter ended June 30, 2012 from \$112,000 for the same period in 2011. The decrease was primarily due to benefits the Company continued to realize on the renewal of certain related service contracts in the fourth quarter of 2011.

Insurance expense increased by \$19,000 to \$32,000 for the three months ended June 30, 2012 from \$13,000 for the same period in 2011 primarily due to increased costs in 2012 associated with insurance policies that the Company had entered into during a more favorable environment in July 2008.

Directors' fees decreased by \$42,000 to \$43,000 for the three months ended June 30, 2012 from \$85,000 for the same period in 2011. The decrease was attributable to a reduction in fees paid to directors effective January 1, 2012 that was approved by the Company's compensation committee.

All other operating expenses aggregating \$223,000 were unchanged for the three months ended June 30, 2012 when compared to the same period in 2011.

Total noninterest expense was \$2,776,000 for the six months ended June 30, 2012 compared to \$2,692,000 for the same period in 2011, an increase of \$84,000 or 3.1%.

Salaries and benefits expense increased \$147,000 to \$1,527,000 for the six months ended June 30, 2012 from \$1,380,000 for the same period in 2011. The increase in salaries and benefits expense during the six months of 2012 when compared to same period in 2011 was primarily attributable to restricted stock compensation expense recorded by the Company based upon the vesting schedule for restricted stock granted to the Chief Executive Officer under his employment agreement and restricted stock agreement executed on February 28, 2012.

Occupancy and equipment expense decreased by \$46,000 to \$296,000 for the six months ended June 30, 2012 from \$342,000 for the same period in 2011 primarily due to declines in asset depreciation expense and lower repairs and maintenance expenditures.

Professional services expense increased by \$103,000 to \$277,000 for the six months ended June 30, 2012 from \$174,000 for the same period in 2011 due to increased expenditures for loan review and internal auditing and consulting services performed during the six months ended June 30, 2012 compared to the same period in 2011.

Fees for data processing and other outside services declined \$69,000 to \$137,000 for the six months ended June 30, 2012 from \$206,000 for the same period in 2011. The decrease was primarily due to benefits the Company continued to realize on the renewal of certain related service contracts in the fourth quarter of 2011.

Insurance expense increased by \$37,000 to \$65,000 for the six months ended June 30, 2012 from \$28,000 for the same period in 2011 primarily due to increased costs in 2012 associated with insurance policies that the Company had entered into during a more favorable environment in July 2008.

Directors' fees decreased by \$83,000 to \$79,000 for the six months ended June 30, 2012 from \$162,000 for the same period in 2011. The decrease was attributable to a reduction in fees paid to directors effective January 1, 2012 that was approved by the Company's compensation committee.

All other operating expenses decreased by \$5,000 to an aggregate amount of \$395,000 for the six months ended June 30, 2012 compared to \$400,000 for the same period in 2011.

#### Off-Balance Sheet Arrangements

See Note 8 to the Financial Statements for information regarding the Company's off-balance sheet arrangements.

#### Liquidity

Management believes the Company's short-term assets provide sufficient liquidity to cover potential fluctuations in deposit accounts and loan demand and to meet other anticipated operating cash and investment requirements.

The Company's liquidity position consisted of liquid assets totaling \$18.7 million and \$28.9 million, as of June 30, 2012 and December 31, 2011 respectively. This represented 14.7% and 19.8%, respectively, of total assets at June 30, 2012 and December 31, 2011. The liquidity ratio is defined as the percentage of liquid assets to total assets. The following categories of assets as described in the accompanying balance sheet are considered liquid assets: Cash and due from banks, short-term investments, interest-bearing certificates of deposit and securities available for sale. Liquidity is a measure of the Company's ability to generate adequate cash to meet financial obligations. The principal cash requirements of a financial institution are to cover downward fluctuations in deposits and increases in its loan portfolio.

In addition to the foregoing sources of liquidity, the Bank maintains a relationship with the Federal Home Loan Bank of Boston and has the ability to pledge certain of the Bank's assets as collateral for borrowings from that institution.

#### Capital

The Company's and Bank's actual capital amounts and ratios at June 30, 2012 and December 31, 2011 were as follows:

The Company's actual capital amounts and ratios at June 30, 2012 and December 31, 2011 were:

(Dollars in thousands)

June 30, 2012	Actual		For Capital Adequacy Purposes				To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio		
Total Capital to Risk-Weighted Assets	\$ 12,920	12.21 %	\$ 8,468	8.00 %	N/A	N/A		
Tier 1 Capital to Risk-Weighted Assets	11,586	10.95 %	4,234	4.00 %	N/A	N/A		
Tier 1 (Leverage) Capital to Average Assets	11,586	8.92 %	5,196	4.00 %	N/A	N/A		

  

December 31, 2011	Actual		For Capital Adequacy Purposes				To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio		
Total Capital to Risk-Weighted Assets	\$ 13,057	10.88 %	\$ 9,601	8.00 %	N/A	N/A		

Tier 1 Capital to Risk-Weighted Assets	11,546	9.62	%	4,800	4.00	%	N/A	N/A
Tier 1 (Leverage) Capital to Average Assets	11,546	7.41	%	6,236	4.00	%	N/A	N/A

The Bank's actual capital amounts and ratios at June 30, 2012 and December 31, 2011 were:

June 30, 2012	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions				
	Amount	Ratio	Amount	Ratio	Amount	Ratio			
Total Capital to Risk-Weighted Assets	\$12,101	11.44	%	\$8,461	8.00	%	\$10,577	10.00	%
Tier 1 Capital to Risk-Weighted Assets	10,768	10.18	%	4,231	4.00	%	6,346	6.00	%
Tier 1 (Leverage) Capital to Average Assets	10,768	8.33	%	5,171	4.00	%	6,464	5.00	%

December 31, 2011	Actual		For Capital Adequacy Purposes				To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio		
Total Capital to Risk-Weighted Assets	\$12,283	10.28 %	\$9,555	8.00 %	\$11,943	10.00 %		
Tier 1 Capital to Risk-Weighted Assets	10,780	9.03 %	4,777	4.00 %	7,166	6.00 %		
Tier 1 (Leverage) Capital to Average Assets	10,780	6.95 %	6,206	4.00 %	7,758	5.00 %		

Capital adequacy is one of the most important factors used to determine the safety and soundness of individual banks and the banking system. To be considered “well capitalized,” an institution must generally have a Tier 1 leverage ratio of at least 5%, a Tier 1 risk-based capital ratio of at least 6% and a total risk-based capital ratio of at least 10%. Based on the above ratios, the Bank is considered to be “well capitalized” under applicable regulations. As of June 30, 2012, the Bank’s Tier I leverage ratio, Tier I risk-based capital ratio and total risk-based capital ratios were above such minimums. However, in July 2012, the Bank entered into a Consent Order with the Federal Deposit Insurance Corporation and the State of Connecticut Department of Banking which, among other things, require it to maintain a minimum Tier 1 leverage ratio of at least 8.0%, a Tier 1 risk-based capital ratio of at least 9% and a total risk-based capital ratio of at least 10%. At June 30, 2012, the Bank’s capital ratios exceeded such minimums set forth in the Consent Order. In June 2012, the Bank submitted a revised capital plan outlining its strategy for increasing its capital amounts and ratios to the Federal Deposit Insurance Corporation and the State of Connecticut Department of Banking for their approval. Following receipt of regulatory approval, the Company and the Bank will seek to implement the plan to increase capital as soon as practicable. Further regulatory action is possible if the Bank does not maintain the minimum capital ratios set forth in the Consent Order.

#### Market Risk

Market risk is defined as the sensitivity of income to fluctuations in interest rates, foreign exchange rates, equity prices, commodity prices and other market-driven rates or prices. Based upon the nature of the Company’s business, market risk is primarily limited to interest rate risk, which is defined as the impact of changing interest rates on current and future earnings.

The Company’s goal is to maximize long-term profitability, while minimizing its exposure to interest rate fluctuations. The first priority is to structure and price the Company’s assets and liabilities to maintain an acceptable interest rate spread, while reducing the net effect of changes in interest rates. In order to reach an acceptable interest rate spread, the Company must generate loans and seek acceptable long-term investments to replace the lower yielding balances in Federal Funds sold and short-term investments. The focus also must be on maintaining a proper balance between the timing and volume of assets and liabilities re-pricing within the balance sheet. One method of achieving this balance is to originate variable loans for the portfolio to offset the short-term re-pricing of the liabilities. In fact, a number of the interest bearing deposit products have no contractual maturity. Customers may withdraw funds from their accounts at any time and deposits balances may therefore run off unexpectedly due to changing market conditions.

The exposure to interest rate risk is monitored by senior management of the Bank and reported quarterly to the Asset and Liability Management Committee and the Board of Directors. Management reviews the interrelationships within the balance sheet to maximize net interest income within acceptable levels of risk.

#### Impact of Inflation and Changing Prices

The Company's consolidated financial statements have been prepared in terms of historical dollars, without considering changes in relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effect of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. Notwithstanding this fact, inflation can directly affect the value of loan collateral, in particular, real estate. Inflation, or disinflation, could significantly affect the Company's earnings in future periods.

#### Factors Affecting Future Results

Some of the statements under "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this Report on Form 10-Q may include forward-looking statements which reflect our current views with respect to future events and financial performance. Statements which include the words "expect," "intend," "plan," "believe," "project," "anticipate" and similar statements of a future or forward-looking nature identify forward-looking statements for purposes of the federal securities laws or otherwise. All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in these statements or that could adversely affect the holders of our common stock. These factors include, but are not limited to, (1) changes in prevailing interest rates which would affect the interest earned on the Company's interest earning assets and the interest paid on its interest bearing liabilities, (2) the timing of re-pricing of the Company's interest earning assets and interest bearing liabilities, (3) the effect of changes in governmental monetary policy, (4) the impact of recently enacted federal legislation and the effect of changes in regulations applicable to the Company and the conduct of its business, (5) changes in competition among financial service companies, including possible further encroachment of non-banks on services traditionally provided by banks, (6) the ability of competitors which are larger than the Company to provide products and services which are impractical for the Company to provide, (7) the volatility of quarterly earnings, due in part to the variation in the number, dollar volume and profit realized from SBA guaranteed loan participation sales in different quarters, (8) the effect of a loss of any executive officer, key personnel, or directors, (9) the effect of the Company's opening of branches and the receipt of regulatory approval to complete such actions, (10) the concentration of the Company's business in southern and southeastern Connecticut, (11) the concentration of the Company's loan portfolio in commercial loans to small-to-medium sized businesses, which may be impacted more severely than larger businesses during periods of economic weakness, (12) lack of seasoning in the Company's loan portfolio, which may increase the risk of future credit defaults, and (13) the effect of any decision by the Company to engage in any business not historically permitted to it. Other such factors may be described in other filings made by the Company with the SEC.

Although the Company believes that it has the resources needed for success, future revenues and interest spreads and yields cannot be reliably predicted. These trends may cause the Company to adjust its operations in the future. Because of the foregoing and other factors, recent trends should not be considered reliable indicators of future financial results or stock prices.

Any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not required.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Based upon an evaluation of the effectiveness of the Company's disclosure controls and procedures performed by the Company's management, with participation of the Company's Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer as of the end of the period covered by this report, the Company's Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer concluded that the Company's disclosure controls and procedures have been effective in ensuring that material information relating to the Company, including its consolidated subsidiary, is made known to the certifying officers by others within the Company and the Bank during the period covered by this report.

As used herein, "disclosure controls and procedures" means controls and other procedures of the Company that are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in Internal Control over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting during the quarter ended June 30, 2012 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

Periodically, there have been various claims and lawsuits against the Company, such as claims to enforce liens, condemnation proceedings on properties in which the Company holds security interests, claims involving the making and servicing of real property loans and other issues incident to our business. However, neither the Company nor any subsidiary is a party to any pending legal proceedings that management believes would have a material adverse effect on the Company's financial condition, results of operations or cash flows.



Item 1A. Risk Factors

Not required.

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

None.

Item 3. Defaults Upon Senior Securities

None.

41

---

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit No.	Description
3(i)	Amended and Restated Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit 3(i) to the Registrant's Quarterly Report on Form 10-QSB filed on August 14, 2002)
3(ii)	By-Laws of the Registrant (incorporated by reference to Exhibit 3(ii) to the Registrant's Current Report on Form 8-K filed on March 6, 2007)
10.1	Change of Control Agreement, effective as of June 21, 2012, by and between The Bank of Southern Connecticut, and David Oliver (filed herewith)
<u>31.1</u>	<u>Rule 13a-14(a)/15d-14(a) Certification by Chief Executive Officer (filed herewith)</u>
<u>31.2</u>	<u>Rule 13a-14(a)/15d-14(a) Certification by Senior Vice President and Chief Financial Officer (filed herewith)</u>
<u>31.3</u>	<u>Rule 13a-14(a)/15d-14(a) Certification by Vice President and Chief Accounting Officer (filed herewith)</u>
<u>32.1</u>	<u>Section 1350 Certification by Chief Executive Officer (filed herewith)</u>
<u>32.2</u>	<u>Section 1350 Certification by Senior Vice President and Chief Financial Officer (filed herewith)</u>
<u>32.3</u>	<u>Section 1350 Certification by Vice President and Chief Accounting Officer (filed herewith)</u>
99.1	Consent Order, dated July 3, 2012(incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed on July 6, 2012)
99.2	Stipulation and Consent to the Issuance of a Consent Order, dated July 2, 2012(incorporated by reference to Exhibit 99.2 to the Registrant's Current Report on Form 8-K filed on July 6, 2012)
101.INS	XBRL Instance Document* (filed herewith)
101.SCH	XBRL Taxonomy Extension Schema Document* (filed herewith)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document* (filed herewith)
101.LAB	XBRL Taxonomy Extension Label Linkbase Document* (filed herewith)

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document\* (filed herewith)

101.DEF Taxonomy Extension Definitions Linkbase Document\* (filed herewith)

\*As provided in Rule 406T of Regulation S-T, this information is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, and is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

SIGNATURES

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

SOUTHERN CONNECTICUT BANCORP, INC.

Date: August 13, 2012

By:	/s/ Joseph J. Greco
Name:	Joseph J. Greco
Title:	Chief Executive Officer

Date: August 13, 2012

By:	/s/ Stephen V. Ciancarelli
Name:	Stephen V. Ciancarelli
Title:	Senior Vice President & Chief Financial Officer

Date: August 13, 2012

By:	/s/ Anthony M. Avellani
Name:	Anthony M. Avellani
Title:	Vice President & Chief Accounting Officer