PATRIOT NATIONAL BANCORP INC
Form 10-Q
November 14, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the Quarter Ended September 30, 2012

Commission file number 000-29599

PATRIOT NATIONAL BANCORP, INC.

(Exact name of registrant as specified in its charter)

Connecticut	**06-1559137**

(State of incorporation)	**(I.R.S. Employer Identification Number)**

900 Bedford Street, Stamford, Connecticut 06901

(Address of principal executive offices)

(203) 324-7500

(Registrant s telephone number)

Check whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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 ¨

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 ¨

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

Large Accelerated Filer	¨	Accelerated Filer	¨
Non-Accelerated Filer	¨	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 ¨ No x

State the number of shares outstanding of each of the registrant s classes of common equity, as of the latest practicable date.

Common stock, $0.01 par value per share, 38,480,114 shares outstanding as of the close of business October 31, 2012.

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PART I - FINANCIAL INFORMATION

Item 1: Consolidated Financial Statements

PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED BALANCE SHEETS

	September 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
Cash and due from banks:		
Noninterest bearing deposits and cash	$ 3,320,319	$ 4,241,552
Interest bearing deposits	40,510,304	50,474,257
Short-term investments	710,499	709,567
Total cash and cash equivalents	44,541,122	55,425,376
Securities:		
Available for sale securities, at fair value (Note 2)	18,314,931	66,469,972
Other Investments	3,500,000	3,500,000
Federal Reserve Bank stock, at cost	1,744,200	1,707,000
Federal Home Loan Bank stock, at cost	4,343,800	4,508,300
Total securities	27,902,931	76,185,272
Loans receivable (net of allowance for loan losses: 2012: $6,691,731 2011: $9,384,672) (Note 3)	493,109,571	501,227,297
Loans held for sale	1,950,000	250,000
Accrued interest and dividends receivable	1,978,668	2,453,179
Premises and equipment, net	4,655,863	4,108,318
Cash surrender value of life insurance	21,369,277	20,984,604
Other real estate owned	1,252,024	2,762,640
Deferred tax asset (Note 6)		
Other assets	18,588,931	2,419,592
Total assets	$ 615,348,387	$ 665,816,278
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities		
Deposits (Note 4):		
Noninterest bearing deposits	$ 59,309,584	$ 65,613,374
Interest bearing deposits	424,643,723	479,296,019
Total deposits	483,953,307	544,909,393
Borrowings:		
Repurchase agreements	7,000,000	7,000,000
Federal Home Loan Bank borrowings	60,000,000	50,000,000
Total borrowings	67,000,000	57,000,000
Junior subordinated debt owed to unconsolidated trust	8,248,000	8,248,000
Accrued expenses and other liabilities	5,014,682	5,109,225
Total liabilities	564,215,989	615,266,618

Commitments (Note 9)		
Shareholders equity		
Preferred stock, no par value; 1,000,000 shares authorized, no shares issued and outstanding		
Common stock, $.01 par value, 100,000,000 shares authorized; 2012: 38,478,778 shares issued; 38,467,073 shares outstanding. 2011: 38,374,432 shares issued; 38,362,727, shares outstanding	**384,787**	383,744
Additional paid-in capital	**105,285,528**	105,050,433
Accumulated deficit	**(53,949,994)**	(54,858,831)
Less: Treasury stock, at cost: 2012 and 2011 11,705 shares	**(160,025)**	(160,025)
Accumulated other comprehensive (loss) income	**(427,898)**	134,339
Total shareholders equity	**51,132,398**	50,549,660
Total liabilities and shareholders equity	**$ 615,348,387**	$ 665,816,278

See Accompanying Notes to Consolidated Financial Statements.

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PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Interest and Dividend Income				
Interest and fees on loans	$ 5,533,304	$ 6,184,920	$ 18,010,829	$ 19,680,074
Interest on investment securities	396,133	664,661	1,299,821	1,425,582
Dividends on investment securities	32,051	56,462	97,211	207,091
Interest on federal funds sold		464		6,875
Other interest income	21,630	1,485	72,268	121,738
Total interest and dividend income	**5,983,118**	**6,907,992**	**19,480,129**	**21,441,360**
Interest Expense				
Interest on deposits	1,239,682	1,384,540	4,177,696	4,803,634
Interest on Federal Home Loan Bank borrowings	358,026	428,183	1,069,454	1,270,587
Interest on subordinated debt	75,162	70,929	226,406	212,546
Interest on other borrowings	77,772	77,772	231,625	230,781
Total interest expense	**1,750,642**	**1,961,424**	**5,705,181**	**6,517,548**
Net interest income	**4,232,476**	**4,946,568**	**13,774,948**	**14,923,812**
Provision for Loan Losses			(2,558,827)	8,464,427
Net interest income after provision for loan losses	**4,232,476**	**4,946,568**	**16,333,775**	**6,459,385**
Non-interest Income				
Mortgage brokerage referral fees	34,730	13,500	69,267	28,110
Loan application, inspection & processing fees	28,530	20,656	59,243	61,421
Deposit fees and service charges	215,209	207,200	670,941	736,140
Gain on sale of loans	30,846		294,492	79,729
Net gain on sale of investment securities	924,317	779,685	916,275	779,685
Earnings on cash surrender value of life insurance	121,710	170,133	384,673	491,378
Other income	101,370	90,306	266,918	398,180
Total non-interest income	**1,456,712**	**1,281,480**	**2,661,809**	**2,574,643**
Non-interest Expense				
Salaries and benefits	2,620,042	2,840,195	8,236,487	9,244,021
Occupancy and equipment expense	1,127,466	1,038,883	3,386,163	3,685,276
Data processing	378,591	315,912	1,070,316	979,721
Advertising and promotional expense	15,355	91,786	41,318	521,541
Professional and other outside services	509,793	545,612	1,979,143	2,662,277
Loan administration and processing expense	35,020	88,373	88,924	173,591
Regulatory assessments	439,035	431,786	1,311,189	1,671,530
Insurance expense	108,595	227,173	386,615	686,584
Other real estate operations	22,523	(26,250)	(111,373)	1,018,707

Material and communications	106,007	163,240	369,919	527,493
Restructuring charges and asset disposals (Note 12)	8,165		503,372	2,986,441
Other operating expense	300,571	255,879	824,674	779,353
Total non-interest expense	**5,671,163**	**5,972,589**	**18,086,747**	**24,936,535**
Income (loss) before income taxes	**18,025**	**255,459**	**908,837**	**(15,902,507)**
Provision for Income Taxes				
Net income (loss)	**$ 18,025**	**$ 255,459**	**$ 908,837**	**$ (15,902,507)**
Basic and diluted income (loss) per share (Note 7)	**$ 0.00**	**$ 0.01**	**$ 0.02**	**$ (0.41)**

See Accompanying Notes to Consolidated Financial Statements.

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PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income (loss)	$ 18,025	$ 255,459	$ 908,837	$ (15,902,507)
Other comprehensive income:				
Unrealized holding (losses) on securities, net of taxes:				
Unrealized holding (losses) gains arising during the period	(174,415)	(850,438)	5,853	(599,692)
Less reclassification adjustment for net gains included in net income	(573,077)		(568,090)	
Total	(747,492)	(850,438)	(562,237)	(599,692)
Comprehensive (loss) income	**$ (729,467)**	**$ (594,979)**	**$ 346,600**	**$ (16,502,199)**

See Accompanying Notes to Consolidated Financial Statements.

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PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(Unaudited)

	Number of Shares	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Nine months ended September 30, 2011							
Balance at December 31, 2010	38,362,727	$ 383,744	$ 105,050,433	$ (39,399,345)	$ (160,025)	$ 1,297,381	$ 67,172,188
Comprehensive loss							
Net loss				(15,902,507)			(15,902,507)
Unrealized holding loss on available for sale securities, net of taxes						(599,692)	(599,692)
Total comprehensive loss							(16,502,199)
Balance, September 30, 2011	38,362,727	$ 383,744	$ 105,050,433	$ (55,301,852)	$ (160,025)	$ 697,689	$ 50,669,989
Nine months ended September 30, 2012							
Balance at December 31, 2011	38,362,727	$ 383,744	$ 105,050,433	$ (54,858,831)	$ (160,025)	$ 134,339	$ 50,549,660
Comprehensive income							
Net income				908,837			908,837
Unrealized holding loss on available for sale securities, net of taxes						(562,237)	(562,237)
Total comprehensive income							346,600
Share-based compensation expense			236,138				236,138
Issuance of restricted stock	104,346	1,043	(1,043)				
Balance, September 30, 2012	38,467,073	$ 384,787	$ 105,285,528	$ (53,949,994)	$ (160,025)	$ (427,898)	$ 51,132,398

See Accompanying Notes to Consolidated Financial Statements.

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PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30, 2012	2011
Cash Flows from Operating Activities:		
Net income (loss)	$ 908,837	$ (15,902,507)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Restructuring charges and asset disposals	39,445	1,094,094
Amortization and accretion of investment premiums and discounts, net	306,157	234,525
Amortization and accretion of purchase loan premiums and discounts, net	9,415	7,542
Provision for loan losses	(2,558,827)	8,464,427
Gain on sale of loans	(294,492)	(79,729)
Gain on sale of investment securities	(916,275)	(779,685)
Amortization of core deposit intangible	6,963	11,259
Earnings on cash surrender value of life insurance	(384,673)	(491,378)
Depreciation and amortization	914,791	974,798
(Gain) loss on disposal of fixed assets	(100)	2,624
(Gain) loss on sale of other real estate owned	(213,555)	58,215
Impairment writedown on other real estate owned		165,764
Share-based compensation	236,138	
Changes in assets and liabilities:		
Decrease in deferred loan costs	85,007	34,092
Decrease in accrued interest and dividends receivable	474,511	191,614
(Increase) decrease in other assets	(1,569,455)	7,162,488
Increase in receivable of settlement of investment securities	(14,638,081)	
Increase (decrease) in accrued expenses and other liabilities	250,052	(466,973)
Net cash (used in) provided by operating activities	**(17,344,142)**	**681,170**
Cash Flows from Investing Activities:		
Purchases of available for sale securities	(10,005,107)	(65,459,630)
Principal repayments on available for sale securities	7,631,717	7,316,078
Proceeds from the sale of available for sale securities	45,231,718	9,757,118
Proceeds from redemption of available for sale securities	5,000,000	
Redemptions of Federal Reserve Bank Stock	11,650	659,100
Purchases of Federal Reserve Bank Stock	(48,850)	(1,174,100)
Proceeds from repurchase of excess Federal Home Loan Bank Stock	164,500	
Proceeds from sale of loans	83,007,065	55,089,794
Net (increase) decrease in loans	(75,068,587)	13,849,922
Purchase of other real estate owned		(481,165)
Proceeds from sale of other real estate owned	2,123,779	15,715,973
Capital improvements of other real estate owned	(111,464)	
Purchase of bank premises and equipment	(520,447)	(457,643)
Net cash provided by investing activities	**57,415,974**	**34,815,447**
Cash Flows from Financing Activities:		
Net decrease in demand, savings and money market deposits	(3,225,872)	(25,697,339)

Net decrease in time certificates of deposits	(57,730,214)	(113,388,461)
Increase in FHLB borrowings	10,000,000	
Net cash used in financing activities	**(50,956,086)**	**(139,085,800)**
Net decrease in cash and cash equivalents	**(10,884,254)**	**(103,589,183)**
Cash and Cash Equivalents:		
Beginning	55,425,376	146,777,658
Ending	$ 44,541,122	$ 43,188,475

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PATRIOT NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS, Continued

(Unaudited)

	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Supplemental Disclosures of Cash Flow Information		
Interest paid	$ 5,488,472	$ 6,319,721
Income taxes paid	$	$ 10,534
Supplemental disclosures of noncash operating, investing and financing activities:		
Unrealized holding loss on available for sale securities arising during the period	$ (906,832)	$ (967,244)
Transfer of loans to other real estate owned	$ 1,238,144	$ 3,781,890
Transfer of other real estate owned to premises and equipment	$ 950,000	$
Transfer of loans to held for sale	$ 1,950,000	$ 250,000

See Accompanying Notes to Consolidated Financial Statements.

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PATRIOT NATIONAL BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1: Basis of Financial Statement Presentation

The Consolidated Balance Sheet at December 31, 2011 has been derived from the audited financial statements of Patriot National Bancorp, Inc. (Bancorp or the Company) at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

The accompanying unaudited financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The accompanying consolidated financial statements and related notes should be read in conjunction with the audited financial statements of Bancorp and notes thereto for the year ended December 31, 2011.

The information furnished reflects, in the opinion of management, all normal recurring adjustments necessary for a fair presentation of the results for the interim periods presented. The results of operations for the nine months ended September 30, 2012 are not necessarily indicative of the results of operations that may be expected for the remainder of 2012.

Note 2: Investment Securities

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2012:				
U. S. Government agency bonds	$ 7,500,000	$ 2,978	$ (11,065)	$ 7,491,913
U. S. Government agency mortgage-backed securities	2,505,087	20		2,505,107
Corporate bonds	9,000,000		(682,089)	8,317,911
	$ 19,005,087	$ 2,998	$ (693,154)	$ 18,314,931
December 31, 2011:				
U. S. Government agency bonds	$ 5,000,000	$ 37,085	$	$ 5,037,085
U. S. Government agency mortgage-backed securities	49,004,232	1,051,097	(5,900)	50,049,429
Corporate bonds	12,249,064	25,338	(890,944)	11,383,458
	$ 66,253,296	$ 1,113,520	$ (896,844)	$ 66,469,972

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The following table presents the gross unrealized loss and fair value of Bancorp s available-for-sale securities, aggregated by the length of time the individual securities have been in a continuous loss position, at September 30, 2012 and December 31, 2011:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
September 30, 2012:						
U. S. Government bonds	$ 4,988,935	$ (11,065)	$	$	$ 4,988,935	$ (11,065)
Corporate bonds	2,896,794	(103,206)	5,421,117	(578,883)	8,317,911	(682,089)
Totals	$ 7,885,729	$ (114,271)	$ 5,421,117	$ (578,883)	$ 13,306,846	$ (693,154)
December 31, 2011:						
U. S. Government mortgage - backed securities	$ 4,941,662	$ (5,492)	$ 68,309	$ (408)	$ 5,009,971	$ (5,900)
Corporate bonds	8,358,120	(890,944)			8,358,120	(890,944)
Totals	$ 13,299,782	$ (896,436)	$ 68,309	$ (408)	$ 13,368,091	$ (896,844)

At September 30, 2012, 4 securities had unrealized holding losses with aggregate depreciation of 5.0% from the amortized cost. At December 31, 2011, nine securities had unrealized losses with aggregate depreciation of 6.3% from the amortized cost.

Bancorp performs a quarterly analysis of those securities that are in an unrealized loss position to determine if those losses qualify as other-than-temporary impairments. This analysis considers the following criteria in its determination: the ability of the issuer to meet its obligations, when the loss position is due to a deterioration in credit quality, management s plans and ability to maintain its investment in the security, the length of time and the amount by which the security has been in a loss position, the interest rate environment, the general economic environment and prospects or projections for improvement or deterioration.

Management believes that none of the unrealized losses on available-for-sale securities noted above are other than temporary due to the fact that they relate to market interest rate changes on corporate debt and bonds issued by U.S. Government agencies. Management considers the issuers of the securities to be financially sound, the corporate bonds are investment grade and the Company expects to receive all contractual principal and interest related to these investments. Because the Company does not intend to sell the investments, and it is not more-likely-than-not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at September 30, 2012.

The amortized cost and fair value of available-for-sale debt securities at September 30, 2012 by contractual maturity are presented below. Actual maturities of mortgage-backed securities may differ from contractual maturities because the mortgages underlying the securities may be prepaid without any penalties. Because mortgage-backed securities are not due at a single maturity date, they are not included in the maturity categories in the following maturity summary:

	Amortized Cost	Fair Value
Maturity:		
Corporate bonds 5 to 10 years	$ 9,000,000	$ 8,317,911
U.S. Government bonds 5 to 10 years	7,500,000	7,491,913
Mortgage-backed securities	2,505,087	2,505,107
Total	$ 19,005,087	$ 18,314,931

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Note 3: Loans Receivable and Allowance for Loan Losses

A summary of the Company s loan portfolio at September 30, 2012 and December 31, 2011 is as follows:

	September 30, 2012	December 31, 2011
Real Estate		
Commercial	$ 255,551,934	$ 215,659,837
Residential	138,666,279	188,108,855
Construction	6,213,797	12,306,922
Construction to permanent	4,312,597	10,012,022
Commercial	41,100,960	31,810,735
Consumer home equity	51,011,804	49,694,546
Consumer installment	2,184,273	2,164,972
Total Loans	499,041,644	509,757,889
Premiums on purchased loans	221,710	231,125
Net deferred costs	537,948	622,955
Allowance for loan losses	(6,691,731)	(9,384,672)
Loans receivable, net	$ 493,109,571	$ 501,227,297

On March 29, 2012, the Bank completed the sale of $66.4 million of residential loans consummated for a cash purchase price of $66.7 million, which represented 101% of the Bank s net book value for these assets. On August 16, 2012 and August 27, 2012, the Bank completed the sale of two additional residential loan sales of $11.9 million and $3.0 million respectively, for a combined cash purchase price of $14.9 million, which represented 101.5% of the Bank s net book value for these assets.

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The changes in the allowance for loan losses for the periods shown are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Balance, beginning of period	$ 6,673,648	$ 11,399,727	$ 9,384,672	$ 15,374,101
Provision for loan losses			(2,558,827)	8,464,427
Loans charged-off	(3,997)	(217,788)	(197,220)	(7,405,926)
Recoveries of loans previously charged-off	22,080	16,086	63,106	779,736
Transferred to loans held-for-sale		(40,347)		(6,054,660)
Balance, end of period	$ 6,691,731	$ 11,157,678	$ 6,691,731	$ 11,157,678

At September 30, 2012 and December 31, 2011, the unpaid balances of loans 90 days or more past maturity, and still accruing interest were $2,497,726 and $9,461,106, respectively. All of the borrowers of said loans at September 30, 2012 continue to make interest payments, six are past maturity and are in the process of being renewed, and one loan has since been renewed.

The unpaid principal balances of loans on nonaccrual status and considered impaired were $30.0 million at September 30, 2012 and $20.7 million at December 31, 2011.

If non-accrual loans had been performing in accordance with their contractual terms, the Company would have recorded approximately $0.5 million of additional income during the quarter ended September 30, 2012 and $0.4 million during the quarter ended September 30, 2011. If non-accrual loans had been performing in accordance with their contractual terms, the Company would have recorded approximately $1.1 million of additional income for the nine months ended September 30, 2012 and $1.9 million for the nine months ended September 30, 2011.

For the three months ended September 30, 2012 and 2011, the interest collected and recognized as income on impaired loans, which includes non-accrual loans, TDRs and loans that were previously classified as TDRs that have been upgraded, was approximately $76,000 and $4,000, respectively. For the nine months ended September 30, 2012 and 2011, the interest income collected and recognized on impaired loans was approximately $514,000 and $465,000 respectively. The average recorded investment in impaired loans for the three and nine months ended September 30, 2012 was $35.9 million and $34.7 million respectively.

At September 30, 2012, there were ten loans totaling $19.1 million that were considered troubled debt restructurings, as compared to December 31, 2011 when there were twelve loans totaling $25.5 million, all of which were included in impaired loans. At September 30, 2012, two of the ten loans aggregating $3.9 million were accruing loans and eight loans aggregating $15.2 million were non-accruing loans.

The Company s lending activities are conducted principally in Fairfield and New Haven Counties in Connecticut and Westchester County, New York City and Long Island, New York. The Company originates commercial real estate loans, commercial business loans, residential real estate loans and a variety of other consumer loans. In addition, the Company had originated loans for the construction of residential homes, residential developments and for land development projects. A moratorium on all new speculative construction loans was instituted by management in July 2008. All residential and commercial mortgage loans are collateralized primarily by first or second mortgages on real estate. The ability and willingness of borrowers to satisfy their loan obligations is dependent to some degree on the status of the regional economy as well as upon the regional real estate market. Accordingly, the ultimate collectability of a substantial portion of the loan portfolio and the recovery of a substantial portion of any resulting real estate acquired is susceptible to changes in market conditions.

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The Company has established credit policies applicable to each type of lending activity in which it engages, evaluates the creditworthiness of each customer and, in most cases, extends credit of up to 75% of the market value of the collateral for commercial real estate at the date of the credit extension depending on the Company s evaluation of the borrowers creditworthiness and type of collateral and up to 80% for residential 1-4 family real estate. In the case of construction loans, the maximum loan-to-value was 65% of the as completed market value. The market value of collateral is monitored on an ongoing basis and additional collateral is obtained when warranted. Real estate is the primary form of collateral. Other important forms of collateral are accounts receivable, inventory, other business assets, marketable securities and time deposits. While collateral provides assurance as a secondary source of repayment, the Company ordinarily requires the primary source of repayment to be based on the borrower s ability to generate continuing cash flows on all loans not related to construction.

Risk characteristics of the Company s portfolio classes include the following:

Commercial Real Estate Loans In underwriting commercial real estate loans, the Company evaluates both the prospective borrower s ability to make timely payments on the loan and the value of the property securing the loans. Repayment of such loans may be negatively impacted should the borrower default or should there be a substantial decline in the value of the property securing the loan or a decline in the general economic conditions. Where the owner occupies the property, the Company also evaluates the business s ability to repay the loan on a timely basis. In addition, the Company may require personal guarantees, lease assignments and/or the guarantee of the operating company when the property is owner occupied. These types of loans may involve some additional risks because payments on such loans are dependent upon the successful operation of the business involved, therefore, repayment of such loans may be negatively impacted by adverse changes in economic conditions affecting the borrowers businesses.

Construction Loans Construction loans are short-term loans (generally up to 18 months) secured by land for both residential and commercial development. The loans are generally made for acquisition and improvements. Funds are disbursed as phases of construction are completed.

In the past, the Company funded construction of single family homes, when no contract of sale existed, based upon the experience of the builder, the financial strength of the owner, the type and location of the property and other factors. Construction loans are generally personally guaranteed by the principal(s). Repayment of such loans may be negatively impacted by the builders inability to complete construction, by a downturn in the new construction market, by a significant increase in interest rates or by a decline in general economic conditions. The Company has had a moratorium in place since mid-2008 on new speculative construction loans.

Residential Real Estate Loans Various loans secured by residential real estate properties are offered by the Company, including 1-4 family residential mortgages, multi-family residential loans and a variety of home equity line of credit products. Repayment of such loans may be negatively impacted should the borrower default, should there be a significant decline in the value of the property securing the loan or should there be a decline in general economic conditions.

Commercial and Industrial Loans The Company s commercial and industrial loan portfolio consists primarily of commercial business loans and lines of credit to businesses and professionals. These loans are usually made to finance the purchase of inventory, new or used equipment or other short or long-term working capital purposes. These loans are generally secured by corporate assets, often with real estate as secondary collateral, but are also occasionally offered on an unsecured basis. In granting this type of loan, the Company primarily looks to the borrower s cash flow as the source of repayment with collateral and personal guarantees, where obtained, as a secondary source. Commercial loans are often larger and may involve greater risks than other types of loans offered by the Company. Payments on such loans are often dependent upon the successful operation of the underlying business involved and, therefore, repayment of such loans may be negatively impacted by adverse changes in economic conditions, management s inability to effectively manage the business, claims of others against the borrower s assets which may take priority over the Company s claims against assets, death or disability of the borrower or loss of market for the borrower s products or services.

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Other Loans The Company also offers installment loans and reserve lines of credit to individuals. Repayments of such loans are often dependent on the personal income of the borrower which may be negatively impacted by adverse changes in economic conditions. The Company does not place an emphasis on originating these types of loans.

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

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The following table sets forth activity in our allowance for loan losses, by loan type, for the three months ended September 30, 2012. The following table also details the amount of loans receivable, net, that are evaluated individually, and collectively, for impairment, and the related portion of the allowance for loan losses that is allocated to each loan portfolio segment.

Three months ended September 30, 2012	Commercial	Commercial Real Estate	Construction	Construction to Permanent	Residential	Consumer	Unallocated	Total
Allowance for loan losses:								
Beginning Balance	$ 735,342	$ 3,782,390	$ 250,511	$ 121,450	$ 1,209,903	$ 503,332	$ 70,720	$ 6,673,648
Charge-offs	(3,942)					(55)		(3,997)
Recoveries	6,362	14,988				730		22,080
Provision	78,403	(212,339)	228	(106,969)	208,920	47,643	(15,886)	
Ending Balance	$ 816,165	$ 3,585,039	$ 250,739	$ 14,481	$ 1,418,823	$ 551,650	$ 54,834	$ 6,691,731
Ending balance: individually evaluated for impairment	$ 37,330	$ 406,279	$ 31,520	$	$ 84,169	$ 246,510	$	$ 805,808
Ending balance: collectively evaluated for impairment	$ 778,835	$ 3,178,760	$ 219,219	$ 14,481	$ 1,334,654	$ 305,140	$ 54,834	$ 5,885,923
Total Allowance for Loan Losses	$ 816,165	$ 3,585,039	$ 250,739	$ 14,481	$ 1,418,823	$ 551,650	$ 54,834	$ 6,691,731
Total Loans ending balance	$ 41,100,960	$ 255,551,934	$ 6,213,797	$ 4,312,597	$ 138,666,279	$ 53,196,077	$	$ 499,041,644
Ending balance: individually evaluated for impairment	$ 182,258	$ 14,990,803	$ 3,077,844	$ 1,274,187	$ 18,142,493	$ 1,420,753	$	$ 39,088,338
Ending balance : collectively evaluated for impairment	$ 40,918,702	$ 240,561,131	$ 3,135,953	$ 3,038,410	$ 120,523,786	$ 51,775,324	$	$ 459,953,306

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The following table sets forth activity in our allowance for loan losses, by loan type, for the nine months ended September 30, 2012. The following table also details the amount of loans receivable, net, that are evaluated individually, and collectively, for impairment, and the related portion of the allowance for loan losses that is allocated to each loan portfolio segment.

Nine months ended September 30, 2012	Commercial	Commercial Real Estate	Construction	Construction to Permanent	Residential	Consumer	Unallocated	Total
Allowance for loan losses:								
Beginning Balance	$ 882,062	$ 4,018,746	$ 867,159	$ 547,333	$ 2,550,588	$ 458,762	$ 60,022	$ 9,384,672
Charge-offs	(48,413)	(49,922)			(84,711)	(14,174)		(197,220)
Recoveries	8,862	51,964				2,280		63,106
Provision	(26,346)	(435,749)	(616,420)	(532,852)	(1,047,054)	104,782	(5,188)	(2,558,827)
Ending Balance	$ 816,165	$ 3,585,039	$ 250,739	$ 14,481	$ 1,418,823	$ 551,650	$ 54,834	$ 6,691,731
Ending balance: individually evaluated for impairment	$ 37,330	$ 406,279	$ 31,520	$	$ 84,169	$ 246,510	$	$ 805,808
Ending balance: collectively evaluated for impairment	$ 778,835	$ 3,178,760	$ 219,219	$ 14,481	$ 1,334,654	$ 305,140	$ 54,834	$ 5,885,923
Total Allowance for Loan Losses	$ 816,165	$ 3,585,039	$ 250,739	$ 14,481	$ 1,418,823	$ 551,650	$ 54,834	$ 6,691,731
Total Loans ending balance	$ 41,100,960	$ 255,551,934	$ 6,213,797	$ 4,312,597	$ 138,666,279	$ 53,196,077	$	$ 499,041,644
Ending balance: individually evaluated for impairment	$ 182,258	$ 14,990,803	$ 3,077,844	$ 1,274,187	$ 18,142,493	$ 1,420,753	$	$ 39,088,338
Ending balance : collectively evaluated for impairment	$ 40,918,702	$ 240,561,131	$ 3,135,953	$ 3,038,410	$ 120,523,786	$ 51,775,324	$	$ 459,953,306

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The Company monitors the credit quality of its loans receivable on an ongoing manner. Credit quality is monitored by reviewing certain credit quality indicators. Management has determined that internally assigned risk ratings and loan-to-value ratios (LTVs), at period end, are the key credit quality indicators that best help management monitor the credit quality of the Company s loans receivable. Loan-to-value ratios used by management in monitoring credit quality are based on current period loan balances and original values at time of origination (unless a current appraisal has been obtained as a result of the loan being deemed impaired or the loan is a maturing construction loan).

Appraisals on properties securing impaired loans and Other Real Estate Owned (OREO) are updated annually. Additionally, appraisals on construction loans are updated four months in advance of scheduled maturity dates. We update our impairment analysis monthly based on the most recent appraisal as well as other factors (such as senior lien positions, e.g. property taxes). We are subscribers to a national real estate valuation database service and use published information regarding home sales prices in the towns/counties where our collateral is located in CT and NY.

The majority of the Company s impaired loans have been resolved through courses of action other than via bank liquidations of real estate collateral through OREO. These include normal loan payoffs, the traditional workout process, triggering personal guarantee obligations, and troubled debt restructurings. However, as loan workout efforts progress to a point where the bank s liquidation of real estate collateral is the likely outcome, the impairment analysis is updated to reflect recent actual experience with bank sales of OREO properties.

A disposition discount is built into our impairment analysis and reflected in our allowance once a property is determined to be a likely OREO (e.g. foreclosure is probable). To determine the discount, we compare the actual sales prices of our OREO properties to the appraised value that was obtained as of the date when we took title to the property. The difference is the bank-owned disposition discount.

The Company has a risk rating system as part of the risk assessment of its loan portfolio. The Company s lending officers are required to assign an Obligor and a Facility risk rating to each loan in their portfolio at origination, which is ratified or modified by the Committee to which the loan is submitted for approval. When the lender learns of important financial developments, the risk rating is reviewed accordingly, and adjusted if necessary. All loans are reviewed annually. Similarly, the Loan Committee can adjust a risk rating.

In addition, the Company engages a third party independent loan reviewer that performs quarterly reviews of a sample of loans, validating the Bank s risk ratings assigned to such loans. The risk ratings play an important role in the establishment of the loan loss provision and to confirm the adequacy of the allowance for loan losses. Any upgrades to criticized loans must be approved by the Board Loan Committee.

When assigning a risk rating to a loan, management utilizes the Bank s internal eleven-point risk rating system.

An asset is considered special mention when it has a potential weakness based on objective evidence, but does not currently expose the Company to sufficient risk to warrant classification in one of the following categories: An asset is considered substandard if it is not adequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets have well defined weaknesses based on objective evidence, and are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

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During the quarter ended June 30, 2012, the Bank implemented enhancements to the allowance methodology, resulting in a reduction of the allowance for loan losses of $1.1 million for that period. In making this transition, the changes serve to update and enhance the methodology to better reflect the direction of the current loan portfolio. The changes were threefold:

First, the Bank adopted a two year, instead of a three year, weighted average historical loss factor as the basis for the calculation of its historical loss experience. This is used to calculate expected losses in the Accounting Standards Codification (ASC) (Topic 450-20), Loss Contingencies pools prior to the application of qualitative risk adjustment factors. This change was made to be more responsive to the changing credit environment. Net charge-offs have declined, especially in 2012 when they averaged $76,000 per quarter through June 30, 2012. This shorter average historical loss period will produce results more indicative of the current and expected behavior of the portfolio.

Second, the Bank adopted an Internal Risk Ratings Based (IRB) approach to calculating historical loss rates. This approach calibrates expected losses with actual risk assessment and equates the likelihood of loss to the level of risk in a credit facility rating. Previously, loss history was applied to categories of loans and qualitative adjustments were apportioned by risk rating within the categories.

Third, the Bank increased the detail of analysis within the segments, particularly within Commercial Real Estate lending, which is currently the Bank s largest concentration overall, by expanding the number of ASC 450-20 pools. In all, ten sub-concentrations have been added to the analysis. The greater level of detail enables the Bank to better apply qualitative risk adjustment factors to the segments affected and to monitor changes in credit risk within the portfolio.

Charge-off generally commences in the month that the loan is classified doubtful and is fully charged off within six months of such classification. If the account is classified loss the full balance is charged off immediately. The full balance is charged off regardless of the potential recovery from the sale of the collateral. This amount is recognized as a recovery once the collateral is sold.

In accordance with FFIEC (Federal Financial Institutions Examination Council) published policies establishing uniform criteria for the classification of retail credit based on delinquency status, Open-end credits are charged-off when 180 days delinquent and Closed-end credits are charged-off when 120 days delinquent. Typically, consumer installment loans are charged off no later than 90 days past due.

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The following table details the credit risk exposure of loans receivable, by loan type and credit quality indicator at September 30, 2012:

CREDIT RISK PROFILE BY CREDITWORTHINESS CATEGORY

Commercial		Commercial Real Estate		Construction		Construction to Permanent		Residential Real Estate		Consumer		
75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	Othe
283,306	$ 356,801	$ 202,086,266	$ 7,898,386	$	$	$ 3,038,410	$	$ 86,042,970	$ 28,640,237	$ 46,392,870	$ 1,844,591	$ 728,3
341,767	167,243	14,911,679	5,662,608	3,135,953				5,311,786		98,532	2,710,932	
025,993	2,925,850	11,366,096	13,626,899	1,215,806	1,862,038		1,274,187	4,839,645	13,831,641	3,011	1,417,742	
651,066	$ 3,449,894	$ 228,364,041	$ 27,187,893	$ 4,351,759	$ 1,862,038	$ 3,038,410	$ 1,274,187	$ 96,194,401	$ 42,471,878	$ 46,494,413	$ 5,973,265	$ 728,3

CREDIT RISK PROFILE

	Commercial	Commercial Real Estate	Construction	Construction to Permanent	Residential Real Estate	Consumer	Totals
Performing	$ 40,918,702	$ 246,782,636	$ 3,135,953	$ 3,038,410	$ 123,370,335	$ 51,775,324	$ 469,021,360
Non Performing	182,258	8,769,298	3,077,844	1,274,187	15,295,944	1,420,753	30,020,284
Total	$ 41,100,960	$ 255,551,934	$ 6,213,797	$ 4,312,597	$ 138,666,279	$ 53,196,077	$ 499,041,644

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The following table details the credit risk exposure of loans receivable, by loan type and credit quality indicator at December 31, 2011:

CREDIT RISK PROFILE BY CREDITWORTHINESS CATEGORY

Commercial		Commercial Real Estate		Construction		Construction to Permanent		Residential Real Estate			Consumer	
75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	Othe
322,200	$ 1,737,893	$ 151,392,526	$ 11,680,310	$	$	$ 903,035	$	$ 129,132,494	$ 34,895,858	$ 44,969,963	$ 1,531,223	$ 636,8
544,420	170,575	22,426,235	4,585,523	9,210,344				5,316,201	2,400,000	274,365	3,029,362	
480,440	55,207	15,981,747	9,593,496	1,243,579	1,852,999		9,108,987	3,587,607	12,776,695		1,417,742	
347,060	$ 1,963,675	$ 189,800,508	$ 25,859,329	$ 10,453,923	$ 1,852,999	$ 903,035	$ 9,108,987	$ 138,036,302	$ 50,072,553	$ 45,244,328	$ 5,978,327	$ 636,8

CREDIT RISK PROFILE

	Commercial	Commercial Real Estate	Construction	Construction to Permanent	Residential Real Estate	Consumer	Totals
Performing	$ 31,521,175	$ 206,322,032	$ 10,928,343	$ 5,808,035	$ 183,629,363	$ 50,865,776	$ 489,074,724
Non Performing	289,560	9,337,805	1,378,579	4,203,987	4,479,492	993,742	20,683,165
Total	$ 31,810,735	$ 215,659,837	$ 12,306,922	$ 10,012,022	$ 188,108,855	$ 51,859,518	$ 509,757,889

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Included in loans receivable are loans for which the accrual of interest income has been discontinued due to deterioration in the financial condition of the borrowers. The recorded balance of these non-accrual loans was $30.0 million and $20.7 million at September 30, 2012, and December 31, 2011 respectively. Generally, loans are placed on non-accruing status when they become 90 days or more delinquent, or earlier if deemed appropriate, and remain on non-accrual status until they are brought current, have six months of performance under the loan terms, and factors indicating reasonable doubt about the timely collection of payments no longer exist. Therefore, loans may be current in accordance with their loan terms, or may be less than 90 days delinquent and still be on a non-accruing status. Additionally, certain loans that cannot demonstrate sufficient global cash flow to continue loan payments in the future and certain troubled debt restructures (TDRs) are placed on non-accrual status.

The following table sets forth the detail, and delinquency status, of non-accrual loans and past due loans at September 30, 2012:

	Non-Accrual and Past Due Loans						
	Non-Accrual Loans						
2012	**31-60 Days Past Due**	**61-90 Days Past Due**	**Greater Than 90 Days**	**Total Past Due**	**Current**	**>90 Days Past Due and Accruing**	**Total Non-Accrual and Past Due Loans**
Commercial							
Pass	$	$	$	$	$	$ 820,120	$ 820,120
Substandard			182,258	182,258		500,000	682,258
Total Commercial	$	$	$ 182,258	$ 182,258	$	$ 1,320,120	$ 1,502,378
Commercial Real Estate							
Pass	$	$	$	$	$	$	$
Special Mention						303,644	303,644
Substandard	$	$	$ 6,638,940	$ 6,638,940	$ 2,130,358	$ 873,962	$ 9,643,260
Total Commercial Real Estate	$	$	$ 6,638,940	$ 6,638,940	$ 2,130,358	$ 1,177,606	$ 9,946,904
Construction							
Substandard	$	$ 1,215,806	$ 1,862,038	$ 3,077,844	$	$	$ 3,077,844
Total Construction	$	$ 1,215,806	$ 1,862,038	$ 3,077,844	$	$	$ 3,077,844
Construction to Permanent							
Substandard	$	$	$	$	$ 1,274,187	$	$ 1,274,187
Total Construction to Permanent	$	$	$	$	$ 1,274,187	$	$ 1,274,187
Residential Real Estate							
Substandard	$	$	$ 14,932,253	$ 14,932,253	$ 363,691	$	$ 15,295,944
Total Residential Real Estate	$	$	$ 14,932,253	$ 14,932,253	$ 363,691	$	$ 15,295,944
Consumer							
Substandard	$	$	$ 1,420,753	$ 1,420,753	$	$	$ 1,420,753
Total Consumer	$	$	$ 1,420,753	$ 1,420,753	$	$	$ 1,420,753
Total	$	$ 1,215,806	$ 25,036,242	$ 26,252,048	$ 3,768,236	$ 2,497,726	$ 32,518,010

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The following table sets forth the detail, and delinquency status, of non-accrual loans and past due loans at December 31, 2011:

	Non-Accrual and Past Due Loans						
	Non-Accrual Loans						
2011	31-60 Days Past Due	61-90 Days Past Due	Greater Than 90 Days	Total Past Due	Current	>90 Days Past Due and Accruing	Total Non-Accrual and Past Due Loans
Commercial							
Special Mention	$	$	$	$	$	$ 44,296	$ 44,296
Substandard			289,560	289,560		947,847	1,237,407
Total Commercial	$	$	$ 289,560	$ 289,560	$	$ 992,143	$ 1,281,703
Commercial Real Estate							
Pass	$	$	$	$	$	$ 402,663	$ 402,663
Special Mention						2,832,452	2,832,452
Substandard	$	$ 443,259	$ 6,670,730	$ 7,113,989	$ 2,223,816	$ 3,515,848	$ 12,853,653
Total Commercial Real Estate	$	$ 443,259	$ 6,670,730	$ 7,113,989	$ 2,223,816	$ 6,750,963	$ 16,088,768
Construction							
Substandard	$	$	$ 135,000	$ 135,000	$ 1,243,579	$ 1,717,999	$ 3,096,578
Total Construction	$	$	$ 135,000	$ 135,000	$ 1,243,579	$ 1,717,999	$ 3,096,578
Construction to Permanent							
Substandard	$	$	$	$	$ 4,203,987	$	$ 4,203,987
Total Construction to Permanent	$	$	$	$	$ 4,203,987	$	$ 4,203,987
Residential Real Estate							
Substandard	$	$	$ 4,479,492	$ 4,479,492	$	$	$ 4,479,492
Total Residential Real Estate	$	$	$ 4,479,492	$ 4,479,492	$	$	$ 4,479,492
Consumer							
Substandard	$	$	$ 993,742	$ 993,742	$	$	$ 993,742
Total Consumer	$	$	$ 993,742	$ 993,742	$	$	$ 993,742
Total	$	$ 443,259	$ 12,568,524	$ 13,011,783	$ 7,671,382	$ 9,461,105	$ 30,144,270

These non-accrual and past due amounts included loans deemed to be impaired of $30.0 million and $20.7 million at September 30, 2012, and December 31, 2011, respectively. Loans past due and still accruing interest were $2.5 million and $9.5 million at September 30, 2012, and December 31, 2011 respectively, and consisted of seven loans at September 30, 2012. All of the borrowers of said loans at September 30, 2012 continue to make interest payments, six are past maturity and are in the process of being renewed, and one loan has since been renewed.

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The following table sets forth the detail and delinquency status of loans receivable, by performing and non-performing loans at September 30, 2012.

	Performing (Accruing) Loans						
2012	**31-60 Days Past Due**	**61-90 Days Past Due**	**Total Past Due**	**Current**	**Total Performing Loans**	**Total Non-Accrual and Past Due Loans**	**Total Loans**
Commercial							
Pass	$	$	$	$ 34,819,987	$ 34,819,987	$ 820,120	$ 35,640,107
Special Mention				509,010	509,010		509,010
Substandard				4,269,585	4,269,585	682,258	4,951,843
Total Commercial	$	$	$	$ 39,598,582	$ 39,598,582	$ 1,502,378	$ 41,100,960
Commercial Real Estate							
Pass	$	$	$	$ 209,984,652	$ 209,984,652	$	$ 209,984,652
Special Mention		2,237,710	2,237,710	18,032,933	20,270,643	303,644	20,574,287
Substandard		1,569,353	1,569,353	13,780,382	15,349,735	9,643,260	24,992,995
Total Commercial Real Estate	$	$ 3,807,063	$ 3,807,063	$ 241,797,967	$ 245,605,030	$ 9,946,904	$ 255,551,934
Construction							
Pass	$	$	$	$	$	$	$
Special Mention				3,135,953	3,135,953		3,135,953
Substandard						3,077,844	3,077,844
Total Construction	$	$	$	$ 3,135,953	$ 3,135,953	$ 3,077,844	$ 6,213,797
Construction to Permanent							
Pass	$	$	$	$ 3,038,410	$ 3,038,410	$	$ 3,038,410
Special Mention							
Substandard						1,274,187	1,274,187
Total Construction to Permanent	$	$	$	$ 3,038,410	$ 3,038,410	$ 1,274,187	$ 4,312,597
Residential Real Estate							
Pass	$	$	$	$ 114,683,207	$ 114,683,207	$	$ 114,683,207
Special Mention	4,800,000		4,800,000	511,786	5,311,786		5,311,786
Substandard				3,375,342	3,375,342	15,295,944	18,671,286
Total Residential Real Estate	$ 4,800,000	$	$ 4,800,000	$ 118,570,335	$ 123,370,335	$ 15,295,944	$ 138,666,279
Consumer							
Pass	$ 30,659	$	$ 30,659	$ 48,935,201	$ 48,965,860	$	$ 48,965,860
Special Mention	562,500		562,500	2,246,964	2,809,464		2,809,464
Substandard						1,420,753	1,420,753
Total Consumer	$ 593,159	$	$ 593,159	$ 51,182,165	$ 51,775,324	$ 1,420,753	$ 53,196,077

Total	$ 5,393,159	$ 3,807,063	$ 9,200,222	$ 457,323,412	$ 466,523,634	$ 32,518,010	$ 499,041,644

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The following table sets forth the detail and delinquency status of loans receivable, net, by performing and non-performing loans at December 31, 2011.

	Performing (Accruing) Loans						
2011	31-60 Days Past Due	Greater Than 60 Days	Total Past Due	Current	Total Perfoming Loans	Total Non-Accrual and Past Due Loans	Total Loans
Commercial							
Pass	$ 10,971	$	$ 10,971	$ 25,504,826	$ 25,515,797	$ 44,296	$ 25,560,093
Special Mention				1,714,995	1,714,995		1,714,995
Substandard	233,781		233,781	3,064,459	3,298,240	1,237,407	4,535,647
Total Commercial	$ 244,752	$	$ 244,752	$ 30,284,280	$ 30,529,032	$ 1,281,703	$ 31,810,735
Commercial Real Estate							
Pass	$	$	$	$ 162,670,173	$ 162,670,173	$ 402,663	$ 163,072,836
Special Mention	1,915,504		1,915,504	22,263,802	24,179,306	2,832,452	27,011,758
Substandard				12,721,590	12,721,590	12,853,653	25,575,243
Total Commercial Real Estate	$ 1,915,504	$	$ 1,915,504	$ 197,655,565	$ 199,571,069	$ 16,088,768	$ 215,659,837
Construction							
Pass	$	$	$	$	$	$	$
Special Mention				9,210,344	9,210,344		9,210,344
Substandard						3,096,578	3,096,578
Total Construction	$	$	$	$ 9,210,344	$ 9,210,344	$ 3,096,578	$ 12,306,922
Construction to Permanent							
Pass	$	$	$	$ 903,035	$ 903,035	$	$ 903,035
Special Mention							
Substandard				4,905,000	4,905,000	4,203,987	9,108,987
Total Construction to Permanent	$	$	$	$ 5,808,035	$ 5,808,035	$ 4,203,987	$ 10,012,022
Residential Real Estate							
Pass	$ 42,181	$	$ 42,181	$ 163,986,171	$ 164,028,352	$	$ 164,028,352
Special Mention	4,800,000		4,800,000	2,916,201	7,716,201		7,716,201
Substandard		84,225	84,225	11,800,585	11,884,810	4,479,492	16,364,302
Total Residential Real Estate	$ 4,842,181	$ 84,225	$ 4,926,406	$ 178,702,957	$ 183,629,363	$ 4,479,492	$ 188,108,855
Consumer							
Pass	$ 1,459	$	$ 1,459	$ 47,136,590	$ 47,138,049	$	$ 47,138,049
Special Mention				3,303,727	3,303,727		3,303,727
Substandard				424,000	424,000	993,742	1,417,742
Total Consumer	$ 1,459	$	$ 1,459	$ 50,864,317	$ 50,865,776	$ 993,742	$ 51,859,518
Total	$ 7,003,896	$ 84,225	$ 7,088,121	$ 472,525,498	$ 479,613,619	$ 30,144,270	$ 509,757,889

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The following table summarizes impaired loans as of September 30, 2012:

	Recorded Investment	Unpaid Principal Balance	Related Allowance
2012			
With no related allowance recorded:			
Commercial	$ 9,050	$ 93,944	$
Commercial Real Estate	11,444,012	12,293,123	
Construction	2,942,844	2,950,613	
Construction to Permanent	1,274,187	1,425,000	
Residential	15,335,658	15,348,290	
Consumer	993,742	993,742	
Total:	$ 31,999,493	$ 33,104,712	$
With an allowance recorded:			
Commercial	$ 173,208	$ 350,000	$ 37,330
Commercial Real Estate	3,546,790	3,730,844	406,279
Construction	135,000	286,625	31,520
Construction to Permanent			
Residential	2,806,834	2,806,834	84,167
Consumer	427,013	427,013	246,512
Total:	$ 7,088,845	$ 7,601,316	$ 805,808
Commercial	$ 182,258	$ 443,944	$ 37,330
Commercial Real Estate	14,990,802	16,023,967	406,279
Construction	3,077,844	3,237,238	31,520
Construction to Permanent	1,274,187	1,425,000	
Residential	18,142,492	18,155,124	84,167
Consumer	1,420,755	1,420,755	246,512
Total:	$ 39,088,338	$ 40,706,028	$ 805,808

Impaired loans consist of non-accrual loans, TDRs and loans that were previously classified as TDRs that have been upgraded.

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The following table summarizes impaired loans as of December 31, 2011:

	Recorded Investment	Unpaid Principal Balance	Related Allowance
2011			
With no related allowance recorded:			
Commercial	$ 210,091	$ 581,974	$
Commercial Real Estate	4,444,315	5,174,124	
Construction	1,243,579	1,247,627	
Construction to Permanent	6,614,333	6,614,333	
Residential	9,789,727	9,789,727	
Consumer	993,742	1,038,640	
Total:	$ 23,295,787	$ 24,446,425	$
With an allowance recorded:			
Commercial	$ 79,469	$ 130,137	$ 61,145
Commercial Real Estate	5,131,655	5,354,025	319,894
Construction	135,000	286,625	31,520
Construction to Permanent	2,494,654	2,634,000	498,254
Residential	5,196,516	5,196,516	197,478
Consumer	424,000	424,000	151,500
Total:	$ 13,461,294	$ 14,025,303	$ 1,259,791
Commercial	$ 289,560	$ 712,111	$ 61,145
Commercial Real Estate	9,575,970	10,528,149	319,894
Construction	1,378,579	1,534,252	31,520
Construction to Permanent	9,108,987	9,248,333	498,254
Residential	14,986,243	14,986,243	197,478
Consumer	1,417,742	1,462,640	151,500
Total:	$ 36,757,081	$ 38,471,728	$ 1,259,791

The recorded investment of impaired loans at September 30, 2012 and December 31, 2011 was $39.1 million and $36.8 million, with related allowances of $806,000 and $1.3 million, respectively.

Included in the tables above at September 30, 2012 and December 31, 2011 are loans with carrying balances of $32.0 million and $23.3 million that required no specific reserves in our allowance for loan losses. Loans that did not require specific reserves at September 30, 2012 and December 31, 2011 have sufficient collateral values, less costs to sell, supporting the carrying balances of the loans. In some cases, there may be no specific reserves because the Company already charged-off the specific impairment. Once a borrower is in default, the Company is under no obligation to advance additional funds on unused commitments.

On a case-by-case basis, the Company may agree to modify the contractual terms of a borrower s loan to remain competitive and assist customers who may be experiencing financial difficulty, as well as preserve the Company s position in the loan. If the borrower is experiencing financial difficulties and a concession has been made at the time of such modification, the loan is classified as a troubled debt restructured loan.

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The following table presents the total troubled debt restructured loans as of September 30, 2012:

	Accrual		Non-accrual		Total	
	# of Loans	Amount	# of Loans	Amount	# of Loans	Amount
Commercial Real Estate		$	2	$ 4,285,359	2	$ 4,285,359
Residential Real Estate	1	2,846,549	3	7,972,300	4	10,818,849
Construction			1	1,215,806	1	1,215,806
Construction to permanent	1	1,051,199	1	1,274,187	2	2,325,386
Consumer home equity			1	424,000	1	424,000
Total Troubled Debt Restructurings	2	$ 3,897,748	8	$ 15,171,652	10	$ 19,069,400

The following table presents the total troubled debt restructured loans as of December 31, 2011:

	Accrual		Non-accrual		Total	
	# of Loans	Amount	# of Loans	Amount	# of Loans	Amount
Commercial Real Estate	1	$ 238,165	3	$ 5,666,882	4	$ 5,905,047
Residential Real Estate	3	10,506,751			3	10,506,751
Construction			1	1,243,579	1	1,243,579
Construction to permanent	1	4,905,000	2	2,494,654	3	7,399,654
Consumer home equity	1	424,000			1	424,000
Total Troubled Debt Restructurings	6	$ 16,073,916	6	$ 9,405,115	12	$ 25,479,031

Two loans were modified in a troubled debt restructuring during the three months ended September 30, 2012 and three loans were modified during the nine months ended September 30, 2012. The following tables summarize loans that were modified in a troubled debt restructuring during the three and nine months ended September 30, 2012.

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	Three months ended September 30, 2012					
	Number of Relationships		Pre-Modification Outstanding Recorded Investment	Number of Relationships		Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings						
Residential Real Estate	1	$	374,773	1	$	363,691
Construction to permanent	1		4,905,000	1		1,051,199
Total Troubled Debt Restructurings	2	$	5,279,773	2	$	1,414,890

	Nine months ended September 30, 2012					
	Number of Relationships		Pre-Modification Outstanding Recorded Investment	Number of Relationships		Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings						
Residential Real Estate	2	$	5,035,882	2	$	5,024,800
Construction to permanent	1		4,905,000	1		1,051,199
Total Troubled Debt Restructurings	3	$	9,940,882	3	$	6,075,999

Substantially all of our troubled debt restructured loan modifications involve lowering the monthly payments on such loans through either a reduction in interest rate below market rate, an extension of the term of the loan, or a combination of these two methods. These modifications rarely result in the forgiveness of principal or accrued interest. In addition, we frequently obtain additional collateral or guarantor support when modifying commercial loans. If the borrower had demonstrated performance under the previous terms and our underwriting process shows the borrower has the capacity to continue to perform under the restructured terms, the loan will continue to accrue interest. Non-accruing restructured loans may be returned to accrual status when there has been a sustained period of repayment performance (generally six consecutive months of payments) and both principal and interest are deemed collectible.

During the nine months ended September 30, 2012, two of the troubled debt restructured loans were upgraded and are no longer classified as troubled debt restructurings as compared to December 31, 2011. The upgrades, due to performance, were a commercial construction loan for $1.2 million where the bank received additional collateral and a commercial real estate loan for $234,000 due to increased cashflow generated from the borrower s business. There was another troubled debt restructuring of a residential loan for $4.7 million that was upgraded to special mention due to increased liquidity of the borrower during the first quarter of 2012, which has since been downgraded to substandard, due to financial hardship of the borrower in the second quarter. One troubled debt restructuring had a payment default on a commercial real estate loan which became an OREO in the second quarter and has since been sold. During the third quarter, one of the construction to permanent troubled debt restructured loans for $4.9 million was restructured into two loans. One loan was upgraded to pass, due to increased liquidity from additional tenants and is now classified as commercial real estate. The other loan remains classified as a troubled debt restructured loan for $1.1 million. There was one troubled debt restructuring of a residential loan for $364,000 due to the discharge from bankruptcy of the borrower.

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All troubled debt restructurings are impaired loans, which are individually evaluated for impairment.

Note 4: Deposits

The following table is a summary of the Company s deposits at:

	September 30, 2012	December 31, 2011
Non-interest bearing	$ 59,309,584	$ 65,613,374
Interest bearing		
NOW	24,859,524	24,396,210
Savings	70,807,709	59,396,310
Money market	44,092,847	52,889,642
Time certificates, less than $100,000	166,654,722	198,207,998
Time certificates, $100,000 or more	118,228,921	144,405,859
Total interest bearing	424,643,723	479,296,019
Total Deposits	$ 483,953,307	$ 544,909,393

Included in time certificates are certificates of deposit through the Certificate of Deposit Account Registry Service (CDARS) network of $0 and $1,361,544 at September 30, 2012 and December 31, 2011, respectively. These are considered brokered deposits. Pursuant to the Agreement discussed in Note 10, the Bank s participation in the CDARS program, as an issuer of deposits to customers of other banks in the CDARS program, may not exceed 10% of total deposits.

Note 5: Share-Based Compensation

The Company maintains the Patriot National Bancorp, Inc. 2012 Stock Plan to provide an incentive by the grant of options, restricted stock awards or phantom stock units to directors and employees of the Company. The Plan provides for the issuance of up to 3,000,000 shares of the Company s common stock subject to certain Plan limitations. 2,045,654 shares of stock remain available for issuance under the Plan as of September 30, 2012. The vesting of options and restricted stock awards may accelerate in accordance with terms of the plan. The Compensation Committee shall make terms and conditions applicable to the vesting of restricted stock awards and stock options. Restricted stock grants vest in quarterly installments over a four year period from the date of grant. The Compensation Committee accelerated the vesting of the initial grant of restricted stock, whereby the first year of the tranche vested immediately. During the third quarter, four Bank directors retired and the Compensation Committee voted to fully vest their remaining shares of restricted stock immediately which resulted in compensation expense of approximately $43,000. Stock options were granted at an exercise price equal to $2.20 based on a price determined by the Compensation Committee and all have an expiration period of 10 years. The fair value of stock options granted on January 24, 2012, was estimated utilizing the Black-Scholes option pricing model using the following assumptions: an expected life of 6.28 years utilizing the simplified method, risk-free rate of return of 1.28%, volatility of 61.29% and no dividend yield. The Company is expensing the grant date fair value of all share-based compensation over the requisite vesting periods on a straight-line basis.

During the three and nine months ended September 30, 2012, the Company recorded $103,010 and $236,138 of total stock-based compensation, respectively.

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The following table is a summary of the Company s non-vested stock options as of September 30, 2012, and changes therein during the period then ended:

	Number of Stock Options	Weighted Average Grant Date Fair Value	Weighted Average Exercise Price	Weighted Average Contractual Life (years)
Outstanding - December 31, 2011		$	$	
Granted	850,000	0.90	2.20	10
Exercised				
Outstanding - September 30, 2012	850,000	$ 0.90	$ 2.20	10
Exercisable - September 30, 2012		$	$	

Expected future stock option expense related to the non-vested options outstanding as of September 30, 2012, is $623,116 over an average period of 2.16 years.

The following is a summary of the status of the Company s restricted shares as of September 30, 2012, and changes therein during the period then ended.

	Number of Shares Awarded	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2011		$
Granted	152,169	1.69
Vested	(68,386)	1.65
Forfeited	(34,782)	1.73
Non-vested at September 30, 2012	49,001	$ 1.73

Expected future stock award expense related to the non-vested restricted awards as of September 30, 2012, is $84,772 over an average period of 2.86 years.

Note 6: Income Taxes

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. A valuation allowance related to deferred tax assets is required when it is considered more likely than not that all or part of the benefit related to such assets will not be realized. Management has reviewed the deferred tax position of the Company at September 30, 2012. The deferred tax position has been affected by several significant transactions in the prior years. These transactions include increased provision for loan losses, the levels of non-accrual loans and other-than-temporary impairment write-offs of certain investments, as well as a loss on the bulk sale of loans in 2011. As a result, the Company is in a cumulative net loss position at September 30, 2012, and under the applicable accounting guidance, has concluded that it is not more-likely-than-not that the Company will be able to realize its deferred tax assets and, accordingly, has established a full valuation allowance totaling $13.7 million against its deferred tax asset at September 30, 2012. The valuation allowance is analyzed quarterly for changes affecting the deferred tax asset. In the future, if the Company generates taxable income on a sustained basis, management s conclusion regarding the need for a deferred tax asset valuation allowance could change, resulting in the reversal of all or a portion of the deferred tax asset valuation allowance.

An ownership change occurred with respect to the Company in 2010 for purposes of Section 382 of the Internal Revenue Code of 1986, as amended. Consequently, the Company s ability to claim net operating loss carryforwards attributable to periods prior to the ownership change and certain recognized built-in losses and deductions (pre-ownership change losses) against income in years subsequent to the ownership change is limited. The amount of pre-ownership change losses that may be applied against income in a tax year subsequent to the ownership change is generally limited to the product of (x) the Company s fair market value on the date of the ownership change and (y) the highest federal long-term tax-exempt rate in effect for any month in the three-month period ending with the calendar month in which the ownership change occurred, plus any unused capacity to claim pre-ownership change losses from prior years.

In 2011 the Company calculated the annual limitation on its use of pre-ownership change losses under Section 382 as a result of the 2010 ownership change as $284,000. The Company also determined that the amount of its pre-ownership change losses was $36.2 million. Based on that analysis and a 20-year carryforward period, the Company may utilize approximately $5.7 million of the pre-ownership change losses. Accordingly, the Company wrote-off approximately $10.4 million of deferred tax assets in 2011. The write-off of the deferred tax asset did not affect the consolidated financial statements as there was a full valuation allowance against the deferred tax assets.

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Note 7: Income (loss) per share

The Company is required to present basic income (loss) per share and diluted income (loss) per share in its consolidated statements of operations. Basic income (loss) per share amounts are computed by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted income (loss) per share reflects additional common shares that would have been outstanding if potentially dilutive common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate to outstanding stock options and are determined using the treasury stock method. The Company is also required to provide a reconciliation of the numerator and denominator used in the computation of both basic and diluted income (loss) per share.

The stock options and non-vested restricted stock awards did not have an impact on the diluted earnings per share. The following is information about the computation of income (loss) per share for the three and nine months ended September 30, 2012 and 2011:

Three months ended September 30, 2012

	Net Income	Weighted Average Common Shares O/S	Amount
Basic and Diluted Income Per Share Income attributable to common shareholders	$ 18,025	38,392,176	$ 0.00

Three months ended September 30, 2011

	Net Loss	Weighted Average Common Shares O/S	Amount
Basic and Diluted Loss Per Share Loss attributable to common shareholders	$ 255,459	38,362,727	$ 0.01

Nine months ended September 30, 2012

	Net Income	Weighted Average Common Shares O/S	Amount
Basic and Diluted Income Per Share Income attributable to common shareholders	$ 908,837	38,382,182	$ 0.02

Nine months ended September 30, 2011

	Net Loss	Weighted Average Common Shares O/S	Amount
Basic and Diluted Loss Per Share Loss attributable to common shareholders	$ (15,902,507)	38,362,727	$ (0.41)

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Note 8: Other Comprehensive Income

Other comprehensive income, which is comprised solely of the change in unrealized gains and losses on available-for-sale securities, is as follows:

	Three Months Ended September 30, 2012			Nine Months Ended September 30, 2012		
	Before Tax Amount	Tax Effect	Net of Tax Amount	Before Tax Amount	Tax Effect	Net of Tax Amount
Unrealized holding (losses) gains arising during the period	$ (281,316)	$ 106,901	$ (174,415)	$ 9,443	$ (3,590)	$ 5,853
Reclassification adjustment for net gains recognized in income	(924,317)	351,240	(573,077)	(916,275)	348,185	(568,090)
Unrealized holding (losses) on available for sale securities, net of taxes	$ (1,205,633)	$ 458,141	$ (747,492)	$ (906,832)	$ 344,595	$ (562,237)

	Three Months Ended September 30, 2011			Nine Months Ended September 30, 2011		
	Before Tax Amount	Tax Effect	Net of Tax Amount	Before Tax Amount	Tax Effect	Net of Tax Amount
Unrealized holding (losses) arising during the period	$ (646,692)	$ 279,659	$ (367,033)	$ (187,559)	$ 71,272	$ (116,287)
Reclassification adjustment for gains recognized in income	(779,685)	296,280	(483,405)	(779,685)	296,280	(483,405)
Unrealized holding (losses) on available for sale securities, net of taxes	$ (1,426,377)	$ 575,939	$ (850,438)	$ (967,244)	$ 367,552	$ (599,692)

Note 9: Financial Instruments with Off-Balance Sheet Risk

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

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The contractual amount of commitments to extend credit and standby letters of credit represent the total amount of potential accounting loss should: the contracts be fully drawn upon; the customers default; and the value of any existing collateral becomes worthless. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments and evaluates each customer s creditworthiness on a case-by-case basis. Management believes that the Company controls the credit risk of these financial instruments through credit approvals, credit limits, monitoring procedures and the receipt of collateral as deemed necessary.

Financial instruments whose contractual amounts represent credit risk at September 30, 2012 are as follows:

Commitments to extend credit:	
Future loan commitments	$ 20,286,347
Home equity lines of credit	29,909,949
Unused lines of credit	34,081,370
Undisbursed construction loans	3,572,260
Financial standby letters of credit	7,000
	$ 87,856,926

Standby letters of credit are written commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Guarantees that are not derivative contracts are recorded on the Company s consolidated balance sheet at their fair value at inception.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments to extend credit generally have fixed expiration dates, or other termination clauses, and may require payment of a fee by the borrower. Since these commitments could expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management s credit evaluation of the counterparty. Collateral held varies, but may include residential and commercial property, deposits and securities. Based on the analysis in the unfunded commitments, the bank has established a reserve of $8,000 as of September 30, 2012.

Note 10: Regulatory and Operational Matters

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

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). In addition, due to the Bank s asset profile and current economic conditions in its markets, the Bank s capital plan targets a minimum 9% Tier 1 leverage capital ratio.

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In February 2009 the Bank entered into a formal written agreement (the Agreement) with the Office of the Comptroller of the Currency. Under the terms of the Agreement, the Bank has appointed a Compliance Committee of outside directors and the Chief Executive Officer. The Committee must report quarterly to the Board of Directors and to the OCC on the Bank s progress in complying with the Agreement. The Agreement requires the Bank to review, adopt and implement a number of policies and programs related to credit and operational issues. The Agreement further provides for limitations on the acceptance of certain brokered deposits and the extension of credit to borrowers whose loans are criticized. The Bank may pay dividends during the term of the Agreement only with prior written permission from the OCC. The Agreement also requires that the Bank develop and implement a three-year capital plan. The Bank has taken or put into process many of the steps required by the Agreement, and does not anticipate that the restrictions included within the Agreement will impair its current business plan.

In June 2010 the company entered into a formal written agreement (the Reserve Bank Agreement) with the Federal Reserve Bank of New York (the Reserve Bank). Under the terms of the Reserve Bank Agreement, the Board of Directors of the Company are required to take appropriate steps to fully utilize the Company s financial and managerial resources to serve as a source of strength to the Bank including taking steps to insure that the Bank complies with the Agreement with the OCC. The Reserve Bank Agreement requires the Company to submit, adopt and implement a capital plan that is acceptable to the Reserve Bank. The Company must also report to the Reserve Bank quarterly on the Company s progress in complying with the Reserve Bank Agreement. The Agreement further provides for certain restrictions on the payment or receipt of dividends, distributions of interest or principal on subordinate debentures or trust preferred securities and the Company s ability to incur debt or to purchase or redeem its stock without the prior written approval of the Reserve Bank. The Company has taken or put into process many of the steps required by the Reserve Bank Agreement, and does not anticipate that the restrictions included within the Reserve Bank Agreement will impair its current business plan.

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The Company s and the Bank s actual capital amounts and ratios at September 30, 2012 and December 31, 2011 were:

(dollars in thousands)	Actual Amount	Actual Ratio	For Capital Adequacy Purposes Amount	For Capital Adequacy Purposes Ratio	To Be Well Capitalized Under Prompt Corrective Action Provisions Amount	To Be Well Capitalized Under Prompt Corrective Action Provisions Ratio
September 30, 2012						
The Company:						
Total Capital (to Risk Weighted Assets)	$ 65,078	14.78%	$ 35,225	8.00%	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	59,560	13.53%	17,608	4.00%	N/A	N/A
Tier 1 Capital (to Average Assets)	59,560	9.60%	24,817	4.00%	N/A	N/A
The Bank:						
Total Capital (to Risk Weighted Assets)	$ 63,619	14.45%	$ 35,222	8.00%	$ 44,027	10.00%
Tier 1 Capital (to Risk Weighted Assets)	58,100	13.19%	17,619	4.00%	26,429	6.00%
Tier 1 Capital (to Average Assets)	58,100	9.37%	24,803	4.00%	31,003	5.00%
December 31, 2011						
The Company:						
Total Capital (to Risk Weighted Assets)	$ 63,658	15.22%	$ 33,469	8.00%	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	58,377	13.95%	16,735	4.00%	N/A	N/A
Tier 1 Capital (to Average Assets)	58,377	9.01%	25,931	4.00%	N/A	N/A
The Bank:						
Total Capital (to Risk Weighted Assets)	$ 61,616	14.75%	$ 33,445	8.00%	$ 41,806	10.00%
Tier 1 Capital (to Risk Weighted Assets)	56,339	13.48%	16,722	4.00%	25,084	6.00%
Tier 1 Capital (to Average Assets)	56,339	8.69%	25,929	4.00%	32,411	5.00%

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Restrictions on dividends, loans and advances

The Company s ability to pay dividends is dependent on the Bank s ability to pay dividends to the Company. Pursuant to the February 9, 2009 Agreement between the Bank and the OCC, the Bank can pay dividends to the Company only pursuant to a dividend policy requiring compliance with the Bank s OCC-approved capital program, in compliance with applicable law and with the prior written determination of no supervisory objection by the Assistant Deputy Comptroller. In addition to the Agreement, certain other restrictions exist regarding the ability of the Bank to transfer funds to the Company in the form of cash dividends, loans or advances. The approval of the OCC is required to pay dividends in excess of the Bank s earnings retained in the current year plus retained net earnings for the preceding two years. As of September 30, 2012, the Bank had an accumulated deficit; therefore, dividends may not be paid to the Company. The Bank is also prohibited from paying dividends that would reduce its capital ratios below minimum regulatory requirements.

The Company s ability to pay dividends and incur debt is also restricted by the Reserve Bank Agreement. Under the terms of the Reserve Bank Agreement, the Company has agreed that it shall not declare or pay any dividends or incur, increase or guarantee any debt without the prior written approval of the Reserve Bank and the Director of the Division of Banking Supervision and Regulation (the Director) of the Board of Governors.

Loans or advances to the Company from the Bank are limited to 10% of the Bank s capital stock and surplus on a secured basis.

Recent Legislative Developments

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Act) was signed into law on July 21, 2010. The Act is a significant piece of legislation that will continue to have a major impact on the financial services industry, including the organization, financial condition and operations of banks and bank holding companies. Management continues to evaluate the impact of the Act; however, uncertainty remains as to its operational impact, which could have a material adverse impact on the Company s business, results of operations and financial condition. Many of the provisions of the Act are aimed at financial institutions that are significantly larger than the Company and the Bank. Notwithstanding this, there are many other provisions that the Company and the Bank are subject to and will have to comply with, including any new rules applicable to the Company and the Bank promulgated by the Bureau of Consumer Financial Protection, a new regulatory body dedicated to consumer protection. As rules and regulations are promulgated by the agencies responsible for implementing and enforcing the Act, the Company and the Bank will have to address each to ensure compliance with applicable provisions of the Act and compliance costs are expected to increase.

The Dodd-Frank Act broadens the base for Federal Deposit Insurance Corporation insurance assessments. Under rules issued by the FDIC in February 2011, the base for insurance assessments changed from domestic deposits to consolidated assets less tangible equity. Assessment rates are calculated using formulas that take into account the risks of the institution being assessed. The rule was effective beginning April 1, 2011. This did not have a material impact on the Company.

On June 28, 2011, the Federal Reserve Board approved a final debit-card interchange rule. This primarily impacts larger banks and has not had a material impact on the Company.

It is difficult to predict at this time what specific impact the Dodd-Frank Act and the yet to be written implementing rules and regulations will have on the Company. The financial reform legislation and any implementing rules that are ultimately issued could have adverse implications on the financial industry, the competitive environment, and our ability to conduct business. Management will have to apply resources to ensure compliance with all applicable provisions of the Dodd-Frank Act and any implementing rules, which may increase our costs of operations and adversely impact our earnings.

Note 11: Fair Value and Interest Rate Risk

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in certain instances, there are no quoted market prices for certain assets or liabilities. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the asset or liability.

Fair value measurements focus on exit prices in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment.

The Company s fair value measurements are classified into a fair value hierarchy based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. The three categories within the hierarchy are as follows:

Level 1 Inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

Level 3 Inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity s own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

The fair value measurement level of an asset or liability within the fair value hierarchy is based on the lower level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

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

Cash and due from banks, federal funds sold, short-term investments and accrued interest receivable and payable: The carrying amount is a reasonable estimate of fair value. These financial instruments are not recorded at fair value on a recurring basis.

Available-for-Sale Securities: These financial instruments are recorded at fair value in the financial statements. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted prices are not available, then fair values are estimated by using pricing models (i.e., matrix pricing) or quoted prices of securities with similar characteristics and are classified within Level 2 of the valuation hierarchy. Examples of such instruments include U.S. government agency bonds and mortgage-backed securities and corporate bonds. The prices for these instruments are obtained through an independent pricing service or dealer market participants with whom the Company has historically transacted both purchases and sales of investment securities. Prices obtained from these sources include prices derived from market quotations and matrix pricings. The fair value measurements considered observable data may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading execution data, market consensus prepayment speeds, credit information and the bond s terms and conditions, among other things. Management reviews the data and assumptions used in pricing the securities by its third party provider to ensure the highest level of significant inputs are derived from market observable data. Level 3 securities are instruments for which significant unobservable input are utilized. Available-for-sale securities are recorded at fair value on a recurring basis.

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Loans: For variable rate loans, which reprice frequently and have no significant change in credit risk, carrying values are a reasonable estimate of fair values, adjusted for credit losses inherent in the portfolios. The fair value of fixed rate loans is estimated by discounting the future cash flows using the period end rates, estimated by using local market data, at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, adjusted for credit losses inherent in the portfolios. The Company does not record loans at fair value on a recurring basis. However, from time to time, nonrecurring fair value adjustments to collateral-dependent impaired loans are recorded to reflect partial write-downs based on the observable market price or current appraised value of collateral. Fair values estimated in this manner do not fully incorporate an exit-price approach to fair value, but instead are based on a comparison to current market rates for comparable loans.

Other Real Estate Owned: The fair values of the Company s other real estate owned (OREO) properties are based on the estimated current property valuations less estimated selling costs. When the fair value is based on current observable appraised values, OREO is classified within Level 2. The Company classifies OREO within Level 3 when unobservable adjustments are made to appraised values. The Company does not record other real estate owned at fair value on a recurring basis.

Deposits: The fair value of demand deposits, regular savings and certain money market deposits is the amount payable on demand at the reporting date. The fair value of certificates of deposit and other time deposits is estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities, estimated using local market data, to a schedule of aggregated expected maturities on such deposits. The Company does not record deposits at fair value on a recurring basis.

Short-term borrowings: The carrying amounts of borrowings under short-term repurchase agreements and other short-term borrowings maturing within 90 days approximate their fair values. The Company does not record short-term borrowings at fair value on a recurring basis.

Junior Subordinated Debt: Junior subordinated debt reprices quarterly and as a result the carrying amount is considered a reasonable estimate of fair value. The Company does not record junior subordinated debt at fair value on a recurring basis.

Federal Home Loan Bank Borrowings: The fair value of the advances is estimated using a discounted cash flow calculation that applies current Federal Home Loan Bank interest rates for advances of similar maturity to a schedule of maturities of such advances. The Company does not record these borrowings at fair value on a recurring basis.

Other Borrowings: The fair values of longer term borrowings and fixed rate repurchase agreements are estimated using a discounted cash flow calculation that applies current interest rates for transactions of similar maturity to a schedule of maturities of such transactions. The Company does not record these borrowings at fair value on a recurring basis.

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

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The following table details the financial assets measured at fair value on a recurring basis as of September 30, 2012 and December 31, 2011, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine fair value:

September 30, 2012	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Balance as of September 30, 2012**
U.S. Government agency mortgage- backed securities	$	$ 2,505,107	$	$ 2,505,107
U.S. Government bonds		7,491,913		7,491,913
Corporate bonds		8,317,911		8,317,911
Securities available for sale	$	$ 18,314,931	$	$ 18,314,931

December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2011
U.S. Government agency mortgage- backed securities	$	$ 50,049,429	$	$ 50,049,429
U.S. Government bonds		5,037,085		5,037,085
Corporate bonds		11,383,458		11,383,458
Securities available for sale	$	$ 66,469,972	$	$ 66,469,972

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).

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The following tables reflect financial assets measured at fair value on a non-recurring basis as of September 30, 2012 and December 31, 2011, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

September 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance
Impaired Loans [1]	**$ -**	**$ -**	**$ 7,088,845**	**$ 7,088,845**
Other real estate owned [2]	**$ -**	**$ -**	**$ 1,252,024**	**$ 1,252,024**
December 31, 2011				
Impaired Loans [1]	$	$	$ 13,498,177	$ 13,498,177
Other real estate owned [2]	$	$	$ 2,762,640	$ 2,762,640

(1) Represents carrying value for which adjustments are based on the appraised value of the collateral.
(2) Represents carrying value for which adjustments are based on the appraised value of the property.

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

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

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

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The following is a summary of the carrying amounts and estimated fair values of the Company s financial instruments not measured and not reported at fair value on the consolidated balance sheets at September 30, 2012 and December 31, 2011 (in thousands):

		September 30, 2012		December 31, 2011	
	Fair Value Hierarchy	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial Assets:					
Cash and noninterest bearing balances due from banks	Level 1	$ 3,320	$ 3,320	$ 4,242	$ 4,242
Interest-bearing deposits due from banks	Level 1	40,510	40,510	50,474	50,474
Short-term investments	Level 1	710	710	710	710
Other investments	Level 2	3,500	3,500	3,500	3,500
Federal Reserve Bank stock	Level 1	1,744	1,744	1,707	1,707
Federal Home Loan Bank stock	Level 1	4,344	4,344	4,508	4,508
Loans receivable, net	Level 3	493,110	503,121	501,477	511,648
Accrued interest receivable	Level 1	1,979	1,979	2,453	2,453
Financial Liabilities:					
Demand deposits	Level 1	$ 59,310	$ 59,310	$ 65,613	$ 65,613
Savings deposits	Level 1	70,808	70,808	59,396	59,396
Money market deposits	Level 1	44,093	44,093	52,890	52,890
NOW accounts	Level 1	24,860	24,860	24,396	24,396
Time deposits	Level 2	284,884	288,818	342,614	347,246
FHLB Borrowings	Level 2	60,000	63,068	50,000	52,645
Securities sold under repurchase agreements	Level 2	7,000	7,737	7,000	8,173
Subordinated debentures	Level 2	8,248	8,248	8,248	8,248
Accrued interest payable	Level 1	1,166	1,166	949	949

The following are the methods and assumptions that were used to estimate the fair value of other financial assets and liabilities in the table above:

***Cash and due from banks and interest deposits with bank*s**: The carrying amount is considered to be a reasonable estimate of fair value due to the short maturity of these items.

Short term investments: The carrying amount is considered to be a reasonable estimate of fair value due to the short maturity of these items.

Other Investments: The redeemable carrying amount of this security, with limited marketability, approximates its fair value.

Federal Reserve Bank and Federal Home Loan Bank stock*:* The redeemable carrying amount of these securities, with limited marketability, approximates their fair value.

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Loans Receivable: The fair values of loans are estimated by discounting the projected future cash flows using market discount rates, primarily based on the Bank s current offer rates on comparable products, which reflect credit and interest-rate risk inherent in the loan. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Fair values estimated in this manner do not fully incorporate an exit price approach to fair value, but instead are based on a comparison to current market rates for comparable loans.

Accrued interest receivable and payable: The carrying amounts of accrued interest approximate their fair value due to the short-term nature of these items.

Deposits: Current carrying amounts approximate estimated fair value of demand deposits, savings, money market and NOW accounts. The fair value of time deposits is based on the discounted value of contractual cash flows using the Bank s current offer rates on comparable products of similar remaining maturities.

FHLB borrowings and securities sold under repurchase agreements*:* The fair values of the borrowings are estimated by discounting the estimated future cash flows using current market discount rates of financial instruments with similar characteristics, terms and remaining maturities.

Junior Subordinated Debt: There is no active market for the trust preferred securities issued by the Company s capital trust. The carrying amount is considered to be a reasonable estimate of fair value because of the frequency they reprice to market rates.

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

Off-balance sheet instruments

Loan commitments on which the committed interest rate is less than the current market rate were insignificant at September 30, 2012 and December 31, 2011. The estimated fair value of fee income on letters of credit at September 30, 2012 and December 31, 2011 was insignificant.

Note 12. Restructuring Charges and Asset Disposals

The Company recorded restructuring charges of $503,000 for the nine months ended September 30, 2012, compared to $3.0 million in the same period as last year. These costs are included in restructuring charges and asset disposals in the Consolidated Statements of Operations.

During 2011, the Company announced that it would be undertaking a series of initiatives that are designed to transform and enhance its operations. In order to strengthen the Company s competitive position and return it to its goal of restored health and profitability, it executed one initiative to consolidate four branch locations and vacate other office space, and a second plan to reduce workforce by approximately 10% of employees.

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On March 3, 2011, the Company announced that it would consolidate four branches, effective June 2011, to reduce operating expenses. All customer accounts in the affected branches were transferred to nearby Patriot branches to minimize any inconvenience to customers. The consolidation of these branches resulted in an earnings charge of $1.8 million, which is comprised of lease termination expenses of $1.2 million, lease liabilities charges of $400,000, and severance payments of $200,000 to affected employees. In addition, there was a $600,000 write-off of leasehold improvements and other fixed assets for these branches that were closed.

In order to further reduce operating expenses, the Company announced on May 16, 2011 that it would be executing a workforce reduction plan with employees in the back office operational areas. There were a total of eighteen employees affected by this reduction. This initiative resulted in an earnings charge of $600,000, which is comprised exclusively of severance payments to affected employees.

On September 23, 2011, the Company subleased vacant office space at 900 Bedford Street, Stamford, CT, effective October 1, 2011 for a term of two years.

On March 30, 2012, the Company announced that it would close the NYC branch, effective June 2012, and executed a workforce reduction of back office personnel to further reduce operating expenses. There were twelve employees in total affected by this announcement. For the six months ended June 30, 2012, a restructuring charge of $495,207 was recorded, which was comprised of $445,429 for severance expenses for the branch and back office personnel, asset disposals of $39,445 and $10,333 in lease termination costs.

On June 29, 2012, the Company announced that it would be consolidating three more branches, effective September 2012 in its continued effort to reduce operating expenses. Management made the decision in the third quarter to push back the closing of the three branches until October 5, 2012.

Restructuring reserves at September 30, 2012 for the restructuring activities taken in connection with these initiatives are comprised of the following:

	Balance at December 31, 2011	Expenses	Cash payments	Non-cash charges	Balance at September 30, 2012
Severance and benefit costs 2011	$ 64,132	$ 34,616	$ (98,402)	$ (346)	$
Lease termination costs 2011	317,808			(108,607)	209,201
Severance and benefit costs 2012		418,978	(418,978)		
Lease termination costs 2012		10,333	(10,333)		
Asset disposals 2012		39,445		(39,445)	
Total	$ 381,940	$ 503,372	$ (527,713)	$ (148,398)	$ 209,201

The restructuring reserves at September 30, 2012 are included in accrued expenses and other liabilities in the Consolidated Balance Sheet.

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Note 13: Recent Accounting Pronouncements

Accounting Standards Update (ASU) No. 2011-04, *Fair Value Measurements (Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs,* was issued as a result of the effort to develop common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards (IFRS). While ASU No. 2011-04 is largely consistent with existing fair value measurement principles in U.S. GAAP, it expands the existing disclosure requirements for fair value measurements and clarifies the existing guidance or wording changes to align with IFRS No. 13. Many of the requirements for the amendments in ASU No. 2011-04 do not result in a change in the application of the requirements in Topic 820. The Company adopted ASU No. 2011-04 on January 1, 2012 and it did not have a material impact on the consolidated financial statements.

ASU No. 2011-05, Comprehensive Income (Topic 220) Presentation of Comprehensive Income, requires an entity to present components of comprehensive income either in a single continuous statement of comprehensive income or in two separate consecutive statements. These amendments will make the financial statement presentation of other comprehensive income more prominent by eliminating the alternative to present comprehensive income within the statement of equity. As originally issued, ASU No. 2011-05 required entities to present reclassification adjustments out of accumulated other comprehensive income by component in the statement in which net income is presented and the statement in which other comprehensive income is presented (for both interim and annual financial statements). This requirement was deferred by *ASU No.2011-12, Comprehensive Income (Topic 220) Deferral of the Effective Date for Amendments to the Presentation of Reclassification of Items Out of Accumulated Other Comprehensive Income in Accounting Standards* . ASU No. 2011-05 is effective for all interim and annual periods beginning on or after December 15, 2011. The Company adopted this guidance in the first quarter of 2012 and elected to present comprehensive income in a separate consolidated statement of comprehensive income.

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

SAFE HARBOR STATEMENT UNDER PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Certain statements contained in Bancorp s public reports, including this report, and in particular in Management s Discussion and Analysis of Financial Condition and Results of Operations, may be forward looking and subject to a variety of risks and uncertainties. These factors include, but are not limited to; (1) changes in prevailing interest rates which would affect the interest earned on Bancorp s interest earning assets and the interest paid on its interest bearing liabilities; (2) the timing of repricing of Bancorp s interest earning assets and interest bearing liabilities; (3) the effect of changes in governmental monetary policy; (4) the effect of changes in regulations applicable to Bancorp and the Bank and the conduct of its business; (5) changes in competition among financial service companies, including possible further encroachment of non-banks on services traditionally provided by banks; (6) the ability of competitors that are larger than Bancorp to provide products and services which it is impracticable for Bancorp to provide; (7) the state of the economy and real estate values in Bancorp s market areas, and the consequent effect on the quality of Bancorp s loans, customers, vendors and communities; (8) recent governmental initiatives that are expected to have a profound effect on the financial services industry and could dramatically change the competitive environment of Bancorp; (9) other legislative or regulatory changes, including those related to residential mortgages, changes in accounting standards, and Federal Deposit Insurance Corporation (FDIC) premiums that may adversely affect Bancorp.

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

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and to disclose contingent assets and liabilities. Actual results could differ from those estimates. Management has identified the accounting for the allowance for loan losses, the analysis of its investment securities and the valuation of deferred income tax assets, as Bancorp s most critical accounting policies and estimates in that they are important to the portrayal of Bancorp s financial condition and results of operations. They require management s most subjective and complex judgment as a result of the need to make an estimate about the effect of matters that are inherently uncertain. These accounting policies, including the nature of the estimates and types of assumptions used, are described throughout this Management s Discussion and Analysis.

Summary

Bancorp realized net income of $18,000 ($0.00 basic and diluted income per share) for the quarter ended September 30, 2012, compared to a net income of $255,000 ($0.01 basic and diluted loss per share) for the quarter ended September 30, 2011. For the nine-month period ended September 30, 2012, Bancorp realized net income of $909,000 ($0.02 basic and diluted income per share) compared to a net loss of $15.9 million ($0.41 basic and diluted loss per share) for the nine months ended September 30, 2011. The primary reason for the decrease in the quarterly comparison is the decline in interest and fees on loans of $652,000 due to the lower interest rate environment, partially offset by lower interest expense of $211,000. Gains on sale of investment securities increased $145,000, when compared to the same period last year, primarily due to the sale of government agency mortgage-backed securities and corporate bonds of $36.8 million and $3.3 million respectively. Operating expenses decreased $301,000, primarily due to lower salaries of $220,000 due to the ongoing impact of the prior year s reduction-in-force. Bancorp s net interest income for the quarter ended September 30, 2012 was $4.2 million compared to $4.9 million for the quarter ended September 30, 2011. Interest income and interest expense decreased by 13% and 11%, respectively, for the quarter ended September 30, 2012 compared to the quarter ended September 30, 2011. The significant decline in interest income is due primarily to the lower interest rate environment. The decline in interest expense is primarily due to the reduction of total deposits and substantially lower interest rates paid on term deposits.

Total assets decreased $50.5 million from $665.8 million at December 31, 2011 to $615.3 million at September 30, 2012. Cash and cash equivalents decreased $10.9 million from $55.4 million at December 31, 2011 to $44.5 million at September 30, 2012. Securities decreased $48.3 million from $76.2 million at December 31, 2011 to $27.9 million September 30, 2012. This decrease is primarily due to sales of $45.2 million of available for sale securities, comprised of $41.9 million of mortgage-backed securities and $3.3 million in corporate bonds. In addition, there were principal paydowns of $7.6 million on mortgage backed securities and $5.0 million from proceeds on a called government agency bond, partially offset by purchases of government agency bonds and mortgage backed securities of $7.5 million and $2.5 million, respectively. The net loan portfolio decreased $8.1 million from $501.2 million at December 31, 2011 to $493.1 million at September 30, 2012. This decrease is primarily a result of $81.2 million in sales of residential loans, partially offset with loan growth of $39.9 million and $31.8 million in commercial and residential real estate, respectively. Deposits decreased $61.0 million from $544.9 million at December 31, 2011 to $483.9 million at September 30, 2012. The Bank continued to reduce its concentration in high costs of certificates of deposit. The overall cost of deposits decreased from 1.28% at December 31, 2011 to 1.07% at September 30, 2012. Borrowings increased $10.0 million from $57.0 million at December 31, 2011 to $67.0 million at September 30, 2012.

FINANCIAL CONDITION

Cash and Cash Equivalents

Cash and cash equivalents decreased $10.9 million, or 20%, to $44.5 million at September 30, 2012 compared to $55.4 million at December 31, 2011. This decrease is primarily the result of the reduction in high cost term deposits.

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Investments

The following table is a summary of Bancorp s available-for-sale securities portfolio, at fair value, at the dates shown:

	September 30, 2012	December 31, 2011
U.S. Government bonds	$ 7,491,913	$ 5,037,085
U.S. Government agency mortgage- backed securities	2,505,107	50,049,429
Corporate bonds	8,317,911	11,383,458
Total Available-for-Sale Securities	$ 18,314,931	$ 66,469,972

Available-for-sale securities decreased $48.2 million, or 72%, from $66.5 million at December 31, 2011 to $18.3 million at September 30, 2012. This decrease is primarily due to sales of $41.9 million of government agency mortgage-backed securities and $3.3 million of corporate bonds, principal pay downs of $7.6 million on mortgage backed securities and $5.0 million in proceeds from a called government agency bond. These were partially offset by purchases of government agency bonds and mortgage-backed securities of $7.5 million and $2.5 million, respectively.

Loans

The following table is a summary of Bancorp s loan portfolio at the dates shown:

	September 30, 2012	December 31, 2011
Real Estate		
Commercial	$ 255,551,934	$ 215,659,837
Residential	138,666,279	188,108,855
Construction	6,213,797	12,306,922
Construction to permanent	4,312,597	10,012,022
Commercial	41,100,960	31,810,735
Consumer home equity	51,011,804	49,694,546
Consumer installment	2,184,273	2,164,972
Total Loans	499,041,644	509,757,889
Premiums on purchased loans	221,710	231,125
Net deferred costs	537,948	622,955
Allowance for loan losses	(6,691,731)	(9,384,672)
Loans receivable, net	$ 493,109,571	$ 501,227,297

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Bancorp s net loan portfolio decreased $8.1 million, or 2%, from $501.2 million at December 31, 2011 to $493.1 million at September 30, 2012. The decrease is primarily a result of $81.2 million in residential loan sales, partially offset by new loan growth in residential mortgages of $31.8 million. Commercial real estate increased $39.9 million. There were increases in commercial loans of $9.3 million and consumer home equity loans of $1.3 million. These were partially offset with decreases in construction and construction to permanent of $6.1 million and $5.7 million, respectively.

At September 30, 2012, the net loan to deposit ratio was 102% and the net loan to total assets ratio was 80%. At December 31, 2011, these ratios were 92% and 76%, respectively.

Allowance for Loan Losses

The allowance for loan losses is established to provide for expected future losses based on the Bank s loss history and the application of qualitative risk adjustment factors to compensate for estimated differences between anticipated potential losses and those predicted by the bank s specific loss history. The allowance is established through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

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

The allowance for loan losses decreased $2.7 million from December 31, 2011 to September 30, 2012 primarily due to a reduction in loan balances, improved credit quality of the loan portfolio and a change in methodology in estimating the allowance as described more fully below. These factors resulted in a release of excess reserves of $2.6 million after net charge-offs of $134,000.

As of the first quarter of 2012, the Bank had used a 12 quarter un-weighted average to calculate loss history. Beginning in the second quarter of 2012, the Bank implemented changes to the allowance methodology, resulting in a reduction of the allowance for loan losses of $1.1 million. In making this transition, the changes serve to update and enhance the methodology to better reflect the direction of the current loan portfolio. The changes are threefold:

First, the Bank adopted a two year, instead of a three year, weighted average historical loss factor as the basis for the calculation of its historical loss experience. This is used to calculate expected losses in the ASC 450-20 pools prior to the application of qualitative risk adjustment factors. Weightings were allocated 59% to the last four quarters and 41% to the previous four quarters. This change was made to be more responsive to the changing credit environment. Net charge-offs have declined, especially in 2012 when they averaged $76,000 per quarter. This shorter average historical loss period will produce results more indicative of the current and expected behavior of the portfolio.

Second, the Bank adopted an Internal Risk Ratings Based (IRB) approach to calculating historical loss rates. This approach calibrates expected losses with actual risk assessment and equates the likelihood of loss to the level of risk in a credit facility rating. All loans are reviewed annually. Similarly, the Loan Committee can adjust a risk rating. Previously, loss history was applied to categories of loans and qualitative adjustments were apportioned by risk rating within the categories.

Third, the Bank increased the detail of analysis within the segments, particularly within Commercial Real Estate lending, which is currently the Bank s largest concentration overall, by expanding the number of ASC 450-20 pools. In all, ten sub-concentrations have been added to the analysis. The greater level of detail enables the Bank to better apply qualitative risk adjustment factors to the segments affected and to monitor changes in credit risk within the portfolio.

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

Management considers all non-accrual loans, troubled debt restructurings and loans that were previously classified as TDRs that have been upgraded, to be impaired. In most cases, loan payments that are past due less than 90 days, based on contractual terms, are considered collection delays and the related loans are not considered to be impaired. The Bank considers consumer installment loans to be pools of smaller balance homogeneous loans, which are collectively evaluated for impairment.

The changes in the allowance for loan losses for the periods shown are as follows:

	Three months ended		Nine months ended	
(Thousands of dollars)	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Balance at beginning of period	$ 6,674	$ 11,400	$ 9,385	$ 15,374
Charge-offs	(4)	(218)	(197)	(7,406)
Recoveries	22	16	63	780
Net Charge-offs	18	(202)	(134)	(6,626)
Transferred to loans held-for-sale		(40)		(6,054)
Provision charged to operations			(2,559)	8,464
Balance at end of period	$ 6,692	$ 11,158	$ 6,692	$ 11,158
Ratio of net charge-offs during the period to average loans outstanding during the period	0.00%	0.04%	0.03%	1.36%
Ratio of ALLL / Gross Loans	1.34%	2.40%	1.34%	2.40%

Based upon the overall assessment and evaluation of the loan portfolio, management believes the allowance for loan losses of $6.7 million, at September 30, 2012, which represents 1.34% of gross loans outstanding, is adequate under prevailing economic conditions, to absorb existing losses in the loan portfolio.

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Non-Accrual, Past Due and Restructured Loans

The following table presents non-accruing loans and loans past due 90 days or more and still accruing:

(Thousands of dollars)	September 30, 2012	December 31, 2011
Loans past due over 90 days still accruing	$ 2,498	$ 9,461
Non accruing loans	30,020	20,683
Total	$ 32,518	$ 30,144
% of Total Loans	6.51%	5.91%
% of Total Assets	5.28%	4.53%

Loans delinquent over 90 days and still accruing aggregating $2.5 million are comprised of seven loans, all of which have matured and continue to make payments. Six of these loans are currently in the process of being renewed and one has since been renewed. Impaired loans, which are comprised of non-accruing loans, troubled debt restructured loans, and loans previously classified as TDRs that have been upgraded, increased by $4.4 million to $39.1 million for the quarter ended September 30, 2012 and increased $2.3 million for the nine months ended September 30, 2012. Impaired loans are attributable to the lingering effects of the downturn in the economy, which has severely impacted the real estate market and placed unprecedented stress on credit markets. The Bank s customers, many of whom are associated with the financial services industry, have been affected by the impact of the poor economy on employment and real estate values.

The $30.0 million of non-accrual loans at September 30, 2012 is comprised of twenty-seven loans, for which a specific reserve of $806,000 has been established. In all cases, the Bank has obtained appraisal reports from independent licensed appraisal firms and discounted those values for estimated selling costs to determine estimated impairment. Of the $30.0 million of non-accrual loans at September 30, 2012 borrowers of three loans with aggregate balances of $3.8 million continue to make loan payments and these loans are current within one and two months as to payments.

Potential Problem Loans

In addition to the above, there are $24.4 million of substandard accruing loans comprised of twenty-two loans and $32.3 million of special mention loans comprised of thirty-nine loans for which management has a concern as to the ability of the borrowers to comply with the present repayment terms. All but $3.5 million of the substandard accruing loans and $7.9 million of the special mention loans continue to make timely payments and are within 30 days at September 30, 2012.

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Other Real Estate Owned

The following table is a summary of Bancorp s other real estate owned at the dates shown:

	September 30, 2012	December 31, 2011
Residential construction	$ 1,252,024	$ 1,140,560
Commercial		1,622,080
Other real estate owned	$ 1,252,024	$ 2,762,640

The balance of other real estate owned at September 30, 2012 is comprised of one property with an aggregate carrying value of $1.3 million that was obtained through loan foreclosure proceedings. During the nine months ended September 30, 2012, three OREO properties were sold with an aggregate carrying value of $1.9 million.

Deferred Taxes

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. A valuation allowance related to deferred tax assets is required when it is considered more likely than not that all or part of the benefit related to such assets will not be realized. Management has reviewed the deferred tax position of the Company at September 30, 2012. The deferred tax position has been affected by several significant transactions in the prior years. These transactions include increased provision for loan losses, the levels of non-accrual loans and other-than-temporary impairment write-offs of certain investments, as well as a loss on the bulk sale of loans in 2011. As a result, the Company is in a cumulative net loss position at September 30, 2012, and under the applicable accounting guidance, has concluded that it is not more-likely-than-not that the Company will be able to realize its deferred tax assets and, accordingly, has established a full valuation allowance totaling $13.7 million against its deferred tax asset at September 30, 2012. The valuation allowance is analyzed quarterly for changes affecting the deferred tax asset. In the future, if the Company generates taxable income on a sustained basis, management s conclusion regarding the need for a deferred tax asset valuation allowance could change, resulting in the reversal of all or a portion of the deferred tax asset valuation allowance.

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Deposits

The following table is a summary of Bancorp s deposits at the dates shown:

	September 30, 2012	December 31, 2011
Non-interest bearing	$ 59,309,584	$ 65,613,374
Interest bearing		
NOW	24,859,524	24,396,210
Savings	70,807,709	59,396,310
Money market	44,092,847	52,889,642
Time certificates, less than $100,000	166,654,722	198,207,998
Time certificates, $100,000 or more	118,228,921	144,405,859
Total interest bearing	424,643,723	479,296,019
Total Deposits	$ 483,953,307	$ 544,909,393

Total deposits decreased $61.0 million, or 11%, from $544.9 million at December 31, 2011 to $483.9 million at September 30, 2012. Interest bearing accounts decreased $54.7 million. This was primarily due to decreases in certificates of deposit (CD s) of $57.7 million and money market accounts of $8.8 million due to the low interest rate environment and the planned reduction of higher cost deposit accounts. These were partially offset by increases of $11.4 million and $463,000 respectively in savings and NOW accounts. Demand deposits decreased $6.3 million primarily as a result decreases in commercial and personal checking accounts of $5.2 million and $1.1 million, respectively.

Borrowings

At September 30, 2012, total borrowings increased $10.0 million to $67.0 million from $57.0 million at December 31, 2011. In addition to the outstanding borrowings disclosed in the consolidated balance sheet, the Bank has the ability to borrow approximately $45.0 million in additional advances from the Federal Home Loan Bank of Boston, including a $2.0 million overnight line of credit. The Bank has also established a line of credit at the Federal Reserve Bank.

The subordinated debentures of $8,248,000 are unsecured obligations of the Company and are subordinate and junior in right of payment to all present and future senior indebtedness of the Company. The Company has entered into a guarantee, which together with its obligations under the subordinated debentures and the declaration of trust governing the Trust, provides a full and unconditional guarantee of amounts on the capital securities. The subordinated debentures, which bear interest at three-month LIBOR plus 3.15% (3.517250% at September 30, 2012), matures on March 26, 2033. Beginning in the second quarter of 2009, the Company began deferring interest payments on the subordinated debentures as permitted under the terms of the debentures. The deferral in the third quarter of 2012 represented the fourteenth consecutive quarter of deferral. The Company continues to accrue and charge interest to operations. The Company may defer the payment of interest through March 2014, and all accrued interest must be paid at the completion of the deferral period, June 2014.

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Capital

Capital increased $583,000 compared to December 31, 2011 primarily as a result of the net income earned of $909,000 for the nine months ended September 30, 2012, partially offset the by the change in other comprehensive income.

Off-Balance Sheet Arrangements

Bancorp s off-balance sheet arrangements, which primarily consist of commitments to lend, decreased by $52.5 million from $140.4 million at December 31, 2011 to $87.9 million at September 30, 2012, due to decreases of $71.0 million in future loan commitments, partially offset by increases of $16.2 million in unused lines of credit. The decrease in future loan commitments was primarily due to the closings in the first quarter of 2012 of the loan originations from the fourth quarter of 2011.

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Results of Operations

Interest and dividend income and expense

The following tables present average balance sheets (daily averages), interest income, interest expense and the corresponding yields earned and rates paid for major balance sheet components:

	Three months ended September 30,					
	2012			2011		
	Average Balance	Interest Income/ Expense	Average Rate	Average Balance	Interest Income/ Expense	Average Rate
			(dollars in thousands)			
Interest earning assets:						
Loans	$ 485,363	$ 5,533	4.56%	$ 459,943	$ 6,185	5.38%
Investments	63,469	428	2.70%	102,171	721	2.82%
Interest bearing deposits in banks	42,277	22	0.21%	17,678	1	0.02%
Federal funds sold			0.00%	2,739	1	0.15%
Total interest earning assets	591,109	5,983	4.05%	582,531	6,908	4.74%
Cash and due from banks	4,813			23,977		
Premises and equipment, net	4,374			4,088		
Allowance for loan losses	(6,689)			(11,385)		
Other assets	26,907			29,234		
Total Assets	$ 620,514			$ 628,445		
Interest bearing liabilities:						
Deposits	$ 434,169	$ 1,240	1.14%	$ 447,553	$ 1,385	1.24%
FHLB advances	50,652	358	2.83%	50,000	428	3.42%
Subordinated debt	8,248	75	3.64%	8,248	71	3.44%
Other borrowings	7,000	78	4.46%	7,000	77	4.42%
Total interest bearing liabilities	500,069	1,751	1.40%	512,801	1,961	1.53%
Demand deposits	63,558			57,933		
Accrued expenses and other liabilities	5,570			6,453		
Shareholders equity	51,317			51,258		
Total liabilities and equity	$ 620,514			$ 628,445		
Net interest income		$ 4,232			$ 4,947	
Interest margin			2.86%			3.40%
Interest spread			2.65%			3.21%

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	Nine months ended September 30, 2012 Average Balance	Interest Income/ Expense	Average Rate	2011 Average Balance	Interest Income/ Expense	Average Rate
			(dollars in thousands)			
Interest earning assets:						
Loans	$ 495,757	$ 18,011	4.84%	$ 488,295	$ 19,680	5.37%
Investments	68,879	1,397	2.70%	76,443	1,632	2.85%
Interest bearing deposits in banks	52,374	72	0.18%	64,595	122	0.25%
Federal funds sold			0.00%	7,516	7	0.12%
Total interest earning assets	617,010	19,480	4.21%	636,849	21,441	4.49%
Cash and due from banks	4,937			21,366		
Premises and equipment, net	4,355			4,576		
Allowance for loan losses	(8,168)			(12,863)		
Other assets	27,347			34,261		
Total Assets	$ 645,481			$ 684,189		
Interest bearing liabilities:						
Deposits	$ 460,144	$ 4,178	1.21%	$ 498,515	$ 4,804	1.28%
FHLB advances	52,376	1,069	2.72%	50,000	1,270	3.39%
Subordinated debt	8,248	226	3.65%	8,248	213	3.44%
Other borrowings	7,000	232	4.42%	7,000	230	4.39%
Total interest bearing liabilities	527,768	5,705	1.44%	563,763	6,517	1.54%
Demand deposits	61,337			56,636		
Accrued expenses and other liabilities	5,319			6,027		
Shareholders equity	51,057			57,763		
Total liabilities and equity	$ 645,481			$ 684,189		
Net interest income		$ 13,775			$ 14,924	
Interest margin			2.98%			3.12%
Interest spread			2.77%			2.95%

The following rate volume analysis reflects the impact that changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities had on net interest income during the periods indicated. Information is provided in each category with respect to changes attributable to changes in volume (changes in volume multiplied by prior rate), changes attributable to changes in rates (changes in rates multiplied by prior volume) and the total net change. The change resulting from the combined impact of volume and rate is allocated proportionately to the change due to volume and the change due to rate.

	Three months ended September 30, 2012 vs 2011 Increase (decrease) in Interest Income/Expense			Nine months ended September 30, 2012 vs 2011 Increase (decrease) in Interest Income/Expense		
	Due to change in:			Due to change in:		
	Volume	Rate	Total	Volume	Rate	Total
	(dollars in thousands)			(dollars in thousands)		
Interest earning assets:						
Loans	$ 329	$ (981)	$ (652)	$ 297	$ (1,966)	$ (1,669)
Investments	(263)	(30)	(293)	(154)	(81)	(235)
Interest bearing deposits in banks		21	21	(20)	(30)	(50)
Federal funds sold		(1)	(1)	(3)	(4)	(7)
Total interest earning assets	66	(991)	(925)	120	(2,081)	(1,961)
Interest bearing liabilities:						
Deposits	$ (39)	$ (106)	$ (145)	$ (370)	$ (256)	$ (626)
FHLB advances	6	(76)	(70)	58	(259)	(201)
Subordinated debt		4	4		13	13
Other borrowings		1	1		2	2
Total interest bearing liabilities	(33)	(177)	(210)	(312)	(500)	(812)
Net interest income	$ 99	$ (814)	$ (715)	$ 432	$ (1,581)	$ (1,149)

For the quarter ended September 30, 2012, average interest earning assets increased $8.6 million, or 1%, to $591.1 million from $582.5 million for the quarter ended September 30, 2011, resulting in interest income for Bancorp of $6.0 million compared to $6.9 million for the same period in 2011. Interest and fees on loans decreased $652,000 or 11%, from $6.2 million for the quarter ended September 30, 2011 to $5.5 million for the quarter ended September 30, 2012. This decrease is primarily the result of lower average interest rates on new loan growth, partially offset by an increase of $25.4 million in the average balance of the loan portfolio. When compared to the same period last year, interest income on investments decreased by 41% due to an decrease of $38.7 million in the average balance of investments outstanding. Income on interest-bearing deposits in banks increased from $1,000 to $22,000 for the quarter ended September 30, 2012 compared to the quarter ended September 30, 2011, which is reflective of the increase in the yields earned on excess funds.

Total interest expense for the quarter ended September 30, 2012 of $1.8 million represents a decrease of $210,000, or 11%, compared to interest expense of $2.0 million for the same period last year. This decrease in interest expense is the result of a decrease in the average balances of interest-bearing liabilities. Average balances of interest bearing deposit accounts decreased $13.4 million, or 3%, which is comprised primarily of decreases in certificates of deposit and money market accounts of $10.7 million and $16.9 million, respectively. These were partially offset by increases in savings accounts and NOW accounts of $12.8 million and $1.5 million, respectively. In addition, lower interest rates contributed to the overall decrease of $106,000 in interest expense on deposits. Average FHLB advances increased by $652,000, but lower interest rates resulted in a decrease of $70,000 in interest expense. Interest expense on the junior subordinated debt and borrowed funds increased by $4,000.

As a result of the above, Bancorp s net interest income decreased $715,000 or 14%, to $4.2 million for the three months ended September 30, 2012 compared to $4.9 million for the same period last year. The net interest margin for the three months ended September 30, 2012 was 2.86% as compared to 3.40% for the three months ended September 30, 2011 as a result of the various reasons mentioned above.

Interest and dividend income was $19.5 million for the nine months ended September 30, 2012, which represents a decrease of $2.0 million, or 9%, as compared to interest and dividend income of $21.4 million for the same period last year. This decrease was due primarily to lower interest rates resulting in a decrease of $1.7 million in interest and fees on loans that was partially offset by higher average balance of loans for the nine month ended September 30, 2012. This was combined with lower interest rates and average balances on investments, resulting in a decrease of $235,000 or 14%. The average balance of the investment portfolio decreased $7.6 million when compared to the nine months ended September 30, 2011. Income on interest bearing deposits in banks decreased 41% for the nine months ended September 30, 2012 compared to the same period in 2011, which is reflective of the decrease in the average balance and yields on the excess funds.

For the nine months ended September 30, 2012, total interest expense decreased $812,000, or 12%, to $5.7 million from $6.5 million for the nine months ended September 30, 2011. The decrease in interest expense was due primarily to lower interest rates and a $36.0 million reduction in the average balances of interest-bearing liabilities. In addition, interest expense on the FHLB advances decreased $201,000 due to lower interest rates, when compared to the same period last year.

As a result of the above, net interest income decreased $1.1 million, or 8%, for the nine months ended September 30, 2012 to $13.8 million as compared to $14.9 million at September 30, 2011. The net interest margin for the nine months ended September 30, 2012 was 2.98% as compared to 3.12% for the nine months ended September 30, 2011.

Provision for Loan Losses

Based on management s most recent evaluation of the adequacy of the allowance for loan losses, no adjustment to the provision for loan losses was necessary for the three months ended September 30, 2012. No charge was required for the three months ended September 30, 2011. For the nine months ended September 30, 2012, the provision for loan losses released from operations was $2.6 million compared to a charge to operations of $8.5 million for the nine months ended September 30, 2011 primarily due to the $6.0 million charge related to loans transferred to held-for-sale in connection with the bulk loan sale in the first quarter of 2011. The allowance for loan losses decreased by $2.7 million from December 31, 2011 to September 30, 2012 due primarily to $2.6 million release of excess reserves, as previously discussed, after net charge-offs of $134,000.

An analysis of the changes in the allowance for loan losses is presented under Allowance for Loan Losses.

Non-interest income

Non-interest income increased $175,000 from $1.3 million for the quarter ended September 30, 2011 to $1.5 million for the quarter ended September 30, 2012. This is primarily due to increased gains recognized on the sale of investment securities and loans of $145,000 and $31,000, respectively. Mortgage brokerage referral fees increased $21,000 when compared to the same period last year. These were partially offset by a decrease in earnings on the cash surrender value of life insurance of $48,000.

For the nine months ended September 30, 2012, non-interest income increased $87,000, or 3%, to $2.7 million as compared to $2.6 million for the nine months ended September 30, 2011. This is primarily due to increases in gains on sale of loans and investment securities of $215,000 and $137,000 respectively. These were partially offset by decreases in other income from interest of $111,000 from federal tax refunds received in 2011, $107,000 decrease in earnings on the cash surrender value of life insurance, $65,000 lower fees and service charges on deposit accounts, and a decrease of $26,000 in earnings on an equity investment when compared to the nine months ended September 30, 2011.

Non-interest expenses

Non-interest expenses decreased $301,000 or 5% from $6.0 million to $5.7 million for the quarter ended September 30, 2012 as compared to the quarter ended September 30, 2011. This decrease is primarily due to the impact of the restructuring in the prior year, resulting in lower salaries and benefits of $220,000. Insurance expenses decreased $119,000 primarily due to lower Directors and Officers insurance costs. Advertising and promotional expenses, material and communications and loan administration and processing expenses decreased $76,000, $57,000 and $53,000 respectively. Professional and other outside services, which are comprised primarily of audit and accounting fees, legal services and consulting fees, decreased $36,000 from $546,000 for the quarter ended September 30, 2011, to $510,000 for the quarter ended September 30, 2012. These were partially offset by increases in occupancy and equipment expenses of $89,000 and data processing of $63,000.

For the nine months ended September 30, 2012, non-interest expense decreased $6.8 million, or 27% to $18.1 million from $24.9 million for the same period in 2011. This decrease was primarily due to lower restructuring charges and asset disposals of $2.5 million related to branch closings and reduction-in-force of back office personnel of $503,000 as compared to $3.0 million for the same period last year. Other real estate owned operations decreased $1.1 million due to fewer properties managed and gains recognized on the sale of three properties. Salaries and benefit expense and occupancy expense decreased $1.0 million and $299,000 respectively, due to the impact of the restructuring activities mentioned above and lower costs of lease renewals. In addition, professional and outside services, advertising and promotional expenses and regulatory assessments decreased $683,000, $480,000 and $360,000 respectively.

LIQUIDITY

Bancorp s liquidity ratio was 10% at September 30, 2012 compared to 21% at September 30, 2011. The liquidity ratio is defined as the percentage of liquid assets to total assets. The following categories of assets, as described in the accompanying consolidated balance sheets, are considered liquid assets: cash and due from banks, federal funds sold, short-term investments and available-for-sale securities. Liquidity is a measure of Bancorp s ability to generate adequate cash to meet financial obligations. The principal cash requirements of a financial institution are to cover downward fluctuations in deposit accounts and increases in its loan portfolio. Management believes Bancorp s short-term assets provide sufficient liquidity to cover loan demand, potential fluctuations in deposit accounts and to meet other anticipated cash operating requirements.

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CAPITAL

The following table illustrates Bancorp s regulatory capital ratios at September 30, 2012 and December 31, 2011 respectively:

	September 30, 2012	December 31, 2011
Tier 1 Leverage Capital	9.60%	9.01%
Tier 1 Risk-based Capital	13.53%	13.95%
Total Risk-based Capital	14.78%	15.22%

The following table illustrates the Bank s regulatory capital ratios at September 30, 2012 and December 31, 2011 respectively:

	September 30, 2012	December 31, 2011
Tier 1 Leverage Capital	9.37%	8.69%
Tier 1 Risk-based Capital	13.19%	13.48%
Total Risk-based Capital	14.45%	14.75%

IMPACT OF INFLATION AND CHANGING PRICES

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

CURRENT MATTERS

On October 29 and 30, 2012, the metropolitan New York City region and sections of Connecticut were severely damaged by Super Storm Sandy. The Company has conducted an assessment of the impact of the storm on its facilities and customers in the affected areas. It does not appear that there will be a significant impact on the results of operations for the fourth quarter of 2012.

Item 3: Quantitative and Qualitative Disclosures about Market Risk

Market risk is defined as the sensitivity of income to fluctuations in interest rates, foreign exchange rates, equity prices, commodity prices and other market-driven rates or prices. Based upon the nature of Bancorp s business, the primary source of market risk is interest rate risk, which is the impact that changing interest rates have on current and future earnings. In addition, Bancorp s loan portfolio is primarily secured by real estate in the company s market area. As a result, the changes in valuation of real estate could also impact Bancorp s earnings.

Qualitative Aspects of Market Risk

Bancorp s goal is to maximize long term profitability while minimizing its exposure to interest rate fluctuations. The first priority is to structure and price Bancorp s assets and liabilities to maintain an acceptable interest rate spread while reducing the net effect of changes in interest rates. In order to accomplish this, the focus is on maintaining a proper balance between the timing and volume of assets and liabilities re-pricing within the balance sheet. One method of achieving this balance is to originate variable rate loans for the portfolio and purchase short-term investments to offset the increasing short term re-pricing of the liability side of the balance sheet. In fact, a number of the interest-bearing deposit products have no contractual maturity. Therefore, deposit balances may run off unexpectedly due to changing market conditions. Additionally, loans and investments with longer term rate adjustment frequencies are matched against longer term deposits and borrowings to lock in a desirable spread.

The exposure to interest rate risk is monitored by the Management Asset and Liability Committee consisting of senior management personnel. The Committee meets on a monthly basis, but may convene more frequently as conditions dictate. The Committee reviews the interrelationships within the balance sheet to maximize net interest income within acceptable levels of risk. This Committee reports to the Board of Directors on a monthly basis regarding its activities. In addition to the Management Asset and Liability Committee, there is a Board Asset and Liability Committee (ALCO), which meets quarterly. ALCO monitors the interest rate risk analyses, reviews investment transactions during the period and determines compliance with Bank policies.

Quantitative Aspects of Market Risk

In order to manage the risk associated with interest rate movements, management analyzes Bancorp s interest rate sensitivity position through the use of interest income simulation and GAP analysis. The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are interest sensitive. An asset or liability is said to be interest sensitive within a specific time period if it will mature or reprice within that time period.

Management s goal is to manage asset and liability positions to moderate the effects of interest rate fluctuations on net interest income. Interest income simulations are completed quarterly and presented to ALCO. The simulations provide an estimate of the impact of changes in interest rates on net interest income under a range of assumptions. Changes to these assumptions can significantly affect the results of the simulations. The simulation incorporates assumptions regarding the potential timing in the repricing of certain assets and liabilities when market rates change and the changes in spreads between different market rates.

Simulation analysis is only an estimate of Bancorp s interest rate risk exposure at a particular point in time. Management regularly reviews the potential effect changes in interest rates could have on the repayment of rate sensitive assets and funding requirements of rate sensitive liabilities.

The table below sets forth examples of changes in estimated net interest income and the estimated net portfolio value based on projected scenarios of interest rate increases and decreases. The analyses indicate the rate risk embedded in Bancorp s portfolio at the dates indicated should all interest rates instantaneously rise or fall. The results of these changes are added to or subtracted from the base case; however, there are certain limitations to these types of analyses. Rate changes are rarely instantaneous and these analyses may also overstate the impact of short-term repricings. As a result of the historically low interest rate environment, the calculated effects of the 100 and 200 basis point downward shocks cannot absolutely reflect the risk to earnings and equity since the interest rates on certain balance sheet items have approached their minimums, and, therefore, it is not possible for the analyses to fully measure the true impact of these downward shocks.

	September 30, 2012					
	Net Interest Income			Net Portfolio Value		
Projected Interest Rate Scenario	Estimated Value	$ Change from Base	% Change from Base	Estimated Value	$ Change from Base	% Change from Base
+ 200	19,421	2,082	12.01%	46,646	(7,281)	-13.50%
+ 100	18,527	1,188	6.85%	50,379	(3,548)	-6.58%
BASE	17,339			53,927		
- 100	18,031	692	3.99%	59,787	5,860	10.86%
- 200	18,011	672	3.88%	72,492	18,565	34.43%

	December 31, 2011					
	Net Interest Income			Net Portfolio Value		
Projected Interest Rate Scenario	Estimated Value	$ Change from Base	% Change from Base	Estimated Value	$ Change from Base	% Change from Base
+ 200	20,987	1,169	5.90%	48,458	(9,194)	-15.95%
+ 100	20,547	729	3.68%	53,555	(4,097)	-7.11%
BASE	19,818			57,652		
- 100	20,504	686	3.46%	61,109	3,457	6.00%
- 200	20,604	786	3.97%	69,915	12,263	21.27%

Item 4: Controls and Procedures

Based on an evaluation of the effectiveness of Bancorp s disclosure controls and procedures performed by Bancorp s management, with the participation of Bancorp s Chief Executive Officer and its Chief Financial Officer as of the end of the period covered by this report, Bancorp s Chief Executive Officer and Chief Financial Officer concluded that Bancorp s disclosure controls and procedures have been effective.

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

There were no changes in Bancorp s internal controls over financial reporting identified in connection with the evaluation described in the preceding paragraph that occurred during Bancorp s fiscal quarter ended September 30, 2012 that has materially affected, or is reasonably likely to materially affect, Bancorp s internal controls over financial reporting.

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PART II - OTHER INFORMATION.

Item 1: Legal Proceedings

Neither Bancorp nor the Bank has any pending legal proceedings, other than ordinary routine litigation incidental to its business, to which Bancorp or the Bank is a party or any of its property is subject.

Item 1A: Risk Factors

During the three months ended September 30, 2012, there were no material changes to the risk factors relevant to Bancorp s operations, which are described in the Annual Report on Form 10-K for the year ended December 31, 2011.

Item 6: Exhibits

No.	Description
2	Agreement and Plan of Reorganization dated as of June 28, 1999 between Bancorp and the Bank (incorporated by reference to Exhibit 2 to Bancorp s Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)).
2.1	Securities Purchase Agreement by and among Patriot National Bancorp, Inc., Patriot National Bank and PNBK Holdings LLC dated as of December 16, 2009 (incorporated by reference to Exhibit 10.1 to Bancorp s Current Report on Form 8-K dated December 17, 2009).
2.2	Amendment to Securities Purchase Agreement by and among Patriot National Bancorp, Inc., Patriot National Bank and PNBK Holdings LLC dated as of May 3, 2010 (incorporated by reference to Exhibit 10(a) to Bancorp s Current Report on Form 8-K dated May 4, 2010).
3(i)	Certificate of Incorporation of Bancorp, (incorporated by reference to Exhibit 3(i) to Bancorp s Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)).
3(i)(A)	Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. dated July 16, 2004 (incorporated by reference to Exhibit 3(i)(A) to Bancorp s Annual Report on Form 10-KSB for the year ended December 31, 2004 (Commission File No. 000-29599)).
3(i)(B)	Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. dated June 15, 2006 (incorporated by reference to Exhibit 3(i)(B) to Bancorp s Quarterly Report of Form 10-Q for the quarter ended September 30, 2006 (commission File No. 000-29599)).
3(i)(C)	Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. (incorporated by reference to Exhibit 3(i) to Bancorp s current report Form 8-K dated October 21, 2010.
3(ii)	Amended and Restated By-laws of Bancorp (incorporated by reference to Exhibit 3(ii) to Bancorp s Current Report on Form 8-K dated November 1, 2010 (Commission File No. 000-29599))

No.	Description
10(a)(1)	2001 Stock Appreciation Rights Plan of Bancorp (incorporated by reference to Exhibit 10(a)(1) to Bancorp s Annual Report on Form 10-KSB for the year ended December 31, 2001 (Commission File No. 000-29599)).
10(a)(2)	2012 Stock Plan of Bancorp (incorporated by reference from Annex A to the Proxy Statement on Form 14C filed November 1, 2011.
10(a)(5)	Employment Agreement dated as of January 1, 2008 among Patriot National Bank, Bancorp and Robert F. O Connell (incorporated by reference to Exhibit 10(a)(5) to Bancorp s Annual Report on Form 10-K for the year ended December 31, 2007 (Commission File No. 000-29599)).
10(a)(6)	Change of Control Agreement, dated as of January 1, 2007 among Robert F. O Connell, Patriot National Bank and Bancorp (incorporated by reference to Exhibit 10(a)(6) to Bancorp s Annual Report on Form 10-K for the year ended December 31, 2006 (Commission File No. 000-29599)).
10(a)(9)	License agreement dated July 1, 2003 between Patriot National Bank and L. Morris Glucksman (incorporated by reference to Exhibit 10(a)(9) to Bancorp s Annual Report on Form 10-KSB for the year ended December 31, 2003 (Commission File No. 000-29599)).
10(a)(12)	2005 Director Stock Award Plan (incorporated by reference to Exhibit 10(a)(12) to Bancorp s Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 (Commission File No. 000 - 295999)).
10(a)(14)	Change of Control Agreement, dated as of January 1, 2007 among Philip W. Wolford, Patriot National Bank and Bancorp (incorporated by reference to Exhibit 10(a)(14) to Bancorp s Annual Report on Form 10-K for the year ended December 31, 2006 (Commission File No. 000-29599)).
10(a)(15)	Formal Written Agreement between Patriot National Bank and the Office of the Comptroller of the Currency (incorporated by reference to Exhibit 10(a)(15) to Bancorp s Current Report on Form 8-K dated February 9, 2009 (Commission File No. 000-29599)).
10(a)(16)	Formal Written Agreement between Patriot National Bank and the Federal Reserve Bank of New York (incorporated by reference to Exhibit 10(a)(16) to Bancorp s Annual Report on Form 10-K for the year ended December 31, 2010 (Commission File No. 000-29599)).
10(a)(17)	Financial Services Agreement dated November 8, 2011 of Bancorp (incorporated by reference to Exhibit 10(a)(20) on the Quarterly Report on Form 10-Q dated November 10, 2011.
10(c)	1999 Stock Option Plan of the Bank (incorporated by reference to Exhibit 10(c) to Bancorp s Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)).
14	Code of Conduct for Senior Financial Officers (incorporated by reference to Exhibit 14 to Bancorp s Annual Report on Form 10 -KSB for the year ended December 31, 2004 (Commission File No. 000-29599).

No.	Description
21	Subsidiaries of Bancorp (incorporated by reference to Exhibit 21 to Bancorp s Annual Report on Form 10-KSB for the year ended December 31, 1999 (Commission File No. 000-29599)).
31(1)	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31(2)	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32	Section 1350 Certifications
101.INS#	XBRL Instance Document
101.SCH#	XBRL Schema Document
101.CAL#	XBRL Calculation Linkbase Document
101.LAB#	XBRL Labels Linkbase Document
101.PRE#	XBRL Presentation Linkbase Document
101.DEF#	XBRL Definition Linkbase Document

The exhibits marked with the section symbol (#) are interactive data files. Pursuant to Rule 406T of Regulations S-T, these interactive data files (i) are not deemed filed or part of a registration statement of prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, are not deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, irrespective of any general incorporation language included in any such filings, and otherwise are not subject to liability under these sections; and (ii) are deemed to have complied with Rule 405 of Regulations S-T (Rule 405) and are not subject to liability under the anti-fraud provisions of the Section 17(a)(1) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 or under any other liability provision if we have made a good faith attempt to comply with Rule 405 and, after we become aware that the interactive data files fail to comply with Rule 405, we promptly amend the interactive data files.

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SIGNATURES

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

PATRIOT NATIONAL BANCORP, INC.
(Registrant)

By: /s/ Robert F. O Connell
Robert F. O Connell,
Senior Executive Vice President
Chief Financial Officer

(On behalf of the registrant and as chief financial officer)

November 14, 2012