

SUSSEX BANCORP  
Form 10-Q  
May 14, 2010

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

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FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2010

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-29030

SUSSEX BANCORP  
(Exact name of registrant as specified in its charter)

New Jersey  
(State or other jurisdiction of  
incorporation or organization)

22-3475473  
(I.R.S. Employer Identification  
No.)

200 Munsonhurst Rd., Franklin,  
NJ  
(Address of principal executive  
offices)

07416  
(Zip Code)

(973) 827-2914  
(Registrant's telephone number, including area code)

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(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 and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

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Yes

No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
[ ]  
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes

No

As of May11, 2010 there were 3,322,548 shares of common stock, no par value, issued.

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SUSSEX BANCORP  
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## PART I - FINANCIAL INFORMATION

## Item 1 - Financial Statements

SUSSEX BANCORP  
CONSOLIDATED BALANCE SHEETS  
(Unaudited)

(Dollars in thousands)	March 31, 2010	December 31, 2009
<b>ASSETS</b>		
Cash and due from banks	\$ 15,694	\$ 8,779
Federal funds sold and interest bearing deposits with other banks	25,705	14,300
Cash and cash equivalents	41,399	23,079
Interest bearing time deposits with other banks	600	100
Trading securities	2,573	2,955
Securities available for sale	73,761	71,315
Federal Home Loan Bank Stock, at cost	2,045	2,045
Loans receivable, net of unearned income	329,782	332,959
Less: allowance for loan losses	6,225	5,496
Net loans receivable	323,557	327,463
Foreclosed real estate, net of allowance for losses of \$922 in 2010 and \$893 in 2009	4,329	3,843
Premises and equipment, net	7,067	7,065
Accrued interest receivable	1,857	1,943
Goodwill	2,820	2,820
Other assets	11,753	12,213
<b>Total Assets</b>	<b>\$ 471,761</b>	<b>\$ 454,841</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities:</b>		
<b>Deposits:</b>		
Non-interest bearing	\$ 37,812	\$ 34,155
Interest bearing	350,259	337,920
<b>Total Deposits</b>	<b>388,071</b>	<b>372,075</b>
Borrowings	33,075	33,090
Accrued interest payable and other liabilities	2,408	2,262
Junior subordinated debentures	12,887	12,887
<b>Total Liabilities</b>	<b>436,441</b>	<b>420,314</b>
<b>Stockholders' Equity:</b>		

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Preferred stock, no par value, 1,000,000 shares authorized; none issued	-	-
Common stock, no par value, authorized 5,000,000 shares; issued shares 3,317,548 in 2010 and 3,259,786 in 2009; outstanding shares 3,249,005 in 2010 and 3,245,811 in 2009	27,821	27,805
Retained earnings	7,220	6,577
Accumulated other comprehensive income	279	145
Total Stockholders' Equity	35,320	34,527
Total Liabilities and Stockholders' Equity	\$ 471,761	\$ 454,841

See Notes to Unaudited Consolidated Financial Statements

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SUSSEX BANCORP  
CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited)

	Three Months Ended March 31,	
(Dollars in thousands except per share data)	2010	2009
<b>INTEREST INCOME</b>		
Loans receivable, including fees	\$ 4,680	\$ 4,808
Securities:		
Taxable	514	627
Tax-exempt	263	273
Federal funds sold	7	12
Interest bearing deposits	2	7
Total Interest Income	5,466	5,727
<b>INTEREST EXPENSE</b>		
Deposits	1,104	2,169
Borrowings	352	352
Junior subordinated debentures	53	104
Total Interest Expense	1,509	2,625
Net Interest Income	3,957	3,102
<b>PROVISION FOR LOAN LOSSES</b>	737	639
Net Interest Income after Provision for Loan Losses	3,220	2,463
<b>OTHER INCOME</b>		
Service fees on deposit accounts	334	367
ATM fees	115	107
Insurance commissions and fees	547	614
Investment brokerage fees	60	47
Holding gains on trading securities	11	35
Gain (loss) on sale of foreclosed real estate	4	(1)
Other	110	168
Total Other Income	1,181	1,337
<b>OTHER EXPENSES</b>		
Salaries and employee benefits	1,841	1,783
Occupancy, net	347	352
Furniture, equipment and data processing	299	340
Stationary and supplies	44	45
Professional fees	159	183
Advertising and promotion	51	59
Insurance	56	41
FDIC Assessment	224	150

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Postage and freight	31	42
Amortization of intangible assets	4	5
Write-down on foreclosed real estate	29	-
Expenses related to foreclosed real estate	69	183
Other	382	365
Total Other Expenses	3,536	3,548
Income before Income Taxes	865	252
PROVISION (BENEFIT) FOR INCOME TAXES	222	(1 )
Net Income	\$ 643	\$ 253
EARNINGS PER SHARE		
Basic	\$ 0.20	\$ 0.08
Diluted	\$ 0.20	\$ 0.08

See Notes to Consolidated Financial Statements

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SUSSEX BANCORP  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
Three Months Ended March 31, 2010 and 2009  
(Unaudited)

(Dollars In thousands, except per share amounts)	Number of Shares Outstanding	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance December 31, 2008	3,248,417	\$27,783	\$4,665	\$ (538 )	\$ 31,910
Comprehensive income:					
Net income	-	-	253	-	253
Change in unrealized losses on securities available for sale, net of tax	-	-	-	(147 )	(147 )
Total Comprehensive Income					106
Restricted stock vested during the period (a)	2,194	-	-	-	-
Compensation expense related to restricted stock grants	-	19	-	-	19
Dividends on common stock (\$.03 per share)	-	-	(99 )	-	(99 )
Balance March 31, 2009	3,250,611	\$27,802	\$4,819	\$ (685 )	\$ 31,936
Balance December 31, 2009	3,245,811	\$27,805	\$6,577	\$ 145	\$ 34,527
Comprehensive income:					
Net income	-	-	643	-	643
Change in unrealized income on securities available for sale, net of tax	-	-	-	134	134
Total Comprehensive Income					777
Restricted stock vested during the period (a)	3,194	-	-	-	-
Compensation expense related to restricted stock grants	-	16	-	-	16
Balance March 31, 2010	3,249,005	\$27,821	\$7,220	\$ 279	\$ 35,320

(a) Balance of unvested shares of restricted stock: 68,543 in 2010 and 20,321 in 2009





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SUSSEX BANCORP  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

(Dollars in thousands)	Three Months Ended March 31,	
	2010	2009
<b>Cash Flows from Operating Activities</b>		
Net income	\$ 643	\$ 253
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	737	639
Provision for depreciation and amortization	166	215
Net change in trading securities	382	1,975
Net amortization of securities premiums and discounts	31	22
Net realized (gain) loss on sale of foreclosed real estate	(4 )	1
Provision for foreclosed real estate	29	-
Earnings on investment in life insurance	(36 )	(27 )
Compensation expense for stock options and restricted stock awards	16	19
(Increase) decrease in assets:		
Accrued interest receivable	86	83
Other assets	402	(281 )
Increase (decrease) in accrued interest payable and other liabilities	146	(46 )
<b>Net Cash Provided by Operating Activities</b>	<b>2,598</b>	<b>2,853</b>
<b>Cash Flows from Investing Activities</b>		
Securities available for sale:		
Purchases	(10,002 )	(18,198 )
Maturities, calls and principal repayments	7,749	3,614
Net (increase) decrease in loans	2,492	(3,364 )
Proceeds from sale of foreclosed real estate	166	256
Purchases of interest bearing time deposits	(500 )	(2,739 )
Purchases of premises and equipment	(164 )	(16 )
Decrease in FHLB stock	-	1
<b>Net Cash Used in Investing Activities</b>	<b>(259 )</b>	<b>(20,446 )</b>
<b>Cash Flows from Financing Activities</b>		
Net increase in deposits	15,996	40,595
Repayments of borrowings	(15 )	(14 )
Dividends paid	-	(99 )
<b>Net Cash Provided by Financing Activities</b>	<b>15,981</b>	<b>40,482</b>
<b>Net Increase in Cash and Cash Equivalents</b>	<b>18,320</b>	<b>22,889</b>
<b>Cash and Cash Equivalents - Beginning</b>	<b>23,079</b>	<b>20,912</b>

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Cash and Cash Equivalents - Ending	\$ 41,399	\$ 43,801
Supplementary Cash Flows Information		
Interest paid	\$ 1,549	\$ 2,699
Income taxes paid	\$ 25	\$ 45
Supplementary Schedule of Noncash Investing and Financing Activities		
Foreclosed real estate acquired in settlement of loans	\$ 677	\$ 1,000

See Notes to Unaudited Consolidated Financial Statements

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SUSSEX BANCORP  
Notes to Consolidated Financial Statements (Unaudited)

Note 1 - Basis of Presentation

The consolidated financial statements include the accounts of Sussex Bancorp (the "Company") and its wholly-owned subsidiary Sussex Bank (the "Bank"). The Bank's wholly-owned subsidiaries are SCB Investment Company, Inc., SCBNY Company, Inc., and Tri-State Insurance Agency, Inc. ("Tri-State") a full service insurance agency located in Sussex County, New Jersey. Tri-State's operations are considered a separate segment for financial disclosure purposes.

All inter-company transactions and balances have been eliminated in consolidation. Sussex Bank is also a 49% partner in SussexMortgage.com LLC, an Indiana limited liability company and mortgage banking joint venture with PNC Mortgage, Inc. The Bank operates ten banking offices, eight located in Sussex County, New Jersey and two in Orange County, New York. The Bank has also received regulatory approval for a branch location in Pike County, Pennsylvania.

The Company is subject to the supervision and regulation of the Board of Governors of the Federal Reserve System (the "FRB"). The Bank's deposits are insured by the Deposit Insurance Fund ("DIF") of the Federal Deposit Insurance Corporation ("FDIC") up to applicable limits. The operations of the Company and the Bank are subject to the supervision and regulation of the FRB, FDIC and the New Jersey Department of Banking and Insurance (the "Department") and the operations of Tri-State are subject to supervision and regulation by the Department.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for full year financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal, recurring nature. Operating results for the three-month period ended March 31, 2010, are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto that are included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

The Financial Accounting Standards Board (FASB) issued FASB Accounting Standards Codification (ASC) effective for financial statements issued for interim and annual periods ending after September 15, 2009. The ASC is an aggregation of previously issued authoritative U.S. generally accepted accounting principles (GAAP) in one comprehensive set of guidance organized by subject area. In accordance with the ASC, references to previously issued accounting standards have been replaced by ASC references. Subsequent revisions to GAAP will be incorporated into the ASC through Accounting Standards Updates (ASU).

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of March 31, 2010 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.

Note 2 – Earnings per Share

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Basic earnings per share are calculated by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares (nonvested restricted stock grants and stock options) had been issued, as well as any adjustment to income that would result from the assumed issuance of potential common shares that may be issued by the Company. Potential common shares related to stock options are determined using the treasury stock method.

	Three Months Ended March 31, 2010			Three Months Ended March 31, 2009		
	Income	Shares	Per Share	Income	Shares	Per Share
(Dollars in thousands, except per share data)	(Numerator)	(Denominator)	Amount	(Numerator)	(Denominator)	Amount
<b>Basic earnings per share:</b>						
Net income applicable to common stockholders	\$ 643	3,248	\$ 0.20	\$ 253	3,251	\$ 0.08
<b>Effect of dilutive securities:</b>						
Stock options	-	42		-	13	
<b>Diluted earnings per share:</b>						
Net income applicable to common stockholders and assumed conversions	\$ 643	3,290	\$ 0.20	\$ 253	3,264	\$ 0.08

Note 3 – Comprehensive Income (Loss)

The components of other comprehensive income (loss) and related tax effects are as follows:

	Three Months Ended March 31,	
	2010	2009
(Dollars in thousands)		
Unrealized holding gain (loss) on available for sale securities	\$ 223	\$ (245 )
Reclassification adjustments for gains (losses) included in net income	-	-
Net unrealized gain (loss)	223	(245 )
Tax effect	(89 )	98
Other comprehensive income (loss), net of tax	\$ 134	\$ (147 )

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## Note 4 – Segment Information

The Company's insurance agency operations are managed separately from the traditional banking and related financial services that the Company also offers. The insurance agency operation provides commercial, individual, and group benefit plans and personal coverage.

(Dollars in thousands)	Three Months Ended March 31, 2010			Three Months Ended March 31, 2009		
	Banking and Financial Services	Insurance Services	Total	Banking and Financial Services	Insurance Services	Total
Net interest income from external sources	\$ 3,957	\$ -	\$ 3,957	\$ 3,102	\$ -	\$ 3,102
Other income from external sources	634	547	1,181	723	614	1,337
Depreciation and amortization	163	3	166	212	3	215
Income before income taxes	850	15	865	220	32	252
Income tax expense (benefit) (1)	216	6	222	(14 )	13	(1 )
Total assets	468,757	3,004	471,761	478,059	3,097	481,156

(1) Insurance services calculated at statutory tax rate of 40%

## Note 5 - Stock-Based Compensation

The Company currently has stock-based compensation plans in place for directors, officers, employees, consultants and advisors of the Company. Under the terms of these plans the Company may grant restricted shares and stock options for the purchase of the Company's common stock. The stock-based compensation is granted under terms determined by the Compensation Committee of the Board of Directors. Stock options granted have a maximum term of ten years, generally vest over periods ranging between one and four years, and are granted with an exercise price equal to the fair market value of the common stock on the date the options are granted. Restricted stock is valued at the market value of the common stock on the date of grant and generally vests between two and five years. All dividends paid on restricted stock, whether vested or unvested, are granted to the stockholder.

Stock options outstanding at March 31, 2010 were 187,362 and there were no stock option grants, exercises or forfeitures during the first three months of 2010. The weighted average exercise price per share of the outstanding options was \$12.43 and the weighted average contractual term was 5.84 years. The option price range for the quarter was \$6.88 to \$16.45. All compensation expense for stock option plans has been expensed and there was no intrinsic value to the stock options at March 31, 2010.

During the first three months of 2010 and 2009, the Company expensed \$16 thousand and \$19 thousand, respectively, in stock-based compensation under restricted stock awards. Information regarding the Company's restricted stock activity as of March 31, 2010 is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Restricted stock, beginning of year	13,975	\$ 8.34
Granted	57,762	3.59
Vested	(3,194 )	9.40
Restricted stock, end of quarter	68,543	\$ 4.29

At March 31, 2010, unrecognized compensation expense for non-vested restricted stock was \$270 thousand, which is expected to be recognized over an average period of 4.2 years.

Note 6 - Guarantees

The Company does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company, generally, holds collateral and/or personal guarantees supporting these commitments. The Company had \$2.1 million of undrawn standby letters of credit outstanding as of March 31, 2010. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The amount of the liability as of March 31, 2010 for guarantees under standby letters of credit issued is not material.

Note 7 - Fair Value of Financial Instruments

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Company could have realized in a sale transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective period ends, and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each period end.

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Under FASB ASC 820, Fair Value Measurement and Disclosures, there is a hierarchal disclosure framework associated with the level of pricing observability utilized in measuring assets and liabilities at fair value. The three broad levels defined by the FASB ASC 820 hierarchy are as follows:

Level I - Quoted prices are available in active markets for identical assets or liabilities as of the reported date.

Level II- Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these asset and liabilities include items for which quoted prices are available but traded less frequently, and items that are fair valued using other financial instruments, the parameters of which can be directly observed.

Level III - Assets and liabilities that have little to no pricing observability as of reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

The following table summarizes the valuation of the Company's financial assets measured on a recurring basis by the above FASB ASC 820 pricing observability levels:

(Dollars in thousands)	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level I)	Significant Other Observable Inputs (Level II)	Significant Unobservable Inputs (Level III)
<b>March 31, 2010:</b>				
Trading securities	\$ 2,573	\$ -	\$ 2,573	\$ -
Available for sale securities	73,761	-	73,761	-
<b>December 31, 2009:</b>				
Trading securities	\$ 2,955	\$ -	\$ 2,955	\$ -
Available for sale securities	71,315	-	71,315	-

All trading securities at March 31, 2010 and December 31, 2009 were mortgage-backed securities. The Company's trading securities and available for sale securities portfolios contain investments which are all rated within the Company's investment policy guidelines and upon review of the entire portfolio all securities are marketable and have observable pricing inputs. There were holding gains on trading securities recorded on the income statement of \$11 thousand for the three months ended March 31, 2010 and \$35 thousand for the same period in 2009.

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level are as follows:

Fair Value	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
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(Dollars in thousands)	Measurements	(Level I)	(Level II)	(Level III)
<b>March 31, 2010:</b>				
Impaired loans	\$ 14,379	\$ -	\$ -	\$ 14,379
Foreclosed real estate	2,650	-	-	2,650
<b>December 31, 2009:</b>				
Impaired loans	\$ 4,452	\$ -	\$ -	\$ 4,452
Foreclosed real estate	2,385	-	-	2,385

Impaired loans are measured for impairment using the fair value of collateral-dependent loans or discounted cash flows based upon the expected proceeds. Impaired loans had carrying amounts of \$27.4 million at March 31, 2010 and \$24.8 million at December 31, 2009. During the first quarter of 2010, the Company valued collateral dependant impaired loans that were modified in troubled debt restructurings by applying the use of discounted cash flows. As a result, impaired loans measured at fair value increased \$9.9 million to \$14.4 million on March 31, 2010 from \$4.5 million at December 31, 2009. Foreclosed real estate is valued at the lower of the principal balance of the secured loan or fair value less estimated costs to sell the property.

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair value of the Company's financial instruments at March 31, 2010 and December 31, 2009:

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Cash and Cash Equivalents (Carried at Cost): The carrying amounts reported in the balance sheet for cash and cash equivalents approximate those assets' fair value.

Deposits (Carried at Cost): Fair value for fixed-rate time 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. The Company generally purchases amounts below the insured limit, limiting the amount of credit risk on these time deposits.

Securities: The fair value of securities, available for sale (carried at fair value) is determined by obtaining quoted market prices on nationally recognized securities exchanges (Level I), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level 3). In the absence of such evidence, management's best estimate is used. Management's best estimate consists of both internal and external support on certain Level 3 investments. Internal cash flow models using a present value formula that includes assumptions market participants would use along with indicative exit pricing obtained from broker/dealers (where available) were used to support fair values of certain Level 3 investments.

Loans Receivable (Carried at Cost): The fair values of loans are estimated using discounted cash flow analyses, using the 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 reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

Impaired Loans (Generally Carried at Fair Value): Impaired loans are those that are accounted for under FASB ASC 310, Accounting by Creditors for Impairment of a Loan, in which the Company has measured 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 upon the expected proceeds. These assets are included in Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

Federal Home Loan Bank Stock (Carried at Cost): The carrying amount of restricted investment in bank stock approximates fair value and considers the limited marketability of such securities.

Deposit Liabilities (Carried at Cost): The fair values disclosed for demand, savings and club 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 (Carried at Cost): Fair values of FHLB advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

Junior Subordinated Debentures (Carried at Cost): Fair values of junior subordinated debt are estimated using discounted cash flow analysis, based on market rates currently offered on such debt with similar credit risk characteristics, terms and remaining maturity.

Accrued Interest Receivable and Accrued Interest Payable (Carried at Cost): The carrying amounts of accrued interest receivable and payable approximate their fair values.

Off-Balance Sheet Instruments (Disclosed at Cost): Fair values for the Company's off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

The following information is an estimate of the fair value of a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful.

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The estimated fair values of the Company's financial instruments at March 31, 2010 and December 31, 2009 were as follows:

(Dollars in thousands)	March 31, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$41,399	\$41,399	\$23,079	\$23,079
Time deposits with other banks	600	600	100	100
Trading securities	2,573	2,573	2,955	2,955
Securities available for sale	73,761	73,761	71,315	71,315
Federal Home Loan Bank stock	2,045	2,045	2,045	2,045
Loans receivable, net of allowance	323,557	327,560	327,463	330,441
Accrued interest receivable	1,857	1,857	1,943	1,943
<b>Financial liabilities:</b>				
Deposits	388,071	388,620	372,075	372,868
Borrowings	33,075	35,042	33,090	34,963
Junior subordinated debentures	12,887	9,686	12,887	9,090
Accrued interest payable	321	321	361	361
<b>Off-balance financial instruments:</b>				
Commitments to extend credit	-	-	-	-
Outstanding letters of credit	-	-	-	-

Note 8 – Securities

The amortized cost and approximate fair value of securities available for sale as of March 31, 2010 and December 31, 2009 are summarized as follows:

(Dollars in thousands)	Amortized Cost	Gross	Gross	Fair Value
		Unrealized Gains	Unrealized Losses	
<b>March 31, 2010</b>				
U.S. Government agencies	\$ 18,229	\$ 81	\$ (44 )	\$18,266
State and political subdivisions	25,934	238	(281 )	25,891
Mortgage-backed securities	27,325	1,008	(91 )	28,242
Equity securities	1,809	-	(447 )	1,362
	\$ 73,297	\$ 1,327	\$ (863 )	\$73,761
<b>December 31, 2009</b>				
U.S. Government agencies	\$ 14,938	\$ 85	\$ (21 )	\$15,002
State and political subdivisions	25,987	221	(331 )	25,877
Mortgage-backed securities	27,338	862	(118 )	28,082
Corporate debt securities	1,005	2	-	1,007
Equity securities	1,806	-	(459 )	1,347
	\$ 71,074	\$ 1,170	\$ (929 )	\$71,315

## Temporarily Impaired Securities

The following table shows our investments' gross unrealized losses and fair value that are not deemed to be other than temporarily impaired, aggregated by investment category and length of time that individual available for sale securities have been in a continuous unrealized loss position, at March 31, 2010 and December 31, 2009.

(Dollars in thousands)	Less Than Twelve Months		Twelve Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
<b>March 31, 2010</b>						
U.S. Government agencies	\$ 8,783	\$ (45 )	\$ -	\$ -	\$ 8,783	\$ (45 )
State and political subdivisions	6,804	(49 )	2,483	(231 )	9,287	(280 )
Mortgage-backed securities	5,805	(91 )	-	-	5,805	(91 )
Equity securities	-	-	1,325	(447)	1,325	(447 )
Total Temporarily Impaired Securities	\$ 21,392	\$ (185 )	\$ 3,808	\$ (678 )	\$ 25,200	\$ (863 )
<b>December 31, 2009</b>						
U.S. Government agencies	\$ 8,585	\$ (21 )	\$ -	\$ -	\$ 8,585	\$ (21 )
State and political subdivisions	13,208	(82 )	2,467	(249 )	15,675	(331 )
Mortgage-backed securities	4,513	(118 )	-	-	4,513	(118 )
Equity securities	124	(66 )	1,187	(393 )	1,311	(459 )
Total Temporarily Impaired Securities	\$ 26,430	\$ (287 )	\$ 3,654	\$ (642 )	\$ 30,084	\$ (929 )

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As of March 31, 2010, we reviewed our investment portfolio for indications of impairment. This review includes analyzing the length of time and the extent to which the fair value has been lower than the cost, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer and the intent and likelihood of selling the security. The intent and likelihood of sale of debt securities is evaluated based upon our investment strategy for the particular type of security and our cash flow needs, liquidity position, capital adequacy and interest rate risk position.

The unrealized losses in U.S. Government agency obligations and mortgage-backed securities were caused by interest rate increases. The decline in market value is attributable to changes in interest rates and not credit quality. The unrealized losses in state and political subdivisions were caused primarily by market illiquidity. Credit risk premiums have increased dramatically during the recent financial crisis. Spreads have begun to normalize but are still holding at elevated levels as the recovery in the economy begins to unfold. The Company does not consider these investments to be other-than-temporarily impaired at March 31, 2010.

The Company's investments in marketable equity securities consist primarily of investments in common stock of entities in the financial services industry. The remaining fair value and unrealized losses are distributed in other entities. All of the Company's holdings of common stock in the financial services industry are in an unrealized loss position as of March 31, 2010. The severity of the impairment is driven by higher projected collateral losses, wider credit spreads and changes in interest rates within the financial services industry. Based on that evaluation and the Company's ability and intent to hold those investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider those investments to be other-than-temporarily impaired at March 31, 2010.

**Other-Than-Temporary Impairment**

As of March 31, 2010, the Company reviewed and evaluated each investment security to determine whether an other-than temporary impairment had occurred. Various inputs to economic models are used to determine if an unrealized loss is other-than-temporary. The most significant inputs are default date, severity and prepay speed. Other inputs may include the actual collateral attributes, which include geographic concentrations, credit ratings, and other performance indicators of the underlying asset. While all securities are considered, the securities primarily impacted by other-than temporary impairment testing are private-label mortgage-backed securities. For each private-label mortgage-backed security in the investment portfolio (including but not limited to those whose fair value is less than their amortized cost basis), an extensive, regular review is conducted to determine if an other-than-temporary impairment has occurred.

Other declines in fair value are attributable to changes in spread and market conditions and not credit quality. As of March 31, 2010, the Company did not intend to the sell and it was not more-likely-than-not that the Company would be required to sell any of these securities before recovery of their amortized cost basis, therefore no securities at March 31, 2010 were deemed to be other than temporarily impaired.

**Note 9 - New Accounting Standards**

The FASB has issued ASU 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. This ASU requires some new disclosures and clarifies some existing disclosure requirements about fair value measurement as set forth in Codification Subtopic 820-10. The FASB's objective is to improve these disclosures and, thus, increase the transparency in financial reporting. Specifically, ASU 2010-06 amends Codification Subtopic 820-10 to now require a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers and in the reconciliation for fair value measurements using significant unobservable inputs, a reporting entity

should present separately information about purchases, sales, issuances, and settlements. In addition, ASU 2010-06 clarifies the requirements of the following existing disclosures: for purposes of reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities; and a reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. ASU 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Early adoption is permitted. The Company was not impacted by the changes effective December 15, 2009 and does not expect the remaining changes effective December 15, 2010 in FASB ASU 2010-06 to have a material impact on its financial statements.

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The FASB has issued ASU 2010-08, Technical Corrections to Various Topics, thereby amending the Codification. This ASU resulted from a review by the FASB of its standards to determine if any provisions are outdated, contain inconsistencies, or need clarifications to reflect the FASB's original intent. The FASB believes the amendments do not fundamentally change U.S. GAAP. However, certain clarifications on embedded derivatives and hedging reflected in Topic 815, Derivatives and Hedging, may cause a change in the application of the guidance in Subtopic 815-15. Accordingly, the FASB provided special transition provisions for those amendments. The ASU contains various effective dates. The clarifications of the guidance on embedded derivatives and hedging (Subtopic 815-15) are effective for fiscal years beginning after December 15, 2009. The amendments to the guidance on accounting for income taxes in a reorganization (Subtopic 852-740) applies to reorganizations for which the date of the reorganization is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. All other amendments are effective as of the first reporting period (including interim periods) beginning after the date this ASU was issued (February 2, 2010). The Company does not expect FASB ASU 2010-08 to have a material impact on its financial statements.

The FASB has issued ASU 2010-09, Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirements. The amendments in the ASU remove the requirement for an SEC filer to disclose a date through which subsequent events have been evaluated in both issued and revised financial statements. Revised financial statements include financial statements revised as a result of either correction of an error or retrospective application of U.S. GAAP. The FASB also clarified that if the financial statements have been revised, then an entity that is not an SEC filer should disclose both the date that the financial statements were issued or available to be issued and the date the revised financial statements were issued or available to be issued. The FASB believes these amendments remove potential conflicts with the SEC's literature. In addition, the amendments in the ASU require an entity that is a conduit bond obligor for conduit debt securities that are traded in a public market to evaluate subsequent events through the date of issuance of its financial statements and must disclose such date. All of the amendments in the ASU were effective upon issuance (February 24, 2010) except for the use of the issued date for conduit debt obligors. That amendment is effective for interim or annual periods ending after June 15, 2010. The Company does not expect FASB ASU 2010-09 to have a material impact on its financial statements.

The FASB has issued ASU 2010-10, Consolidation (Topic 810): Amendments for Certain Investment Funds. The amendments in the ASU defer the effective date of certain amendments to the consolidation requirements of Topic 810, Consolidation, resulting from the issuance of FASB Accounting Standard No. 167, Amendments to FASB Interpretation 46(R). Specifically, the amendments to the consolidation requirements of Topic 810 resulting from the issuance of Statement 167 are deferred for a reporting entity's interest in an entity: that has all the attributes of an investment company; or for which it is industry practice to apply measurement principles for financial reporting purposes that are consistent with those followed by investment companies. The ASU does not defer the disclosure requirements in the Statement 167 amendments to Topic 810. The amendments in this ASU are effective as of the beginning of a reporting entity's first annual period that begins after November 15, 2009, and for interim periods within that first annual reporting period. Early application is not permitted. The implementation of this standard will not have a material impact on the Company's consolidated financial statements.

In November 2008, the SEC released a proposed roadmap regarding the potential use by U.S. issuers of financial statements prepared in accordance with International Financial Reporting Standards (IFRS). IFRS is a comprehensive series of accounting standards published by the International Accounting Standards Board ("IASB"). Under the proposed roadmap, the Company may be required to prepare financial statements in accordance with IFRS as early as 2014. The SEC will make a determination in 2011 regarding the mandatory adoption of IFRS. The Company is currently assessing the impact that this potential change would have on its consolidated financial statements, and it will continue to monitor the development of the potential implementation of IFRS.



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

MANAGEMENT STRATEGY

The Company's goal is to be a community-oriented financial institution serving the northern New Jersey, northeastern Pennsylvania and Orange County, New York marketplace. While offering traditional community bank loan and deposit products and services, the Company obtains non-interest income through its Tri-State Insurance Agency, Inc. ("Tri-State") insurance brokerage operations and the sale of non-deposit products. We report the operations of Tri-State as a separate segment from our commercial banking operations.

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Our improved results of operations have been achieved by improving our net interest income and margin by closely monitoring our yield on earning assets and adjusting the rates offered on deposit products. The economic downturn continues to impact our level of nonperforming assets and in turn has increased our provision for loan losses. The Company has been actively controlling expenses to help offset the higher costs of working out non-performing assets.

**FORWARD LOOKING STATEMENTS**

When used in this discussion the words: “believes”, “anticipates”, “contemplates”, “expects” or similar expressions are intended to identify forward looking statements. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected. Those risks and uncertainties include those listed under Item 1A - Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2009 and changes to interest rates, the ability to control costs and expenses, general economic conditions, the success of the Company’s efforts to diversify its revenue base by developing additional sources of non-interest income while continuing to manage its existing fee based business, risks associated with the quality of the Company’s assets and the ability of its borrowers to comply with repayment terms. The Company undertakes no obligation to publicly release the results of any revisions to those forward looking statements that may be made to reflect events or circumstances after this date or to reflect the occurrence of unanticipated events.

**CRITICAL ACCOUNTING POLICIES**

Our accounting policies are fundamental to understanding Management’s Discussion and Analysis of Financial Condition and Results of Operations. Disclosure of the Company’s significant accounting policies is included in Note 1 to the consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2009. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions about future events that affect the amounts reported in our consolidated financial statements and accompanying notes. Since future events and their effect cannot be determined with absolute certainty, actual results may differ from those estimates. Management makes adjustments to its assumptions and judgments when facts and circumstances dictate. The amounts currently estimated by us are subject to change if different assumptions as to the outcome of future events were made. We evaluate our estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Management believes the critical accounting policies relating to the allowance for loan losses, stock-based compensation, income taxes, goodwill and other intangible assets, and investment securities impairment evaluation, encompass the most significant judgments and estimates used in preparation of our consolidated financial statements. These estimates, judgments and policies were unchanged from the Company’s Annual Report on Form 10-K for the year ended December 31, 2009.

**COMPARISON OF OPERATING RESULTS FOR THREE MONTHS ENDED MARCH 31, 2010 AND 2009**

Overview - The Company realized net income of \$643 thousand for the first quarter of 2010, an increase of \$390 thousand from net income of \$253 thousand reported for the same period in 2009. Basic and diluted earnings per share for the three months ended March 31, 2010 were \$0.20 compared to the basic and diluted earnings per share of \$0.08 for the comparable period of 2009.

The increase in both net income and earnings per share are largely the result of an increase in net interest income, partially offset by increases in the provision for loan losses and a decrease in non-interest income. During the first quarter of 2010, our net interest income increased \$855 thousand compared to the prior year period, as our total interest income decreased \$261 thousand and our interest expense declined by \$1.1 million. These results reflect management’s effort to reduce funding costs, which helped improve the Company’s net interest margin while maintaining its average balances in earning assets and average liabilities.

**Comparative Average Balances and Average Interest Rates**

The following table presents, on a fully taxable equivalent basis, a summary of the Company's interest-earning assets and their average yields, and interest-bearing liabilities and their average costs for the three month period ended March 31, 2010 and 2009.

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(Dollars in thousands)	Three Months Ended March 31,							
	2010				2009			
	Average Balance	Interest (1)	Average Rate (2)		Average Balance	Interest (1)	Average Rate (2)	
<b>Earning Assets:</b>								
<b>Securities:</b>								
Tax exempt (3)	\$26,817	\$ 394	5.96	%	\$26,709	\$ 408	6.19	%
Taxable	48,949	514	4.26	%	56,817	627	4.48	%
Total securities	75,766	908	4.86	%	83,526	1,035	5.02	%
Total loans receivable (4)	330,709	4,680	5.74	%	322,535	4,808	6.05	%
Other interest-earning assets	25,656	9	0.14	%	26,676	19	0.29	%
Total earning assets	432,131	\$ 5,597	5.25	%	432,737	\$ 5,862	5.49	%
Non-interest earning assets	37,836				34,491			
Allowance for loan losses	(5,806 )				(6,000 )			
Total Assets	\$464,161				\$461,228			
<b>Sources of Funds:</b>								
<b>Interest bearing deposits:</b>								
NOW	\$61,623	\$ 143	0.94	%	\$57,897	\$ 159	1.11	%
Money market	12,435	24	0.78	%	14,703	48	1.33	%
Savings	167,545	494	1.20	%	159,739	1,026	2.61	%
Time	103,096	443	1.74	%	112,901	936	3.36	%
Total interest bearing deposits	344,699	1,104	1.30	%	345,240	2,169	2.55	%
Borrowed funds	33,081	352	4.25	%	33,138	352	4.25	%
Junior subordinated debentures	12,887	53	1.64	%	12,887	104	3.22	%
Total interest bearing liabilities	390,667	\$ 1,509	1.57	%	391,264	\$ 2,625	2.72	%
<b>Non-interest bearing liabilities:</b>								
Demand deposits	36,840				36,479			
Other liabilities	1,706				1,261			
Total non-interest bearing liabilities	38,546				37,740			
Stockholders' equity	34,948				32,223			
Total Liabilities and Stockholders' Equity	\$464,161				\$461,228			
Net Interest Income and Margin (5)		\$ 4,088	3.84	%		\$ 3,237	3.03	%

(1) Includes loan fee income

(2) Average rates on securities are calculated on amortized costs

(3) Fully taxable equivalent basis, using a 39% effective tax rate and adjusted for TEFRA (Tax and Equity Fiscal Responsibility Act) interest expense disallowance

(4) Loans outstanding include non-accrual loans

(5) Represents the difference between interest earned and interest paid, divided by average total interest-earning assets

Net Interest Income - Net interest income is the difference between interest and fees on loans and other interest-earning assets and interest paid on interest-bearing liabilities. Net interest income is directly affected by changes in volume and mix of interest-earning assets and interest-bearing liabilities that support those assets, as well as changing interest rates when differences exist in repricing dates of assets and liabilities.

Net interest income, on a fully taxable equivalent basis (a 39% tax rate), increased \$851 thousand, or 26.3%, to \$4.1 million for the three months ended March 31, 2010 from \$3.2 million for the first quarter of 2009. Although the average balance in interest earning assets decreased \$607 thousand, or 0.1%, to \$432.1 million for the three months ended March 31, 2010, the average balance in total loans increased \$8.2 million, or 2.5%, to \$330.7 million. Overall the average balance in interest bearing liabilities decreased \$598 million, or 0.2 %, to \$390.7 million during the same three month period, as savings deposits average balances increased \$7.8 million or 4.9%.

The net interest margin increased, on a fully taxable equivalent basis, by 81 basis points to 3.84% for the three months ended March 31, 2010 compared to 3.03% for the same period in 2009, as the yield on total earning assets decreased 24 basis points to 5.25% and the cost of total interest bearing liabilities decreased 115 basis points to 1.57% in the three month period ended March 31, 2010 from the same period a year earlier. The decrease in yield on earning assets reflects the decrease in market rates of interest and the effect of an increase in non-performing loan balances between the two first quarter periods. The decrease in cost of interest bearing liabilities is related to a shift from higher costing time deposits to a lower costing savings account product between the two quarterly periods. The Company reduced its interest expense by shifting its strategy to core deposit accounts and reducing its reliance on time deposits, in a declining interest rate environment.

Interest Income - Total interest income, on a fully taxable equivalent basis, decreased \$265 thousand for the current three month period from the prior year period. Total interest income earned on average first quarter securities balances decreased \$127 thousand and on average loan balances \$128 thousand.

Other interest-earning asset average balances decreased \$1.0 million to \$25.7 million in the first quarter of 2010 from \$26.7 million during the first quarter a year earlier. As the current market rates of interest on federal funds sold are at historical lows, the yield on these assets fell 15 basis points to 0.14% in the first quarter of 2010 from 0.29% during the same period a year earlier and the interest earned decreased \$10 thousand to \$9 thousand in the first quarter of 2010. The decrease in the average balance in other interest-earning assets was due to a decrease in the average balance in federal funds sold.

Total interest income on securities, on a fully taxable equivalent basis, decreased \$127 thousand, to \$908 thousand for the quarter ended March 31, 2010 from \$1.0 million for the first quarter of 2009. As the average balance of total securities decreased \$7.8 million, or 9.3%, the yield on securities decreased 16 basis points, from 5.02% in the first quarter of 2009 to 4.86% for the first quarter of 2010. The decrease in the average balance in the securities portfolio reflects a \$7.9 million decrease in taxable securities and a \$108 thousand increase in tax-exempt securities. The overall decrease in security balances between the two first quarter periods were used to fund loan growth.

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The interest earned on total loans receivable decreased \$128 thousand to \$4.7 million for the first three months of 2010 from \$4.8 million for the first quarter in 2009, while the average balance in loans receivable increased \$7.2 million, or 2.5%, to \$330.7 million in the current three month period from \$322.5 million in the same period of 2009. The average rate earned on loans decreased 31 basis points from 6.05% for the three months ended March 31, 2009 to 5.74% for the same period in 2010. The increase in our loan portfolio average balance reflects our continuing efforts to build market share and remain a source of credit for businesses in our communities. Approximately 10 basis points of the decrease in yield is related to lower market rates of interest, while the remaining 21 basis point decrease can be attributed to an \$11.0 million increase in non-accrual loan balances between the two quarterly periods.

Interest Expense - The Company's interest expense for the three months ended March 31, 2010 decreased \$1.1 million to \$1.5 million from \$2.6 million for the same period in 2009, as the balance in average interest-bearing liabilities decreased \$598 thousand, or 0.2%, to \$390.7 million from \$391.3 million in the year ago period. The average rate paid on total interest-bearing liabilities has decreased by 115 basis points from 2.72% for the three months ended March 31, 2009 to 1.57% for the same period in 2010. The decrease in rate reflects the Company's efforts to shift from higher costing time deposits into a lower costing savings account product, reduced market rates of interest on deposit products and quarterly repricing of the junior subordinated debentures in a declining interest rate environment.

The promotion of a high yielding savings account product, which began in the first quarter of 2008, continues to change the Company's average balance breakdown between products. The Company has successfully increased its core deposit base, which includes demand, NOW, savings and money market accounts, to over 70% of total deposits. First quarter 2010 average savings balances increased \$7.8 million to \$167.5 million, from \$159.7 million for the same period in 2009, as the yield on savings accounts decreased 141 basis points to 1.20% from 2.61% between the three month periods ending March 31, 2010 and 2009, respectively. The result was a decrease of \$532 thousand, or 51.8%, in savings deposit interest expense to \$494 thousand for the first quarter of 2010 from \$1.0 million a year earlier.

As the average balance in savings accounts increased, the average balance in time deposits decreased \$9.8 million, or 8.7%, to \$103.1 million for the three month period ended March 31, 2010 compared to \$112.9 million for the same period in 2009, while the related interest expense on time deposits decreased \$492 thousand, or 52.6%, to \$443 thousand from \$936 thousand in the first quarter of 2009. The average rate paid on time deposits decreased 162 basis points from 3.36% for the three months ended March 31, 2009 to 1.74% for the same period in 2010 reflecting management's active repricing of time deposit rates in a falling rate market.

Money market average balances declined \$2.3 million, or 15.4%, to \$12.4 million for the three month period ended March 31, 2010 from \$14.7 million one year earlier, as the yield on money market accounts declined 55 basis points from 1.33% to 0.78% during the two periods. NOW accounts average balances increased \$3.7 million between the first quarter of 2010 and the same period of 2009 to \$61.6 million, and the yield fell 17 basis points to 0.94% from 1.11%. The decline in yield on our money market and NOW accounts reflect the decline in market rates between the two three month periods.

For the quarters ended March 31, 2010 and 2009, the Company's average borrowed funds remained unchanged at \$33.1 million. The balance at March 31, 2010 consisted of six convertible notes totaling \$30.0 million and one \$3.1 million amortizing advance from the Federal Home Loan Bank of New York. The average rate paid on total borrowed funds remained unchanged at 4.25%.

The Company had an average balance of \$12.9 million in junior subordinated debentures outstanding during the first quarters of 2010 and 2009. The \$12.9 million junior subordinated debentures, issued on June 28, 2007 bear a floating rate of interest tied to the three month LIBOR. The average rate paid on the debentures declined 158 basis points

from 3.22% for the three months ended March 31, 2009 to 1.64% for the same period in 2010, as the LIBOR rate decreased between the two first quarter periods.

Provision for Loan Losses - The loan loss provision for the first quarter of 2010 increased \$98 thousand to \$737 thousand compared to a provision of \$639 thousand in the first quarter of 2009. The higher provision during the first quarter of 2010 was related to a higher volume of non-performing loan balances in the first quarter of 2010 (\$22.1 million) as compared to 2009 (\$11.1 million). The current period provision also reflects the further deterioration in the portfolio between the two quarterly periods, as real estate values in our trade area have declined and the general economic slow-down in our market area, which has affected borrowers' cash flows. The provision for loan losses reflects management's judgment concerning the risks inherent in the Company's existing loan portfolio and the size of the allowance necessary to absorb the risks, as well as the activity in the allowance during the periods. Management reviews the adequacy of its allowance on an ongoing basis and will provide additional provisions, as management may deem necessary.

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Non-Interest Income - The Company's non-interest income is primarily generated through insurance commissions earned through the operation of Tri-State and service fees on deposit accounts. The Company's non-interest income decreased \$156 thousand, or 11.7%, to \$1.2 million for the three months ended March 31, 2010 from non-interest income of \$1.3 million for the same period in 2009.

Insurance commission income from Tri-State has decreased \$67 thousand, or 10.9%, to \$547 thousand in the first quarter of 2010 over the same period in 2009. The decline in Tri-State's income mostly reflects reduced contingency commission pay