DILLARD JOAN H
Form 4
February 22, 2011

FORM 4

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

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL

OMB Number:	3235-0287
Expires:	January 31, 2005
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(Print or Type Responses)

1. Name and Address of Reporting Person *
DILLARD JOAN H

(Last) (First) (Middle)

ALLIED WORLD ASSURANCE CO. HOLDINGS, AG, LINDENSTRASSE 8

(Street)

BAAR/ZUG, V8 CH-6340

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
Allied World Assurance Co Holdings, AG [AWH]

3. Date of Earliest Transaction (Month/Day/Year)
02/21/2011

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
EVP & CFO

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Shares	02/21/2011		A		37,500 (1)	A	$ 0	122,253	D	
Common Shares	02/22/2011		M		1,650	A	$ 0 (2)	123,903	D	
Common Shares	02/22/2011		D		660	D	$ 62.0515 (3)	123,243	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and An Underlying Se (Instr. 3 and 4)
								Date Exercisable	Expiration Date	Title
				Code	V	(A)	(D)			
Restricted Stock Units	(2)	02/22/2011		M			1,650 (2)	02/22/2011 (4)	02/22/2014 (4)	Common Shares
Restricted Stock Units	(5)	02/22/2011		A		1,980 (5)		(6)	(6)	Common Shares
Employee Stock Option (right to buy)	$ 61.51	02/22/2011		A		7,510		(6)	(6)	Common Shares

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
DILLARD JOAN H ALLIED WORLD ASSURANCE CO. HOLDINGS, AG LINDENSTRASSE 8 BAAR/ZUG, V8 CH-6340			EVP & CFO	

Signatures

/s/ Wesley D. Dupont, by Power of Attorney	02/22/2011
**Signature of Reporting Person	Date

Explanation of Responses:

*	If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).
**	Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).
(1)	Represents the Company's Common Shares that were earned pursuant to a 2008 LTIP award for no monetary consideration and which vested at 150% of target based on the achievement of pre-established performance criteria during the applicable three-year performance period established under the Company's Third Amended and Restated Long-Term Incentive Plan.
(2)	On February 22, 2010, the reporting person was granted 6,600 Restricted Stock Units for no monetary consideration. The Restricted Stock Units convert into (i) 3,960 of the Company's Common Shares and (ii) cash equal to the market value of 2,640 Common Shares (measured at the date of vesting) upon the vesting of such Restricted Stock Units.
(3)	The fair market value of the cash portion was determined using the daily volume-weighted average sales price of the Company's Common Shares for the five consecutive trading days up to and including February 22, 2011.
(4)	The Restricted Stock Units vest in four equal installments with the first installment vesting on February 22, 2011.
(5)	Grant of Restricted Stock Units for no monetary consideration. 1,980 Restricted Stock Units convert into (i) 990 of the Company's Common Shares and (ii) cash equal to the market value of 990 Common Shares (measured at the date of vesting) upon the vesting of such Restricted Stock Units.
(6)	The Restricted Stock Units and Employee Stock Options vest in four equal installments with the first installment vesting on February 22, 2012.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
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26

33

Other securities

58

163

102

242

Total interest and dividends on securities

	2,304
	2,872
	4,693
	5,863
Interest on interest-bearing deposits and federal funds sold	
	36
	31
	62
	67
Total interest income	
	11,283
	14,389
	22,791
	29,548

Interest expense

Deposits

Interest-bearing demand

539

863

1,151

	1,895
Savings	
	87
	128
	182
	257
Time ($100,000 and over)	
	664
	881
	1,362
	1,812
Other time	
	1,167
	1,794

2,408

3,734

Total interest on deposits

2,457

3,666

5,103

7,698

Interest on borrowed funds

Interest on FHLB advances

797

	1,347
	1,666
	2,798
Interest on subordinated debentures	
	569
	569
	1,131
	1,108
Interest on junior subordinated debentures	
	51
	51
	102
	101
Total interest on borrowed funds	

	1,417
	1,967
	2,899
	4,007
Total interest expense	
	3,874
	5,633
	8,002
	11,705
Net interest income before provision for loan and lease losses	
	7,409
	8,756
	14,789
	17,843

Provision for loan and lease losses

765

4,574

2,509

9,682

Net interest income after provision for loan and lease losses

6,644

4,182

12,280

8,161

Non-interest income (loss)

Service charges	783	835	1,510	1,648
Net gain (loss) on the sale of securities	2,302	(21)	2,302	1,175
Gross other-than-temporary impairment (OTTI) losses	(479)	(2,938		

)

(209

)

(11,173

)

Portion of (gain) loss recognized in OCI (before taxes)

130

382

(140

)

8,271

Other-than-temporary-impairment losses recognized in earnings

(349

)

(2,556

)

(349

)

(2,902

)

Net gain on the sale of loans held for sale

123

155

298

403

Net gain on the sale of other real estate owned

23

48

2,567

48

Net gain on the sale of other assets

19

28

20

28

Bank owned life insurance income

199

186

395

383

Other

357

394

696

777

Total non-interest income (loss)

3,457

(931

)

7,439

1,560

Non-interest expense	
Salaries and employee benefits	
	3,459
	3,229
	6,855
	6,337
Occupancy expense	
	821
	517
	1,498

	1,164
Equipment expense	
	409
	454
	794
	886
Advertising expense	
	182
	214
	343
	333
Data processing expense	
	518
	568

1,019

982

FDIC assessment

587

502

1,376

971

Bank shares tax

276

255

552

510

Expense of other real estate

121

1,170

688

1,305

Provision for off-balance sheet commitments

43

(24

)

(191

)

30

Legal expense

1,103

133

1,401

281

Professional fees

	1,206
	206
	3,445
	500
Insurance expense	
	98
	75
	197
	155
Other operating expenses	
	1,089
	1,147
	2,079
	2,287

Total non-interest expense

9,912

8,446

20,056

15,741

Income (loss) before income taxes

189

(5,195

)

(337

)

(6,020

)

Provision for income taxes

Net Income (loss)

$

189

$

(5,195

)

$

(337

)

$

(6,020

)

Income (Loss) Per Share

Basic

$

0.01

$

(0.32

)

$

(0.02

)

$

(0.37

)

Diluted

$

0.01

$

(0.32

)

$

(0.02

)

$

(0.37

)

Cash Dividends Declared Per Common Share

$

$

$

$

WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:

Basic	
	16,440,190
	16,306,670
	16,437,491
	16,300,515
Diluted	
	16,440,190

16,306,670
16,437,491
16,300,515

The accompanying notes to consolidated financial statements are an integral part of these statements.

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FIRST NATIONAL COMMUNITY BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

For the Six Months Ended June 30, 2011 and 2010 (in thousands)

(Unaudited)

	Number of Common Shares	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Shareholders Equity
BALANCES, DECEMBER 31, 2009	16,289,970	$ 20,362	$ 61,190	$ (6,162)	**$ (12,306)**	$ 63,084
Net loss for the period				(6,020)		(6,020)
Other comprehensive income, net of tax:						
Net change in unrealized gains and losses on securities available for sale (AFS), net of taxes of $10,886					20,220	
Non-credit related losses on OTTI securities not expected to be sold, net of taxes of $9,649					(17,920)	
Reclassification adjustment for gains and (losses) included in net loss, net of tax of $411					764	
Other comprehensive income					3,064	3,064
Total comprehensive loss						(2,956)
Proceeds from issuance of common shares through dividend reinvestment plan	25,635	33	81			114
Balances, June 30, 2010	16,315,605	$ 20,395	$ 61,271	$ (12,182)	$ (9,242)	$ 60,242
BALANCES, DECEMBER 31, 2010	16,433,020	$ 20,541	$ 61,539	$ (37,882)	$ (12,143)	$ 32,055
Net loss for the period				(337)		(337)
Other comprehensive income, net of tax:						
Net change in unrealized gains and losses on securities available for sale (AFS), net of tax of $3,097					6,012	
Non-credit related losses on OTTI securities not expected to be sold, net of tax of $71					138	
Reclassification adjustment for losses included in net loss, net of tax of $664					(1,289)	
Other comprehensive income					4,861	4,861
Total comprehensive income						4,524
Proceeds from issuance of common shares through dividend reinvestment plan	8,299	10	17			27
Balances, June 30, 2011	16,441,319	$ 20,551	$ 61,556	$ (38,219)	$ (7,282)	$ 36,606

The accompanying notes to consolidated financial statements are an integral part of these statements.

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Explanation of Responses:

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FIRST NATIONAL COMMUNITY BANCORP, INC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	Six months ended June 30,	
(in thousands)	**2011**	**2010**
Cash Flows from Operating Activities:		
Net loss	$ (337)	$ (6,020)
Adjustments to Reconcile Net loss to Net Cash Provided by Operating Activities:		
Investment securities accretion, net	(754)	(1,402)
Equity in trust	(1)	(2)
Depreciation and amortization	750	881
Provision for loan and lease losses	2,509	9,682
Provision for off balance sheet commitments	(191)	30
Provision for deferred taxes		2,137
Net gain on sale of investment securities	(2,302)	(1,175)
Other-than temporary impairment losses	349	2,902
Net gain on the sale of loans held for sale	(298)	(403)
Net gain on the sale of other real estate owned	(2,567)	(48)
Write-down of other real estate owned	266	896
Gain on the sale of other assets	(20)	(28)
Bank owned life insurance income	(395)	(383)
Proceeds from the sale of loans held for sale	15,512	17,680
Funds used to originate loans held for sale	(13,460)	(17,396)
Increase (decrease) in interest payable	669	(360)
Increase (decrease) in other liabilities	378	(528)
Decrease in interest receivable	319	339
Increase in refundable federal income taxes	(2)	
Decrease in prepaid expenses and other assets	4,388	797
Net Cash Provided by Operating Activities	4,813	7,599
Cash Flows from Investing Activities:		
Investment Securities:		
Proceeds from maturities, calls and principal payments	14,869	17,502
Proceeds from sales	16,103	25,548
Purchases		(38,769)
Purchases of Federal Reserve Bank stock		(336)
Redemption of FHLB stock	1,005	
Net decrease in loans to customers	26,899	41,194
Proceeds from the sale of other real estate owned	6,101	357
Purchases of bank premises and equipment	(517)	(746)
Proceeds from the sale of bank premises and equipment	32	97
Net Cash Provided by Investing Activities	64,492	44,847
Cash Flows from Financing Activities:		
Net decrease in demand deposits, money market demand, interest-bearing demand accounts, and savings accounts	(19,346)	(12,514)
Net decrease in time deposits	(30,388)	(37,313)
Proceeds from issuance of subordinated debentures		1,900
Proceeds from FHLB advances	97,947	94,305
Repayment of FHLB advances	(134,006)	(102,559)
Repayment of other borrowed funds	(227)	(21)
Proceeds from issuance of common shares - dividend reinvestment plan	27	112
Net Cash Used by Financing Activities	(85,993)	(56,090)

Net Decrease in Cash and Cash Equivalents		(16,688)		(3,644)
Cash & Cash Equivalents at Beginning of Period		74,505		86,364
Cash & Cash Equivalents at End of Period	$	57,817	$	82,720
Supplemental Cash Flow Information				
Cash paid during the period for:				
Interest	$	7,333	$	12,065
Other transactions:				
Principal balance of loans transferred to OREO		2,356		5,043
Transfer from other assets to loans held for sale		830		
Transfer from loans held for sale to loans		1,803		119

The accompanying notes to consolidated financial statements are an integral part of these statements.

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FIRST NATIONAL COMMUNITY BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Notes to Consolidated Financial Statements

Note 1. Basis of Presentation

The consolidated financial statements are comprised of First National Community Bancorp, Inc. and its wholly owned subsidiary, First National Community Bank (the Bank) as well as the Bank s wholly-owned subsidiaries (collectively the Company). All inter-company transactions and balances have been eliminated. The accounting and reporting policies of the Company conform to U.S. Generally Accepted Accounting Principles (GAAP) and general practices within the financial services industry. In the opinion of management, all adjustments necessary to a fair statement of the results for the quarterly period ended June 30, 2011 have been included.

In preparing the consolidated financial statements, management has made estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated statements of financial condition and results of operations for the periods indicated. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to change are the allowance for loan and lease losses (ALLL), security valuations, the evaluation of deferred income taxes, and the impairment of securities. The current economic environment has increased the degree of uncertainty inherent in these material estimates.

These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s December 31, 2010 audited financial statements filed on Form 10-K and the Company s March 31, 2011 unaudited financial statements filed on Form 10-Q.

Note 2. New Authoritative Accounting Guidance

In January 2010, the FASB issued an update (Accounting Standards Update No. 2010-06, *Improving Disclosures about Fair Value Measurements*). The update provides clarification regarding existing disclosures and requires additional disclosures regarding fair value measurements. Specifically, the guidance now requires reporting entities to disclose the amounts of significant transfers between levels and the reasons for the transfers. In addition, the reconciliation should present separate information about purchases, sales, issuances and settlements. A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value. The new standard is effective for reporting periods beginning after December 15, 2009 except for disclosures about purchases, sales, issuances and settlements which are not effective until reporting periods beginning after December 15, 2010. The adoption of this guidance did not have a material impact on the Company s consolidated financial statements. The disclosures required by this update are included in Note 7 to the consolidated financial statements.

In July 2010, the FASB issued an update (Accounting Standards Update No. 2010-20, *Receivables, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*). This update expands the disclosures that an entity must provide about the credit quality of its financing receivables and the related allowance for credit losses. As a result of these amendments, an entity is required to disaggregate, by portfolio segment or class, certain existing disclosures, and to provide certain new disclosures about its financing receivables and related allowances for credit losses. The disclosures as of the end of a reporting period were effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period were effective for interim and annual reporting periods beginning on or after December 15, 2010. The amendment does not require comparative disclosures for earlier reporting periods that ended before adoption; however, an entity should provide comparative disclosures for those reporting periods after initial adoption. The adoption of this amendment did not have a material effect on the Company s consolidated financial statements. The disclusures required by this update are included in Note 4 to the consolidated financial statements.

In January 2011, the FASB issued an update (Accounting Standards Update No. 2011-01, *Receivables*) which temporarily delayed the effective date of the disclosures about trouble debt restructurings in Update 2010-20 for public entities. The delay was intended to allow the Board time to complete its deliberations on what constitutes a trouble debt restructuring. The effective date of the new disclosures about troubled debt restructurings and the guidance for determining what constitutes a troubled debt restructuring was effective for interim and annual periods ending after June 15, 2011.

In April 2011, the FASB issued an update (Accounting Standards Update No. 2011-02, *A Creditor s Determination of Whether a Restructuring is a Troubled Debt Restructuring*) which clarifies when creditors should classify loan modifications as troubled debt

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restructurings. The new guidance was effective for interim and annual periods beginning on or after June 15, 2011, and applies retrospectively to restructurings occurring on or after January 1, 2011. A provision in Update 2011-02 also ends the FASB s deferral of the additional disclosures about troubled debt restructurings as required by Update 2010-20. The Company elected to adopt Update 2011-02 in the quarter ending March 31, 2011. The adoption of this update did not have a material impact on the Company s consolidated financial statements.

Accounting Guidance to be Adopted In Future Periods

In May 2011, the FASB issued an update (Accounting Standards Update 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*). This update results in common fair value measurement and disclosure requirements among U.S. GAAP and International Financial Reporting Standards. The amendments in Update 2011-04 include clarifications about the application of existing fair value measurement requirements and changes to principles for measuring fair value. This update also requires additional disclosures about fair value measurements, is required to be applied prospectively, and is effective for interim and annual periods beginning after December 15, 2011. The Company is currently evaluating the impact of adoption of Update 2011-04 on the Company s consolidated financial statements.

In June 2011, the FASB issued an update (Accounting Standards Update 2011-05, *Presentation of Comprehensive Income*). This update was issued to improve the comparability, consistency and transparency of financial reporting. The amendment provides the entity an option to present the total of comprehensive income 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. Update 2011-05 is required to be applied retrospectively and is effective for interim and annual periods beginning after December 15, 2011. Update 2011-05 is an update only for presentation and as such will not impact the Company s consolidated financial statements.

In December 2011, the FASB issued an update (Accounting Standards Update No. 2011-11, *Disclosures about Offsetting Assets and Liabilities*). The objective of this update is to provide enhanced disclosures that will enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on an entity s financial position. This includes the effect or potential effect of rights of setoff associated with an entity s recognized assets and recognized liabilities within the scope of this update. The amendments require enhanced disclosures by requiring expanded information about financial instruments and derivative instruments that are either (1) offset in accordance with either Section 210-20-45 or Section 815-10-45 or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with either Section 210-20-45 or Section 815-10-45. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented.

In December 2011, the FASB issued ASU No. 2011-12 - Comprehensive Income (Topic 220) Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU No. 2011-05. This update defers only those changes in ASU No. 2011-05 that relate to the presentation of reclassification adjustments, the paragraphs in this update supersede certain pending paragraphs in ASU No. 2011-05. All other requirements in ASU No. 2011-05 are not affected by this update, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011.

Reclassification of Prior Year Financial Statements

Certain reclassifications have been made to the prior year s consolidated financial statements to conform to the current year s presentation. Such reclassifications had no impact on results of operations.

Note 3. Regulatory Matters

The Bank is under a Consent Order (the Order) from the Office of the Comptroller of the Currency (OCC) dated September 1, 2010. The Company is also subject to a written Agreement (the Agreement) with the Federal Reserve Bank of Philadelphia (the Reserve Bank) dated November 24, 2010.

OCC Consent Order. The Bank, pursuant to a Stipulation and Consent to the Issuance of a Consent Order dated September 1, 2010 without admitting or denying any wrongdoing, consented and agreed to the issuance of the Order by the OCC, the Bank s primary

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regulator. The Order requires the Bank to undertake certain actions within designated timeframes, and to operate in compliance with the provisions thereof during its term. The Order is based on the results of an examination of the Bank as of March 31, 2009. Since the examination, management has engaged in discussions with the OCC and has taken steps to improve the condition, policies and procedures of the Bank. Compliance with the Order is to be monitored by a committee (the Committee) of at least three directors, none of whom is an employee or controlling shareholder of the Bank or its affiliates or a family member of any such person. The Committee is required to submit written progress reports on a monthly basis and the Agreement requires the Bank to make periodic reports and filings with the OCC. The members of the Committee are John P. Moses, Joseph Coccia, Joseph J. Gentile and Thomas J. Melone. The material provisions of the Order are as follows:

(i) By October 31, 2010, the Board of Directors of the Bank (the Board) is required to adopt and implement a three-year strategic plan which must be submitted to the OCC for review and prior determination of no supervisory objection; the strategic plan must establish objectives for the Bank s overall risk profile, earnings performance, growth, balance sheet mix, off-balance sheet activities, liability structure, capital adequacy, reduction in the volume of nonperforming assets, product line development, and market segments that the Bank intends to promote or develop, and is to include strategies to achieve those objectives; if the strategic plan involves the sale or merger of the Bank, it must address the timeline and steps to be followed to provide for a definitive agreement within 90 days after the receipt of a determination of no supervisory objection;

(ii) by October 31, 2010, the Board is required to adopt and implement a three year capital plan, which must be submitted to the OCC for review and prior determination of no supervisory objection;

(iii) by November 30, 2010, the Bank is required to achieve and thereafter maintain a total risk-based capital equal to at least 13% of risk-weighted assets and a Tier 1 capital equal to at least 9% of adjusted total assets;

(iv) the Bank may not pay any dividend or capital distribution unless it is in compliance with the higher capital requirements required by the Order, the Capital Plan, applicable legal requirements and, then only after receiving a determination of no supervisory objection from the OCC;

(v) by November 15, 2010, the Committee must review the Board and the Board s committee structure; by November 30, 2010, the Board must prepare or cause to be prepared an assessment of the capabilities of the Bank s executive officers to perform their past and current duties, including those required to respond to the most recent examination report, and to perform annual performance appraisals of each officer;

(vi) by October 31, 2010, the Board must adopt, implement and thereafter ensure compliance with a comprehensive conflict of interest policy applicable to the Bank s and the Company s directors, executive officers, principal shareholders and their affiliates and such person s immediate family members and their related interests, employees, and by November 30, 2010, conduct a review of existing relationships with such persons to identify those, if any, not in compliance with the policy; and review all subsequent proposed transactions with such persons or modifications of transactions;

(vii) by October 31, 2010, the Board must develop, implement and ensure adherence to policies and procedures for Bank Secrecy Act (BSA) compliance; and account opening and monitoring procedures compliance;

(viii) by October 31, 2010, the Board must ensure the BSA audit function is supported by an adequately staffed department or third party firm; adopt, implement and ensure compliance with an independent BSA audit; and assess the capabilities of the BSA officer and supporting staff to perform present and anticipated duties;

(ix) by October 31, 2010, the Board is required to adopt, implement and ensure adherence to a written credit policy, including specified features, to improve the Bank s loan portfolio management;

(x) the Board is required to take certain actions to resolve certain credit and collateral exceptions;

(xi) by October 31, 2010, the Board is required to establish an effective, independent and ongoing loan review system to review, at least quarterly, the Bank s loan and lease portfolios to assure the timely identification and categorization of problem credits; by October 31, 2010, to adopt and adhere to a program for the maintenance of an adequate ALLL, and to review the adequacy of the Bank s ALLL at least quarterly;

(xii) by October 31, 2010, the Board must adopt and the Bank implement and adhere to a program to protect the Bank s interest in criticized assets; and the Bank may only extend additional credit (including renewals) to a borrower whose loans are criticized under specified circumstances;

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(xiii) by October 31, 2010, the Board must adopt and ensure adherence to action plans for each piece of other real estate owned;

(xiv) by November 30, 2010, the Board is required to develop, implement and ensure adherence to a policy for effective monitoring and management of concentrations of credit;

(xv) by October 31, 2010, the Board must revise and implement the Bank s other than temporary impairment policy;

(xvi) by October 31, 2010, the Board must take action to maintain adequate sources of stable funding and liquidity and a contingency funding plan; by October 31, 2010, the Board is required to adopt, implement and ensure compliance with an independent, internal audit program; and

(xvii) take actions to correct cited violations of law; and adopt procedures to prevent future violations and address compliance management.

Federal Reserve Agreement. On November 24, 2010, the Company entered into a written Agreement (the Agreement) with the Federal Reserve Bank of Philadelphia (the Reserve Bank). The Agreement requires the Company to undertake certain actions within designated timeframes, and to operate in compliance with the provisions thereof during its term. The material provisions of the Agreement include the following:

(i) the Company s Board must take appropriate steps to fully utilize the Company s financial and managerial resources to serve as a source of strength to the Bank, including taking steps to ensure that the Bank complies with its Consent Order entered into with the OCC;

(ii) the Company may not declare or pay any dividends without the prior written approval of the Reserve Bank and the Director of the Division of Banking Supervision and Regulation (the Director) of the Federal Reserve Board;

(iii) the Company may not take dividends or other payments representing a reduction of the Bank s capital without the prior written approval of the Reserve Bank;

(iv) the Company and its nonbank subsidiary may not make any payment of interest, principal or other amounts on the Company s subordinated debentures or trust preferred securities without the prior written approval of the Reserve Bank and the Director;

(v) the Company may not make any payment of interest, principal or other amounts on debt owed to insiders of the Company without the prior written approval of the Reserve Bank and Director;

(vi) the Company and its nonbank subsidiary may not incur, increase or guarantee any debt without the prior written approval of the Reserve Bank;

(vii) the Company may not purchase or redeem any shares of its stock without the prior written approval of the Reserve Bank;

(viii) the Company must submit to the Reserve Bank, by January 23, 2011, an acceptable written plan to maintain sufficient capital at the Company on a consolidated basis. Thereafter, the Company must notify the Reserve Bank within 45 days of the end of any quarter in which the Company s capital ratios fall below the approved capital plan s minimum ratios, and submit an acceptable written plan to increase the Company s capital ratios above the capital plan s minimums;

(ix) the Company must immediately take all actions necessary to ensure that: (1) each regulatory report accurately reflects the Company s condition on the date for which it is filed and all material transactions between the Company and its subsidiaries; (2) each such report is prepared in accordance with its instructions; and (3) all records indicating how the report was prepared are maintained for supervisory review;

(x) the Company must submit to the Reserve Bank, by January 23, 2011, acceptable written procedures to strengthen and maintain internal controls to ensure all required regulatory reports and notices filed with the Board of Governors are accurate and filed in accordance with the instructions for preparation;

(xi) the Company must submit to the Reserve Bank, by January 8, 2011, a cash flow projection for 2011, reflecting the Company s planned sources and uses of cash, and submit a cash flow projection for each subsequent calendar year at least one month prior to the beginning of such year;

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(xii) the Company must comply with: (1) the notice provisions of Section 32 of the FDI Act and Subpart H of Regulation Y in appointing any new director or senior executive officer or changing the duties of any senior executive officer; and (2) the restrictions on indemnification and severance payments of Section 18(k) of the FDI Act and Part 359 of the FDIC s regulations; and

(xiii) the Board must submit written progress reports within 30 days of the end of each calendar quarter.

The Order and Agreement have not and are not expected to have an impact on the Company s ability to attract and maintain deposits or the Company s cost of funds. In order to meet the increased capital requirements imposed under the Order and the Agreement, however, unless the Company is able to raise additional capital, the Company could be limited in the aggregate amount of loans it can have outstanding, which may constrain loan growth. While it is not anticipated that the Order and the Agreement will have an immediate impact on the Company s net interest margin, the overall cost of compliance with the Order and the Agreement will continue to impact profitability at least through the end of 2012.

Banking regulations also limit the amount of dividends that may be paid without prior approval of the Bank s regulatory agency. As of August 10, 2012, the Company and the Bank are restricted from paying any dividends, without regulatory approval.

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

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined).

In accordance with the Order, the Bank is required to achieve and thereafter maintain a total risk-based capital equal to at least 13% of risk-weighted assets and a Tier 1 capital equal to at least 9% of adjusted total assets. At June 30, 2011, the Bank did not meet these requirements. The minimum capital requirements under the Order take precedence over the standard regulatory capital adequacy definitions described in the tables below. The Company s and the Bank s actual capital positions and ratios at June 30, 2011 and December 31, 2010 are presented in the following table:

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CAPITAL ANALYSIS

(In thousands)	June 30, 2011	December 31, 2010
Company		
Tier I Capital:		
Total Tier I Capital	$ 52,956	$ 53,297
Tier II Capital:		
Subordinated notes	25,000	25,000
Allowable portion of allowance for loan losses	10,228	11,201
Total Tier II Capital	35,228	36,201
Total Risk-Based Capital	88,184	89,498
Total Risk Weighted Assets	$ 804,126	$ 883,887
Bank		
Tier I Capital:		
Total Tier I Capital	$ 76,550	$ 75,659
Tier II Capital:		
Allowable portion of allowance for loan losses	10,223	11,197
Total Tier II Capital	10,223	11,197
Total Risk-Based Capital	86,773	86,856
Total Risk Weighted Assets	$ 803,772	$ 883,535

(in thousands)	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provision	
At June 30, 2011	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to Risk Weighted Assets)						
Company	$ 88,184	10.97%	$ >64,330	>8.00%	N/A	N/A
Bank	$ 86,773	10.80%	$ >64,302	>8.00%	$ >80,377	>10.00%
Tier I Capital (to Risk Weighted Assets)						
Company	$ 52,956	6.59%	$ >32,165	>4.00%	N/A	N/A
Bank	$ 76,550	9.52%	$ >32,151	>4.00%	$ >48,226	>6.00%
Tier I Capital (to Average Assets)						
Company	$ 52,956	4.60%	$ >46,054	>4.00%	N/A	N/A
Bank	$ 76,550	6.65%	$ >46,040	>4.00%	$ >57,550	>5.00%

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(in thousands) At December 31, 2010		Actual Amount	Ratio		For Capital Adequacy Purposes Amount	Ratio		To Be Well Capitalized Under Prompt Corrective Action Provision Amount	Ratio
Total Capital (to Risk Weighted Assets)									
Company	$	89,499	10.13%	$	>70,711	>8.00%		N/A	N/A
Bank	$	86,856	9.83%	$	>70,683	>8.00%	$	>88,354	>10.00%
Tier I Capital (to Risk Weighted Assets)									
Company	$	53,297	6.03%	$	>35,535	>4.00%		N/A	N/A
Bank	$	75,659	8.56%	$	>35,341	>4.00%	$	>53,012	>6.00%
Tier I Capital (to Average Assets)									
Company	$	56,297	4.27%	$	>49,964	>4.00%		N/A	N/A
Bank	$	75,659	6.06%	$	>49,950	>4.00%	$	>62,438	>5.00%

Note 4. Loans

Loans receivable, net, consists of the following at June 30, 2011 and December 31, 2010:

(in thousands)		June 30, 2011		December 31, 2010
Residential real estate	$	85,159	$	87,925
Commercial real estate		275,715		256,327
Construction, land acquisition and development		46,742		77,395
Commercial and industrial		188,412		197,697
Consumer		106,622		110,853
State and political subdivisions		23,132		27,739
Total loans, gross		725,782		757,936
Unearned discount		(191)		(332)
Net deferred loan fees and costs		586		784
Allowance for loan and lease losses		(23,701)		(22,575)
Loans, net	$	702,476	$	735,813

The Company has granted loans, letters of credit and lines of credit to certain executive officers and directors of the Company as well as to certain related parties of executive officers and directors. See Note 9 to these consolidated financial statements for more information about related party transactions.

The Company originates one-to-four family mortgage loans primarily for sale in the secondary market. During the three and six month period ended June 30, 2011, the Company sold $3.5 and $15.2 million, respectively, of one-to-four family mortgages. The Company retains servicing rights on these mortgages.

The Company had $1.8 million and $3.6 million in loans held-for-sale at June 30, 2011 and December 31, 2010, respectively. All loans held for sale are one-to-four family residential mortgage loans.

The Company does not have any lending programs commonly referred to as subprime lending. Subprime lending generally targets borrowers with weakened credit histories typically characterized by payment delinquencies, previous charge-offs, judgments, bankruptcies, or borrowers with questionable repayment capacity as evidenced by low credit scores or high debt-burden ratios.

See Note 2 to the Company s consolidated financial statements included in the 2010 Form 10-K for the risk characteristics related to the Company s loan segments.

The Company provides for loan losses based on the consistent application of its documented ALLL methodology. Loan losses are charged to the ALLL and recoveries are credited to it. Additions to the ALLL are provided by charges against income based on various factors which, in management s judgment, deserve current recognition of estimated probable losses. Loan losses are charged-

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off in the period the loans, or portions thereof, are deemed uncollectible. Generally, the Company will record a loan charge-off (including a partial charge-off) to reduce a loan to the estimated recoverable amount based on its methodology detailed below. The Company regularly reviews the loan portfolio and makes adjustments for loan losses in order to maintain the ALLL in accordance with U.S. GAAP. The ALLL consists primarily of the following two components:

(1) Specific allowances are established for impaired loans (defined by the Company as all loans with an outstanding balance greater than $100,000 rated doubtful or substandard and on non-accrual status and all TDRs). The amount of impairment provided for as an allowance is represented by the deficiency, if any, between the carrying value of the loan and either (a) the present value of expected future cash flows discounted at the loan s effective interest rate, (b) the loan s observable market price, or (c) the fair value of the underlying collateral, less estimated costs to sell, for collateral dependent loans. Impaired loans that have no impairment losses are not considered for general valuation allowances described below. If the Company determines that collection of the impairment amount is remote, the Company will record a charge-off.

(2) General allowances are established for loan losses on a portfolio basis for loans that do not meet the definition of impaired. The Company divides its portfolio into loan segments, with loans exhibiting similar characteristics. These segments are further disaggregated into classes. Loans rated special mention or substandard and accruing which are embedded in these loan segments are then separated from them. These separated loans are then subject to an analysis placing increased emphasis on the credit risk associated with these specific loans. The Company applies an estimated loss rate to each loan group. The loss rates applied are primarily based on the Company s own historical loss experience based on the loss rate for each group of loans with similar risk characteristics in its portfolio. In addition management evaluates and applies certain qualitative or environmental factors that are likely to cause estimated credit losses associated with the Company s existing portfolio that may differ from historical experience, which are discussed below. This evaluation is inherently subjective, as it requires material estimates that may be susceptible to significant revisions based upon changes in economic and real estate market conditions. Actual loan losses may be significantly more than the ALLL that is established, which could have a material negative effect on the Company s financial results.

In underwriting a loan secured by real property (unless exempt based on legal requirements), the Company requires an appraisal of the property by an independent licensed appraiser approved by the Company s Board of Directors. The appraisal is either reviewed internally or by an independent third party hired by the Company. Generally, management obtains updated appraisals when a loan is deemed impaired. These appraisals may be more limited than those prepared for the underwriting of a new loan. In addition, when the Company acquires OREO upon foreclosure, it generally obtains a current appraisal to substantiate the net carrying value of the asset.

Management makes adjustments for loan losses based on its evaluation of several qualitative and environmental factors, including but not limited to:

- Changes in national, local, and business economic conditions and developments, including the condition of various market segments;
- Changes in the nature and volume of the Company s loan portfolio;
- Changes in the Company s lending policies and procedures, including underwriting standards, collection, charge-off and recovery practices and results;
- Changes in the experience, ability and depth of the Company s lending management and staff;

- Changes in the quality of the Company s loan review system and the degree of oversight by the Company s Board of Directors;

- Changes in the trend of the volume and severity of past due and classified loans, including trends in the volume of non-accrual loans, troubled debt restructurings and other loan modifications;

- The existence and effect of any concentrations of credit and changes in the level of such concentrations;

- The effect of external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the Company s current loan portfolio; and

- Analysis of its customers credit quality.

Management evaluates the ALLL based on the combined total of the impaired and general components. Generally, when the loan portfolio increases, absent other factors, the Company s ALLL methodology results in a higher dollar amount of estimated probable losses. Conversely, when the loan portfolio decreases, absent other factors, the Company s ALLL methodology results in a lower dollar amount of estimated probable losses.

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Each quarter, management evaluates the ALLL and adjusts the ALLL as appropriate through a provision for loan losses. While the Company uses the best information available to make evaluations, future adjustments to the ALLL may be necessary if conditions differ substantially from the information used in making the evaluations. In addition, as an integral part of its examination process, the Office of the Comptroller of the Currency periodically reviews the Company s ALLL. The OCC may require the Company to adjust the ALLL based on its analysis of information available to it at the time of its examination.

The following tables set forth activity in the ALLL, by loan type, for the three and six months ended June 30, 2011:

	Real Estate			Commercial & Industrial		Consumer			
(in thousands)	Residential Real Esate	Commercial Real Estate	Construction, Land Acquisition & Development	Solid Waste Landfills	Other	Indirect Auto	Installment/ HELOC	State and Political Subdivisions	Total
Three Months Ended June 30, 2011:									
Allowance for loan losses:									
Beginning Balance, April 1, 2011	$ 2,241	$ 10,860	$ 4,623	$ 16	$ 4,643	$ 581	$ 576	$ 690	$ 24,230
Charge-offs	(145)	(1,377)			(15)	(104)	(13)		(1,654)
Recoveries	7	11	117		173	51			359
Provisions	135	2,092	(1,077)		(126)	37	44	(339)	766
Ending Balance, June 30, 2011	$ 2,238	$ 11,586	$ 3,663	$ 16	$ 4,675	$ 565	$ 607	$ 351	$ 23,701
Six Months Ended June 30, 2011:									
Allowance for loan losses:									
Beginning Balance, January 1, 2011	$ 2,176	$ 9,640	$ 4,170	$ 11	$ 4,839	$ 597	$ 576	$ 566	$ 22,575
Charge-offs	(281)	(1,833)	(6)		(124)	(232)	(105)		(2,581)
Recoveries	14	24	823		247	89	1		1,198
Provisions	329	3,755	(1,324)	5	(287)	111	135	(215)	2,509
Ending Balance, June 30, 2011	$ 2,238	$ 11,586	$ 3,663	$ 16	$ 4,675	$ 565	$ 607	$ 351	$ 23,701

Changes in the ALLL for the periods indicated are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
	(In thousands)			
Balance, beginning of period	$ 24,230	$ 25,505	$ 22,575	$ 22,458
Charge offs	(1,654)	(2,744)	(2,581)	(4,865)
Recoveries	359	43	1,198	103
Provisions	766	4,574	2,509	9,682
Balance, end of period	$ 23,701	$ 27,378	$ 23,701	$ 27,378

The following tables represent the allocation of the allowance for loan losses and the related loan by loan portfolio segment disaggregated based on the impairment methodology at June 30, 2011 and December 31, 2010:

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(in thousands)	Real Estate: Residential Real Esate	Real Estate: Commercial Real Estate	Real Estate: Construction, Land Acquisition & Development	Commercial & Industrial: Solid Waste Landfills	Commercial & Industrial: Other	Consumer: Indirect Auto	Consumer: Installment/ HELOC	State and Political Subdivisions	Total
June 30, 2011									
Allowance for loan losses:									
Individually evaluated for impairment	$ 778	$ 675	$ 566	$	$ 3	$	$	$	$ 2,022
Collectively evaluated for impairment	1,460	10,911	3,097	16	4,672	565	607	351	21,679
Total	$ 2,238	$ 11,586	$ 3,663	$ 16	$ 4,675	$ 565	$ 607	$ 351	$ 23,701
Loans receivable:									
individually evaluated for impairment	$ 3,080	$ 13,330	$ 6,686	$	$ 4,970	$	$ 31	$	$ 28,097
collectively evaluated for impairment	82,079	262,385	40,056	52,270	131,172	59,268	47,323	23,132	697,685
Total	$ 85,159	$ 275,715	$ 46,742	$ 52,270	$ 136,142	$ 59,268	$ 47,354	$ 23,132	$ 725,782
December 31, 2010									
Allowance for loan losses:									
Individually evaluated for impairment	$ 785	$ 372	$ 310	$	$ 339	$	$	$	$ 1,806
Collectively evaluated for impairment	1,391	9,268	3,860	11	4,500	597	576	566	20,769
Total	$ 2,176	$ 9,640	$ 4,170	$ 11	$ 4,839	$ 597	$ 576	$ 566	$ 22,575
Loans receivable:									
individually evaluated for impairment	$ 2,926	$ 9,477	$ 11,365	$	$ 6,029	$	$ 132	$	$ 29,929
collectively evaluated for impairment	84,999	246,850	66,030	52,270	139,398	63,509	47,212	27,739	728,007
Total	$ 87,925	$ 256,327	$ 77,395	$ 52,270	$ 145,427	$ 63,509	$ 47,344	$ 27,739	$ 757,936

Credit Quality Indicators Commercial Loans

The Company continuously monitors the credit quality of its commercial loan receivables. Credit quality is monitored by reviewing certain credit quality indicators. Management has determined that internally assigned credit risk ratings by loan type are the key credit quality indicators that best help management monitor the credit quality of the Company s loan receivables.

The Bank s commercial loan classification and credit grading processes are part of the lending, underwriting, and credit administration functions to ensure an ongoing assessment of credit quality. Accurate and timely loan classification or credit grading is a critical component of loan portfolio management. Loan officers are required to review their loan portfolio risk ratings regularly for accuracy. The loan review function uses the same risk rating system in the loan review process. This allows an independent third party to assess the quality of the portfolio and compare the accuracy of ratings with the loan officer s and management s assessment.

A formal loan classification and credit grading system reflects the risk of default and credit losses. The Company maintains a written description of the risk ratings that includes a discussion of the factors used to assign appropriate classifications of credit grades to loans. The process identifies groups of loans that warrant the special attention of management. The risk grade groupings provide a mechanism to identify risk within the loan portfolio and provide management and the Board with periodic reports by risk category. The credit risk ratings play an important role in the establishment and evaluation of ALLL. After determining the historical loss factor which is adjusted for qualitative and environmental factors for each portfolio segment, segment balances collectively evaluated for impairment are multiplied by the general reserve loss factor for the respective portfolio segments in order to determine the general reserve. Loans that have an internal credit rating of special mention or substandard follow the same process: however, the qualitative and environmental factors are further adjusted for the increased risk.

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The Company utilizes a loan rating system that assigns a degree of risk to commercial loans based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors. Management analyzes these non-homogeneous loans individually based on credit risk and probability of collection for each type of class. Commercial loans include commercial indirect auto loans which are not individually risk rated. These loans are monitored on a pool basis due to their homogeneous nature as described in Credit Quality Indicators Other Loans below. The grading system contains the following basic risk categories:

1. Minimal Risk
2. Above Average Credit Quality
3. Average Risk
4. Acceptable Risk
5. Pass - Watch
6. Special Mention
7. Substandard - Accruing
8. Substandard - Non-Accrual
9. Doubtful
10. Loss

This analysis is performed on a quarterly basis using the following definitions for risk ratings:

Pass - Assets rated 1 through 5 are considered pass ratings. These assets show no current or potential problems and are considered fully collectible. All such loans are considered collectively for ALLL calculation purposes.

Special Mention Assets classified as special mention do not currently expose the Company to a sufficient degree of risk to warrant an adverse classification but do possess credit deficiencies or potential weaknesses deserving close attention. Special Mention assets have a potential weakness or pose an unwarranted financial risk which, if not corrected, could weaken the asset and increase risk in the future.

Substandard - Assets classified as substandard have well defined weaknesses based on objective evidence and are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful - Assets classified as doubtful have all of the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable based on current circumstances.

Loss - Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets is not warranted.

The following tables detail the recorded investment in loans receivable by the aforementioned class of loan and credit quality indicator at June 30, 2011 and December 31, 2010, respectively:

	Real Estate			Commercial & Industrial				
June 30, 2011 (in thousands)	**Residential Real Esate**	**Commercial Real Estate**	**Construction, Land Acquisition & Development**	**Solid Waste Landfills**	**Other**	**Installment HELOC**	**State and Political Subdivisions**	**Total**
Internal Risk Rating								
Pass	$ 23,929	$ 220,872	$ 24,327	$ 52,270	$ 122,010	$ 3,379	$ 13,071	$ 459,858
Special Mention	196	20,337	1,120		1,768	291	10,061	33,773
Substandard	1,431	34,506	17,477		6,080	157		59,651
Doubtful	682		400					1,082
Loss								
Total Loans Recievable	$ 26,238	$ 275,715	$ 43,324	$ 52,270	$ 129,858	$ 3,827	$ 23,132	$ 554,364

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	Real Estate			Commercial & Industrial			
December 31, 2010 (in thousands)	Residential Real Esate	Commercial Real Estate	Construction, Land Acquisition & Development	Solid Waste Landfills	Other	State and Political Subdivisions	Total
Internal Risk Rating							
Pass	$ 24,854	$ 200,847	$ 46,657	$ 52,270	$ 123,848	$ 17,481	$ 465,957
Special Mention	1,633	18,455	14,001		6,061	10,258	56,308
Substandard	1,308	35,100	10,199		7,951		48,658
Doubtful		1,925	2,611				4,536
Loss							
Total Loans Recievable	$ 27,795	$ 256,327	$ 73,468	$ 52,270	$ 137,860	$ 27,739	$ 575,459

Credit Quality Indicators Other Loans

Residential, consumer and commercial, and consumer indirect auto loans are monitored on a pool basis due to their homogeneous nature. Loans that are delinquent 90 days or more are considered non-accrual. The Company utilizes accruing versus non-accruing status as the credit quality indicator for these loan pools. The following table presents the recorded investment in residential, consumer and indirect auto loans based on payment activity as of June 30, 2011 and December 31, 2010.

	June 30, 2011			December 31, 2010		
(in thousands)	Performing Loans	Non-accrual Loans	Total	Performing Loans	Non-accrual Loans	Total
Construction, Land Acquisition & Development - Residential	$ 3,418	$	$ 3,418	$ 3,927	$	$ 3,927
Residential Real Estate	56,311	2,610	58,921	57,665	2,465	60,130
Indirect Auto - Consumer	59,268		59,268	63,493	16	63,509
Indirect Auto - Commercial	6,284		6,284	7,445		7,445
Installment/HELOC	43,268	259	43,527	47,245	221	47,466
Total	$ 168,549	$ 2,869	$ 171,418	$ 179,775	$ 2,702	$ 182,477

Included in loans receivable are loans for which the accrual of interest income has been discontinued due to deterioration in the financial condition of the borrowers. The recorded investment in these non-accrual loans was $26.8 million and $28.3 million at June 30, 2011 and December 31, 2010, respectively. Generally, loans are placed on non-accruing status when they become 90 days or more delinquent, and remain on non-accrual status until they are brought current, have six months of performance under the loan terms and factors indicating reasonable doubt about the timely collection of payments no longer exist. Therefore, loans may be current in accordance with their loan terms, or may be fewer than 90 days delinquent and still be on a non-accruing status. Loans past due 90 days or more and still accruing interest were $74 thousand and $99 thousand at June 30, 2011 and December 31, 2010, respectively, and consisted of loans that are well secured and are in the process of renewal.

The following tables set forth the detail, and delinquency status, of past due and non-accrual loans at June 30, 2011 and December 31, 2010:

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(in thousands)	June 30, 2011 Performing (Accruing) Loans 0-29 Days Past Due	30-59 Days Past Due	60-89 Days Past Due	>/= 90 Days Past Due	Total Performing Loans
Real Estate					
Residential Real Estate	$ 80,362	$ 849	$ 497	$ 37	$ 81,745
Commercial Real Estate	259,743	3,254	670		263,667
Construction, Land Acquisition & Development	40,656	50	34		40,740
Total Real Estate	380,761	4,153	1,201	37	386,152
Commercial and Industrial					
Solid Waste Landfills	52,270				52,270
Other	130,591	437	22	28	131,078
Total Commercial and Industrial	182,861	437	22	28	183,348
Consumer					
Indirect Auto	58,499	692	68	9	59,268
Installment/HELOC	46,731	310	54		47,095
Total Consumer	105,230	1,002	122	9	106,363
State and Political Subdivisions	23,132				23,132
Totals	$ 691,984	$ 5,592	$ 1,345	$ 74	$ 698,995

	Non-Accruing Loans 0-29 Days Past Due	30-59 Days Past Due	60-89 Days Past Due	>/= 90 Days Past Due	Total
Real Estate					
Residential Real Estate	$ 1,718	$ 437	$ 72	$ 1,187	$ 3,414
Commercial Real Estate	3,159	61	81	8,747	12,048
Construction, Land Acquisition & Development				6,002	6,002
Total Real Estate	4,877	498	153	15,936	21,464
Commercial and Industrial					
Solid Waste Landfills					
Other	94	41	7	4,922	5,064
Total Commercial and Industrial	94	41	7	4,922	5,064
Consumer					
Indirect Auto					
Installment/HELOC				259	259
Total Consumer				259	259
State and Political Subdivisions					
Total Non-accruing loans	$ 4,971	$ 539	$ 160	$ 21,117	$ 26,787
Total loans receivable	$ 696,955	$ 6,131	$ 1,505	$ 21,191	$ 725,782

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(in thousands)	December 31, 2010 Performing (Accruing) Loans 0-29 Days Past Due	30-59 Days Past Due	60-89 Days Past Due	>/= 90 Days Past Due	Total Performing Loans
Real Estate					
Residential Real Estate	$ 83,371	$ 1,095	$ 465	$	$ 84,931
Commercial Real Estate	247,217	949	85		248,251
Construction, Land Acquisition & Development	65,785	285	231	99	66,400
Total Real Estate	396,373	2,329	781	99	399,582
Commercial and Industrial					
Solid Waste Landfills	52,270				52,270
Other	138,743	567	153		139,463
Total Commercial and Industrial	191,013	567	153		191,733
Consumer					
Indirect Auto	62,269	959	264		63,492
Installment/HELOC	47,000	112	11		47,123
Total Consumer	109,269	1,071	275		110,615
State and Political Subdivisions	27,739				27,739
Totals	$ 724,394	$ 3,967	$ 1,209	$ 99	$ 729,669

	Non-Accruing Loans 0-29 Days Past Due	30-59 Days Past Due	60-89 Days Past Due	>/= 90 Days Past Due	Total
Real Estate					
Residential Real Estate	$ 1,256	$ 327	$ 240	$ 1,171	$ 2,994
Commercial Real Estate	3,173		200	4,703	8,076
Construction, Land Acquisition & Development				10,995	10,995
Total Real Estate	4,429	327	440	16,869	22,065
Commercial and Industrial					
Solid Waste Landfills					
Other	5,319			645	5,964
Total Commercial and Industrial	5,319			645	5,964
Consumer					
Indirect Auto			12	5	17
Installment/HELOC			31	190	221
Total Consumer			43	195	238
State and Political Subdivisions					
Total Non-accruing loans	$ 9,748	$ 327	$ 483	$ 17,709	$ 28,267
Total loans receivable	$ 734,142	$ 4,294	$ 1,692	$ 17,808	$ 757,936

The total recorded investment in impaired loans, which consists of non-accrual loans greater than $100,000 and performing TDRs, amounted to $28.1 million and $29.9 million at June 30, 2011 and December 31, 2010, respectively. The related allowance on impaired loans was $2.0 million and $1.8 million at June 30, 2011 and December 31, 2010, respectively.

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The following table provides an analysis of our impaired loans at June 30, 2011 and December 31, 2010:

June 30, 2011

(in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
With No Allowance Recorded:			
Residential Real Estate	$ 1,636	$ 1,928	$
Commercial Real Estate	3,219	3,302	
Construction, Land Acquisition & Development	2,530	5,803	
Total Real Estate	7,385	11,033	
Commercial and Industrial			
Solid Waste Landfills			
Other	4,847	4,984	
Total Commercial and Industrial	4,847	4,984	
Consumer			
Indirect Auto			
Installment/HELOC	31	35	
Total Consumer	31	35	
State and Political Subdivisions			
Total With No Allowance Recorded	**$ 12,263**	**$ 16,052**	**$**
With a Related Allowance Recorded:			
Residential Real Estate	$ 1,444	$ 1,533	$ 778
Commercial Real Estate	10,111	18,554	675
Construction, Land Acquisition & Development	4,156	12,043	566
Total Real Estate	15,711	32,130	2,019
Commercial and Industrial			
Solid Waste Landfills			
Other	123	123	3
Total Commercial and Industrial	123	123	3
Consumer			
Indirect Auto			
Installment/HELOC			
Total Consumer			
State and Political Subdivisions			
Total with Related Allowance	**$ 15,834**	**$ 32,253**	**$ 2,022**

				Average Balance	Interest Income (2)
Total					
Residential Real Estate	$ 3,080	$ 3,461	$ 778	$ 2,998	$ 3

Commercial Real Estate		13,330		21,856		675		12,578		41
Construction, Land Acquisition & Development		6,686		17,846		566		8,126		16
Total Real Estate		23,096		43,163		2,019		23,702		60
Commercial and Industrial										
Solid Waste Landfills										
Other		4,970		5,107		3		5,393		9
Total Commercial and Industrial		4,970		5,107		3		5,393		9
Consumer										
Indirect Auto										
Installment/HELOC		31		35				130		
Total Consumer		31		35				130		
State and Political Subdivisions										
Total Impaired Loans (1)	**$**	**28,097**	**$**	**48,305**	**$**	**2,022**	**$**	**29,225**	**$**	**69**

(1) Non-accrual loans with outstanding balances of less than $100,000 are not considered for individual impairment evaluation and are accordingly not included in the table above. However, these loans are evaluated collectively as homogenous pools in the general allowance calculation under ASC Topic 310. Total non-accrual loans with individual balances of less than $100 thousand equaled $1.6 million at June 30, 2011.

(2) Interest income represents income recognized on performing TDRs.

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December 31, 2010

(in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
With No Allowance Recorded:			
Residential Real Estate	$ 1,530	$ 1,780	$
Commercial Real Estate	4,839	5,693	
Construction, Land Acquisition & Development	7,936	19,921	
Total Real Estate	14,305	27,394	
Commercial and Industrial			
Solid Waste Landfills			
Other	5,368	5,368	
Total Commercial and Industrial	5,368	5,368	
Consumer			
Indirect Auto			
Installment/HELOC	132	134	
Total Consumer	132	134	
State and Political Subdivisions			
Total With No Allowance Recorded	**$ 19,805**	**$ 32,896**	**$**
With a Related Allowance Recorded:			
Residential Real Estate	$ 1,396	$ 1,455	$ 785
Commercial Real Estate	4,638	12,115	372
Construction, Land Acquisition & Development	3,429	5,077	310
Total Real Estate	9,463	18,647	1,467
Commercial and Industrial			
Solid Waste Landfills			
Other	661	932	338
Total Commercial and Industrial	661	932	338
Consumer			
Indirect Auto			
Installment/HELOC			
Total Consumer			
State and Political Subdivisions			
Total with Related Allowance	**$ 10,124**	**$ 19,579**	**$ 1,806**

Total			
Residential Real Estate	$ 2,926	$ 3,235	$ 785
Commercial Real Estate	9,477	17,808	372
Construction, Land Acquisition & Development	11,365	24,998	310
Total Real Estate	23,768	46,041	1,467
Commercial and Industrial			

Solid Waste Landfills			
Other	6,029	6,300	339
Total Commercial and Industrial	6,029	6,300	339
Consumer			
Indirect Auto			
Installment/HELOC	132	134	
Total Consumer	132	134	
State and Political Subdivisions			
Total Impaired Loans (1)	**$ 29,929**	**$ 52,475**	**$ 1,806**

(1) Non-accrual loans with outstanding balances of less than $100,000 are not considered for individual impairment evaluation and are accordingly not included in the table above. However, these loans are included as homogenous pools in the general allowance calculation under ASC Topic 310. Total non-accrual loans with individual balances of less than $100 thousand equaled $838 thousand at December 31, 2010.

The average balance of impaired loans was $44.2 million for the six months ended June 30, 2010. The Company recorded $396 thousand of interest income on impaired loans for the six months ended June 30, 2010. The additional interest income that would have been earned on non-accrual and restructured loans in accordance with their original terms approximated $684 thousand and $1.4 million, for the three and six months ended June 30, 2011, respectively, and $687 thousand, and $1.3 million for the three and six months ended June 30, 2012, respectively.

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Troubled Debt Restructured Loans

Effective January 1, 2011, the Company adopted the provisions of Accounting Standards Update (ASU) No. 2011-02, *A Creditor s Determination of Whether a Restructuring is a Troubled Debt Restructuring.* As such, the Company reassessed all loan modifications occurring since January 1, 2011 for identification as TDRs, resulting in no newly identified TDRs.

The book balance of TDRs at June 30, 2011 and December 31, 2010 was $6.1 million and $5.8 million, respectively. The balances at June 30, 2011 included approximately $3.6 million of TDRs on non-accrual status and $2.5 million of TDRs on accrual status compared to $3.3 million of TDRs on non-accrual status and $2.5 million of TDRs in accrual status at December 31, 2010. Approximately $24 thousand and $34 thousand in specific reserves have been established for these loans as of June 30, 2011 and December 31, 2010, respectively.

The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan, an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk, or a permanent reduction of the recorded investment in the loan. Non-accruing restructured loans remain on non-accrual status until there has been a period of sustained repayment performance for a reasonable period, usually six months. In some instances, where the Company modifies a loan that is delinquent but not on non-accrual status, the restructured loan remains on accrual status provided the repayment performance remains in accordance with the modified terms.

The following tables show the pre- and post- modification recorded investment in loans modified as TDRs by portfolio segment and class of financing receivable during the three and six months ended June 30, 2011:

	Three Months Ended June 30, 2011			Six Months Ended June 30, 2011		
(In thousands)	**Number of Contracts**	**Pre-Modification Outstanding Recorded Investments**	**Post-Modification Outstanding Recorded Investments**	**Number of Contracts**	**Pre-Modification Outstanding Recorded Investments**	**Post-Modification Outstanding Recorded Investments**
Troubled Debt Restructuring						
Residential Real Estate	1	$ 18	$ 18	2	$ 193	$ 73
Construction, Land Acquisition & Development	4	820	820	5	903	903
Total New Troubled Debt Restructuring	5	$ 838	$ 838	7	$ 1,096	$ 976

The TDRs described above did not have any impact on the allowance for loan losses but resulted in a charge off of $120 thousand during the six months ended June 30, 2011.

The following table shows the types of modifications made during the three and six months ended June 30, 2011:

(In thousands)	Three months ended June 30, 2011 Residential Real Estate	Commercial Real Estate	Contruction Land Acquisition & Development	Total	Six months ended June 30, 2011 Residential Real Estate	Commercial Real Estate	Contruction Land Acquisition & Development	Total
Type of modification								
Extension of Term	$ 18	$	$ 820	$ 838	$ 18	$	$ 903	$ 921
Extension of Term and Principal Forgiveness					55			55
Total TDRs	$ 18	$	$ 820	$ 838	$ 73	$	$ 903	$ 976

The following table summarizes TDRs which have re-defaulted (defined as past due 90 days) during the three and six months ended June 30, 2011 that were restructured within the last twelve months prior to such re-default:

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(In thousands)	Three Months Ended June 30, 2011 Number of Contracts	Three Months Ended June 30, 2011 Recorded Investment	Six Months Ended June 30, 2011 Number of Contracts	Six Months Ended June 30, 2011 Recorded Investment
Commercial Real Estate		$	1	$ 145

Note 5. Other Real Estate Owned

The following table reflects a breakdown of OREO for the periods reviewed.

(in thousands)	June 30, 2011	December 31, 2010
Land/Lots	$ 2,268	$ 8,357
Commercial Real Estate	5,661	1,086
Residential Real Estate	260	190
Total	$ 8,189	$ 9,633

The following table reflects the activity in OREO for the six months ended June 30, 2011 and 2010:

(in thousands)	June 30, 2011	June 30, 2010
Balance, beginning of year	$ 9,633	$ 11,184
Additions	2,356	5,043
Write-downs	(266)	(896)
Carrying value of OREO sold	(3,534)	(309)
Balance, end of period	$ 8,189	$ 15,022

The following table details the components of net expense of OREO for the six months ended June 31, 2011 and 2010:

(in thousands)	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Insurance	$ 8	$ 43
Legal fees	82	54
Maintenance	1	60
(Income)/losses from the operation of foreclosed properties	(6)	134
Professional Fees	56	14
Real estate taxes	396	87
Utilities	16	10
Other	82	7
Impairment charges	266	896
Total	$ 901	$ 1,305

Note 6. Securities

Securities have been classified in the consolidated financial statements according to management s intent. The amortized cost, gross unrealized gains and losses, and the fair value of the Company s securities available-for-sale at June 30, 2011 and at December 31, 2010 are as follows:

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June 30, 2011 (in thousands)	Amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Obligations of U.S. government agencies	$ 7,979	$ 221	$	$ 8,200
Obligations of state and political subdivisions	108,395	1,644	6,574	103,465
Collateralized mortgage obligations:				
Government sponsored agency	68,266	1,492	46	69,712
Residential mortgage-backed securities				
Government sponsored agency	43,779	738	131	44,386
Pooled Trust Preferred Senior Class	3,869		2,442	1,427
Pooled Trust Preferred Mezzanine Class	7,257		5,843	1,414
Corporate debt securities	500		88	412
Equity securities	1,010		5	1,005
Total available-for-sale securities	$ 241,055	$ 4,095	$ 15,129	$ 230,021

December 31, 2010 (in thousands)	Amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Obligations of U.S. government agencies	$ 8,068	$ 239	$	$ 8,307
Obligations of state and political subdivisions	121,157	723	10,527	111,353
Collateralized mortgage obligations:				
Government sponsored agency	77,172	1,057	413	77,816
Residential mortgage-backed securities				
Government sponsored agency	49,450	557	887	49,120
Pooled Trust Preferred Senior Class	3,863		2,441	1,422
Pooled Trust Preferred Mezzanine Class	8,250		6,603	1,647
Corporate debt securities	500		105	395
Equity securities	1,010	2		1,012
Total available-for-sale securities	$ 269,470	$ 2,578	$ 20,976	$ 251,072

The amortized cost, gross unrealized gains or losses, and the fair value of the Company s securities held-to-maturity at June 30, 2011 and December 31, 2010 are as follows:

June 30, 2011 (in thousands)	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Obligations of state and political subdivisions	$ 2,043	$	$ 40	$ 2,003

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December 31, 2010 (in thousands)	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Obligations of state and political subdivisions	$ 1,994	$	$ 137	$ 1,857

At June 30, 2011 and December 31, 2010, securities with a carrying amount of $225.8 million and $220.4 million, respectively, were pledged as collateral to secure public deposits and for other purposes.

The following table shows the approximate fair value of the Company s debt securities at June 30, 2011 using contractual maturities. Expected maturities will differ from contractual maturity because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Because mortgage-backed securities are not due at a single maturity date, they are not included in the maturity categories in the following maturity summary.

	Available-for-sale		Held-to-maturity	
(in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Amounts maturing in:				
One Year or Less	$	$	$	$
One Year through Five Years	2,305	2,319		
After Five Years through Ten Years	7,780	7,880	1,624	1,591
After Ten Years	117,915	104,719	419	412
Collateralized mortgage obligations	68,266	69,712		
Mortgage-backed securities	43,779	44,386		
Total	$ 240,045	$ 229,016	$ 2,043	$ 2,003

Gross proceeds from the sale of securities for the three months ended June 30, 2011 and 2010 were $16.1 million and $800 thousand, respectively, with the gross realized gains being $2.3 million and $33 thousand, respectively, and there were no securities sold at a realized loss during the three months ended June 30, 2011 and 2010.

Gross proceeds from the sale of securities for the six months ended June 30, 2011 and 2010 were $16.1 million and $25.5 million, respectively, with the gross realized gains being $2.3 million and $1.2 million, respectively. There were no securities sold at a realized loss during the six months ended June 30, 2011 and 2010.

The table below indicates the length of time that individual securities held-to-maturity and available-for-sale have been in a continuous unrealized loss position at June 30, 2011 and December 31, 2010:

Less than 12 Months		12 Months or Greater		Total	
Fair	Gross Unrealized	Fair	Gross Unrealized	Fair	Gross Unrealized

June 30, 2011 (in thousands)	Value	Losses	Value	Losses	Value	Losses
Obligations of U.S. government agencies	$	$	$	$	$	$
Obligations of state and political subdivisions	26,018	1,089	25,043	5,525	51,061	6,614
Collateralized mortgage obligations						
Government sponsored agency	3,172	46			3,172	46
Residential mortgage-backed securities						
Government sponsored agency	24,573	131			24,573	131
Pooled Trust Preferred Senior Class			1,428	2,442	1,428	2,442
Pooled Trust Preferred Mezzanine Class			1,414	5,843	1,414	5,843
Corporate debt securities			412	88	412	88
Equity Securities	995	5			995	5
	$ 54,758	$ 1,271	$ 28,297	$ 13,898	$ 83,055	$ 15,169

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December 31, 2010 (in thousands)	Less than 12 Months Fair Value	Less than 12 Months Gross Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Gross Unrealized Losses	Total Fair Value	Total Gross Unrealized Losses
Obligations of U.S. government agencies	$	$	$	$	$	$
Obligations of state and political subdivisions	56,751	3,199	23,425	7,465	80,176	10,664
Collateralized mortgage obligations						
Government sponsored agency	19,763	413			19,763	413
Residential mortgage-backed securities						
Government sponsored agency	32,957	887			32,957	887
Pooled Trust Preferred Senior Class			1,422	2,441	1,422	2,441
Pooled Trust Preferred Mezzanine Class			1,647	6,603	1,647	6,603
Corporate debt securities			395	105	395	105
Total	$ 109,471	$ 4,499	$ 26,889	$ 16,614	$ 136,360	$ 21,113

At June 30, 2011, excluding pooled trust preferred securities (PreTSLs), 148 of the Company s debt securities holdings having unrealized losses have depreciated 7.9% from their amortized cost basis. These securities are guaranteed by either the U.S. Government, government sponsored agencies, other governments or corporations, and all are considered investment grade. Seventy-five percent (75%) of the Company s investment in obligations of state and political subdivisions are also guaranteed by underlying insurance which further secures the safety of principal. These unrealized losses relate principally to current interest rates for similar types of securities. The Company does not intend to sell these securities and does not anticipate that it will be required to sell these securities before the full recovery of principal and interest due, which may be at maturity. Therefore, the Company did not consider the carrying value of these securities to be other-than-temporarily impaired (OTTI) at June 30, 2011.

At June 30, 2011, four of the Company s PreTSLs having realized cumulative OTTI losses of $8.2 million and unrealized losses of $8.3 million have depreciated 74% and 86% from their current amortized cost and face values, respectively.

On a quarterly basis, management evaluates the Company s investment securities for OTTI. Unrealized losses on securities are considered to be other-than-temporarily-impaired when management believes the security s impairment is due to factors that could include the issuer s inability to pay interest or dividends, its potential for default, and/or other factors. When a held-to-maturity or available-for-sale debt security is assessed for OTTI, management must first consider (a) whether management intends to sell the security and (b) whether it is more likely than not that the Company will be required to sell the security prior to recovery of its amortized cost basis. If one of these circumstances applies to a security, an OTTI loss is recognized in the statement of operations equal to the full amount of the decline in fair value below amortized cost. If neither of these circumstances applies to a security, but the Company does not expect to recover the entire amortized cost basis, an OTTI loss has occurred that must be separated into two categories: (a) the amount related to credit loss and (b) the amount related to other factors (such as market risk). In assessing the level of OTTI attributable to credit loss, the Company compares the present value of cash flows expected to be collected with the amortized cost basis of the security. As discussed previously, the portion of the total OTTI related to credit loss is recognized in earnings, while the amount related to other factors is recognized in other comprehensive income. The total OTTI loss is presented in the statement of operations, less the portion recognized in other comprehensive income. When a debt security becomes other-than-temporarily impaired, its amortized cost basis is reduced to reflect the portion of the total impairment related to credit loss.

To determine whether a security s impairment is other-than-temporary, the Company considers factors that include:

- the causes of the decline in fair value, such as credit problems, interest rate fluctuations, or market volatility;
- the severity and duration of the decline;
- the Company s ability and intent to hold equity security investments until they recover in value, as well as the likelihood of such a recovery in the near term;
- the Company s intent to sell security investments, or if it is more likely than not that the Company will be required to sell such securities before recovery of their individual amortized cost basis less any current period credit loss.

For debt securities that the Company does not intend to sell, or will not be required to sell, the primary consideration in determining whether impairment is other-than-temporary is whether or not the Company expects to receive all contractual cash flows.

Based on the Company s evaluation at June 30, 2011, the Company has determined that the decreases in estimated fair value of the securities it holds in its portfolio are temporary with the exception of four PreTSLs. The Company s estimate of projected discounted cash flows it expects to receive was less than the securities carrying value resulting in a credit-related impairment charge to earnings for the three and six months ended June 30, 2011 of $349 thousand.

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OTTI of Pooled Trust Preferred Collateralized Debt Obligations:

At June 30, 2011, the amortized cost of the Company s PreTSLs totaled $11.1 million with an estimated fair value of $2.8 million and were comprised of four securities, each of which is collateralized by debt issued by bank holding companies and insurance companies. The Company holds one senior tranche and three mezzanine tranches and all possess credit ratings below investment grade. During 2010, all of the pooled issues were downgraded further by either Moody s or Fitch. At the time of initial issue, no more than 5% of any pooled security consisted of a security issued by any one institution. At June 30, 2011, three of these securities had no excess subordination and one had excess subordination which was 11.7% of the current performing collateral. Excess subordination is the amount by which the underlying performing collateral exceeds the outstanding bonds in the current class plus all senior classes. It can also be referred to as credit enhancement. As deferrals and defaults of underlying issuers occur, the excess subordination is reduced or eliminated, increasing the risk of the security experiencing principal or interest shortfalls. Conversely, subordination can be increased as collateral transitions from non-performing to performing. The coverage ratio, or overcollateralization, of a specific security measures the rate of performing collateral to a given class of notes. It is calculated by dividing the performing collateral in a transaction by the current balance of the class of notes plus all classes senior to that class.

The following table presents information about the Company s collateral and subordination for its PreTSLs at June 30, 2011:

Security	Performing Collateral	Bonds Outstanding	Excess/ (Insufficient) Collateral	Coverage Ratio	Excess Subordination	Current Number of Performing Issuers	Actual Deferrals / Defaults as a % of Current Collateral	Expected Future Default Rate
(in thousands)								
PreTSL IX	$ 303,520	$ 324,023	$ (20,503)	93.67%	N/A	35	31.00%	1.63%
PreTSL XI	405,465	458,660	(53,195)	88.40%	N/A	45	31.10%	1.85%
PreTSL XIX	507,406	541,503	(34,097)	93.70%	N/A	51	27.50%	1.99%
PreTSL XXVI	696,700	623,626	73,074	111.72%	11.72%	56	27.70%	1.60%

The following list details information for each of the Company s PreTSLs at June 30, 2011:

Security	Class	Amortized Cost	Fair Value	Unrealized Gain/Loss	Moody s / Fitch Ratings	Credit Impairment Quarter to Date	Credit Impairment Year to Date	Cumulative Credit Impairment
(in thousands)								
PreTSL IX	Mezzanine	$ 1,320	$ 339	$ (981)	Ca/C	$	$	$ 1,680
PreTSL XI	Mezzanine	1,574	305	(1,269)	Ca/C			3,426
PreTSL XIX	Mezzanine	4,363	$ 769	(3,594)	Ca/CC	349	349	2,813
PreTSL XXVI	Senior	3,869	1,428	(2,441)	B1/CCC			251
Total		$ 11,126	$ 2,841	$ (8,285)		$ 349	$ 349	$ 8,170

The Company s PreTSLs are measured for OTTI by determining whether an adverse change in estimated cash flows has occurred. The Company uses a third-party service provider to perform this analysis. Determining whether there has been an adverse change in estimated cash flows from the cash flows previously projected involves comparing the present value of remaining cash flows previously projected against the present value of the cash flows estimated at June 30, 2011. The Company considers the discounted cash flow analysis to be its primary evidence when determining whether credit related OTTI exists.

Results of a discounted cash flow test are significantly affected by variables such as the estimate of the probability of default, discount rates, prepayment rates and the creditworthiness of the underlying issuers. The following provides additional information for each of these variables:

- Probability of Default An issuer level approach is used to analyze each security and default and recovery assumptions are based on the credit quality of the underlying issuers (generally, bank holding companies or insurance companies). Each bank issuer is evaluated based upon an examination of the trends in its earnings, net interest margin, operating efficiency, liquidity, capital position, level of nonperforming loans to total loans, apparent sufficiency of loan loss reserves, Texas ratio and whether the bank received TARP monies. From this information, each issuer bank that is currently performing is assigned a category of Good, Average, Weak, or Troubled. Default rates are then assigned based upon the historical performance of each category. Additionally, because the information available to the Company regarding the underlying insurance company issuers is more limited than for bank issuers, rather than

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performing an analysis of each issuer s results and assigning insurance company issuers to these same categories, the Company uses the Moody s one year long-term default rate assumption for insurance companies. The historical default rates used in this analysis are:

	Default Rate			
Category	**Year 1**	**Year 2**	**Year 3**	**Thereafter**
Good	0.50%	0.60%	0.60%	0.40%
Average	1.80%	2.30%	2.30%	1.50%
Insurance	1.00%	1.20%	1.20%	0.80%
Weak	5.80%	7.20%	7.20%	4.80%
Troubled	9.70%	12.20%	12.20%	8.10%

Each issuer in the collateral pool is assigned a probability of default for each year until maturity. Banks currently in default or deferring interest payments thus far are assumed to default immediately. A zero percent projected recovery rate is applied to defaults and deferrals. The probability of default is updated quarterly based upon changes in the creditworthiness of each underlying issuer. Timing of defaults and deferrals has a substantial impact on each valuation. As a result of this analysis, each issuer is assigned an expected default rate specific to that issuer.

- Estimates of Future Cash Flows While understanding the composition and characteristics of each bank issuer is important in evaluating the security, certain issuers have a disproportionate impact (both positive and negative) based upon other attributes, such as the interest rate payable by each issuer. Each credit is assessed independently, and the timing and nature of each issuer s performance is assessed. Once assessed, the expected performance of each issuer is applied to a structural cash flow model. Due to the complexity of these transactions, the expected performance of each unique issuer requires an adherence to the governing documents of the securitization to derive a cash flow. A model produced by a third party is utilized to assist in determining cash flows. Utilization of third party cash flow modeling to derive cash flows from assumptions is a market convention for these types of securities.

- Discount Rate The Company is discounting projected cash flows based upon its discount margin defined at the time of purchase, which constitutes a spread over 3-month LIBOR plus credit premium, consistent with our pre-purchase yield.

- Prepayment Rate Lack of liquidity in the market for PreTSL securities, credit rating downgrades and market uncertainties related to the financial industry are factors contributing to the impairment of these securities. During the early years of PreTSL securities, prepayments were common as issuers were able to refinance into lower cost borrowings. Since the middle of 2007, however, this option has all but disappeared and the Company is operating in an environment which makes early redemption of these instruments unlikely. Accordingly, the Company has assumed zero prepayments when modeling the cash flows of these securities. The Company performed a sensitivity analysis using 1% and 3% prepayment assumptions. As a result of this analysis, the Company determined that employing a 1% and a 3% prepayment assumption rather than assuming zero prepayments would have resulted in an additional credit loss of approximately $103 thousand and $311 thousand, respectively, to the $349 thousand impairment charge taken during the first six months of 2011. Credit losses would increase as a result of an increase in the prepayment assumption because prepayments reduce the amount of excess subordination that would be available to absorb expected losses.

• Credit Analysis A quarterly credit evaluation is performed for each of the securities. While the underlying core component of these securities are the credit characteristics of the underlying issuers , typically banks, other characteristics of the securities and issuers are evaluated and stressed to determine cash flow. These include but are not limited to the interest rate payable by each issuer, certain derivative contracts, default timing, and interest rate volatility. Issuer level credit considers all evidence available to us and includes the nature of the issuer s business, its years of operating history, corporate structure, loan composition, loan concentrations, deposit mix, asset growth rates, geographic footprint and local environment. Depending upon the security, and its place in the capital structure, certain analytical assumptions are isolated with greater scrutiny. The core analysis for each specific issuer focuses on profitability, return on assets, shareholders equity, net interest margin, credit quality ratios, operating efficiency, capital adequacy and liquidity.

The Company has evaluated its PreTSLs considering all available evidence, including information received after the statement of financial condition date but before the filing date, and determined that the estimated projected cash flows are less than the securities carrying value, resulting in impairment charges to earnings of $349 thousand for the three and six months ended June 30, 2011.

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The table below provides a cumulative roll forward of credit losses recognized:

Rollforward of Cumulative Credit Loss

(in thousands)		2011		2010
Beginning Balance January 1	$	22,598	$	20,649
Credit losses on debt securities for which OTTI was not previously recognized				
Additional credit losses on debt securities for which OTTI was previously recognized		349		2,902
Less: Sale of PreTSLs for which OTTI was previously recognized		(14,777)		
Ending Balance, June 30	$	8,170	$	23,551

Investments in FHLB and FRB stock, which have limited marketability, are carried at cost and totaled $10.6 million and $11.6 million at June 30, 2011 and December 31, 2010, respectively. FRB stock of $1.3 million is included in Other Assets at June 30, 2011 and December 31, 2010. Management noted no indicators of impairment for the FHLB of Pittsburgh and FRB of Philadelphia at June 30, 2011.

Note 7. Fair Value Measurements

In determining fair value, the Company uses various valuation approaches, including market, income and cost approaches. Accounting standards establish a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability, which are developed based on market data obtained from sources independent of the Company. Unobservable inputs reflects the Company s assumptions about the assumptions the market participants would use in pricing an asset or liability, which are developed based on the best information available in the circumstances.

The fair value hierarchy gives the highest priority to unadjusted quoted market prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The fair value hierarchy is broken down into three levels based on the reliability of inputs as follows:

- Level 1 valuation is based upon unadjusted quoted market prices for identical instruments traded in active markets.

- Level 2 valuation is based upon quoted market prices for similar instruments traded in active markets, quoted market prices for identical or similar instruments traded in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by market data.

- Level 3 valuation is derived from other valuation methodologies including discounted cash flow models and similar techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in determining fair value.

An asset or liability s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

A description of the valuation methodologies used for assets recorded at fair value, and for estimating fair value of financial instruments not recorded at fair value, is set forth below.

Cash, Short-term Investments, Accrued Interest Receivable and Accrued Interest Payable

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

Securities

The estimated fair values of available for sale equity securities are determined by obtaining quoted prices on nationally recognized exchanges (Level 1 inputs). The estimated fair values for the Company s investments in obligations of U.S. government agencies, obligations of state and political subdivisions, government sponsored agency collateralized mortgage obligations, private label collateralized mortgage obligations, government sponsored agency residential mortgage backed securities, and corporate debt securities are obtained by the Company from a nationally-recognized pricing service. This pricing service develops estimated fair values by analyzing like securities and applying available market information through processes such as benchmark curves,

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benchmarking of like securities, sector groupings and matrix pricing (Level 2 inputs), to prepare valuations. Matrix pricing is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities relationship to other benchmark quoted securities.The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond s terms and conditions, among other things and are based on market data obtained from sources independent from the Company. The Level 2 investments in the Company s portfolio are priced using those inputs that, based on the analysis prepared by the pricing service, reflect the assumptions that market participants would use to price the assets. The Company has determined that the Level 2 designation is appropriate for these securities because, as with most fixed-income securities, those in the Company s portfolio are not exchange-traded, and such non-exchange-traded fixed income securities are typically priced by correlation to observed market data. The Company has reviewed the pricing service s methodology to confirm its understanding that such methodology results in a valuation based on quoted market prices for similar instruments traded in active markets, quoted markets for identical or similar instruments traded in markets that are not active and model-based valuation techniques for which the significant assumptions can be corroborated by market data as appropriate to a Level 2 designation.

For those securities for which the inputs used by an independent pricing service were derived from unobservable market information, the Company evaluated the appropriateness and quality of each price. The Company reviewed the volume and level of activity for all classes of securities and attempted to identify transactions which may not be orderly or reflective of a significant level of activity and volume. For securities meeting these criteria, the quoted prices received from either market participants or an independent pricing service may be adjusted, as necessary, to estimate fair value (fair values based on Level 3 inputs). If applicable, the adjustment to fair value was derived based on present value cash flow model projections prepared by the Company or obtained from third party providers utilizing assumptions similar to those incorporated by market participants. The estimated fair value of the PreTSLs in the Company s securities portfolio are obtained from a third-party service provider that prepared the valuation using a discounted cash flow approach with inputs derived from unobservable market information (Level 3 inputs). The valuation of PreTSLs is further described below and in Note 6 of these financial statements.

At June 30, 2011, the Company owned four PreTSLs having an amortized cost of $11.1 million. The market for these securities at June 30, 2011 was not active and markets for similar securities were also not active. PreTSLs were historically priced using Level 2 inputs. However, the decline in the level of observable inputs and market activity in this class of investments by the measurement date has been significant and resulted in unreliable external pricing. Broker pricing and bid/ask spreads, when available, vary widely. The once active market has become comparatively inactive. As such, the valuation of these investments is now determined using Level 3 inputs. The Company obtained the valuations from a third-party service provider that prepared the valuations using a discounted cash flows approach. The Company takes measures to validate the service provider s analysis and is actively involved in the valuation process, including reviewing and verifying the assumptions used in the valuation calculations. The difference between the discounted cash flow calculations for the purpose of estimating OTTI credit losses, described in Note 6, and the calculations used for fair value relates only to the discount rate used.

Results of a discounted cash flow test are significantly affected by variables such as the estimate of the probability of default, estimates of future cash flows, discount rates, prepayment rates and the creditworthiness of the underlying issuers. Refer to the discussion of these variables in Note 6. The Company considers these inputs to be unobservable Level 3 inputs because they are based on the Company s estimates about the assumptions market participants would use in pricing this type of asset and developed based on the best information available in the circumstances rather than on observable inputs. The Company continues to monitor the market for PreTSLs to assess the market activity and the availability of observable inputs and will continue to apply these controls and procedures to the valuations received from its third party service provider for the period it continues to use an outside valuation service. As it relates to fair value measurements, once each issuer is categorized and the forecasted default rates have been applied, the expected cash flows are modeled using the variables described above. The Company then applies a 15% discount rate to PreTSL XIX and PreTSL XXVI and a 20% discount rate for the remaining PreTSLs to the expected cash flows to estimate fair value.

At June 30, 2011, the Company owned a state and political subdivision security having an amortized cost of $2.0 million that was downgraded by several nationally recognized credit rating agencies in 2010. As a result of the downgrade, the market for this security at June 30, 2011 is no longer active. The security was historically priced using Level 2 inputs. The credit downgrade has resulted in a decline in the level of significant other observable inputs for this investment security at the measurement date. Broker pricing and bid/ask spreads are very limited, the weaker credit rating has resulted in additional price discounts and the absence of a CUSIP limits the amount of information that is available about the credit. As such, the valuation of this investment is now determined using Level 3 inputs. The Company obtained a bid indication from a third party municipal trading desk to determine its fair value.

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Loans

For non-impaired loans and non-collateral dependent impaired loans, fair values are estimated by discounting the projected future cash flows using market discount rates that reflect the credit, liquidity, and interest rate risk inherent in the loan. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. The estimated fair value of collateral dependent impaired loans is based on the appraised loan value or other reasonable offers less estimated costs to sell. 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 the collateral less estimated costs to sell. The fair value of the collateral is 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. See also Note 4 Loans.

Loans Held For Sale

Fair values of mortgage loans held-for-sale are based on commitments on hand from investors or prevailing market prices.

Mortgage Servicing Rights

The fair value of mortgage servicing rights is estimated using a discounted cash flow model that applies current estimated prepayments derived from the mortgage-backed securities market and utilizes a current market discount rate for observable credit spreads. The Bank does not record mortgage servicing rights at fair value on a recurring basis.

Federal Home Loan Bank (FHLB) and Federal Reserve Bank (FRB) Stock

Ownership in equity securities of FHLB of Pittsburgh and the FRB is restricted and there is no established market for their resale. The carrying amount is a reasonable estimate of fair value.

Deposits

The fair value of demand deposits, savings deposits, and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated based on discounted cash flows using the rates currently offered for deposits of similar remaining maturities.

Borrowed funds

The Bank uses discounted cash flows using rates currently available for debt with similar terms and remaining maturities are used to estimate fair value.

Commitments to extend credit and standby letters of credit

The fair value of commitments to extend credit and standby letters of credit are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of off-balance- sheet commitments is insignificant and therefore not included in the table for non-recurring assets and liabilities.

Assets measured on a recurring basis

The following tables detail the financial asset amounts that are carried at fair value and measured at fair value on a recurring basis at June 30, 2011 and December 31, 2010 and indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine the fair value:

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Fair Value Measurements at June 30, 2011

(in thousands)		Fair value		Quoted prices in active markets for identical assets (Level 1)		Significant other observable inputs (Level 2)		Significant unobservable inputs (Level 3)
Available-for-sale securities:								
Obligations of U.S. Government Agencies	$	8,200	$		$	8,200	$	
Obligations of political and state subdivisions		103,465				101,480		1,985
Government sponsored agency CMOs		69,712				69,712		
Residential mortgage backed securities		44,386				44,386		
Pooled trust preferred senior class		1,427						1,427
Pooled trust preferred mezzanine class		1,414						1,414
Corporate debt securities		412				412		
Equity securities		1,005		1,005				
Total securities available-for-sale	$	230,021	$	1,005	$	224,190	$	4,826

Fair Value Measurements at December 31, 2010

(in thousands)		Fair value		Quoted prices in active markets for identical assets (Level 1)		Significant other observable inputs (Level 2)		Significant unobservable inputs (Level 3)
Available-for-sale securities:								
Obligation to U.S. Government Agencies	$	8,307	$		$	8,307	$	
Obligations of political and state subdivisions		111,353				109,108		2,245
Government sponsored agency CMO		77,816				77,816		
Residential mortgage backed securities		49,120				49,120		
Pooled trust preferred senior class		1,422						1,422
Pooled trust preferred mezzanine class		1,647						1,647
Corporate debt securities		395				395		
Equity securities		1,012		1,012				
Total securities available-for-sale	$	251,072	$	1,012	$	244,746	$	5,314

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The table below presents a reconciliation and statement of operations classifications of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the six month periods ended June 30, 2011 and 2010:

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

(in thousands)	PreTSLs	State and Political Subdivisions	Total
Balance at December 31, 2010	$ 3,069	$ 2,245	5,314
Accretion of discount	6		6
Paydowns		(260)	(260)
Sales	(19)		(19)
Total gains or losses (realized/unrealized):			
Included in earnings	(349)		(349)
Included in other comprehensive income	134		134
Balance at June 30, 2011	$ 2,841	$ 1,985	$ 4,826

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

(in thousands)	PreTSLs
Balance at December 31, 2009	$ 3,810
Accretion of discount	7
Total gains or losses (realized/unrealized):	
Included in earnings	(4,106)
Included in other comprehensive income	3,081
Balance at June 30, 2010	$ 2,792

There were no transfers between levels within the fair value hierarchy during the period ended June 30, 2011.

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Assets measured at fair value on a non-recurring basis

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

	Fair Value Measurements at June 30, 2011			Fair Value Measurements at December 31, 2010		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
			(in thousands)			
Collateral dependent impaired loans (1)			$ 21,480			$ 26,336
Other real estate owned			3,556			4,923

(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.

Collateral dependent impaired loans are classified as Level 3 assets and the estimated fair value of the collateral is based on the appraised loan value or other reasonable offers less estimated costs to sell. When the measure of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through a valuation allowance or is charged-off. The amount shown is the balance of impaired loans, net of any charge-offs and the related allowance for loan losses.

Other real estate owned properties are recorded at the fair value less the estimated cost to sell at the date of foreclosure. Subsequent to foreclosure, the balance might be subject to additional write-downs. It is the Company s policy to obtain certified external appraisals of real estate collateral underlying impaired loans, including OREO, and it estimates fair value using those appraisals. Other valuation sources may be used, including broker price opinions, letters of intent and executed sale agreements. The amounts in the table above represent the value of OREO properties at June 30, 2011 and December 31, 2010, that were subject to additional write-downs subsequent to foreclosure.

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. The following estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, management s judgment is required to interpret data and develop fair value estimates. Accordingly, the estimates below are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The estimated fair values of the Company s financial instruments are as follows:

	June 30, 2011		December 31, 2010	
(in thousands)	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial Assets				
Cash and short term investments	$ 57,817	$ 57,817	$ 74,505	$ 74,505
Securities	232,064	232,024	253,006	252,929
FHLB and FRB Stock	10,577	10,577	11,572	11,572
Loans, net	702,476	718,105	735,813	736,992
Loans held for sale	1,803	1,803	3,557	3,557
Accrued interest receivable	2,800	2,800	3,119	3,119
Mortgage servicing rights	726	967	751	1,258
Financial Liabilities				
Deposits	$ 932,702	$ 922,867	$ 982,436	$ 987,675
Borrowed funds	101,318	107,660	137,604	143,025
Accrued interest payable	3,432	3,432	2,763	2,763

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Note 8. Earnings per Share

For the Company, the numerator of both the basic and diluted earnings per common share is net income available to common shareholders (which is equal to net income less dividends on preferred stock and related discount accretion). The weighted average number of common shares outstanding used in the denominator for basic earnings per common share is increased to determine the denominator used for diluted earnings per common share by the effect of potentially dilutive common share equivalents utilizing the treasury stock method. For the Company, common share equivalents are outstanding stock options to purchase the Company s common shares.

The following table shows the calculation of both basic and diluted earnings per common share for the three and six months ended June 30, 2011 and 2010:

	Three months ended June 30,		Six months ended June 30,	
(In thousands, except for share amounts)	**2011**	**2010**	**2011**	**2010**
Net income (loss)	$ 189	$ (5,195)	$ (337)	$ (6,020)
Basic weighted-average shares outstanding basic	16,440,190	16,306,670	16,437,491	16,300,515
Plus: Common share equivalents				
Weighted average shares outstanding diluted	16,440,190	16,306,670	16,437,491	16,300,515
Earnings per share basic	$ 0.01	$ (0.32)	$ (0.02)	$ (0.37)
Earnings per share diluted	$ 0.01	$ (0.32)	$ (0.02)	$ (0.37)

Common share equivalents, in the table above, exclude stock options with exercise prices that exceed the average market price of the Company s common shares during the periods presented. Inclusion of these stock options would be anti-dilutive to the diluted earnings per common share calculation.

Note 9. Related Party Transactions

The Company and the Bank have engaged in and intend to continue to engage in banking and financial transactions in the conduct of its business with directors and the executive officers of the Company and the Bank and their related parties.

The Bank has granted loans, letters of credit and lines of credit to directors, executive officers and their related parties. These loans, letters of credit, and lines of credit were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and, when made, did not involve more than normal risk of uncollectability. The following table summarizes the changes in the total amounts of such outstanding loans, advances under lines of credit as well as repayments during the six months ended June 30, 2011 and 2010:

(In thousands)	June 30, 2011		2010
Outstanding at beginning of the year	$ 92,217		$ 102,705
New loans and advances	38,955		43,984
Repayments / reductions	(35,905)		(37,872)
Other*	(578)		
Outstanding at end of period	$ 94,689		$ 108,817

* Other represents loans to related parties that ceased being related parties during the period.

At June 30, 2011, there were no loans to directors, executive officers and their related parties which were not performing in accordance with the terms of the loan agreements. However, as of June 30, 2011, loans in the amount of $252 thousand to directors,

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executive officers and their related parties were categorized as criticized loans within the Bank s risk rating system, meaning they are considered to present a higher risk of collection than other loans.

Included in related party loans is $3.7 million outstanding under a commercial line of credit (line) to a company owned by a director. The Company also sold a participation interest in this line to the same director in the amount of $5.2 million, of which $3.7 million is outstanding. The Bank receives a 25 basis point annual servicing fee from this director on the participation balance.

Deposits from directors, executive officers and their related parties held by the Bank at June 30, 2011 and December 31, 2010 amounted to $136.0 million and $131.6 million, respectively. Interest paid on the deposits amounted to $295 thousand and $485 thousand for the six months ended June 30, 2011 and 2010, respectively.

In the course of its operations, the Company acquires goods and services from and transacts business with various companies affiliated with related parties. The Company believes these transactions were made on the same terms as those for comparable transactions. The Company recorded payments for these services of $208 thousand and $207 thousand for the six months ended June 30, 2011 and 2010, respectively.

Subordinated notes held by officers and directors and/or their related parties totaled $10 million at June 30, 2011 and $11 million at December 31, 2010, respectively. Interest paid to directors on these notes totaled $0 thousand and $478 thousand for the six months ended June 30, 2011 and 2010, respectively. Interest accrued and unpaid on loans to directors totaled $450 thousand at June 30, 2011.

The Company leases its Honesdale branch from a related party. Total lease payments were $5 thousand for the six months ended June 30, 2011 and 2010, respectively.

Note 10. Stock Option Plans

On August 30, 2000, the Company s Board adopted an Employee Stock Incentive Plan in which options may be granted to key officers and other employees of the Company. The aggregate number of shares which may be issued upon exercise of the options under the plan cannot exceed 1,100,000 shares. Options and rights granted under the plan become exercisable six months after the date the options are awarded and expire ten years after the award date. Upon exercise, the shares are issued from the Company s authorized but unissued stock. The Stock Incentive Plan expired on August 30, 2010, therefore, no further grants will be made under the plan.

The Board also adopted on August 30, 2000, the Independent Directors Stock Option Plan (the Directors Stock Plan) for directors who are not officers or employees of the Company. The aggregate number of shares issuable under the Directors Stock Plan cannot exceed 550,000 shares and are exercisable six months from the date the awards are granted and expire three years after the award date. Upon exercise, the shares are issued from the Company s authorized but unissued shares. The Directors Stock Plan expired on August 30, 2010, therefore, no further grants will be made under the plan.

There was no compensation expense related to options under both the Stock Incentive Plan and the Directors Stock Plan for the six months ended June 30, 2011 and 2010.

In accordance with current accounting guidance, all options are charged against income at their fair value. Awards granted under the plans vest immediately and the entire expense of the award is recognized in the year of grant.

A summary of the status of the Company s stock option plans is presented below:

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	Six months ended June, 30					
	2011			2010		
	Shares		Weighted Average Exerice Price	Shares		Weighted Average Exerice Price
Outstanding at the beginning of the period	222,616	$	12.58	366,248	$	12.18
Granted						
Exercised						
Forfeited	(3,974)	$	15.94	(133,721)	$	11.55
Outstanding at the end of the period	218,642	$	12.52	232,527	$	12.55
Options exercisable at September 30,	218,642	$	12.52	232,527	$	12.55
Weighted average fair value of options granted during the year		$			$	
Stock-Based Compensation Expense		$			$	

There were no options exercised during these periods. As of June 30, 2011, there was no unrecognized compensation expense.

Information pertaining to options outstanding at June 30, 2011 is as follows:

	Options Outstanding				Options Exercisable		
Range of Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life		Weighted Average Exercise Price	Number Exercisable		Weighted Average Exercise Price
$5.81 - $23.13	222,616	4.1	$	12.58	222,616	$	12.58

At June 30, 2011, there was no aggregate intrinsic value of exercisable options.

ITEM 2 - MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Quarterly Report should be read in conjunction with the more detailed and comprehensive disclosures included on our Form 10-K for the year ended December 31, 2010 and our Form 10-Q for the quarter ended March 31, 2011. In addition, please read this section in conjunction with our Consolidated Financial Statements and Notes to Consolidated Financial Statements contained herein.

We are in the business of providing customary retail and commercial banking services to individuals and businesses. Our core market is northeastern Pennsylvania.

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FORWARD-LOOKING STATEMENTS

The Company may from time to time make written or oral forward-looking statements, including statements contained in the Company s filings with the SEC (including this report and the exhibits hereto), in its reports to shareholders and in other communications by the Company, which are made in good faith by the Company pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements include statements with respect to the Company s beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions, that are subject to significant risks and uncertainties, and are subject to change based on various factors (some of which are beyond the Company s control). The words may, could, should, would, believe, anticipate, estimate, expect, intend, plan expressions are intended to identify forward-looking statements. The following factors, among others, could cause the Company s financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements: the strength of the United States economy in general and the strength of the local economies in the Company s markets; the effects of, and changes in trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System; inflation, interest rate, market and monetary fluctuations; the timely development of and acceptance of new products and services; the impact of the Company s ability to comply with its regulatory agreements and orders; the effectiveness of the Company s revised system of internal controls; the ability of the Company to attract additional capital investment; the impact of changes in financial services laws and regulations (including laws concerning taxes, banking, securities and insurance); technological changes; acquisitions; changes in consumer spending and saving habits; the nature, extent, and timing of governmental actions and reforms, and the success of the Company at managing the risks involved in the foregoing.

The Company cautions that the foregoing list of important factors is not exclusive. Readers are also cautioned not to place undue reliance on any forward-looking statements, which reflect management s analysis only as of the date of this report, even if subsequently made available by the Company on its website or otherwise. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company to reflect events or circumstances occurring after the date of this report.

Readers should carefully review the risk factors described in the Annual Report and other documents that we periodically file with the Securities and Exchange Commission, including our Form 10-K for the year ended December 31, 2010 and our Form 10-Q for the quarter ended March 31, 2011.

CRITICAL ACCOUNTING POLICIES

In preparing the consolidated financial statements, management has made estimates, judgments and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated statements of condition and results of operations for the periods indicated. Actual results could differ significantly from those estimates.

The Company s accounting policies are fundamental to understanding management s discussion and analysis of its financial condition and results of operations. Management has identified the policies on the Allowance for Loan and Lease Losses (ALLL), securities valuation, other intangible assets, and the evaluation of deferred income tax and the impairment of securities to be critical as management is required to make subjective and/or complex judgments about matters that are inherently uncertain and could be most subject to revision as new information becomes available.

The judgments used by management in applying the critical accounting policies discussed below may be affected by a further and prolonged deterioration in the economic environment, which may result in changes to future financial results. Specifically, subsequent evaluations of the loan portfolio, in light of the factors then prevailing, may result in significant changes in the ALLL in future periods, and the inability to collect on outstanding loans could result in increased loan losses. In addition, the valuation of certain securities in the Company s investment portfolio could be negatively impacted by illiquidity or dislocation in marketplaces resulting in significantly depressed market prices thus leading to further impairment losses.

Allowance for Loan and Lease Losses

The ALLL is established as losses are estimated to have occurred through a provision for loan losses charged to earnings, and is maintained at a level that management considers adequate to absorb losses in the loan portfolio. Loans are charged against the ALLL when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the ALLL.

The ALLL represents management s estimate of probable loan losses inherent in the loan portfolio. Determining the amount of the ALLL is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on

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historical loss experience, qualitative factors, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. Various banking regulators, as an integral part of their examination of the Company, also review the ALLL. Such regulators may require, based on their judgments about information available to them at the time of their examination, that certain loan balances be charged off or require that adjustments be made to the ALLL. Additionally, the ALLL is determined, in part, by the composition and size of the loan portfolio.

The ALLL consists of specific and general components. The specific component relates to loans that are classified as impaired. For such loans an allowance is established when the discounted cash flows, collateral value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers all other loans and is based on historical loss experience adjusted by qualitative factors. The Company changed its policy for determining the ALLL effective for 2009. The general reserve component of the ALLL, previously based on one aggregated pool of unimpaired loans, was increased after assigning these loans to one of three pools of Pass , Special Mention or Accruing and Substandard and applying historical loss factors and varied qualitative factor basis point allocations based on the risk profile in each pool to determine the appropriate reserve related to those loans. The general reserve component of the ALLL also increased because of higher historical loss experience resulting from the increased loan charge-offs of impaired loans. Substandard loans on non-accrual status are included in impaired loans.

See Note 4 Loans of the consolidated financial statements included in Item 1 hereof for additional information about the ALLL.

Securities Valuation

Management utilizes various inputs to determine the fair value of its investment portfolio. To the extent they exist, unadjusted quoted market prices in active markets (level 1) or quoted prices on similar assets or models using inputs that are observable, either directly or indirectly (level 2) are utilized to determine the fair value of each investment in the portfolio. In the absence of observable inputs or if markets are illiquid, valuation techniques would be used to determine fair value of any investments that require inputs that are both unobservable and significant to the fair value measurement (level 3). For level 3 inputs, valuation techniques are based on various assumptions, including, but not limited to cash flows, discount rates, rate of return, adjustments for nonperformance and liquidity, and liquidation values. A significant degree of judgment is involved in valuing investments using level 3 inputs. The use of different assumptions could have a positive or negative effect on consolidated financial condition or results of operations. See Note 6 and Note 7 of the consolidated financial statements included in Item 1 hereof for more information about our securities valuation techniques.

Management must periodically evaluate if unrealized losses (as determined based on the securities valuation methodologies discussed above) on individual securities classified as held to maturity or available for sale in the investment portfolio are considered to be OTTI. The analysis of OTTI requires the use of various assumptions, including, but not limited to, the length of time an investment s fair value is less than book value, the severity of the investment s decline, any credit deterioration of the issuer, whether management intends to sell the security, and whether it is more likely than not that the Company will be required to sell the security prior to recovery of its amortized cost basis. Debt investment securities deemed to be OTTI are written down by the impairment related to the estimated credit loss and the non-credit related impairment loss is recognized in other comprehensive income. The Company recognized OTTI charges on securities of $349 thousand and $2.9 million for the six months ended June 30, 2011 and June 30, 2010, respectively, within the consolidated statements of operations. For both years, the OTTI charges relate to estimated credit losses on pooled trust preferred securities. See - Financial Condition-Securities section below and Note 6 Securities to the consolidated financial statements included in Item 1 hereof for additional information about our OTTI charges.

Other Real Estate Owned

Other real estate owned (OREO) consists of property acquired by foreclosure or deed in-lieu of foreclosure, are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. The fair value is based on appraised value through a current appraisal, adjusted by the estimated costs to sell the property. At the date of acquisition, any write down to fair value less estimated selling costs is charged to the ALLL. This determination is made on an individual asset basis. Fair value is determined through external appraisals, current letters of intent, broker price opinions or executed agreements of sale. Costs relating to the development and improvement of the OREO properties may be capitalized; holding period costs and subsequent changes to the valuation allowance are charged to expense.

Income Taxes

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity s financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in our

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consolidated financial statements or tax returns. Fluctuations in the actual outcome of these future tax consequences could impact our consolidated financial condition or results of operations.

We record income tax provision or benefit based on the amount of tax currently payable or receivable and the change in deferred tax assets and liabilities. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial and tax reporting purposes. We conduct quarterly assessments of all available evidence to determine the amount of deferred tax assets that are more-likely-than-not to be realized. The available evidence used in connection with these assessments includes taxable income in current and prior periods, cumulative losses in prior periods, projected future taxable income, potential tax-planning strategies, and projected future reversals of deferred tax items. These assessments involve a certain degree of subjectivity which may change significantly depending on the related circumstances.

In connection with determining our income tax provision or benefit, the Company considers maintaining liabilities for uncertain tax positions and tax strategies that management believes contain an element of uncertainty. Periodically, the Company evaluates each of our tax positions and strategies to determine whether a liability for uncertain tax benefits is required. At June 30, 2011 and 2010, the Company did not have any uncertain tax positions or tax strategies and no liability was required to be recorded.

New Authoritative Accounting Guidance

In January 2010, the FASB issued an update (Accounting Standards Update No. 2010-06, *Improving Disclosures about Fair Value Measurements*). The update provides clarification regarding existing disclosures and requires additional disclosures regarding fair value measurements. Specifically, the guidance now requires reporting entities to disclose the amounts of significant transfers between levels and the reasons for the transfers. In addition, the reconciliation should present separate information about purchases, sales, issuances and settlements. A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value. The new standard is effective for reporting periods beginning after December 15, 2009 except for disclosures about purchases, sales, issuances and settlements which are not effective until reporting periods beginning after December 15, 2010. The adoption of this guidance did not have a material impact on the Company s consolidated financial statements. The disclosures required by this update are included in Note 7 to the consolidated financial statements.

In July 2010, the FASB issued an update (Accounting Standards Update No. 2010-20, *Receivables, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*). This update expands the disclosures that an entity must provide about the credit quality of its financing receivables and the related allowance for credit losses. As a result of these amendments, an entity is required to disaggregate, by portfolio segment or class, certain existing disclosures, and to provide certain new disclosures about its financing receivables and related allowances for credit losses. The disclosures as of the end of a reporting period were effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period were effective for interim and annual reporting periods beginning on or after December 15, 2010. The amendment does not require comparative disclosures for earlier reporting periods that ended before adoption; however, an entity should provide comparative disclosures for those reporting periods after initial adoption. The adoption of this amendment did not have a material effect on the Company s consolidated financial statements. The disclusures required by this update are included in Note 4 to the consolidated financial statements.

In January 2011, the FASB issued an update (Accounting Standards Update No. 2011-01, *Receivables*) which temporarily delayed the effective date of the disclosures about trouble debt restructurings in Update 2010-20 for public entities. The delay was intended to allow the Board time to complete its deliberations on what constitutes a trouble debt restructuring. The effective date of the new disclosures about troubled debt restructurings and the guidance for determining what constitutes a troubled debt restructuring was effective for interim and annual periods ending after June 15, 2011.

In April 2011, the FASB issued an update (Accounting Standards Update No. 2011-02, *A Creditor s Determination of Whether a Restructuring is a Troubled Debt Restructuring*) which clarifies when creditors should classify loan modifications as troubled debt restructurings. The new guidance was effective for interim and annual periods beginning on or after June 15, 2011, and applies retrospectively to restructurings occurring on or after January 1, 2011. A provision in Update 2011-02 also ends the FASB s deferral of the additional disclosures about troubled debt restructurings as required by Update 2010-20. The Company elected to adopt Update 2011-02 in the quarter ending March 31, 2011. The adoption of this update did not have a material impact on the Company s consolidated financial statements.

Accounting Guidance to be Adopted In Future Periods

In May 2011, the FASB issued an update (Accounting Standards Update 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*). This update results in common fair value measurement and

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disclosure requirements among U.S. GAAP and International Financial Reporting Standards. The amendments in Update 2011-04 include clarifications about the application of existing fair value measurement requirements and changes to principles for measuring fair value. This update also requires additional disclosures about fair value measurements, is required to be applied prospectively, and is effective for interim and annual periods beginning after December 15, 2011. The Company is currently evaluating the impact of adoption of Update 2011-04 on the Company s consolidated financial statements.

In June 2011, the FASB issued an update (Accounting Standards Update 2011-05, *Presentation of Comprehensive Income*). This update was issued to improve the comparability, consistency and transparency of financial reporting. The amendment provides the entity an option to present the total of comprehensive income 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. Update 2011-05 is required to be applied retrospectively and is effective for interim and annual periods beginning after December 15, 2011. Update 2011-05 is an update only for presentation and as such will not impact the Company s consolidated financial statements.

In December 2011, the FASB issued an update (Accounting Standards Update No. 2011-11, *Disclosures about Offsetting Assets and Liabilities*). The objective of this update is to provide enhanced disclosures that will enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on an entity s financial position. This includes the effect or potential effect of rights of setoff associated with an entity s recognized assets and recognized liabilities within the scope of this update. The amendments require enhanced disclosures by requiring expanded information about financial instruments and derivative instruments that are either (1) offset in accordance with either Section 210-20-45 or Section 815-10-45 or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with either Section 210-20-45 or Section 815-10-45. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented.

In December 2011, the FASB issued ASU No. 2011-12 - Comprehensive Income (Topic 220) Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU No. 2011-05. This update defers only those changes in ASU No. 2011-05 that relate to the presentation of reclassification adjustments, the paragraphs in this update supersede certain pending paragraphs in ASU No. 2011-05. All other requirements in ASU No. 2011-05 are not affected by this update, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011.

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Executive Summary

The following overview should be read in conjunction with our MD&A in its entirety.

The Company recorded net income for the three month period ended June 30, 2011 of $189 thousand, or $0.01 per diluted common share, an increase of $5.4 million compared to a net loss of $5.2 million or $(0.32) per diluted common share for the same period in the prior year. The net loss for the six month period ended June 30, 2011 was $337 thousand or $(0.02) per diluted common share, an increase of $5.7 million compared to a loss of $6.0 million or $(0.37) per diluted common share for the same period in the prior year. The return on average equity was 0.55% and (0.98%) for the three and six months periods ended June 30, 2011, compared to (8.12%) and (9.40%) for the comparable periods in 2010. Return on average assets was 0.02 % and (0.03%) for the three and six months ended June 30, 2011, compared to (0.39%) and (0.45%) for the comparable periods in 2010.

The $5.4 million increase in net income for the three months ended June 30, 2011, as compared to the three months ended June 30, 2010, was largely due to a $3.8 million decrease in the provision for loan and lease losses that was a direct result of a $163.4 million decrease in gross loans, a $2.2 million decrease in other-than-temporary-impairment losses recorded on PreTSLs, a $1.8 million decrease in total interest expense due to a $89.1 million decrease in deposits combined with an $80.2 million decrease in other borrowings; these decreases were offset by a $3.1 million decrease in total interest income due to a decreasing interest rate environment coupled with a decrease in gross loans. The $5.7 million decrease in net loss for the six months ended June 30, 2011 as

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compared to the six months ended June 30, 2010 was largely due to a $7.2 million decrease in provision for loan and lease losses that was a direct result of a $163.4 million decrease in gross loans, a $2.6 million decrease in other-than-temporary-impairment losses recorded on PreTSLs, a $3.7 million decrease in total interest expense due to an $89.1 million decrease in deposits combined with an $80.2 million decrease in other borrowings; these decreases were offset by a $6.8 million decrease in total interest income due to a decreasing interest rate environment coupled with a decrease in gross loans.

Total assets decreased $80.6 million, or 6.91%, to $1.09 billion, at June 30, 2011 as compared to $1.17 billion at December 31, 2010 primarily due to a $33.3 million decrease in loans net of ALLL, a $21.1 million decrease in the available-for-sale securities, a $16.7 million decrease in cash and cash equivalents, a $5.2 million decrease in other assets, a $1.8 million decrease in loans held-for-sale, and a $1.4 million decrease in other real estate owned.

Total deposits decreased $49.7 million, or 5.06%, to $932.7 million at June 30, 2011 as compared to $982.4 million at December 31, 2010. During the same period interest-bearing demand deposits decreased $21.5 million, or 6.17%, and total time deposits decreased by $30.4 million, or 6.75%. These decreases were partially offset by a $1.5 million, or 1.61%, increase in demand deposits, over the same period. Borrowed funds decreased by $36.3 million, or 26.37%, to $101.3 million at June 30, 2011 as compared to $137.6 million at December 31, 2010.

Total shareholders equity increased $4.5 million, or 14.20%, to $36.6 million at June 30, 2011 from $32.1 million at December 31, 2010. The increase is primarily due to a $4.9 million reduction in other accumulated comprehensive loss for the six months ended June 30, 2011.

Summary of Performance

Net Interest Income

Net interest income consists of interest income and fees on interest-earning assets less interest expense on deposits and borrowed funds. It represents the largest component of the Company s operating income and as such is the primary determinant of profitability. The net interest margin on a fully tax-equivalent basis is calculated by dividing tax-equivalent net interest income by average interest earning assets and is a key measurement used in the banking industry to measure income from earning assets. The net interest margin was 3.15% for the three months ended June 30, 2011, a decrease of 4 basis points compared to the same period in 2010. This decrease in the net interest margin was due to a decrease of 42 basis points in the tax-equivalent yield on total earning assets, partially offset by a decrease of 39 basis points in the tax-equivalent cost on total interest-bearing liabilities. Net interest margin was 3.13% for the six months ended June 30, 2011, a decrease of 7 basis points compared to the same period in 2010. This decrease in the net interest margin was due to a decrease of 45 basis points in the tax-equivalent yield on earning assets partially offset by a decrease of 40 basis points in the tax-equivalent cost on total interest-bearing liabilities. Rate spread, the difference between the average yield on interest earning assets and the average cost of liabilities shown on a fully tax-equivalent basis was 3.05% for both the three and six months ended June 30, 2011, an decrease of 3 basis points and a decrease of 5 basis points versus the same periods in 2010, respectively.

Net interest income on a tax-equivalent basis decreased $1.4 million and $3.2 million and totaled $8.4 million and $16.7 million for the three and six months ended June 30, 2011, respectively, compared to $9.8 million and $19.9 million for the comparable periods in 2010. For the six months ended June 30, 2011, compared to the six months ended June 30, 2010, average interest-earning assets decreased 14.2% to $1.07 billion from $1.24 billion, and average interest-bearing liabilities decreased by 14.6% to $1.01 billion from $1.18 billion. For the three and six months ended June 30, 2011, the yield on average interest-earning assets decreased 42 and 45 basis points, respectively, while the cost of average interest-bearing liabilities declined 39 and 40 basis points when compared to the three and six months ended June 30, 2010, respectively.

Interest income on loans on a tax-equivalent basis decreased $2.6 million and $5.8 million for the three and six months ended June 30, 2011, respectively compared to the same periods in 2010. The decrease in interest income for the three months ended June 30, 2011 was as a result of a 25 basis point decline in the tax-equivalent yield and a decrease in average loan balances of $166.4 million to $748.9 million. The decrease in interest income for the six months ended June 30, 2011 was as a result of a 33 basis point decline in the tax-equivalent yield and a decrease in average loan balances of $172.9 million to $755.9 million. The decrease in the yield on loans for both the three and six months ended June 30, 2011 was due to payoffs of higher yielding loans which cannot be replaced in this low interest rate environment and lower loan demand caused by the continuing economic slowdown.

Interest and dividend income on investment securities on a tax-equivalent basis decreased by $0.6 million and $1.2 million for the three and six months ended June 30, 2011, respectively, compared to the same periods in 2010 primarily due to the reinvestment of pay downs and maturities into more liquid, lower-yielding assets.

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Average interest-bearing liabilities totaled $1.00 billion and $1.01 billion for the three and six months ended June 30, 2011, respectively, which resulted in a decrease of $161.1 million and $172.3 million, or 13.9% and 14.6%, compared to the same periods in 2010. The decrease for the three months ended June 30, 2011 was primarily due to a decrease in average borrowings of $84.6 million or 39.6%, a decrease in average other time deposits of $56.6 million, or 18.8%, a decrease in average time deposits over $100,000 of $25.3 million, or 11.5%, partially offset by an increase in average interest-bearing demand deposits of $7.9 million, or 2.4%. The decrease for the six months ended June 30, 2011 was due to a decrease in average borrowings of $80.4 million, or 37.4%, a decrease in average other time deposits of $60.0 million or 19.4%, a decrease in average time deposits over $100,000 of $27.4 million, or 12.4%, a decrease in average savings deposits of $1.7 million or 1.8%, and a decrease in average interest-bearing demand deposits of $2.8 million, or 0.8%. The average cost of interest-bearing deposits decreased by 42 basis points and 42 basis points to 1.13% and 1.17% during the three and six months ended June 30, 2011, respectively, from 1.55% and 1.59% during the same period in 2010. The decrease in the rate on interest-bearing deposits was driven primarily by pricing decreases from money markets and time deposits, which are sensitive to interest rate changes. The pricing decreases for these products resulted from an overall decrease in market rates.

Average borrowed funds decreased $84.6 million and $80.4 million or 39.6% and 37.4% for the three and six months ended June 30, 2011 compared to the same periods in 2010. The cost of borrowed funds increased by 72 and 57 basis points to 4.41% and 4.29% for the three and six months ended June 30, 2011 as compared to the same periods in 2010 due to the Company paying off FHLB advances that were at lower rates. This resulted in the higher-rate borrowing, such as the subordinated notes, becoming a larger percentage of total borrowings and causing the cost of borrowed funds to increase.

Net interest income represents the difference between income on interest-earning assets and expense on interest-bearing liabilities. Net interest income depends upon the relative amount of interest-earning assets and interest-bearing liabilities and the interest rate earned or paid on them. The following tables set forth certain information relating to our consolidated statements of financial condition and operations for the three and six month periods ended June 30, 2011 and 2010, and reflect the average yield on assets and average cost of liabilities for the periods indicated. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods shown. Average balances are derived from average daily balances. The yields include amortization of fees which are considered adjustments to yields.

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	Three months ended June 30, 2011			Three months ended June 30, 2010		
	Average Balance	Interest	Yield/ Cost	Average Balance	Interest	Yield/ Cost
	(Dollars in thousands)					
ASSETS						
Interest-Earning Assets (2)(3)						
Loans-taxable (4)	$ 709,195	$ 8,482	4.79%	$ 861,877	$ 10,882	5.05%
Loans-tax free (4)	39,685	698	7.03%	53,450	915	6.85%
Total Loans (1)(2)	748,880	9,180	4.91%	915,327	11,797	5.16%
Securities-taxable	136,814	898	2.63%	141,440	1,481	4.19%
Securities-tax free	121,855	2,130	6.99%	120,983	2,108	6.97%
Total Securities (1)(5)	258,669	3,028	4.68%	262,422	3,589	5.47%
Interest-bearing deposits in other banks and federal funds sold	55,169	36	0.26%	48,171	31	0.26%
Total Interest-Earning Assets	1,062,718	12,244	4.61%	1,225,920	15,417	5.03%
Non interest-earning assets	105,489			117,329		
Allowance for loan and lease losses	(24,652)			(26,390)		
Total Assets	$ 1,143,555			$ 1,316,859		
LIABILITIES AND SHAREHOLDERS EQUITY						
Interest-bearing Liabilities						
Interest-bearing demand deposits	$ 338,070	539	0.64%	$ 330,127	863	1.05%
Savings deposits	92,904	87	0.38%	95,490	128	0.54%
Time deposits over $100,000	194,202	664	1.37%	219,486	881	1.61%
Other time deposits	244,802	1,167	1.91%	301,366	1,794	2.39%
Total Interest-bearing Deposits	869,978	2,457	1.13%	946,469	3,666	1.55%
Borrowed funds and other interest-bearing liabilities	128,993	1,417	4.41%	213,607	1,967	3.69%
Total Interest-Bearing Liabilities	998,971	3,874	1.56%	1,160,075	5,633	1.95%
Demand deposits	94,820			79,747		
Other liabilities	15,448			13,023		
Shareholders equity	34,316			64,014		
Total Liabilities and Shareholders Equity	$ 1,143,555			$ 1,316,859		
Net Interest Income/Interest Rate Spread (6)		8,370	3.05%		9,784	3.08%
Tax equivalent adjustment		(961)			(1,028)	
Net interest income as reported		$ 7,409			$ 8,756	
Net Interest Margin (7)			3.15%			3.19%

(1) Interest income is presented on a tax equivalent basis using a 34% rate.
(2) Loans are stated net of unearned income.
(3) Nonaccrual loans are included in loans within earning assets
(4) Loan fees included in interest income are not significant
(5) The yields for securities that are classified as available for sale are based on the average historical amortized cost.
(6) Interest rate spread represents the difference between the average yield on interest earning assets and the cost of interest bearing liabilities and is presented on a tax equivalent basis.
(7) Net interest income as a percentage of total average interest earning assets.

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	Six months ended June 30, 2011			Six months ended June 30, 2010		
	Average Balance	Interest	Yield/ Cost	Average Balance	Interest	Yield/ Cost
	(Dollars in thousands)					
ASSETS						
Interest-Earning Assets (2)(3)						
Loans-taxable (4)	$ 716,541	$ 17,130	4.78%	$ 873,903	$ 22,386	5.12%
Loans-tax free (4)	39,310	1,372	6.98%	54,829	1,867	6.81%
Total Loans (1)(2)	755,851	18,502	4.89%	928,732	24,253	5.22%
Securities-taxable	138,966	1,877	2.70%	141,621	3,072	4.34%
Securities-tax free	122,112	4,267	6.99%	121,219	4,228	6.98%
Total Securities (1)(5)	261,078	6,144	4.71%	262,840	7,300	5.55%
Interest-bearing deposits in other banks and federal funds sold	50,130	62	0.25%	52,340	67	0.26%
Total Interest-Earning Assets	1,067,059	24,708	4.63%	1,243,912	31,620	5.08%
Non interest-earning assets	105,612			117,496		
Allowance for loan and lease losses	(23,795)			(24,897)		
Total Assets	$ 1,148,876			$ 1,336,511		
LIABILITIES AND SHAREHOLDERS EQUITY						
Interest-bearing Liabilities						
Interest-bearing demand deposits	$ 339,376	1,151	0.68%	$ 342,131	1,895	1.10%
Savings deposits	91,400	182	0.40%	93,065	257	0.55%
Time deposits over $100,000	193,473	1,362	1.40%	220,921	1,812	1.64%
Other time deposits	248,801	2,408	1.93%	308,812	3,734	2.42%
Total Interest-bearing Deposits	873,050	5,103	1.17%	964,929	7,698	1.59%
Borrowed funds and other interest-bearing liabilities	134,730	2,899	4.29%	215,106	4,007	3.72%
Total Interest-Bearing Liabilities	1,007,780	8,002	1.58%	1,180,035	11,705	1.98%
Demand deposits	91,923			79,006		
Other liabilities	15,638			13,449		
Shareholders equity	33,535			64,023		
Total Liabilities and Shareholders Equity	$ 1,148,876			$ 1,336,513		
Net Interest Income/Interest Rate Spread (6)		16,706	3.05%		19,915	3.10%
Tax equivalent adjustment		(1,917)			(2,072)	
Net interest income as reported		$ 14,789			$ 17,843	
Net Interest Margin (7)			3.13%			3.20%

(1) Interest income is presented on a tax equivalent basis using a 34% rate.
(2) Loans are stated net of unearned income.
(3) Nonaccrual loans are included in loans within earning assets.
(4) Loan fees included in interest income are not significant.
(5) The yields for securities that are classified as available for sale are based on the average historical amortized cost.
(6) Interest rate spread represents the difference between the average yield on interest earning assets and the cost of interest bearing liabilities and is presented on a tax equivalent basis.
(7) Net interest income as a percentage of total average interest earning assets.

The following table shows the effect of changes in volume and interest rates on net interest income. The variance in interest income or expense due to the combination of rate and volume has been allocated proportionately.

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	Three Months Ended June 30, 2011 Compared with June 30, 2010 Increase (Decrease) Due to Change in			Six Months Ended June 30, 2011 Compared with June 30, 2010 Increase (Decrease) Due to Change in		
	Volume	Rate	Total	Volume	Rate	Total
Interest income:						
Loans (taxable)	$ (1,849)	$ (551)	$ (2,400)	$ (3,835)	$ (1,421)	$ (5,256)
Loans (tax-free) (1)	(230)	13	(217)	(516)	21	(495)
Investment securities (taxable)	(47)	(536)	(583)	(57)	(1,138)	(1,195)
Investment securities (tax-free)(1)	(220)	242	22	31	8	39
Time deposits with banks and federal funds sold	5		5	(3)	(2)	(5)
Total interest income	(2,341)	(832)	(3,173)	(4,380)	(2,532)	(6,912)
Interest expense						
Interest-bearing demand deposits	20	(344)	(324)	(15)	(729)	(744)
Savings deposits	(4)	(37)	(41)	(5)	(70)	(75)
Time deposits	(590)	(254)	(844)	(1,007)	(769)	(1,776)
Borrowed funds and other interest-bearing liabilities	(880)	330	(550)	(1,661)	553	(1,108)
Total interest expense	(1,454)	(305)	(1,759)	(2,688)	(1,015)	(3,703)
Decrease in interest differential	$ (887)	$ (527)	$ (1,414)	$ (1,692)	$ (1,517)	$ (3,209)

(1) Changes in interest income and interest expense attributable to changes in both volume and rate have been allocated proportionately to changes due to volume and changes due to rate.

Provision for Loan and Lease Losses

Management closely monitors the loan portfolio and the adequacy of the ALLL considering underlying borrower financial performance and collateral values and increasing credit risks. Future material adjustments may be necessary to the provision for loan and lease losses and the ALLL if economic conditions or loan performance differ substantially from the assumptions management used in making its evaluation of the ALLL. The provision for loan and lease losses is an expense charged against net interest income to provide for estimated losses attributable to uncollectible loans and is based on management s analysis of the adequacy of the ALLL. A provision for loan and lease losses of $0.8 million and $2.5 million was recorded for the three and six month periods ended June 30, 2011, respectively, compared to $4.6 million and $9.7 million, respectively, for the same periods in the prior year. The decrease of $3.8 million and $7.2 million for the three and six month periods ended June 30, 2011 from the same periods in the prior year is the result of a reduction in charge-offs of classified credits and the $163.4 million reduction in gross loans.

During the six months ended June 30, 2011, non-performing loans decreased $1.5 million to $26.8 million from $28.3 million at December 31, 2010. Net charge-offs decreased $3.4 million to $1.4 million for the six months ended June 30, 2011 from $4.8 million for the same period in 2010. Non-performing loans primarily consist of loans secured by real estate. Refer to Financial Condition - Allowance for Loan and Lease Losses .

Non-interest Income

The Company recorded total non-interest income of $3.5 million for the three months ended June 30, 2011, an increase of $4.4 million from the $(0.9) million loss for the comparable period in 2010. The increase in non-interest income was primarily due to a $2.3 million increase in gain on sale of securities and a $2.2 million decrease in OTTI losses recorded on PreTSLs. Non-interest income was $7.4 million for the six months ended June 30, 2011, an increase of $5.8 million from the $1.6 million for the six months ended June 30, 2010. The increase in non-interest income was primarily due to a $2.6 million decrease in OTTI losses recorded on Pre TSLs, a $2.5 million increase in gain on sale of other real estate owned, and a $1.1 million increase in gain on sale of securities.

Non-interest Expense

Non-interset expense was $9.9 million for the three months ended June 30, 2011, an increase of $1.5 million from the $8.4 million at June 30, 2010. The increase in non-interest expense was primarily due to a $1.0 million increase in professional fees attributable to increased regulatory compliance expenses and a $1.0 million increase in other operating expenses. Non-interest expense was $20.1 million for the six months ended June 30, 2011, an increase of $4.3 million from $15.7 million at June 30, 2010. The increase in non-interest expense was primarily due to a $2.9 million increase in professional fees attributable to increase regulatory compliance expenses, and $1.0 million increase in other operating expenses.

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Provision for Income Taxes

The Company did not record a provision or benefit for income taxes for the three and six month periods ended June 30, 2011 and 2010. In future periods, the Company anticipates that it will have a minimal tax provision or benefit until such time as it is able to reverse the deferred tax asset valuation allowance that it recorded in 2009.

FINANCIAL CONDITION

Assets

Total assets were $1.09 billion at June 30, 2011, which is a decrease of $80.6 million, or 6.9%, from $1.17 billion at December 31, 2010.

Cash and Cash Equivalents

Cash and cash equivalents decreased $16.7 million, or 22.4%, during the six months ended June 30, 2011 to $57.8 million. The Company did not pay any dividends during the quarter ended June 30, 2011 as it suspended paying dividends to conserve capital and comply with regulatory requirements.

Securities

The Company holds debt securities primarily for liquidity, interest rate risk management needs and to provide a source of interest income. Securities are classified as held to maturity and are carried at amortized cost when the Company has the positive intent and ability to hold them to maturity. Securities not classified as held to maturity are classified as available-for-sale and are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax. The Company determines the appropriate classification of securities at the time of purchase. The decision to purchase or sell securities is based upon the current assessment of long and short-term economic and financial conditions, including the interest rate environment and other statement of financial condition components. Securities with limited marketability and/or restrictions, such as Federal Home Loan Bank and Federal Reserve Bank stocks, are carried at cost. Federal Reserve Bank stock is included in other assets.

At June 30, 2011, the Company s investment portfolio was comprised of U.S Government agency securities, tax-exempt and taxable obligations of states and political subdivisions, government sponsored agency collateralized mortgage obligations, government sponsored agency residential mortgage-backed securities, pooled trust preferred securities (PreTSLs) principally collateralized by bank holding companies (bank issuers) and insurance companies, corporate debt and equity securities.

Among other securities, the Company s investments in PreTSLs may pose a higher risk of future impairment charges by the Company as a result of the current downturn in the U.S. economy and its potential negative effect on the future performance of these bank issuers. Many of the bank issuers of PreTSLS within the Company s investment portfolio remain participants in the U.S. Treasury s TARP CPP. For TARP participants, dividend payments to trust preferred security holders are currently senior to and payable before dividends can be paid on the preferred stock issued under the TARP CPP. Some bank issuers may elect to defer future payments of interest on such securities either based upon recommendations by the U.S. Treasury and the banking regulators or management decisions driven by potential liquidity needs. Such elections by issuers of securities within our investment portfolio could adversely affect securities valuations and result in future impairment charges if collection of deferred and accrued interest (or principal upon maturity) is deemed unlikely by management. See the Other-Than-Temporary-Impairment section below for further information.

The following table sets forth the carrying value of available-for-sale securities, which are carried at fair value, and held to maturity securities, which are carried at amortized cost, at the dates indicated:

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	June 30, 2011	December 31, 2010
	(In Thousands)	
Obligations of U.S. government agencies	$ 8,200	$ 8,307
Obligation of state and political subdivisions	105,508	113,347
Collateralized mortgage obligations Government sponsored agency	69,712	77,816
Residential mortgage-backed securities Government sponsored agency	44,386	49,120
Pooled trust preferred senior class	1,427	1,422
Pooled trust preferred mezzanine class	1,414	1,647
Corporate debt securities	412	395
Equity securities	1,005	1,012
Total	$ 232,064	$ 253,066

During 2010, the Company sold its entire portfolio of private label collateralized mortgage obligation securities to better manage and improve credit risk in its investment portfolio. The Company used proceeds from these sales and cash provided by operations to purchase high quality U.S. Government guaranteed and U.S. Government agency sponsored mortgage-backed securities. During the second quarter of 2011, the Company sold three of the PreTSLs in its securities portfolio to better manage and improve the credit risk in its investment portfolio. Additionally, there were no single issuers with an aggregate amortized cost which exceeded ten percent (10%) of total shareholders equity.

The following table sets forth the maturities of available-for-sale securities and held-to-maturity securities, based on book value, at June 30, 2011 and the weighted average yields of such securities calculated on the basis of the cost and effective yields weighted for the scheduled maturity of each security.

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	Within One Year	> 1 5 Years	6 - 10 Years	Over 10 Years	Mortgage-Backed Securities and Collateralized Mortgage Obligations	No Fixed Maturity	Total
Available-for-sale securities							
U.S. Treasury securities	$	$	$	$	$	$	$
Yield							
Obligations of U.S. government agencies				8,200			8,200
Yield				3.25%			3.25%
Obligations of state and political subdivisions (1)		2,319	7,880	93,266			103,465
Yield		6.34%	6.56%	7.01%			6.96%
Corporate debt securities				412			412
Yield				0.89%			0.89%
Collateralized mortgage obligations:							
Government sponsored agencies					69,712		69,712
Yield					3.32%		3.32%
Residential mortgage-backed securities:							
Government sponsored agencies					44,386		44,386
Yield					3.65%		3.65%
Pooled Trust Preferred Senior Class				1,427			1,427
Yield				0.00%			0.00%
Pooled Trust Preferred Mezzanine Class				1,414			1,414
Yield				0.00%			0.00%
Equity securities (2)						1,005	1,005
Yield						4.72%	4.72%
Total available-for-sale maturities	$	$ 2,319	$ 7,880	$ 104,719	$ 114,098	$ 1,005	$ 230,021
Weighted yield	0.00%	6.34%	6.56%	6.08%	3.45%	4.72%	4.88%
Held-to-maturity securities							
Obligations of state and political subdivisions			1,624	419			2,043
Yield			4.90%	4.86%			4.89%
Total held-to-maturity securities	$	$	$ 1,624	$ 419	$	$	$ 2,043
Weighted yield	0.00%	0.00%	4.90%	4.86%	0.00%	0.00%	4.89%

(1) Yields on state and municipal securities have been adjusted to a tax equivalent yields using a 34% federal income tax rate.

(2) Yield represents actual return for the six months ended June 30, 2011.

Other-Than-Temporary Impairment (OTTI)

The Company tests its securities for OTTI using authoritative guidance. Under this guidance, if management has no intent to sell the security and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost, then other-than-temporary declines in the fair value of the debt security that are related to credit losses must be recognized in earnings as realized losses and those that are related to other factors are recognized in other comprehensive income. Numerous factors, including lack of liquidity for re-sales of certain investment securities, absence of reliable pricing information for investment securities, adverse changes in business climate, adverse actions by regulators, or unanticipated changes in the competitive environment could have a negative effect on our investment portfolio and may result in OTTI on the Company s investment securities in future periods.

On a quarterly basis, the Company evaluates its investment securities for OTTI. Unrealized losses on securities are considered to be other-than-temporarily-impaired when the Company believes the security s impairment is due to factors that could include the issuer s inability to pay interest or dividends, its potential for default, and/or other factors. When a held-to-maturity or available-for-sale debt security is assessed for OTTI, the Company must first consider (a) whether management intends to sell the security and (b) whether it is more likely than not that the Company will be required to sell the security prior to recovery of its amortized cost basis. If one of these circumstances applies to a security, an OTTI loss is recognized in the statement of operations equal to the full amount of the decline in fair value below amortized cost. If neither of these circumstances applies to a security, but the Company does not expect to recover the entire amortized cost basis, an OTTI loss has occurred that must be separated into two categories: (a) the amount related to credit loss and (b) the amount related to other factors such as market risk. In assessing the level of OTTI attributable to credit loss, the Company compares the present value of cash flows expected to be collected with the amortized cost basis of the security. As discussed above, the portion of the total OTTI related to credit loss is recognized in earnings, while the amount related to other factors is recognized in other comprehensive income. The total OTTI loss is presented in the statement of operations, less the portion recognized in other comprehensive income. When a debt security becomes other-than-temporarily-impaired, its amortized cost basis is reduced to reflect the portion of the total impairment related to credit loss.

To determine whether a security s impairment is other than temporary, management considers factors that include:

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- the causes of the decline in fair value, such as credit problems, interest rate fluctuations, or market volatility;
- the severity and duration of the decline;
- the Company s ability and intent to hold equity security investments until they recover in value, as well as the likelihood of such a recovery in the near term;
- the Company s intent to sell security investments, or if it is more likely than not that the Company will be required to sell such securities before recovery of their individual amortized cost basis less any current-period credit loss.

For debt securities that the Company does not intend to sell, or will not be required to sell, the primary consideration in determining whether impairment is other-than-temporary is whether or not the Company expects to receive all contractual cash flows.

Based on the Company s evaluation at June 30, 2011, the Company has determined that the decreases in estimated fair value of the securities it holds in its portfolio are temporary with the exception of four PreTSLs. The Company s estimate of discounted cash flows it expects to receive was less than the securities carrying value resulting in a credit-related impairment charge to earnings of $349 thousand for the three and six months ended June 30, 2011.

OTTI of Pooled Trust Preferred Collateralized Debt Obligations:

At June 30, 2011, the amortized cost of our PreTSLs totaled $11.1 million with an estimated fair value of $2.8 million and is comprised of four securities each of which are collateralized by debt issued by bank holding companies and insurance companies. The Company holds one senior tranche and six mezzanine tranches. All of the securities have been downgraded below investment grade. At the time of initial issue, no more than 5% of any pooled security consisted of a security issued by any one institution. At June 30, 2011, three of these securities had no excess subordination and one had excess subordination of 11.72% of the current performing collateral. Excess subordination is the amount by which the underlying performing collateral exceeds the outstanding bonds in the current class plus all senior classes. It can also be referred to as credit enhancement. As deferrals and defaults of underlying issuers occur, the excess subordination is reduced or eliminated, increasing the risk of the security experiencing principal or interest shortfalls. Conversely, subordination can be increased as collateral transitions from non-performing to performing. The coverage ratio, or overcollateralization, of a specific security measures the rate of performing collateral to a given class of notes. It is calculated by dividing the performing collateral in a transaction by the current balance of the class of notes plus all classes senior to that class.

The following table presents information about the Company s collateral and subordination for its PreTSLs at June 30, 2011:

Security	Performing Collateral	Bonds Outstanding (in thousands)	Excess/ (Insufficient) Collateral	Coverage Ratio	Excess Subordination	Number of Performing Issuers	Defaults as a % of Current Collateral	Expected Future Default Rate
PreTSL IX	$ 303,520	$ 324,023	$ (20,503)	93.67%	N/A	35	31.00%	1.63%
PreTSL XI	405,465	458,660	(53,195)	88.40%	N/A	45	31.10%	1.85%
PreTSL XIX	507,406	541,503	(34,097)	93.70%	N/A	51	27.50%	1.99%
PreTSL XXVI	696,700	623,626	73,074	111.72%	11.72%	56	27.70%	1.60%

The following list details information for each of the Company s PreTSLs at June 30, 2011:

Security	Class	Amortized Cost	Fair Value	Unrealized Gain/Loss	Moody s / Fitch Ratings	Credit Impairment Quarter to Date	Credit Impairment Year to Date	Cumulative Credit Impairment
PreTSL IX	Mezzanine	$ 1,320	$ 339	$ (981)	Ca/C	$	$	$ 1,680
PreTSL XI	Mezzanine	1,574	305	(1,269)	Ca/C			3,426
PreTSL XIX	Mezzanine	4,363	$ 769	(3,594)	Ca/CC	349	349	2,813
PreTSL XXVI	Senior	3,869	1,428	(2,441)	B1/CCC			251
Total		$ 11,126	$ 2,841	$ (8,285)		$ 349	$ 349	$ 8,170

The Company s PreTSLs are evaluated for OTTI within the scope of ASC Topic 325 by determining whether an adverse change in estimated cash flows has occurred. The Company uses a third party service provider to perform this analysis. Determining whether there has been an adverse change in estimated cash flows from the cash flows previously projected involves comparing the present value of remaining cash flows previously projected against the present value of the cash flows estimated at June 30, 2011. The Company considers the discounted cash flow analysis to be its primary evidence when determining whether credit related OTTI exists.

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Results of a discounted cash flow test are significantly affected by variables such as the estimate of the probability of default, estimates of future cash flows, discount rates, prepayment rates and the creditworthiness of the underlying issuers. The following provides additional information for each of these variables:

• Probability of Default An issuer level approach is used to analyze each security and default and recovery assumptions are based on the credit quality of the underlying issuers (generally, bank holding companies or insurance companies). Each bank issuer is evaluated based upon an examination of the trends in its earnings, net interest margin, operating efficiency, liquidity, capital position, level of nonperforming loans to total loans, apparent sufficiency of loan loss reserves, Texas ratio and whether the bank received TARP monies. From this information, each issuer bank that is currently performing is assigned a category of Good, Average, Weak, or Troubled. Default rates are then assigned based upon the historical performance of each category. Additionally, because the information available to the Company regarding the underlying insurance company issuers is more limited than for bank issuers, rather than performing an analysis of each such issuer s results and assigning insurance company issuers to these same categories, the Company uses the Moody s one year long-term default rate assumption for insurance companies. The historical default rates used in this analysis are:

	Default Rate			
Category	**Year 1**	**Year 2**	**Year 3**	**Thereafter**
Good	0.50%	0.60%	0.60%	0.40%
Average	1.80%	2.30%	2.30%	1.50%
Insurance	1.00%	1.20%	1.20%	0.80%
Weak	5.80%	7.20%	7.20%	4.80%
Troubled	9.70%	12.20%	12.20%	8.10%

Each issuer in the collateral pool is assigned a probability of default for each year until maturity. Banks currently in default or deferring interest payments thus far are assumed to default immediately. A zero percent projected recovery rate is applied to both deferring and defaulted issuers. The probability of default is updated quarterly based upon changes in the creditworthiness of each underlying issuer. Timing of defaults and deferrals has a substantial impact on each valuation. As a result of this analysis, each issuer is assigned an expected default rate specific to that issuer.

• Estimates of Future Cash Flows While understanding the composition and characteristics of each bank issuer is important in evaluating the security, certain issuers have a disproportionate impact (both positive and negative) based upon other attributes, such as the interest rate payable by each issuer. Each credit is assessed independently, and the timing and nature of each issuer s performance is assessed. Once assessed, the expected performance of each issuer is applied to a structural cash flow model. Due to the complexity of these transactions, the expected performance of each unique issuer requires an adherence to the governing documents of the securitization to derive a cash flow. A model produced by a third party is utilized to assist in determining cash flows. Utilization of third party cash flow modeling to derive cash flows from assumptions is a market convention for these types of securities.

• Discount Rate The Company is discounting projected cash flows based upon its discount margin defined at the time of purchase, which constitutes a spread over 3-month LIBOR plus credit premium, consistent with our pre-purchase yield.

• Prepayment Rate Lack of liquidity in the market for PreTSL securities, credit rating downgrades and market uncertainties related to the financial industry are factors contributing to the impairment on these securities. During the early years of PreTSL securities, prepayments were common as issuers were able to refinance into lower cost borrowings. Since the middle of 2007, however, this option has all but disappeared and the Company is operating in an environment which makes early redemption of these instruments unlikely. Accordingly, the Company has assumed zero prepayments when modeling the cash flows of these securities. The Company will reevaluate its prepayment assumptions from time to time as appropriate. The Company performed a sensitivity analysis using 1% and 3% prepayment assumptions. As a result of this analysis, the Company determined that employing a 1% and a 3% prepayment assumption rather than assuming zero prepayments would have resulted in an additional credit loss of approximately $103 thousand and $311 thousand, respectively, to the $349 million impairment charge taken during the first six months of 2011. Credit losses would increase as a result of an increase in the prepayment assumption because prepayments reduce the amount of excess subordination that would be available to absorb expected losses.

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• Credit Analysis A quarterly credit evaluation is performed for each of the securities. While the underlying core component of these securities are the credit characteristics of the underlying issuers , typically banks, other characteristics of the securities and issuers are evaluated and stressed to determine cash flow. These include but are not limited to the interest rate payable by each issuer, certain derivative contracts, default timing, and interest rate volatility. Issuer level credit considers all evidence available to us and includes the nature of the issuer s business, its years of operating history, corporate structure, loan composition, loan concentrations, deposit mix, asset growth rates, geographic footprint and local environment. Depending upon the security, and its place in the capital structure, certain analytical assumptions are isolated with greater scrutiny. The core analysis for each specific issuer focuses on profitability, return on assets, shareholders equity, net interest margin, credit quality ratios, operating efficiency, capital adequacy and liquidity.

The Company has evaluated its PreTSLs considering all available evidence, including information received after the statement of financial condition date but before the filing date, and determined that the estimated projected cash flows are less than the securities carrying value, resulting in impairment charges to earnings of $349 thousand for the three and six months ended June 30, 2011.

The table below provides a cumulative roll forward of credit losses recognized :

Rollforward of Cumulative Credit Loss

(in thousands)

		2011		2010
Beginning Balance, January 1	$	22,598	$	20,649
Credit losses on debt securities for which OTTI was not previously recognized				
Additional credit losses on debt securities for which OTTI was previously recognized		349		2,902
Less: Sale of PreTSLs for which OTTI was previously recognized		(14,777)		
Ending Balance, June 30	$	8,170	$	23,551

Investments in FHLB and FRB stock, which have limited marketability, are carried at cost and totaled $10.6 million and $11.6 million at June 30, 2011 and December 31, 2010, respectively. FRB stock of $1.3 million is included in Other Assets at June 30, 2011 and December 31, 2010. Management noted no indicators of impairment for the FHLB of Pittsburgh and FRB of Philadelphia at June 30, 2011.

Loans

The net loan balance declined during the six months ended June 30, 2011 primarily as a result of payoffs and transfers to OREO. Net loans declined $33.3 million, or 4.5%, to $702.5 million at June 30, 2011 from $735.8 million at December 31, 2010. Net loans represented 64.6% of total assets at June 30, 2011, compared to 63.0% at December 31, 2010. Historically, commercial lending activities have represented a significant portion of the Company s loan activities. This includes commercial and industrial loans, commercial real estate loans and construction, land acquisition and development loans. Furthermore, from a collateral standpoint, a majority of the Company s loan portfolio consisted of loans secured by real estate. Real estate secured loans, which includes commercial real estate, construction, land acquisition and development, residential real estate, and home equity loans, declined by $13.3 million, or 2.9% to $452.6 million at June 30, 2011, from $465.9

million at December 31, 2010. Real estate secured loans as a percentage of total gross loans has increased from 61.5% at December 31, 2010 to 62.4% of the loan portfolio at June 30, 2011.

Commercial and industrial loans decreased $9.3 million, or 4.7%, during the year from $197.7 million at December 31, 2010 to $188.4 million at June 30, 2011. Commercial and industrial loans consist primarily of equipment loans, working capital financing, revolving lines of credit and loans secured by cash and marketable securities. The decrease was primarily a reduction in borrowings under revolving line of credit facilities within the portfolio. Loans secured by commercial real estate increased $19.4 million, or 7.6%, from $256.3 million at December 31, 2010 to $275.7 million at June 30, 2011. Commercial real estate loans include long-term commercial mortgage financing and are primarily secured by first or second lien mortgages. The increase in commercial real estate loans is primarily attributable to new loan originations. Construction, land acquisition and development loans decreased $30.7 million, or 39.6%, during the year from $77.4 million at December 31, 2010 to $46.7 million at June 30, 2011. The decrease in construction land acquisition and development loans is primarily attributable to charge-offs, transfers to OREO and a decrease in lending in this segment.

Residential real estate loans decreased $2.7 million, or 3.2%, during the year from $87.9 million at December 31, 2010 to $85.2 million at June 30, 2011. The components of residential real estate loans include fixed rate mortgage loans and home equity loans and lines of credit. The Company continues to adhere to a philosophy of underwriting fixed rate purchases and refinancing of

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residential mortgage loans that are generally then sold in the secondary market to reduce interest rate risk and provide funding for additional loans.

Consumer loans decreased $4.3 million during the year, or 3.8%, from $110.9 million at December 31, 2010 to $106.6 million at June 30, 2011. In 2010, the Company sold $36.7 million in loans from its indirect auto loan portfolio.

Loans to states and political subdivisions decreased $4.6 million, or 16.6%, during the year from $27.7 million at December 31, 2010 to $23.1 million at June 30, 2011. The decrease in loans to state and political subdivisions was due to state and municipal government s ability to refinance their outstanding obligations with lower cost funding.

Details regarding the loan portfolio are as follows:

(in thousands)		**June 30, 2011**		**December 31, 2010**
Residential real estate	$	85,159	$	87,925
Commercial real estate		275,715		256,327
Commercial and industrial		188,412		197,697
Construction land acquisition and development		46,742		77,395
Consumer		106,622		110,853
State and political subdivisions		23,132		27,739
Gross loans		725,782		757,936
Allowance for loan and lease losses		(23,701)		(22,575)
Unearned discount		(191)		(332)
Net deferred loan fees and costs		586		784
Net loans	$	702,476	$	735,813

Loan Concentrations: At June 30, 2011 and December 31, 2010, the Company s loan portfolio was concentrated in the following industries. The majority of loans included in the Solid Waste Landfills are fully secured by cash collateral on deposit at the Company.

	June 30, 2011		**December 31, 2010**	
(in thousands)	**Amount**	**% of gross loans**	**Amount**	**% of gross loans**
Land subdivision	22,193	3.06%	29,518	3.89%
Shopping centers/complexes	20,610	2.84%	26,298	3.47%
Gas stations	18,359	2.53%	18,289	2.41%
Office complexes/units	16,450	2.27%	16,842	2.22%
Solid waste landfills	52,270	7.20%	52,270	6.90%

Asset Quality

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at the amount of unpaid principal, net of unearned interest, deferred loan fees and costs, and reduced by the ALLL. The ALLL is established through a provision for loan losses charged to earnings.

The Company manages credit risk through the efforts of loan officers, the loan review function, and the Loan Quality and the ALLL management committees as well as oversight from the board of directors, along with the application of policies and procedures designed to foster sound underwriting and credit monitoring practices. The Company continually evaluates this process to ensure it is reacting to problems in the loan portfolio in a timely manner. Although, as is the case with any financial institution, a certain degree of credit risk is dependent in part on local and general economic conditions that are beyond the Company s control.

Under the Company s risk rating system, loans rated as pass/watch, special mention, substandard, doubtful or loss are reviewed regularly as part of the Company s risk management practices. The Company s Loan Quality Committee, which consists of key members of senior management and credit administration, meets monthly or more often, as necessary, to review individual problem credits and workout strategies and makes reports to the Board of Directors.

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A loan is considered impaired when it is probable that the Bank will be unable to collect all amounts due (including principal and interest) according to the contractual terms of the note and loan agreement. For purposes of the Company s analysis, loans which are identified as troubled debt restructures (TDRs) or are non-accrual and rated substandard or doubtful are considered impaired. Impaired loans are analyzed individually for the amount of impairment. The Company generally utilizes the fair value of collateral method for collateral dependent loans, which make up the majority of the Company s impaired loans. A loan is considered to be collateral dependent when repayment of the loan is anticipated to come from the liquidation of the collateral held. For loans that are secured by real estate, external appraisals are obtained annually, or more frequently as warranted, to ascertain a fair value so that the impairment analysis can be updated. Should a current appraisal not be available at the time of impairment analysis, other sources of valuation such as current letters of intent, broker price opinions or executed agreements of sale may be used. For non-collateral dependent loans, the Company measures impairment based on the present value of expected future cash flows, net of disposal costs, discounted at the loan s original effective interest rate.

Loans to borrowers that are experiencing financial difficulty that are modified and result in the Company granting concessions to the borrower are classified as TDRs and are considered to be impaired. Concessions granted under a troubled debt restructuring generally involve an extension of a loan s stated maturity date or a reduction of the rate, or payment modifications. Non-accrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after modification.

Non-performing loans are monitored on an ongoing basis as part of the Company s loan review process. Additionally, work-out efforts continue and are actively monitored for non-performing loans and OREO through the Loan Quality Committee. Potential loss on non-performing assets is generally evaluated by comparing the outstanding loan balance to the fair market value of the pledged collateral.

Loans are placed on non-accrual when a loan is specifically determined to be impaired or when management believes that the collection of interest or principal is doubtful. This is generally when a default of interest or principal has existed for 90 days or more, unless such loan is well secured and in the process of collection, or when management becomes aware of facts or circumstances that the loan would default before 90 days. The Company determines delinquency status based on the number of days since the date of the borrower s last required contractual loan payment. When the interest accrual is discontinued, all unpaid interest is reversed and charged back against current earnings. Any cash payments received are applied, first to the outstanding loan amounts, then to the recovery of any charged-off loan amounts. Any excess is treated as a recovery of lost interest. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured and are current for six consecutive months after modification.

Management actively manages impaired loans in an effort to reduce loan balances by working with customers to develop strategies to resolve borrower difficulties, through sale or liquidation of collateral, foreclosure, and other appropriate means. If real estate values continue to decline, it is more likely that we would be required to further increase our provision for loan and lease losses, which in turn, could result in reduced earnings.

Under the fair value of collateral method, the impaired amount of the loan is deemed to be the difference between the loan amount and the fair value of the collateral, less the estimated costs to sell. For the Company s calculations on real estate secured loans, a factor of 10% is generally utilized to estimate costs to sell, which is based on typical cost factors, such as a 6% broker commission, 1% transfer taxes, and 3% various other miscellaneous costs associated with the sales process. If the valuation indicates that the fair value has deteriorated below the carrying value of the loan, either the entire loan is written off or the difference between the fair value and the principal balance is charged off. For loans which are considered to be impaired, but for which the value of the collateral less costs to sell exceeds the loan value, the impairment is considered to be zero.

The following table reflects non-performing loans, OREO and performing TDRs at the dates noted:

	June 30, 2011	December 31, 2010
	(in thousands)	
Non-accrual loans	$ 26,787	$ 28,267
Loans past due 90 days or more and still accruing	74	99
Total Non-Performing Loans	26,861	28,366
Other Real Estate Owned	8,189	9,633
Total Non-Performing Loans and OREO	$ 35,050	$ 37,999
Performing TDRs	2,528	2,513
Non-performing loans as a percentage of gross loans	3.70%	3.74%

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	June 30, 2011	December 31, 2010
	(in thousands)	
Loans with no allocated allowance for loan and lease losses	$ 12,397	$ 19,805
Loans with allocated allowance for loan and lease losses	10,767	10,124
Total Balance of loans considered impaired	$ 23,164	$ 29,929

In the six months ended June 30, 2011, total non-performing loans and OREO decreased $3.0 million, or 7.8%, from $38.0 million at December 31, 2010 to $35.0 million at June 30, 2011, as the effects of the prolonged economic downturn continued to impact individual and business customers of the Company. Non-performing loans and OREO represented 95.7% of shareholders equity at June 30, 2011, as compared to 118.5% of shareholders equity at December 31, 2010. The decrease in non-performing loans and OREO as a percentage of shareholders equity was driven primarily as a result of the $3.0 million reduction in non-performing loans and OREO coupled with an increase in the Company s equity as a result of a $4.9 million decrease in unrealized holding losses on the Company s holdings of securities. Included in non-performing assets are non-accrual loans which decreased $1.5 million during the period. The decrease in non-accrual loans is primarily centered in construction, land acquisition and development loans offset by increases in commercial real estate.

Changes in non-performing loans for the periods indicated are as follows:

(in thousands)	Three Months Ended June 30, 2011	Six Months Ended June 30, 2011
Balance at beginning of period	$ 28,467	$ 28,366
Newly placed on non-accrual		7,568
Loans past due 90 days or more and still accruing	(151)	74
Transferred to OREO	(252)	(2,356)
Additional charge-offs	(1,203)	(1,203)
Loan payments		(861)
Loan sold		(4,727)
Balance at end of period	$ 26,861	$ 26,861

During the six months ended June 30, 2011, a $7.0 million credit was placed on non-accrual status. This credit represents a commercial loan secured by both commercial real estate and a partial guarantee from a government agency. This credit was written down to $5.8 million as of June 30, 2011. Additionally $90 thousand of the allowance for loan and lease losses is allocated to this credit.

During the six months ended June 30, 2011, a term loan and line of credit secured by commercial real estate in the amount of $1.8 million was transferred to OREO.

During the six months ended June 30, 2011, a land development loan secured by a residential subdivision in the amount of $2.2 million and a participation in an out of area real estate bridge loan which was secured by real estate in the amount of $2.5 million were sold.

The additional interest income that would have been earned on non-accrual and restructured loans for the three months ended June 30, 2011 and 2010 in accordance with their original terms approximated $684 thousand and $687 million, respectively, and for the six months ended June 30, 2011 and 2010 approximated $1.4 million and $1.3 million, respectively.

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The following table outlines delinquency within the Company s loan portfolio.

	June 30, 2011	December 31, 2010
30-59 days	0.77%	0.52%
60-89 days	0.19%	0.16%
90 + days	0.01%	0.01%
Non-Accrual	3.69%	3.74%
Total Delinquencies	4.66%	4.43%

Delinquencies for accruing loans remained relatively stable in 2011 compared to 2010 due to transfers of loans to non-accrual and more rigorous collection activity. The increases in the delinquency percentages are predominately attributable to the significant decrease in the Company loan portfolio. In its evaluation for the ALLL, management considers a variety of qualitative factors including changes in the volume and severity of delinquencies.

At June 30, 2011 and December 31, 2010, the Company s ratio of non-accrual loans to total gross loans was 3.7%. The Company continues to acknowledge the weakness in local real estate markets, emphasizing strict underwriting standards to minimize the negative impact of the current environment.

Allowance for Loan and Lease Losses

The ALLL represents management s estimate of probable loan losses inherent in the loan portfolio. The ALLL is analyzed in accordance with GAAP and varies from year to year based on management s evaluation of the adequacy of the ALLL in relation to the risks inherent in the loan portfolio.

In its evaluation, management considers qualitative and environmental factors, including, but not limited to:

- Changes in national, local, and business economic conditions and developments, including the condition of various market segments;
- Changes in the nature and volume of the Company s loan portfolio;
- Changes in the Company s lending policies and procedures, including underwriting standards, collection, charge-off and recovery practices and results;
- Changes in the experience, ability and depth of the Company s lending management and staff;
- Changes in the quality of the Company s loan review system and the degree of oversight by the Company s Board of Directors;

- Changes in the trend of the volume and severity of past due and classified loans, including trends in the volume of non-accrual loans, troubled debt restructurings and other loan modifications;

- The existence and effect of any concentrations of credit and changes in the level of such concentrations;

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- The effect of external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the Company s current loan portfolio; and

- Analysis of its customers credit quality.

Evaluations are intrinsically subjective, as the results are estimated based on management knowledge and experience and are subject to interpretation and modification as information becomes available or as future events occur. Management monitors the loan portfolio on an ongoing basis with emphasis on the declining real estate market and a weakened economy and its effect on repayment. Adjustments to the ALLL are made based on management s assessment of the factors noted above.

Doubtful loans, non-accrual and substandard loans and troubled debt restructurings are considered to be impaired and are analyzed individually to determine the amount of impairment. Circumstances such as construction delays, declining real estate values, and the inability of the borrowers to make scheduled payments have resulted in these loan relationships being classified as impaired. The fair value of collateral method is generally used for this measurement unless the loan is non-collateral dependent in which case, a discounted cash flow analysis is performed. Appraisals are received at least annually to ensure that impairment measurements reflect current market conditions. Should a current appraisal not be available at the time of impairment analysis, other valuation sources including current letters of intent, broker price opinions or executed agreements of sale may be used. Only downward adjustments are made based on these supporting values. Included in all impairment calculations is a cost to sell adjustment of approximately 10%, which is based on typical cost factors, including a 6% broker commission, 1% transfer taxes and 3% various other miscellaneous costs associated with the sales process. Sales costs are periodically revised based on actual experience. The ALLL analysis is adjusted for subsequent events that may arise after the end of the reporting period but before the financial reports are filed.

The Company s ALLL consists of both specific and general components. At June 30, 2011, the ALLL that related to impaired loans was $2.0 million, or 8.5% of total ALLL. The ALLL also included a general allocation of $21.7 million, which represented 91.5% of the total ALLL of $23.7 million. The ratio of the ALLL to total loans at June 30, 2011 and December 31, 2010 was 3.27% and 2.98%, respectively, based on total loans of $725.8 million and $757.9 million, respectively.

The following table presents an allocation of the ALLL and percent of loans in each category at June 30, 2011 and December 31, 2010:

Allocation of the Allowance for Loan Losses

(in thousands)

	June 30, 2011		**December 31, 2010**	
	Amount	**Percentage**	**Amount**	**Percentage**
Residential real estate	$ 2,238	9.44%	$ 2,176	11.60%
Commercial real estate	11,586	48.89%	9,640	33.82%
Construction, land acquisition & development	3,663	15.46%	4,170	10.21%
Commercial and industrial	4,691	19.79%	4,850	26.08%
Consumer	1,172	4.94%	1,173	14.63%
State and political subdivision	351	1.48%	566	3.66%
Total	$ 23,701	100.00%	$ 22,575	100.00%

The following table outlines the changes in the allowance for loan and lease losses for the three and six months ended June 30, 2011 and 2010.

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Analysis of the Allowance for Loan and Lease Losses

(Dollars in thousands)	For the three months ended June 30, 2011	2010	For the six months ended June 30, 2011	2010
Balance at the beginning of the period	$ 24,230	$ 25,505	$ 22,575	$ 22,458
Provision for loan losses	765	4,574	2,509	9,682
Loans Charged Off:				
Residential real estate	(145)		(281)	
Commercial real estate	(1,376)	(1,820)	(1,833)	(2,248)
Commercial land acquisition and development		(734)	(6)	(2,054)
Commercial and industrial	(15)	(163)	(124)	(382)
Consumer	(117)	(27)	(337)	(181)
State and political subdivisions				
Total loans charged-off	(1,653)	(2,744)	(2,581)	(4,865)
Recoveries:				
Residential real estate	7	9	14	13
Commercial real estate	11	17	24	27
Commercial land acquisition and development	117		823	
Commercial and industrial	173	5	247	11
Consumer	51	12	90	52
State and political subdivisions				
Total recoveries	359	43	1,198	103
Net charge-offs	(1,294)	(2,701)	(1,383)	(4,762)
Balance at end of period	$ 23,701	$ 27,378	$ 23,701	$ 27,378
Ratio of net charge-offs during the period as a percentage of average loans outstanding during the period	(0.17)%	(0.31)%	(0.18)%	(0.53)%
Ratio of allowance for loan losses as a percentage of gross loans at end of period	3.27%	3.08%	3.27%	3.08%

Other Real Estate Owned

OREO totaled $8.2 million at June 30, 2011, which is a decrease of $1.4 million from $9.6 million at December 31, 2010. OREO consisted of 28 properties at June 30, 2011 and December 31, 2010. Nine of the properties held in OREO at June 30, 2011 totaled $5.9 million and represented 72.0% of the total. Included in OREO are six properties totaling $798 thousand, or 9.7%, of OREO, located outside of the Company s general market area. Additionally, $2.7 million, or 32.5%, of OREO is located in the Pocono Mountains region located within the Company s primary market area that has been hit particularly hard during the current economic recession.

The Company is actively marketing these properties for sale through a variety of channels including internal marketing and the use of outside brokers/realtors. The carrying value of OREO is generally calculated at an amount not greater than 90% of the most recent fair market appraised value. A 10% factor is generally used to estimate costs to sell, which is based on typical cost factors, such as 6% broker commission, 1% transfer taxes, and 3% various other miscellaneous costs associated with the sales process. This market value is updated on an annual basis or more frequently if new valuation information is available. Further deterioration in the real estate market could result in additional losses on these properties.

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The following table reflects the roll forward of OREO:

(in thousands)		June 30, 2011		2010
Balance, beginning of year	$	9,633	$	11,184
Additions		2,356		5,043
Write-downs		(266)		(896)
Carrying value of OREO sold		(3,534)		(309)
Balance, end of period	$	8,189	$	15,022

The following schedule reflects a breakdown of OREO for the periods presented:

(in thousands)		June 30, 2011		December 31, 2010
Land/Lots	$	2,268	$	8,357
Commercial Real Estate		5,661		1,086
Residential Real Estate		260		190
Total	$	8,189	$	9,633

Liabilities

Total liabilities were $1.05 billion at June 30, 2011, a decrease of $85.2 million, or 7.5%, from $1.14 billion at December 31, 2010. The decrease is primarily attributable to the decrease in total deposits and borrowed funds. Deposit liabilities decreased $49.7 million, or 5.1%, primarily as a result of a $30.4 million, or 6.8% decrease in time deposits, and a $21.5 million or 6.2% decrease in interest-bearing demand deposits. Borrowed funds decreased $36.3 million, or 26.4%, as the Company used the proceeds generated by net loan repayments to pay down FHLB advances.

Equity

Total shareholders equity increased $4.5 million, or 14.20%, to $36.6 million at June 30, 2011 from $32.1 million at December 31, 2010. The increase is primarily due to a $4.9 million reduction in accumulated comprehensive loss from $12.1 million at December 31, 2010 to $7.3 million at June 30, 2011. The decrease in accumulated other comprehensive loss was primarily attributed to the increase in the fair value of securities held in the available-for-sale portfolio. Book value per common share was $2.23 at June 30, 2011 compared to $1.95 at December 31, 2010.

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Liquidity

The term liquidity refers to the ability of the Company to generate sufficient amounts of cash to meet its cash flow needs. Liquidity is required to fulfill the borrowing needs of the Company s credit customers and the withdrawal and maturity requirements of its deposit customers, as well as to meet other financial commitments. Cash and cash equivalents (cash and due from banks and federal funds sold) are the Company s most liquid assets. At June 30, 2011, cash and cash equivalents totaled $57.8 million, a decrease of $16.7 million from $74.5 million at December 31, 2010. Investing activities provided $64.5 million and operating activities provided $4.8 million of cash and cash equivalents during the year, while financing activities utilized $86.0 million. The cash flows provided by investing activities were largely attributable to the proceeds from maturities, calls and principal payments of investment securities totaling $14.9 million, proceeds from sales of securities totaling $16.1 million, and net decrease in loans to customers totaling $26.9 million. The $86.0 million used by financing activities was primarily attributed to a $19.3 million decrease in demand deposits and savings accounts, a $30.4 million decrease in time deposits, and $36.1 of net repayments of FHLB borrowings. The funds provided by operating activities pertain to interest payments received on loans and investments.

Interest Rate Risk

Our consolidated statements of financial position have been prepared in accordance with GAAP, which requires the measurement of financial position and operating results in terms of historical dollars without considering the changes in fair value of certain investments due to changes in interest rates. Generally, the fair value of financial investments such as loans and securities fluctuates inversely with changes in interest rates. As a result, increases in interest rates could result in decreases in the fair value of our interest-earning assets and could adversely affect our results of operation if such assets were sold, or, in the case of securities classified as available-for-sale, could lead to decreases in our shareholders equity, if such securities were retained.

We manage the mix of interest-earning assets and interest-bearing liabilities on a continuous basis to maximize return and adjust our exposure to interest rate risk. This report quantifies the potential changes in net interest income and net portfolio value should interest rates go up or down (shocked) 200 basis points, assuming the yield curves of the rate shocks will be parallel to each other. Net portfolio value is defined as the market value of assets net of the market value of liabilities. The fair value of assets and liabilities is determined using a discounted cash flow calculation. The net portfolio value ratio is the ratio of the net portfolio value to the market value of assets. All changes in income and value are measured as percentage changes from the projected net interest income and net portfolio value at the base interest rate scenario. The base interest rate scenario assumes interest rates at June 30, 2011. Various estimates regarding prepayment assumptions are made at each level of rate shock. However, prepayment penalty income is excluded from this analysis. Actual results could differ significantly from these estimates.

The following table illustrates the simulated impact of a 200 basis point upward or downward movement in interest rates on net interest income and the change in economic value. This analysis assumed that interest-earning asset and interest-bearing liability levels at June 30, 2011 remained constant. The impact of the rate movements were developed by simulating the effect of rates changing over a three-month period from the June 30, 2011 levels.

	RATES + 200	**RATES 200**
Earnings at risk:		
Percent change in net interest income	(1.06)%	(6.96)%
Economic value at risk:		
Percent change in economic value of equity	(13.99)%	16.95%

Off-Balance Sheet Arrangements

In the normal course of operations, the Company engages in a variety of financial transactions that, in accordance with U.S. GAAP, are not recorded in our consolidated financial statements, or are recorded in amounts that differ from the notional amounts. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used for general corporate purposes or for customer needs. Corporate purpose transactions are used to help manage credit, interest rate and liquidity risk or to optimize capital. Customer transactions are used to manage customers requests for funding.

For the three and six month periods ended June 30, 2011, the Company did not engage in any off-balance sheet transactions that would have or would be reasonably likely to have a material effect on its consolidated financial condition.

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ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in the company s exposure to market risk during the first six months of 2011. For discussion of the Company s exposure to market risk, refer to Item 7A, Quantitative and Qualitative Disclosure about Market Risk, contained in the Company s Amended Form 10-K for the year ended December 31, 2010.

ITEM 4 CONTROLS AND PROCEDURES

As of June 30, 2011, the Company carried out an evaluation, under the supervision and with the participation of the Company s management, including the Company s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures pursuant to Rule 13a-15(b), as adopted by the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934 (Exchange Act). The Company had previously reported that, as of December 31, 2010, it had identified a material weaknesses in its internal control over financial reporting as described in the Company s Annual Report on Form 10-K for the year ended December 31, 2010. While the Company made progress in remediating the deficiencies in its internal controls over financial reporting relating to the weaknesses noted in its 2010 Annual Report, all actions were not fully implemented and there was an insufficient period of time to determine whether those processes that were implemented were operating effectively as of June 30, 2011. Based upon that evaluation, the Company s Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures were not effective as of the end of the period covered by this report.

The Company s weaknesses will not be considered remediated until new internal controls are operational for a sufficient period of time and are tested, and management concludes that these controls are operating effectively. The Company is not aware of any transactions that were improperly undertaken as a result of the material weaknesses described in its Annual Report and therefore does not believe that the material weaknesses had any material impact on the Company s financial statements.

Disclosure controls and procedures are the controls and other procedures that are designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files or submits to the SEC under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Internal control over financial reporting includes those policies and procedures that pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company; provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are only being made in accordance with authorizations of management and directors of the Company; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company s assets that could have a material effect on the financial statements. Due to inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our financial statements would be prevented or detected.

The Company continually seeks to improve the effectiveness and efficiency of its internal control over financial reporting, resulting in frequent process refinements. Except for refinements necessary to correct the deficiencies identified in the Company s Annual Report on Form 10-K for the year ended December 31, 2010, there have been no changes to the Company s internal control over financial reporting during the quarter ended June 30, 2011 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II Other Information

Item 1 Legal Proceedings.

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 its business. On August 8, 2011, the Company announced that it has received document subpoenas from the SEC. The information requested generally relates to disclosure and financial reporting by the Company and the restatement of the Company s financial statements for the year ended December 31, 2009, and the quarters ended March 31, 2010 and June 30,

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2010. The Company is cooperating with the SEC in this matter.

On May 24, 2012, a putative shareholder by the name of Lori Gray filed a complaint in the Court of Common Pleas in Lackawanna County against certain present and former directors of the Company (including all of the current directors except for Steven R. Tokach and Thomas J. Melone) and Demetrius & Company, LLC (Demetrius) alleging, inter alia breach of fiduciary duty, abuse of control, corporate waste, unjust enrichment and, in the case of Demetrius, professional negligence, negligent misrepresentation, breach of contract and aiding and abetting breach of fiduciary duty. The Company has been named as a nominal defendant. This matter is in a preliminary stage. In January 2012, the Board appointed a special litigation committee to investigate the matters raised in the Gray complaint. The special litigation committee retained independent counsel to assist with the investigation. The Company is not a party to any pending legal proceedings that the Company believes would have a material adverse effect on its financial condition, results of operations or cash flows.

Item 1A. Risk Factors.

Management of the Company does not believe there have been any material changes in the risk factors that were previously disclosed in the Company s amended Form 10-K for the year ending December 31, 2010.

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

None.

Item 3 - Defaults upon Senior Securities.

None.

Item 4 Mine Safety Disclosures.

Not Applicable.

Item 5 - Other Information.

None.

Item 6 Exhibits.

Exhibit 3.1	Amended and Restated Articles of Incorporation (Incorporated by reference to Exhibit 3.1 of the Company s Form 10-K for the year ended December 31, 2005)
Exhibit 3.2	Amended and Restated Bylaws (Incorporated by reference to Exhibit 3.2 of the Company s Form 10-Q filed on April 6, 2012)
Exhibit 4.1	Form of Subordinated Note (Incorporated by reference to Exhibit 4.1 of the Company s Form 8-K filed with the Commission on August 28, 2009)
Exhibit 4.2	Form of Common Stock Certificate of the Company (Incorporated by reference to Exhibit 4.1 of the Company s Form 10-K for the year ended December 31, 2009)
Exhibit 31.1*	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
Exhibit 31.2*	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
Exhibit 32.1#	Certification of Chief Executive Officer and Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act
Exhibit 101.INS	XBRL Instance Document
Exhibit 101.SCH	XBRL Taxonomy Extension Schema
Exhibit 101.CAL	XBRL Taxonomy Extension Calculation Linkbase
Exhibit 101.DEF	XBRL Taxonomy Extension Definition Linkbase
Exhibit 101.LAB	XBRL Taxonomy Extension Label Linkbase
Exhibit 101.PRE	XBRL Taxonomy Extension Presentation Linkbase

* Filed herewith

Furnished herewith

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SIGNATURES

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

Registrant: FIRST NATIONAL COMMUNITY BANCORP, INC.

Date: August 10, 2012	By: Steven R. Tokach President and Chief Executive Officer	/s/ Steven R. Tokach
Date: August 10, 2012	By: Edward J. Lipkus Chief Financial Officer Principal Financial Officer Principal Accounting Officer	/s/ Edward J. Lipkus