1ST CONSTITUTION BANCORP
Form 10-Q
August 15, 2011

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2011

or

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

For the transition period from _____ to _____

Commission file Number: 000-32891

1ST CONSTITUTION BANCORP
(Exact Name of Registrant as Specified in Its Charter)

| | |
|---|---|
| New Jersey<br>(State of Other Jurisdiction of Incorporation or Organization) | 22-3665653<br>(I.R.S. Employer Identification No.) |
| 2650 Route 130, P.O. Box 634, Cranbury, NJ<br>(Address of Principal Executive Offices) | 08512<br>(Zip Code) |

(609) 655-4500
(Issuer's Telephone Number, Including Area Code)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

| | | | |
|---|---|---|---|
| Large accelerated filer | o | Accelerated filer | o |
| Non-accelerated filer<br>(Do not check if a smaller reporting company) | o | Smaller reporting company | x |

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

As of August 12, 2011, there were 4,805,750 shares of the registrant's common stock, no par value, outstanding.

1ST CONSTITUTION BANCORP

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

1st Constitution Bancorp and Subsidiaries
Consolidated Balance Sheets
(unaudited)

| | June 30, 2011 | December 31, 2010 |
|---|---|---|
| ASSETS | | |
| CASH AND DUE FROM BANKS | $ 90,046,173 | $ 17,699,103 |
| FEDERAL FUNDS SOLD / SHORT-TERM INVESTMENTS | 11,403 | 11,398 |
| Total cash and cash equivalents | 90,057,576 | 17,710,501 |
| INVESTMENT SECURITIES: | | |
| Available for sale, at fair value | 111,698,188 | 85,470,993 |
| Held to maturity (fair value of $145,124,864 and $81,712,004 at June 30, 2011 and December 31, 2010, respectively) | 141,915,638 | 81,889,895 |
| Total investment securities | 253,613,826 | 167,360,888 |
| LOANS HELD FOR SALE | 6,971,757 | 21,219,230 |
| LOANS | 339,867,302 | 411,987,339 |
| Less- Allowance for loan losses | (5,869,581) | (5,762,712) |
| Net loans | 333,997,721 | 406,224,627 |
| PREMISES AND EQUIPMENT, net | 10,661,331 | 6,148,626 |
| ACCRUED INTEREST RECEIVABLE | 2,684,914 | 2,405,741 |
| BANK-OWNED LIFE INSURANCE | 11,673,301 | 11,474,643 |
| OTHER REAL ESTATE OWNED | 6,789,147 | 4,850,818 |
| OTHER ASSETS | 12,980,983 | 7,000,155 |
| Total assets | $ 729,430,556 | $ 644,395,229 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| LIABILITIES: | | |
| Deposits | | |
| Non-interest bearing | $ 112,963,755 | $ 92,023,123 |
| Interest bearing | 530,144,317 | 451,712,026 |
| Total deposits | 643,108,072 | 543,735,149 |

| | | |
|---|---|---|
| BORROWINGS | 10,000,000 | 25,900,000 |
| REDEEMABLE SUBORDINATED DEBENTURES | 18,557,000 | 18,557,000 |
| ACCRUED INTEREST PAYABLE | 1,287,389 | 1,434,338 |
| ACCRUED EXPENSES AND OTHER LIABILITIES | 4,044,943 | 5,087,586 |
| Total liabilities | 676,997,404 | 594,714,073 |
| COMMITMENTS AND CONTINGENCIES | | |
| SHAREHOLDERS' EQUITY: | | |
| Common stock, no par value; 30,000,000 shares authorized; 4,814,635 and 4,812,344 shares issued and 4,805,750 and 4,803,459 shares outstanding at June 30, 2011 and December 31, 2010, respectively | 39,002,113 | 38,899,855 |
| Retained earnings | 12,360,563 | 10,741,779 |
| Treasury Stock, at cost, 8,885 shares | (62,409) | (58,652) |
| Accumulated other comprehensive income | 1,132,885 | 98,174 |
| Total shareholders' equity | 52,433,152 | 49,681,156 |
| Total liabilities and shareholders' equity | $ 729,430,556 | $ 644,395,229 |

See accompanying notes to consolidated financial statements.

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1st Constitution Bancorp and Subsidiaries
Consolidated Statements of Income
(unaudited)

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| INTEREST INCOME | 2011 | 2010 | 2011 | 2010 |
| Loans, including fees | $ 5,167,439 | $ 5,736,377 | $ 10,521,646 | $ 11,065,242 |
| Securities | | | | |
| Taxable | 1,503,134 | 1,219,755 | 2,788,078 | 2,613,641 |
| Tax-exempt | 351,728 | 106,241 | 636,800 | 214,171 |
| Federal funds sold and short-term investments | 63,004 | 12,910 | 72,110 | 32,619 |
| Total interest income | 7,085,305 | 7,075,283 | 14,018,634 | 13,925,673 |
| | | | | |
| INTEREST EXPENSE | | | | |
| Deposits | 1,530,274 | 1,681,345 | 2,928,404 | 3,562,013 |
| Borrowings | 103,712 | 278,007 | 210,632 | 544,422 |
| Redeemable subordinated debentures | 237,280 | 267,540 | 501,434 | 531,690 |
| Total interest expense | 1,871,266 | 2,226,892 | 3,640,470 | 4,638,125 |
| Net interest income | 5,214,039 | 4,848,391 | 10,378,164 | 9,287,548 |
| Provision for loan losses | 275,000 | 550,000 | 674,998 | 850,000 |
| Net interest income after provision for loan losses | 4,939,039 | 4,298,391 | 9,703,166 | 8,437,548 |
| | | | | |
| NON-INTEREST INCOME | | | | |
| Service charges on deposit accounts | 234,898 | 188,672 | 410,740 | 365,028 |
| Gain on sales of loans | 411,643 | 392,577 | 848,382 | 713,121 |
| Income on bank-owned life insurance | 103,522 | 105,056 | 198,659 | 201,695 |
| Other income | 390,249 | 320,715 | 707,281 | 676,022 |
| Total non-interest income | 1,140,312 | 1,007,020 | 2,165,062 | 1,955,866 |
| | | | | |
| NON-INTEREST EXPENSE | | | | |
| Salaries and employee benefits | 2,843,948 | 2,417,234 | 5,420,612 | 4,793,934 |
| Occupancy expense | 580,969 | 452,838 | 1,147,707 | 898,765 |
| Data processing expenses | 313,776 | 272,391 | 617,249 | 531,198 |
| FDIC insurance expenses | 246,458 | 247,568 | 474,005 | 495,251 |
| Other operating expenses | 1,170,634 | 889,059 | 2,159,044 | 1,693,888 |
| Total non-interest expenses | 5,155,785 | 4,279,090 | 9,818,617 | 8,413,036 |
| Income before income taxes | 923,566 | 1,026,321 | 2,049,611 | 1,980,378 |
| | | | | |
| INCOME TAXES | 94,650 | 230,762 | 430,827 | 485,561 |
| Net income | 828,916 | 795,559 | 1,618,784 | 1,494,817 |
| Dividends and accretion on preferred stock | 0 | 176,984 | 0 | 353,968 |
| Net income available to common shareholders | $ 828,916 | $ 618,575 | $ 1,618,784 | $ 1,140,849 |
| | | | | |
| NET INCOME PER COMMON SHARE | | | | |
| Basic | $ 0.17 | $ 0.13 | $ 0.34 | $ 0.24 |
| Diluted | $ 0.17 | $ 0.13 | $ 0.33 | $ 0.24 |

See accompanying notes to consolidated financial statements.

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1st Constitution Bancorp and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
For the Six Months Ended June 30, 2011 and 2010
(unaudited)

| | Preferred Stock | Common Stock | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|---|---|---|---|---|---|---|
| ANCE, January 1, 2010 | $11,473,262 | $36,774,621 | $10,307,331 | $(73,492) | $(1,080,669) | $57,401, |
| nce of vested shares under employee benefit program | | 89,565 | | | | 89,565 |
| e-based compensation | | 30,242 | | | | 30,242 |
| dends on preferred stock | | | (300,000) | | | (300,00 |
| etion of discount on preferred stock | 53,968 | | (53,968) | | | - |
| prehensive Income: | | | | | | |
| et Income for the six months led June 30, 2010 | | | 1,494,817 | | | 1,494,8 |
| inimum pension liability, net of tax | | | | | 137,381 | 137,381 |
| nrealized gain on securities available for sale, f tax | | | | | 924,682 | 924,682 |
| Unrealized gain on interest rate swap contract, net of tax | | | | | 145,852 | 145,852 |
| prehensive Income | | | | | | 2,702,7 |
| nce, June 30, 2010 | $11,527,230 | $36,894,428 | $11,448,180 | $(73,492) | $127,246 | $59,923, |
| nce, January 1, 2011 | $0 | $38,899,855 | $10,741,779 | $(58,652) | $98,174 | $49,681, |
| cise of stock options (1,651 shares) and issuance f vested shares under employee benefit programs | | 75,058 | | 11,597 | | 86,655 |
| e-based compensation | | 27,200 | | | | 27,200 |
| sury stock purchased (1,651 shares) | | | | (15,354) | | (15,354 |
| prehensive Income: | | | | | | |
| et Income for the six months led June 30, 2011 | | | 1,618,784 | | | 1,618,7 |
| inimum pension liability, net of tax | | | | | 3,853 | 3,853 |

| | | | | | | |
|---|---|---|---|---|---|---|
| nrealized gain on securities available for net of tax | | | | | 819,296 | 819,296 |
| realized gain on interest rate swap contract, f tax | | | | | 211,562 | 211,562 |
| prehensive Income | | | | | | 2,653,4 |
| nce, June 30, 2011 | $0 | $39,002,113 | $12,360,563 | $(62,409) | $1,132,885 | $52,433, |

See accompanying notes to consolidated financial statements.

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1st Constitution Bancorp and Subsidiaries
Consolidated Statements of Cash Flows
(unaudited)

| | Six Months Ended June 30, 2011 | 2010 |
|---|---|---|
| OPERATING ACTIVITIES: | | |
| Net income | $1,618,784 | $1,494,817 |
| Adjustments to reconcile net income to net cash provided by operating activities- | | |
| Provision for loan losses | 674,998 | 850,000 |
| Provision for loss on other real estate owned | 147,178 | 0 |
| Depreciation and amortization | 510,473 | 283,856 |
| Net amortization of premiums and discounts on securities | 815,173 | 449,067 |
| Gains on sales of loans held for sale | (848,382) | (713,121) |
| Originations of loans held for sale | (47,402,373) | (55,441,982) |
| Proceeds from sales of loans held for sale | 62,498,228 | 62,803,590 |
| Income on Bank – owned life insurance | (198,658) | (201,695) |
| Share-based compensation expense | 187,921 | 110,242 |
| (Increase) decrease in accrued interest receivable | (276,159) | 73,975 |
| (Increase) decrease in other assets | (1,574,007) | 630,503 |
| Decrease in accrued interest payable | (240,064) | (270,980) |
| Decrease in accrued expenses and other liabilities | (914,212) | (974,451) |
| Net cash provided by operating activities | 14,998,900 | 9,093,821 |
| INVESTING ACTIVITIES: | | |
| Purchases of securities - | | |
| Available for sale | (69,849,189) | (32,936,864) |
| Held to maturity | (83,188,354) | (69,325,000) |
| Proceeds from maturities and prepayments of securities - | | |
| Available for sale | 44,610,442 | 101,957,520 |
| Held to maturity | 22,600,347 | 1,839,718 |
| Net decrease (increase) in loans | 69,306,181 | (54,642,352) |
| Purchase of bank-owned life insurance | 0 | (750,000) |
| Capital expenditures | (347,008) | (1,457,617) |
| Additional investment in other real estate owned | (607,158) | (42,051) |
| Proceeds from sales of other real estate owned | 1,629,315 | 590,316 |
| Cash consideration received in connection with acquisition of branches | 101,539,588 | 0 |
| Net cash provided by (used in) investing activities | 85,694,164 | (54,766,330) |
| FINANCING ACTIVITIES: | | |
| Exercise of stock options and issuance of vested shares | 86,655 | 89,565 |
| Purchase of Treasury Stock | (15,354) | 0 |
| Dividend paid on preferred stock | 0 | (300,000) |
| Net increase (decrease) in demand, savings and time deposits | (12,517,290) | (38,685,346) |
| Net (decrease) increase in borrowings | (15,900,000) | 74,600,000 |

| | | |
|---|---|---|
| Net cash (used in) provided by financing activities | (28,345,989 ) | 35,704,219 |
| | | |
| Increase (decrease) in cash and cash equivalents | 72,347,075 | (9,968,290 ) |
| | | |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 17,710,501 | 25,854,285 |
| | | |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | $90,057,576 | $15,885,995 |
| | | |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Cash paid during the period for - | | |
| Interest | $3,880,534 | $4,909,105 |
| Income taxes | 857,000 | 1,035,000 |
| Non-cash investing activities | | |
| Real estate acquired in full satisfaction of loans in foreclosure | $3,107,664 | $899,146 |

See accompanying notes to consolidated financial statements.

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1st Constitution Bancorp and Subsidiaries
Notes To Consolidated Financial Statements
June 30, 2011 (Unaudited)

(1) Summary of Significant Accounting Policies

The accompanying unaudited Consolidated Financial Statements include 1ST Constitution Bancorp (the "Company"), its wholly-owned subsidiary, 1ST Constitution Bank (the "Bank"), and the Bank's wholly-owned subsidiaries, 1ST Constitution Investment Company of Delaware, Inc., 1ST Constitution Investment Company of New Jersey, Inc., FCB Assets Holdings, Inc., 1ST Constitution Title Agency, LLC, Riverside Lofts, LLC and 249 New York Avenue, LLC. 1ST Constitution Capital Trust II, a subsidiary of the Company, is not included in the Company's consolidated financial statements, as it is a variable interest entity and the Company is not the primary beneficiary. All significant intercompany accounts and transactions have been eliminated in consolidation and certain prior period amounts have been reclassified to conform to current year presentation. The accounting and reporting policies of the Company and its subsidiaries conform to accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") including the instructions to Form 10-Q and Article 8 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to such rules and regulations. These Consolidated Financial Statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Form 10-K for the year ended December 31, 2010, filed with the SEC on March 23, 2011.

In the opinion of the Company, all adjustments (consisting only of normal recurring accruals) which are necessary for a fair presentation of the operating results for the interim periods have been included. The results of operations for periods of less than a year are not necessarily indicative of results for the full year.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of June 30, 2011 for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through the date these financial statements were issued.

(2) Acquisition of Unaffiliated Branches

On March 25, 2011, the Bank acquired certain deposit and other liabilities, real estate and related assets of the Rocky Hill, Hillsborough and Hopewell, New Jersey branch banking offices from another financial institution for a purchase price of $9.85 million (the "Acquisition"). The Acquisition was completed pursuant to the terms and conditions of the Branch Purchase and Assumption Agreement and Agreement for Purchase dated as of December 30, 2010, which was previously disclosed on a Current Report on Form 8-K filed by the Company with the SEC on January 3, 2011.

The Company accounted for this transaction using applicable accounting guidance regarding business combinations. The fair value of savings and transaction deposit accounts acquired was assumed to approximate the carrying value as these accounts have no stated maturity and are payable on demand. A core deposit intangible was ascribed to the value of non-maturity deposits based upon an independent third party evaluation which was prepared using the actual characteristics of the deposits and assumptions we believe to be reasonable. Certificates of deposit accounts were valued utilizing a discounted cash flows analysis based upon the underlying accounts' contractual maturities and interest rates. The present value of the projected cash flow was then determined using discount rates based upon certificate of deposit interest rates available in the marketplace for accounts with similar terms. The fair value of the three branch buildings was determined via appraisals performed by qualified independent third party appraisers. The fair value of loans acquired, all of which were performing, was assumed to approximate amortized cost based upon the small size and nature of those loans. The fair value amounts stated above are preliminary estimates and are subject to adjustment but are not expected to be materially different than those disclosed.

As a result of the Acquisition, the three branches became branches of the Bank. Included in the Acquisition were the assumption of deposit liabilities of $111.9 million, primarily consisting of demand deposits, and the acquisition of cash of approximately $101.5 million, fixed assets of approximately $4.6 million, which includes, without limitation, ownership of the real estate and improvements upon which the branches are situated, and loans of $862,000. The Bank recorded goodwill of approximately $3.2 million and a core deposit intangible asset of approximately $1.7 million as a result of the Acquisition.

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(3) Net Income Per Common Share

Basic net income per common share is calculated by dividing net income less dividends and discount accretion on preferred stock by the weighted average number of common shares outstanding during each period.

Diluted net income per common share is calculated by dividing net income less dividends and discount accretion on preferred stock by the weighted average number of common shares outstanding, as adjusted for the assumed exercise of potential common stock options and unvested restricted stock awards (as defined below), using the treasury stock method. All share information has been adjusted for the effect of a 5% common stock dividend declared December 16, 2010 and paid on February 2, 2011 to shareholders of record on January 18, 2011.

The following tables illustrate the reconciliation of the numerators and denominators of the basic and diluted earnings per common share (EPS) calculations. Dilutive securities in the tables below exclude common stock options and warrants with exercise prices that exceed the average market price of the Company's common stock during the periods presented. Inclusion of these common stock options and warrants would be anti-dilutive to the diluted earnings per common share calculation.

| | Three Months Ended June 30, 2011 | | |
|---|---|---|---|
| | Income | Weighted-average shares | Per share Amount |
| Basic EPS | | | |
| Net income | $ 828,916 | | |
| Preferred stock dividends and accretion | 0 | | |
| Income available to common shareholders | 828,916 | 4,803,337 | $ 0.17 |
| | | | |
| Effect of dilutive securities | | | |
| Stock options and unvested stock awards | | 46,608 | |
| | | | |
| Diluted EPS | | | |
| Income available to common shareholders Plus assumed conversion | $ 828,916 | 4,849,945 | $ 0.17 |

| | Three Months Ended June 30, 2010 | | |
|---|---|---|---|
| | Income | Weighted-average shares | Per share Amount |
| Basic EPS | | | |
| Net income | $ 795,559 | | |
| Preferred stock dividends and accretion | (176,984) | | |
| Income available to common shareholders | 618,575 | 4,753,152 | $ 0.13 |
| | | | |
| Effect of dilutive securities | | | |
| Stock options and unvested stock awards | | 24,921 | |
| | | | |
| Diluted EPS | | | |
| Net income available to common shareholders plus assumed conversion | 618,575 | 4,778,073 | $ 0.13 |

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| | Six Months Ended June 30, 2011 | | |
|---|---|---|---|
| | Income | Weighted-average shares | Per share Amount |
| Basic EPS | | | |
| Net income | $ 1,618,784 | | |
| Preferred stock dividends and accretion | 0 | | |
| Income available to common shareholders | 1,618,784 | 4,803,166 | $ 0.34 |
| | | | |
| Effect of dilutive securities | | | |
| Stock options and unvested stock awards | | 58,783 | |
| | | | |
| Diluted EPS | | | |
| Income available to common shareholders Plus assumed conversion | $ 1,618,784 | 4,861,949 | $ 0.33 |

| | Six Months Ended June 30, 2010 | | |
|---|---|---|---|
| | Income | Weighted-average shares | Per share Amount |
| Basic EPS | | | |
| Net income | $ 1,494,817 | | |
| Preferred stock dividends and accretion | (353,968) | | |
| Income available to common shareholders | 1,140,849 | 4,754,401 | $ 0.24 |
| | | | |
| Effect of dilutive securities | | | |
| Stock options and unvested stock awards | | 20,063 | |
| | | | |
| Diluted EPS | | | |
| Net income available to common shareholders plus assumed conversion | $ 1,140,849 | 4,774,464 | $ 0.24 |

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(4) Investment Securities

Amortized cost, gross unrealized gains and losses, and the estimated fair value by security type are as follows:

| June 30, 2011 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Available for sale- | | | | |
| U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”) and agencies | $ 32,420,768 | $ 193,991 | 0 | $ 32,614,759 |
| Residential collateralized mortgage obligations – GSE | 15,639,285 | 511,537 | 0 | 16,150,822 |
| Residential collateralized mortgage obligations – non-GSE | 4,833,326 | 139,309 | (12,167) | 4,960,468 |
| Residential mortgage backed securities – GSE | 46,190,801 | 1,781,721 | 0 | 47,972,522 |
| Obligations of State and Political subdivisions | 5,381,351 | 172,040 | 0 | 5,553,391 |
| Trust preferred debt securities – single issuer | 2,461,796 | 0 | (407,754) | 2,054,042 |
| Corporate Debt Securities | 1,469,864 | 8,220 | 0 | 1,478,084 |
| Restricted stock | 889,100 | 0 | 0 | 889,100 |
| Mutual fund | 25,000 | 0 | 0 | 25,000 |
| | $ 109,311,291 | $ 2,806,818 | $ (419,921) | $ 111,698,188 |

| June 30, 2011 | Amortized Cost | Other-Than-Temporary Impairment Recognized In Accumulated Other Comprehensive Income | Carrying Value | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|---|---|
| Held to maturity- | | | | | | |
| U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”) and agencies | $4,146,892 | $0 | $4,146,892 | $36,278 | 0 | $4,183,170 |
| Residential collateralized Mortgage obligations – GSE | 26,455,681 | 0 | 26,455,681 | 868,933 | 0 | 27,324,614 |
| Residential collateralized Mortgage obligations - non-GSE | 15,111,197 | 0 | 15,111,197 | 613,195 | 0 | 15,724,392 |
| Residential mortgage backed | 20,772,576 | 0 | 20,772,576 | 612,012 | 0 | 21,384,588 |

| | | | | | | |
|---|---|---|---|---|---|---|
| securities – GSE | | | | | | |
| Obligations of State and Political subdivisions | 48,458,872 | 0 | 48,458,872 | 1,161,174 | (85,500) | 49,534,546 |
| Trust preferred debt securities – pooled | 644,563 | (500,944) | 143,619 | 0 | (140,639) | 2,980 |
| Corporate debt securities | 26,826,801 | 0 | 26,826,801 | 149,487 | (5,714) | 26,970,574 |
| | $142,416,582 | $(500,944) | $141,915,638 | $3,441,079 | $(231,853) | $145,124,864 |

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| December 31, 2010 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Available for sale- | | | | |
| U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”) and agencies | $ 34,299,374 | $ 60,189 | $ 0 | $ 34,359,563 |
| Residential collateralized mortgage obligations- GSE | 18,653,850 | 483,908 | 0 | 19,137,758 |
| Residential collateralized mortgage obligations- non GSE | 5,677,577 | 113,496 | (29,751) | 5,761,322 |
| Residential mortgage backed securities – GSE | 16,963,589 | 1,206,146 | 0 | 18,169,735 |
| Obligations of State and Political subdivisions | 3,110,145 | 23,768 | (112,485) | 3,021,428 |
| Trust preferred debt securities | 2,460,380 | 0 | (602,877) | 1,857,503 |
| Corporate debt securities | 1,495,438 | 4,973 | (1,827) | 1,498,584 |
| Restricted stock | 1,640,100 | 0 | 0 | 1,640,100 |
| Mutual fund | 25,000 | 0 | 0 | 25,000 |
| | $ 84,325,453 | $ 1,892,480 | $ (746,940) | $ 85,470,993 |

| December 31, 2010 | Amortized Cost | Other-Than-Temporary Impairment Recognized In Accumulated Other Comprehensive Income | Carrying Value | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|---|---|
| Held to maturity- | | | | | | |
| U. S. Treasury securities and obligations of U.S. Government sponsored corporations (“GSE”) and agencies | $23,170,741 | $0 | $23,170,741 | $93,600 | $(50,721) | $23,213,620 |
| Residential collateralized mortgage obligations – GSE | 2,520,690 | 0 | 2,520,690 | 84,253 | 0 | 2,604,943 |
| Residential mortgage backed securities – GSE | 9,344,517 | 0 | 9,344,517 | 131,443 | (41,711) | 9,434,249 |
| Obligations of State and Political subdivisions | 19,467,404 | 0 | 19,467,404 | 245,290 | (352,534) | 19,360,160 |
| Trust preferred debt securities – pooled | 642,478 | (500,944) | 141,534 | 0 | (137,361) | 4,173 |
| Corporate debt securities | 27,245,009 | 0 | 27,245,009 | 67,696 | (217,846) | 27,094,859 |
| | $82,390,839 | $(500,944) | $81,889,895 | $622,282 | $(800,173) | $81,712,004 |

Restricted stock at June 30, 2011 and December 31, 2010 consisted of $874,100 and $1,625,100, respectively, of Federal Home Loan Bank of New York stock and $15,000 of Atlantic Central Bankers Bank stock.

The amortized cost and estimated fair value of investment securities at June 30, 2011, by contractual maturity, are shown below.  Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.  Restricted stock is included in “Available for sale - Due in one year or less.”

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| | Amortized Cost | Fair Value |
|---|---|---|
| Available for sale- | | |
| Due in one year or less | $ 1,432,777 | $ 1,436,414 |
| Due after one year through five years | 18,765,941 | 18,912,432 |
| Due after five years through ten years | 21,799,374 | 22,348,348 |
| Due after ten years | 67,313,199 | 69,000,994 |
| Total | $ 109,311,291 | $ 111,698,188 |
| | | |
| Held to maturity- | | |
| Due in one year or less | $ 7,640,715 | $ 7,652,870 |
| Due after one year through five years | 31,731,899 | 31,988,833 |
| Due after five years through ten years | 24,785,532 | 25,380,640 |
| Due after ten years | 78,258,436 | 80,102,521 |
| Total | $ 142,416,582 | $ 145,124,864 |

Gross unrealized losses on securities and the estimated fair value of the related securities aggregated by security category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2011 and December 31, 2010 are as follows:

| June 30, 2011 | | Less than 12 months | | 12 months or longer | | Total | |
|---|---|---|---|---|---|---|---|
| | Number of Securities | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Residential collateralized mortgage obligations – non-GSE | 1 | $ 0 | $ 0 | $ 316,097 | $ (12,167) | $ 316,097 | $ (12,167) |
| Obligations of State and Political Subdivisions | 34 | 10,500,462 | (85,500) | 0 | 0 | 10,500,462 | (85,500) |
| Trust preferred debt securities – single issuer | 4 | 0 | 0 | 2,054,042 | (407,754) | 2,054,042 | (407,754) |
| Trust preferred debt securities – single issuer – pooled | 1 | 0 | 0 | 2,980 | (641,583) | 2,980 | (641,583) |
| Corporate Debt Securities | 6 | 2,470,843 | (5,714) | 0 | 0 | 2,470,843 | (5,714) |
| Total temporarily impaired securities | 46 | $ 12,971,305 | $ (91,214) | $ 2,373,119 | $ (1,061,504) | $ 15,344,424 | $ (1,152,718) |

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| December 31, 2010 | | Less than 12 months | | 12 months or longer | | Total | |
|---|---|---|---|---|---|---|---|
| | Number of Securities | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Government sponsored corporations and agencies | 6 | $5,120,020 | $(50,721) | $- | $- | $5,120,020 | $(50,721) |
| Residential collateralized mortgage Obligations – Non-GSE | 2 | 2,035,105 | (21,478) | 372,747 | (8,273) | 2,407,852 | (29,751) |
| Residential mortgage backed securities GSE | 4 | 4,393,707 | (41,711) | - | - | 4,393,707 | (41,711) |
| Obligations of State and Political Subdivisions | 31 | 11,124,090 | (378,918) | 927,538 | (86,101) | 12,051,628 | (465,019) |
| Trust preferred debt securities – Single issuer | 4 | 0 | 0 | 1,857,503 | (602,877) | 1,857,503 | (602,877) |
| Trust preferred debt securities – Pooled | 1 | 0 | 0 | 4,173 | (638,305) | 4,173 | (638,305) |
| Corporate debt securities | 45 | 24,917,591 | (219,673) | 0 | 0 | 24,917,591 | (219,673) |
| Total temporarily impaired securities | 93 | $47,590,513 | $(712,501) | $3,161,961 | $(1,335,556) | $50,752,474 | $(2,048,057) |

Residential collateralized mortgage obligations and residential mortgaged-backed securities: The unrealized losses on investments in residential collateralized residential mortgage obligations and mortgage-backed securities were caused by interest rate increases. The contractual cash flows of these securities are guaranteed by the issuer, which are generally government or government sponsored agencies. It is expected that the securities would not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

Obligations of State and Political Subdivisions: The unrealized losses or investments in these securities were caused by interest rate increases. It is expected that the securities would not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

Corporate debt securities: The unrealized losses on investments in corporate debt securities were caused by interest rate increases. None of the corporate issuers have defaulted on interest payments. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

Trust preferred debt securities – single issuer: The investments in these securities with unrealized losses are comprised of four corporate trust preferred securities that mature in 2027, all of which were single-issuer securities. The contractual terms of the trust preferred securities do not allow the issuer to settle the securities at a price less than the face value of the trust preferred securities, which is greater than the amortized cost of the trust preferred securities. None of the corporate issuers have defaulted on interest payments. Because the decline in fair value is attributable to widening of interest rate spreads and the lack of an active trading market for these securities and to a lesser degree market concerns on the issuers' credit quality, and because the Company does not intend to sell these investments and it is not more likely than not that the Company will be required to sell these investments before a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

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Trust preferred debt security – pooled: This trust preferred debt security was issued by a two issuer pool (Preferred Term Securities XXV, Ltd. co-issued by Keefe, Bruyette and Woods, Inc. and First Tennessee ("PreTSL XXV")), consisting primarily of financial institution holding companies. During 2009, the Company recognized an other-than-temporary impairment charge of $864,727, of which $363,783 was determined to be a credit loss and charged to operations and $500,944 was recognized in other comprehensive income (loss) component of shareholders' equity.

The primary factor used to determine the credit portion of the impairment loss to be recognized in the income statement for this security was the discounted present value of projected cash flow where that present value of cash flow was less than the amortized cost basis of the security. The present value of cash flow was developed using a model that considered performing collateral ratios, the level of subordination to senior tranches of the security, credit ratings of and projected credit defaults in the underlying collateral.

On a quarterly basis, management evaluates this security to determine if any additional other-than-temporary impairment. As of June 30, 2011, our evaluation was as follows:

a. We obtained the PreTSL XXV Depository Institutions Issuer List as of June 30, 2011 from the FTN Financial Corp. ("FTN") website and reviewed the financial ratios and capital levels of each individual financial institution issuer.

b. We sorted the financial institutions on the issuer list to develop three "buckets" (or categories) for further deferred/default analysis based upon the indicated "Texas Ratio." The Texas Ratio is calculated by dividing the institution's Non-Performing Assets plus loans 90 days past due by the combined total of Tangible Equity plus the Allowance for Loan Losses. The three buckets consisted of those institutions with a Texas Ratio of:

(1) Above 100;

(2) 75 to 100; and

(3) below 75.

c. We then applied the following asset specific deferral/default assumptions to each of these buckets:

(1) Above 100 - 100% default; 0% recovery;

(2) 75 to 100 – 100% deferred; 15% recovery at 2 years from initial date of deferral; and

(3) Below 75 – no deferral/default.

d. We then ran a cash flow projection to analyze the impact of future deferral/default activity by applying the following assumption on those institutions in bucket (3) of our analysis:

- defaults at 75 basis points applied annually; 15% recovery with a 2-year lag from the initial date of deferral.

Our rationale for these metrics is as follows: (1) The FDIC lists the number of bank failures each year from 1934 – 2008. Comparing bank failures to the number of FDIC institutions produces an annual average default rate of 36 basis points. Given the continuing uncertain economic environment, we believe double this amount, or 75 basis points, to be an appropriate measurement for defaults; and (2) Standard & Poor's published "Global Methodology for Rating Trust Preferred/Hybrid Securities Revised" on November 21, 2008. This analysis uses a recovery assumption of 15%, which we also deem an appropriate measurement.

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Our position is that it is appropriate to apply this future default factor in our analysis as it is not realistic to assume no adverse conditions will occur over the remaining 26-year stated maturity of this pooled security even though the individual institutions are currently performing according to terms.

e. This June 30, 2011 projection of future cash flows produced as present value factor that exceeded the carrying value of the pooled trust preferred security; therefore, management concluded that no other-than-temporary impairment issues were present at June 30, 2011.

Any one or more factors, or combinations thereof, could cause management to conclude in future reporting periods that an unrealized loss that exists with respect to PreTSL XXV constitutes an additional credit impairment. These factors include, but are not limited to, failure to make interest payments, an increase in the severity of the unrealized loss, an increase in the continuous duration of the unrealized loss without an impairment in value or changes in market conditions and/or industry or issuer specific factors that would render management unable to forecast a full recovery in value. In addition, the fair value of trust preferred securities could decline if the overall economy and the financial condition of the issuers continue to deteriorate and there remains limited liquidity for this security.

The following table sets forth information with respect to this security at June 30, 2011:

| Security | Class | Amortized Cost | Fair Value | Unrealized Gain (Loss) | Percent of Underlying Collateral Performing | Percent of Underlying Collateral In Deferral (1) | Percent of Underlying Collateral In Default (1) | Expected Deferrals and Defaults as a % of Remaining Performing Collateral | Moody's S&P / Ratings | Excess Subordination (2) Amount | Excess Subordination (2) % of Current Performing Collateral |
|---|---|---|---|---|---|---|---|---|---|---|---|
| PreTSL XXV | B-1 | $644,563 | $2,980 | ($641,583) | 63.4% | 21.8% | 14.8% | 18.2% | Caa2/ NR | $59,000,000 | 11.0% |

Notes to table above:

(1) This percentage represents the amount of specific deferrals / defaults that have occurred, plus those that are known for the following quarters to the total amount of original collateral. Fewer deferrals / defaults produce a lower percentage.

(2) "Excess subordination" amount is the additional defaults / deferrals necessary in the next reporting period to deplete the entire credit enhancement (excess interest and over-collateralization) beneath our tranche within each pool to the point that would cause a "break in yield". This amount assumes that all currently performing collateral continues to perform. A break in yield means that our security would not be expected to receive all the contractual cash flows (principal and interest) by maturity. The "percent of underlying collateral performing" is the ratio of the "excess subordination amount" to current performing collateral - a higher percentage means there is more excess subordination to absorb additional defaults / deferrals, and the better our security is protected from loss.

The following table presents a cumulative roll forward of the amount of other-than-temporary impairment related to credit losses, all of which relate to PreTSL XXV, which have been recognized in earnings for debt securities held to maturity and not intended to be sold.

| (in thousands) | Three and six months ended June 30, 2011 | Three and six months ended June 30, 2010 |
|---|---|---|
| Balance at beginning of period | $ 364 | $ 364 |
| Change during the period | - | - |
| Balance at end of period | $ 364 | $ 364 |

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(5) Loans and Allowance for Loan Losses

The Company's primary lending emphasis is the origination of commercial and commercial real estate loans and mortgage warehouse lines of credit. Based on the composition of the loan portfolio, the inherent primary risks are deteriorating credit quality, a decline in the economy, and a decline in New Jersey real estate market values. Any one, or a combination, of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

The following table provides an aging of the loan portfolio by loan class at June 30, 2011:

| | 30-59 Days | 60-89 Days | Greater than 90 Days | Total Past Due | Current | Total Loans Receivable | Recorded Investment > 90 Days Accruing | Non-accrual Loans |
|---|---|---|---|---|---|---|---|---|
| Commercial | | | | | | | | |
| Construction | $0 | $0 | $3,027,421 | $3,027,421 | $55,900,431 | $58,927,852 | $0 | $3,027,421 |
| Commercial Business | 96,725 | 0 | 1,055,246 | 1,151,971 | 44,780,614 | 45,932,585 | 0 | 1,182,047 |
| Commercial Real Estate | 2,340,497 | 0 | 1,056,965 | 3,397,462 | 89,716,787 | 93,114,249 | 0 | 1,401,426 |
| Mortgage Warehouse Lines | 0 | 0 | 0 | 0 | 117,490,567 | 117,490,567 | 0 | 0 |
| | | | | | | | | |
| Residential Real Estate | 471,836 | 0 | 0 | 471,836 | 10,141,551 | 10,613,387 | 0 | 0 |
| | | | | | | | | |
| Consumer | | | | | | | | |
| Loans to Individuals | 0 | 0 | 77,858 | 77,858 | 12,668,814 | 12,746,672 | 0 | 77,858 |
| Other | 0 | 0 | 0 | 0 | 233,602 | 233,602 | 0 | 0 |
| | | | | | | | | |
| Deferred Loan Fees | 0 | 0 | 0 | 0 | 808,388 | 808,388 | 0 | 0 |
| | | | | | | | | |
| Total | $2,909,058 | $0 | $5,217,490 | $8,126,548 | $331,740,754 | $339,867,302 | $0 | $5,688,752 |

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The following table provides an aging of the loan portfolio by loan class at December 31, 2010:

| | 30-59 Days | 60-89 Days | Greater than 90 Days | Total Past Due | Current | Total Loans Receivable | Recorded Investment > 90 Days Accruing | Non-accrual Loans |
|---|---|---|---|---|---|---|---|---|
| Commercial | | | | | | | | |
| Construction | $0 | $0 | $6,569,296 | $6,569,296 | $61,321,407 | $67,890,703 | $0 | $6,569,296 |
| Commercial Business | 113,801 | 60,526 | 605,208 | 779,335 | 53,953,637 | 54,733,172 | 0 | 750,623 |
| Commercial Real Estate | 3,179,541 | 0 | 1,411,390 | 4,590,931 | 90,686,883 | 95,277,814 | 0 | 1,411,390 |
| Mortgage Warehouse Lines | 0 | 0 | 0 | 0 | 169,575,899 | 169,575,899 | 0 | 0 |
| Residential Real Estate | 173,708 | 0 | 0 | 173,708 | 10,261,330 | 10,435,038 | 0 | 0 |
| Consumer | | | | | | | | |
| Loans to Individuals | 0 | 0 | 77,858 | 77,858 | 13,271,178 | 13,349,036 | 0 | 77,858 |
| Other | 0 | 0 | 0 | 0 | 181,924 | 181,924 | 0 | 0 |
| Deferred Loan Fees | 0 | 0 | 0 | 0 | 543,753 | 543,753 | 0 | 0 |
| Total | $3,467,050 | $60,526 | $8,663,752 | $12,191,328 | $399,796,011 | $411,987,339 | $0 | $8,809,167 |

Management reviews the adequacy of the allowance on at least a quarterly basis to ensure that the provision for loan losses has been charged against earnings in an amount necessary to maintain the allowance at a level that is adequate based on management's assessment of probable estimated losses.  The Company's methodology for assessing the adequacy of the allowance for loan losses consists of several key elements.  These elements include a specific reserve for impaired loans, an allocated reserve, and an unallocated portion.

The Company consistently applies the following comprehensive methodology.  During the quarterly review of the allowance for loan losses, the Company considers a variety of factors that include:

- General economic conditions.
- Trends in charge-offs.
- Trends and levels of delinquent loans.
- Trends and levels of non-performing loans, including loans over 90 days delinquent.
- Trends in volume and terms of loans.
- Levels of allowance for specific classified loans.
- Credit concentrations.

The methodology includes the segregation of the loan portfolio into loan types with a further segregation into risk rating categories, such as special mention, substandard, doubtful, and loss. This allows for an allocation of the allowance for loan losses by loan type; however, the allowance is available to absorb any loan loss without restriction. Larger balance, non-homogeneous loans representing significant individual credit exposures are evaluated individually through the internal loan review process. It is this process that produces the watch list. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated. Based on these reviews, an estimate of probable losses for the individual larger-balance loans are determined, whenever possible, and used to establish specific loan loss reserves. In general, for non-homogeneous loans not individually assessed, and for homogeneous groups, such as residential mortgages and consumer credits, the loans are collectively evaluated based on delinquency status, loan type, and historical losses. These loan groups are then internally risk rated.

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The watch list includes loans that are assigned a rating of special mention, substandard, doubtful and loss. Loans classified special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans rated as doubtful in whole, or in part, are placed in non-accrual status. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses.

The specific reserve for impaired loans is established for specific loans which have been identified by management as being impaired. These impaired loans are assigned a doubtful risk rating grade because the loan has not performed according to payment terms and there is reason to believe that repayment of the loan principal in whole, or part, is unlikely. The specific portion of the allowance is the total amount of potential unconfirmed losses for these individual doubtful loans. To assist in determining the fair value of loan collateral, the Company often utilizes independent third party qualified appraisal firms which in turn employ their own criteria and assumptions that may include occupancy rates, rental rates, and property expenses, among others.

The second category of reserves consists of the allocated portion of the allowance. The allocated portion of the allowance is determined by taking pools of loans outstanding that have similar characteristics and applying historical loss experience for each pool. This estimate represents the potential unconfirmed losses within the portfolio. Individual loan pools are created for commercial and commercial real estate loans, construction loans, and various types of loans to individuals. The historical estimation for each loan pool is then adjusted to account for current conditions, current loan portfolio performance, loan policy or management changes, or any other factor which may cause future losses to deviate from historical levels.

The Company also maintains an unallocated allowance. The unallocated allowance is used to cover any factors or conditions which may cause a potential loan loss but are not specifically identifiable. It is prudent to maintain an unallocated portion of the allowance because no matter how detailed an analysis of potential loan losses is performed, these estimates by definition lack precision. Management must make estimates using assumptions and information that is often subjective and changing rapidly.

The following discusses the risk characteristics of each of our loan portfolio segments, commercial and consumer.

Commercial

The Company's primary lending emphasis is the origination of commercial and commercial real estate loans and mortgage warehouse lines of credit. Based on the composition of the loan portfolio, the inherent primary risks are deteriorating credit quality, a decline in the economy, and a decline in New Jersey real estate market values. Any one, or a combination, of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

Consumer

The Company's loan portfolio consumer segment is comprised of residential real estate loans, home equity loans and other loans to individuals. Individual loan pools are created for the various types of loans to individuals.

In general, for homogeneous groups, such as residential mortgages and consumer credits, the loans are collectively evaluated based on delinquency status, loan type, and industry historical losses. These loan groups are then internally risk rated.

The Company considers the following credit quality indicators in assessing the risk in the loan portfolio:

- Consumer credit scores
- Internal credit risk grades
- Loan-to-value ratios
- Collateral
- Collection experience

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The Company’s internal credit risk grades are based on the definitions currently utilized by the banking regulatory agencies. The grades assigned and definitions are as follows, and loans graded excellent, above average, good and watch list are treated as “pass” for grading purposes:

1. Excellent - Loans that are based upon cash collateral held at the Bank and adequately margined. Loans that are based upon "blue chip" stocks listed on the major exchanges and adequately margined.

2. Above Average - Loans to companies whose balance sheets show excellent liquidity and long-term debt is on well-spread schedules of repayment easily covered by cash flow. Such companies have been consistently profitable and have diversification in their product lines or sources of revenue. The continuation of profitable operations for the foreseeable future is likely. Management is comprised of a mix of ages, experience, and backgrounds and management succession is in place. Sources of raw materials and service companies, the source of revenue is abundant. Future needs have been planned for. Character and ability of individuals or company principals are excellent. Loans to individuals supported by high net worths and liquid assets.

3. Good - Loans to companies whose balance sheets show good liquidity and cash flow adequate to meet maturities of long-term debt with a comfortable margin. Such company has established a profitable record over a number of years, and there has been growth in net worth. Operating ratios are in line with those of the industry, and expenses are in proper relationship to the volume of business done and the profits achieved. Management is well-balanced and competent in their responsibilities. Economic environment is favorable; however, competition is strong. The prospects for growth are good. Loans in this category do not meet the collateral requirements of loans in categories 1 and 2 above. Loans to individuals supported by good net worths but whose supporting assets are illiquid.

3w. Watch List - Included in this category are loans evidencing problems identified by Bank management requiring closer supervision. Such problem has not developed to the point which requires a Special Mention rating. This category also covers situations where the Bank does not have adequate current information upon which credit quality can be determined. The account officer has the obligation to correct these deficiencies within 30 days after the time of notification.

4. Special Mention - Loans or borrowing relationships that require more than the usual amount of attention by Bank management. Industry conditions may be adverse or weak. The borrower's ability to meet current payment schedules may be questionable, even though interest and principal are being paid as agreed. Heavy reliance has been placed on the collateral. Profits, if any, are interspersed with losses. Management is "one man" or weak or incompetent or there is no plan for management succession. Expectations of a loan loss are not immediate; however, if present trends continue, a loan loss could be expected.

5. Substandard - Loans in this category possess weaknesses that jeopardize the ultimate collection of total outstandings. These weaknesses require close supervision by Bank management. Current financial statements are unavailable and the loan is inadequately protected by the collateral pledged. This category will normally include loans that have been classified as substandard by the regulators.

6. Doubtful - Loans with weaknesses inherent in the substandard classification and where collection or liquidation in full is highly questionable. It is likely that the loan will not be collected in full and the Bank will suffer some loss which is not quantifiable at the time of review.

7. Loss - Loans considered uncollectable and of such little value that their continuance as an active asset is not warranted. Loans in this category should immediately be eliminated from the Bank's loan loss reserve. Any accrued interest should immediately be backed out of income.

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The following table provides a breakdown of the loan portfolio by credit quality indictor at June 30, 2011.

| Commercial Credit Exposure - By Internally Assigned Grade | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse Lines | Residential Real Estate |
|---|---|---|---|---|---|
| Grade: | | | | | |
| Pass | $46,666,637 | $43,310,186 | $81,134,613 | $117,490,567 | $10,094,693 |
| Special Mention | 4,761,276 | 1,164,409 | 7,743,292 | 0 | 0 |
| Substandard | 7,499,939 | 1,256,317 | 3,632,092 | 0 | 518,694 |
| Doubtful | 0 | 201,673 | 604,252 | 0 | 0 |
| Total | $58,927,852 | $45,932,585 | $93,114,249 | $117,490,567 | $10,613,387 |

| Consumer Credit Exposure - By Payment Activity | Loans To Individuals | Other |
|---|---|---|
| Performing | $12,668,814 | $233,602 |
| Nonperforming | 77,858 | 0 |
| Total | $12,746,672 | $233,602 |

The following table provides a breakdown of the loan portfolio by credit quality indictor at December 31, 2010.

| Commercial Credit Exposure - By Internally Assigned Grade | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse Lines | Residential Real Estate |
|---|---|---|---|---|---|
| Grade: | | | | | |
| Pass | $52,445,421 | $52,587,444 | $85,122,509 | $169,575,899 | $10,435,038 |
| Special Mention | 4,482,569 | 433,377 | 3,668,243 | 0 | 0 |
| Substandard | 10,962,713 | 1,499,461 | 5,823,312 | 0 | 0 |
| Doubtful | 0 | 212,890 | 663,750 | 0 | 0 |
| Total | $67,890,703 | $54,733,172 | $95,277,814 | $169,575,899 | $10,435,038 |

| Consumer Credit Exposure - By Payment Activity | Loans To Individuals | Other |
|---|---|---|
| Performing | $13,271,178 | $181,924 |
| Nonperforming | 77,858 | 0 |
| Total | $13,349,036 | $181,924 |

Impaired Loans Disclosures

Loans are considered to be impaired when, based on current information and events, it is determined that the Company will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. When a loan is placed on non-accrual status, it is also considered to be impaired. Loans are placed on non-accrual status when: (1) the full collection of interest or principal becomes uncertain; or (2) they are contractually past due 90 days or more as to interest or principal payments unless both well secured and in the process of collection.

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The following tables summarize the distribution of the allowance for loan losses and loans receivable by loan class and impairment method at June 30, 2011 and December 31, 2010:

ances By Impairment Method – June 30, 2011

| | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse | Residential Real Estate | Consumer | Other | Unallocated | Deferred Fees |
|---|---|---|---|---|---|---|---|---|---|
| loan losses: | | | | | | | | | |
| e | $2,455,257 | $922,398 | $1,621,112 | $528,708 | $77,235 | $187,451 | $2,453 | $74,967 | $0 |
| | | | | | | | | | |
| e | | | | | | | | | |
| valuated ent | 817,418 | 338,125 | 295,627 | 0 | 11,619 | 77,858 | 0 | 0 | 0 |
| valuated nent | 1,637,839 | 584,273 | 1,325,485 | 528,708 | 65,616 | 109,593 | 2,453 | 74,967 | 0 |
| | | | | | | | | | |
| les: | | | | | | | | | |
| e | $58,927,852 | $45,932,585 | $93,114,249 | $117,490,567 | $10,613,387 | $12,746,672 | $233,602 | $0 | $808,388 |
| valuated ment | 3,027,421 | 1,267,050 | 1,401,427 | 0 | 518,694 | 77,858 | 0 | 0 | 0 |
| valuated nent | 55,900,431 | 44,665,535 | 91,712,822 | 117,490,567 | 10,094,693 | 12,668,814 | 233,602 | 0 | 808,388 |

ances By Impairment Method – December 31, 2010

| | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse | Residential Real Estate | Consumer | Other | Unallocated | Deferred Fees |
|---|---|---|---|---|---|---|---|---|---|
| oan losses: | | | | | | | | | |
| | $1,744,068 | $971,994 | $1,723,865 | $763,092 | $67,828 | $192,457 | $1,910 | $297,498 | $0 |
| | | | | | | | | | |
| | | | | | | | | | |
| valuated ent | 45,000 | 180,525 | 271,382 | 0 | 0 | 77,858 | 0 | 0 | 0 |
| valuated ent | 1,699,068 | 791,469 | 1,452,483 | 763,092 | 67,828 | 114,599 | 1,910 | 297,498 | 0 |
| | | | | | | | | | |
| es: | | | | | | | | | |
| | $67,890,703 | $54,733,172 | $95,277,814 | $169,575,899 | $10,435,038 | $13,349,036 | $181,924 | 0 | 543,753 |
| valuated ment | 6,569,296 | 750,623 | 1,411,390 | 0 | 0 | 77,858 | 0 | 0 | 0 |
| valuated ent | 63,748,566 | 51,555,390 | 93,866,424 | 169,575,899 | 10,435,038 | 13,271,178 | 181,924 | 0 | 543,753 |

The allowance for loan loss by loan class at both June 30, 2011 and December 31, 2010, and related activity for the six months ended June 30, 2011, are as follows:

| | Construction | Commercial Business | Commercial Real Estate | Mortgage Warehouse | Residential Real Estate | Consumer | Other | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|---|

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| ance - December 31, 2010 | $1,744,068 | $971,994 | $1,723,865 | $763,092 | $67,828 | $192,457 | $1,910 | $297,498 | $5,762,7 |
| vision charged to operations | 1,183,736 | (55,760 ) | (318,432 ) | (344,826) | 9,777 | (1,990 ) | 571 | (73,078 ) | 399,998 |
| ans charged off | (366,587 ) | (46,319 ) | - | - | - | - | - | - | (412,90 |
| coveries of loans charged off | - | 239 | - | - | - | - | - | - | 239 |
| ance - March 31, 2011 | $2,561,217 | $870,154 | $1,405,433 | $418,266 | $77,605 | $190,467 | $2,481 | $224,420 | $5,750,0 |
| vision charged to operations | 52,940 | 48,806 | 215,679 | 110,442 | (370 ) | (3,016 ) | (28 ) | (149,453) | 275,000 |
| ans charged off | (158,900 ) | - | - | - | - | - | - | - | (158,90 |
| coveries of loans charged off | - | 3,438 | - | - | - | - | - | - | 3,438 |
| ance - June 30, 2011 | $2,455,257 | $922,398 | $1,621,112 | $528,708 | $77,235 | $187,451 | $2,453 | $74,967 | $5,869,5 |

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When a loan is identified as impaired, the measurement of impairment is based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole remaining source of repayment for the loan is the liquidation of the collateral. In such cases, the current fair value of the collateral less selling costs is used. If the value of the impaired loan is less than the recorded investment in the loan, the impairment is recognized through an allowance estimate or a charge to the allowance.

Impaired Loans Receivables (By Class) – June 30, 2011

| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Year to Date Average Recorded Investment | Year to Date Interest Income Recognized |
|---|---|---|---|---|---|
| With no related allowance: | | | | | |
| | | | | | |
| Commercial | | | | | |
| Construction | $-- | $-- | $-- | $ 113,947 | $ -- |
| Commercial Business | 87,922 | 99,312 | -- | 348,094 | -- |
| Commercial Real Estate | 260,060 | 260,060 | -- | 292,682 | -- |
| Mortgage Warehouse Lines | -- | -- | -- | -- | -- |
| | 347,982 | 359,372 | -- | 754,723 | -- |
| Residential Real Estate | -- | -- | -- | -- | -- |
| | | | | | |
| Consumer | | | | | |
| Loans to Individuals | -- | -- | -- | -- | -- |
| Other | -- | -- | -- | -- | -- |
| | | | | | |
| With no related allowance: | 347,982 | 359,372 | - | 754,723 | -- |
| | | | | | |
| With a related allowance: | | | | | |
| | | | | | |
| Commercial | | | | | |
| Construction | 3,027,421 | 3,071,921 | 817,418 | 3,268,474 | -- |
| Commercial Business | 1,179,128 | 1,179,128 | 338,125 | 832,399 | -- |
| Commercial Real Estate | 1,141,367 | 1,141,367 | 295,627 | 1,111,122 | -- |
| Mortgage Warehouse Lines | -- | -- | -- | -- | -- |
| | 5,347,916 | 5,392,416 | 1,451,170 | 5,211,995 | -- |
| Residential Real Estate | 518,694 | 518,694 | 11,619 | 519,000 | 4,544 |
| | | | | | |
| Consumer | | | | | |
| Loans to Individuals | 77,858 | 77,858 | 77,858 | 77,858 | -- |
| Other | -- | -- | -- | -- | -- |
| | 77,858 | 77,858 | 77,858 | 77,858 | -- |
| With a related allowance: | 5,944,468 | 5,988,968 | 1,540,647 | 5,808,853 | 4,544 |
| | | | | | |
| Total: | | | | | |
| Commercial | 5,695,898 | 5,751,788 | 1,451,170 | 5,966,718 | -- |
| Residential Real Estate | 518,694 | 518,694 | 11,619 | 519,000 | 4,544 |
| Consumer | 77,858 | 77,858 | 77,858 | 77,858 | -- |
| | $6,292,450 | $6,348,340 | $1,540,647 | $ 6,563,576 | $ 4,544 |

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Impaired Loans Receivables (By Class) – December 31, 2010

| | | Recorded Investment | | Unpaid Principal Balance | | Related Allowance |
|---|---|---|---|---|---|---|
| With no related allowance: | | | | | | |
| Commercial | | | | | | |
| Construction | $ | 4,409,296 | $ | 4,453,796 | $ | -- |
| Commercial Business | | 385,370 | | 394,654 | | -- |
| Commercial Real Estate | | 554,986 | | 554,986 | | -- |
| Mortgage Warehouse Lines | | -- | | -- | | -- |
| | | 5,349,652 | | 5,403,436 | | -- |
| Residential Real Estate | | -- | | -- | | -- |
| Consumer | | | | | | |
| Loans to Individuals | | -- | | -- | | -- |
| Other | | -- | | -- | | -- |
| | | -- | | -- | | -- |
| | | 5,349,652 | | 5,403,436 | | -- |
| With an allowance: | | | | | | |
| Commercial | | | | | | |
| Construction | | 2,160,000 | | 2,160,000 | | 45,000 |
| Commercial Business | | 365,253 | | 365,253 | | 180,525 |
| Commercial Real Estate | | 856,404 | | 856,404 | | 271,382 |
| Mortgage Warehouse Lines | | -- | | -- | | -- |
| | | 3,381,657 | | 3,381,657 | | 496,907 |
| Residential Real Estate | | -- | | -- | | -- |
| Consumer | | | | | | |
| Loans to Individuals | | 77,858 | | 77,858 | | 77,858 |
| Other | | -- | | -- | | -- |
| | | 77,858 | | 77,858 | | 77,858 |
| | | 3,459,515 | | 3,459,515 | | 574,765 |
| Total: | | | | | | |
| Commercial | | 8,731,309 | | 8,785,093 | | 496,907 |
| Residential Real Estate | | -- | | -- | | -- |
| Consumer | | 77,858 | | 77,858 | | 77,858 |
| | $ | 8,809,167 | $ | 8,862,951 | $ | 574,765 |

(6) Share-Based Compensation

The Company establishes fair value for its equity awards to determine its cost and recognizes the related expense for stock options over the vesting period using the straight-line method. The grant date fair value for stock options is calculated using the Black-Scholes option valuation model.

The Company’s stock-based incentive plans (the “Stock Plans”) authorize the issuance of an aggregate of 1,236,375 shares of Company common stock pursuant to awards that may be granted in the form of stock options to purchase common stock (“Options”) and awards of shares of common stock (“Stock Awards”). The purpose of the Stock Plans is to attract and retain personnel for positions of substantial responsibility and to provide additional incentive to certain officers, directors, employees and other persons to promote the success of the Company. Under the Stock Plans, options have a term of ten years after the date of grant, subject to earlier termination in certain circumstances. Options are granted with an exercise price at the then fair market value of the Company’s common stock. As of June 30, 2011, there were 199,003 shares of common stock (as adjusted for the 5% stock dividend declared December 16, 2010 and paid February 2, 2011 to shareholders of record on January 18, 2011) available for future grants under the Stock Plans.

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Stock-based compensation expense related to Options was $27,200 and $30,242 for the six months ended June 30, 2011 and 2010, respectively.

Transactions under the Stock Plans during the six months ended June 30, 2011 are summarized as follows:

| Stock Options | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding at January 1, 2011 | 156,244 | $ 10.74 | | |
| Granted | 27,930 | 8.34 | | |
| Exercised | (1,709 ) | 5.85 | | |
| Forfeited | - | - | | |
| Expired | - | - | | |
| Outstanding at June 30, 2011 | 182,465 | $ 10.42 | 5.5 | $40,410 |
| | | | | |
| Exercisable at June 30, 2011 | 131,952 | $ 11.13 | 4.4 | $35,766 |

The total intrinsic value (market value on date of exercise less grant price) of options exercised during the six months ended June 30, 2011 was $4,491.

The fair value of each option and the significant weighted average assumptions used to calculate the fair value of the options granted for the six months ended June 30, 2011 are as follows:

| | |
|---|---|
| Fair value of options granted | $ 3.24 |
| Risk-free rate of return | 1.99% |
| Expected option life in years | 7 |
| Expected volatility | 33.02% |
| Expected dividends (1) | - |

(1) To date, the Company has not paid cash dividends on its common stock.

As of June 30, 2011, there was approximately $145,989 of unrecognized compensation cost related to nonvested stock options based compensation arrangements granted under the Stock Plans. That cost is expected to be recognized over the next four years.

The following table summarizes nonvested restricted shares for the six months ended June 30, 2011 (as adjusted to reflect the 5% stock dividend declared in December 2010).

| Non-vested shares | Number of Shares | Average Grant Date Fair Value |
|---|---|---|
| Non-vested at January 1, 2011 | 109,518 | $ 7.70 |
| Granted | 30,855 | 7.91 |
| Vested | (5,895 ) | 9.07 |
| Forfeited | (3,782 ) | 8.15 |

| | | | |
|---|---|---|---|
| Non-vested at June 30, 2011 | 130,696 | $ | 7.67 |

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The value of restricted shares is based upon the closing price of the common stock on the date of grant. The shares generally vest over a four year service period with compensation expense recognized on a straight-line basis.

Stock based compensation expense related to stock grants was $160,721 and $80,000 for the six months ended June 30, 2011 and 2010.

As of June 30, 2011, there was approximately $737,037 of unrecognized compensation cost related to nonvested stock grants that will be recognized over the next four years.

(7) Benefit Plans

The Company has a 401(k) plan which covers substantially all employees with six months or more of service. The Company's contributions to the 401(k) plan are expensed as incurred.

The Company also provides retirement benefits to certain employees under supplemental executive retirement plans (the "SERPs"). The SERPs are unfunded and the Company accrues actuarial determined benefit costs over the estimated service period of the employees in the SERPs. The Company recognizes the over funded or under funded status of a defined benefit post-retirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur, through comprehensive income.

The components of net periodic expense for the Company's SERPs for the three months ended June 30, 2011 and 2010 are as follows:

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Service cost | $ 68,425 | $ 56,514 | $ 136,850 | $ 113,028 |
| Interest cost | 57,057 | 48,435 | 114,114 | 96,870 |
| Actuarial (gain) loss recognized | (2,062) | 38,517 | (4,124) | 77,034 |
| Prior service cost recognized | 19,859 | 24,858 | 39,718 | 49,716 |
| | $ 143,279 | $ 168,324 | $ 286,558 | $ 336,648 |

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(8) Other Comprehensive Income and Accumulated Other Comprehensive Income

The components of accumulated other comprehensive income and their related income tax effects were as follows:

| | June 30, 2011 | December 31, 2010 |
|---|---|---|
| Unrealized holding gains on securities available for sale | $ 2,386,897 | $ 1,145,540 |
| Related income tax effect | (811,544 ) | (389,483 ) |
| | 1,575,353 | 756,057 |
| | | |
| Unrealized impairment loss on held to maturity security | (500,944 ) | (500,944 ) |
| Related income tax effect | 170,321 | 170,321 |
| | (330,623 ) | (330,623 ) |
| | | |
| Unrealized loss on interest rate swap contract | 0 | (353,552 ) |
| Related income tax effect | 0 | 141,990 |
| | 0 | (211,562 ) |
| | | |
| Pension liability | (185,101 ) | (191,539 ) |
| Related income tax effect | 73,256 | 75,841 |
| | (111,845 ) | (115,698 ) |
| | | |
| Accumulated other comprehensive income | $ 1,132,885 | $ 98,174 |

The components of other comprehensive income and their related income tax effects for the three and six month periods ended June 30, 2011 and 2010 are as follows:

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | June 30, 2011 | June 30, 2010 | June 30, 2011 | June 30, 2010 |
| Unrealized holding gain on securities available for sale | $ 1,418,929 | $ 568,173 | $ 1,241,357 | $ 1,401,031 |
| Related income tax effect | (482,436) | (163,423) | (422,061) | (476,349) |
| | 936,493 | 404,750 | 819,296 | 924,682 |
| | | | | |
| Unrealized gain on interest rate swap contract | 179,773 | 175,499 | 353,552 | 242,843 |
| Related income tax effect | (72,582) | (65,686) | (141,990) | (96,991) |
| | 107,191 | 109,813 | 211,562 | 145,852 |
| | | | | |
| Pension liability amortization | 3,219 | 113,922 | 6,438 | 227,845 |
| Related income tax effect | (1,293) | (45,771) | (2,585) | (90,464) |
| | 1,926 | 68,151 | 3,853 | 137,381 |
| | | | | |
| Other comprehensive income | $ 1,045,610 | $ 582,714 | $ 1,034,711 | $ 1,207,915 |

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(9) Recent Accounting Pronouncements

ASU 2011-05 (Presentation of Comprehensive Income)

The provisions of this ASU amend FASB ASC Topic 220, Comprehensive Income, to facilitate the continued alignment of U.S. GAAP with International Accounting Standards. The ASU prohibits the presentation of the components of comprehensive income in the statement of shareholders' equity. Reporting entities are allowed to present either: a statement of comprehensive income, which reports both net income and other comprehensive income; or separate, but consecutive, statements of net income and other comprehensive income. Under previous GAAP, all three presentations were acceptable. Regardless of the presentation selected, the reporting entity is required to present all reclassifications between other comprehensive and net income on the face of the new statement or statements. The provisions of this ASU are effective for fiscal years and interim periods beginning after December 31, 2011 for public entities. As the two remaining options for presentation existed prior to the issuance of this ASU, early adoption is permitted.

ASU 2011-04 (Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs)

This ASU amends FASB ASC Topic 820, Fair Value Measurements, to bring U.S. GAAP for fair value measurements in line with International Accounting Standards. The ASU clarifies existing guidance for items such as: the application of the highest and best use concept to non-financial assets and liabilities; the application of fair value measurement to financial instruments classified in a reporting entity's shareholders' equity; and disclosure requirements regarding quantitative information about unobservable inputs used in the fair value measurements of level 3 assets. The ASU also creates an exception to Topic 820 for entities which carry financial instruments within a portfolio or group, under which the entity is now permitted to base the price used for fair valuation upon a price that would be received to sell the net asset position or transfer a net liability position in an orderly transaction. The ASU also allows for the application of premiums and discounts in a fair value measurement if the financial instrument is categorized in level 2 or 3 of the fair value hierarchy. Lastly, the ASU contains new disclosure requirements regarding fair value amounts categorized as level 3 in the fair value hierarchy such as: disclosure of the valuation process used; effects of and relationships between unobservable inputs; usage of nonfinancial assets for purposes other than their highest and best use when that is the basis of the disclosed fair value; and categorization by level of items disclosed at fair value, but not measured at fair value for financial statement purposes. For public entities, this ASU is effective for interim and annual periods beginning after December 15, 2011. Early adoption is not permitted. It is anticipated that adoption of this ASU will not affect the Company's consolidated financial position or results of operations.

ASU 2011-02 (A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring)

The FASB has issued this ASU to clarify the accounting principles applied to loan modifications, as defined by FASB ASC Subtopic 310-40, Receivables – Troubled Debt Restructurings by Creditors. The ASU clarifies guidance on a creditor's evaluation of whether or not a concession has been granted, with an emphasis on evaluating all aspects of the modification rather than a focus on specific criteria, such as the effective interest rate test, to determine a concession. The ASU goes on to provide guidance on specific types of modifications such as changes in the interest rate of the borrowing, and insignificant delays in payments, as well as guidance on the creditor's evaluation of whether or not a debtor is experiencing financial difficulties. For public entities, the amendments in the ASU are effective for the first interim or annual periods beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. The entity should also disclose information required by ASU 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, which had previously been deferred by ASU 2011-01, Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in ASU No. 2010-20, for interim and annual periods beginning on or after June 15, 2011. Early adoption is permitted. It is anticipated that adoption of this ASU will not materially affect the Company's consolidated financial position or results of operations.

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ASU 2010-08 (When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts)

In December 2010, the FASB issued ASU No. 2010-28, When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts ("ASU 2010-28"). For reporting units with zero or negative carrying amounts, ASU 2010-28 adds a requirement to Step 1 of the goodwill impairment test that any adverse qualitative factors should be considered in determining whether it is more likely than not that goodwill impairment exists. If it is more likely than not that goodwill impairment exists, the second step of the goodwill impairment test shall be performed. For public entities, the amended guidance was effective for fiscal years, and interim periods within those years, beginning after December 15, 2010, with early adoption not permitted. The adoption of this guidance did not affect the Company's consolidated financial position or results of operations.

(10) Fair Value Disclosures

U.S. GAAP has established a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset's 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 instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Company's financial assets and financial liabilities carried at fair value.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and counterparty creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Company's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective value or reflective of future values. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Securities Available for Sale. Securities classified as available for sale are reported at fair value utilizing Level 2 Inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. 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 prepayments speeds, credit information and the security's terms and conditions, among other things.

Impaired loans. Loans included in the following table are those which the Company has measured and recognized impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third party appraisals of the properties, or discounted cash flows based on the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value consists of the loan balances less specific valuation allowances.

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Other Real Estate Owned. Foreclosed properties are adjusted to fair value less estimated selling costs at the time of foreclosure in preparation for transfer from portfolio loans to other real estate owned ("OREO"), establishing a new accounting basis. The Company subsequently adjusts the fair value on the OREO utilizing Level 3 inputs on a non-recurring basis to reflect partial write-downs based on the observable market price, current appraised value of the asset or other estimates of fair value.

Derivatives – Interest Rate Swap. Derivatives are reported at fair value utilizing Level 2 Inputs. The Company obtains dealer quotations to value its interest rate swap.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

| | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs | Total Fair Value |
|---|---|---|---|---|
| June 30, 2011: | | | | |
| Securities available for sale: | | | | |
| U. S. Treasury securities and obligations of U.S. Government sponsored corporations ("GSE") and agencies | - | $ 32,614,759 | - | $ 32,614,759 |
| Residential collateralized mortgage obligations- GSE | - | 16,150,822 | - | 16,150,822 |
| Residential collateralized mortgage obligations - non GSE | - | 4,960,468 | - | 4,960,468 |
| Residential mortgage backed securities – GSE | - | 47,972,522 | - | 47,972,522 |
| Obligations of State and Political subdivisions | - | 5,553,391 | - | 5,553,391 |
| Trust preferred debt securities – single issuer | - | 2,054,042 | - | 2,054,042 |
| Corporate debt securities | - | 1,478,084 | - | 1,478,084 |
| Restricted stock | - | 889,100 | - | 889,100 |
| Mutual fund | - | 25,000 | - | 25,000 |
| | | | | |
| Derivative liabilities | - | -- | - | |
| | | | | |
| December 31, 2010: | | | | |
| Securities available for sale: | | | | |
| U. S. Treasury securities and obligations of U.S. Government sponsored corporations ("GSE") and agencies | - | $ 34,359,563 | - | $ 34,359,563 |
| Residential collateralized mortgage obligations- GSE | - | 19,137,758 | - | 19,137,758 |
| Residential collateralized mortgage obligations - non GSE | - | 5,761,322 | - | 5,761,322 |
| | - | 18,169,735 | - | 18,169,735 |

| | | | | |
|---|---|---|---|---|
| Residential mortgage backed securities – GSE | | | | |
| Obligations of State and Political subdivisions | - | 3,021,428 | - | 3,021,428 |
| Trust preferred debt securities – single issuer | - | 1,857,503 | - | 1,857,503 |
| Corporate debt securities | - | 1,498,584 | - | 1,498,584 |
| Restricted stock | - | 1,640,100 | - | 1,640,100 |
| Mutual fund | - | 25,000 | - | 25,000 |
| | | | | |
| Derivative liabilities | - | (353,552) | - | (353,552) |

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets and financial liabilities measured at fair value on a non-recurring basis at June 30, 2011 and December 31, 2010 are as follows:

| | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs | Total Fair Value |
|---|---|---|---|---|
| June 30, 2011: | | | | |
| Impaired loans | - | - | $ 4,403,821 | $ 4,403,821 |
| Other real estate owned | - | - | 945,020 | 945,020 |
| | | | | |
| | | | | |
| December 31, 2010: | | | | |
| Impaired loans | - | - | $ 2,884,750 | $ 2,884,750 |
| Other real estate owned | - | - | 243,023 | 243,023 |

Impaired loans measured at fair value and included in the above table, consisted of 16 loans having an aggregate balance of $5,994,468 and specific loan loss allowances of $1,540,647 at June 30, 2011 and seven loans at December 31, 2010, having an aggregate balance of $3,459,515 and specific loan loss allowances of $574,765.

The fair value of other real estate owned was determined using appraisals, which may be discounted based on management's review and changes in market conditions.

The following is a summary of fair value versus the carrying value of all the Company's financial instruments. For the Company and the Bank, as for most financial institutions, the bulk of its assets and liabilities are considered financial instruments. Many of the financial instruments lack an available trading market as characterized by a willing buyer and willing seller engaging in an exchange transaction. Therefore, significant estimations and present value calculations were used for the purpose of this note. Changes in assumptions could significantly affect these estimates.

Estimated fair values have been determined by using the best available data and an estimation methodology suitable for each category of financial instruments as follows:

Cash and Cash Equivalents, Accrued Interest Receivable and Accrued Interest Payable (Carried at Cost). The carrying amounts reported in the balance sheet for cash and cash equivalents, accrued interest receivable and accrued interest payable approximate fair value.

Securities Held to Maturity (Carried at Amortized Cost). The fair values of securities held to maturity are determined in the same manner as for securities available for sale.

Loans Held For Sale (Carried at Lower of Aggregated Cost or Fair Value). The fair values of loans held for sale are determined, when possible, using quoted secondary market prices. If no such quoted market prices exist, fair values are determined using quoted prices for similar loans, adjusted for the specific attributes of the loans.

Gross Loans Receivable (Carried at Cost). The fair values of loans, excluding impaired loans subject to specific loss reserves, are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying values.

Deposit Liabilities (Carried at Cost). The fair values disclosed for demand deposits (e.g., interest and non-interest demand and savings accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Borrowings and Subordinated Debentures (Carried at Cost). The carrying amounts of short-term borrowings approximate their fair values. The fair values of long-term FHLB advances and subordinated debentures are estimated using discounted cash flow analysis, based on quoted or estimated interest rates for new borrowings with similar credit risk characteristics, terms and remaining maturity.

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The estimated fair values, and the recorded book balances, were as follows:

| | June 30, 2011 | | December 31, 2010 | |
|---|---|---|---|---|
| | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| Cash and cash equivalents | $ 90,057,576 | $ 90,057,576 | 17,710,501 | $ $17,710,501 |
| Securities available for sale | 111,698,188 | 111,698,188 | 85,470,993 | 85,470,993 |
| Securities held to maturity | 141,915,638 | 145,124,864 | 81,889,895 | 81,712,003 |
| Loans held for sale | 6,971,757 | 6,971,757 | 21,219,230 | 21,219,230 |
| Gross loans | 339,867,302 | 339,860,000 | 411,987,339 | 410,144,000 |
| Accrued interest receivable | 2,684,914 | 2,684,914 | 2,405,741 | 2,405,741 |
| Deposits | (643,108,072) | (644,708,000) | (543,735,149) | (545,225,000) |
| Other borrowings | (10,000,000) | (11,905,000) | (25,900,000) | (27,979,000) |
| Redeemable subordinated debentures | (18,557,000) | (18,557,000) | (18,557,000) | (18,557,000) |
| Interest rate swap contract | - | - | (353,552) | (353,552) |
| Accrued interest payable | (1,287,389) | (1,287,389) | (1,434,338) | (1,434,338) |

Loan commitments and standby letters of credit as of June 30, 2011 and December 31, 2010 are based on fees charged for similar agreements; accordingly, the estimated fair value of loan commitments and standby letters of credit is nominal.

(11) Derivative Financial Instruments

The use of derivative financial instruments creates exposure to credit risk. This credit risk relates to losses that would be recognized if the counterparts fail to perform their obligations under the contracts. As part of the Company's interest rate risk management process, the Company entered into an interest rate derivative contract effective November 27, 2007. Interest rate derivative contracts are typically used to limit the variability of the Company's net interest income that could result due to shifts in interest rates. This derivative interest rate contract was an interest rate swap used to modify the repricing characteristics of a specific liability. This contract matured on June 15, 2011 and was not renewed by the Company. At December 31, 2010, the Company's position in derivative contracts consisted entirely of this interest rate swap.

| Maturity | Hedged Liability | Notional Amounts | Swap Fixed Interest Rates | Swap Variable Interest Rates |
|---|---|---|---|---|
| June 15, 2011 | Subordinated Debenture | $18,000,000 | 5.87% | 3 month LIBOR plus 165 basis points |

During 2006, the Company issued trust preferred securities to fund loan growth and generate liquidity. In conjunction with the trust preferred securities issuance, the Company entered into a $18.0 million pay fixed swap designated as fair value hedges that was used to convert floating rate quarterly interest payments indexed to three month LIBOR, based on common notional amounts and maturity dates. The pay fixed swap changed the repricing characteristics of the quarterly interest payments from floating rate to fixed rate. The fair value of the pay fixed swap outstanding at December 31, 2010 was ($353,552), and was recorded in other liabilities in the consolidated balance sheet, with the change in fair value, net of deferred taxes, recorded through Other Comprehensive Income.

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

The purpose of this discussion and analysis of the operating results and financial condition at June 30, 2011 is intended to help readers analyze the accompanying financial statements, notes and other supplemental information contained in this document. Results of operations for the three month and six month periods ended June 30, 2011 are not necessarily indicative of results to be attained for any other period.

This discussion and analysis should be read in conjunction with the Consolidated Financial Statements, notes and tables included elsewhere in this report and Part II, Item 7 of the Company’s Form 10-K (Management’s Discussion and Analysis of Financial Condition and Results of Operations) for the year ended December 31, 2010, as filed with the Securities and Exchange Commission (the “SEC”) on March 23, 2011.

General

Throughout the following sections, the “Company” refers to 1st Constitution Bancorp and, as the context requires, its wholly-owned subsidiary, 1st Constitution Bank (the “Bank”) and the Bank’s wholly-owned subsidiaries, 1st Constitution Investment Company of Delaware, Inc., 1st Constitution Investment Company of New Jersey, Inc., FCB Assets Holdings, Inc., 1st Constitution Title Agency, LLC, Riverside Lofts, LLC and 249 New York Avenue, LLC. 1st Constitution Capital Trust II, (“Trust II”) a subsidiary of the Company is not included in the Company’s consolidated financial statements as it is a variable interest entity and the Company is not the primary beneficiary.

The Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company was organized under the laws of the State of New Jersey in February 1999 for the purpose of acquiring all of the issued and outstanding stock of the Bank, a full service commercial bank which began operations in August 1989, and thereby enabling the Bank to operate within a bank holding company structure. The Company became an active bank holding company on July 1, 1999. The Bank is a wholly-owned subsidiary of the Company. Other than its ownership interest in the Bank, the Company currently conducts no other significant business activities.

The Bank operates fourteen branches, and manages an investment portfolio through its subsidiaries, 1st Constitution Investment Company of Delaware, Inc. and 1st Constitution Investment Company of New Jersey, Inc. FCB Assets Holdings, Inc., a subsidiary of the Bank, is used by the Bank to manage and dispose of repossessed real estate.

Trust II, a subsidiary of the Company, was created in May 2006 to issue trust preferred securities to assist the Company to raise additional regulatory capital.

Forward-Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). The Private Securities Litigation Reform Act of 1995 provides a “safe harbor” for forward looking statements. When used in this and in future filings by the Company with the SEC, in the Company’s press releases and in oral statements made with the approval of an authorized executive officer of the Company, the words or phrases “will,” “will likely result,” “could,” “anticipates,” “believes,” “continues,” “expects,” “plans,” “will continue,” “is anticipated,” “estimated,” “project” or “outlo expressions (including confirmations by an authorized executive officer of the Company of any such expressions made by a third party with respect to the Company) are intended to identify forward-looking statements. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, each of which speak only as of the date made. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected.

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Factors that may cause actual results to differ from those results expressed or implied, include, but are not limited to, those listed under "Business", "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Annual Report on Form 10-K filed with the SEC on March 23, 2011 and in other filings made by the Company with the SEC, such as the overall economy and the interest rate environment; the ability of customers to repay their obligations; the adequacy of the allowance for loan losses; competition; significant changes in accounting, tax or regulatory practices and requirements; certain interest rate risks; risks associated with investments in mortgage-backed securities; and risks associated with speculative construction lending. Although management has taken certain steps to mitigate any negative effect of the aforementioned items, significant unfavorable changes could severely impact the assumptions used and could have an adverse effect on profitability. The Company undertakes no obligation to publicly revise any forward-looking statements to reflect anticipated or unanticipated events or circumstances occurring after the date of such statements, except as required by law.

Recent Developments

On March 25, 2011, the Bank acquired certain deposit and other liabilities, real estate and related assets of the Rocky Hill, Hillsborough and Hopewell, New Jersey branch banking offices from another financial institution for a purchase price of $9.85 million (the "Acquisition"). The Acquisition was completed pursuant to the terms and conditions of the Branch Purchase and Assumption Agreement and Agreement for Purchase dated as of December 30, 2010, which was previously disclosed on a Current Report on Form 8-K filed by the Company with the SEC on January 3, 2011.

As a result of the Acquisition, the three branches became branches of the Bank. Included in the Acquisition were the assumption of deposit liabilities of $111.9 million, primarily consisting of demand deposits, and the acquisition of cash of approximately $101.5 million, fixed assets of approximately $4.6 million, which includes, without limitation, ownership of the real estate and improvements upon which the branches are situated, and loans of $862,000. The Bank recorded goodwill of approximately $3.2 million and a core deposit intangible asset of approximately $1.7 million as a result of the Acquisition.

RESULTS OF OPERATIONS

Three Months Ended June 30, 2011 Compared to the Three Months Ended June 30, 2010

Summary

The Company realized net income of $828,916 for the three months ended June 30, 2011, an increase of $33,357, or 4.2%, from the $795,559 reported for the three months ended June 30, 2010. The increase is due primarily to increases in net interest income and noninterest income and a lower provision for loan losses which, in total, offset an increase in non-interest expenses. Net income per diluted common share was $0.17 for the three months ended June 30, 2011 compared to net income per diluted common share of $0.13 for the three months ended June 30, 2010. Net income available to common shareholders increased from $618,575 for the three months ended June 30, 2010 to $828,916 for the three months ended June 30, 2011. Net income available to common shareholders for the three months ended June 30, 2010 reflected an aggregate of $176,984 attributable to dividends and discount accretion related to the preferred stock issued to the United States Department of the Treasury (the "Treasury") under the TARP Capital Purchase Program in December 2008. On October 27, 2010, the Company repurchased from the Treasury all of the outstanding shares of the Company's preferred stock issued to the Treasury for an aggregate purchase price (including accrued and unpaid dividends) of $12,120,000. All prior year share information has been adjusted for the effect of a 5% stock dividend declared on December 16, 2010 and paid on February 2, 2011 to shareholders of record on January 18, 2011.

Key performance ratios remained stable for the three months ended June 30, 2011 compared to the three months ended June 30, 2010. Return on average assets and return on average equity were 0.45% and 6.55% for the three months ended June 30, 2011 compared to 0.49% and 5.42%, respectively, for the three months ended June 30, 2010.

The Bank's results of operations depend primarily on net interest income, which is primarily affected by the market interest rate environment, the shape of the U.S. Treasury yield curve, and the difference between the yield on interest-earning assets and the rate paid on interest-bearing liabilities. Other factors that may affect the Bank's operating results are general and local economic and competitive conditions, government policies and actions of regulatory authorities. The net interest margin on a tax-equivalent basis for the three months ended June 30, 2011 was 3.25% as compared to the 3.17% net interest margin recorded for the three months ended June 30, 2010, an increase of 8 basis points. The Company will continue to closely monitor the mix of earning assets and funding sources to maximize net interest income during this challenging interest rate environment.

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Earnings Analysis

Net Interest Income

Net interest income, the Company's largest and most significant component of operating income, is the difference between interest and fees earned on loans and other earning assets, and interest paid on deposits and borrowed funds. This component represented 82.1% of the Company's net revenues for the three month period ended June 30, 2011 and 82.8% of net revenues for the three-month period ended June 30, 2010. Net interest income also depends upon the relative amount of average interest-earning assets, average interest-bearing liabilities, and the interest rate earned or paid on them, respectively.

The Company's net interest income increased by $365,648, or 7.5%, to $5,214,039 for the three months ended June 30, 2011 from the $4,848,391 reported for the three months ended June 30, 2010. The increase in net interest income was primarily attributable to lower rates paid on interest-bearing liabilities during the current period. The average rate paid on interest-bearing liabilities for the three months ended June 30, 2011 was 1.32%, a reduction of 47 basis points compared to 1.79% paid for the three months ended June 30, 2010.

Average interest earning assets increased by $43,439,575, or 7.0%, to $663,568,176 for the three month period ended June 30, 2011 from $620,128,601 for the three month period ended June 30, 2010. However, the overall yield on interest earning assets, on a tax-equivalent basis, decreased 15 basis points to 4.38% for the three month period ended June 30, 2011 when compared to 4.60% for the three month period ended June 30, 2010.

Average interest bearing liabilities increased by $67,255,498, or 13.5%, to $566,965,189 for the three month period ended June 30, 2011 from $499,709,691 for the three month period ended June 30, 2010. Overall, the cost of total interest bearing liabilities decreased 47 basis points to 1.32% for the three months ended June 30, 2011 compared to 1.79% for the three months ended June 30, 2010.

The net interest margin (on a tax-equivalent basis), which is net interest income divided by average interest earning assets, was 3.25% for the three months ended June 30, 2011 compared to 3.17% the three months ended June 30, 2010.

Provision for Loan Losses

Management considers a complete review of the following specific factors in determining the provisions for loan losses: historical losses by loan category, non-accrual loans, problem loans as identified through internal classifications, collateral values, and the growth and size of the loan portfolio. In addition to these factors, management takes into consideration current economic conditions and local real estate market conditions. Using this evaluation process, the Company's provision for loan losses was $275,000 for the three months ended June 30, 2011 and $550,000 for the three months ended June 30, 2010. As a result the risk profile of the loan portfolio being reduced by a change in its composition via a $5,711,005 reduction in higher risk construction loans, and non-performing loans decreasing by $3,120,415, this change in the overall risk profile necessitated the decreased provision.

Non-Interest Income

Total non-interest income for the three months ended June 30, 2011 was $1,140,312, an increase of $133,292, or 13.2%, over non-interest income of $1,007,020 for the three months ended June 30, 2010.

Service charges on deposit accounts represents a consistent source of non-interest income. Service charge revenues increased to $234,898 for the three months ended June 30, 2011 from $188,672 for the three months ended June 30, 2010. This increase is primarily the result of the increase in the number of deposit accounts subject to service charges due to the March 25, 2011 acquisition of three branch offices from another financial institution.

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Gain on sales of loans held for sale increased modestly by $19,066, or 4.9%, to $411,643 for the three months ended June 30, 2011 when compared to $392,577 for the three months ended June 30, 2010. The Bank sells both residential mortgage loans and Small Business Administration loans in the secondary market. The volume of mortgage loan sales remained stable for the three months ended June 30, 2011 compared to the three months ended June 30, 2010.

Non-interest income also includes income from bank-owned life insurance (“BOLI”), which amounted to $103,522 for the three months ended June 30, 2011 compared to $105,056 for the three months ended June 30, 2010, a decrease of $1,534 for the second quarter of 2011 as compared to the second quarter of 2010. The Bank purchased tax-free BOLI assets to partially offset the cost of employee benefit plans and reduced the Company’s overall effective tax rate.

The Bank also generates non-interest income from a variety of fee-based services. These include safe deposit box rental, wire transfer service fees and Automated Teller Machine fees for non-Bank customers. Customer demand for these services contributed to the other income component of non-interest income amounting to $390,249 for the three months ended June 30, 2011, compared to $320,715 for the three months ended June 30, 2010, an increase of $69,534 for the second quarter of 2011 as compared to the second quarter of 2010.

Non-Interest Expense

Non-interest expenses increased by $876,695, or 20.5%, to $5,155,785 for the three months ended June 30, 2011 from $4,279,090 for the three months ended June 30, 2010. The March 25, 2011 Acquisition was the primary cause for this current period increase in total noninterest expense and each of its major components when compared with noninterest expense for the prior period.

The following table presents the major components of non-interest expenses for the three months ended June 30, 2011 and 2010.

Non-interest Expenses

| | Three months ended June 30, 2011 | Three months ended June 30, 2010 |
|---|---|---|
| Salaries and employee benefits | $ 2,843,948 | $ 2,417,234 |
| Occupancy expenses | 580,969 | 452,838 |
| Data processing services | 313,776 | 272,391 |
| Equipment expense | 194,368 | 167,895 |
| Marketing | 52,021 | 42,672 |
| Regulatory, professional and other fees | 286,084 | 268,557 |
| Office expense | 234,315 | 180,189 |
| FDIC insurance expense | 246,458 | 247,568 |
| Directors’ fees | 22,000 | 27,000 |
| Other real estate owned expenses | 72,971 | 28,447 |
| Amortization of intangible assets | 66,992 | 9,178 |
| All other expenses | 241,883 | 165,121 |
| | $ 5,155,785 | $ 4,279,090 |

Salaries and employee benefits, which represent the largest portion of non-interest expenses, increased by $426,714, or 17.7%, to $2,843,948 for the three months ended June 30, 2011 compared to $2,417,234 for the three months ended June 30, 2010. The increase in salaries and employee benefits for the three months ended June 30, 2011 was a result of an increase in the number of employees, regular merit increases and increased health care costs. Staffing levels overall increased to 151 full-time equivalent employees at June 30, 2011 as compared to 130 full-time equivalent employees at June 30, 2010. The number of full-time equivalent employees at June 30, 2011 includes 13 full-time equivalent employees added as a result of the March 25, 2011 Acquisition.

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Occupancy expenses increased by $128,131, or 28.3%, to $580,969 for the three months ended June 30, 2011 compared to $452,838 for the three months ended June 30, 2010. In addition to the operating costs of the three new branches, the increase in expense was primarily attributable to increased depreciation, property taxes and maintenance costs in maintaining the Bank's branch properties. In addition, the Bank's Lawrenceville, New Jersey branch office opened in May 2010 and a full quarter of operating expenses for this branch office are included in the 2011 second quarter whereas the 2010 quarter includes one month of expenses.

The cost of data processing services increased by $41,385, or 13.2%, to $313,776 for the three months ended June 30, 2011 from $272,391 for the three months ended June 30, 2010, as additional expenses were incurred to convert and maintain the three new branch offices acquired in the Acquisition to the Bank's data systems.

Equipment expense increased by $26,473, or 15.8%, to $194,368 for the three months ended June 30, 2011 from $167,895 for the three months ended June 30, 2010 primarily due to an increase in the number of maintenance contracts on equipment in the three new acquired branches plus the Lawrenceville branch as compared with the prior year period.

Marketing expense increased by $9,349, or 21.9%, to $52,021 for the three months ended June 30, 2011 compared to $42,672 for the three months ended June 30, 2010, as the Bank resumed the use of radio broadcast media in promoting products and services during 2011.

Regulatory, professional and other fees increased by $17,527, or 6.5%, to $286,084 for the three months ended June 30, 2011 compared to $268,557 for the three months ended June 30, 2010. During the second quarter of 2011, the Company incurred professional fees in connection with the Acquisition, which was completed on March 25, 2011.

Office expense increased by $54,126, or 30.0%, to $234,315 for the three months ended June 30, 2011 from $180,189 for the three months ended June 30, 2010 primarily due to increases in office supplies and telephone expenses for the three newly acquired branch offices in the 2011 period.

Other real estate owned expenses increased by $44,524, to $72,971 for the three months ended June 30, 2011 compared to $28,447 for the three months ended June 30, 2010, as the Company incurred maintenance expenses on more properties during the second quarter of 2011 than during the second quarter of 2010.

Amortization of intangible assets expense increased to $66,992 for the three months ended June 30, 2011 compared to $9,178 for the three months ended June 30, 2010, as the expenses for the current period includes amortization of the $1.7 million core deposit intangible asset resulting from the Acquisition.

All other expenses increased by $76,262, to $241,883 for the three months ended June 30, 2011 compared to $165,121 for the three months ended June 30, 2010, as current year increases occurred in correspondent bank fees, maintenance agreements and ATM operating expenses. All other expenses are comprised of a variety of operating expenses and fees as well as expenses associated with lending activities.

An important financial services industry productivity measure is the efficiency ratio. The efficiency ratio is calculated by dividing total operating expenses by net interest income plus non-interest income. An increase in the efficiency ratio indicates that more resources are being utilized to generate the same or greater volume of income, while a decrease would indicate a more efficient allocation of resources. The Company's efficiency ratio increased to 81.1% for the three months ended June 30, 2011, compared to 73.1% for the three months ended June 30, 2010. The increase in the efficiency ratio is due to the above-noted increases in non-interest expenses.

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Income Taxes

Income tax expense decreased by $136,112 to $94,650 for the three months ended June 30, 2011 from $230,762 for the three months ended June 30, 2010. The decrease was primarily due to a lower level of pretax income combined with higher level of tax-exempt interest income for the second quarter of 2011 as compared to the second quarter of 2010.

Six Months Ended June 30, 2011 Compared to the Six Months Ended June 30, 2010

Summary

The Company realized net income of $1,618,784 for the six months ended June 30, 2011, an increase of 8.3% from the $1,494,817 reported for the six months ended June 30, 2010. The increase is due primarily to increases in net interest income and noninterest income and a lower provision for loan losses which, in total, offset an increase in noninterest expenses for the six months ended June 30, 2011 compared to the same period in 2010. Net income available to common shareholders for the six months ended June 30, 2011 increased to $1,618,784 from $1,140,849 for the six months ended June 30, 2010 principally for the reasons indicated above. Net income available to common shareholders for the six months ended June 30, 2010 reflected an aggregate of $353,968 attributable to dividends and discount accretion related to the preferred stock issued to the United States Department of Treasury (the “Treasury”) under the TARP Capital Purchase Program in December 2008. On October 27, 2010, the Company repurchased from the Treasury all of the outstanding shares of the Company’s preferred stock issued to the Treasury for an aggregate purchase price (including accrued and unpaid dividends) of $12,120,000.

Diluted net income per common share was $0.33 for the six months ended June 30, 2011 compared to diluted net income per common share of $0.24 for the six months ended June 30, 2010. All prior year share information has been adjusted for the effect of a 5% stock dividend declared on December 16, 2010, and paid on February 2, 2011 to shareholders of record on January 18, 2011.

Key performance ratios improved for the six months ended June 30, 2011 as compared to the six months ended June 30, 2010 due to higher net income for the 2011 period. Return on average assets and return on average equity were 0.47% and 6.52% for the six months ended June 30, 2011 compared to 0.46% and 5.18%, respectively, for the six months ended June 30, 2010.

The Bank’s results of operations depend primarily on net interest income, which is primarily affected by the market interest rate environment, the shape of the U.S. Treasury yield curve, and the difference between the yield on interest-earning assets and the rate paid on interest-bearing liabilities. Other factors that may affect the Bank’s operating results are general and local economic and competitive conditions, government policies and actions of regulatory authorities. The net interest margin for the six months ended June 30, 2011 was 3.38% as compared to the 3.05% net interest margin recorded for the six months ended June 30, 2010, an increase of 33 basis points. The Company continues to closely monitor the mix of earning assets and funding sources to maximize net interest income during this challenging interest rate environment.

Earnings Analysis

Net Interest Income

Net interest income, the Company’s largest and most significant component of operating income, is the difference between interest and fees earned on loans and other earning assets, and interest paid on deposits and borrowed funds. This component represented 82.7% of the Company’s net revenues for the six month period ended June 30, 2011 and

82.6% of net revenues for the six-month period ended June 30, 2010. Net interest income also depends upon the relative amount of interest-earning assets, interest-bearing liabilities, and the interest rate earned or paid on them.

The following table sets forth the Company's consolidated average balances of assets, liabilities and shareholders' equity as well as interest income and expense on related items, and the Company's average yield or rate for the six month periods ended June 30, 2011 and 2010, respectively. The average rates are derived by dividing interest income and expense by the average balance of assets and liabilities, respectively.

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Average Balance Sheets with Resultant Interest and Rates

| (yields on a tax-equivalent basis) | Six months ended June 30, 2011 | | | Six months ended June 30, 2010 | | |
|---|---|---|---|---|---|---|
| | Average Balance | Interest | Average Rate | Average Balance | Interest | Average Rate |
| Assets: | | | | | | |
| Federal Funds Sold/Short-Term Investments | $ 53,784,770 | $ 72,109 | 0.27% | $ 28,523,656 | $ 32,619 | 0.24% |
| Investment Securities: | | | | | | |
| Taxable | 208,521,295 | 2,788,078 | 2.70% | 209,676,859 | 2,613,641 | 2.51% |
| Tax-exempt | 37,213,024 | 942,463 | 5.04% | 11,021,570 | 316,974 | 5.66% |
| Total | 245,734,319 | 3,730,541 | 3.06% | 220,698,429 | 2,930,615 | 2.68% |
| | | | | | | |
| Loan Portfolio: | | | | | | |
| Construction | 64,630,882 | 1,994,670 | 6.22% | 73,404,258 | 2,325,826 | 6.39% |
| Residential real estate | 10,512,306 | 322,570 | 6.19% | 11,207,646 | 320,836 | 5.77% |
| Home Equity | 12,380,687 | 353,045 | 5.75% | 13,857,468 | 404,580 | 5.89% |
| Commercial and commercial real estate | 131,980,885 | 5,047,386 | 7.71% | 139,432,230 | 5,038,932 | 7.29% |
| Mortgage warehouse lines | 95,073,344 | 2,348,262 | 4.98% | 102,555,437 | 2,476,010 | 4.87% |
| Installment | 429,371 | 14,948 | 7.02% | 598,390 | 22,458 | 7.57% |
| All Other Loans | 23,078,861 | 440,765 | 3.85% | 30,166,139 | 476,600 | 3.19% |
| Total | 338,086,336 | 10,521,646 | 6.28% | 371,221,568 | 11,065,242 | 6.01% |
| | | | | | | |
| Total Interest-Earning Assets | 637,605,425 | 14,324,296 | 4.53% | 620,443,653 | 14,028,476 | 4.56% |
| | | | | | | |
| Allowance for Loan Losses | (6,007,813) | | | (4,837,099) | | |
| Cash and Due From Bank | 23,608,726 | | | 7,864,917 | | |
| Other Assets | 39,973,930 | | | 28,840,209 | | |
| Total Assets | $ 695,180,268 | | | $ 652,311,680 | | |
| | | | | | | |
| Interest-Bearing Liabilities: | | | | | | |
| Money Market and NOW Accounts | $ 164,207,897 | $ 853,425 | 1.05% | $ 117,892,695 | $ 925,588 | 1.58% |
| Savings Accounts | 179,218,559 | 747,154 | 0.84% | 177,040,353 | 1,040,154 | 1.18% |
| Certificates of Deposit | 157,516,362 | 1,327,825 | 1.70% | 164,254,334 | 1,596,271 | 1.96% |
| Other Borrowed Funds | 11,936,740 | 210,632 | 3.56% | 27,365,138 | 544,422 | 4.01% |
| Trust Preferred Securities | 18,557,000 | 501,434 | 5.37% | 18,557,000 | 531,690 | 5.70% |
| Total Interest-Bearing Liabilities | 531,436,558 | 3,640,470 | 1.38% | 505,109,520 | 4,638,125 | 1.85% |
| | | | | | | |
| Net Interest Spread | | | 3.15% | | | 2.71% |
| | | | | | | |
| Demand Deposits | 103,997,443 | | | 81,216,027 | | |
| Other Liabilities | 9,677,753 | | | 7,745,826 | | |
| Total Liabilities | 645,111,754 | | | 594,071,373 | | |
| Shareholders' Equity | 50,068,514 | | | 58,240,307 | | |
| Total Liabilities and Shareholders' Equity | $ 695,180,268 | | | $ 652,311,680 | | |
| | | | | | | |
| Net Interest Margin | | $ 10,683,826 | 3.38% | | $ 9,390,351 | 3.05% |

The Company's net interest income increased by $1,090,616, or 11.7%, to $10,378,164 for the six months ended June 30, 2011 from the $9,287,548 reported for the six months ended June 30, 2010. The increase in net interest income was attributable to an increased investment portfolio volume combined with lower rates paid on interest-bearing liabilities volume, which was more than sufficient to offset the reduced volume of the loan portfolio.

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Average interest earning assets increased by $17,161,772, or 2.8%, to $637,605,425 for the six month period ended June 30, 2011 from $620,443,653 for the six month period ended June 30, 2010. The average investment securities portfolio increased by $25,035,890, or 11.3%, to $245,734,319 for the six month period ended June 30, 2011 compared to $220,698,429 for the six month period ended June 30, 2010, as funds were invested during the 2011 period in low risk U.S. Treasury securities, U.S. Government sponsored agency bonds and obligations of states and political subdivisions rather than being invested in the relatively higher risk loan portfolio. The average loan portfolio decreased by $33,135,232, or 8.9%, to $338,086,336 for the six month period ended June 30, 2011 compared to $371,221,568 for the six month period ended June 30, 2010. The overall risk profile of the loan portfolio was reduced by a change in its composition via a reduction in average construction loans of $8,773,376, or 12.0%, to $64,630,882 for the six month period ended June 30, 2011 compared to $73,404,258 for the six month period ended June 30, 2010, as the current adverse economic conditions have resulted in depreciation of collateral values securing these loans. Overall, the yield on interest earning assets, on a tax-equivalent basis, decreased 3 basis points to 4.53% for the six month period ended June 30, 2011 when compared to 4.56% for the six month period ended June 30, 2010.

Average interest bearing liabilities increased by $26,327,038, or 5.2%, to $531,436,558 for the six month period ended June 30, 2011 from $505,109,520 for the six month period ended June 30, 2010. Overall, the cost of total interest bearing liabilities decreased 47 basis points to 1.38% for the six months ended June 30, 2011 compared to 1.85% for the six months ended June 30, 2010.

The net interest margin (on a tax-equivalent basis), which is net interest income divided by average interest earning assets, was 3.38% for the six months ended June 30, 2011 compared to 3.05% the six months ended June 30, 2010.

Provision for Loan Losses

Management considers a complete review of the following specific factors in determining the provisions for loan losses: historical losses by loan category, non-accrual loans, problem loans as identified through internal classifications, collateral values, and the growth and size of the loan portfolio. In addition to these factors, management takes into consideration current economic conditions and local real estate market conditions. Using this evaluation process, the Company’s provision for loan losses was $674,998 for the six months ended June 30, 2011 and $850,000 for the six months ended June 30, 2010. As a result the risk profile of the loan portfolio being reduced by a change in its composition via a $8,962,851 reduction in higher risk construction loans, and non-performing loans decreasing by $1,182,086, this change in the overall risk profile necessitated the decreased provision.

Non-Interest Income

Total non-interest income for the six months ended June 30, 2011 was $2,165,062, an increase of $209,196, or 10.7%, over non-interest income of $1,955,866 for the six months ended June 30, 2010.

Service charges on deposit accounts represents a significant source of non-interest income. Service charges on deposit accounts revenues increased by $45,712, or 12.5%, to $410,740 for the six months ended June 30, 2011 from the $365,028 for the six months ended June 30, 2010. This increase was primarily the result of an increase in the number of deposit accounts subject to service charges due to the Acquisition, which was completed on March 25, 2011.

Gain on sales of loans increased by $135,261, or 19.0%, to $848,382 for the six months ended June 30, 2011 when compared to $713,121 for the six months ended June 30, 2010. The Bank sells both residential mortgage loans and SBA loans in the secondary market. The volume of mortgage loan sales remained relatively consistent for the six months ended June 30, 2011 compared to the six months ended June 30, 2010.

Non-interest income also includes income from bank-owned life insurance (“BOLI”), which amounted to $198,659 for the six months ended June 30, 2011 compared to $201,695 for the six months ended June 30, 2010. The Bank purchased tax-free BOLI assets to partially offset the cost of employee benefit plans and reduced the Company’s overall effective tax rate.

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The Bank also generates non-interest income from a variety of fee-based services. These include safe deposit box rental, wire transfer service fees and Automated Teller Machine fees for non-Bank customers. Customer demand for these services contributed to the other income component of non-interest income amounting to $707,281 for the six months ended June 30, 2011, compared to $676,022 for the six months ended June 30, 2010.

Non-Interest Expense

Non-interest expenses increased by $1,405,581, or 16.7%, to $9,818,617 for the six months ended June 30, 2011 from $8,413,036 for the six months ended June 30, 2010. The March 25, 2011 Acquisition was the primary cause for this current period increase in total noninterest expense and each of its major components when compared with the prior period noninterest expense. The following table presents the major components of non-interest expenses for the six months ended June 30, 2011 and 2010.

| Non-interest Expenses | Six months ended June 30, 2011 | 2010 |
|---|---|---|
| Salaries and employee benefits | $ 5,420,612 | $ 4,793,934 |
| Occupancy expenses | 1,147,707 | 898,765 |
| Data processing services | 617,249 | 531,198 |
| Equipment expense | 365,170 | 319,881 |
| Marketing | 79,987 | 66,123 |
| Regulatory, professional and other fees | 484,236 | 441,141 |
| Office expense | 372,140 | 349,782 |
| FDIC insurance expense | 474,005 | 495,251 |
| Directors' fees | 49,000 | 53,500 |
| Other real estate owned expenses | 309,352 | 46,237 |
| Amortization of intangible assets | 76,170 | 18,356 |
| All other expenses | 422,989 | 398,868 |
| | $ 9,818,617 | $ 8,413,036 |

Salaries and employee benefits, which represent the largest portion of non-interest expenses, increased by $626,678, or 13.1%, to $5,420,612 for the six months ended June 30, 2011 compared to $4,793,934 for the six months ended June 30, 2010. The increase in salaries and employee benefits for the six months ended June 30, 2011 was a result of an increase in the number of employees, regular merit increases and increased health care costs. Staffing levels overall increased to 151 full-time equivalent employees at June 30, 2011 as compared to 130 full-time equivalent employees at June 30, 2010. The number of full-time equivalent employees at June 30, 2011 includes 13 full-time equivalent employees added as a result of the March 25, 2011 Acquisition.

Occupancy expenses increased by $248,942, or 27.7%, to $1,147,707 for the six months ended June 30, 2011 compared to $898,765 for the six months ended June 30, 2010. In addition to the operating costs of the three new branches, the increase in expense was primarily attributable to increased depreciation, property taxes and maintenance costs in maintaining the Bank's branch properties. In addition, the Bank's Lawrenceville, New Jersey branch office opened in May 2010 and six months of operating expenses for this branch office are included in 2011 whereas 2010 includes only two months of expenses.

The cost of data processing services increased by $86,051, or 16.2%, to $617,249 for the six months ended June 30, 2011 from $531,198 for the six months ended June 30, 2010, as additional expenses were incurred to convert and maintain the three new branch offices acquired in the Acquisition to the Bank's data systems.

Equipment expense increased by $45,289, or 14.2%, to $365,170 for the six months ended June 30, 2011 compared to $319,881 for the six months ended June 30, 2010 primarily due to increased costs associated with the number of maintenance contracts on equipment in the three newly acquired branch offices as compared with the prior period.

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Regulatory, professional and other fees increased by $43,095, or 9.8%, to $484,236 for the six months ended June 30, 2011 compared to $441,141 for the six months ended June 30, 2010. During the first six months of 2011, the Company incurred additional fees primarily in connection with the March 25, 2011 Acquisition.

Office expenses increased by $22,358, or 6.4%, to $372,140 for the six months ended June 30, 2011 compared to $349,782 for the six months ended June 30, 2010. The increase in expense was primarily attributable to the March 25, 2011 Acquisition.

Other real estate owned expenses increased by $263,115, to $309,352 for the six months ended June 30, 2011 compared to $46,237 for the six months ended June 30, 2010 as the Company recorded $147,178 in loss provisions during 2011 and incurred maintenance costs on more properties held as other real estate during the first six months of 2011 as compared to the first six months of 2010.

Amortization of intangible assets expense increased to $76,170 for the six months ended June 30, 2011 compared to $18,356 for the six months ended June 30, 2010, as the expense for the current period includes amortization of the $1.7 million core deposit intangible asset resulting from the March 25, 2011 Acquisition.

All other expenses increased by $24,121, or 6.0%, to $422,989 for the six months ended June 30, 2011 compared to $398,868 for the six months ended June 30, 2010. Current year increases occurred in correspondent bank fees, maintenance agreements and ATM operating expenses. All other expenses are comprised of a variety of operating expenses and fees as well as expenses associated with lending activities.

An important financial services industry productivity measure is the efficiency ratio. The efficiency ratio is calculated by dividing total operating expenses by net interest income plus non-interest income. An increase in the efficiency ratio indicates that more resources are being utilized to generate the same or greater volume of income, while a decrease would indicate a more efficient allocation of resources. The Company's efficiency ratio increased to 78.3% for the six months ended June 30, 2011, compared to 74.8% for the six months ended June 30, 2010.

Income Taxes

The Company had income tax expense of $430,827 for the six months ended June 30, 2011 compared to income tax expense of $485,561 for the six months ended June 30, 2010. The decrease in the income tax expense for the 2011 period was primarily due to the higher level of tax-exempt interest income for the first six months of 2011 as compared to the first six months of 2010.

Tax-exempt interest income increased to $636,800 or the six months ended June 30, 2011 from $214,171 for the six months ended June 30, 2010.

Financial Condition

June 30, 2011 Compared with December 31, 2010

Total consolidated assets at June 30, 2011 were $729,430,556, representing an increase of $85,035,327, or 13.2%, from total consolidated assets of $644,395,229 at December 31, 2010. The increase in assets was primarily attributable to the Acquisition, which was completed on March 25, 2011 and resulted in three former Amboy Bank branch banking offices becoming branches of the Bank. Included in the Acquisition were the assumption of deposit liabilities of $111.9 million, primarily consisting of demand deposits, and the acquisition of cash of approximately $101.5 million, fixed assets of approximately $4.6 million, which includes, without limitation, ownership of the real estate and improvements upon which the branches are situated, and loans of $862,000. The Bank recorded goodwill of approximately $3.2 million and a core deposit intangible asset of approximately $1.7 million as a result of the Acquisition.

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Cash and Cash Equivalents

Cash and cash equivalents at June 30, 2011 totaled $90,057,576 compared to $17,710,501 at December 31, 2010. Cash and cash equivalents at June 30, 2011 consisted of cash and due from banks of $90,046,173 and Federal funds sold/short term investments of $11,403. The corresponding balances at December 31, 2010 were $17,699,103 and $11,398, respectively. The current period increase was primarily due to the cash inflow of approximately $101.5 million resulting from the Acquisition, which closed on March 25, 2011. To the extent that the Bank did not utilize the funds for loan originations or securities purchases, the cash inflows accumulated in cash and cash equivalents.

Loans Held for Sale

Loans held for sale at June 30, 2011 amounted to $6,971,757 compared to $21,219,230 at December 31, 2010. The primary cause for this decrease was a high volume of sales of existing loans held for sale combined with a lower volume of mortgage loan refinance activity during the first six months of 2011 compared with the level of activity during the last six months of 2010. The amount of loans originated for sale was $47,402,373 for the first six months of 2011 compared with $55,441,982 for the first six months of 2010.

Investment Securities

Investment securities represented 34.8% of total assets at June 30, 2011 and 26.0% at December 31, 2010. Total investment securities increased $86,252,938, or 51.5%, to $253,613,826 at June 30, 2011 from $167,360,888 at December 31, 2010. Purchases of investments totaled $153,037,543 during the six months ended June 30, 2011, which exceeded proceeds from calls and repayments totaling $67,210,789 during the period.

Securities available for sale are investments that may be sold in response to changing market and interest rate conditions or for other business purposes. Activity in this portfolio is undertaken primarily to manage liquidity and interest rate risk and to take advantage of market conditions that create more economically attractive returns. At June 30, 2011, securities available for sale totaled $111,698,188, which is an increase of $26,227,195, or 30.7%, from securities available for sale totaling $85,470,993 at December 31, 2010.

At June 30, 2011, the securities available for sale portfolio had net unrealized gains of $2,386,897, compared to net unrealized gains of $1,145,540 at December 31, 2010. These unrealized gains are reflected, net of tax, in shareholders' equity as a component of accumulated other comprehensive income.

Securities held to maturity, which are carried at amortized historical cost, are investments for which there is the positive intent and ability to hold to maturity. At June 30, 2011, securities held to maturity were $141,915,638, an increase of $60,025,743, or 73.3%, from $81,889,895 at December 31, 2010. The fair value of the held to maturity portfolio at June 30, 2010 was $145,124,864.

Due to the continued uncertain economic environment that includes historically low levels of market interest rates, proceeds from maturities and prepayments of securities during the first six months of 2011 were reinvested primarily in the low risk tax-exempt obligations of states and political subdivision bonds (with credit support) component of the Bank's held to maturity portfolio. It is management's intention to hold these tax-exempt securities to their maturity.

Loans

The Company's primary lending emphasis is the origination of commercial and commercial real estate loans and mortgage warehouse lines of credit. Based on the composition of our loan portfolio, the inherent primary risks are deteriorating credit quality, a decline in the economy, and a decline in New Jersey real estate market values. Any one, or a combination, of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

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The following table sets forth the classification of loans by major category at June 30, 2011 and December 31, 2010.

| Loan Portfolio Composition | June 30, 2011 | | December 31, 2010 | |
|---|---|---|---|---|
| Component | Amount | % of total | Amount | % of total |
| Construction loans | $58,927,852 | 17% | $67,890,703 | 16% |
| Residential real estate loans | 10,613,387 | 3% | 10,435,038 | 3% |
| Commercial business | 45,932,585 | 14% | 54,733,172 | 13% |
| Commercial real estate | 93,114,249 | 27% | 95,277,814 | 23% |
| Mortgage warehouse lines | 117,490,567 | 35% | 169,575,899 | 41% |
| Loans to individuals | 12,746,672 | 4% | 13,349,036 | 3% |
| Deferred loan fees and costs | 808,388 | 0% | 543,753 | 0% |
| All other loans | 233,602 | 0% | 181,924 | 0% |
| | $339,867,302 | 100% | $411,987,339 | 100% |

The loan portfolio decreased by $72,120,037, or 17.5%, to $339,867,302 at June 30, 2011, compared to $411,987,339 at December 31, 2010. The mortgage warehouse lines portfolio decreased by $52,085,332, or 30.7%, to $117,490,567 at June 30, 2011 compared to $169,575,899 at December 31, 2010. This component's decrease at June 30, 2011 compared to December 31, 2010 was principally the result of the discontinuation of the Federal government's first-time home buyer tax credit program combined with a current period increase in market rates for mortgage loans.

The Bank's Mortgage Warehouse Funding Group offers a revolving line of credit that is available to licensed mortgage banking companies (the "Warehouse Line of Credit") and that we believe has been successful from inception in 2008. The Warehouse Line of Credit is used by mortgage bankers to originate one-to-four family residential mortgage loans that are pre-sold to the secondary mortgage market, which includes state and national banks, national mortgage banking firms, insurance companies and government-sponsored enterprises, including the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and others. On average, an advance under the Warehouse Line of Credit remains outstanding for a period of less than 30 days, with repayment coming directly from the sale of the loan into the secondary mortgage market. Interest (the spread between our borrowing cost and the rate charged to the client) and a transaction fee are collected by the Bank at the time of repayment. Additionally, customers of the Warehouse Line of Credit are required to maintain deposit relationships with the Bank that, on average, represent 10% to 15% of the loan balances.

A significant portion of our loan portfolio consists of the mortgage warehouse lines of credit. Risks associated with these loans include, without limitation, credit risks relating to the mortgage bankers that borrow from us, the risk of intentional misrepresentation or fraud by any of such mortgage bankers, changes in the market value of mortgage loans originated by the mortgage banker, the sale of which is the expected source of repayment of the borrowings under a warehouse line of credit, due to changes in interest rates during the time in warehouse, or unsalable or impaired mortgage loans so originated, which could lead to decreased collateral value and the failure of a purchaser of the mortgage loan to purchase the loan from the mortgage banker.

The impact of interest rates on our mortgage warehouse business can be significant. Changes in interest rates can impact the number of residential mortgages originated and initially funded under mortgage warehouse lines of credit and thus our mortgage warehouse related revenues. A decline in mortgage rates generally increases the demand for mortgage loans. Conversely, in a constant or increasing rate environment, we would expect fewer loans to be originated. Although we use models to assess the impact of interest rates on mortgage related revenues, the estimates of net income produced by these models are dependent on estimates and assumptions of future loan demand, prepayment speeds and other factors which may overstate or understate actual subsequent experience. Further, the concentration of our loan portfolio on loans originated through our mortgage warehouse business increases the risk associated with our loan portfolio because of the concentration of loans in a single line of business, namely one-to-four family residential mortgage lending, and in a particular segment of that business, namely mortgage warehouse lending.

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The ability of the Company to enter into larger loan relationships and management's philosophy of relationship banking are key factors in the Company's strategy for loan growth. The ultimate collectability of the loan portfolio and recovery of the carrying amount of real estate are subject to changes in the economic environment and real estate market in the Company's market region.

Non-Performing Assets

Non-performing assets consist of non-performing loans and other real estate owned. Non-performing loans are composed of (1) loans on a non-accrual basis, (2) loans which are contractually past due 90 days or more as to interest and principal payments but have not been classified as non-accrual, and (3) loans whose terms have been restructured to provide a reduction or deferral of interest and/or principal because of a deterioration in the financial position of the borrower.

The Bank's policy with regard to non-accrual loans is that generally, loans are placed on a non-accrual status when they are 90 days past due, unless these loans are well secured and in the process of collection or, regardless of the past due status of the loan, when management determines that the complete recovery of principal or interest is in doubt. Consumer loans are generally charged off after they become 120 days past due. Subsequent payments on loans in non-accrual status are credited to income only if collection of principal is not in doubt.

Non-performing loans decreased by $3,120,415 to $5,688,752 at June 30, 2011 from $8,809,167 at December 31, 2010. The major segments of non-accrual loans consist of commercial loans, commercial real estate loans and SBA loans, which are in the process of collection and residential real estate which is either in foreclosure or under contract to close after June 30, 2011. The table below sets forth non-performing assets and risk elements in the Bank's portfolio for the periods indicated.

As the table demonstrates, non-performing loans to total loans decreased to 1.67% at June 30, 2011 from 2.14% at December 31, 2010. Loan quality is still considered to be sound. This was accomplished through quality loan underwriting, a proactive approach to loan monitoring and aggressive workout strategies.

| Non-Performing Assets and Loans | June 30, 2011 | December 31, 2010 |
|---|---|---|
| Non-Performing loans: | | |
| Loans 90 days or more past due and still accruing | $0 | $0 |
| Non-accrual loans | 5,688,752 | 8,809,167 |
| Total non-performing loans | 5,688,752 | 8,809,167 |
| Other real estate owned | 6,789,147 | 4,850,818 |
| Total non-performing assets | $12,477,899 | $13,659,985 |
| | | |
| Non-performing loans to total loans | 1.67% | 2.14% |
| Non-performing loans to total loans excluding mortgage warehouse lines | 2.56% | 3.63% |
| Non-performing assets to total assets | 1.71% | 2.12% |
| Non-performing assets to total assets excluding mortgage warehouse lines | 2.04% | 2.88% |

Non-performing assets decreased by $1,182,086 to $12,477,899 at June 30, 2011 from $13,659,985 at December 31, 2010. Other real estate owned increased by $1,938,329 to $6,789,147 at June 30, 2011 from $4,850,818 at December 31, 2010. Since December 31, 2010, the Bank has added approximately $3,714,822 to other real estate owned and sold and transferred out of other real estate owned properties totaling approximately $1,629,315. In addition, during the six months ended June 30, 2011, the Bank recorded a provision for loss on other real estate owned of $147,178.

Non-performing assets represented 1.71% of total assets at June 30, 2011 and 2.12% of total assets at December 31, 2010.

The Bank had no loans classified as restructured loans at June 30, 2011 or December 31, 2010.

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Management takes a proactive approach in addressing delinquent loans. The Company's President meets weekly with all loan officers to review the status of credits past-due 10 days or more. An action plan is discussed for delinquent loans to determine the steps necessary to induce the borrower to cure the delinquency and restore the loan to a current status. Also, delinquency notices are system generated when loans are five days past-due and again at 15 days past-due.

In most cases, the Company's collateral is real estate and when the collateral is foreclosed upon, the real estate is carried at the lower of fair market value less the estimated selling costs or the initially recorded amount. The amount, if any, by which the recorded amount of the loan exceeds the fair market value of the collateral is a loss which is charged to the allowance for loan losses at the time of foreclosure or repossession. Resolution of a past-due loan can be delayed if the borrower files a bankruptcy petition because a collection action cannot be continued unless the Company first obtains relief from the automatic stay provided by the bankruptcy code.

Allowance for Loan Losses and Related Provision

The allowance for loan losses is maintained at a level sufficient to absorb estimated credit losses in the loan portfolio as of the date of the financial statements. The allowance for loan losses is a valuation reserve available for losses incurred or inherent in the loan portfolio and other extensions of credit. The determination of the adequacy of the allowance for loan losses is a critical accounting policy of the Company.

The Company's primary lending emphasis is the origination of commercial and commercial real estate loans and mortgage warehouse lines of credit. Based on the composition of the loan portfolio, the inherent primary risks are deteriorating credit quality, a decline in the economy, and a decline in New Jersey real estate market values. Any one, or a combination, of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

All, or part, of the principal balance of commercial and commercial real estate loans, and construction loans are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Consumer loans are generally charged off no later than 120 days past due on a contractual basis, earlier in the event of bankruptcy, or if there is an amount deemed uncollectible. Because all identified losses are immediately charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

Management reviews the adequacy of the allowance on at least a quarterly basis to ensure that the provision for loan losses has been charged against earnings in an amount necessary to maintain the allowance at a level that is adequate based on management's assessment of probable estimated losses. The Company's methodology for assessing the adequacy of the allowance for loan losses consists of several key elements. These elements may include a specific reserve for doubtful or high risk loans, an allocated reserve, and an unallocated portion.

The Company consistently applies the following comprehensive methodology. During the quarterly review of the allowance for loan losses, the Company considers a variety of factors that include:

- General economic conditions.
- Trends in charge-offs.
- Trends and levels of delinquent loans.
- Trends and levels of non-performing loans, including loans over 90 days delinquent.
- Trends in volume and terms of loans.
- Levels of allowance for specific classified loans.
- Credit concentrations.

The methodology includes the segregation of the loan portfolio into loan types with a further segregation into risk rating categories. This allows for an allocation of the allowance for loan losses by loan type; however, the allowance is available to absorb any loan loss without restriction. Larger balance, non-homogeneous loans representing significant individual credit exposures are evaluated individually through the internal loan review process. It is this process that produces the watch list. The borrower’s overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated. Based on these reviews, an estimate of probable losses for the individual larger-balance loans are determined, whenever possible, and used to establish loan loss reserves. In general, for non-homogeneous loans not individually assessed, and for homogeneous loans, such as residential mortgages and consumer credits, the loans are collectively evaluated based on delinquency status, loan type, and historical losses. These loan groups are then internally risk rated.

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The watch list includes loans that are assigned a rating of special mention, substandard, doubtful and loss. Loans classified special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans rated as doubtful in whole, or in part, are placed in non-accrual status. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses.

The specific reserve for impaired loans is established for specific loans which have been identified by management as being high risk loan assets. These impaired loans are assigned a doubtful risk rating grade because the loan has not performed according to payment terms and there is reason to believe that repayment of the loan principal in whole, or part, is unlikely. The specific portion of the allowance is the total amount of potential unconfirmed losses for these individual doubtful loans. To assist in determining the fair value of loan collateral, the Company often utilizes independent third party qualified appraisal firms which in turn employ their own criteria and assumptions that may include occupancy rates, rental rates, and property expenses, among others.

The second category of reserves consists of the allocated portion of the allowance. The allocated portion of the allowance is determined by taking pools of loans outstanding that have similar characteristics and applying historical loss experience for each pool. This estimate represents the potential unconfirmed losses within the portfolio. Individual loan pools are created for commercial and commercial real estate loans, construction loans, and various types of loans to individuals. The historical estimation for each loan pool is then adjusted to account for current conditions, current loan portfolio performance, loan policy or management changes, or any other factor which may cause future losses to deviate from historical levels.

The Company also maintains an unallocated allowance. The unallocated allowance is used to cover any factors or conditions which may cause a potential loan loss but are not specifically identifiable. It is prudent to maintain an unallocated portion of the allowance because no matter how detailed an analysis of potential loan losses is performed, these estimates by definition lack precision. Management must make estimates using assumptions and information that is often subjective and changing rapidly.

Loans are placed in a non-accrual status when the ultimate collectability of principal or interest in whole, or part, is in doubt. Past-due loans contractually past-due 90 days or more for either principal or interest are also placed in non-accrual status unless they are both well secured and in the process of collection. Impaired loans are evaluated individually.

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The following table presents, for the periods indicated, an analysis of the allowance for loan losses and other related data.

Allowance for Loan Losses

| | June 30, 2011 | December 31, 2010 | June 30, 2010 |
|---|---|---|---|
| Balance, beginning of period | $ 5,762,712 | $ 4,505,387 | $ 4,505,387 |
| | | | |
| Provision charged to operating expenses | 674,998 | 2,325,000 | 850,000 |
| | | | |
| Loans charged off : | | | |
| Construction loans | (525,487) | (450,000) | - |
| Residential real estate loans | - | - | - |
| Commercial and commercial real estate | (46,319) | (609,468) | (410,416) |
| Loans to individuals | | (22,087) | (18,243) |
| Lease financing | - | - | (792) |
| All other loans | - | - | - |
| | (571,806) | (1,081,555) | (429,451) |
| Recoveries | | | |
| Construction loans | - | - | - |
| Residential real estate loans | - | - | - |
| Commercial and commercial real estate | 3,677 | 13,880 | 11,955 |
| Loans to individuals | - | - | - |
| Lease financing | - | - | - |
| All other loans | - | - | - |
| | 3,677 | 13,880 | 11,955 |
| | | | |
| Net (charge offs) / recoveries | (568,129) | (1,067,675) | (417,496) |
| | | | |
| Balance, end of period | $ 5,869,581 | $ 5,762,712 | $ 4,937,891 |
| | | | |
| Loans : | | | |
| At period end | $ 339,867,302 | $ 411,987,339 | $ 433,271,444 |
| Average during the period | 326,804,031 | 387,575,677 | 353,238,389 |
| Net charge offs to average loans outstanding (annualized) | (0.35%) | (0.28%) | (0.24%) |
| | | | |
| Allowance for loan losses to : | | | |
| Total loans at period end | 1.73% | 1.40% | 1.14% |
| Total loans at period end excluding mortgage warehouse lines | 2.64% | 2.38% | 2.00% |
| Non-performing loans | 103.18% | 65.78% | 67.57% |

The Company’s provision for loan losses was $674,998 for the six months ended June 30, 2011 and $850,000 for the six months ended June 30, 2010. While the risk profile of the loan portfolio was reduced by a $72,120,037 decrease in the total loan portfolio at June 30, 2011 compared to the December 31, 2010 balance and non-performing loans decreased by $3,120,415 from December 31, 2010 to June 30, 2011, the continuing adverse economic conditions that resulted in depreciation of collateral values securing construction and commercial loans necessitated the recorded provision. Also, management replenished the reserves to compensate for the current period net charge-offs. Net charge offs/recoveries amounted to a net charge-off of $568,129 for the six months ended June 30, 2011.

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At June 30, 2011, the allowance for loan losses was $5,869,581 compared to $5,762,712 at December 31, 2010, an increase of $106,869. The ratio of the allowance for loan losses to total loans at June 30, 2011 and December 31, 2010 was 1.73% and 1.40%, respectively. The allowance for loan losses as a percentage of non-performing loans was 65.78% at December 31, 2010, compared to 103.18% at June 30, 2011. Management believes the quality of the loan portfolio remains sound considering the economic climate and economy in the State of New Jersey and that the allowance for loan losses is adequate in relation to credit risk exposure levels.

Deposits

Deposits, which include demand deposits (interest bearing and non-interest bearing), savings deposits and time deposits, are a fundamental and cost-effective source of funding. The flow of deposits is influenced significantly by general economic conditions, changes in market interest rates and competition. The Bank offers a variety of products designed to attract and retain customers, with the Bank's primary focus being on building and expanding long-term relationships.

The following table summarizes deposits at June 30, 2011 and December 31, 2010.

| | June 30, 2011 | December 31, 2010 |
|---|---|---|
| Demand | | |
| Non-interest bearing | $ 112,963,755 | $ 92,023,123 |
| Interest bearing | 195,413,388 | 129,869,045 |
| Savings | 176,190,405 | 165,388,564 |
| Time | 158,540,524 | 156,454,417 |
| | $ 643,108,072 | $ 543,735,149 |

At June 30, 2011, total deposits were $643,108,072, an increase of $99,372,923, or 18.3%, from $543,735,149 at December 31, 2010. The current period increase was due to the March 25, 2011 Acquisition, in which the Bank assumed deposit liabilities of $111.9 million.

Borrowings

Borrowings are mainly comprised of Federal Home Loan Bank ("FHLB") borrowings and overnight funds purchased. These borrowings are primarily used to fund asset growth not supported by deposit generation. The balance of borrowings was $10,000,000 at June 30, 2011, consisting solely of FHLB long-term borrowings and $25,900,000 at December 31, 2010, consisting of long-term FHLB borrowings of $10,000,000 and overnight funds purchased of $15,900,000.

The Bank has a fixed rate convertible advance from the FHLB in the amounts of $10,000,000 that bears interest at the rate of 4.08%. This advance may be called by the FHLB quarterly at the option of the FHLB if rates rise and the rate earned by the FHLB is no longer a "market" rate. This advance is fully secured by marketable securities.

Shareholders' Equity and Dividends

Shareholders' equity increased by $2,751,996, or 5.5%, to $52,433,152 at June 30, 2011, from $49,681,156 at December 31, 2010. Tangible book value per common share was $9.75 at June 30, 2011 and $9.73 at December 31, 2010. The ratio of shareholders' equity to total assets was 7.19% and 7.71% at June 30, 2011 and December 31, 2010, respectively. The increase in shareholders' equity was primarily the result of net income available to common shareholders of $1,618,784 for the six months ended June 30, 2011.

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In lieu of cash dividends to common shareholders, the Company (and its predecessor the Bank) has declared a stock dividend every year since 1992 and has paid such dividends every year since 1993. 5% stock dividends were declared in 2010 and 2009 and paid in 2011 and 2010, respectively.

The Company's common stock is quoted on the Nasdaq Global Market under the symbol "FCCY".

In 2005, the Company's board of directors authorized a common stock repurchase program that allows for the repurchase of a limited number of the Company's shares at management's discretion on the open market. The Company undertook this repurchase program in order to increase shareholder value. Disclosure of repurchases of Company shares, if any, made during the quarter ended June 30, 2011 is set forth under Part II, Item 2 of this report, "Unregistered Sales of Equity Securities and Use of Proceeds."

Actual capital amounts and ratios for the Company and the Bank as of June 30, 2011 and December 31, 2010 are as follows:

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provision | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of June 30, 2011 | | | | | | |
| Company | | | | | | |
| Total Capital to Risk Weighted Assets | $ 69,269,776 | 15.13% | $ 36,625,680 | >8% | N/A | N/A |
| Tier 1 Capital to Risk Weighted Assets | 62,627,765 | 13.68% | 18,312,840 | >4% | N/A | N/A |
| Tier 1 Capital to Average Assets | 62,627,765 | 8.56% | 29,263,173 | >4% | N/A | N/A |
| Bank | | | | | | |
| Total Capital to Risk Weighted Assets | $ 66,396,887 | 14.50% | $ 36,625,680 | >8% | $ 45,782,100 | >10% |
| Tier 1 Capital to Risk Weighted Assets | 60,671,887 | 13.25% | 18,312,840 | >4% | 27,469,260 | >6% |
| Tier 1 Capital to Average Assets | 60,671,887 | 7.96% | 30,494,260 | >4% | 38,117,825 | >5% |
| | | | | | | |
| As of December 31, 2010 | | | | | | |
| Company | | | | | | |
| Total Capital to Risk Weighted Assets | $ 72,736,033 | 14.43% | $ 40,335,354 | >8% | N/A | N/A |
| Tier 1 Capital to Risk Weighted Assets | 65,484,454 | 12.99% | 20,167,677 | >4% | N/A | N/A |
| Tier 1 Capital to Average Assets | 65,484,454 | 9.63% | 27,196,758 | >4% | N/A | N/A |
| Bank | | | | | | |
| Total Capital to Risk Weighted Assets | $ 70,084,660 | 15.46% | $ 40,272,800 | >8% | $ 50,341,000 | >10% |
| Tier 1 Capital to Risk Weighted Assets | 64,321,948 | 14.37% | 20,136,400 | >4% | 30,204,600 | >6% |
| Tier 1 Capital to Average Assets | 64,321,948 | 11.10% | 27,054,854 | >4% | 33,818,567 | >5% |

The minimum regulatory capital requirements for financial institutions require institutions to have a Tier 1 capital to average assets ratio of 4.0%, a Tier 1 capital to risk weighted assets ratio of 4.0% and a total capital to risk weighted assets ratio of 8.0%. To be considered "well capitalized," an institution must have a minimum Tier 1 leverage ratio of 5.0%. At June 30, 2011, the ratios of the Company exceeded the ratios required to be considered well capitalized. It is management's goal to monitor and maintain adequate capital levels to continue to support asset growth and continue its status as a well capitalized institution.

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Liquidity

At June 30, 2011, the amount of liquid assets remained at a level management deemed adequate to ensure that contractual liabilities, depositors' withdrawal requirements, and other operational and customer credit needs could be satisfied.

Liquidity management refers to the Company's ability to support asset growth while satisfying the borrowing needs and deposit withdrawal requirements of customers. In addition to maintaining liquid assets, factors such as capital position, profitability, asset quality and availability of funding affect a bank's ability to meet its liquidity needs. On the asset side, liquid funds are maintained in the form of cash and cash equivalents, Federal funds sold, investment securities held to maturity maturing within one year, securities available for sale and loans held for sale. Additional asset-based liquidity is derived from scheduled loan repayments as well as investment repayments of principal and interest from mortgage-backed securities. On the liability side, the primary source of liquidity is the ability to generate core deposits. Short-term borrowings are used as supplemental funding sources when growth in the core deposit base does not keep pace with that of earnings assets.

The Bank has established a borrowing relationship with the FHLB which further supports and enhances liquidity. During 2010, FHLB replaced its Overnight Line of Credit and One-Month Overnight Repricing Line of Credit facilities available to member banks with a fully secured line of up to 50 percent of a bank's quarter-end total assets. Under the terms of this facility, the Bank's total credit exposure to FHLB cannot exceed 50 percent, or $367,543,836, of its total assets at March 31, 2011. In addition, the aggregate outstanding principal amount of the Bank's advances, letters of credit, the dollar amount of the FHLB's minimum collateral requirement for off-balance sheet financial contracts and advance commitments cannot exceed 30 percent of the Bank's total assets, unless the Bank obtains approval from FHLB's Board of Directors or its Executive Committee. These limits are further restricted by a member's ability to provide eligible collateral to support its obligations to FHLB as well as the ability to meet the FHLB's stock requirement. The Bank also maintains an unsecured federal funds line of $20,000,000 with a correspondent bank.

The Consolidated Statements of Cash Flows present the changes in cash from operating, investing and financing activities. At June 30, 2011, the balance of cash and cash equivalents was $90,057,576.

Net cash provided by operating activities totaled $14,998,900 for the six months ended June 30, 2011 compared to net cash provided by operations of $9,093,821 for the six months ended June 30, 2010. The primary source of funds is net income from operations adjusted for activity related to loans originated for sale, the provision for loan losses, depreciation expenses, and net amortization of premiums on securities.

Net cash provided by investing activities totaled $85,694,164 for the six months ended June 30, 2011 compared to net cash used in investing activities of $54,766,330 for the six months ended June 30, 2010. The increase for the 2011 period compared to the 2010 period resulted from $101,539,588 in cash and cash equivalents acquired in the Acquisition.

Net cash used in financing activities totaled $28,345,989 for the six months ended June 30, 2011 compared to net cash provided by financing activities of $35,704,219 for the six months ended June 30, 2011. The cash used in the 2011 period resulted primarily from a decrease in demand, savings and time deposits and repayment of borrowed funds.

The securities portfolios are also a source of liquidity, providing cash flows from maturities and periodic repayments of principal. For the six months ended June 30, 2011, prepayments and maturities of investment securities totaled $67,210,789. Another source of liquidity is the loan portfolio, which provides a flow of payments and maturities.

Interest Rate Sensitivity Analysis

The largest component of the Company's total income is net interest income, and the majority of the Company's financial instruments are composed of interest rate-sensitive assets and liabilities with various terms and maturities. The primary objective of management is to maximize net interest income while minimizing interest rate risk. Interest rate risk is derived from timing differences in the repricing of assets and liabilities, loan prepayments, deposit withdrawals, and differences in lending and funding rates. Management actively seeks to monitor and control the mix of interest rate-sensitive assets and interest rate-sensitive liabilities.

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The Company continually evaluates interest rate risk management opportunities, including the use of derivative financial instruments. Management believes that hedging instruments currently available are not cost-effective, and therefore, has focused its efforts on increasing the Bank's spread by attracting lower-cost retail deposits.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not required.

## Item 4. Controls and Procedures.

The Company has established disclosure controls and procedures 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 SEC rules and forms and is accumulated and communicated to management, including the principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure.

The Company's principal executive officer and principal financial officer, with the assistance of other members of the Company's management, have evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this quarterly report. Based upon such evaluation, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures are effective as of the end of the period covered by this quarterly report.

The Company's principal executive officer and principal financial officer have also concluded that there was no change in the Company's internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) that occurred during the quarter ended June 30, 2011 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

# PART II. OTHER INFORMATION

## Item 1A. Risk Factors.

Except as set forth below, there were no material changes to the Company's risk factors as discussed in Item 1A. Risk Factors, in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 23, 2011:

Add the following risk factor:

Our mortgage warehouse lending business represents a significant portion of our overall lending activity and is subject to numerous risks.

Our primary lending emphasis is the origination of commercial and commercial real estate loans and mortgage warehouse lines of credit. Based on the composition of our loan portfolio, the inherent primary risks are deteriorating credit quality, a decline in the economy, and a decline in New Jersey real estate market values. Any one, or a combination, of these events may adversely affect the loan portfolio and may result in increased delinquencies, loan losses and increased future provision levels.

A significant portion of our loan portfolio consists of the mortgage warehouse lines of credit. Risks associated with these loans include, without limitation, (i) credit risks relating to the mortgage bankers that borrow from us, (ii) the risk of intentional misrepresentation or fraud by any of such mortgage bankers, (iii) changes in the market value of mortgage loans originated by the mortgage banker, the sale of which is the expected source of repayment of the borrowings under a warehouse line of credit, due to changes in interest rates during the time in warehouse, or (iv) unsalable or impaired mortgage loans so originated, which could lead to decreased collateral value and the failure of a purchaser of the mortgage loan to purchase the loan from the mortgage banker.

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The impact of interest rates on our mortgage warehouse business can be significant. Changes in interest rates can impact the number of residential mortgages originated and initially funded under mortgage warehouse lines of credit and thus our mortgage warehouse related revenues. A decline in mortgage rates generally increases the demand for mortgage loans. Conversely, in a constant or increasing rate environment, we would expect fewer loans to be originated. Although we use models to assess the impact of interest rates on mortgage related revenues, the estimates of net income produced by these models are dependent on estimates and assumptions of future loan demand, prepayment speeds and other factors which may overstate or understate actual subsequent experience. Further, the concentration of our loan portfolio on loans originated through our mortgage warehouse business increases the risk associated with our loan portfolio because of the concentration of loans in a single line of business, namely one-to-four family residential mortgage lending, and in a particular segment of that business, namely mortgage warehouse lending.

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

Issuer Purchases of Equity Securities

On July 21, 2005, the board of directors authorized a stock repurchase program under which the Company may repurchase in open market or privately negotiated transactions up to 5% of its common shares outstanding at that date. The Company undertook this repurchase program in order to increase shareholder value. The following table provides common stock repurchases made by or on behalf of the Company during the three months ended June 30, 2011, if any.

Issuer Purchases of Equity Securities (1)

| Period | | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased As Part of Publicly Announced Plan or Program | Maximum Number of Shares That May Yet be Purchased Under the Plan or Program |
|---|---|---|---|---|---|
| Beginning | Ending | | | | |
| April 1, 2011 | April 30, 2011 | - | - | - | 170,222 |
| May 1, 2011 | May 31, 2011 | - | - | - | 170,222 |
| June 1, 2011 | June 30, 2011 | - | - | - | 170,222 |
| | Total | | | | 170,222 |

(1) The Company's common stock repurchase program covers a maximum of 195,076 shares of common stock of the Company, representing 5% of the outstanding common stock of the Company on July 21, 2005, as adjusted for the subsequent common stock dividends.

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Item 6. Exhibits.

| | | |
|---|---|---|
| 31.1 | * | Certification of Robert F. Mangano, principal executive officer of the Company, pursuant to Securities Exchange Act Rule 13a-14(a) |
| 31.2 | * | Certification of Joseph M. Reardon, principal financial officer of the Company, pursuant to Securities Exchange Act Rule 13a-14(a) |
| 32 | * | Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, signed by Robert F. Mangano, principal executive officer of the Company, and Joseph M. Reardon, principal financial officer of the Company |
| 101.INS | * | XBRL Instance DocumentX |
| 101.SCH | * | XBRL Taxonomy Extension Schema DocumentX |
| 101.CAL | * | XBRL Taxonomy Extension Calculation Linkbase DocumentX |
| 101.DEF | * | XBRL Taxonomy Extension Definition Linkbase Document X |
| 101.LAB | * | XBRL Taxonomy Extension Label Linkbase DocumentX |
| 101.PRE | * | XBRL Taxonomy Extension Presentation Linkbase DocumentX |

* Filed herewith.

X These interactive data files are being furnished as part of this Quarterly Report, and in accordance with Rule 402 of Regulation S-T, shall not be deemed filed for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under those sections.

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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.

1ST CONSTITUTION BANCORP

| | | |
|---|---|---|
| Date: August 15, 2011 | By: | /s/ ROBERT F. MANGANO<br>Robert F. Mangano<br>President and Chief Executive Officer<br>(Principal Executive Officer) |
| Date: August 15, 2011 | By: | /s/ JOSEPH M. REARDON<br>Joseph M. Reardon<br>Senior Vice President and Treasurer<br>(Principal Financial and Accounting Officer) |