DIME COMMUNITY BANCSHARES INC
Form 10-Q
November 09, 2010

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

FORM 10-Q

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

For the quarterly period ended September 30, 2010

OR

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

For the transition period from to

Commission file number 0-27782

Dime Community Bancshares, Inc.
(Exact name of registrant as specified in its charter)

Delaware	11-3297463
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification number)
209 Havemeyer Street, Brooklyn, NY	11211
(Address of principal executive offices)	(Zip Code)

(718) 782-6200
(Registrant's telephone number, including area code)

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

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. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

LARGE ACCELERATED FILER ___	ACCELERATED FILER X	NON -ACCELERATED FILER ___	SMALLER REPORTING COMPANY ___

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES NO X

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

Classes of Common Stock	Number of Shares Outstanding at November 8, 2010
$.01 Par Value	34,583,180

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Certain statements contained in this quarterly report on Form 10-Q that are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the “Act”), notwithstanding that such statements are not specifically identified as such. In addition, certain statements may be contained in future filings with the U.S. Securities and Exchange Commission (the "SEC"), press releases, and oral and written statements made by management or with its approval that are not statements of historical fact and constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, expenses, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other financial items; (ii) statements of plans, objectives and expectations of Dime Community Bancshares, Inc. and its subsidiaries (the "Company") or those of its management or board of directors, including those relating to products or services; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements.

Forward-looking statements include information concerning possible or assumed future results of operations and statements preceded by, followed by or that include the words “believes,” “expects,” “feels,” “anticipates,” “intends,” “pl “estimates,” “predicts,” “projects,” “potential,” “outlook,” “could,” “will,” “may” or similar expressions. Forward-looking s are not guarantees of future performance and are subject to risks, uncertainties and assumptions. Actual results may differ materially from those expressed in or implied by these forward-looking statements. Factors that could cause actual results to differ from these forward-looking statements include, but are not limited to, the following, as well as those discussed elsewhere in this report and the documents incorporated by reference herein:

- the timing and occurrence or non-occurrence of events may be subject to circumstances beyond the Company's control;
- there may be increases in competitive pressure among financial institutions or from non-financial institutions;

- changes in the interest rate environment may reduce interest margins;
- changes in deposit flows, loan demand or real estate values may adversely affect the business of The Dime Savings Bank of Williamsburgh (the "Bank");
- changes in accounting principles, policies or guidelines may cause the Company's financial condition to be perceived differently;
- changes in corporate and/or individual income tax laws may adversely affect the Company's business or financial condition;
- general economic conditions, either nationally or locally in some or all areas in which the Company conducts business, or conditions in the securities markets or banking industry, may be less favorable than currently anticipated;
- legislation or regulatory changes may adversely affect the Company's business;
- technological changes may be more difficult or expensive than the Company anticipates;
- success or consummation of new business initiatives may be more difficult or expensive than the Company anticipates;
- litigation or other matters before regulatory agencies, whether currently existing or commencing in the future, may delay the occurrence or non-occurrence of events longer than the Company anticipates; and
- the risks referred to in the section entitled "Risk Factors."

Undue reliance should not be placed on any forward-looking statements. Forward-looking statements speak only as of the date they are made, and the Company undertakes no obligation to update them in light of new information or future events except to the extent required by Federal securities laws.

Item 1. Condensed Consolidated Financial Statements

DIME COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Dollars in thousands except share amounts)

	September 30, 2010	December 31, 2009
ASSETS:		
Cash and due from banks	$70,761	$39,338
Federal funds sold and other short-term investments	23,848	3,785
Investment securities held-to-maturity (estimated fair value of $3,865 and $5,330 at September 30, 2010 and December 31, 2009, respectively) (Fully unencumbered)	6,639	7,240
Investment securities available-for-sale, at fair value ($52,935 and $27,646 encumbered at September 30, 2010 and December 31, 2009, respectively)	64,675	43,162
Mortgage-backed securities available-for-sale, at fair value ($159,535 and $221,048 encumbered at September 30, 2010 and December 31, 2009, respectively)	165,221	224,773
Trading securities	1,420	-
Loans:		
One-to-four family and cooperative apartment	119,991	131,475
Multifamily residential and underlying cooperative	2,456,348	2,377,278
Commercial real estate	823,018	834,724
Construction and land acquisition	16,348	44,544
Unearned discounts and net deferred loan fees	4,526	4,017
Total real estate loans, net	3,420,231	3,392,038
Other loans	2,327	3,221
Less allowance for loan losses	(16,942)	(21,505)
Total loans, net	3,405,616	3,373,754
Loans held for sale	4,879	416
Premises and fixed assets, net	31,224	29,841
Federal Home Loan Bank of New York ("FHLBNY") capital stock	47,848	54,083
Other real estate owned ("OREO")	85	755
Goodwill	55,638	55,638
Other assets	118,914	119,489
Total Assets	$3,996,768	$3,952,274
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Due to depositors:		
Interest bearing deposits	$2,260,700	$2,110,387
Non-interest bearing deposits	119,966	106,449
Total deposits	2,380,666	2,216,836
Escrow and other deposits	91,965	65,895
Securities sold under agreements to repurchase	195,000	230,000
FHLBNY advances	904,525	1,009,675
Subordinated notes payable	-	25,000
Trust Preferred securities payable	70,680	70,680
Other liabilities	31,470	39,415
Total Liabilities	$3,674,306	$3,657,501

Commitments and Contingencies		
Stockholders' Equity:		
Preferred stock ($0.01 par, 9,000,000 shares authorized, none issued or outstanding at September 30, 2010 and December 31, 2009)	-	-
Common stock ($0.01 par, 125,000,000 shares authorized, 51,151,115 shares and 51,131,784 shares issued at September 30, 2010 and December 31, 2009, respectively, and 34,547,769 shares and 34,395,531 shares outstanding at September 30, 2010 and December 31, 2009, respectively)	$511	$511
Additional paid-in capital	224,239	214,654
Retained earnings	323,777	306,787
Accumulated other comprehensive loss, net of deferred taxes	(5,073)	(5,082)
Unallocated common stock of Employee Stock Ownership Plan ("ESOP")	(3,528)	(3,701)
Unearned Restricted Stock Award common stock	(3,226)	(2,505)
Common stock held by Benefit Maintenance Plan ("BMP")	(7,979)	(8,007)
Treasury stock, at cost (16,603,346 shares and 16,736,253 shares at September 30, 2010 and December 31, 2009, respectively)	(206,259)	(207,884)
Total Stockholders' Equity	$322,462	$294,773
Total Liabilities And Stockholders' Equity	$3,996,768	$3,952,274

See notes to condensed consolidated financial statements.

DIME COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(Dollars in thousands except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Interest income:				
Loans secured by real estate	$50,648	$48,422	$151,839	$144,412
Other loans	28	35	97	110
Mortgage-backed securities	1,846	2,748	6,199	8,997
Investment securities	290	76	1,009	515
Federal funds sold and other short-term investments	702	809	2,125	2,170
Total interest income	53,514	52,090	161,269	156,204
Interest expense:				
Deposits and escrow	7,383	9,156	22,986	35,086
Borrowed funds	11,855	13,965	38,036	41,720
Total interest expense	19,238	23,121	61,022	76,806
Net interest income	34,276	28,969	100,247	79,398
Provision for loan losses	667	3,769	7,948	8,661
Net interest income after provision for loan losses	33,609	25,200	92,299	70,737
Non-interest income:				
Total other than temporary impairment ("OTTI") losses	(1,858)	(675)	(2,594)	(7,939)
Less: Non-credit portion of OTTI recorded in other comprehensive income (before taxes)	219	119	282	1,457
Net OTTI recognized in earnings	(1,639)	(556)	(2,312)	(6,482)
Service charges and other fees	1,284	1,376	3,165	3,118
Net mortgage banking (loss) income	316	246	829	(66)
Net gain on securities and sales of other assets (1)	76	-	861	339
Income from bank owned life insurance	472	511	1,464	1,506
Other	559	527	2,028	1,500
Total non-interest income (loss)	1,068	2,104	6,035	(85)
Non-interest expense:				
Salaries and employee benefits	7,497	7,047	22,966	20,586
Stock benefit plan amortization expense	1,017	894	2,957	2,772
Occupancy and equipment	2,190	1,926	7,096	5,894
Federal deposit insurance premiums	1,116	960	3,099	4,531
Data processing costs	766	754	2,328	2,240
Provision for losses on OREO	65	-	422	-
Other	2,241	2,060	7,506	6,550
Total non-interest expense	14,892	13,641	46,374	42,573
Income before income taxes	19,785	13,663	51,960	28,079
Income tax expense	8,430	5,337	21,131	9,987
Net income	$11,355	$8,326	$30,829	$18,092
Earnings per Share:				
Basic	$0.34	$0.25	$0.93	$0.55
Diluted	$0.34	$0.25	$0.93	$0.55

(1) Amount includes periodic valuation gains or losses on trading securities.

STATEMENTS OF COMPREHENSIVE INCOME

Net Income	$11,355	$8,326	$30,829	$18,092
Amortization and reversal of net unrealized loss on securities transferred from available-for-sale to held-to-maturity, net of taxes of $12 and $51 during the three months ended September 30, 2010 and 2009, respectively, and $41 and $858 during the nine months ended September 30, 2010 and 2009, respectively	15	61	51	1,042
Reduction in non-credit component of OTTI charge, net of taxes of $601 and $217 during the three months ended September 30, 2010 and 2009, respectively, and $905 and $385 during the nine months ended September 30, 2010 and 2009, respectively	731	263	1,101	467
Non-credit component of OTTI charge recognized during the period, net of tax benefits of $(99) and $(54) during the three months ended September 30, 2010 and 2009, respectively, and $(126) and $(658) during the nine months ended September 30, 2010 and 2009, respectively	(120)	(65)	(156)	(799)
Reclassification adjustment for securities sold during the period, net of taxes of $384 and $127 during the nine months ended September 30, 2010 and 2009, respectively	-	-	(467)	(236)
Net unrealized securities gains arising during the period, net of taxes of $(348) and $1,166 during the three months ended September 30, 2010 and 2009, respectively, and $131 and $4,621 during the nine months ended September 30, 2010 and 2009, respectively	(422)	1,416	160	5,850
Defined benefit plan adjustments, net of tax benefits of $(560) during the nine months ended September 30, 2010	-	-	(680)	-
Comprehensive Income	$11,559	$10,001	$30,838	$24,416

See notes to condensed consolidated financial statements.

DIME COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Dollars in thousands)

	Nine Months Ended September 30,	
	2010	2009
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY		
Common Stock (Par Value $0.01):		
Balance at beginning of period	$511	$511
Balance at end of period	511	511
Additional Paid-in Capital:		
Balance at beginning of period	214,654	213,917
Stock options exercised	165	43
Forfeited restricted stock award shares returned to treasury stock	3	-
Tax (expense) benefit of stock plans	88	(130)
BMP award distribution	(28)	-
BMP reclassification	8,007	-
Amortization of excess fair value over cost – ESOP stock and stock options expense	1,303	1,266
Release from treasury stock for restricted stock award shares	47	(842)
Balance at end of period	224,239	214,254
Retained Earnings:		
Balance at beginning of period	306,787	297,848
Net income for the period	30,829	18,092
Cash dividends declared and paid	(13,971)	(13,865)
Cumulative effect adjustment for the adoption of Accounting Standards Codification ("ASC") 320-10-65, net of taxes of $1,034	-	1,255
BMP reclassification	132	-
Balance at end of period	323,777	303,330
Accumulated Other Comprehensive Loss, net of tax:		
Balance at beginning of period	(5,082)	(11,111)
Cumulative effect adjustment for the adoption of ASC 320-10-65, net of taxes of $1,034 during the nine months ended September 30, 2009	-	(1,255)
Amortization and reversal of net unrealized loss on securities transferred from available-for-sale to held-to-maturity, net of tax	51	1,042
Non-credit component of OTTI charge recognized during the period, net of tax	(156)	(799)
Reduction in non-credit component of OTTI during the period, net of tax	1,101	467
Decrease in unrealized loss on available-for-sale securities during the period	(307)	5,614
Adjustments related to defined benefit plans, net of tax	(680)	-
Balance at end of period	(5,073)	(6,042)
ESOP:		
Balance at beginning of period	(3,701)	(3,933)
Amortization of earned portion of ESOP stock	173	174
Balance at end of period	(3,528)	(3,759)
Unearned Restricted Stock Award Common Stock:		
Balance at beginning of period	(2,505)	(1,790)
Amortization of earned portion of restricted stock awards	954	775
Forfeited restricted stock award shares returned to treasury stock	149	-
Release from treasury stock for restricted stock award shares	(1,824)	(1,745)
Balance at end of period	(3,226)	(2,760)

Treasury Stock, at cost:		
Balance at beginning of period	(207,884)	(210,471)
Forfeited restricted stock award shares returned to treasury stock	(152)	-
Release from treasury stock for restricted stock award shares	1,777	2,587
Balance at end of period	(206,259)	(207,884)
Common Stock Held by BMP:		
Balance at beginning of period	(8,007)	(8,007)
BMP award distribution	28	-
Balance at end of period	(7,979)	(8,007)
TOTAL STOCKHOLDERS' EQUITY	$322,462	$289,643

See notes to condensed consolidated financial statements.

DIME COMMUNITY BANCSHARES, INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars In thousands)

	Nine Months Ended September 30 ,	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	$30,829	$18,092
Adjustments to reconcile net income to net cash provided by operating activities:		
Net loss on sale of OREO	10	92
Net gain on sale of loans originated for sale	(321)	(674)
Net gain on sale of investment securities available-for-sale	(609)	(431)
Net gain recognized on the transfer of securities from available-for-sale into trading	(242)	-
Net gain on trading securities	(20)	-
Net depreciation and amortization	1,892	1,932
ESOP compensation expense	740	590
Stock plan compensation (excluding ESOP)	1,690	1,625
Provision for loan losses	7,948	8,661
Provision for losses on OREO	422	-
Provision to increase the liability for loans sold with recourse	-	1,403
Recovery of write down of mortgage servicing asset	-	(60)
OTTI charge for investment securities recognized in earnings	2,312	6,482
Increase in cash surrender value of Bank Owned Life Insurance	(1,464)	(1,506)
Deferred income tax credit	696	(6,082)
Excess tax cost (benefit) of stock plans	(88)	130
Changes in assets and liabilities:		
Origination of loans held for sale	(22,361)	(14,743)
Proceeds from sale of loans held for sale	22,753	115,417
Decrease in other assets	1,317	547
(Decrease) Increase in other liabilities	(938)	10,982
Net cash provided by operating activities	44,566	142,457
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net increase in federal funds sold and other short term investments	(20,063)	(560)
Proceeds from principal repayments of investment securities held-to-maturity	124	202
Proceeds from maturities of investment securities available-for-sale	-	100
Proceeds from calls and principal repayments of investment securities available-for-sale	46,510	-
Proceeds from sales of investment securities available-for-sale	2,519	10,359
Purchases of investment securities available-for-sale	(71,429)	(22,000)
Principal collected on mortgage backed securities available-for-sale	59,062	63,846
Purchases of mortgage backed securities available-for-sale	-	-
Net increase in loans	(44,664)	(120,131)
Proceeds from the sale of OREO	558	208
Purchases of fixed assets, net	(3,027)	(792)
Redemption of FHLBNY capital stock	6,235	1,602
Net cash used in investing activities	(24,175)	(67,166)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in due to depositors	163,830	(64,053)

Net increase (decrease) in escrow and other deposits	26,070	(48,806)
Decrease in securities sold under agreements to repurchase	(35,000)	-
Decrease in FHLBNY advances	(105,150)	(60,000)
Repayment of subordinated note	(25,000)	_
Cash dividends paid	(13,971)	(13,865)
Exercise of stock options	165	43
Excess tax (cost) benefit of stock plans	88	(130)
Net cash provided by (used in) financing activities	11,032	(186,811)
INCREASE (DECREASE) IN CASH AND DUE FROM BANKS	31,423	(111,520)
CASH AND DUE FROM BANKS, BEGINNING OF PERIOD	39,338	211,020
CASH AND DUE FROM BANKS, END OF PERIOD	$70,761	$99,500
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for income taxes	$22,385	$8,189
Cash paid for interest	61,801	76,548
Loans transferred to OREO	320	168
Portfolio loans transferred to held for sale	-	100,000
Amortization of unrealized loss on securities transferred from available-for-sale to held-to-maturity	92	166
Reversal of unrealized loss on securities transferred from available-for-sale to held-to-maturity	-	1,734
Net decrease in the non-credit component of OTTI	(1,724)	(605)
Adjustments to other comprehensive income from defined benefit plans, net of tax	$(680)	-

See notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. NATURE OF OPERATIONS

Dime Community Bancshares, Inc. (the "Holding Company") is a Delaware corporation and parent company of the Bank, a federally-chartered stock savings bank. The Holding Company's direct subsidiaries are the Bank, Dime Community Capital Trust 1 and 842 Manhattan Avenue Corp. The Bank's direct subsidiaries are Boulevard Funding Corp., Dime Insurance Agency Inc. (f/k/a Havemeyer Investments, Inc.), DSBW Preferred Funding Corporation, DSBW Residential Preferred Funding Corp., Dime Reinvestment Corp. and 195 Havemeyer Corp.

The Bank maintains its headquarters in the Williamsburg section of Brooklyn, New York and operates twenty-five full service retail banking offices located in the New York City boroughs of Brooklyn, Queens, and the Bronx, and in Nassau County, New York. The Bank’s principal business is gathering deposits from customers within its market area and via the internet, and investing them primarily in multifamily residential, commercial real estate, one- to four-family residential, construction and land acquisition, and consumer loans, as well as mortgage-backed securities (“MBS”), obligations of the U.S. Government and Government Sponsored Entities ("GSEs"), and corporate debt and equity securities.

2. SUMMARY OF ACCOUNTING POLICIES

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary for a fair presentation of the Company's financial condition as of September 30, 2010, the results of operations and statements of comprehensive income for the three-month and nine-month periods ended September 30, 2010 and 2009, and the changes in stockholders' equity and cash flows for the nine months ended September 30, 2010 and 2009. The results of operations for the three-month and nine-month periods ended September 30, 2010 are not necessarily indicative of the results of operations for the remainder of the year ending December 31, 2010. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been omitted pursuant to the rules and regulations of the SEC.

The preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Please see “Item 2. - Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies” for a discussion of areas in the accompanying condensed consolidated financial statements where significant estimates are utilized.

These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements as of and for the year ended December 31, 2009 and notes thereto.

3. RECENT ACCOUNTING PRONOUNCEMENTS

In July 2010. the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2010-20, "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses" ("ASU 2010-20"). ASU 2010-20 requires companies to provide a greater level of disaggregated information regarding: (1) the credit quality of their financing receivables; and (2) their allowance for credit losses. ASU 2010-20 further

requires companies to disclose credit quality indicators, past due information, and modifications of their financing receivables. For public companies, ASU 2010-20 is effective for interim and annual reporting periods ending on or after December 15, 2010. ASU 2010-20 encourages, but does not require, comparative disclosures for earlier reporting periods that ended before initial adoption. Adoption of ASU 2010-20 is not expected to have a material impact upon the Company's consolidated financial condition or results of operations.

In February 2010, the FASB issued ASU No. 2010-11, "Derivatives and Hedging (Topic 815) – Scope Exception Related to Embedded Credit Derivatives" ("ASU 2010-11"). ASU 2010-11 clarifies the type of embedded credit derivative that is exempt from embedded derivative bifurcation (separate accounting) requirements, and addresses various accounting issues associated with subordination of one financial instrument to another. ASU 2010-11 affirms that a credit derivative feature related to the transfer of credit risk that is the only form of subordination of one financial instrument to another is not subject to the embedded derivative bifurcation requirement. Under ASU 2010-11, entities that have contracts containing an embedded credit derivative feature in a form other than such subordination may thus need to separately account for the embedded credit derivative feature. In initially adopting ASU 2010-11, an entity may elect the fair value option for any investment in a beneficial interest in a securitized financial asset. The election must be made on an instrument-by-instrument basis at the beginning of the fiscal quarter of initial adoption. However, an entity must perform an impairment analysis of the investment before the initial adoption. ASU 2010-11 is effective at the beginning of an entity’s first fiscal quarter commencing after June 15, 2010. Adoption of ASU 2010-11 did not have a material effect upon the Company's financial condition or results of operations.

In January 2010, FASB issued Accounting Standards Update No. 2010-06, " Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements" ("ASU 2010-6"). ASU 2010-6 required new disclosures related to transfers in and out of fair value hierarchy Levels 1 and 2, as well as certain activities for assets whose fair value is measured under the Level 3 hierarchy. ASU 2010-6 also provided amendments clarifying the level of disaggregation and disclosures about inputs and valuation techniques along with conforming amendments to the guidance on employers' disclosures about postretirement benefit plan assets. ASU 2010-6 was effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the rollforward of activity in Level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Adoption of ASU 2010-6 has not had, and is not expected to have, a material impact upon the Company's financial condition or results of operations.

4. TREASURY STOCK

The Company did not repurchase any shares of treasury stock during the nine months ended September 30, 2010 and 2009. On April 30, 2010, 143,083 shares of the Company's common stock were released from treasury in order to fulfill benefit obligations under the Company's 2004 Stock Incentive Plan. The closing price of the Company's common stock on that date was $12.75. The shares were released utilizing the average historical cost method.

During the nine months ended September 30, 2010, the Company returned 10,176 forfeited restricted stock awards into treasury stock.

5. ACCOUNTING FOR GOODWILL

The Company has designated the last day of its fiscal year as its date for annual impairment testing. The Company performed an impairment test as of December 31, 2009 and concluded that no impairment of goodwill existed. No events or circumstances have occurred subsequent to December 31, 2009 that would reduce the fair value of the Company's reporting unit below its carrying value. Such events or circumstances would require the immediate performance of an impairment test in accordance with ASC 350.

6. EARNINGS PER SHARE ("EPS")

EPS is calculated and reported in accordance with ASC 260. For entities like the Company with complex capital structures, ASC 260 requires disclosure of basic EPS and diluted EPS on the face of the income statement, along with a reconciliation of their numerators and denominators.

Basic EPS is computed by dividing net income by the weighted-average number of common shares outstanding during the period (weighted-average common shares are adjusted to exclude unallocated ESOP shares). Diluted EPS is computed using the same method as basic EPS, however, the computation reflects the potential dilution that would occur if outstanding in-the-money stock options were exercised and converted into common stock.

The following is a reconciliation of the numerators and denominators of basic EPS and diluted EPS for the periods presented:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in Thousands)			
Numerator:				
	$11,355	$8,326	$30,829	$18,092

Net Income per the Consolidated Statements of Operations				
Denominator:				
Weighted-average number of shares outstanding utilized in the calculation of basic EPS	33,297,297	33,094,672	33,237,395	33,001,416
Common stock equivalents resulting from the dilutive effect of "in-the-money" outstanding stock options	110,192	39,429	104,329	4,196
Anti-dilutive effect of tax benefits associated with "in-the-money" outstanding stock options	(12,967)	(7,160)	(13,150)	(63)
Weighted average number of shares outstanding utilized in the calculation of diluted EPS	33,394,522	33,126,941	33,328,574	33,005,549

Common stock equivalents resulting from the dilutive effect of "in-the-money" outstanding stock options are calculated based upon the excess of the average market value of the Holding Company's common stock over the exercise price of outstanding in-the-money stock options during the period.

There were 2,666,287 and 2,703,186 weighted-average stock options outstanding for the three-month periods ended September 30, 2010 and 2009, respectively, that were not considered in the calculation of diluted EPS since their exercise prices exceeded the average market price during the period. There were 2,721,171 and 3,081,287 weighted-average stock options outstanding for the nine-month periods ended September 30, 2010 and 2009, respectively, that were not considered in the calculation of diluted EPS since their exercise prices exceeded the average market price during the period.

7. ACCOUNTING FOR STOCK BASED COMPENSATION

During the three-month and nine-month periods ended September 30, 2010 and 2009, the Holding Company and Bank maintained the Dime Community Bancshares, Inc. 1996 Stock Option Plan for Outside Directors, Officers and Employees; the Dime Community Bancshares, Inc. 2001 Stock Option Plan for Outside Directors, Officers and Employees; and the 2004 Stock Incentive Plan (collectively the "Stock Plans"), which are discussed more fully in Note 15 to the Company's audited consolidated financial statements for the year ended December 31, 2009, and which are subject to the accounting requirements of ASC 505-50 and ASC 718.

Stock Option Awards

Combined activity related to stock options granted under the Stock Plans during the periods presented was as follows:

	At or for the Three Months Ended September 30,		At or for the Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in Thousands, Except per Share Amounts)			
Options outstanding – beginning of period	3,327,984	3,319,135	3,266,920	3,116,564
Options granted	-	-	97,294	205,633
Weighted average exercise price of grants	-	-	$12.75	$8.34
Options exercised	-	9,465	19,331	9,465
Weighted average exercise price of exercised options	-	$4.56	8.53	$4.56
Options forfeited	-	22,750	16,899	25,812
Weighted average exercise price of forfeited options	-	$17.67	$14.30	$17.34
Options outstanding – end of period	3,327,984	3,286,920	3,327,984	3,286,920
Weighted average exercise price of outstanding options at the end of period	$14.54	$14.57	$14.54	$14.57
Remaining options available for grant	553,738	747,040	553,738	747,040
Exercisable options at end of period	2,860,928	2,558,915	2,860,928	2,558,915
Weighted average exercise price of exercisable options at the end of period	$14.86	$15.17	$14.86	$15.17
Cash received for option exercise cost	-	43	165	43
Income tax benefit recognized	-	-	20	-
Compensation expense recognized	246	233	738	850
Remaining unrecognized compensation expense	928	1,574	928	1,574
Weighted average remaining years for which compensation expense is to be recognized	1.8	2.1	1.8	2.1

The range of exercise prices and weighted-average remaining contractual lives of options outstanding, vested and unvested, under the Stock Plans were as follows:

Outstanding Options as of September 30, 2010				
Range of Exercise Prices	Amount	Weighted Average Exercise Price	Weighted Average Contractual Years Remaining	Vested Options as of September 30, 2010
$8.00 - $8.50	187,709	$8.34	8.6	86,695
10.50 - $$11.00	376,694	10.91	1.1	376,694
12.50 - $$13.00	97,294	12.75	9.6	-
$13.01-$13.50	526,566	13.16	2.3	526,566
$13.51-$14.00	930,125	13.74	6.6	709,125
$14.50-$15.00	34,425	14.92	7.4	17,212
$15.01-$15.50	318,492	15.10	4.7	318,492
$16.00-$16.50	76,320	16.45	4.3	76,320
$16.51-$17.00	61,066	16.73	7.8	30,531
$18.00-$18.50	80,000	18.18	7.7	80,000
$19.50-$20.00	639,293	19.90	3.3	639,293
Total	3,327,984	$14.54	4.7	2,860,928

The weighted average exercise price and contractual years remaining for vested options under the Stock Plans were $14.86 and 4.2 years, respectively, at September 30, 2010. There were no grants of options during the three months ended September 30, 2010 and 2009. The weighted average fair value per option at the date of grant for stock options granted during the nine months ended September 30, 2010 and 2009 was estimated as follows:

	Nine Months Ended September 30,	
	2010	2009
Total options granted	97,294	205,633
Estimated fair value on date of grant	$ 3.70	$ 1.73
Pricing methodology utilized	Black-Scholes	Black-Scholes
Expected life (in years)	5.99	5.99
Interest rate	2.76 %	2.39 %
Volatility	43.69	41.34
Dividend yield	4.39	6.72

Restricted Stock Awards

The Company, from time to time, issues restricted stock awards to outside directors and officers under the 2004 Stock Incentive Plan. Typically, awards to outside directors fully vest on the first anniversary of the grant date, while awards to officers vest in equal annual installments over a four- or five-year period.

The following is a summary of activity related to the restricted stock awards granted under the 2004 Stock Incentive Plan during the periods indicated:

	At or for the Three Months Ended September 30,		At or for the Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in Thousands)			
Unvested allocated shares – beginning of period	332,866	295,066	295,066	141,710
Shares granted	-	-	143,083	207,197
Shares vested	-	-	95,107	52,810
Shares forfeited	-	-	10,176	1,031
Unvested allocated shares – end of period	332,866	295,066	332,866	295,066
Unallocated shares - end of period	-	-	-	-
Compensation recorded to expense	$347	$255	$954	$775
Income tax (expense) benefit recognized	-	25	68	(131)

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8. ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for loan losses for loans owned by the Bank were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in Thousands)			
Balance at beginning of period	$23,350	$19,991	$21,505	$17,454
Provision for loan losses	667	3,769	7,948	8,661
Charge-offs	(6,817)	(3,619)	(12,610)	(6,038)
Recoveries	-	-	-	15
Transfer from (to) reserves on loan commitments	(258)	120	99	169
Balance at end of period	$16,942	$20,261	$16,942	$20,261

Management's quarterly evaluation of the loan loss reserves considers not only performance of the current owned and serviced loan portfolios, but also general credit conditions and volume of new business, in determining the timing and amount of any future credit loss provisions. The provision for loan losses recognized during the three-month and nine-month periods ended September 30, 2010 and 2009 reflected the conditions existing in the Company's local real estate marketplace during these periods. Please see “Item 2. - Management's Discussion and Analysis of Financial Condition and Results of Operations – Allowance for Loan Losses and Reserve Liability on Loan Origination Commitments” for a further discussion of activity related to the allowance for loan losses during the three and nine month periods ended September 30, 2010 and 2009.

9. FIRST LOSS EXPOSURE ON SERVICED LOANS

From December 2002 through February 2009, the Bank sold multifamily loans to Fannie Mae ("FNMA"). Pursuant to the sale agreement, the Bank retained an obligation (off-balance sheet contingent liability) to absorb a portion of any losses (as defined in the agreement) incurred by FNMA in connection with the loans sold (the "First Loss Position"). The Bank has established a liability account for probable credit losses in connection with the First Loss Position. The reserve liability, similar to the Company’s calculation for our allowance for loan losses, is determined based upon an analysis of two components: performing and non-performing loans. Provisions for performing loans are applied the same loss percentage at origination as is applied to comparable loans originated for portfolio. Since the first loss position is not impacted by loan seasoning, no adjustments are made to the initial loss percentages applied to the FNMA performing loans. Delinquent potential problem loans are individually evaluated for impairment and a reserve is established for probable credit losses.

The following is a summary of the aggregate balance of multifamily loans serviced for FNMA, the period-end balance of the total First Loss Position associated with these loans, and activity related to the liability established for the First Loss Position.

	At or for the Three Months Ended September 30,		At or for the Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in Thousand)			
Outstanding balance of multifamily loans serviced for FNMA at period end	$392,582	$450,238	$392,582	$450,238
Total First Loss Position at end of period	18,697	21,865	18,697	21,865

Liability Against the Total First Loss Position				
Balance at beginning of period	$2,993	$3,459	$4,373	$5,573
Additions for loans sold during the period	-	-	-	15
Transfer out for serviced loans re-acquired by the Bank	-	(178)	(1,123)	(3,545)
Provision for losses on problem loans(1)	-	-	-	1,403
Charge-offs and other net reductions in balance	-	(22)	(257)	(187)
Balance at period end	$2,993	$3,259	$2,993	$3,259

(1) Amount recognized as a component of mortgage banking income during the period.

During the nine-months ended September 30 2010, the Bank received approval from FNMA to reduce the total First Loss Position by $1.5 million for losses incurred. As of September 30, 2010, the Bank had outstanding requests for approval from FNMA to reduce the First Loss Position by an additional $3.6 million for losses incurred on loans sold during the nine months ended September 30, 2010. In October 2010, FNMA approved $1.9 million of this amount, with the remaining $1.7 million still pending approval.

The Bank has elected to periodically repurchase problematic or non-problematic loans from within the FNMA serviced loan pool. The repurchase of problematic loans are made in order to expedite their resolution and control losses. All such elections have been made on an individual loan/borrower basis. All repurchases from FNMA are made at par, and any reserves recognized on the re-acquired loan within the FNMA reserve analysis serve to reduce

the recorded balance of the loan when it is transferred to the Bank's portfolio. In most instances, all economic losses realized by the Bank on the re-acquired loans can be applied against the First Loss Position, and any material exceptions for individual loans are disclosed in the Company's public filings.

From January 2009 through September 30, 2010, 18 problematic loans totaling $24.0 million were repurchased at par from FNMA, and aggregate economic losses of $8.1 million were recognized on these loans, of which $5.3 million were recognized prior to re-acquisition and $2.8 million were recognized subsequent to re-acquisition. As of September 30, 2010, FNMA had approved an aggregate reduction of $5.0 million to the First Loss Position as a result of losses incurred by the Bank on this pool of loans.

Since the Bank is fully responsible for all losses on loans up to our first loss position, it has greater incentive to minimize losses. Had the resolution of these loans been left to FNMA to manage, management believes that the ultimate losses recognized would have been greater.

During the three months ended September 30, 2010, the Bank did not re-acquire any problematic loans within the pool of loans serviced for FNMA. During the three months ended September 30, 2009, the Bank re-acquired three problematic loans within the pool of loans serviced for FNMA having an aggregate principal balance of $1.8 million. Upon re-acquisition, aggregate liabilities of $178,000 that were recorded related to these loans within the liability for the First Loss Position served to reduce the outstanding principal balance of the loans (reflecting a write-down of their outstanding principal balance to the lower of the current appraised or likely realizable value of the loan or underlying collateral). During the nine months ended September 30, 2010, the Bank re-acquired sixteen loans (problematic or non-problematic) within the pool of loans serviced for FNMA having an aggregate principal balance of $22.3 million. Upon re-acquisition, aggregate liabilities of $1.1 million that were recorded related to problematic loans within the liability for the First Loss Position served to reduce the outstanding principal balance of the loans (reflecting a write-down of their outstanding principal balance to the likely realizable value of the loan or underlying collateral). During the nine months ended September 30, 2009, the Bank re-acquired eleven problem loans within the pool of loans serviced for FNMA having an aggregate principal balance of $8.8 million. Upon re-acquisition, aggregate liabilities of $3.6 million that were recorded related to these loans within the liability for the First Loss Position served to reduce the outstanding principal balance of the loans (reflecting a write-down of their outstanding principal balance to the likely realizable value of the loan or underlying collateral).

10. INVESTMENT AND MORTGAGE-BACKED SECURITIES

The following is a summary of major categories of securities owned by the Company at September 30, 2010.

			Unrealized Gains or Losses Recognized in Accumulated Other Comprehensive Loss					
	Purchase Amortized / Historical Cost	Recorded Amortized/ Historical Cost (1)	Non-Credit OTTI	Unrealized Gains	Unrealized Losses	Book Value	Other Unrealized Losses	Fair Value
	(Dollars in Thousands)							
Held-to-Maturity:								
Pooled bank trust preferred securities	$ 19,431	$ 11,347	$ (2,700)	-	$ (2,008)(2)	$ 6,639	$ (2,774)	$ 3,865
Available-for-sale:								
Mutual fund investments	4,924	3,500	-	733	-	4,233	-	4,233
Agency notes	60,390	60,390	-	52	-	60,442	-	60,442

Pass-through MBS issued by GSEs	113,667	113,667	-	6,241	-	119,908		119,908
Collateralized mortgage obligations ("CMOs") issued by GSEs	39,208	39,208	-	1,295	-	40,503	-	40,503
Private issuer pass through MBS	2,495	2,495	-	-	(94)	2,401	-	2,401
Private issuer CMOs	2,344	2,344	-	65	-	2,409	-	2,409
Total	$ 242,459	$ 232,951	$ (2,700)	$ 8,386	$ (2,102)	$ 236,535	$ (2,774)	$ 233,761

(1) Amount represents the purchase amortized / historical cost less any credit-related OTTI charges recognized through earnings.
(2) Amount represents the unamortized portion of the unrealized loss that was recognized in accumulated other comprehensive loss on
September 1, 2008 (the day on which these securities were transferred from available-for-sale to held-to-maturity).

The pooled bank trust preferred securities held-to-maturity had a weighted average term to maturity of 24.4 years at September 30, 2010.

At September 30, 2010, the agency note investments in the above table had contractual maturities as follows:

	Amortized Cost	Estimated Fair Value
	(Dollars in Thousands)	
Due after one year through five years	$ 60,000	$ 60,050
Due after five years through ten years	390	392
	$ 60,390	$ 60,442

At September 30, 2010, MBS available-for-sale (which include pass-through MBS issued by GSEs, CMOs issued by GSEs, private issuer pass through MBS and private issuer CMOs) possessed a weighted average contractual maturity of 16.9 years and a weighted average estimated duration of 2.2 years. There were no sales of MBS available-for-sale during the nine months ended September 30, 2010 and 2009.

Proceeds from the sales of investment securities available-for-sale (which include mutual funds and agency notes) were $2.5 million during the nine months ended September 30, 2010. Gains of $850,000 were recognized on these sales. During the nine months ended September 30, 2009, proceeds from the sales of investment securities available-for-sale totaled $10.4 million. A gain of $431,000 was recognized on these sales. There were no sales of investment securities held-to-maturity during the nine months ended September 30, 2010 and 2009.

On March 31, 2010, the Company transferred six mutual fund investments totaling $1.4 million from available-for-sale to trading. Unrealized holding gains totaling $242,000 were recognized on these investments on the date of transfer. This transfer is discussed further later in this note. During the three months ended September 30, 2010, the Company recognized aggregate losses of $65,000 on these mutual funds, reflecting a decline in their valuation. Proceeds from the sale of trading securities totaled $659,000 during the nine months ended September 30, 2010.

At September 30, 2010, in management’s judgment, the credit quality of the collateral pool underlying six of the Company's eight pooled bank trust preferred securities had deteriorated to the point that full recovery of the Company’s initial investment was considered uncertain, thus resulting in recognition of OTTI charges. At September 30, 2010, these six securities had credit ratings ranging from "D" to "Ba3."

For the six pooled bank trust preferred securities that were deemed to meet the OTTI criteria established under ASC 320-10-65, the Company applied the ASC 320-10-65 provisions for determining the credit related component of OTTI by discounting the expected future cash flows applicable to the securities at the effective interest rate implicit in the security at the date of acquisition by the Company.

The following table provides a reconciliation of the pre-tax OTTI charges recognized on the Company's trust preferred securities.

	At or for the Three Months Ended September 30, 2010			At or for the Three Months Ended September 30, 2009		
	Credit Related OTTI Recognized	Non-Credit OTTI Recognized in	Total OTTI	Credit Related OTTI Recognized	Non-Credit OTTI Recognized in	Total OTTI

	in Earnings	Accumulated Other Comprehensive Loss		in Earnings	Accumulated Other Comprehensive Loss	
	(Dollars in Thousands)					
Cumulative balance at the beginning of the period	$ 6,445	$ 3,815	$ 10,260	$ 3,785	$ 3,253	$ 7,038
OTTI recognized during the period	1,639	219	1,858	556	119	675
Reductions and transfers to non-credit OTTI	-	(1,327)	(1,327)	-	(478)	(478)
Amortization of previously recognized OTTI	-	(6)	(6)	-	(2)	(2)
Cumulative balance at end of the period	$ 8,084	$ 2,701	$ 10,785	$ 4,341	$ 2,892	$ 7,233

	At or for the Nine Months Ended September 30, 2010			At or for the Nine Months Ended September 30, 2009		
	Credit Related OTTI Recognized in Earnings	Non-Credit OTTI Recognized in Accumulated Other Comprehensive Loss	Total OTTI	Credit Related OTTI Recognized in Earnings	Non-Credit OTTI Recognized in Accumulated Other Comprehensive Loss	Total OTTI
	(Dollars in Thousands)					
Cumulative balance at the beginning of the period	$ 5,772	$ 4,425	$ 10,197	$ 3,209	$ -	$ 3,209
Cumulative effect adjustment of adopting FSP 115-2	-	-	-	(2,287)	2,287	-
OTTI recognized during the period	2,312	282	2,594	3,419	1,457	4,876
Reductions and transfers to non-credit OTTI	-	(1,946)	(1,946)	-	(832)	(832)
Amortization of previously recognized OTTI	-	(60)	(60)	-	(20)	(20)
Cumulative balance at end of the period	$ 8,084	$ 2,701	$ 10,785	$ 4,341	$ 2,892	$ 7,233

The remaining aggregate amortized cost of pooled bank trust preferred securities that could be subject to future OTTI charges through earnings was $11.3 million at September 30, 2010. Of this total, unrealized losses of $4.7 million have already been recognized as a component of accumulated other comprehensive loss.

During the nine months ended September 30, 2009, the Company recognized aggregate credit-related OTTI charges of $3.1 million on five actively-managed equity mutual fund investments, reflecting both the significant deterioration in the valuation of the U.S. and international equity markets at that time, as well as the extended duration of the decline. All of these funds were highly correlated to broader equity indices, and, as a result, experienced significant recoveries in their market value during the period April 2009 through March 2010. In March 2010, the Company sold a portion of one of the five mutual fund investments, recovering $685,000 of the apportioned OTTI charges previously recognized on these fund shares.

The Company owned four additional mutual fund investments at September 30, 2010. These assets are earmarked for the payment of benefits earned by participants in the BMP. Modifications made to the BMP in March 2010 impacted the potential form of future benefit payments under the plan (which was frozen to all future benefits effective January 1, 2005 and currently remains frozen). As a result, the Company elected to transfer a portion of four mutual fund investments earmarked for future settlement of non-qualified 401(k) Plan defined contribution benefits earned under the BMP from available-for-sale into trading effective March 31, 2010. The Company simultaneously transferred two additional mutual fund balances that are similarly earmarked for payment of non-qualified 401(k) benefits earned under the BMP, which were never deemed to meet the criteria of OTTI, from available-for-sale into

trading. Commencing on April 1, 2010, the transfer of these six mutual funds produced an offset within the Company's operating results for any required changes in future BMP benefit expense caused by fluctuations in the market value of these earmarked investments. As a result of the transfer from available-for-sale into trading, approximately $336,000 of previously recognized credit-related OTTI charges on these investments was recovered.

The portion of the Company's investment in the initial four mutual funds discussed in the previous paragraph that was not transferred into trading is earmarked for future settlement of non-qualified pension benefits earned under the BMP. These benefits were not affected by the March 2010 modifications to the BMP, and they thus remained designated as available-for-sale. The recovery of their apportioned OTTI charges from March 31, 2009 through September 30, 2010 thus remains unrealized as a component of accumulated other comprehensive income.

The following table provides a reconciliation of the pre-tax OTTI charges recognized on the Company's equity mutual funds.

	At or for the Three Months Ended September 30,		At or for the Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in Thousands)			
Cumulative balance at the beginning of the period	$1,425	$3,063	$3,063	3,063
OTTI recognized during the period	-	-	_	-
Recovery of OTTI for securities sold during the period	-	-	(1,302)	-
Recovery of OTTI for securities transferred to trading during the period	-	-	(336)	-
Cumulative balance at end of the period	$1,425	$3,063	$1,425	$3,063

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The following table summarizes the gross unrealized losses and fair value of investment securities and MBS as of September 30, 2010, aggregated by investment category and the length of time the securities were in a continuous unrealized loss position.

	Total		12 or More Consecutive Months of Unrealized Losses		Less than 12 Consecutive Months of Unrealized Losses	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
Held-to-Maturity Securities:						
Pooled bank trust preferred securities (1)	$3,865	$7,482	$3,865	$7,482	$-	$-
Available-for-Sale Securities:					-	-
Private issuer pass through MBS	2,401	94	2,401	94	-	-
Total	$6,266	$7,576	$6,266	$7,576	$-	$-

(1) At September 30, 2010, the recorded balance of these securities was $6.6 million. This balance reflected both the remaining unrealized loss of $2.0 million that was recognized in accumulated other comprehensive loss on September 1, 2008 (the day on which these securities were transferred from available-for-sale to held-to-maturity) for two trust preferred securities that have not been deemed OTTI, and an unrealized loss of $2.7 million that has been recognized in accumulated other comprehensive loss that represents the non-credit component of impairment for five trust preferred securities that have been deemed OTTI. In accordance with both ASC 320-10-35-17 and ASC 320-10-65, these unrealized losses are currently being amortized over the remaining estimated life of these securities.

Trust Preferred Securities That Have Maintained an Unrealized Holding Loss for 12 or More Consecutive Months

At September 30, 2010, two of the Company's eight pooled bank trust preferred securities, with an amortized cost of $7.5 million, were not deemed other than temporarily impaired. These securities remained in an unrealized loss for 12 or more consecutive months, and their cumulative unrealized loss was $2.4 million at September 30, 2010, reflecting both illiquidity in the marketplace and concerns over future bank failures. At September 30, 2010, these securities had ratings ranging from "CC" to "Ba1" on one and "CCC" to "Ba1" on the other. Despite both the significant decline in market value and the duration of their impairment, management believes that the unrealized losses on these securities at September 30, 2010 were temporary, and that the full value of the investments will be realized once the market dislocations have been removed, or as the securities continue to make their contractual payments of principal and interest. In making this determination, management considered the following:

- Based upon an internal review of the collateral backing the trust preferred securities portfolio, which accounted for current and prospective deferrals, each of the securities could reasonably be expected to continue making all contractual payments
- The Company has the intent and ability to hold these securities until they fully recover their impairment, evidenced by the election to reclassify them as held-to-maturity in 2008
- There were no cash or working capital requirements nor contractual or regulatory obligations that would compel the Company to sell any of these securities prior to their forecasted recovery or maturity
- Each security has a pool of underlying issuers comprised primarily of banks
- None of the securities have exposure to real estate investment trust issued debt (which has experienced high default rates)
- Each security features either a mandatory auction or a de-leveraging mechanism that could result in principal repayments to the Bank prior to the stated maturity of the security
- Each security is characterized by some level of over-collateralization

The remaining six trust preferred securities, with an aggregate amortized cost of $3.9 million at September 30, 2010, have previously been determined to meet the OTTI criteria.

Private Issuer Pass Through MBS That Has Maintained an Unrealized Holding Loss for 12 or More Consecutive Months

At September 30, 2010, the Company owned one private label pass-through MBS that possessed unrealized losses for 12 or more consecutive months, with an amortized cost of $2.5 million and an unrealized loss of $94,000. The Company's investment is in the most senior tranche (or repayment pool) of this security. Despite a challenging real estate marketplace, the private label pass-through MBS made contractual principal and interest payments that reduced its principal balance by approximately 27% during the twelve months ended September 30, 2010. At September 30, 2010, the Company performed an analysis of likely potential defaults of the real estate loans underlying this security in the current economic environment, and determined that this security could reasonably be expected to continue making all contractual payments. The Company has no intent to sell this security and it is not likely that the Company will be required to sell this security before the recovery of its remaining amortized cost.

11. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company adopted ASC 820-10 on January 1, 2008. The fair value hierarchy established under ASC 820-10 is summarized as follows:

Level 1 Inputs – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs – Significant other observable inputs such as any of the following: (1) quoted prices for similar assets or liabilities in active markets, (2) quoted prices for identical or similar assets or liabilities in markets that are not active, (3) inputs other than quoted prices that are observable for the asset or liability (e.g., interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates), or (4) inputs that are derived principally from or corroborated by observable market data by correlation or other means (market-corroborated inputs).

Level 3 Inputs – Unobservable inputs for the asset or liability. Unobservable inputs reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). Unobservable inputs shall be used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date.

The following tables present the assets that are reported on the condensed consolidated statements of financial condition at fair value as of September 30, 2010 by level within the fair value hierarchy. As required by ASC 820-10, financial assets are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

Assets Measured at Fair Value on a Recurring Basis at September 30, 2010

		Fair Value Measurements Using				
Description	Total	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Losses for the Three Months Ended September 30, 2010	Losses for the Nine Months Ended September 30, 2010
			(Dollars in Thousands)			
Trading securities	$1,420	$1,420	$-	$-	$-	-
Investment securities available-for-sale	64,675	4,233	60,442	-	-	-
MBS available-for-sale	165,221	-	165,221	-	-	-

Assets Measured at Fair Value on a Recurring Basis at September 30, 2009

		Fair Value Measurements Using			
Description	Total at September 30, 2009	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Losses for the Nine Months Ended September 30, 2009

	(Dollars in Thousands)				
Investment securities available-for-sale	$29,059	$6,127	$22,932	$-	$3,063
MBS available-for-sale	243,869	-	243,869	-	-

The Company’s trading securities and available-for-sale investment securities and MBS are reported at fair value, which is determined utilizing prices obtained from independent parties. The valuations obtained are based upon market data, and often utilize evaluated pricing models that vary by asset and incorporate available trade, bid and other market information. For securities that do not trade on a daily basis, pricing applications apply available information such as benchmarking and matrix pricing. The market inputs normally sought in the evaluation of securities include benchmark yields, reported trades, broker/dealer quotes (obtained only from market makers or broker/dealers recognized as market participants), issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data. Prioritization of inputs may vary on any given day based on market conditions.

The Company’s trading securities are registered, actively-traded mutual funds that satisfy the criteria for Level 1 valuation. The Company's available-for-sale investment securities and MBS at September 30, 2010 were categorized as follows:

Investment Category	Percentage of Total	Valuation Level Under ASC 820-10
Pass Through MBS or CMOs issued by GSEs	69.8%	Two
Agency notes	26.3	Two
Pass Through MBS or CMOs issued by entities other than GSEs	2.1	Two
Mutual fund investments	1.8	One

The agency notes owned by the Company possessed the highest possible credit rating published by multiple established credit rating agencies as of September 30, 2010. Obtaining a market value as of September 30, 2010 for these securities utilizing significant observable inputs as defined under ASC 820-10 was not difficult due to their continued marketplace demand. The pass-through MBS and CMOs issued by GSEs, which comprised approximately 69.8% of the Company's total available-for-sale investment securities and MBS at September 30, 2010, all possessed the highest possible credit rating published by multiple established credit rating agencies as of September 30, 2010. Obtaining a market value as of September 30, 2010 for these securities utilizing significant observable inputs as defined under ASC 820-10 was not difficult due to their considerable demand. In accordance with established policies and procedures, the Company utilized a midpoint value obtained as its recorded fair value for securities that were valued with significant observable inputs.

As of September 30, 2010, the Company owned one pass through MBS issued by an entity other than a GSE, with an amortized cost basis of $2.5 million. Since 2008, this security has not traded actively. The Company owns an investment within the senior tranche of this security, and the weighted average contractual interest rate on the security was 5.0% at September 30, 2010. The assets underlying this security are a pool of 15-year fixed rate amortizing prime mortgages on residential properties located throughout the United States. The underlying mortgages were originated in 2005, and, as of September 30, 2010, had a weighted average coupon of 5.33% and a weighted average loan-to-value ratio of 48%. There is no significant geographical concentration on the underlying mortgages, and less than 9% of the total underlying mortgage pool was delinquent at September 30, 2010. The credit ratings on this security ranged from CC to Caa1 at September 30, 2010. As a result of the overall credit quality of this investment, sufficient marketplace demand was deemed present at September 30, 2010 to permit this security to be valued utilizing estimated sales determined under benchmarking and matrix pricing. The Company obtained such values from at least two credible market sources, and verified that these values were prepared utilizing significant observable inputs as defined under ASC 820-10.

As of September 30, 2010, the Company owned one CMO issued by an entity other than a GSE, with an amortized cost basis of $2.3 million. Since 2008, this security has not traded actively. The Company owns an investment within the senior tranche of this security, and the weighted average contractual interest rate on the security was 4.5% at September 30, 2010. The assets underlying this security are a pool of 15-year fixed rate amortizing prime mortgages on residential properties located throughout the United States. The underlying mortgages were originated in 2003, and, as of September 30, 2010, had a weighted average coupon of 5.38% and a weighted average loan-to-value ratio of 33%. Approximately one-half of the underlying mortgages are located in California, while the remaining half are diversified geographically. Less than 1% of the total underlying mortgage pool was delinquent at September 30, 2010. This security possessed the highest possible credit rating published by multiple established credit rating agencies at September 30, 2010. As a result of the overall credit quality of this investment, sufficient marketplace demand was deemed present at September 30, 2010 to permit this security to be valued utilizing estimated sales determined under benchmarking and matrix pricing. The Company obtained such values from at least two credible market sources, and verified that these values were prepared utilizing significant observable inputs as defined under ASC 820-10.

Assets Measured at Fair Value on a Non-Recurring Basis at September 30, 2010								
		Fair Value Measurements Using						
Description	Total		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Losses for the Three Months Ended September 30, 2010		Losses for the Nine Months Ended September 30, 2010	
		(Dollars in Thousands)						
	$658	(1)	$-	$-	$658	$1,858	(2)	$2,594	(2)

Pooled trust preferred securities						
Impaired loans	27,466	-	-	27,466	6,658 (3)	12,044 (3)

(1) Amount represents the fair value of five held-to-maturity trust preferred securities that were deemed other-than temporarily impaired at September 30, 2010.

(2) Amount represents the total OTTI (credit or non-credit related) recognized on trust preferred securities during the three-month and nine-month periods ended September 30, 2010.

(3) Amount represents total charge-offs on impaired loans during the three-month and nine-month periods ended September 30, 2010.

Assets Measured at Fair Value on a Non-Recurring Basis at September 30, 2009

		Fair Value Measurements Using				
Description	Total at September 30, 2009	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Losses for the Three Months Ended September 30, 2009	Losses for the Nine Months Ended September 30, 2009
		(Dollars in Thousands)				
Pooled trust preferred securities(1)	$ 1,855	$-	$-	$1,855	$675 (1)	$4,876 (1)
Impaired loans	9,534	-	-	9,534	2,747 (2)	3,423 (2)

(1) Amount represents the fair value of five held-to-maturity trust preferred securities that were deemed other-than temporarily impaired at September 30, 2009. Losses represent the total OTTI recognized (credit or non-credit related) during the period.

(2) Amount represents charge-offs recognized on these loans during the respective periods to write the outstanding principal down to the current appraised or marketed value of the underlying collateral property.

Pooled Trust Preferred Securities, Held to Maturity - At September 30, 2010, the Company owned eight pooled trust preferred securities classified as held-to-maturity. Late in 2008, the market for these securities became illiquid, and continued to be deemed as such as of September 30, 2010. As a result, at both September 30, 2010 and September 30, 2009, their estimated fair value was obtained utilizing a blended valuation approach (Level 3

pricing). Under the blended valuation approach, the Bank utilized the following valuation sources: 1) broker quotations, which were deemed to meet the criteria of "distressed sale" pricing under the guidance of ASC 820-10-65-4, and were given a 10% weighting; 2) An internally created cash flow valuation model that considered the creditworthiness of each individual issuer underlying the collateral pools, and utilized default, cash flow and discount rate assumptions determined by the Company's management (the "Internal Cash Flow Valuation"), that was given a 45% weighting; and 3) a minimum of two of three available independent cash flow model valuations were averaged and given a 45% weighting.

The major assumptions utilized (each of which represents a significant unobservable input as defined by ASC 820-10) in the Internal Cash Flow Valuation were as follows:

(i) Discount Rate - Pursuant to ASC 320-10-65, the Company utilized two different discount rates for discounting the cash flows for each of the eight pooled trust preferred securities, as follows:

(1) Purchase discount rate – the rate used to determine the “credit” based valuation of the security.
(2) Current discount rate - the current discount rate utilized was derived from the Bloomberg fair market value curve for debt offerings of similar credit rating. In the event that a security had a split investment rating, separate cash flow valuations were made utilizing the appropriate discount rate and were averaged in order to determine the Internal Cash Flow Valuation. In addition, the discount rate was interpolated from the Bloomberg fair market value curve for securities possessing a credit rating below “B.”

(ii) Defaults – The Company utilized the most recently published Fitch bank scores to identify potential defaults in the collateral pool of performing issuers underlying the eight securities. Using a rating scale of 1 to 5 (best-to-worst), all underlying issuers with a Fitch bank rating of 5.0 were assumed to default. Underlying issuers with a Fitch bank rating of 3.5 through 4.5 were assumed to default at levels ranging from 5% to 75% based upon both their rating as well as whether they had been granted approval to receive funding under the U.S. Department of Treasury's Troubled Asset Relief Program Capital Purchase Program. In addition to the defaults derived from the Fitch bank scores, the Company utilized a standard default rate of 1.2% every three years.

(iii) Cash Flows - The expected payments for the tranche of each security owned by the Company, as adjusted to assume that all estimated defaults occur immediately. The cash flows further assume an estimated recovery rate of 6% per annum to occur one year after initial default.

In addition to the Internal Cash Flow Model Valuation and broker quotations discussed above, the Company utilizes a minimum of two of the three additional available pricing sources. Two of the three independent cash flow model valuations utilized a methodology similar to the Internal Cash Flow Valuation, differing only in the underlying assumptions deriving estimated cash flows, individual bank defaults and discount rate. The third independent cash flow valuation was derived from a different methodology in which the actual cash flow estimate based upon the underlying collateral of the securities (including default estimates) was not considered. Instead, this cash flow valuation utilized a discount rate determined from the Bloomberg fair market value curve for similar assets that continued to trade actively, with adjustments made for the illiquidity of the pooled trust preferred market. Because of the significant judgment underlying each of the pricing assumptions, management elected to recognize each of the independent valuations and apply a weighting system to all of the valuations, including the Internal Cash Flow Valuation, as all of these valuations were determined utilizing a valid and objective pricing methodology.

Impaired Loans - Loans with certain characteristics are evaluated individually for impairment. A loan is considered impaired under ASC 310-10-35 when, based upon existing information and events, it is probable that the Bank will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the loan agreement. The Bank's impaired loans at September 30, 2010 were collateralized by real estate and were thus carried at the lower of the outstanding principal balance or the estimated fair value of the collateral. Fair value is estimated

through either a negotiated note sale value, or, more commonly, either a current independent appraisal, or a drive-by inspection combined with a comparison of the collateral with similar properties in the area by either a licensed appraiser or real estate broker. An appraisal is generally ordered for all impaired multifamily residential, mixed use or commercial real estate loans for which the most recent appraisal is more than one year old. The Bank never adjusts independent appraisal data upward. Occasionally, management will adjust independent appraisal data downward based upon its own lending expertise and/or experience with the subject property, utilizing such factors as potential note sale values, or a more refined estimate of costs to repair and time to lease the property. Adjustments for potential disposal costs are also considered when determining the final appraised value. Of the 39 impaired loans at September 30, 2010, management utilized a likely negotiated note sale value as the valuation for seven of the loans and reduced the independent appraisal value in determining the fair value of nineteen of the loans. In instances in which foreclosure and sale of the collateral property is assumed to be the ultimate realizable value, estimated disposal costs of 10% of the appraised value are assumed to be incurred.

OREO – The fair value of OREO is determined utilizing the lower of an independent appraised or estimated disposal value of the property.

Financial Instruments Not Actively Traded - Quoted market prices available in active trading marketplaces are generally recognized as the best evidence of fair value of financial instruments, however, several of the

Company's financial instruments are not bought or sold in active trading marketplaces. Accordingly, their fair values are derived or estimated based on a variety of alternative valuation techniques. All such fair value estimates are based on relevant market information about the financial instrument. These estimates do not reflect any possible tax ramifications, estimated transaction costs, or potential premium or discount that could result from a one time sale of the entire holdings of a particular financial instrument. In addition, the estimates are based on assumptions of future loss experience, current economic conditions, risk characteristics, and other such factors. These assumptions are subjective in nature and involve inherent uncertainty. Changes in these assumptions could significantly affect the estimates.

Methods and assumptions used to estimate fair values for financial instruments that are not valued utilizing formal marketplace quotations (other than those previously discussed) are summarized as follows:

Cash and Due From Banks - The fair value is assumed to be equal to their carrying value as these amounts are due upon demand.

Federal Funds Sold and Other Short Term Investments – As a result of their short duration to maturity, the fair value of these assets, principally overnight deposits, is assumed to be equal to their carrying value due.

FHLBNY Capital Stock – It is not practicable to determine the fair value of FHLBNY capital stock due to restrictions placed on transferability.

Loans, Net - The fair value of loans receivable is determined by discounting anticipated future cash flows of the loans, net of anticipated prepayments, using a discount rate reflecting current market rates for loans with similar terms. This methodology is applied to all loans, inclusive of non-accrual loans, as well as impaired loans for which a write-down to the current fair market value of the underlying collateral is not determined to be warranted (generally loans that are sufficiently collateralized). In addition, the valuation of loans reflects the consideration of sale pricing for loan types that have traditionally been subject to marketplace sales (over 80% of the outstanding loan portfolio). Due to significant market dislocation, secondary market prices were given little weighting in deriving loan valuation at September 30, 2010.

Deposits - The fair value of savings, money market, and checking accounts is assumed to be their carrying amount. The fair value of certificates of deposit ("CDs") is based upon the present value of contractual cash flows using current interest rates for instruments of the same remaining maturity.

Escrow and Other Deposits - The estimated fair value of escrow and other deposits is assumed to be their carrying amount payable.

Securities Sold Under Agreements to Repurchase (“REPOs”) and FHLBNY Advances – REPOs are accounted for as financing transactions. Their fair value is measured by the discounted anticipated cash flows through contractual maturity or next interest repricing date, or an earlier call date if, as of the valuation date, the borrowing is expected to be called. The carrying amount of accrued interest payable is its fair value.

Commitments to Extend Credit - The fair value of commitments to extend credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current interest rates and the committed rates.

Based upon the aforementioned valuation methodologies, the estimated carrying amounts and estimated fair values of all of the Company's financial instruments and liabilities were as follows:

At September 30, 2010	Carrying Amount	Fair Value
	(Dollars in Thousands)	
Assets:		
Cash and due from banks	$70,761	$70,761
Federal funds sold and other short term investments	23,848	23,848
Investment securities held to maturity (pooled trust preferred securities)	6,639	3,865
Available-for-sale securities:		
Mutual fund investments	4,233	4,233
Agency notes	60,442	60,442
Pass-through MBS issued by GSEs	119,908	119,908
CMOs issued by GSEs	40,503	40,503
Private issuer pass-through MBS	2,401	2,401
Private issuer CMOs	2,409	2,409
Trading securities	1,420	1,420
Loans, net	3,405,616	3,567,750
Loans held for sale	4,879	4,882
Mortgage Servicing Rights ("MSR")	2,457	2,751
FHLBNY capital stock	47,848	N/A
Liabilities:		
Savings, money market and checking accounts	1,286,215	1,286,215
CDs	1,094,451	1,111,632
Escrow and other deposits	91,965	91,965
REPOs	195,000	224,675
FHLBNY advances	904,525	962,485
Trust Preferred securities payable1	70,680	63,612
Commitments to extend credit	476	476

1 The fair value of these liabilities is measured by independent market quotations obtained based upon transactions occurring in the market as of the disclosure date.

12. RETIREMENT AND POSTRETIREMENT PLANS

The Holding Company or the Bank maintains the Retirement Plan of The Dime Savings Bank of Williamsburgh (the "Employee Retirement Plan"), the Retirement Plan for Board Members of Dime Community Bancshares, Inc. (the "Outside Director Retirement Plan"), the BMP, and the Postretirement Welfare Plan of The Dime Savings Bank of Williamsburgh ("Postretirement Plan"). Net expenses associated with these plans were comprised of the following components:

	Three Months Ended September 30, 2010		Three Months Ended September 30, 2009	
	BMP, Employee and Outside Director Retirement Plans	Postretirement Plan	BMP, Employee and Outside Director Retirement Plans	Postretirement Plan

	(Dollars in thousands)			
Service cost	$-	$ 29	$-	$ 29
Interest cost	358	79	340	76
Actuarial adjustment to prior period interest cost and amortization	-	-	-	-
Expected return on assets	(347)	-	(297)	-
Unrecognized past service liability	-	14	-	14
Amortization of unrealized loss	263	-	291	-
Net periodic cost	$274	$ 122	$334	$ 119

	Nine Months Ended September 30, 2010		Nine Months Ended September 30, 2009	
	BMP, Employee and Outside Director Retirement Plans	Postretirement Plan	BMP, Employee and Outside Director Retirement Plans	Postretirement Plan
	(Dollars in thousands)			
Service cost	$-	$ 87	$-	$ 87
Interest cost	1,073	237	1,020	226
Actuarial adjustment to prior period interest cost and amortization	353	-	-	-
Expected return on assets	(1,041)	-	(890)	-
Unrecognized past service liability	-	42	-	42
Amortization of unrealized loss	789	-	872	-
Net periodic cost	$1,174	$ 366	$1,002	$ 355

The Company disclosed in its consolidated financial statements for the year ended December 31, 2009 that it expected to make contributions or benefit payments totaling $205,000 to the BMP, $131,000 to the Outside Director Retirement Plan, and $153,000 to the Postretirement Plan during the year ending December 31, 2010. The Company made benefit payments of $97,000 to the Outside Director Retirement Plan during the nine months ended September 30, 2010, and expects to make an additional $32,000 of contributions or benefit payments during the remainder of 2010. The Company made net contributions totaling $96,000 to the Postretirement Plan during the nine months ended September 30, 2010, and expects to make the remainder of the estimated $57,000 of net contributions or benefit payments during 2010. The Company made no contributions to the BMP during the nine months ended September 30, 2010. The Company does not expect to make any benefit payments from or contributions to the BMP during the remainder of 2010, since anticipated retirements that formed the basis for the expected benefit payments in 2010 are presently not expected to occur.

The Company disclosed in its consolidated financial statements for the year ended December 31, 2009 that it did not expect to make any contributions to the Employee Retirement Plan during 2010. Upon a review of projected future benefits and projected asset returns, the Company made a contribution of $2.1 million to the Employee Retirement Plan in June 2010. The Company does not expect to make any further contributions to the Employee Retirement Plan during the remainder of 2010.

13. INCOME TAXES

During the three months ended September 30, 2010, New York State and New York City enacted a change in tax law associated with bad debt deductions permissible by savings banks effective January 1, 2010. This change adversely impacted the Company’s consolidated 2010 tax rate. Since both tax jurisdictions made the change retroactive to January 1, 2010, an adjustment was required during the three months ended September 30, 2010 in order to account for the difference between the previous and new tax rules for the first six months of 2010. As a result, the Company’s consolidated effective tax rate was 42.6% during the three months ended September 30, 2010. The Company's customary consolidated tax rate, which had previously approximated 37%, is now expected to approximate 40%. The effective tax rate for the nine months ended September 30, 2010 was 40.7% after adjusting for the changes in New York State and New York City tax law.

During the nine months ended September 30, 2009, the Company's consolidated effective tax rate, which had normally approximated 37%, was reduced to 35.6% as a result of $6.5 million of recorded OTTI expense, which was partially offset by additions to income tax expense that resulted from the reconciliation to the finalization of the 2008 consolidated income tax return. The effective tax rate was increased to 39% during the three months ended September 30, 2009 as a result of the reconciliation to the finalization of the 2008 consolidated income tax returns. Excluding the OTTI charges and reconciliation to the 2008 income tax returns, the Company's effective tax rate approximated 37.0% during both the three-month and nine-month periods ended September 30, 2009.

14. NET MORTGAGE BANKING INCOME

Net mortgage banking income presented in the condensed consolidated statements of operations was comprised of the following items:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in thousands)			
Gain on the sale of loans originated for sale	$140	$38	$321	$674
Credit (Provision) to the liability for First Loss Position	-	-	-	(1,403)
Recovery of write down of mortgage servicing asset	-	-	-	60
Mortgage banking fees	176	208	508	603
Net mortgage banking income(loss)	$316	$246	$829	$(66)

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

General

The Holding Company is a Delaware corporation and parent company of the Bank, a federally-chartered stock savings bank. The Bank maintains its headquarters in the Williamsburg section of Brooklyn, New York and operates twenty-five full service retail banking offices located in the New York City ("NYC") boroughs of Brooklyn, Queens, and the Bronx, and in Nassau County, New York. The Bank's principal business is gathering deposits from customers within its market area and via the internet, and investing them primarily in multifamily residential, commercial real estate, one- to four-family residential, construction and land acquisition loans, consumer loans, MBS, obligations of the U.S. government and GSEs, and corporate debt and equity securities.

Executive Summary

The Holding Company's primary business is the ownership of the Bank. The Company's consolidated results of operations are dependent primarily on net interest income, which is the difference between the interest income earned on interest-earning assets, such as loans and securities, and the interest expense paid on interest-bearing liabilities, such as deposits and borrowings. The Bank additionally generates non-interest income such as service charges and other fees, as well as income associated with Bank Owned Life Insurance. Non-interest expense primarily consists of employee compensation and benefits, federal deposit insurance premiums, data processing costs, and occupancy and equipment, marketing and other operating expenses. The Company's consolidated results of operations are also significantly affected by general economic and competitive conditions (particularly fluctuations in market interest rates), government policies, changes in accounting standards and actions of regulatory agencies.

The Bank's primary strategy is generally to seek to increase its product and service utilization for each individual depositor, and to increase its household and deposit market shares in the communities that it serves. The Bank's primary strategy additionally includes the origination of, and investment in, mortgage loans, with an emphasis on multifamily residential and mixed use real estate loans. In late 2008 and during the nine months ended September 30, 2009, the Company restricted asset growth due to concerns over the health of the commercial real estate markets, and the desire to preserve capital levels to accommodate these concerns. During the three-month and nine-month periods ended September 30, 2010, the Company utilized a measured growth strategy related to its asset volume.

The Company believes that multifamily residential and mixed use loans provide advantages as investment assets. Initially, they offer a higher yield than investment securities of comparable maturities or terms to repricing, and typically offer higher yields than fixed-rate one- to four-family residential mortgage loans. In addition, origination and processing costs for the Bank's multifamily residential and mixed use loans are lower per thousand dollars of originations than comparable one-to four-family loan costs. Further, the Bank's market area has generally provided a stable flow of new and refinanced multifamily residential and mixed use loan originations. In order to

address the credit risk associated with multifamily residential and mixed use lending, the Bank has developed underwriting standards that it believes are reliable in order to maintain consistently high credit quality for its loans.

The Bank also strives to provide a stable source of liquidity and earnings through the purchase of investment grade securities; seeks to maintain the asset quality of its loans and other investments; and uses appropriate portfolio and asset/liability management techniques in an effort to manage the effects of interest rate volatility on its profitability and capital.

The years ended December 31, 2008 and 2009 were dominated by a global real estate and economic recession fueled by significant weakness in and/or failures of many of the world's largest financial institutions. Although the recessionary conditions began to subside during the nine months ended September 30, 2010, overall credit conditions in the Company's local real estate marketplace remained challenged. As a result, the Bank recognized higher credit costs on portfolio loans during the three-month and nine-month periods ended September 30, 2010 than the corresponding periods of 2009. However, historically high dislocations in credit markets caused origination spreads from the benchmark origination interest rate to remain historically high during the year ended December 31, 2009 and the three-month and nine-month periods ended September 30, 2010. This increase, coupled with a reduction in benchmark

short-term interest rates by the Federal Open Market Committee ("FOMC") (which significantly impact the pricing of the Bank's retail deposits), favorably impacted the Company's net interest spread and net interest margin during the three-month and nine-month periods ended September 30, 2010 compared to their corresponding periods of 2009.

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Reform Act”). The Reform Act is intended to address perceived weaknesses in the U.S. financial regulatory system and prevent future economic and financial crises. Certain aspects of the Reform Act will have an impact on the Company, as described in more detail below in Part II, Item IA, “Risk Factors.”

Recent Market Developments

Insurance of Deposit Accounts

On October 19, 2010, the Board of Directors of the Federal Deposit Insurance Corporation (“FDIC”) adopted a new Restoration Plan (the “Restoration Plan”) to ensure that the Deposit Insurance Fund reserve ratio reaches 1.35% by September 30, 2020, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Reform Act”). Among other matters, the Restoration Plan provides that the FDIC will forego the uniform three basis point increase in initial assessment rates that was previously scheduled to take effect on January 1, 2011 and will maintain the current assessment rate schedule for all insured depository institutions until the reserve ratio reaches 1.15%. The FDIC intends to pursue further rulemaking in 2011 regarding the requirement under the Reform Act that the FDIC offset the effect on institutions with less than $10 billion in assets (such as the Bank) of the requirement that the reserve ratio reach 1.35% by September 30, 2020, rather than 1.15% by the end of 2016 (as required under the prior restoration plan), so that more of the cost of raising the reserve ratio to 1.35% will be borne by institutions with more than $10 billion in assets. Implementation of the Restoration Plan is not expected to have a material effect upon the Company's consolidated operating results.

Selected Financial Highlights and Other Data
(Dollars in Thousands Except Per Share Amounts)

	At or For the Three Months Ended September 30,		At or For the Nine Months Ended September 30,	
	2010	2009	2010	2009
Performance and Other Selected Ratios:				
Return on Average Assets	1.11 %	0.85 %	1.00 %	0.60 %
Return on Average Stockholders' Equity	14.23	11.66	13.22	8.55
Stockholders' Equity to Total Assets	8.07	7.41	8.07	7.41
Tangible Equity to Total Tangible Assets (1)	6.90	6.23	6.90	6.23
Loans to Deposits at End of Period	143.97	150.53	143.97	150.53
Loans to Earning Assets at End of Period	91.71	90.83	91.71	90.83
Net Interest Spread	3.44	2.91	3.28	2.55
Net Interest Margin	3.60	3.11	3.47	2.80
Average Interest Earning Assets to Average Interest Bearing Liabilities	108.83	108.95	108.80	108.72
Non-Interest Expense to Average Assets	1.46	1.39	1.51	1.42
Efficiency Ratio	40.35	43.13	43.05	49.82
Effective Tax Rate	42.61	39.06	40.67	35.57
Dividend Payout Ratio	41.18	56.00	45.16	76.36
Average Tangible Equity	$268,477	$236,680	$259,821	$234,538
Per Share Data:				

Reported EPS (Diluted)	$0.34		$0.25		$0.93		$0.55	
Cash Dividends Paid Per Share	0.14		0.14		0.42		0.42	
Stated Book Value	9.33		8.42		9.33		8.42	
Tangible Book Value	7.86		6.97		7.86		6.97	
Asset Quality Summary:								
Net Charge-offs	$6,817		$3,619		$12,610		$6,023	
Non-performing Loans	19,598		14,162		15,064		14,162	
Non-performing Loans/Total Loans	0.57	%	0.43	%	0.44	%	0.43	%
Non-performing Assets	$20,242		$16,090		$15,708		$16,090	
Non-performing Assets/Total Assets	0.51	%	0.41	%	0.39	%	0.41	%
Allowance for Loan Loss/Total Loans	0.49		0.61		0.49		0.61	
Allowance for Loan Loss/Non-performing Loans	86.45		143.07		112.47		143.07	

table continued on next page

	At or For the Three Months Ended September 30,				At or For the Nine Months Ended September 30,			
	2010		2009		2010		2009	
	1.11	%	0.85	%	1.00	%	0.60	%
Regulatory Capital Ratios (Bank Only):								
Tangible Capital	8.01	%	8.03	%	8.01	%	8.03	%
Leverage Capital	8.01		8.03		8.01		8.03	
Tier 1 Risk-based Capital	10.47		10.97		10.47		10.97	
Total Risk-based Capital	11.08		11.73		11.08		11.73	
Earnings to Fixed Charges Ratios (2)								
Including Interest on Deposits	1.98	x	1.57	x	1.49	x	1.36	x
Excluding Interest on Deposits	2.56		1.93		1.78		1.66	

(1) Tangible Equity is a non-GAAP measure. Please refer to Note 19 of the Company's financial statements contained within in its Annual Report on Form 10-K for the year ended December 31, 2009 for a reconciliation of GAAP Stockholders' Equity and Tangible Equity. Tangible Equity is also referred to as Tier 1 Risk Based capital.
(2) Please refer to Exhibit 12.1 for further detail on the calculation of these ratios.

Critical Accounting Policies

Various elements of the Company’s accounting policies are inherently subject to estimation techniques, valuation assumptions and other subjective assessments. The Company’s policies with respect to the methodologies it uses to determine the allowance for loan losses, reserves for loan commitments, the liability for the First Loss Position, the valuation of MSR, asset impairments (including the assessment of impairment of goodwill and other than temporary declines in the valuation of securities), the recognition of deferred tax assets and unrecognized tax positions, the recognition of loan income, the valuation of financial instruments and accounting for defined benefit plans are its most critical accounting policies because they are important to the presentation of the Company’s consolidated financial condition and results of operations, involve a significant degree of complexity and require management to make difficult and subjective judgments which often necessitate assumptions or estimates about highly uncertain matters. The use of different judgments, assumptions and estimates could result in material variations in the Company's consolidated results of operations or financial condition.

The following are descriptions of the Company's critical accounting policies and explanations of the methods and assumptions underlying their application.

Allowance for Loan Losses. GAAP requires the Bank to maintain an appropriate allowance for loan losses. Management uses available information to estimate losses on loans and believes that the Bank maintains its allowance for loan losses at appropriate levels. Adjustments may be necessary, however, if future economic, market or other conditions differ from the current operating environment.

Although the Bank believes it utilizes the most reliable information available, the level of the allowance for loan losses remains an estimate subject to significant judgment. These evaluations are subjective because, although based upon objective data, it is management's interpretation of the data that determines the amount of the appropriate allowance. The Company, therefore, periodically reviews the actual performance and charge-offs of its portfolio and compares them to the previously determined allowance coverage percentages. In doing so, the Company evaluates the impact that the variables discussed below may have on the portfolio to determine whether or not changes should be made to the assumptions and analyses.

The Bank's loan loss reserve methodology consists of several components, including a review of the two elements of its loan portfolio: problem loans (i.e., criticized loans and impaired loans under ASC 310-10-35), and performing loans. The Bank applied the process of determining the allowance for loan losses consistently throughout the three-month and nine-month periods ended September 30, 2010 and 2009.

Performing Loans

At September 30, 2010, the majority of the allowance for loan losses was allocated to performing loans, which represented the overwhelming majority of the Bank's loan portfolio. Performing loans are reviewed at least quarterly based upon the premise that there are losses reasonably expected to be incurred within the loan portfolio that have not been recognized as of the review date. The Bank thus calculates an allowance for loan losses related to its performing loans by deriving an expected loan loss percentage and applying it to its performing loans. In deriving the expected loan loss percentage, the Bank generally considers, among others, the following criteria: the Bank's historical loss experience; the age and payment history of the loans (commonly referred to as their "seasoned quality"); the type of loan (i.e., one- to four-family, multifamily residential, commercial real estate, cooperative apartment, construction and land acquisition or consumer); both the current condition and recent history of the overall local real estate market (in order to determine the accuracy of utilizing recent historical charge-off data to derive the expected loan loss percentages); the level of, and trend in, non-performing loans; the level and composition of new loan activity; and the existence of geographic loan concentrations (as the overwhelming majority of the Bank's loans are secured by real estate located in the NYC metropolitan area), or specific industry conditions within the portfolio segments. Since these criteria affect the expected loan loss percentages that are applied to performing loans, changes in

any of them may affect the amounts of the allowance and the provision for loan losses. Between September 30, 2009 and September 30, 2010, the Bank increased the impact of the current condition of the overall local real estate marketplace and reduced the impact of the level and composition of new loan activity (the competitive lending landscape) in deriving the expected loss percentages applied to performing loans. Otherwise, the remaining factors utilized in deriving the expected loss percentages applied to both problem and performing loans remained unchanged from both September 30, 2009 and December 31, 2009.

Problem Loans

(i) Criticized Loans. OTS regulations and Bank policy require that loans possessing certain weaknesses be classified as Substandard, Doubtful or Loss assets. Assets that do not expose the Bank to risk sufficient to justify classification in one of these categories, however, which possess potential weaknesses that deserve management's attention, are designated Special Mention. Loans classified as Special Mention, Substandard or Doubtful are reviewed individually on a quarterly basis by the Bank's Loan Loss Reserve Committee to determine the level of possible loss, if any, that should be provided for within the Bank's allowance for loan losses.

The Bank's policy is to charge-off immediately the expected amount of loss on loans classified as Loss and reduce both the loan balance and the allowance for loan losses by this amount. Charge-offs of principal balances (full or partial) that were classified as Loss totaled $6.8 million and $3.7 million during the nine months ended September 30, 2010 and 2009, respectively. In addition, charge-offs of $5.8 million and $2.3 million were recognized during the nine months ended September 30, 2010 and 2009, respectively, on criticized loans that were disposed of during the respective periods.

(ii) Impaired Loans. Under the guidance established by ASC 310-10-35, loans determined to be impaired (i.e., loans where it is probable that all contractual amounts due will not be collected in accordance with the terms of the loan; generally, non-accrual one- to four-family loans in excess of $625,500 and non-accrual and troubled-debt restructured multifamily residential and commercial real estate loans) are evaluated at least quarterly in order to establish impairment. For each loan that the Bank determines to be impaired, impairment is measured by the amount that the carrying balance of the loan, including all accrued interest, exceeds the estimated fair value of the collateral. All principal balances of impaired loans are reduced to their likely realizable value, as determined by the impairment analysis. (See "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations – Asset Quality – Impaired Loans" for a discussion of impaired loans).

Non-accrual one- to four-family loans of $625,500 or less are not required to be evaluated individually for impairment. However, the Company classifies these loans as Substandard, Doubtful or Loss, and typically reviews and calculates loan loss reserves for them in substantially the same manner as the loans evaluated individually for impairment.

Reserve for Loan Commitments. The Bank maintains a separate reserve within other liabilities associated with commitments to fund future loans that have been accepted by the borrower. This reserve is determined based upon the historical loss experience of similar loans owned by the Bank at each period end. Any increases in this reserve amount are obtained via a transfer of reserves from the Bank's allowance for loan losses, with any resulting shortfall in the Bank's allowance for loan losses being satisfied through the quarterly provision for loan losses. Any decreases in this reserve amount are recognized as a transfer of reserve balances back to the allowance for loan losses at each period end.

Liability for the First Loss Position on Multifamily Loans Sold to FNMA. A liability is also recorded related to the First Loss Position on multifamily residential real estate loans sold with recourse under an agreement with FNMA. This liability reserve, which is included in other liabilities in the Company's consolidated statements of financial condition, is determined in a manner similar to the Company's allowance for loan losses related to loans held

in portfolio.

Valuation of MSR. The proceeds received on mortgage loans sold with servicing rights retained by the Bank are allocated between the loans and the servicing rights based on their estimated fair values at the time of the loan sale. In accordance with GAAP, MSR are carried at the lower of cost or fair value and are amortized in proportion to, and over the period of, anticipated net servicing income. In accordance with ASC 860-50-35, all separately recognized MSR are required to be initially measured at fair value, if practicable. The estimated fair value of MSR is determined by calculating the present value of estimated future net servicing cash flows, using estimated prepayment, default, servicing cost and discount rate assumptions. All estimates and assumptions utilized in the valuation of MSR are derived based upon actual historical results for the Bank, or, in the absence of such data, from historical results for the Bank's peers.

The fair value of MSR is sensitive to changes in assumptions. Fluctuations in prepayment speed assumptions have the most significant impact on the estimated fair value of MSR. In the event that actual loan prepayments exceed the assumed amount (generally due to increased loan refinancing), the fair value of MSR would likely decline. In the event that actual loan prepayments fall below the assumed amount (generally due to a decline in loan refinancing), the fair value of MSR would likely increase. Any measurement of the value of MSR is limited by the existing conditions and assumptions utilized at a particular point in time, and would not necessarily be appropriate if applied at a different point in time.

Assumptions utilized in measuring the fair value of MSR additionally include the stratification based on predominant risk characteristics of the underlying loans. Increases in the risk characteristics of the underlying loans from the assumptions would result in a decline in the fair value of the MSR. A valuation allowance is established in the event the recorded value of an individual stratum exceeds its fair value for the full amount of the difference.

Asset Impairment Adjustments. Certain assets are carried in the Company's consolidated statements of financial condition at fair value or at the lower of cost or fair value:

(i) Goodwill Impairment Analysis. As of September 30, 2010, the Company had goodwill totaling $55.6 million, which is accounted for in accordance with ASC 805-10. ASC 805-10 requires performance of an annual impairment test at the reporting unit level. Management annually performs analyses to test for impairment of goodwill. In the event an impairment of goodwill is determined to exist, it is recognized as a charge to earnings.

The Company identified a single reporting unit for purposes of its goodwill impairment testing, and thus performs its impairment test on a consolidated basis. The impairment test has two potential stages. In the initial stage, the Holding Company's market capitalization (reporting unit fair value) is compared to its outstanding equity (reporting unit carrying value). The Company utilizes closing price data for the Holding Company's common stock as reported on the Nasdaq National Market in order to compute market capitalization. The Company has designated the last day of its fiscal year as the annual date for impairment testing. The Company performed its annual impairment test as of December 31, 2009 and concluded that no potential impairment of goodwill existed since the fair value of the Company's reporting unit exceeded its carrying value. No events or circumstances have occurred subsequent to December 31, 2009 that would reduce the fair value of the Company's reporting unit below its carrying value. Such events or circumstances would require the immediate performance of an impairment test in accordance with ASC 805-10.

(ii) Valuation of Financial Instruments and Analysis of OTTI Related to Investment Securities and MBS. Debt securities are classified as held-to-maturity, and carried at amortized cost, only if the Company has a positive intent and ability to hold them to maturity.

At September 30, 2010, the Company owned eight pooled trust preferred securities classified as held-to-maturity. Late in 2008, the market for these securities became highly illiquid, and continued to be deemed as such as of September 30, 2010. As a result, at both September 30, 2010 and December 31, 2009, their estimated fair value was obtained utilizing a blended valuation approach (Level 3 pricing as described in Note 11 to the condensed consolidated financial statements). Under the blended valuation approach, broker quotations, which were deemed to meet the criteria of "distressed sale" pricing under the guidance of ASC 820-10-65-4, were given a minor 10% weighting. A cash flow valuation for the eight securities performed utilizing the Internal Cash Flow Valuation was given a 45% weighting. In addition, for five of the eight securities, three independent cash flow model valuations were averaged and given a 45% weighting. For the remaining three securities, two independent cash flow valuations were available and were similarly given a 45% weighting. See Note 11 to the condensed consolidated financial statements for a further discussion of this valuation.

At September 30, 2010, the Company had an investment in nine mutual funds totaling $1.4 million that were classified as trading. All changes in valuation of these securities are recognized in the Company's results of operations. The Company owned no securities classified as trading during the three-month or nine-month periods ended September 30, 2009. Debt securities that are not classified as either held-to-maturity or trading are classified as available-for-sale. Available-for-sale debt and equity securities that have readily determinable fair values are carried at fair value. All of the Company's available-for-sale securities at September 30, 2010 had readily determinable fair values, which were based on published or securities dealers' market values.

The Company conducts a periodic review and evaluation of its securities portfolio, taking into account the severity and duration of each unrealized loss, as well as management's intent and ability to hold the security until the unrealized loss is substantially eliminated, in order to determine if a decline in market value of any security below its carrying value is either temporary or other than temporary. Unrealized losses on held-to-maturity securities that are deemed temporary are disclosed but not recognized. Unrealized losses on debt or equity securities available-for-sale that are deemed temporary are excluded from net income and reported net of deferred taxes as other comprehensive income or loss. All unrealized losses that are deemed other than temporary on either available-for-sale or held-to-maturity securities are recognized immediately as a reduction of the carrying amount of the security, with a corresponding decline in either net income or accumulated other comprehensive income or loss in accordance with ASC 320-10-65. See Note 10 to the condensed consolidated financial statements for a reconciliation of OTTI on securities during the three-month and nine-month periods ended both September 30, 2010 and 2009.

Recognition of Deferred Tax Assets. Management reviews all deferred tax assets periodically. Upon such review, in the event that there is a greater than 50% likelihood that the deferred tax asset will not be fully realized, a valuation allowance is recognized against the deferred tax asset in the amount for which realization is determined to be more unlikely than likely to occur.

Unrecognized Tax Positions. The Company performs two levels of evaluation for all uncertain tax positions. Initially, a determination is made, based on the technical merits of the position, as to whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation. In conducting this evaluation, management is required to presume that the position will be examined by the

appropriate taxing authority possessing full knowledge of all relevant information. The second level of evaluation is the measurement of a tax position that satisfies the more-likely-than-not recognition threshold. This measurement is performed in order to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely to be realized upon ultimate settlement. In making its evaluation, management reviews applicable tax rulings and other advice provided by reputable tax professionals.

Loan Income Recognition. Interest income on loans is recorded using the level yield method. Loan origination fees and certain direct loan origination costs are deferred and amortized as yield adjustments over the contractual loan terms.

Accrual of interest is determined on a loan by loan basis in accordance with regulatory guidelines, however, is generally discontinued on loans that have missed three consecutive monthly payments, at which time the Bank reverses all previously accrued interest. Payments on non-accrual loans are generally applied initially to principal. Management may elect to continue the accrual of interest when a loan is in the process of collection and the estimated fair value of the collateral is sufficient to satisfy the outstanding principal balance (including any outstanding advances related to the loan) and accrued interest. Loans are returned to accrual status once the doubt concerning collectability has been removed and the borrower has demonstrated performance in accordance with the loan terms and conditions for a period of at least 6 months.

Accounting for Defined Benefit Plans. Defined benefit plans are accounted for in accordance with ASC 715, which requires an employer sponsoring a single employer defined benefit plan to recognize the funded status of a benefit plan in its statements of financial condition, measured as the difference between plan assets at fair value (with limited exceptions) and the benefit obligation. The Company utilizes the services of trained actuaries employed at an independent benefits plan administration entity in order to assist in measuring the funded status of its defined benefit plans.

Liquidity and Capital Resources

The Board of Directors of the Bank has approved a liquidity policy that it reviews and updates at least annually. Senior management is responsible for implementing the policy. The Bank's Asset-Liability Committee ("ALCO") is responsible for general oversight and strategic implementation of the policy, and management of the appropriate departments are designated responsibility for implementing any strategies established by ALCO. On a daily basis, senior management receives a current cash position report and one-week forecast to ensure that all short-term obligations are timely satisfied and that adequate liquidity exists to fund future activities. On a monthly basis, reports detailing the Bank's liquidity reserves and forecasted cash flows are presented to both senior management and the Board of Directors. In addition, on a monthly basis, a twelve-month liquidity forecast is presented to ALCO in order to assess potential future liquidity concerns. A forecast of cash flow data for the upcoming 12 months is presented to the Board of Directors on an annual basis.

The Bank's primary sources of funding for its lending and investment activities include deposits, loan and MBS payments, investment security maturities, advances from the FHLBNY, and REPOS entered into with various financial institutions, including the FHLBNY. The Bank may also sell selected multifamily residential, mixed use and one- to four-family residential real estate loans to private sector secondary market purchasers and has in the past sold such loans to FNMA. The Company may additionally issue debt under appropriate circumstances. Although maturities and scheduled amortization of loans and investments are predictable sources of funds, deposit flows and prepayments on mortgage loans and MBS are influenced by interest rates, economic conditions and competition.

The Bank gathers deposits in direct competition with commercial banks, savings banks and brokerage firms, many among the largest in the nation. It must additionally compete for deposit monies against the stock and bond markets,

especially during periods of strong performance in those arenas. The Bank's deposit flows are affected primarily by the pricing and marketing of its deposit products compared to its competitors, as well as the market performance of depositor investment alternatives such as the U.S. bond or equity markets. To the extent that the Bank is responsive to general market increases or declines in interest rates, its deposit flows should not be materially impacted. However, favorable performance of the equity or bond markets could adversely impact the Bank's deposit flows.

Retail branch and internet banking deposits increased $163.8 million during the nine months ended September 30, 2010, compared to a decline of $64.1 million during the nine months ended September 30, 2009. During the nine months ended September 30, 2010, CDs increased $109.4 million, fueled by a promotional 15-month individual retirement account CD promotion, while core deposits (i.e., non-CDs) increased $54.4 million, led by $34.7 million of inflows of competitively priced money markets. During the nine months ended September 30, 2009, CDs declined $200.3 million and were partially offset by an increase of $136.3 million in core deposits. During this period, the Bank did not replace maturing promotional CDs gathered in late 2008 in an effort to both improve its overall funding costs and limit undesired balance sheet growth. The increase in core deposits during the nine months ended September 30, 2009 occurred as deposit pricing pressure diminished in the Bank's marketplace and the Bank experienced an unusually large inflow of money market and checking deposits from commercial customers during the period.

During the nine months ended September 30, 2010, principal repayments totaled $328.9 million on real estate loans and $59.1 million on MBS. During the nine months ended September 30, 2009, principal repayments totaled $249.7 million on real estate loans and $63.8 million on MBS. The increase in principal repayments on real estate loans reflected additional loan refinancing activity as portfolio loans approached their contractual repricing date. The reduction in principal repayments on MBS reflected a decline of $84.0 million in their average balance from the nine months ended September 30, 2009 to the nine months ended September 30, 2010, as the Company has elected not to purchase any MBS during the past several years and experiences monthly principal amortization on its existing MBS. The Company does not presently believe that its future levels of principal repayments will be materially impacted by problems currently experienced in the residential mortgage market. (See "Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations - Asset Quality" for a further discussion of the Bank's asset quality).

During the nine months ended September 30, 2010, the Company converted $35.0 million of REPO borrowings into an FHLBNY advance with the same remaining term to maturity, paying a small conversion premium in the process. The conversion was accomplished in order to change the required underlying collateral from investment securities and MBS (required for REPO borrowings) to real estate loans (permitted for FHLBNY advances). Excluding the conversion of the $35.0 million of REPO borrowings, the Company reduced FHLBNY advances by $140.2 million during the nine months ended September 30, 2010 due to the significant inflow of deposits which was sufficient to fund operations during the period. During the nine months ended September 30, 2009, the Company reduced its FHLBNY advances by $60.0 million, as it elected to utilize liquidity from deposit inflows to reduce its overall borrowing level during the period.

In the event that the Bank should require funds beyond its ability or desire to generate them internally, an additional source of funds is available through use of its borrowing line at the FHLBNY. At September 30, 2010, the Bank had an additional potential borrowing capacity of $489.9 million through the FHLBNY, subject to customary minimum common stock ownership requirements imposed by the FHLBNY (i.e., 4.5% of the Bank's outstanding FHLBNY borrowings).

The Bank is subject to minimum regulatory capital requirements imposed by its primary regulator, The Office of Thrift Supervision (the "OTS"), which, as a general matter, are based on the amount and composition of an institution's assets. At September 30, 2010, the Bank was in compliance with all applicable regulatory capital requirements and was considered "well-capitalized" for all regulatory purposes.

The Company generally utilizes its liquidity and capital resources primarily to fund the origination of real estate loans, the purchase of mortgage-backed and other securities, the repurchase of Holding Company common stock into treasury and the payment of quarterly cash dividends to shareholders of the Holding Company's common stock. During the nine months ended September 30, 2010 and 2009, real estate loan originations totaled $341.3 million and $342.1 million, respectively. Purchases of investment securities (excluding trading securities, short-term investments and federal funds sold) were $71.4 million during the nine months ended September 30, 2010, compared to $22.0 million during the nine months ended September 30, 2009. All of these purchases were limited to medium-term agency notes. The increase in the aggregate level of investment security purchases resulted from management's election to curb asset growth during the year ended December 31, 2009, and thus retain an unusually high level of liquidity in order to maintain balance sheet flexibility during the remainder of 2009, especially in the event deposit balances declined as a result of their historically low offering rates. The higher level of security purchases during the nine months ended September 30, 2010 was more consistent with a measured growth strategy versus the non-growth strategy implemented in early 2009.

The Holding Company did not repurchase any shares of its common stock during the nine months ended September 30, 2010. As of September 30, 2010, up to 1,124,549 shares remained available for purchase under authorized share purchase programs. Based upon the $12.63 per share closing price of its common stock as of September 30, 2010, the

Holding Company would utilize $15.6 million in order to purchase all of the remaining authorized shares. For the Holding Company to complete these share purchases, it would likely require dividend distributions from the Bank.

The Company paid $14.0 million and $13.9 million in cash dividends on its common stock during the nine months ended September 30, 2010 and 2009, respectively. In addition, on May 1, 2010, the Company repaid a $25.0 million subordinated note borrowing at its contractual maturity.

Contractual Obligations

The Bank is obligated for rental payments under leases on certain of its branches and equipment and for minimum monthly payments under its data systems contract. The Bank generally has outstanding at any time significant borrowings in the form of FHLBNY advances and/or REPOS. The Holding Company also has $70.7 million of callable trust preferred borrowings from third parties due to mature in April 2034, which are callable at any time after April 2009. The Holding Company does not currently intend to call this debt. On May 1, 2010, the Holding Company satisfied at maturity an outstanding $25.0 million non-callable subordinated note. None of the outstanding contractual obligations have changed materially since December 31, 2009. The Company additionally had a reserve recorded related to unrecognized income tax benefits totaling $1.4 million at September 30, 2010. The facts and

circumstances surrounding this obligation have not changed materially since December 31, 2009. Please refer to Note 14 to the Company's consolidated audited financial statements for the year ended December 31, 2009 for a further discussion of the unrecognized income tax benefits.

Off-Balance Sheet Arrangements

From December 2002 through February 2009, the Bank originated and sold multifamily residential mortgage loans in the secondary market to FNMA while retaining servicing. The Bank is required to retain the First Loss Position related to all loans sold under this program, which will remain in effect until either the entire portfolio of loans sold to FNMA is satisfied or the Bank indemnifies FNMA for losses (as defined in the agreement) in the aggregate amount of the First Loss Position.

In addition, as part of its loan origination business, the Bank generally has outstanding commitments to extend credit to third parties, which are granted pursuant to its regular underwriting standards. Since many of these loan commitments expire prior to funding, in whole or in part, the contract amounts are not estimates of future cash flows.

The following table presents off-balance sheet arrangements as of September 30, 2010:

	Less than One Year	One Year to Three Years	Over Three Years to Five Years	Over Five Years	Total
			(Dollars in thousands)		
Credit Commitments:					
Available lines of credit	$37,959	$-	$-	$-	$37,959
Other loan commitments (1)	83,356	-	-	-	83,356
Other Commitments:					
First Loss Position on loans sold to FNMA (1)	18,697	-	-	-	18,697
Total Commitments	$140,012	$-	$-	$-	$140,012

(1) In accordance with the requirements of both ASC 450-20-25 and ASC 460-10-25, as of September 30, 2010, reserves on loan commitments and the liability for the First Loss Position on loans sold to FNMA were $323,000 and $3.0 million, respectively, and were recorded in other liabilities in the Company's condensed consolidated statements of financial condition.

Asset Quality

General

At both September 30, 2010 and December 31, 2009, the Company had neither whole loans nor loans underlying MBS that would be considered subprime loans, i.e., mortgage loans advanced to borrowers who did not qualify for market interest rates because of problems with their income or credit history. See Note 10 to the condensed consolidated financial statements for a discussion of impaired investment securities and MBS.

Monitoring and Collection of Delinquent Loans

Management of the Bank reviews delinquent loans on a monthly basis and reports to its Board of Directors regarding the status of all non-performing and otherwise delinquent loans in the Bank's portfolio.

The Bank's loan servicing policies and procedures require that an automated late notice be sent to a delinquent borrower as soon as possible after a payment is ten days late in the case of multifamily residential or commercial real estate loans, or fifteen days late in connection with one- to four-family or consumer loans. A second letter is sent to the borrower if payment has not been received within 30 days of the due date. Thereafter, periodic letters are mailed and phone calls are placed to the borrower until payment is received. When contact is made with the borrower at any time prior to foreclosure, the Bank will attempt to obtain the full payment due or negotiate a repayment schedule with the borrower if that is in the best interest of the Bank.

Accrual of interest is determined on a loan by loan basis in accordance with regulatory guidelines, however, is generally discontinued on loans that have missed three consecutive monthly payments, at which time the Bank reverses all previously accrued interest. Payments on non-accrual loans are generally applied initially to principal. Management may elect to continue the accrual of interest when a loan is in the process of collection and the estimated fair value of the collateral is sufficient to satisfy the outstanding principal balance (including any outstanding advances related to the loan) and accrued interest. Loans are returned to accrual status once the doubt concerning collectability has been removed and the borrower has demonstrated performance in accordance with the loan terms and conditions for a period of at least 6 months.

Generally, the Bank initiates foreclosure proceedings when a loan enters non-accrual status. At some point during foreclosure proceedings, the Bank procures current appraisal information in order to prepare an estimate of the fair value of the underlying collateral. If a foreclosure action is instituted and the loan is not brought current, paid in full, or refinanced before the foreclosure action is completed, the property securing the loan is generally sold. It is

the Bank's general policy to dispose of non-accrual loans and OREO properties as quickly and prudently as possible in consideration of market conditions, the physical condition of the property and any other mitigating circumstances.

Non-accrual Loans

Within the Bank's portfolio, non-accrual loans totaled $19.6 million and $11.3 million at September 30, 2010 and December 31, 2009, respectively, representing 0.57% and 0.33% of total loans at September 30, 2010 and December 31, 2009. During the nine months ended September 30, 2010, twenty-one loans totaling $12.8 million were added to non-accrual status. Partially offsetting this increase were thirteen loans totaling $2.3 million that were removed from non-accrual status as they were satisfied during the period, and one non-accrual loan totaling $320,000 that was transferred to OREO. The difficulties experienced in both the national real estate and financial services marketplaces combined to adversely impact the metropolitan NYC area multifamily and commercial real estate markets during the three-month and nine-month periods ended September 30, 2010.

Impaired Loans

A loan is considered impaired when it is probable that all contractual amounts due will not be collected in accordance with the terms of the loan. A loan is not deemed impaired, even during a period of delayed payment by the borrower, if the Bank ultimately expects to collect all amounts due, including interest accrued at the contractual rate. Generally, the Bank considers non-accrual and troubled-debt restructured multifamily residential and commercial real estate loans, along with non-accrual one- to four-family loans exceeding $625,500, to be impaired. Non-accrual one-to four-family loans of $625,500 or less, as well as all consumer loans, are considered homogeneous loan pools and are not required to be evaluated individually for impairment. Impairment is measured by the amount that the carrying balance of the loan, including all accrued interest, exceeds its likely realizable value (typically obtained from an appraisal of the underlying collateral). Principal balances of all impaired loans are reduced to their likely realizable value, as determined by the impairment analysis. The recorded investment in loans deemed impaired was approximately $27.5 million, consisting of thirty-nine loans, at September 30, 2010, compared to $15.0 million, consisting of nineteen loans, at December 31, 2009. During the nine months ended September 30, 2010, twenty-four loans totaling $18.0 million were added to impaired status, while two loans totaling $1.8 million were sold, one $425,000 loan was upgraded, and one $320,000 loan was transferred to OREO. In addition, $3.1 million of aggregate principal balance on fourteen impaired loans at December 31, 2009 were charged-off during the nine months ended September 30, 2010. During the nine months ended September 30, 2009, twenty-one loans totaling $12.1 million were added to impaired status, while ten loans totaling $4.8 million were removed from impaired status. Of the $4.8 million removed from impaired status, $1.9 million represented a satisfaction that occurred during the period, and the remainder represented loans that were no longer deemed impaired due primarily to continued performance in accordance with their contractual terms. The average balance of impaired loans approximated their period-end balance during the nine months ended both September 30, 2010 and 2009. The increase in the average balance of impaired loans during the nine months ended September 30, 2010 compared to the nine months ended September 30, 2009 reflected the increase of $12.4 million in impaired loans from September 30, 2009 to June 30, 2010.

At September 30, 2010, total impaired loans exceeded total non-accrual loans by $7.9 million due to two accruing troubled-debt restructured loans with an aggregate balance of $7.7 million, and one additional loan with a balance of $495,000 that, despite being on accrual status, were deemed impaired as a result of unique extenuating circumstances related to the borrower and/or collateral property. The impaired loans that remained on accrual status were partially offset by thirteen non-accrual loans totaling $268,000 which, while on non-accrual status, were not deemed impaired since they were either one- to four-family loans with individual outstanding balances of $625,500 or less or consumer loans.

Troubled-Debt Restructurings ("TDRs")

Under ASC 310-40-15, the Bank is required to account for certain loan modifications or restructurings as TDRs. In determining whether a loan modification meets the criteria for classification as a TDR, management considers the following:

- For economic or legal reasons related to the debtor's financial difficulties, a concession has been granted that would not have otherwise been considered
    - A reduction of interest rate has been made for the remaining term of the loan
- The maturity date of the loan has been extended with a stated interest rate lower than the current market rate for new debt with similar risk
    - The outstanding principal amount and/or or accrued interest have been reduced

In instances in which the interest rate has been reduced or the loan term extended, management further considers the following:

- The reduction in interest rate reflected either a general decline in market interest rates or an effort to maintain a relationship with a borrower who could readily obtain funds from other sources at the current market interest rate. [FAS 015, paragraph 7]]
- The terms of the restructured loan are comparable to the terms offered by the Bank to non-troubled debtors.

The Bank never accepts receivables or equity interests in satisfaction of TDRs.

Current OTS regulations require that TDRs remain classified as such until the loan is either repaid or returns to its original terms. At September 30, 2010, the Bank had four loans totaling $10.7 million whose terms were modified in a manner that met the criteria for a TDR. Two of these loans, with an aggregate outstanding principal balance of $3.0 million, were on non-accrual status as of September 30, 2010, while the remaining two loans, with an outstanding principal balance of $7.7 million, were accruing TDRs at September 30, 2010. Two of the four TDRs, totaling $7.9 million, were commercial real estate loans and two loans totaling $2.8 million were multifamily residential real estate loans. At December 31, 2009, the Bank had three loans totaling $5.3 million outstanding whose terms were modified in a manner that met the criteria for a TDR. One of these three loans, with an outstanding principal balance of $1.0 million, was classified as an accruing TDR at December 31, 2009, while the remaining two loans remained on non-accrual status. Two of these three loans were commercial real estate loans, while the remaining loan was a multifamily residential real estate loan.

Of the four TDRs outstanding at September 30, 2010, the following table summarizes the concessions made:

Concession Granted	Number of TDRs
Reduction of Interest rate for remaining term	4
Reduction of outstanding principal due or accrued interest receivable	2
Below market interest rate granted	2
Temporary suspension of amortization	4
Extension of maturity period	1

Since all TDRs are collateralized by real estate, an appraisal of the underlying real estate collateral is deemed the most appropriate measure to utilize when evaluating impairment. Any shortfall in valuation on TDRs is accounted for through a charge-off, which can impact the level of periodic loan loss provisions. The Bank recognized principal charge-offs of $1.3 million on the two non-accrual TDR loans during the nine months ended September 30, 2010.

Accrual status for TDR loans is determined separately for each TDR. At the time the TDR is agreed to between the Bank and the borrower, the loan can be either on accrual or non-accrual status. According to Bank policy, accruals typically cease when a loan misses three consecutive monthly payments. Therefore, if a loan is on non-accrual status at the time it is restructured, it continues being classified as non-accrual until the borrower has demonstrated compliance with the modified loan terms for a period of at least six months. Conversely, if at the time of restructuring the loan is performing (and accruing), it will remain accruing throughout its restructuring period, unless three consecutive payments are not made under the restructuring agreement, and the loan thus becomes non-performing in accordance with either the Bank's policy, as disclosed on page F-12 of the Annual Report on Form 10-K for the year ended December 31, 2009, and/or the criteria related to accrual of interest established by the OTS. Accrual of interest would cease for any TDR in which a charge-off of principal has been determined during the reporting period.

OREO

Property acquired by the Bank, or a subsidiary, as a result of foreclosure on a mortgage loan or a deed in lieu of foreclosure is classified as OREO Upon entering OREO, the Bank obtains a current appraisal on the property and reassesses the likely realizable value of the property quarterly thereafter. Only either contractual or formal marketed values that fall below the appraised value are used when determining the likely realizable value of OREO at each reporting period. The Bank typically seeks to dispose of OREO properties in a timely manner. As a result, OREO properties have generally not warranted a subsequent independent appraisal.

The Bank owned two OREO properties with an aggregate recorded balance of $85,000 at September 30, 2010. At December 31, 2009, the Bank owned five OREO properties with an aggregate recorded balance of $755,000. During the nine months ended September 30, 2010, the Company added one OREO property with a balance of $320,000 and disposed of four properties with an aggregate balance of $568,000. The Company also reduced the balance of two OREO properties by a total of $422,000 during the period to reflect their likely disposal value. In all instances, these reductions reflected valuation information obtained during the reporting period.

The following table sets forth information regarding non-accrual loans, OREO, and non-performing investment securities at the dates indicated:

	At September 30, 2010		At December 31, 2009	
	(Dollars in Thousands)			
Non-accrual loans				
One- to four-family	$ 224		$ 371	
Multifamily residential	12,934		7,820	
Commercial real estate	6,396		3,070	
Cooperative apartment	25		26	
Other	19		7	
Total non-accrual loans	$ 19,598		$ 11,294	
OREO	85		755	
Non-performing investment securities	559		688	
Total non-performing assets	$ 20,242		$ 12,737	
Ratios:				
Total non-accrual loans to total loans	0.57	%	0.33	%
Total non-performing assets to total assets	0.51		0.32	

Other Potential Problem Loans

(i) Loans Delinquent 30 to 89 Days

The Bank had 26 real estate loans, totaling $16.5 million, that were delinquent between 30 and 89 days at September 30, 2010, a net reduction of $13.0 million compared to 38 such loans totaling $29.5 million at December 31, 2009. Included within the 30 to 89 day delinquent loans as of September 30, 2010 was a $496,000 principal balance loan that was included in the previously discussed $27.5 million of loans deemed impaired at September 30, 2010. Given the challenges facing the NYC area real estate market at September 30, 2010, it is anticipated that 30-89 day delinquencies will remain above $10 million for the foreseeable future. The 30 to 89 day delinquent levels fluctuate monthly, and are generally considered a less accurate indicator of credit quality trends than non-accrual loans.

(ii) Loan Modifications

At September 30, 2010, the Bank had 29 loans totaling $50.0 million that were mutually modified with the borrowers in a manner that did not meet the criteria for TDRs, and were either current or less than 30 days delinquent at September 30, 2010. These modifications, which have a typical term of 12 months, were granted by the Bank to borrowers who requested cash flow relief in order to assist them through periods of sub-optimal occupancy. The key features of the modified loans are: 1) temporary and/or minor reductions in the cash flow requirements of debt service; and 2) no forgiveness of contractual principal and interest amounts due to the Bank. The relief granted via modified loans has been provided in the form of either: (1) temporary suspension of monthly principal amortization; or (2) either a temporary reduction of interest rate, or a permanent reduction to an interest rate higher than that offered a prime borrower and generally reflective of the credit condition of the loan at the time of modification. In consideration of paragraph 12c of ASC 310-40-15, the interest rate offered the borrower in a modification was consistent with an interest rate that: 1) the Bank would have offered a different borrower with comparable loan-to-value and debt service coverage ratios (after recognizing the sub-optimal rental status in determining such loan-to-value and debt service coverage ratios); and 2) the borrower could have received from another financial

institution at the time of modification. To date, no modified loans have had their maturities extended, nor would this be a typical negotiable item for the Bank. While all of the modified loans at September 30, 2010 were secured by real estate, none of them were reliant upon the liquidation of the underlying collateral for the repayment of the outstanding loan. In the rare instance in which the Bank also held a second lien on a first mortgage that was modified, it would consider the combined debt obligations of both liens in determining potential impairment. Any impairment determined based upon this combined debt would result in a charge-off of the second lien initially, and the first loan only after the full second lien has been eliminated.

Any loan modification that either: 1) reduced the contractual rate below market as defined in the previous paragraph; or 2) forgave principal owed; or 3) met any of the other criteria designated in ASC 310-40-15 would have been deemed a TDR at September 30, 2010. Since the Bank is an active prime multifamily residential and commercial real estate lender, it has continuous access to marketplace offering rates for such properties. Any adjustments to lending rates for loans experiencing sub-optimal lending conditions would be authorized under the loan approval and underwriting polices outlined on page F-11 of the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

Based upon the criteria established by the Bank to review its potentially problem loans for impairment, designation of these modified loans as TDRs would not have had a material impact upon the determination of the adequacy of the Bank's allowance for loan losses during the nine months ended September 30, 2010.

Problem Loans Serviced for FNMA Subject to the First Loss Position

The Bank services a pool of multifamily loans sold to FNMA which had an outstanding principal balance of $392.6 million at September 30, 2010. This pool is subject to recourse in the form of the First Loss Position, which totaled $18.7 million at September 30, 2010. Within this pool of loans, two loans totaling $2.2 million were 90 days or more delinquent at September 30, 2010. At September 30, 2010, the Bank had further identified one additional loan over 30 days past due totaling $1.4 million within the FNMA pool. The Bank manages the collection of these loans in the same manner as it does for portfolio loans. Under the terms of the servicing agreement with FNMA, the Bank is obligated to fund FNMA all monthly principal and interest payments under the original terms of the loans, and to indemnify FNMA for any further losses (as defined in the sale agreement) until the earlier of the following events: (i) the Bank re-acquires the loan from FNMA; or (ii) the loans have either been fully satisfied or enter OREO status. However, the aggregate losses incurred by the Bank on this pool of serviced loans cannot exceed the total First Loss Position. The Bank has previously repurchased, and may opt to continue to repurchase, loans sold to FNMA with recourse exposure that become 90 or more days delinquent. Such repurchased loans are reported as non-performing portfolio loans and are typically purchased from FNMA in order to control losses and expedite resolution of the loan, via restructure, reinstatement, note sale or enforcement of legal remedies.

Allowance for Loan Losses

The Bank's allowance for loan losses has traditionally been comprised three primary components. The first two components relate to problematic loans and are divided between loans deemed impaired and loans classified as special mention. The final component of the allowance for loan losses relates to non-problematic or performing loans.

Impaired Loan Component

The component of the allowance associated with impaired loans is determined individually for each impaired loan. To the extent that the individual loan analysis determines an impaired balance, the Bank may either allocate a reserve within the allowance for loan losses or charge off the amount of principal deemed impaired. Based upon this methodology, increases or decreases in either the amount of impaired loans, or the magnitude of impairment of such loans will impact the allocated portion of the allowance for loan losses associated with such loans. In addition, the election to recognize the impairment as either an allocated reserve or a charge-off of principal deemed loss would further impact this allocated balance. As a result, the allowance for loan losses associated with impaired loans is subject to significant volatility.

At December 31, 2009, an allocated reserve of $1.9 million, or 0.06% of total loans, was recognized for impaired loans. As a result of additions to impaired loans as well as deterioration in the condition of the existing impaired loans, this allocated reserve grew to $5.8 million, or 0.17% of total loans, at June 30, 2010. During the quarter ended September 30, 2010, management elected to charge off its allocated reserve balance associated with impaired loans, thus carrying no allocated reserve on impaired loans at September 30, 2010.

The following table summarizes the impaired loan component of the allowance for loan losses at the dates presented:

	Total Impaired Loan Balance	Allocated Allowance Balance	Allocated Allowance Balance as a Percentage	Allocated Allowance Balance as a Percentage

			of the Total Balance of Impaired Loans	of Total Loans
	(Dollars in Thousands)			
At December 31, 2009	$15,049	$1,943	12.9%	0.06%
At June 30, 2010	29,515	5,782	19.6	0.17
At September 30, 2010	27,466	-	-	-

Special Mention Component

Prior to the quarterly period ended September 30, 2010, the component of the allowance for loan losses associated with special mention loans was determined based upon an expectation of default, and expected loss experience associated with loans that were deemed likely to default. Each individual special mention loan was reviewed separately for purposes of this analysis. Commencing during the three months ended September 30, 2010, a 12-month loss migration analysis on loans classified as special mention was utilized in order to determine an expected loss percentage to be applied to the aggregate pool of special mention loans. Based upon this methodology, increases or decreases in either the amount of special mention loans, or the magnitude of charge-offs recognized within the past 12 months, will impact the allocated portion of the allowance for loan losses associated with such loans. As a result, the allowance for loan losses associated with special mention loans is also subject to significant volatility.

The following table summarizes the special mention loan component of the allowance for loan losses at the dates presented:

	Total Special Mention Loan Balance	Allocated Allowance Balance	Allocated Allowance Balance as a Percentage of the Total Balance of Special Mention Loans	Allocated Allowance Balance as a Percentage of Total Loans
	(Dollars in Thousands)			
At December 31, 2009	$69,582	$3,862	5.55%	0.11%
At June 30, 2010	23,676	1,293	5.46	0.04
At September 30, 2010	32,266	1,469	4.55	0.04

The decline in Special Mention loans during the nine months ended September 30, 2010 reflected either the resolution or improved status of several significant borrower relationships that were classified as Special Mention at December 31, 2009.

Performing Loan Component

In determining the allowance for loan losses associated with performing loans, the following five elements are considered: (i) charge-off experience; (ii) concentrations of credit; (iii) underwriting standards and experience; (iv) economic conditions; and (v) the period of time the loan has been held and performing. The charge-off experience utilized at December 31, 2009, as well at each reporting period during the nine months ended September 30, 2010, was derived from the loss experience of each loan collateral type during the Bank's most recent fully completed real estate recessionary cycle, which occurred from 1992 through 1996. Management expects to transition to the current recessionary period loss experience once it believes that the current cycle is approaching its completion. In the interim, management regularly compares the loss experience in the current recessionary cycle to the 1992 through 1996 recessionary cycle in order to ensure that utilizing the 1992 through 1996 loss data is not understating the loss experience expected to be recognized in the current recessionary cycle. To date, the loss experience of the current recessionary period has fallen below the loss experience of the 1992 through 1996 recessionary cycle. The four remaining elements driving the allowance for loan losses associated with performing loans experienced little to no change during the period December 31, 2009 through September 30, 2010, due primarily to both the ongoing stability in the Bank's lending activities and loan delinquencies, as well as the relative stability of the New York City rental market.

The following table compares September 30, 2010 to December 31, 2009 for each of the five components of the Bank's allowance for loan losses associated with performing loans:

Component:	Comparison of September 30, 2010 and December 31, 2009
Charge-off experience	Unchanged
Concentrations of credit	Unchanged
Underwriting standards and experience	Unchanged
Economic conditions	Unchanged
The period of time the loan has been held and performing	Slight improvement

As a result , this portion of the allowance for loan losses remained relatively constant during the nine months ended September 30, 2010, ranging between 0.45% and 0.47% of total loans. The following table summarizes the portion of

the allowance for loan losses associated with performing loans as of the dates indicated:

	Total Performing Loan Balance	Allocated Allowance Balance	Allocated Allowance Balance as a Percentage of the Total Balance of Performing Loans	Allocated Allowance Balance as a Percentage of Total Loans
	(Dollars in Thousands)			
At December 31, 2009	$3,310,628	$15,700	0.47%	0.46%
At June 30, 2010	3,411,851	16,275	0.48	0.47
At September 30, 2010	3,367,360	15,473	0.46	0.45

Management's quarterly evaluation of the loan loss reserves associated with performing loans takes into account not only performance of the current loan portfolio, but also general credit conditions and volume of new business, in determining the timing and amount of any future loan loss provisions.

The allowance for loan losses was $16.9 million at September 30, 2010, down from $21.5 million at December 31, 2009. During the nine months ended September 30, 2010, the Bank recorded a provision of $7.9 million to its allowance for loan losses in order to provide for probable credit losses in the portfolio and loans committed for funding at period end. During the same period, the Bank also recorded net charge-offs of approximately $12.6 million

against its allowance for loan losses, and transferred $99,000 of reserves from the liability related to loan origination commitments into the allowance for loan losses.

Charge-offs totaled $6.8 million during the three months ended September 30, 2010. Of this total, $886,000 resulted from the disposition of four loans to two problem borrowers totaling $6.6 million. In addition, at June 30, 2010, the Bank had $5.2 million of reserves allocated within its allowance for loan losses for probable credit losses on $26.7 million of loans deemed impaired at June 30, 2010. Given the uncertainty of the ultimate resolution of the $5.2 million allocated reserve, the Bank, at June 30, 2010, recognized it as a component of its general allowance for loan losses. During the most recent quarter, the Bank's dispositions of impaired loans continued to occur at a discount to the appraised values on such loans (as had also occurred in the previous quarter). Management thus elected to charge-off the $5.2 million reserve balance, as well as an additional $470,000 of probable credit losses resulting from further reduction in the likely realizable value of these loans during the September 2010 quarter. In accordance with established policy, escrow advances of $310,000 on these loans were also charged off.

During the twelve months ended September 30, 2010, the Company recognized approximately $15.6 million in net charge-offs and recorded loan loss provisions totaling $12.4 million. Both of these amounts were significantly in excess of levels experienced prior to commencement of the real estate recession in 2008. The Company remains committed to resolving non-accrual loans as expeditiously as possible. While there has been a corollary relationship between the heightened levels of both loan loss provisions and charge-offs during the period, these two amounts have not necessarily closely correlated within individual quarters, especially during the first three quarters of 2010. As a result, the great majority of charge-offs recognized during both the June 2010 and September 2010 quarters were more closely associated with the loan loss provisions recognized in late 2009 and the first six months of 2010. (See "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies – Allowance for Loan Losses" for a further discussion).

The significant fluctuations in recorded charge-offs from quarter to quarter are also attributable to the following: (1) there have been so few problem loans; (2) the average loan size in the portfolio is larger than a typical single family portfolio; (3) one borrower occasionally has a portfolio of loans financed by the Bank, therefore when such a borrower encounters payment problems it can affect several loans simultaneously; and (4) the timing and resolution of problem loans is unpredictable.

Reserve Liability on Loan Origination Commitments

The Bank also had a reserve liability related to loan origination commitments (recorded in other liabilities) that totaled $581,000 at September 30, 2010 and $679,000 at December 31, 2009. This amount fluctuates based upon the amount and composition of the Bank's loan commitment pipeline.

Comparison of Financial Condition at September 30, 2010 and December 31, 2009

Assets. Assets totaled $4.00 billion at September 30, 2010, an increase of $44.5 million from total assets of $3.95 billion at December 31, 2009.

Cash and due from banks and federal funds sold and other short-term investments increased $31.4 million and $20.1 million, respectively, during the period. During the first nine months of 2010, the Company gathered $163.8 million in new deposits and has elected to retain a portion of these funds in liquid balances to fund future cash obligations. Portfolio real estate loans increased $28.1 million during the period, as a result of $341.3 million of originations and $45.1 million of purchases, which were partially offset by amortization and satisfactions of $286.1 million and portfolio sales of $65.5 million during the same period. MBS available-for-sale declined $59.6 million during the period on principal repayments of $59.1 million during the nine months ended September 30, 2010.

Liabilities. Total liabilities increased $16.8 million during the nine months ended September 30, 2010, primarily as a result of the addition of $163.8 million in deposits, and $26.1 million in mortgagor escrow balances during the period. The Company repaid a maturing $25.0 million subordinated note on May 1, 2010 and reduced its aggregate balance of FHLBNY advances and REPO borrowings by $140.2 million during the nine months ended September 30, 2010. Mortgagor escrow balances increased as a result of both increased loan balances and borrowers funding real estate escrow obligations in advance of annual payments to be made by the Bank on their behalf in December 2010. See "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" for a discussion of the changes in retail branch and Internet banking deposits, FHLBNY advances, REPOS and the subordinated note payable during the period.

Stockholders' Equity. Stockholders' equity increased $27.7 million during the nine months ended September 30, 2010, due primarily to net income of $30.8 million, a reclassification of $8.0 million from liabilities to equity related to the ESOP benefit component of the Company’s BMP that resulted from modifications made to the BMP in March 2010, and $2.4 million of stock benefit plan expense amortization that added to the cumulative balance of stockholders' equity. Partially offsetting these items were $14.0 million in cash dividends paid during the period.

Comparison of Operating Results for the Three Months Ended September 30, 2010 and 2009

General. Net income was $11.4 million during the three months ended September 30, 2010, an increase of $3.0 million from net income of $8.3 million during the three months ended September 30, 2009. During the comparative period, net interest income increased $5.3 million and non-interest income declined $1.0 million, while the provision for loan losses fell $3.1 million and non-interest expense increased $1.3 million, resulting in an increase in pre-tax income of $6.1 million. Income tax expense increased $3.1 million during the comparative period due to both the increase in pre-tax earnings as well as a higher effective tax rate.

Net Interest Income. The discussion of net interest income for the three months ended September 30, 2010 and 2009 presented below should be read in conjunction with the following tables, which set forth certain information related to the condensed consolidated statements of operations for those periods, and which also present the average yield on assets and average cost of liabilities for the periods indicated. The average yields and costs were derived by dividing income or expense by the average balance of their related assets or liabilities during the periods represented. Average balances were derived from average daily balances. The yields include fees that are considered adjustments to yields.

Analysis of Net Interest Income

	Three Months Ended September 30,					
	2010			2009		
	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
Assets:	(Dollars In Thousands)					
Interest-earning assets:						
Real estate loans	$3,439,448	$50,648	5.89 %	$3,266,416	$48,422	5.93 %
Other loans	1,316	28	8.51	1,568	35	8.93
MBS	166,672	1,846	4.43	246,354	2,748	4.46
Investment securities	64,325	290	1.80	26,039	76	1.17
Federal funds sold and other short-term investments	134,749	702	2.08	181,303	809	1.78
Total interest-earning assets	3,806,510	$53,514	5.62 %	3,721,680	$52,090	5.60 %
Non-interest earning assets	283,523			190,633		
Total assets	$4,090,033			$3,912,313		
Liabilities and Stockholders' Equity:						
Interest-bearing liabilities:						
Interest bearing checking accounts	$98,588	$99	0.40 %	$105,938	$179	0.67 %
Money Market accounts	760,509	1,221	0.64	730,634	1,738	0.94
Savings accounts	317,243	202	0.25	297,450	201	0.27
CDs	1,107,791	5,861	2.10	1,016,246	7,038	2.75
Borrowed Funds	1,213,607	11,855	3.88	1,265,644	13,965	4.38
Total interest-bearing liabilities	3,497,738	$19,238	2.18 %	3,415,912	$23,121	2.69 %
Non-interest bearing checking accounts	122,722			105,211		
Other non-interest-bearing liabilities	150,483			105,502		
Total liabilities	3,770,943			3,626,625		
Stockholders' equity	319,090			285,688		
	$4,090,033			$3,912,313		

Total liabilities and stockholders' equity								
Net interest income		$34,276				$28,969		
Net interest spread			3.44	%			2.91	%
Net interest-earning assets	$308,772				$305,768			
Net interest margin			3.60	%			3.11	%
Ratio of interest-earning assets to interest-bearing liabilities			108.83	%			108.95	%

Rate/Volume Analysis

	Three Months Ended September 30, 2010 Compared to Three Months Ended September 30, 2009 Increase/ (Decrease) Due to:		
	Volume	Rate	Total
	(Dollars In thousands)		
Interest-earning assets:			
Real Estate Loans	$2,559	$(333)	$2,226
Other loans	(6)	(1)	(7)
MBS	(886)	(16)	(902)
Investment securities	143	71	214
Federal funds sold and other short-term investments	(226)	119	(107)
Total	$1,584	$(160)	$1,424
Interest-bearing liabilities:			
Interest bearing checking accounts	$(10)	$(70)	$(80)
Money market accounts	50	(567)	(517)
Savings accounts	15	(14)	1
CDs	549	(1,726)	(1,177)
Borrowed funds	(550)	(1,560)	(2,110)
Total	$54	$(3,937)	$(3,883)
Net change in net interest income	$1,530	$3,777	$5,307

During the period January 1, 2009 through September 30, 2010, FOMC monetary policies resulted in the maintenance of the overnight federal funds rate in a range of 0.0% to 0.25%. As a result, beginning in early 2009, the Company was able to commence an orderly reduction of both its deposit and borrowing costs that continued through September 2010. In addition, dislocations in the securitization marketplace for loans secured by multifamily and commercial real estate reduced the overall competition for the Bank's primary loan product, thus permitting reductions in origination rates on these loans to lag the general reductions in their benchmark interest rates. Both of these factors favorably impacted the Company's net interest margin during the three months ended September 30, 2010 compared to the three months ended September 30, 2009.

Interest Income. Interest income was $53.5 million during the three months ended September 30, 2010, an increase of $1.4 million from the three months ended September 30, 2009, primarily reflecting growth in interest income of $2.2 million on real estate loans and $214,000 on investment securities. The increase in interest income on real estate loans resulted from an increase of $173.0 million in their average balance, and the increase in investment interest income similarly resulted from an increase of $38.3 million in their average balance during the three months ended September 30, 2010 compared to the three months ended September 30, 2009.

Offsetting these items was a decline of $902,000 in interest income on MBS that resulted from a reduction of $79.7 million in their average balance during the three months ended September 30, 2010 compared to the three months ended September 30, 2009. The reduction in average balance resulted from $77.3 million in principal repayments during the period October 2009 through September 2010. The Company has not purchased any MBS since January 1, 2009. Interest income on other short-term investments declined $107,000 during the comparative period, primarily as a result of a reduction of $95,000 in FHLBNY capital stock income, reflecting both a reduction in average balance of the Company's FHLBNY capital stock investment and a lower quarterly dividend rate declared by the FHLBNY in 2010 compared to the comparable period of 2009.

Interest Expense. Interest expense decreased $3.9 million, to $19.2 million, during the three months ended September 30, 2010, from $23.1 million during the three months ended September 30, 2009. The decline resulted from reductions in interest expense of $517,000 on money market accounts, $1.2 million on CDs, and $2.1 million on borrowed funds.

The decrease in interest expense on money market accounts and CDs resulted from declines of 30 basis points and 65 basis points, respectively, in their average cost, as a result of the Company's orderly reduction in offering rates on all deposit accounts from October 2009 through September 2010. In addition, the Company was able to re-finance maturing borrowings at lower average costs during the period October 2009 through September 2010, creating a reduction of 50 basis points in its average borrowing costs from the three months ended September 30, 2009 to the three months ended September 30, 2010. Partially offsetting these items was additional interest expense resulting from an increase in the average balance of money markets and CDs of $29.9 million and $91.5 million, respectively, from the three months ended September 30, 2009 to the three months ended September 30, 2010, reflecting $163.8 million of deposits added during the first nine months of 2010 (the great majority of which were money markets and CDs). The average balance of borrowed funds declined $52.0 million during the three months ended September 30, 2010 compared to the three months ended September 30, 2009, reflecting both a reduction of $140.2 million in the aggregate balance of FHLBNY Advances and REPOs from December 31, 2009 to September 30, 2010, as well as the satisfaction of the Holding Company’s $25.0 million subordinated note in May 2010.

Provision for Loan Losses. The provision for loan losses was $667,000 during the three months ended September 30, 2010, a decrease of $3.1 million from the provision of $3.8 million recorded during the three months ended September 30, 2009. During the nine months ended September 30, 2010, the Bank recognized charge-offs of $12.6 million on impaired loans. As a result of these charge-offs, the level of probable credit losses on impaired loans was significantly reduced. While loans deemed impaired were added during the period, the level of probable credit losses on these impaired loans remained lower at September 30, 2010 compared to September 30, 2009. As a result, although impaired loans were higher at September 30, 2010 than September 30, 2009, a lower loan loss provision was recorded in the September 2010 quarter. Management remains committed to providing for expected losses on impaired loans in a timely manner, thus any deterioration in conditions within the Bank's loan portfolio will be recognized timely within the provision for loan losses. Due to the reduced level of probable credit losses on impaired loans at September 30, 2010, as well as the continued strong performance of the overall loan portfolio, the Company's analysis of the adequacy of its allowance for loan losses at September 30, 2010 did not warrant replenishment of the great majority of the $6.8 million of charge-offs recognized during the quarter. The provision thus totaled $667,000 during the quarter ended September 30, 2010, a significant decline from the previous quarter.

Non-Interest Income. Total non-interest income declined $1.0 million from the three months ended September 30, 2009 to the three months ended September 30, 2010, due primarily to an increase in credit-related OTTI charges of $1.1 million. The great majority of the increased OTTI charge reflected a deterioration in the expected cash flows associated with one bond that, as of September 30, 2010, had virtually no remaining recorded balance.

Non-Interest Expense. Non-interest expense was $14.9 million during the three months ended September 30, 2010, an increase of $1.3 million from $13.6 million during the three months ended September 30, 2009.

Salaries and employee benefits increased $450,000 due to both ongoing salary increases and an increase in the expected payout on the Company's long-term incentive plan. Occupancy and equipment expense increased $264,000, primarily as a result of two new branch locations. Federal deposit insurance costs increased $156,000 during the comparative period and other expenses increased $181,000 primarily as a result of higher legal costs.

Non-interest expense was 1.46% of average assets during the three months ended September 30, 2010, compared to 1.39% during the three months ended September 30, 2009, reflecting the $1.3 million increase in expenses.

Income Tax Expense. Income tax expense increased $3.1 million during the three months ended September 30, 2010 compared to the three months ended September 30, 2009, due primarily to an increase of $6.1 million in pre-tax earnings. The Company's customary consolidated tax rate had previously approximated 37%. During the three months ended September 30, 2010, New York State enacted a change in both state and New York City tax law associated with bad debt deductions permissible by savings banks, effective retroactively to January 1, 2010. As a result, the Company was required to recognize an adjustment of approximately $700,000 during the three months ended September 30, 2010 for the difference between the previous and new rules for the first six months of 2010. The Company's consolidated effective tax rate thus increased to 42.6% during the most recent quarter. Looking forward, the consolidated effective tax rate is expected to approximate 40%.

Comparison of Operating Results for the Nine Months Ended September 30, 2010 and 2009

General. Net income was $30.8 million during the nine months ended September 30, 2010, an increase of $12.7 million from net income of $18.1 million during the nine months ended September 30, 2009. During the comparative period, net interest income increased $20.8 million and non-interest income increased $6.1 million, while the provision for loan losses declined $713,000 and non-interest expense increased $3.8 million, resulting in an increase in pre-tax income of $23.9 million. Income tax expense increased $11.1 million during the comparative period due to both the increase in pre-tax earnings as well as a higher effective tax rate.

Net Interest Income. The discussion of net interest income for the nine months ended September 30, 2010 and 2009 presented below should be read in conjunction with the following tables, which set forth certain information related to the condensed consolidated statements of operations for those periods, and which also present the average yield on assets and average cost of liabilities for the periods indicated. The average yields and costs were derived by dividing income or expense by the average balance of their related assets or liabilities during the periods represented. Average balances were derived from average daily balances. The yields include fees that are considered adjustments to yields.

Analysis of Net Interest Income

	Nine Months Ended September 30,					
	2010			2009		
	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
Assets:	(Dollars In Thousands)					
Interest-earning assets:						
Real estate loans	$3,454,596	$151,839	5.86%	$3,270,839	$144,412	5.89%
Other loans	1,373	97	9.42	1,633	110	8.98
MBS	185,917	6,199	4.45	269,911	8,997	4.44
Investment securities	57,398	1,009	2.34	21,521	515	3.19
Federal funds sold and other short-term investments	153,475	2,125	1.85	223,412	2,170	1.30
Total interest-earning assets	3,852,759	$161,269	5.58%	3,787,316	$156,204	5.50

plans to achieve economies of scale by expan

- enhancements to our existing operating syste
- certain planned benefits of the new operating
- we will now be able to invest our resources i

We recorded an impairment charge of $48 million in the

Adjusted EBITDA

The following table provides a summary of changes in t

(In millions)
Three months ended March 31, 2013
Change in operating revenue

Interest and net investment income
Contract claims
Tax-related reserves
Selling and administrative expenses
Three months ended March 31, 2014

In the first quarter of 2014 and 2013, the segment s Ad

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Franchise Services Group Segment

First Quarter of 2014 Compared to First Quarter of 2013

The Franchise Services Group segment, which consists of the ServiceMaster Restore (disaster restoration), ServiceMaster Clean (janitorial), Merry Maids (residential cleaning), Furniture Medic (furniture repair) and AmeriSpec (home inspection) businesses, reported an 8.1 percent increase in operating revenue and a 1.5 percent increase in Adjusted EBITDA for the first quarter of 2014 compared to the first quarter of 2013.

Operating Revenue

Operating Revenue by service line is as follows:

(In millions)	Three months ended March 31, 2014	2013	% of Operating Revenue 2014
Royalty Fees	$ 29	$ 28	47.3%
Company-Owned Merry Maids Branches	15	15	24.5%
Janitorial National Accounts	7	5	11.9%
Sales of Products	7	5	10.9%
Other	2	3	5.4%
Total operating revenue	$ 60	$ 56	100.0%

Royalty fees increased 3.1 percent compared to the first quarter of 2013, primarily driven by increases in disaster restoration services. Revenue from company-owned Merry Maids branches was comparable to the first quarter of 2013 with customer counts as of March 31, 2014 comparable to March 31, 2013. Revenue from janitorial national accounts increased 44.0 percent compared to the first quarter of 2013, driven by strong sales activity. Sales of products to franchisees increased 40.4 percent compared to the first quarter of 2013, driven by high franchisee demand for equipment.

Adjusted EBITDA

The following table provides a summary of changes in the segment s Adjusted EBITDA for the first quarter of 2014 compared with the first quarter of 2013:

(In millions)	
Three months ended March 31, 2013	$ 17
Change in operating revenue	1

Three months ended March 31, 2014	$	18

The impact of the increase in operating revenue was driven by the increase in royalty fees and increases in relatively low margin revenue from janitorial national accounts and sales of products to franchisees.

Other Operations and Headquarters Segment

First Quarter of 2014 Compared to First Quarter of 2013

This segment includes SMAC and our headquarters functions. The segment reported a 66.2 percent increase in Adjusted EBITDA for the first quarter of 2014 compared to the first quarter of 2013.

Adjusted EBITDA

The following table provides a summary of changes in the segment s Adjusted EBITDA for the first quarter of 2014 compared with the first quarter of 2013:

(In millions)		
Three months ended March 31, 2013	$	(10)
Insurance program		(2)
Selling and administrative expenses		8
Three months ended March 31, 2014	$	(4)

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The increased expenses in our automobile, general liability and workers compensation insurance program was driven by adverse claims trends. The decrease in selling and administrative expenses primarily included decreased costs in our centers of excellence driven by the transition of certain costs to New TruGreen and other cost reductions realized through recent initiatives.

Discontinued Operations

On January 14, 2014, we completed the TruGreen Spin-off resulting in the spin-off of the assets and certain liabilities of the TruGreen Business through a tax-free, pro rata dividend to Holdings stockholders. As a result of the completion of the TruGreen Spin-off, New TruGreen operates the TruGreen Business as a private independent company. The TruGreen Business experienced a significant downturn in recent years. Since 2011, the TruGreen Business lost 400,000 customers, or 19 percent of its customer base. The TruGreen Business s operating margins also eroded during this time-frame due to production inefficiencies, higher chemical costs and inflationary pressures, compounded by lower fixed cost leverage as falling customer counts drove revenue down. The TruGreen Business experienced operating revenue and Adjusted EBITDA declines of 18.6 percent and 87.6 percent, respectively, from 2011 to 2013. In light of these developments, we made the decision to effect the TruGreen Spin-off, which we expect will enable the Company s management to increase its focus on Terminix, American Home Shield and the Franchise Services Group segment while providing New TruGreen, as an independently operated, private company, the time and focus required to execute a turnaround. In addition, the TruGreen Spin-off was effected to enhance Holdings ability to complete an IPO of its common stock, the proceeds of which are expected to be used to reduce consolidated indebtedness.

As a result of the TruGreen Spin-off, we were required to perform an interim impairment analysis as of January 14, 2014 on the TruGreen trade name. The assumptions were developed with the view of the TruGreen Business as a stand-alone company, resulting in an increase in the assumed discount rate of 350 bps as compared to the discount rate used in the October 1, 2013 impairment test for the TruGreen trade name. This interim impairment analysis resulted in a pre-tax non-cash trade name impairment charge of $139 million ($84 million, net of tax) to reduce the carrying value of the TruGreen trade name to its estimated fair value. This impairment charge was recorded in Loss from discontinued operations, net of income taxes, in the first quarter of 2014.

Loss from discontinued operations, net of income taxes, for all periods presented includes the operating results of the TruGreen Business and the previously sold businesses noted in the 2013 Form 10-K.

The operating results of discontinued operations are as follows:

	Three months ended March 31,	
(In millions)	**2014**	**2013**
Operating Revenue	$ 6	$ 94
Loss before income taxes(1)	(155)	(50)
Benefit for income taxes(1)	(60)	(21)
Loss from discontinued operations, net of income taxes(1)	$ (95)	$ (29)

(1) During the first quarter of 2014, a pre-tax non-cash trade name impairment charge of $139 million ($84 million, net of tax) was recorded to reduce the carrying value of the TruGreen trade name to its estimated fair value.

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Liquidity and Capital Resources

Liquidity

We are highly leveraged, and a substantial portion of our liquidity needs is due to service requirements on our significant indebtedness. The agreements governing the Term Facilities, the 2020 Notes and the Revolving Credit Facility contain covenants that limit or restrict the ability of ServiceMaster and certain of its subsidiaries to incur additional indebtedness, repurchase debt, incur liens, sell assets, make certain payments (including dividends) and enter into transactions with affiliates. As of March 31, 2014, we were in compliance with the covenants under these agreements that were in effect on such date.

Our ongoing liquidity needs are expected to be funded by cash on hand, net cash provided by operating activities and, as required, borrowings under the Revolving Credit Facility. We expect that cash provided from operations and available capacity under the Revolving Credit Facility will provide sufficient funds to operate our business, make expected capital expenditures and meet our liquidity requirements for the following 12 months, including payment of interest and principal on our debt. As of March 31, 2014, we had $242 million of remaining capacity available under the Revolving Credit Facility. Our borrowing capacity will decrease to $183 million on July 25, 2014.

Cash and short- and long-term marketable securities totaled $534 million as of March 31, 2014, compared with $625 million as of December 31, 2013. Cash and short- and long-term marketable securities include balances associated with regulatory requirements at American Home Shield. See Limitations on Distributions and Dividends by Subsidiaries. American Home Shield s investment portfolio has been invested in a combination of high-quality, short-duration fixed-income securities and equities. We closely monitor the performance of the investments. From time to time, we review the statutory reserve requirements to which our regulated entities are subject and any changes to such requirements. These reviews may result in identifying current reserve levels above or below minimum statutory reserve requirements, in which case may adjust our reserves. The reviews may also identify opportunities to satisfy certain regulatory reserve requirements through alternate financial vehicles.

Under the terms of our fuel swap contracts, we are required to post collateral in the event that the fair value of the contracts exceeds a certain agreed upon liability level and in other circumstances required by the counterparty. As of March 31, 2014, the estimated fair value of our fuel swap contracts was a net asset of $1 million, and we had posted $1 million in letters of credit as collateral under our fuel hedging program, none of which were issued under our Revolving Credit Facility. The continued use of letters of credit for this purpose could limit our ability to post letters of credit for other purposes and could limit our borrowing availability under the Revolving Credit Facility. However, we do not expect the fair value of the outstanding fuel swap contracts to materially impact our financial position or liquidity.

We may from time to time repurchase or otherwise retire or extend our debt and/or take other steps to reduce our debt or otherwise improve our financial position. These actions may include open market debt repurchases, negotiated repurchases, other retirements of outstanding debt and/or opportunistic refinancing of debt. The amount of debt that may be repurchased or otherwise retired or refinanced, if any, will depend on market conditions, trading levels of our debt, our cash position, compliance with debt covenants and other considerations. Our affiliates may also purchase our debt from time to time, through open market purchases or other transactions. In such cases, our debt may not be retired, in which case we would continue to pay interest in accordance with the terms of the debt, and we would continue to reflect the debt as outstanding in its condensed consolidated financial statements.

Term Facilities

As of March 31, 2014, we had approximately $2,184 million of outstanding borrowings under our Term Loan Facility, maturing January 31, 2017, after including the unamortized portion of the original issue discount paid.

Senior Notes

The 8% 2020 Notes will mature on February 15, 2020, and the 7% 2020 Notes will mature on August 15, 2020. On March 24, 2014, Holdings filed a Registration Statement on Form S-1 with the SEC for an IPO. As disclosed in such Form S-1, Holdings intends to use the net proceeds of the IPO to redeem a portion of the 8% 2020 Notes at 108% of the principal amount thereof, plus accrued and unpaid interest, and redeem a portion of the 7% 2020 Notes at 107% of the principal amount thereof, plus accrued and unpaid interest. No assurance can be given that the IPO will be completed and that our obligations under the 2020 Notes will be reduced as intended.

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Fleet and Equipment Financing Arrangements

We have entered into the Fleet Agreement which, among other things, allows us to obtain fleet vehicles through a leasing program. We expect to fulfill substantially all of our vehicle fleet needs in 2014 through the leasing program under the Fleet Agreement. For the first quarter of 2014, we acquired $2 million of vehicles under the Fleet Agreement leasing program. All leases under the Fleet Agreement are capital leases for accounting purposes. The lease rental payments include an interest component calculated using a variable rate based on one-month LIBOR plus other contractual adjustments and a borrowing margin totaling 2.45 percent as of March 31, 2014. We have no minimum commitment for the number of vehicles to be obtained under the Fleet Agreement. We anticipate that new lease financings under the Fleet Agreement for the full year 2014 will range from approximately $15 million to $25 million.

Limitations on Distributions and Dividends by Subsidiaries

ServiceMaster is a holding company, and as such we have no independent operations or material assets other than ownership of equity interests in our subsidiaries. We depend on our subsidiaries to distribute funds to us so that we may pay obligations and expenses, including satisfying obligations with respect to indebtedness. The ability of our subsidiaries to make distributions and dividends to us depends on their operating results, cash requirements and financial condition and general business conditions, as well as restrictions under the laws of our subsidiaries jurisdictions.

The terms of the indenture governing the 2020 Notes and the agreements governing the Credit Facilities significantly restrict the ability of our subsidiaries to pay dividends, make loans or otherwise transfer assets to us. Further, our subsidiaries are permitted under the terms of the Credit Facilities and other indebtedness to incur additional indebtedness that may restrict or prohibit the making of distributions, the payment of dividends or the making of loans by such subsidiaries to us.

Furthermore, there are third-party restrictions on the ability of certain of our subsidiaries to transfer funds to us. These restrictions are related to regulatory requirements at American Home Shield and to a subsidiary borrowing arrangement at SMAC. The payment of ordinary and extraordinary dividends by our home warranty and similar subsidiaries (through which we conduct our American Home Shield business) are subject to significant regulatory restrictions under the laws and regulations of the states in which they operate. Among other things, such laws and regulations require certain such subsidiaries to maintain minimum capital and net worth requirements and may limit the amount of ordinary and extraordinary dividends and other payments that these subsidiaries can pay to us. As of March 31, 2014, the total net assets subject to these third-party restrictions was $184 million. We expect that such limitations will be in effect through the end of 2014. None of our subsidiaries are obligated to make funds available to us through the payment of dividends.

We consider undistributed earnings of our foreign subsidiaries as of March 31, 2014 to be indefinitely reinvested and, accordingly, no U.S. income taxes have been provided thereon. The amount of cash associated with indefinitely reinvested foreign earnings was approximately $29 million and $14 million as of March 31, 2014 and December 31, 2013, respectively. We have not repatriated, nor do we anticipate the need to repatriate, funds to the United States to satisfy domestic liquidity needs arising in the ordinary course of business, including liquidity needs associated with our domestic debt service requirements.

Cash Flows from Operating Activities from Continuing Operations

Net cash provided from operating activities from continuing operations decreased $2 million to $21 million for the first quarter of 2014 compared to $23 million for the first quarter of 2013.

Net cash provided from operating activities for the first quarter of 2014 was comprised of $57 million in earnings adjusted for non-cash charges, offset, in part, by a $33 million increase in cash required for working capital and $3 million in cash payments related to restructuring charges. Working capital requirements for the first quarter of 2014 were adversely impacted by the timing of interest payments on the 2020 Notes, incentive compensation payments related to 2013 performance and seasonal activity.

Net cash provided from operating activities for the first quarter of 2013 was comprised of $45 million in earnings adjusted for non-cash charges, offset, in part, by an $18 million increase in cash required for working capital and $4 million in cash payments related to restructuring charges. Working capital requirements for the first quarter of 2013 were adversely impacted by the timing of interest payments on the 2020 Notes, incentive compensation payments related to 2012 performance and seasonal activity.

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Cash Flows from Investing Activities from Continuing Operations

Net cash used for investing activities from continuing operations was $17 million for the first quarter of 2014 compared to $16 million for the first quarter of 2013.

Capital expenditures increased to $14 million for the first quarter of 2014 from $9 million in the first quarter of 2013 and included recurring capital needs and information technology projects. We anticipate that capital expenditures for the full year 2014 will range from approximately $55 million to $65 million, reflecting recurring needs and the continuation of investments in information systems and productivity enhancing technology. We expect to fulfill our ongoing vehicle fleet needs through vehicle capital leases. The Company has no additional material capital commitments at this time.

Cash payments for acquisitions for the first quarter of 2014 totaled $41 million, compared with $3 million for the first quarter of 2013. On February 28, 2014, we acquired HSA, based in Madison, Wisconsin, for cash consideration of $32 million. Consideration paid for tuck-in acquisitions consisted of cash payments and debt payable to sellers. We expect to continue our tuck-in acquisition program at levels consistent with prior periods.

Cash flows provided from notes receivable, financial investments and securities, net, for the first quarter of 2014 were $38 million and were primarily driven by the sale of marketable securities at American Home Shield. Cash flows used for notes receivable, financial investments and securities, net, for the first quarter of 2013 were $4 million and were primarily driven by increased investments in marketable securities at American Home Shield, offset, in part, by collections of amounts financed by SMAC.

Cash Flows from Financing Activities from Continuing Operations

Net cash used for financing activities from continuing operations was $46 million for the first quarter of 2014 compared to $27 million for the first quarter of 2013.

During the first quarter of 2014, we made scheduled principal payments on long-term debt of $11 million. Additionally, the Company contributed $35 million to New TruGreen during the first quarter of 2014.

During the first quarter of 2013, we made scheduled principal payments on long-term debt of $9 million and made payments on other long-term financing obligations of $2 million. Additionally, the Company borrowed an incremental $1 million, paid $12 million in original issue discount and paid debt issuance costs of $5 million during the first quarter of 2013.

Contractual Obligations

The 2013 Form 10-K includes disclosure of our contractual obligations and commitments as of December 31, 2013. We continue to make the contractually required payments, and, therefore, the 2014 obligations and commitments as listed in the 2013 Form 10-K have been reduced by the required payments. Additionally, the TruGreen Spin-off has reduced our contractual obligations and commitments as reported as of December 31, 2013. While contractual obligations relating to principal repayments, estimated interest payments, non-cancelable operating leases and other long-term liabilities of the TruGreen Business are separately identifiable and were transferred to New TruGreen pursuant to the Separation and Distribution Agreement, purchase obligations generally relate to Company-wide spend and commitments of multiple business segments and, therefore, the obligations which were transferred to New TruGreen are more difficult to separately identify and are included in costs under the transition services agreement. We are in the process of negotiating the transfers of these contractual obligations to New TruGreen. The impact of the TruGreen Spin-off was the only material change in our previously disclosed contractual obligations and commitments during the three months ended March 31, 2014.

Off-Balance Sheet Arrangements

As of March 31, 2014, we had off-balance sheet arrangements in the form of guarantees as discussed in Note 4 of our condensed consolidated financial statements.

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, established for the purpose of facilitating off- balance sheet arrangements or other contractually narrow or limited purposes. Accordingly, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

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Regulatory Matters

In April 2014, the Bureau of Consumer Financial Protection (the CFPB) issued a Civil Investigative Demand (the CID) to American Home Shield seeking documents and information to determine whether home warranty providers or other unnamed persons have engaged or are engaging in unlawful acts and practices in connection with referral arrangements and relationships in violation of the Real Estate Settlement Procedures Act and its implementing regulation (RESPA) and other laws enforceable by the CFPB. American Home Shield intends to comply with its obligations to respond to the CID and believes that it has complied with RESPA and other laws applicable to American Home Shield s home warranty business. If the CFPB determines to bring an enforcement action, it could include demands for money penalties, changes to certain of American Home Shield s business practices and customer restitution or disgorgement.

Information Regarding Forward-Looking Statements

This report contains forward-looking statements and cautionary statements. Some of the forward-looking statements can be identified by the use of forward-looking terms such as believes, expects, may, will, shall, should, would, could, seeks, aims, projects, is optim estimates, anticipates or other comparable terms. Forward-looking statements include, without limitation, all matters that are not historical facts. They appear in a number of places throughout this report and include, without limitation, statements regarding our intentions, beliefs, assumptions or current expectations concerning, among other things, financial position; results of operations; cash flows; prospects; growth strategies or expectations; customer retention; the continuation of acquisitions, including the integration of any acquired company and risks relating to any such acquired company; fuel prices; attraction and retention of key personnel; the impact of fuel swaps; the valuation of marketable securities; estimates of accruals for self-insured claims related to workers compensation, auto and general liability risks; estimates of accruals for home warranty claims; estimates of future payments under operating and capital leases; the outcome (by judgment or settlement) and costs of legal or administrative proceedings, including, without limitation, collective, representative or class action litigation; and the impact of prevailing economic conditions.

Forward-looking statements are subject to known and unknown risks and uncertainties, many of which may be beyond our control. We caution you that forward-looking statements are not guarantees of future performance or outcomes and that actual performance and outcomes, including, without limitation, our actual results of operations, financial condition and liquidity, and the development of the market segments in which we operate, may differ materially from those made in or suggested by the forward-looking statements contained in this report. In addition, even if our results of operations, financial condition and cash flows, and the development of the market segments in which we operate, are consistent with the forward-looking statements contained in this report, those results or developments may not be indicative of results or developments in subsequent periods. A number of important factors, including, without limitation, the risks and uncertainties discussed in Risk Factors in this report, could cause actual results and outcomes to differ materially from those reflected in the forward-looking statements. Additional factors that could cause actual results and outcomes to differ from those reflected in forward-looking statements include, without limitation:

- weakening general economic conditions, especially as they may affect home sales, unemployment and consumer confidence or spending levels;

- our ability to successfully implement our business strategies;

- our recognition of future impairment charges;

- adverse credit and financial markets impeding access, increasing financing costs or causing our customers to incur liquidity issues leading to some of our services not being purchased or cancelled;

- increases in prices for fuel and raw materials;

- changes in the source and intensity of competition in our market segments;

- adverse weather conditions;

- our ability to attract and retain key personnel, including our ability to attract, retain and maintain positive relations with trained workers and third-party contractors;

- our franchisees and third-party distributors and vendors taking actions that harm our business;

- disruptions or failures in our information technology systems and our failure to protect the security of personal information about our customers;

- changes in our services or products;

- our ability to protect our intellectual property and other material proprietary rights;

- negative reputational and financial impacts resulting from future acquisitions or strategic transactions;
- laws and governmental regulations and legal proceedings and investigations increasing our legal and regulatory expenses;
- compliance with, or violation of, environmental, health and safety laws and regulations;
- increases in interest rates increasing the cost of servicing our substantial indebtedness;
- increased borrowing costs due to lowering or withdrawal of the ratings, outlook or watch assigned to our debt securities;
- restrictions contained in our debt agreements;
- our ability to refinance all or a portion of our indebtedness or obtain additional financing; and
- other factors described in this report and from time to time in documents that we file with the SEC.

You should read this report completely and with the understanding that actual future results may be materially different from expectations. All forward-looking statements made in this report are qualified by these cautionary statements. These forward-looking statements are made only as of the date of this report, and we do not undertake any obligation, other than as may be required by law, to update or revise any forward-looking or cautionary statements to reflect changes in assumptions, the occurrence of events, unanticipated or otherwise, and changes in future operating results over time or otherwise.

Comparisons of results for current and any prior periods are not intended to express any future trends, or indications of future performance, unless expressed as such, and should only be viewed as historical data.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The economy and its impact on discretionary consumer spending, labor wages, fuel prices and other material costs, home resales, unemployment rates, insurance costs and medical costs could have a material adverse impact on future results of operations.

We do not hold or issue derivative financial instruments for trading or speculative purposes. We have entered into specific financial arrangements, primarily fuel swap agreements, and in the past interest rate swap agreements, in the normal course of business to manage certain market risks, with a policy of matching positions and limiting the terms of contracts to relatively short durations. The effect of derivative financial instrument transactions could have a material impact on our financial statements.

Interest Rate Risk

We are exposed to the impact of interest rate changes and manage this exposure through the use of variable-rate and fixed-rate debt. In our opinion, the market risk associated with debt obligations and other significant instruments as of March 31, 2014 has not materially changed from December 31, 2013 (see Item 7A of the 2013 Form 10-K).

Fuel Price Risk

We are exposed to market risk for changes in fuel prices through the consumption of fuel by our vehicle fleet in the delivery of services to our customers. We expect to use approximately 11 million gallons of fuel in 2014. A ten percent change in fuel prices would result in a change of approximately $4 million in our annual fuel cost before considering the impact of fuel swap contracts. Our exposure to changes in fuel prices has not significantly changed our per gallon fuel costs since December 31, 2013.

We use fuel swap contracts to mitigate the financial impact of fluctuations in fuel prices. We do not enter into these contracts for trading or speculative purposes. As of March 31, 2014, we had fuel swap contracts to pay fixed prices for fuel with an aggregate notional amount of $21 million, maturing through 2014. The estimated fair value of these contracts as of March 31, 2014 was a net asset of $1 million. These fuel swap contracts provide a fixed price for approximately 68 percent of our estimated fuel usage for the remainder of 2014.

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ITEM 4. CONTROLS AND PROCEDURES

Effectiveness of Disclosure Controls and Procedures. ServiceMaster s Chief Executive Officer, Robert J. Gillette, and ServiceMaster s Senior Vice President and Chief Financial Officer, Alan J. M. Haughie, have evaluated ServiceMaster s disclosure controls and procedures (as defined in Rule 15d-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q. Messrs. Gillette and Haughie have concluded that both the design and operation of ServiceMaster s disclosure controls and procedures were effective as of March 31, 2014.

Changes in Internal Control over Financial Reporting. No change in ServiceMaster s internal control over financial reporting occurred during the first quarter of 2014 that has materially affected, or is reasonably likely to materially affect, ServiceMaster s internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the ordinary course of conducting business activities, ServiceMaster and its subsidiaries become involved in judicial, administrative and regulatory proceedings involving both private parties and governmental authorities. These proceedings include insured and uninsured matters that are brought on an individual, collective, representative and class action basis, or other proceedings involving regulatory, employment, general and commercial liability, automobile liability, wage and hour, environmental and other matters. We have entered into settlement agreements in certain cases, including with respect to putative collective and class actions, which are subject to court or other approvals. If one or more of our settlements are not finally approved, we could have additional or different exposure, which could be material. At this time, we do not expect any of these proceedings to have a material effect on our reputation, business, financial position, results of operations or cash flows; however, we can give no assurance that the results of any such proceedings will not materially affect our reputation, business, financial position, results of operations and cash flows.

ITEM 1A. RISK FACTORS

The Company encourages you to read carefully all of the risks and uncertainties described below, as well as other information included in this report, including our consolidated financial statements and related notes appearing in this report. The risks described below are not the only ones facing us. The occurrence of any of the following risks or additional risks and uncertainties not presently known to us or that we currently believe to be immaterial could materially and adversely affect our business, financial position, results of operations or cash flows. This report also contains forward-looking statements and estimates that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of specific factors, including the risks and uncertainties described below.

Risks Related to Our Business and Our Industry

Weakening in general economic conditions, especially as they may affect home sales, unemployment or consumer confidence or spending levels, may adversely impact our business, financial position, results of operations and cash flows.

A substantial portion of our results of operations is dependent upon spending by consumers. Deterioration in general economic conditions and consumer confidence, particularly in California, Texas and Florida, which collectively represented approximately one-third of our 2013 operating revenue in our Terminix and American Home Shield segments, could affect the demand for our services. Consumer spending and confidence tend to decline during times of declining economic conditions. A worsening of macroeconomic indicators, including weak home sales, higher home foreclosures, declining consumer confidence or rising unemployment rates, could adversely affect consumer spending levels, reduce the demand for our services and adversely impact our business, financial position, results of operations and cash flows. These factors could also negatively impact the timing or the ultimate collection of accounts receivable, which would adversely impact our business, financial position, results of operations and cash flows.

We may not successfully implement our business strategies, including achieving our growth objectives.

We may not be able to fully implement our business strategies or realize, in whole or in part within the expected time frames, the anticipated benefits of our various growth or other initiatives. Our various business strategies and initiatives, including growth of our customer base, introduction of new service offerings, geographic expansion, growth of our

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commercial business and enhancement of profitability, are subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control.

In addition, we may incur certain costs to achieve efficiency improvements and growth in our business and we may not meet anticipated implementation timetables or stay within budgeted costs. As these efficiency improvement and growth initiatives are undertaken, we may not fully achieve our expected cost savings and efficiency improvements or growth rates, or these initiatives could adversely impact our customer retention or our operations. Also, our business strategies may change from time to time in light of our ability to implement our new business initiatives, competitive pressures, economic uncertainties or developments, or other factors.

We may be required to recognize additional impairment charges.

We have significant amounts of goodwill and intangible assets, such as trade names, and have incurred impairment charges in 2013 and earlier periods with respect to goodwill and intangible assets. In the first quarter of 2014 we incurred impairment charges with respect to fixed assets, and we have also incurred impairment charges in the past in connection with our disposition activities. In accordance with applicable accounting standards, goodwill and intangible assets that are not amortized are subject to assessment for impairment by applying a fair-value based test annually, or more frequently if there are indicators of impairment, including:

- significant adverse changes in the business climate, including economic or financial conditions;
- significant adverse changes in expected operating results;
- adverse actions or assessments by regulators;
- unanticipated competition;
- loss of key personnel; and
- a current expectation that it is more likely than not that a reporting unit or intangible asset will be sold or otherwise disposed of.

In each of the past three years based on lower projected revenue and operating results for TruGreen, we recorded pre-tax non-cash impairment charges to reduce the carrying value of TruGreen s goodwill and the TruGreen trade name, respectively, as a result of our interim or annual

impairment testing of indefinite-lived intangible assets. These charges were $418 million and $256 million, respectively in 2013, and $790 million and $119 million, respectively, in 2012.

As a result of the TruGreen Spin-off, we performed an interim impairment analysis as of January 14, 2014 on the TruGreen trade name. The assumptions used in this analysis were based on the TruGreen Business as a standalone company, and resulted in an impairment charge of $139 million during the first quarter of 2014.

In February 2014, American Home Shield ceased efforts to deploy a new operating system that had been intended to improve customer relationship management capabilities and enhance its operations. We recorded an impairment charge of $48 million in the first quarter of 2014 relating to this decision.

Based upon future economic and financial market conditions, the operating performance of our reporting units and other factors, including those listed above, future impairment charges could be incurred. It is possible that such impairment, if required, could be material. Any future impairment charges that we are required to record could have a material adverse impact on our results of operations.

Adverse credit and financial market events and conditions could, among other things, impede access to or increase the cost of financing or cause our commercial and governmental customers to incur liquidity issues that could lead to some of our services not being purchased or being cancelled, or result in reduced operating revenue and lower Adjusted EBITDA, any of which could have an adverse impact on our business, financial position, results of operations and cash flows.

Disruptions in credit or financial markets could, among other things, lead to impairment charges, make it more difficult for us to obtain, or increase our cost of obtaining, financing for our operations or investments or to refinance our indebtedness, cause our lenders to depart from prior credit industry practice and not give technical or other waivers under the Credit Facilities, to the extent we may seek them in the future, thereby causing us to be in default under one or more of the

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Credit Facilities. These disruptions also could cause our commercial customers to encounter liquidity issues that could lead to some of our services being cancelled or reduced, or that could result in an increase in the time it takes our customers to pay us, or that could lead to a decrease in pricing for our services and products, any of which could adversely affect our accounts receivable, among other things, and, in turn, increase our working capital needs. Volatile swings in the commercial real estate segment could also impact the demand for our services as landlords cut back on services provided to their tenants. In addition, adverse developments at federal, state and local levels associated with budget deficits resulting from economic conditions could result in federal, state and local governments decreasing their purchasing of our products or services and/or increasing taxes or other fees on businesses, including us, to generate more tax revenues, which could negatively impact spending by commercial customers and municipalities on our services.

Our market segments are highly competitive. Competition could reduce our share of the market segments served by us and adversely impact our reputation, business, financial position, results of operations and cash flows.

We operate in highly competitive market segments. Changes in the source and intensity of competition in the market segments served by us impact the demand for our services and may also result in additional pricing pressures. The relatively low capital cost of entry into certain of our business categories has led to strong competitive market segments, including competition from smaller regional and local owner-operated companies. Regional and local competitors operating in a limited geographic area may have lower labor, benefits and overhead costs. The principal methods of competition in our businesses include name recognition, quality and speed of service, customer satisfaction, reputation and pricing. We may be unable to compete successfully against current or future competitors, and the competitive pressures that we face may result in reduced market segment share, reduced pricing or adversely impact our reputation, business, financial position, results of operations and cash flows.

Weather conditions and seasonality affect the demand for our services and our results of operations and cash flows.

The demand for our services and our results of operations are affected by weather conditions, including, without limitation, potential impacts, if any, from climate change, known and unknown, and by the seasonal nature of our termite and pest control services, home inspection services, home warranties and disaster restoration services. Adverse weather conditions (e.g., cooler temperatures or droughts), whether created by climate change factors or otherwise, can impede the development of the termite swarm and lead to lower demand for our termite remediation services. Severe winter storms can also impact our home cleaning business if personnel cannot travel to service locations due to hazardous road conditions. In addition, extreme temperatures can lead to an increase in service requests related to household systems and appliances in our American Home Shield business, resulting in higher claim frequency and costs and lower profitability, thereby adversely impacting our business, financial position, results of operations and cash flows.

Increases in raw material prices, fuel prices and other operating costs could adversely impact our business, financial position, results of operations and cash flows.

Our financial performance is affected by the level of our operating expenses, such as fuel, chemicals, refrigerants, appliances and equipment, parts, raw materials, wages and salaries, employee benefits, health care, vehicle maintenance, self-insurance costs and other insurance premiums as well as various regulatory compliance costs, all of which may be subject to inflationary pressures. In particular, our financial performance is adversely affected by increases in these operating costs. In recent years, fuel prices have fluctuated widely, and previous increases in fuel prices increased our costs of operating vehicles and equipment. We cannot predict what effect recent global events or any future Middle East or other crisis could have on fuel prices, but it is possible that such events could lead to higher fuel prices. With respect to fuel, our Terminix fleet, which consumes approximately 11 million gallons annually, has been negatively impacted by significant increases in fuel prices in the past and could

be negatively impacted in the future. Although we hedge a significant portion of our fuel costs, we do not hedge all of those costs. In 2014, we expect to use approximately 11 million gallons of fuel. A ten percent change in fuel prices would result in a change of approximately $4 million in our 2014 fuel cost before considering the impact of fuel swap contracts. Although based upon Department of Energy fuel price forecasts, as well as the hedges we have executed to date for 2014, we have projected that fuel prices will not significantly increase our per gallon fuel costs for 2014 compared to 2013, those forecasts and projections may not prove correct. Fuel price increases can also result in increases in the cost of chemicals and other materials used in our business. We cannot predict the extent to which we may experience future increases in costs of fuel, chemicals, refrigerants, appliances and equipment, parts, raw materials, wages and salaries, employee benefits, health care, vehicle, self-insurance costs and other insurance premiums as well as various regulatory compliance costs and other operating costs. To the extent such costs increase, we may be prevented, in whole or in part, from passing these cost increases through to our existing and prospective customers, and the rates we pay to our subcontractors and suppliers may increase, any of which could have a material adverse impact on our business, financial position, results of operations and cash flows.

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We may not be able to attract and retain qualified key executives or transition smoothly to new leadership, which could adversely impact us and our businesses and inhibit our ability to operate and grow successfully.

The execution of our business strategy and our financial performance will continue to depend in significant part on our executive management team and other key management personnel and the smooth transition of new senior leadership. We have recently enhanced our senior management team, including through the hiring of Robert J. Gillette as Chief Executive Officer and Alan J. M. Haughie as Chief Financial Officer. Any inability to attract in a timely manner other qualified key executives, retain our leadership team and recruit other important personnel could have a material adverse impact on our business, financial position, results of operations and cash flows.

Our franchisees and third-party distributors and vendors could take actions that could harm our business.

For the quarter ended March 31, 2014, and the year ended December 31, 2013, $33 million and $137 million, respectively, of our consolidated operating revenue was received in the form of franchise revenues. Accordingly, our financial results are dependent in part upon the operational and financial success of our franchisees. Our franchisees, third-party distributors and vendors are contractually obligated to operate their businesses in accordance with the standards set forth in our agreements with them. Each franchising brand also provides training and support to franchisees. However, franchisees, third-party distributors and vendors are independent third parties that we do not control, and who own, operate and oversee the daily operations of their businesses. As a result, the ultimate success of any franchise operation rests with the franchisee. If franchisees do not successfully operate their businesses in a manner consistent with required standards, royalty payments to us will be adversely affected and our brands image and reputation could be harmed, which in turn could adversely impact our business, financial position, results of operations and cash flows. Similarly, if third-party distributors and vendors do not successfully operate their businesses in a manner consistent with required laws, standards and regulations, we could be subject to claims from regulators or legal claims for the actions or omissions of such third-party distributors and vendors. In addition, our relationship with our franchisees, third-party distributors and vendors could become strained (including resulting in litigation) as we impose new standards or assert more rigorous enforcement practices of the existing required standards. These strains in our relationships or claims could have a material adverse impact on our reputation, business, financial position, results of operations and cash flows.

Disruptions or failures in our information technology systems could create liability for us or limit our ability to effectively monitor, operate and control our operations and adversely impact our reputation, business, financial position, results of operations and cash flows.

Our information technology systems facilitate our ability to monitor, operate and control our operations. Changes or modifications to our information technology systems could cause disruption to our operations or cause challenges with respect to our compliance with laws, regulations or other applicable standards. As the development and implementation of our information technology systems (including our operating systems) evolve, we may elect to modify, replace or abandon certain technology initiatives, which could result in write-downs. For example, in February 2014, American Home Shield ceased efforts to deploy a new operating system that had been intended to improve customer relationship management capabilities and enhance its operations. We recorded an impairment charge of $48 million in the first quarter of 2014 relating to this decision.

Any disruption in, capacity limitations, instability or failure to operate as expected of, our information technology systems, could, depending on the magnitude of the problem, adversely impact our business, financial position, results of operations and cash flows, including by limiting our capacity to monitor, operate and control our operations effectively. Failures of our information technology systems could also lead to violations of privacy laws, regulations, trade guidelines or practices related to our customers and associates. If our disaster recovery plans do not work as anticipated, or if the third-party vendors to which we have outsourced certain information technology, contact center or other services fail to

fulfill their obligations to us, our operations may be adversely impacted, and any of these circumstances could adversely impact our reputation, business, financial position, results of operations and cash flows.

Changes in the services we deliver or the products we use could impact our reputation, business, financial position, results of operations and cash flows and our future plans.

Our financial performance is affected by changes in the services and products we offer our customers. For example, Terminix has been developing new products relating to mosquito control and wildlife exclusion. In addition, in the second quarter of 2014, our ServiceMaster Restore and AmeriSpec teams intend to introduce InstaScope, a new, proprietary technology for instant mold detection and water categorization. There can be no assurance that our new strategies or product

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offerings will succeed in increasing operating revenue and growing profitability. An unsuccessful execution of new strategies, including the rollout or adjustment of our new services or products or sales and marketing plans, could cause us to re-evaluate or change our business strategies and could have a material adverse impact on our reputation, business, financial position, results of operations and cash flows and our future plans.

If we fail to protect the security of personal information about our customers, we could be subject to interruption of our business operations, private litigation, reputational damage and costly penalties.

We rely on, among other things, commercially available systems, software, tools and monitoring to provide security for processing, transmission and storage of confidential customer information, such as payment card and personal information. The systems currently used for transmission and approval of payment card transactions, and the technology utilized in payment cards themselves, all of which can put payment card data at risk, are central to meeting standards set by the payment card industry (PCI). We continue to evaluate and modify our systems and protocols for PCI compliance purposes, and such PCI standards may change from time to time. Activities by third parties, advances in computer and software capabilities and encryption technology, new tools and discoveries and other events or developments may facilitate or result in a compromise or breach of our systems. Any compromises, breaches or errors in applications related to our systems or failures to comply with standards set by the PCI could cause damage to our reputation and interruptions in our operations, including our customers ability to pay for our services and products by credit card or their willingness to purchase our services and products and could result in a violation of applicable laws, regulations, orders, industry standards or agreements and subject us to costs, penalties and liabilities which could have a material adverse impact on our reputation, business, financial position, results of operations and cash flows.

We may not be able to adequately protect our intellectual property and other proprietary rights that are material to our business.

Our ability to compete effectively depends in part on our rights to service marks, trademarks, trade names and other intellectual property rights we own or license, particularly our registered brand names, ServiceMaster, Terminix, American Home Shield, ServiceMaster Restore, ServiceMaster Clean, Merry Maids, Furniture Medic and AmeriSpec. We have not sought to register or protect every one of our marks either in the United States or in every country in which they are or may be used. Furthermore, because of the differences in foreign trademark, patent and other intellectual property or proprietary rights laws, we may not receive the same protection in other countries as we would in the United States. If we are unable to protect our proprietary information and brand names, we could suffer a material adverse impact on our reputation, business, financial position, results of operations and cash flows. Litigation may be necessary to enforce our intellectual property rights and protect our proprietary information, or to defend against claims by third parties that our products, services or activities infringe their intellectual property rights.

Future acquisitions or other strategic transactions could impact our reputation, business, financial position, results of operations and cash flows.

We may pursue strategic transactions in the future, which could involve acquisitions or dispositions of businesses or assets. Any future strategic transaction could involve integration or implementation challenges, business disruption or other risks, or change our business profile significantly. Any inability on our part to consolidate and manage growth from acquired businesses or successfully implement other strategic transactions could have an adverse impact on our reputation, business, financial position, results of operations and cash flows. Any acquisition that we make may not provide us with the benefits that were anticipated when entering into such acquisition. The process of integrating an acquired business may create unforeseen difficulties and expenses, including the diversion of resources needed to integrate new businesses, technologies, products, personnel or systems; the inability to retain associates, customers and suppliers; the assumption of actual or contingent

liabilities (including those relating to the environment); failure to effectively and timely adopt and adhere to our internal control processes and other policies; write-offs or impairment charges relating to goodwill and other intangible assets; unanticipated liabilities relating to acquired businesses; and potential expense associated with litigation with sellers of such businesses. Any future disposition transactions could also impact our business and may subject us to various risks, including failure to obtain appropriate value for the disposed businesses, post-closing claims being levied against us and disruption to our other businesses during the sale process or thereafter.

Laws and government regulations applicable to our businesses and legal proceeding and investigations could increase our legal and regulatory expenses, and impact our business, financial position, results of operations and cash flows.

Our businesses are subject to significant international, federal, state, provincial and local laws and regulations. These laws and regulations include laws relating to consumer protection, wage and hour requirements, franchising, the employment

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of immigrants, labor relations, permitting and licensing, building code requirements, workers safety, the environment, insurance and home warranties, employee benefits, marketing (including, without limitation, telemarketing) and advertising, the application and use of pesticides and other chemicals. In particular, we anticipate that various international, federal, state, provincial and local governing bodies may propose additional legislation and regulation that may be detrimental to our business or may substantially increase our operating costs, including proposed legislation, such as the Employee Free Choice Act, the Paycheck Fairness Act and the Arbitration Fairness Act; environmental regulations related to chemical use, climate change, equipment efficiency standards, refrigerant production and use and other environmental matters; other consumer protection laws or regulations; health care coverage; or do-not-knock, do-not-mail, do-not-leave or other marketing regulations. It is difficult to predict the future impact of the broad and expanding legislative and regulatory requirements affecting our businesses and changes to such requirements may adversely affect our business, financial position, results of operations and cash flows. In addition, if we were to fail to comply with any applicable law or regulation, we could be subject to substantial fines or damages, be involved in litigation or governmental investigations, suffer losses to our reputation or suffer the loss of licenses or incur penalties that may affect how our business is operated, which, in turn, could have a material adverse impact on our business, financial position, results of operations and cash flows.

In April 2014, the CFPB issued a CID to American Home Shield seeking documents and information to determine whether home warranty providers or other unnamed persons have engaged or are engaging in unlawful acts and practices in connection with referral arrangements and relationships in violation of RESPA and other laws enforceable by the CFPB. American Home Shield intends to comply with its obligations to respond to the CID and believes that it has complied with RESPA and other laws applicable to American Home Shield s home warranty business. If the CFPB determines to bring an enforcement action, it could include demands for money penalties, changes to certain of American Home Shield s business practices and customer restitution or disgorgement.

Public perceptions that the products we use and the services we deliver are not environmentally friendly or safe may adversely impact the demand for our services.

In providing our services, we use, among other things, pesticides and other chemicals. Public perception that the products we use and the services we deliver are not environmentally friendly or safe or are harmful to humans or animals, whether justified or not, or our improper application of these chemicals, could reduce demand for our services, increase regulation or government restrictions or actions, result in fines or penalties, impair our reputation, involve us in litigation, damage our brand names and otherwise have a material adverse impact on our business, financial position, results of operations and cash flows.

Compliance with, or violation of, environmental, health and safety laws and regulations, including laws pertaining to the use of pesticides could result in significant costs that adversely impact our reputation, business, financial position, results of operations and cash flows.

International, federal, state, provincial and local laws and regulations relating to environmental, health and safety matters affect us in several ways. In the United States, products containing pesticides generally must be registered with the U.S. Environmental Protection Agency, or the EPA, and similar state agencies before they can be sold or applied. The failure to obtain or the cancellation of any such registration, or the withdrawal from the market place of such pesticides, could have an adverse effect on our business, the severity of which would depend on the products involved, whether other products could be substituted and whether our competitors were similarly affected. The pesticides we use are manufactured by independent third parties and are evaluated by the EPA as part of its ongoing exposure risk assessment. The EPA may decide that a pesticide we use will be limited or will not be re- registered for use in the United States. We cannot predict the outcome or the severity of the effect of the EPA s continuing evaluations.

In addition, the use of certain pesticide products is regulated by various international, federal, state, provincial and local environmental and public health agencies. Although we strive to comply with such regulations and have processes in place designed to achieve compliance, given our dispersed locations, distributed operations and numerous associates, we may be unable to prevent violations of these or other regulations from occurring. Even if we are able to comply with all such regulations and obtain all necessary registrations and licenses, the pesticides or other products we apply or use, or the manner in which we apply or use them, could be alleged to cause injury to the environment, to people or to animals, or such products could be banned in certain circumstances. The regulations may also apply to third-party vendors who are hired to repair or remediate property and who may fail to comply with environmental laws, health and safety regulations and subject us to risk of legal exposure. The costs of compliance, non-compliance, remediation, combating unfavorable public perceptions or defending products liability lawsuits could have a material adverse impact on our reputation, business, financial position, results of operations and cash flows.

International, federal, state, provincial and local agencies regulate the disposal, handling and storage of waste, discharges from our facilities and the investigation and clean-up of contaminated sites. We could incur significant costs, including investigation and clean-up costs, fines, penalties and civil or criminal sanctions and claims by third parties for property damage and personal injury, as a result of violations of, or liabilities under, these laws and regulations. In addition, potentially significant expenditures could be required to comply with environmental, health and safety laws and regulations, including requirements that may be adopted or imposed in the future.

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We are subject to various restrictive covenants that could adversely impact our business, financial position, results of operations and cash flows.

From time to time, we enter into noncompetition agreements or other restrictive covenants (e.g., exclusivity, take or pay and non-solicitation), including in connection with business dispositions or strategic contracts, that restrict us from entering into lines of business or operating in certain geographic areas into which we may desire to expand our business. We also are subject to various non-solicitation and no-hire covenants that may restrict our ability to solicit potential customers or associates. If we do not comply with such restrictive covenants, or if a dispute arises regarding the scope and interpretation thereof, litigation could ensue, which could have an adverse impact on our business, financial position, results of operations and cash flows. Further, to the extent that such restrictive covenants prevent us from taking advantage of business opportunities, our business, financial position, results of operations and cash flows may be adversely impacted.

Our business process outsourcing initiatives have increased our reliance on third-party contractors and may expose our business to harm upon the termination or disruption of our third-party contractor relationships.

Our strategy to increase profitability, in part, by reducing our costs of operations includes the implementation of certain business process outsourcing initiatives. Any disruption, termination or substandard performance of these outsourced services, including possible breaches by third-party vendors of their agreements with us, could adversely affect our brands, reputation, customer relationships, financial position, results of operations and cash flows. Also, to the extent a third-party outsourcing provider relationship is terminated, there is a risk that we may not be able to enter into a similar agreement with an alternate provider in a timely manner or on terms that we consider favorable, and even if we find an alternate provider, or choose to insource such services, there are significant risks associated with any transitioning activities. In addition, to the extent we decide to terminate outsourcing services and insource such services, there is a risk that we may not have the capabilities to perform these services internally, resulting in a disruption to our business, which could adversely impact our reputation, business, financial position, results of operations and cash flows. We could incur costs, including personnel and equipment costs, to insource previously outsourced services like these, and these costs could adversely affect our results of operations and cash flows.

In addition, when a third-party provider relationship is terminated, there is a risk of disputes or litigation and that we may not be able to enter into a similar agreement with an alternate provider in a timely manner or on terms that we consider favorable, and even if we find an alternate provider, there are significant risks associated with any transitioning activities.

Our future success depends on our ability to attract, retain and maintain positive relations with trained workers and third-party contractors.

Our future success and financial performance depend substantially on our ability to attract, train and retain workers, attract and retain third-party contractors and ensure third-party contractor compliance with our policies and standards. Our ability to conduct our operations is in part impacted by our ability to increase our labor force, including on a seasonal basis, which may be adversely impacted by a number of factors. In the event of a labor shortage, we could experience difficulty in delivering our services in a high-quality or timely manner and could be forced to increase wages in order to attract and retain associates, which would result in higher operating costs and reduced profitability. New election rules by the National Labor Relations Board, including expedited elections and restrictions on appeals, could lead to increased organizing activities at our subsidiaries or franchisees. If these labor organizing activities were successful, it could further increase labor costs, decrease operating efficiency and productivity in the future, or otherwise disrupt or negatively impact our operations. In addition, potential competition from key associates who leave ServiceMaster could impact our ability to maintain our market segment share in certain geographic areas.

Risks Related to Our Substantial Indebtedness

We have substantial indebtedness and may incur substantial additional indebtedness, which could adversely affect our financial health and our ability to obtain financing in the future, react to changes in our business and satisfy our obligations.

As of March 31, 2014, we had $3,904 million of total long-term consolidated indebtedness outstanding. In anticipation of the TruGreen Spin-off, on November 27, 2013, we entered into Amendment No. 3, or the 2013 Revolver Amendment, to the credit agreement governing our Revolving Credit Facility, or the Revolving Credit Agreement. Pursuant to the 2013 Revolver Amendment, we had, effective on January 14, 2014 upon completion of the TruGreen Spin-off, $242 million of available borrowing capacity under the Revolving Credit Agreement through July 23, 2014 and $183 million from July 24, 2014 through January 31, 2017. As of March 31, 2014, there were no outstanding borrowings under our Revolving Credit Facility. In addition, we are able to incur additional indebtedness in the future, subject to the

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limitations contained in the agreements governing our indebtedness. Our substantial indebtedness could have important consequences to you. Because of our substantial indebtedness:

- our ability to engage in acquisitions without raising additional equity or obtaining additional debt financing is limited;

- our ability to obtain additional financing for working capital, capital expenditures, acquisitions, debt service requirements or general corporate purposes and our ability to satisfy our obligations with respect to our indebtedness may be impaired in the future;

- a large portion of our cash flow from operations must be dedicated to the payment of principal and interest on our indebtedness, thereby reducing the funds available to us for other purposes;

- we are exposed to the risk of increased interest rates because a portion of our borrowings, including under the Credit Facilities, and certain floating rate operating and capital leases are at variable rates of interest;

- it may be more difficult for us to satisfy our obligations to our creditors, resulting in possible defaults on, and acceleration of, such indebtedness;

- we may be more vulnerable to general adverse economic and industry conditions;

- we may be at a competitive disadvantage compared to our competitors with proportionately less indebtedness or with comparable indebtedness on more favorable terms and, as a result, they may be better positioned to withstand economic downturns;

- our ability to refinance indebtedness may be limited or the associated costs may increase;

- our flexibility to adjust to changing market conditions and ability to withstand competitive pressures could be limited; and

- we may be prevented from carrying out capital spending and restructurings that are necessary or important to our growth strategy and efforts to improve operating margins of our businesses.

Increases in interest rates would increase the cost of servicing our indebtedness and could reduce our profitability.

A significant portion of our outstanding indebtedness, including indebtedness under the Credit Facilities, bears interest at variable rates. As a result, increases in interest rates would increase the cost of servicing our indebtedness and could materially reduce our profitability and cash flows. As of March 31, 2014, each one percentage point change in interest rates would result in an approximately $22 million change in the annual interest expense on our Term Loan Facility. Assuming all revolving loans were fully drawn as of March 31, 2014, each one percentage point change in interest rates would result in an approximately $2 million change in annual interest expense on our Revolving Credit Facility. The impact of increases in interest rates could be more significant for us than it would be for some other companies because of our substantial indebtedness.

A lowering or withdrawal of the ratings, outlook or watch assigned to our debt securities by rating agencies may increase our future borrowing costs and reduce our access to capital.

Our indebtedness currently has a non-investment grade rating, and any rating, outlook or watch assigned could be lowered or withdrawn entirely by a rating agency if, in that rating agency s judgment, current or future circumstances relating to the basis of the rating, outlook, or watch such as adverse changes to our business, so warrant. Any future lowering of our ratings, outlook or watch likely would make it more difficult or more expensive for us to obtain additional debt financing.

The agreements and instruments governing our indebtedness contain restrictions and limitations that could significantly impact our ability to operate our business.

The Credit Facilities and the indenture governing our 2020 Notes contain covenants that, among other things, restrict the ability of ServiceMaster and its subsidiaries to:

- incur additional indebtedness (including guarantees of other indebtedness);

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- pay dividends to ServiceMaster, redeem stock, or make other restricted payments, including investments and, in the case of the Revolving Credit Facility, make acquisitions;
- prepay, repurchase or amend the terms of certain outstanding indebtedness;
- enter into certain types of transactions with affiliates;
- transfer or sell assets;
- create liens;
- merge, consolidate or sell all or substantially all of our assets; and
- enter into agreements restricting dividends or other distributions by subsidiaries to ServiceMaster.

The restrictions in the indenture governing the 2020 Notes, the Credit Facilities and the instruments governing ServiceMaster s other indebtedness may prevent us from taking actions that we believe would be in the best interest of our business and may make it difficult for us to execute our business strategy successfully or effectively compete with companies that are not similarly restricted. We may also incur future debt obligations that might subject us to additional restrictive covenants that could affect our financial and operational flexibility. We may be unable to refinance our indebtedness, at maturity or otherwise, on terms acceptable to us, or at all.

Our ability to comply with the covenants and restrictions contained in the Credit Facilities, the indenture governing the 2020 Notes, and the instruments governing our other indebtedness may be affected by economic, financial and industry conditions beyond our control including credit or capital market disruptions. The breach of any of these covenants or restrictions could result in a default that would permit the applicable lenders or noteholders, as the case may be, to declare all amounts outstanding thereunder to be due and payable, together with accrued and unpaid interest. If we are unable to repay indebtedness, lenders having secured obligations, such as the lenders under the Credit Facilities, could proceed against the collateral securing the indebtedness. In any such case, we may be unable to borrow under the Credit Facilities and may not be able to repay the amounts due under the Credit Facilities or our other outstanding indebtedness. This could have serious consequences to our financial position and results of operations and could cause us to become bankrupt or insolvent.

Our ability to generate the significant amount of cash needed to pay interest and principal on our indebtedness and our ability to refinance all or a portion of our indebtedness or obtain additional financing depends on many factors beyond our control.

ServiceMaster is a holding company, and as such it has no independent operations or material assets other than ownership of equity interests in its respective subsidiaries. ServiceMaster depends on its subsidiaries to distribute funds to it so that it may pay obligations and expenses, including satisfying obligations with respect to indebtedness. Our ability to make scheduled payments on, or to refinance our obligations under, our indebtedness depends on the financial and operating performance of our subsidiaries, and their ability to make distributions and dividends to us, which, in turn, depends on their results of operations, cash flows, cash requirements, financial position and general business conditions and any legal and regulatory restrictions on the payment of dividends to which they may be subject, many of which may be beyond our control.

There are third-party restrictions on the ability of certain of our subsidiaries to transfer funds to us. If we cannot receive sufficient distributions from our subsidiaries, we may not be able to meet our obligations to fund general corporate expenses or service our debt obligations. These restrictions are related to regulatory requirements at American Home Shield and to a subsidiary borrowing arrangement at SMAC. The payment of ordinary and extraordinary dividends by our home warranty and similar subsidiaries (through which we conduct our American Home Shield business) are subject to significant regulatory restrictions under the laws and regulations of the states in which they operate. Among other things, such laws and regulations require certain such subsidiaries to maintain minimum capital and net worth requirements and may limit the amount of ordinary and extraordinary dividends and other payments that these subsidiaries can pay to us. As of March 31, 2014, the total net assets subject to these third-party restrictions was $184 million. Such limitations will be in effect through the end of 2014, and similar limitations are expected to be in effect in 2015.

We may be unable to maintain a level of cash flows from operating activities sufficient to permit us to pay the principal and interest on our indebtedness. If our cash flow and capital resources are insufficient to fund our debt service obligations, we may be forced to reduce or delay capital expenditures, sell assets, seek to obtain additional equity capital or

restructure our indebtedness. In the future, our cash flow and capital resources may not be sufficient for payments of interest on and principal of our indebtedness, and such alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations.

The $2,184 million of outstanding borrowings under the Term Facilities, after including the unamortized portion of the original issue discount paid, have a maturity date of January 31, 2017. The Revolving Credit Facility is also scheduled to mature on January 31, 2017. The 8% 2020 Notes will mature on February 15, 2020, and the 7% 2020 Notes will mature on August 15, 2020. We may be unable to refinance any of our indebtedness or obtain additional financing, particularly because of our high levels of indebtedness. Market disruptions, such as those experienced in 2008 and 2009, as well as our significant indebtedness levels, may increase our cost of borrowing or adversely affect our ability to refinance our obligations as they become due. If we are unable to refinance our indebtedness or access additional credit, or if short-term or long-term borrowing costs dramatically increase, our ability to finance current operations and meet our short-term and long- term obligations could be adversely affected.

If we cannot make scheduled payments on our indebtedness, we will be in default, holders of the 2020 Notes could declare all outstanding principal and interest to be due and payable, the lenders under the Credit Facilities could terminate their commitments to loan money, the secured lenders could foreclose against the assets securing their borrowings and we could be forced into bankruptcy or liquidation.

Risks Related to the TruGreen Spin-off

If the TruGreen Spin-off were ultimately determined to be a taxable transaction for U.S. federal income tax purposes, then we could be subject to significant tax liability.

In connection with the TruGreen Spin-off we received an opinion of tax counsel with respect to the tax-free nature of the TruGreen Spin-off to Holdings and Holdings stockholders under Section 355 and related provisions of the Internal Revenue Code of 1986, as amended (the Code). The opinion relied on an Internal Revenue Service (IRS) private letter ruling as to matters covered by the ruling. The tax opinion was based on, among other things, certain assumptions and representations as to factual matters made by us, which, if incorrect or inaccurate in any material respect, would jeopardize the conclusions reached by tax counsel in its opinion. The opinion is not binding on the IRS or the courts, and the IRS or the courts may not agree with the opinion. If the TruGreen Spin-off were ultimately determined not to be tax-free, we could be liable for the U.S. federal income taxes imposed as a result of the transaction. Furthermore, events subsequent to the TruGreen Spin-off could cause us to recognize a taxable gain in connection therewith. In addition, as is customary with tax-free spin-off transactions, we and our equity sponsors are limited in our ability to pursue certain strategic transactions with respect to ServiceMaster.

Federal and state fraudulent transfer laws and Delaware corporate law may permit a court to void the TruGreen Spin-off, which would adversely affect our financial condition and our results of operations.

In connection with the TruGreen Spin-off, we undertook several corporate restructuring transactions which, along with the contributions and distributions to be made as part of the spin-off, may be subject to challenge under federal and state fraudulent conveyance and transfer laws as well as under Delaware corporate law.

Under applicable laws, any transaction, contribution or distribution completed as part of the spin-off could be voided as a fraudulent transfer or conveyance if, among other things, the transferor received less than reasonably equivalent value or fair consideration in return and was insolvent or rendered insolvent by reason of the transfer.

We cannot be certain as to the standards a court would use to determine whether or not any entity involved in the spin-off was insolvent at the relevant time. In general, however, a court would look at various facts and circumstances related to the entity in question, including evaluation of whether or not:

- the sum of its debts, including contingent and unliquidated liabilities, was greater than the fair saleable value of all of its assets;

- the present fair saleable value of its assets was less than the amount that would be required to pay its probable liability on its existing debts, including contingent liabilities, as they become absolute and mature; or

- it could not pay its debts as they became due.

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If a court were to find that any transaction, contribution or distribution involved in the spin-off was a fraudulent transfer or conveyance, the court could void the transaction, contribution or distribution. In addition, the spin-off could also be voided if a court were to find that the spin-off was not a legal dividend under Delaware corporate law. The resulting complications, costs and expenses of either finding could materially adversely affect our business, financial condition and results of operations.

Our directors and officers may have actual or potential conflicts of interest because of their equity ownership in New TruGreen.

Directors and officers of ServiceMaster and Holdings may own shares of New TruGreen s common stock or be affiliated with certain equity owners of New TruGreen. This ownership may create, or may create the appearance of, conflicts of interest when these directors and officers are faced with decisions that could have different implications for us and New TruGreen. In connection with the TruGreen Spin-off, we entered into a transition services agreement with New TruGreen under which we will provide a range of support services to New TruGreen for a limited period of time. Potential conflicts of interest could arise in connection with the resolution of any dispute that may arise between us and New TruGreen regarding the terms of the transition services agreement or other agreements governing the TruGreen Spin-off and the relationship thereafter between the companies.

ITEM 6. EXHIBITS

Exhibit No.	Description of Exhibit
2.1	Agreement and Plan of Merger, dated as of December 31, 2013, by and between The ServiceMaster Company and The ServiceMaster Company, LLC, is incorporated by reference to Exhibit 2.1 to the registrant s Current Report on Form 8-K filed January 17, 2014 (File No. 001-14762 (the 2014 8-K)).
2.2	Separation and Distribution Agreement, dated as of January 14, 2014, by and among ServiceMaster Global Holdings, Inc., The ServiceMaster Company, TruGreen Holding Corporation and TruGreen Limited Partnership, is incorporated by reference to Exhibit 2.2 of the 2014 8-K.
2.3	Employee Matters Agreement, dated as of January 14, 2014, by and among ServiceMaster Global Holdings, Inc., The ServiceMaster Company, LLC, TruGreen Limited Partnership and TruGreen Holding Corporation, is incorporated by reference to Exhibit 2.3 of the 2014 8-K.
2.4	Tax Matters Agreement, dated as of January 14, 2014, by and among ServiceMaster Global Holdings, Inc., The ServiceMaster Company, LLC, TruGreen Holding Corporation and TruGreen Limited Partnership, is incorporated by reference to Exhibit 2.4 of the 2014 8-K.
2.5	Transition Services Agreement, dated as of January 14, 2014, by and between The ServiceMaster Company, LLC and TruGreen Limited Partnership, is incorporated by reference to Exhibit 2.5 of the 2014 8-K.
4.1	Fourth Supplemental Indenture, dated as January 14, 2014, among The ServiceMaster Company, LLC, the Subsidiary Guarantors named therein and Wilmington Trust, National Association, as Trustee is incorporated by reference to Exhibit 4.1 to the 2014 8-K.
4.2	Fifth Supplemental Indenture, dated as January 14, 2014, among The ServiceMaster Company, LLC, the Subsidiary Guarantors named therein and Wilmington Trust, National Association, as Trustee is incorporated by reference to Exhibit 4.2 to the 2014 8-K.
4.3	

	Fifth Supplemental Indenture, dated as of January 14, 2014, among The ServiceMaster Company, LLC and The Bank of New York Mellon Trust Company, N.A. (as successor to Harris Trust and Savings Bank), as Trustee is incorporated by reference to Exhibit 4.3 to the 2014 8-K.
10.1#	Termination of Indemnification Agreement, dated as of March 21, 2014, by Banc of America Capital Investors V, L.P., BAS Capital Funding Corporation, BACSVM, L.P., Banc of America Strategic Investments Corporation, Banc of America Capital Management V, L.P., BACM I GP, LLC and BA Equity Co-Invest GP LLC.

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10.2#	Indemnification Agreement, dated as of March 21, 2014, among The ServiceMaster Company, LLC, ServiceMaster Global Holdings, Inc. and Ridgemont Partners Management, LLC.
10.3#	Amendment No. 2 to Consulting Agreement, dated as of March 21, 2014, among The ServiceMaster Company, LLC, ServiceMaster Global Holdings, Inc., BAS Capital Funding Corporation and Ridgemont Partners Management, LLC.
10.4#	Consulting Agreement, dated March 21, 2014, among The ServiceMaster Company, LLC, ServiceMaster Global Holdings, Inc. and Ridgemont Partners Management, LLC.
10.5#	Employee Stock Option Agreement for Mark J. Barry dated as of March 18, 2014.
10.6	Term Loan Credit Agreement Joinder Agreement, dated as of January 14, 2014, among The ServiceMaster Company, The ServiceMaster Company, LLC, Citibank, N.A., as administrative agent, and the other parties thereto is incorporated by reference to Exhibit 10.1 to the 2014 8-K.
10.7	Assumption Agreement, dated as of January 14, 2014, by SMCS Holdco, Inc. and SMCS Holdco II, Inc., in favor of Citibank, N.A., as administrative agent and collateral agent for the banks and other financial institutions from time to time parties to the Credit Agreement referred to therein and the other Secured Parties (as defined therein) is incorporated by reference to Exhibit 10.3 to the 2014 8-K.
10.8	Revolving Credit Agreement Joinder Agreement, dated as of January 14, 2014, among The ServiceMaster Company, The ServiceMaster Company, LLC, Citibank, N.A., as administrative agent, and the other parties thereto is incorporated by reference to Exhibit 10.2 to the 2014 8-K.
10.9	Assumption Agreement, dated as of January 14, 2014, by SMCS Holdco, Inc. and SMCS Holdco II, Inc., in favor of Citibank, N.A., as administrative agent and collateral agent for the banks and other financial institutions from time to time parties to the Revolving Credit Agreement referred to therein and the other Secured Parties (as defined therein) is incorporated by reference to Exhibit 10.4 to the 2014 8-K.
10.10	Amendment No. 2 to Employment Agreement, dated as of February 28, 2014, by and between Robert J. Gillette and ServiceMaster Global Holdings, Inc. is incorporated by reference to Exhibit 10.33 to the Company s Annual Report on Form 10-K for the year ended December 31, 2013 (File No. 001-14762).
31.1#	Certification of Chief Executive Officer Pursuant to Rule 15d 14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2#	Certification of Chief Financial Officer Pursuant to Rule 15d 14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1#	Certification of Chief Executive Officer Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2#	Certification of Chief Financial Officer Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS#	XBRL Instance Document
101.SCH#	XBRL Taxonomy Extension Schema
101.CAL#	XBRL Taxonomy Extension Calculation Linkbase
101.DEF#	XBRL Taxonomy Extension Definition Linkbase
101.LAB#	XBRL Taxonomy Extension Label Linkbase
101.PRE#	XBRL Extension Presentation Linkbase

Filed herewith.

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SIGNATURE

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

Date: May 2, 2014

THE SERVICEMASTER COMPANY, LLC
(Registrant)

By: /s/ Alan J. M. Haughie
Alan J. M. Haughie
Senior Vice President and Chief Financial Officer