First Business Financial Services, Inc.
Form 10-K
March 11, 2011

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2010

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

For the transition period from __________ to __________

Commission file number 001-34095

FIRST BUSINESS FINANCIAL SERVICES, INC.

(Exact name of registrant as specified in its charter)

Wisconsin	39-1576570
(State or jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
401 Charmany Drive, Madison, WI	53719
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code (608) 238-8008

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.01 par value	NASDAQ Stock Exchange
Common Share Purchase Rights	NASDAQ Stock Exchange

Securities registered pursuant to section 12(g) of the Act

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No þ

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

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

Indicate by check mark if the disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this From 10-K or any amendment to this Form 10-K. o

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No þ
The aggregate market value of the common equity held by non-affiliates computed by reference to the closing price of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter was approximately $24.6 million.
As of February 23, 2011, 2,597,538 shares of common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III Portions of the Proxy Statement for the Annual Meeting of Stockholders to be held on May 16, 2011 are incorporated by reference into Part III hereof.

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PART I.

Item 1. Business

General

First Business Financial Services, Inc. (together with all of its subsidiaries, collectively referred to as FBFS, Corporation, we, us, or our) is a registered bank holding company incorporated under the laws of the State of Wisconsin and is engaged in the commercial banking business through its wholly-owned banking subsidiaries First Business Bank and First Business Bank Milwaukee (the Banks). All of the operations of FBFS are conducted through the Banks and certain subsidiaries of First Business Bank. The Banks operate as business banks focusing on delivering a full line of commercial banking products and services tailored to meet the specific needs of small and medium-sized businesses, business owners, executives, professionals and high net worth individuals. The Banks generally target businesses with sales between $2 million and $50 million. For a more detailed discussion of loans, leases and the underwriting criteria of the Banks, see **Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Loans and Leases.** To supplement its business banking deposit base, the Banks utilize wholesale funding alternatives to fund a portion of their assets. The Banks do not utilize a branch network to attract retail clients.

First Business Bank (FBB) is a state bank that was chartered in 1909 under the name Kingston State Bank. In 1990, FBB relocated its home office to Madison, Wisconsin, opened a banking facility in University Research Park, and began focusing on providing high-quality banking services to small and medium-sized businesses located in Madison, Wisconsin and the surrounding area. FBB s product lines include commercial and consumer treasury management services, commercial lending, commercial real estate lending, equipment financing and a variety of deposit accounts and personal loans to business owners, executives and high net worth individuals. FBB also offers trust and investment services through First Business Trust & Investments (FBTI), a division of FBB. FBB has three loan production offices in the Northeast Region of Wisconsin to serve Appleton, Wisconsin, Oshkosh, Wisconsin and Green Bay, Wisconsin and their surrounding areas.

FBB has four wholly-owned subsidiaries. First Business Capital Corp. (FBCC) operates as an asset-based commercial lending company specializing in providing secured lines of credit as well as term loans on equipment and real estate assets primarily to manufacturers and wholesale distribution companies located throughout the United States. First Business Equipment Finance, LLC (FBEF) operates as a commercial equipment finance company specializing in financing of general equipment to small and middle market companies. FBB Real Estate, LLC (FBBRE) is a limited liability company established for the purpose of holding and liquidating real estate and other assets acquired through foreclosure or other legal proceedings. First Madison Investment Corp. (FMIC) is located in and formed under the laws of the state of Nevada. FMIC was organized for the purpose of managing a portion of the Bank s investment portfolio. FMIC invests in marketable securities and loans purchased from FBB. FBB also has one indirect subsidiary, First Madison Capital Corp Nevada Corp (FMCCNC), a wholly-owned subsidiary of FBCC located in and formed under the laws of the state of Nevada, organized for the purpose of investing in loans purchased from FBCC.

First Business Bank Milwaukee (FBB Milwaukee) is a state bank that was chartered in 2000 in Wisconsin. Like FBB, FBB Milwaukee s product lines include commercial and consumer treasury management services, commercial lending and commercial real estate lending for similar sized businesses as FBB. FBB Milwaukee also offers trust and investment services through a trust service office agreement with FBB. FBB Milwaukee offers business owners, executives, professionals and high net worth individuals, consumer services which include a variety of deposit accounts and personal loans. FBB Milwaukee has one wholly owned subsidiary, FBB Milwaukee Real Estate, LLC (FBBMRE). FBBMRE is a limited liability company established for the purpose of holding and liquidating real estate and other assets acquired through foreclosure or other legal proceedings.

In September 2008, FBFS formed FBFS Statutory Trust II, (Trust II), a Delaware business trust wholly owned by the Corporation. In 2008, Trust II completed the sale of $10.0 million of 10.5% fixed rate trust preferred securities. Trust II also issued common securities in the amount of $315,000 to the Corporation. Trust II used the proceeds from the offering to purchase $10.3 million of 10.5% junior subordinated notes (the Notes) issued by the Corporation. The Corporation has the right to redeem the Notes at any time on or after September 26, 2013. The preferred securities are mandatorily redeemable upon the maturity of the Notes on September 26, 2038.

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Available Information

The Corporation maintains a web site at www.firstbusiness.com. This Form 10-K and all of the Corporation s filings under the Securities Exchange Act of 1934, as amended, including the Corporation s proxy statement, are available through that web site, free of charge, including copies of annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports, on the date that the Corporation files those materials with, or furnishes them to, the Securities and Exchange Commission (SEC). These filings are also available to the public on the internet at the SEC s website at www.sec.gov. Shareholders may also read and copy any document that we file at the SEC s public reference rooms located at 100 F Street, NE, Washington, DC 20549. Shareholders may call the SEC at 1-800-SEC-0300 for further information on the public reference room.

Employees

At December 31, 2010, FBFS had 141 employees which equates to 124 full-time equivalent employees. No employee is covered by a collective bargaining agreement, and we believe our relationship with our employees to be good.

Competition

The Banks encounter strong competition in attracting commercial loan, equipment finance and deposit clients as well as trust and investment clients. Such competition includes banks, savings institutions, mortgage banking companies, credit unions, finance companies, equipment finance companies, mutual funds, insurance companies, brokerage firms and investment banking firms. The Banks market areas include branches of several commercial banks that are substantially larger in terms of loans and deposits. Furthermore, tax exempt credit unions operate in the Banks market areas and aggressively price their products and services to a large portion of the market. The Banks also compete with regional and national financial institutions, many of which have greater liquidity, higher lending limits, greater access to capital, more established market recognition and more resources and collective experience than the Banks. Our profitability depends upon the Banks ability to successfully maintain and increase market share.

Supervision and Regulation

Below is a brief description of certain laws and regulations that relate to the Corporation and the Banks. This narrative does not purport to be complete and is qualified in its entirety by reference to applicable laws and regulations.

General

The Banks are chartered in the State of Wisconsin and are subject to regulation and supervision by the Division of Banking of the Wisconsin Department of Financial Institutions (WDFI), and are subject to periodic examinations. Review of fiduciary operations is included in the periodic examinations. The Banks deposits are insured by the Deposit Insurance Fund (DIF). The DIF is administered by the Federal Deposit Insurance Corporation (FDIC), and therefore the Banks are also subject to regulation by the FDIC. Periodic examinations of the Banks are also conducted by the FDIC. The Banks must file periodic reports with the FDIC concerning their activities and financial condition and must obtain regulatory approval prior to entering into certain transactions such as mergers with or acquisitions of other depository institutions and opening or acquiring branch offices. This regulatory structure gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies regarding the classification of assets and the establishment of adequate loan and lease loss reserves.

Wisconsin banking laws restrict the payment of cash dividends by the Banks by providing that (i) dividends may be paid only out of the Banks undivided profits, and (ii) prior consent of the WDFI is required for the payment of a dividend which exceeds current year income if dividends declared have exceeded net profits in either of the two immediately preceding years. The various bank regulatory agencies have authority to prohibit the banks under their jurisdiction from engaging in an unsafe or unsound practice. Under certain circumstances, the payment of a dividend by the Banks could be considered an unsafe or unsound practice. In the event that (i) the FDIC or the WDFI should increase minimum required levels of capital; (ii) the total assets of the Banks increase significantly; (iii) the income of the Banks decrease significantly; or (iv) any combination of the foregoing occurs, then the Boards of Directors of the Banks may decide or be required by the FDIC or the WDFI to retain a greater portion of the Banks earnings, thereby reducing or eliminating dividends.

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The Banks are subject to certain restrictions imposed by the Federal Reserve Act on any extensions of credit to their parent holding company, FBFS. Also included in the Federal Reserve Act are restrictions on investments in the capital stock or other securities of FBFS and on taking of such stock or securities as collateral for loans to any borrower. Under the Federal Reserve Act and regulations of the Federal Reserve Board, FBFS and its Banks are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit or any property or service.

The Corporation

FBFS is a financial holding company registered under the Bank Holding Company Act of 1956, as amended, and is subject to regulation, supervision, and examination by the Board of Governors of the Federal Reserve System (the FRB). The Corporation is required to file an annual report with the FRB and such other reports as the FRB may require. Prior approval must be obtained before the Corporation may merge with or consolidate into another bank holding company, acquire substantially all the assets of any bank or bank holding company, or acquire ownership or control of any voting shares of any bank or bank holding company if after such acquisition it would own or control, directly or indirectly, more than 5% of the voting shares of such bank or bank holding company.

In reviewing applications for such transactions, the FRB considers managerial, financial, capital and other factors, including financial performance of the bank or banks to be acquired under the Community Reinvestment Act of 1977, as amended. Also, under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, as amended, state laws governing interstate banking acquisitions subject bank holding companies to some limitations in acquiring banks outside of their home state without regard to local law.

The Gramm-Leach Bliley Act of 1999 (GLBA) eliminates many of the restrictions placed on the activities of bank holding companies. Bank holding companies such as FBFS can expand into a wide variety of financial services, including securities activities, insurance, and merchant banking without the prior approval of the FRB.

The FRB has the authority to prohibit bank holding companies under their jurisdiction from engaging in unsafe or unsound practices. In the event that (i) the FRB should increase minimum required levels of capital; (ii) the total assets of our Corporation increases significantly; (iii) the income of our Corporation decreases significantly; or (iv) any combination of the foregoing occurs, then the Board of Directors of our Corporation may decide or be required by the FRB to retain a greater portion of our Corporation s earnings, thereby reducing or eliminating dividends paid to its shareholders.

Emergency Economic Stabilization Act of 2008. The Emergency Economic Stabilization Act of 2008 (EESA), gives the U.S. Department of Treasury (UST) authority to take certain actions to restore liquidity and stability to the U.S. Banking markets. Based upon its authority in the EESA, a number of programs to implement EESA have been announced. Those programs include the following:

- Capital Purchase Program (CPP). Pursuant to this program, the UST, on behalf of the U.S. government, was authorized to purchase preferred stock, along with warrants to purchase common stock, from certain financial institutions, including bank holding companies, savings and loan holding companies and banks or savings associations not controlled by a holding company. We received approval from the UST to participate in this program. We chose not to participate in the program. Refer to **Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources** for further discussion.
- Temporary Liquidity Guarantee Program. The program contained both (i) a debt guarantee component, whereby the FDIC will guarantee until June 30, 2012, the senior unsecured debt issued by eligible financial institutions between October 14, 2008 and June 30, 2009 (of which we did not issue any qualifying debt) and (ii) a transaction account guarantee program (TAGP), whereby the FDIC will insure 100% of certain transaction accounts held at eligible financial institutions through December 31, 2009 and further extended to December 31, 2010. We elected to fully participate in this program.

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Dodd-Frank Wall Street Reform and Consumer Protection Act. Since 2008, Congress and the U.S. government have taken a variety of actions to strengthen supervision of financial institutions and systemically important nonbank financial companies, including the passage, on July 21, 2010, into law of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The Dodd-Frank Act represents the most comprehensive change to banking laws since the Great Depression of the 1930s, and mandates change in several key areas: regulation and compliance (both with respect to financial institutions and systemically important nonbank financial companies), securities regulation, executive compensation, regulation of derivatives, corporate governance, and consumer protection. While these changes in the law will have a major impact on large institutions, even smaller institutions such as ours will be affected. The Dodd-Frank Act calls for federal regulatory agencies to adopt almost 250 new rules and conduct more than 60 studies over the next several years in order to implement its provisions. The ultimate impact of the legislation on the Corporation will not be known for many months or years.

The following summary is intended only to highlight those provisions of the Dodd-Frank Act that the Corporation believes will have the most significant impact on the Corporation and its operations in the future. The summary does not describe every provision of the Dodd-Frank Act that may in any way affect the Corporation, and is not intended to provide a summary of the legislation in its entirety.

Key provisions of the Dodd-Frank Act that are likely to affect the Corporation and its subsidiaries in the near- and long-term include:

Changes in FDIC insurance. The Dodd-Frank Act increases the FDIC s minimum ratio of reserves to insured deposits and changes how deposit insurance premium assessments from the FDIC are calculated through provisions specifically designed to capture more deposit insurance premium income from the larger U.S. banks. These provisions may lead to lower FDIC insurance premiums for the Banks than if the change was not made. The legislation also permanently increases federal deposit insurance coverage to $250,000. Additionally, under the Dodd-Frank Act, beginning December 31, 2010 (the scheduled termination date for the TAGP) and continuing through January 1, 2013, all funds held in noninterest-bearing transaction accounts and Interest on Lawyer Trust Accounts (IOLTAs) will be guaranteed by the FDIC for the entire balance of the account. However, this unlimited insurance coverage will not extend to low interest NOW accounts, which were covered under TAGP through December 31, 2010.

Regulation of derivatives. The Dodd-Frank Act imposes significant restrictions on the trading of derivatives, and provides for increased regulation by the SEC and the Commodities Futures Trading Commission of the over-the-counter derivative market. The Dodd-Frank Act will require bank holding companies to spin off certain riskier derivative trading activities to separately capitalized affiliates, while continuing to authorize perceived lower-risk derivative activities by banks to the extent these activities qualify as risk mitigating activities directly related to the bank s activities. The Corporation does not currently expect these provisions to have a significant impact on its operations, though they may limit potential areas of expansion by the Corporation s banking subsidiaries of their derivative activities, products and services.

Bank capital. The Collins Amendment in the Dodd-Frank Act affects the capital requirements for commercial banks, and includes a phased-in exclusion of trust preferred securities as an element of Tier 1 capital for certain bank holding companies. Bank holding companies with total assets of $15 billion or more have three years to phase-out trust preferred securities from their Tier 1 capital, beginning January 1, 2013. Preferred stock issued to the U.S. Treasury under the CPP is exempt from the Collins Amendment and is permanently includible in Tier 1 capital for all bank holding companies. The Corporation s total assets are less than $15 billion and therefore it is not required to phase out its trust preferred securities as an element of Tier 1 capital; however, it is prohibited from issuing new trust preferred securities after July 21, 2010.

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Leverage and risk-based capital requirements. The Dodd-Frank Act mandates federal banking agencies to establish new leverage and risk-based capital requirements for banks, bank holding companies, and systemically important non-banking companies. These new requirements must be established within 18 months of the Dodd-Frank Act s effective date. While the Dodd-Frank Act does not provide any specific guidance on what the new capital levels should be, the law does provide that the capital levels currently in force should serve as a floor for any new capital requirements. Accordingly, the Corporation expects that these new prudential standards will lead to higher capital requirements in the future. The new law further mandates regulators to adapt capital requirements as banks grow in size or engage in riskier activities, and codifies for the first time the requirement imposed by bank regulators that a bank holding company must serve as a source of strength or provider of funds to its subsidiary depository institutions, if those funds are ever needed.

The extent to which the new legislation and existing and planned governmental initiatives will succeed in alleviating tight credit conditions or otherwise result in an improvement in the national economy is uncertain. In addition, because most of the component parts of the new legislation will be subject to intensive agency rulemaking and subsequent public comment over the next several quarters prior to eventual implementation, it is difficult to predict the ultimate effect of the Dodd-Frank Act on the Corporation at this time. However, the Corporation anticipates expenses will increase as a result of new compliance requirements.

The Banks

As state-chartered DIF-insured banks, the Banks are subject to extensive regulation by the WDFI and the FDIC. Lending activities, fiduciary activities and other investments must comply with federal statutory and regulatory requirements. This federal regulation establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the DIF, the FDIC, and depositors.

Insurance of Deposits. The Banks deposits are insured under the DIF of the FDIC. On July 21, 2010, the Dodd-Frank Act made permanent the standard maximum deposit insurance amount of $250,000 per deposit account.

Further, the FDIC Board of Directors issued a final rule under the Dodd-Frank Act that amends the Federal Deposit Insurance Act to provide temporary unlimited coverage for noninterest-bearing transaction accounts at all FDIC-insured depository institutions. All funds held in noninterest-bearing transaction accounts will be fully insured, without limit, from December 31, 2010, through December 31, 2012. This unlimited coverage is separate from, and in addition to, the coverage provided to a depositor with other accounts held at the Banks. It replaced the unlimited coverage under TAGP and applies to all insured depository institutions and, unlike the FDIC s Temporary Liquidity Guarantee Program, no opt outs are permitted and low-interest NOW accounts are not covered.

On December 29, 2010, the FDIC Board of Directors issued a final rule to implement an amendment to the Federal Deposit Insurance Act to include IOLTAs within the definition of a noninterest-bearing transaction account, thus expanding the temporary, unlimited deposit insurance coverage authorized by the Dodd-Frank Act.

The Banks also elected to participate in the Debt Guarantee Program that temporarily guarantees all newly-issued senior unsecured debt, up to 2% of the Corporation s liabilities, issued by the participating entities on or after October 14, 2008 through and including June 30, 2009. The guarantee expires on June 30, 2012. At December 31, 2010, the Banks did not have any debt guaranteed under this program. The cost for this program upon participation is based on an annualized basis points weighted by the maturity of the debt multiplied by the amount of debt issued, and calculated for the maturity period of that debt or June 30, 2012, whichever is earlier.

The FDIC assigns each institution it regulates to a particular risk category based on the levels of the institution s capital well-capitalized, adequately capitalized, or undercapitalized and the varying levels of supervisory concern, ranging from those institutions considered to be healthy to those that raise substantial supervisory concern. The result is four risk categories with well-capitalized, financially sound institutions paying lower rates than those paid by undercapitalized institutions with substantial supervisory concern that pose a risk to the insurance fund. The Banks assessment rate depends on the risk category to which they are assigned. Assessment rates for deposit insurance currently range from 7 to 77.5 basis points. The Banks are well capitalized. The supervisory risk category to which the Banks are assigned by the FDIC is confidential and may not be disclosed.

The FDIC insurance premium rates increased for all financial institutions in 2009 based upon enacted regulations. During the second quarter of 2009, the FDIC issued a special assessment to all banks of which approximately

$481,000 was assessed to our Banks. In December 2009, all banks, including our Banks, received a notice requiring the prepayment of the 2010-2012 FDIC insurance premiums. The payment was required on or before December 30, 2009 in an effort to strengthen the cash position of the DIF immediately without immediately impacting earnings of the banking industry. The prepaid assessment was based upon the Banks assessment rate in effect on September 30, 2009 and will be subject to adjustments on a quarterly basis throughout the prepayment period based upon actual levels of deposits and related risk ratings. The Banks share of the prepayment was a cash payment of approximately $5.4 million at December 30, 2009 of which $2.5 million was remaining as a prepaid asset as of December 31, 2010. In general, any increase in insurance assessment, including special assessments, would have an adverse affect on the earnings of the Banks. The prepaid FDIC insurance prepayment has a negative impact on our net interest margin because the prepaid asset will be considered a non-earning asset for us as the FDIC will not pay interest on the prepaid amounts nor will we have the ability to use that cash for higher yielding alternatives.

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On February 9, 2011, the FDIC issued a final rule which redefines the deposit insurance base as required by the Dodd-Frank Act; makes changes to assessment rates; implements the Dodd-Frank Act deposit insurance fund dividend provisions; and revises the risk based assessment system for all large insured depository institutions, generally, those institutions with at least $10 billion in total assets. Nearly all of the 7,600 plus institutions with assets less than $10 billion, including our Banks, will pay smaller assessments as a result of this final rule.

Regulatory Capital Requirements

The FRB monitors the capital adequacy of the consolidated holding company because on a consolidated basis it has assets in excess of $500.0 million. A combination of risk-based and leverage ratios are determined by the FRB. Failure to meet these capital guidelines could result in supervisory or enforcement actions by the FRB. Under the risk-based capital guidelines, different categories of assets, including certain off-balance sheet items, such as loan commitments in excess of one year and letters of credit, are assigned different risk weights, based on the perceived credit risk of the asset. These risk-weighted assets are calculated by assigning risk weights to corresponding asset balances to determine the risk weight of the entire asset base. Total capital, under this definition, is defined as the sum of Tier 1 and Tier 2 capital elements, with Tier 2 capital being limited to 100% of Tier 1 capital. Tier 1 capital, with some restrictions, includes common stockholders equity, any perpetual preferred stock, qualifying trust preferred securities and minority interests in any unconsolidated subsidiaries. Tier 2 capital, with certain restrictions, includes any perpetual preferred stock not included in Tier 1 capital, subordinated debt, any trust preferred securities not qualifying as Tier 1 capital, specific maturing capital instruments and the allowance for loan and lease losses (limited to 1.25% of risk-weighted assets). The regulatory guidelines require a minimum total capital to risk-weighted assets of 8%, of which at least 4% must be in the form of Tier 1 capital. The FRB also has a leverage ratio requirement which is defined as Tier 1 capital divided by average total consolidated assets. The minimum leverage ratio required is 3%. The Banks have consistently maintained regulatory capital ratios at or above the well capitalized standards. For further detail on capital and capital ratios see discussion under **Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.**

Prompt Corrective Action

The Banks are also subject to capital adequacy requirements under the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). Under FDICIA, all commonly controlled FDIC insured depository institutions may be held liable for any loss incurred by the FDIC resulting from a failure of, or any assistance given by the FDIC to, any commonly controlled institutions.

Pursuant to certain provisions of FDICIA, the federal regulatory agencies have broad powers to take prompt corrective action if a depository institution fails to maintain certain capital levels. Prompt corrective action may include, without limitation, restricting a depository institution s ability to pay dividends, restricting acquisitions, branch establishment, or other activities and placing limitations on asset growth and may prohibit payment of management fees to control persons, if such payments and distributions would cause undercapitalization. At this time, our capital levels are above the levels at which federal regulatory authorities could invoke their authority to initiate any manner of prompt corrective action under the applicable provisions of the FDICIA.

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The following table sets forth the FDIC s definition of the five capital categories, in the absence of a specific capital directive.

Category	Total Capital to Risk Weighted Assets	Tier 1 Capital to Risk Weighted Assets	Tier 1 Leverage Ratio
Well capitalized	≥ 10%	≥ 6%	≥ 5%
Adequately capitalized	≥ 8%	≥ 4%	≥ 4%*
Undercapitalized	< 8%	< 4%	< 4%*
Significantly undercapitalized	< 6%	< 3%	< 3%
Critically undercapitalized	Ratio of tangible equity to total assets ≤ 2%		

* 3% if the bank receives the highest rating under the uniform system.

Limitations on Dividends and Other Capital Distributions

Federal and state regulations impose various restrictions or requirements on state-chartered banks with respect to their ability to pay dividends or make various other distributions of capital. Generally, such laws restrict dividends to undivided profits or profits earned during preceding periods.

In addition to federal and state regulations, FDIC insured institutions may not pay dividends while undercapitalized or if such a payment would cause undercapitalization. The FDIC also has authority to prohibit the payment of dividends if such a payment constitutes an unsafe or unsound practice in light of the financial condition of a particular bank.

Liquidity

The Banks are required by federal regulation to maintain sufficient liquidity to ensure safe and sound operations. We believe that the Banks have an acceptable liquidity percentage to match the balance of net withdrawable deposits and short-term borrowings in light of present economic conditions and deposit flows. Refer to **Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources** for additional information.

Federal Reserve System

The Banks are required to maintain reserves at specified levels against their transaction accounts and non-personal time deposits. As of December 31, 2010, the Banks were in compliance with these requirements.

Federal Home Loan Bank System

The Banks are members of the Federal Home Loan Bank of Chicago (FHLB). The FHLB serves as a central credit facility for its members. The FHLB is funded primarily from proceeds from the sale of obligations of the FHLB system. It makes loans to member banks in the form of FHLB advances. All advances from the FHLB are required to be fully collateralized as determined by the FHLB.

As a member, each Bank is required to own shares of capital stock in the FHLB in an amount equal to the greatest of $500, 1% of its aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year or 20% of its outstanding advances. The FHLB also imposes various limitations on advances relating to the amount and type of collateral, the amount of advances and other items. At December 31, 2010, the Banks owned a total of $2.4 million in FHLB stock and both were in compliance with FHLB requirements. The Banks received no dividends from the FHLB for the years ended December 31, 2010, and 2009. Outstanding FHLB advances as of December 31, 2010 and 2009 were $2.4 million and $18.5 million, respectively.

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Since October 2007, the FHLB has been under a consensual cease and desist order with its regulator, the Federal Housing Finance Board. Under the terms of the order, capital stock repurchases and redemptions, including redemptions upon membership withdrawal or other termination, are prohibited unless the FHLB has received approval of the Director of the Office of Supervision of the Finance Board. The FHLB has not declared or paid a dividend since the third quarter of 2007. However, on February 1, 2011, the FHLB issued a press release declaring a cash dividend at an annualized rate of 10 basis points per share based upon the FHLB s preliminary financial results for the fourth quarter of 2010. While the dividend has been declared, the Banks do not expect dividend income from their holdings of FHLB stock to be a significant source of income for the foreseeable future. The Banks currently hold $2.4 million, at cost, of FHLB stock, of which $1.3 million is deemed voluntary stock. We believe we will ultimately recover the value of this stock. Refer to **Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources** for further discussion relating to the impact of this order on our ability to obtain resources from the FHLB to meet the liquidity needs of the Banks.

Transactions with Affiliates

The Banks loans to their own and the Corporation s executive officers, directors and owners of greater than 10% of any of their respective stock (so-called insiders) and any entities affiliated with such insiders are subject to the conditions and limitations under Section 23A of the Federal Reserve Act and the Federal Reserve Bank s Regulation O. In general, the provisions of Section 23A require that transactions between a banking institution or its subsidiaries and such institution s affiliates be on terms as favorable to the institution as transactions with non-affiliates. In addition, these provisions contain certain restrictions on loans to affiliates, restricting such loans to a percentage of the institution s capital. A covered affiliate, for purposes of these provisions, would include the Corporation and any other company that is under our common control. Certain transactions with our directors, officers or controlling persons are also subject to conflict of interest regulations. Among other things, these regulations require that loans to such persons and their related interests be made on terms substantially the same as for loans to unaffiliated individuals and must not create an abnormal risk of repayment or other unfavorable features for the Banks in accordance with Regulation O. The Banks can make exceptions to the foregoing procedures if they offer extensions of credit that are widely available to employees of the Banks and that do not give any preference to insiders over other employees of the Banks.

Privacy

Financial institutions are required by statute and regulation to disclose their privacy policies. In addition, such financial institutions must appropriately safeguard their clients nonpublic, personal information.

Community Reinvestment Act Requirements

The Community Reinvestment Act requires each Bank to have a continuing and affirmative obligation in a safe and sound manner to help meet the credit needs of its entire community, including low and moderate income neighborhoods. Federal regulators regularly assess the Banks record of meeting the credit needs of their respective communities. Applications for additional acquisitions would be affected by the evaluation of the Banks effectiveness in meeting its Community Reinvestment Act requirements.

Anti Money Laundering

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the Patriot Act) is designed to deny terrorists and criminals the ability to obtain access to the United States financial system and has significant implications for depository institutions, brokers, dealers and other businesses involved in the transfer of money. The Patriot Act mandates financial services companies to have policies and procedures with respect to measures designed to address any or all of the following matters: customer identification programs, money laundering, terrorist financing, identifying and reporting suspicious activities and currency transactions, currency crimes, and cooperation between financial institutions and law enforcement authorities.

Commercial Real Estate Guidance

The FDIC s Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices (CRE Guidance) provides supervisory criteria, including the following numerical indicators, to assist bank examiners in identifying banks with potentially significant commercial real estate loan concentrations that may warrant greater supervisory scrutiny: (1) commercial real estate loans exceed 300% of capital and increased 50% or more in the preceding three years or (2) construction and land development loans exceed 100% of capital. The CRE Guidance does not limit banks levels of commercial real estate lending activities but rather guides institutions in developing risk management practices and levels of capital that are commensurate with the level and nature of their commercial real estate concentrations. Based on our current loan portfolio, our Banks do not exceed these guidelines. Even though the Banks do not exceed these regulatory guidelines, we believe that we have taken appropriate precautions to address the risks associated with our concentrations in commercial real estate lending. We do not expect the CRE Guidance to adversely affect our operations or our ability to execute our growth strategy.

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Interagency Appraisal and Evaluation Guidelines

In December 2010, the federal banking agencies released revised and updated the Interagency Appraisal and Evaluation Guidelines. This guidance represented the first update since 1994 and sets forth the minimum regulatory standards for appraisals. It incorporates examiner expectations regarding the appraisal process in loan workouts, expectations for loan and portfolio monitoring and appraisal independence and management. This guidance also requires institutions to utilize strong internal controls to ensure appraisals and evaluations are reliable and emphasizes the importance of strong policies to monitor and update valuations of collateral for existing real estate loans and transactions. We do not expect the updates to the Interagency Appraisal Guidelines to adversely affect our operations.

Processing of Deposit Accounts in the Event of an Insured Depository Institution Failure

The FDIC issued a final rule establishing practices for determining deposit and other liability account balances at a failed insured depository institution. The final rule requires institutions to prominently disclose to sweep account clients whether the swept funds are deposits and the status of the swept funds if the institution were to fail. We do not transfer deposit funds to sweep investments outside of the Banks, and therefore, the deposit funds would be FDIC insured under their established limits.

Other Regulations

The Banks are also subject to a variety of other regulations with respect to the operation of their businesses, including but not limited to the Dodd-Frank Act, Fair and Accurate Transactions Act, Truth in Lending Act, Truth in Savings Act, the Equal Credit Opportunity Act, the Electronic Funds Transfer Act, Funds Availability Act, Privacy of Consumer Financial Information Act, the Fair Housing Act, the Home Mortgage Disclosure Act, the Fair Debt Collection Practices Act, Unlawful Internet Gambling Enforcement Act, and the Fair Credit Reporting Act.

Changing Regulatory Structure

Regulation of the activities of national and state banks and their holding companies imposes a heavy burden on the banking industry. The FRB, FDIC, and WDFI all have extensive authority to police unsafe or unsound practices and violations of applicable laws and regulations by depository institutions and their holding companies. These agencies can assess civil monetary penalties, issue cease and desist or removal orders, seek injunctions, and publicly disclose such actions. Moreover, the authority of these agencies has expanded in recent years, and the agencies have not yet fully tested the limits of their powers.

The laws and regulations affecting banks and financial or bank holding companies have changed significantly in recent years, and there is reason to expect changes will continue in the future, although it is difficult to predict the outcome of these changes. From time to time, various bills are introduced in the United States Congress with respect to the regulation of financial institutions. Certain of those proposals, if adopted, could significantly change the regulation of banks and the financial services industry.

Monetary Policy

The monetary policy of the FRB has a significant effect on the operating results of financial or bank holding companies and their subsidiaries. Among the means available to the FRB to affect the money supply are open market transactions in U.S. government securities, changes in the discount rate on member bank borrowings and changes in reserve requirements against member bank deposits. These means are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits, and their use may affect interest rates charged on loans or paid on deposits.

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Executive Officers of the Registrant

The following contains certain information about the executive officers of FBFS. There are no family relationships between any directors or executive officers of FBFS.

Corey A. Chambas, age 48, has served as the President and Chief Executive Officer of First Business Financial Services, Inc. since December 2006. Mr. Chambas joined the Corporation in 1993 and has held various positions including Chief Operating Officer, Executive Vice President, and Chief Executive Officer of First Business Bank. Mr. Chambas has over 25 years of commercial banking experience. Prior to joining the Corporation, he was a Vice President of Commercial Lending with M&I Bank in Madison, Wisconsin.

James F. Ropella, age 51, has served as Senior Vice President and Chief Financial Officer of the Corporation since September 2000. Mr. Ropella also serves as the Chief Financial Officer of the subsidiaries of the Corporation. Mr. Ropella has 22 years of experience in finance and accounting, primarily in the banking industry. Prior to joining First Business Financial Services, Inc., Mr. Ropella was Treasurer of a consumer products company. Prior to that, he was Treasurer of Firstar Corporation, now known as US Bank.

Michael J. Losenegger, age 53, has served as Chief Operating Officer of First Business Financial Services, Inc. since September 2006. Mr. Losenegger joined the Corporation in 2003 and has held various positions with First Business Bank including Chief Executive Officer, Chief Operating Officer and Senior Vice President of Business Development. Mr. Losenegger has over 23 years of experience in commercial lending. Prior to joining the Corporation, Mr. Losenegger was Senior Vice President of Lending at M&I Bank in Madison, Wisconsin.

Barbara M. Conley, age 57, has served as Senior Vice President Corporate Secretary of the Corporation since December 2007. In addition, she has served as the Corporation s General Counsel since June 2008. She has served as a Director of First Business Capital Corp. since June 2009. Ms. Conley has over 30 years of experience in commercial banking. Directly prior to joining the Corporation in 2007, Ms. Conley was a Senior Vice President in Corporate Banking with Associated Bank. She had been employed at Associated Bank since May 1976.

Mark J. Meloy, age 49, has served as President and Chief Executive Officer of First Business Bank since December 2007. Mr. Meloy joined the Corporation in 2000 and has held various positions including Executive Vice President of First Business Bank and President and Chief Executive Officer of First Business Bank Milwaukee. Mr. Meloy has over 25 years of commercial lending experience. Prior to joining the Corporation, Mr. Meloy was a Vice President and Senior Relationship Manager with Firstar Bank, NA, Cedar Rapids, Iowa and Milwaukee, Wisconsin, working in their financial institutions group with mergers and acquisition financing.

Joan A. Burke, age 59, has served as President of First Business Bank s Trust Division since September 2001. Ms. Burke has over 30 years of experience in providing trust and investment advice. Prior to joining the Corporation, Ms. Burke was the President, Chief Executive Officer and Chairperson of the Board of Johnson Trust Company and certain of its affiliates.

Charles H. Batson, age 57, has served as the President and Chief Executive Officer of First Business Capital Corp since January 2006. Mr. Batson has 32 years of experience in asset-based lending. Directly prior to joining First Business Capital Corp., Mr. Batson served as Vice President and Business Development Manager for Wells Fargo Business Credit, Inc. since 1990.

David J. Vetta, age 56, has served as President and Chief Executive Officer of First Business Bank-Milwaukee since January 2007. Prior to joining First Business Bank Milwaukee, Mr. Vetta was Managing Director at JP Morgan Asset Management since 1992 overseeing National Institutional Investment Sales teams and the Regional Private Client Group, while a member of the executive committee. Mr. Vetta was affiliated with JP Morgan Chase and its predecessor companies in various other roles since 1976.

Item 1A. Risk Factors

You should carefully read and consider the following risks and uncertainties because they could materially and adversely affect our business, financial condition and results of operations.

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Adverse changes in economic conditions, particularly a continuing or worsening slowdown in Dane, Waukesha and Outagamie counties where our business is concentrated, could harm our business.

Our success depends on the economic conditions in the U.S. and general economic conditions in the specific local markets in which we operate, principally in Dane County, Wisconsin and to a lesser extent, Waukesha County, Wisconsin, and Outagamie County, Wisconsin. We primarily provide banking and financial services to meet the needs of small to mid-sized businesses. The origination of loans secured by real estate and business assets of those businesses is our primary business and our principal source of profits. Client demand for loans could be reduced further by a weakening economy, increases in unemployment or an increase in interest rates in these areas. In addition, these businesses generally have fewer financial resources in terms of capital or borrowing capacity than larger entities. The duration and severity of economic declines, including declines in real estate and equipment values, in these areas could reduce our growth rate, impair our ability to collect loans or attract deposits, cause loans to become inadequately collateralized and generally have an adverse impact on our results of operations and financial condition. The national and global economic downturn resulted in unprecedented levels of financial market volatility, depressed the overall market value of financial institutions, limited access to capital, and had a material adverse effect on the financial condition or results of banking companies in general and our Corporation. There can be no assurance that the actions taken by the U.S. Government, FRB and other governmental and regulatory bodies for the purpose of stabilizing the financial markets, including the CPP, temporary liquidity guarantee program, and permanent increases in FDIC insurance levels, or market responses to those actions, will achieve their intended effect or will be continued.

Declines in fair market values of commercial real estate or equipment provided as collateral could increase our exposure to future probable losses.

The market value of real estate can fluctuate significantly in a short period of time as a result of economic conditions. Adverse developments affecting real estate values in one or more of our markets could impact collateral coverage associated with our commercial real estate portfolio possibly leading to increased specific reserves or charge-offs. We also provide loans collateralized by general business assets including accounts receivable, inventory, and business equipment. Significant adverse changes in various industries could cause rapid declines in values and collectability associated with those business assets resulting in inadequate collateral coverage that may expose us to future losses. An increase in specific reserves and charge-offs may have a material adverse impact on our results of operation.

Our loan portfolio has a concentration of commercial real estate loans.

We have a concentration of commercial real estate in the primary markets we serve. Commercial real estate lending typically involves larger loan principal amounts than that for residential mortgage loans or consumer loans. Commercial real estate loans have historically been viewed as having more inherent risk of default implying a higher potential loss on an individual loan basis. The repayment of these loans generally is dependent on sufficient income from the properties securing the loans to cover operating expenses and debt service. Payments on loans secured by commercial real estate are often dependent upon the successful operation and management of the properties. Therefore repayment of these loans may be affected by factors outside the borrower s control, including adverse conditions in the real estate market or the economy. In the event that the cash flow from the property is reduced, the borrower s ability to repay the loan could be impacted. The deterioration of one or a few of these loans could cause a significant increase in our percentage of non-performing loans. An increase in non-performing loans results in a loss of earnings from these loans and could result in an increase in the provision for loan and lease loss and an increase in charge-offs, all of which could have a material adverse impact on our net income.

Our allowance for loan and lease losses may not be adequate to cover actual losses.

We are exposed to the risk that our loan and lease clients may not repay their loans and leases according to their terms and that the collateral securing the payment of these loans and leases may be insufficient to assure repayment. We may experience significant loan and lease losses which could have a material adverse impact on operating results. There is a risk that some of our assumptions and judgments about the collectability of the loan and lease portfolios could be formed from inaccurately assessed conditions. Those assumptions and judgments are based, in part, on assessment of the following conditions:

- current economic conditions and their estimated effects on specific borrowers and collateral values;
- an evaluation of the existing relationships among loans and leases, probable loan and lease losses and the present level of the allowance for loan and lease losses;
- results of examinations of our loan and lease portfolios by regulatory agencies; and
- our management s internal review of the loan and lease portfolios.

We maintain an allowance for loan and lease losses to cover probable losses inherent in the loan and lease portfolios. Additional loan and lease losses will likely occur in the future and may occur at a rate greater than that experienced to date. An analysis of the loan and lease portfolios, historical loss experience and an evaluation of general economic conditions are all utilized in determining the size of the allowance. Additional adjustments may be necessary to allow for unexpected volatility or deterioration in the local or national economy. If significant additions are made to the allowance for loan and leases losses, this would materially decrease net income. Additionally, regulators periodically review our allowance for loan and lease losses or identify further loan or lease charge-offs to be recognized based on judgments different from ours. Any increase in the allowance for loan and lease losses, including as required by regulatory agencies could have a material adverse impact on net income.

To maintain adequate capital levels, we may be required to raise additional capital in the future, but that capital may not be available when it is needed and could be dilutive to our existing shareholders.

We are required by regulatory authorities to maintain adequate levels of capital to support our operations. In order to ensure our ability to support the operations of our Banks we may need to limit or terminate cash dividends that can be paid to our shareholders. In addition, we may need to raise capital in the future. Our ability to raise capital, if needed, will depend in part on our financial performance and/or conditions in the capital markets at that time, and accordingly, we cannot provide assurance of our ability to raise capital on terms acceptable to us. The current economic environment, the significant decline of stock prices and the overall condition of capital markets, all of which are outside of our control, as well as any decline in our performance or stock price, increase uncertainty as to when capital on acceptable terms will be available to us. In addition, if we decide to raise equity capital, the interest of our shareholders could be diluted. Any issuance of common stock at current trading prices would dilute the ownership of many of our current shareholders. In addition, the market price of our common stock could decrease as a result of the sale of a large number of shares or similar securities, or the perception that such sales could occur. If we cannot raise capital when needed, our ability to pay dividends, operate, maintain adequate capital levels and liquidity, or further expand our operations could be materially impaired.

The Corporation Is a Bank Holding Corporation and Its Sources of Funds Are Limited.

The Corporation is a bank holding company, and its operations are primarily conducted by the Banks, which are subject to significant federal and state regulation. Cash available to pay dividends to the shareholders of the Corporation and meet other debt service requirements is derived primarily from its existing cash flow sources, its third party line of credit, dividends received from the Banks, or a combination thereof. Dividend payments by the Banks to the Corporation in the future will require generation of future earnings by the Banks, are subject to certain regulatory restrictions and could require regulatory approval.

The Corporation May Be Adversely Affected by the Soundness of Other Financial Institutions.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. The Corporation has exposure to many different industries and counterparties and routinely executes transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose the Corporation to credit risk in the event of a default by a counterparty or client. Any such losses could have a material adverse effect on the Corporation s financial condition and results of operations.

We rely, in part, on external financing to fund our operations and the lack of availability of such funds in the future could adversely affect our operations.

Our ability to implement our business strategy will depend on our ability to obtain funding for loan originations, working capital and other general corporate purposes. If our core banking and commercial deposits are not sufficient to meet our funding needs, we may increase our utilization of brokered deposits, FHLB advances and other wholesale funding sources necessary to fund desired growth levels. Because these funds generally are more sensitive to interest rate changes than our core deposits, they are more likely to move to the highest rate available. In addition, the use of brokered deposits without regulatory approval is limited to banks that are well capitalized according to regulation. If our Banks are unable to maintain their capital levels at well capitalized minimums, we could lose a significant source of funding, which would force us to utilize additional wholesale funding or potentially sell loans at a time when loan sales pricing may be unfavorable. To the extent we are not successful in obtaining such funding, we will be unable to implement our strategy as planned, which could have a material adverse effect on our financial condition, results of operations and cash flows.

Our financial condition and results of operations could be negatively affected if we fail to effectively execute our strategic plan.

Our ability to increase profitability will depend on a variety of factors including the identification of desirable business opportunities, competitive responses from financial institutions in our market areas and our ability to manage liquidity and funding sources. While we believe we have the management resources and internal systems in place to successfully manage our strategic plan, there can be no assurances that opportunities will be available and that the strategic plan will be successfully managed.

Competition from other financial institutions could adversely affect our profitability.

We encounter heavy competition in attracting commercial loan, equipment finance and deposit clients as well as trust and investment clients. We believe the principal factors that are used to attract core deposit accounts and that distinguish one financial institution from another include value-added relationships, rates of return, types of accounts, service fees, convenience of office locations and hours and quality of service to the depositors. We believe the primary factors in competing for commercial loans are value-added relationships, interest rates, loan fee charges, loan structure and timeliness and quality of service to the borrower.

Our competition includes banks, savings institutions, mortgage banking companies, credit unions, finance companies, equipment finance companies, mutual funds, insurance companies, brokerage firms and investment banking firms. Our market areas include branches of several commercial banks that are substantially larger in terms of loans and deposits. Furthermore, tax exempt credit unions operate in most of our market areas and aggressively price their products and services to a large portion of the market. We also compete with regional and national financial institutions, many of which have greater liquidity, higher lending limits, greater access to capital, more established market recognition and more resources and collective experience than us. Our profitability depends, in part, upon our ability to successfully maintain and increase market share.

We rely on our management, and the loss of one or more of those managers may harm our business.

Our success has been and will be greatly influenced by our continuing ability to retain the services of our existing senior management and, as we expand, to attract and retain additional qualified senior and middle management. The unexpected loss of key management personnel or the inability to recruit and retain qualified personnel in the future could have an adverse effect on our business and financial results.

Variations in interest rates may harm our financial results.

We are subject to interest rate risk. Changes in the interest rate environment, whether as a result of changes in monetary policies of the FRB or otherwise, may reduce our profits. Net interest spreads are affected by the difference between the maturities and repricing characteristics of interest-earning assets and interest-bearing liabilities. They are also affected by the proportion of interest-earning assets that are funded by interest-bearing liabilities. Loan volume and yield are affected by market interest rates on loans, and increasing interest rates are generally associated with a lower volume of loan originations. There is no assurance that we can minimize our interest rate risk. In addition, an increase in the general level of interest rates may adversely affect the ability of certain borrowers to pay their obligations if the increase in rates is not concurrent with a general expansion of the economy. Accordingly, changes in levels of market interest rates could materially and adversely affect our net interest spread, asset quality, loan origination volume and overall profitability.

We are subject to extensive regulation, and changes in banking laws and regulations could adversely affect our business.

Our businesses are subject to extensive state and federal government supervision, regulation, and control. Existing state and federal banking laws subject us to substantial limitations with respect to loans, purchases of securities, payment of dividends and many other aspects of our businesses. There can be no assurance that future legislation or government policy will not adversely affect the banking industry and our operations by further restricting activities or increasing the cost of compliance. **See Item 1, Business Supervision and Regulation.**

Our trust operations subject us to financial and reputational risks.

We are subject to trust operations risk related to performance of fiduciary responsibilities. Clients may make claims and take legal action pertaining to our performance of our fiduciary responsibilities. Whether client claims and legal action related to our performance of our fiduciary responsibilities are founded or unfounded, if such claims and legal actions are not resolved in a manner favorable to us, they may result in significant financial liability and/or adversely affect the market perception of us and our products and services, as well as impact client demand for those products and services. Any financial liability or reputational damage could have a material adverse affect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

If we are unable to keep pace with technological advances in our industry, our ability to attract and retain clients could be adversely affected.

The banking industry is constantly subject to technological changes with frequent introductions of new technology-driven products and services. In addition to better serving clients, the effective use of technology increases our efficiency and enables us to reduce costs. Our future success will depend in part on our ability to address the needs of our clients by using technology to provide products and services that will satisfy client demands for convenience as well as create additional efficiencies in our operations. A number of our competitors have substantially greater resources to invest in technological improvements, as well as significant economies of scale. There can be no assurance that we will be able to implement and offer new technology-driven products and services to our clients. If we fail to do so, our ability to attract and retain clients may be adversely affected.

Our business continuity plans or data security systems could prove to be inadequate, resulting in a material interruption in or disruption to, our business and a negative impact on our results of operations.

We rely heavily on communications and information systems to conduct our business and our operations are dependent on our ability to protect our systems against damage from fire, power loss, or telecommunication failure. The computer systems and network infrastructure we use could be vulnerable to unforeseen problems. These problems may arise in both our internally developed systems and the systems of our third-party service providers. Any failure, interruption or breach in security of these systems, whether due to severe weather, natural disasters, acts of war or terrorism, criminal activity or other factors, could result in failures or disruptions in general ledger, deposit, loan, client relationship management and other systems. While we have a business continuity plan and other policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of clients, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our results of operations.

A breach in security of our systems or our third party service providers communications and information technologies could have a material adverse effect on our business.

We rely heavily on communications and information technology to conduct our business. Any failure or interruption due to a breach in security of these systems could result in failures or disruptions in our general ledger, deposit, loan, investment management, electronic banking and other systems. We have policies and procedures designed to prevent or limit the effect of such a failure or interruption due to a security breach of our information systems; however, there can be no assurance that any such events will not occur or, if they do, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of clients, subject us to additional regulatory scrutiny, or expose us to litigation and possible financial liability which could have an adverse effect on our operating results and financial condition. Failure in any of these situations subjects us to risks that may vary in size and scope.

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In addition, we rely on third-party service providers for a substantial portion of our communications, information, operating and financial control systems technology. If any of these third-party service providers experience financial, operational or technological difficulties, security breaches, or if there is any disruption in our relationships with them, we may be required to locate alternative sources for these services. There can be no assurance that we could negotiate terms as favorable to us or obtain services with similar functionality as we currently have without the expenditure of substantial resources. Any of these circumstances could have a material adverse effect on our business.

Our stock is thinly traded.

Low volume of trading activity of our stock may make it difficult for investors to resell their common stock when they want at prices they find attractive. Our stock price can fluctuate significantly in response to a variety of factors and the volume of shares traded can be influenced by:

- our operating performance;
- limited research analysis performed on our Corporation;
- operating results and stock price performance of other companies that investors deem comparable to us;
- news reports relating to trends, concerns and other issues in the financial services industry;
- perceptions in the marketplace regarding us and/or our competitors; and
- changes in government regulations.

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends could also cause our stock price to decrease regardless of operating results.

Our framework for managing risks may not be effective in mitigating risk and loss to us.

Our risk management framework seeks to mitigate risk and loss to us. We have established processes and procedures intended to identify, measure, monitor, report and analyze the types of risk to which we are subject, including liquidity risk, credit risk, market risk, interest rate risk, operational risk, legal and compliance risk, and reputational risk, among others. However, as with any risk management framework, there are inherent limitations to our risk management strategies as there may exist, or develop in the future, risks that we have not appropriately anticipated or identified. Our ability to successfully identify and manage risks facing us is an important factor that can significantly impact our results. If our risk management framework proves ineffective, we could suffer unexpected losses and could be materially adversely affected.

Changes in accounting standards may materially impact our financial statements.

From time to time, the Financial Accounting Standards Board changes the financial accounting and reporting standards that govern the preparation of financial statements. These changes can be hard to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, it may be necessary to apply a new or revised standard retroactively, resulting in the significant restatement of prior period financial statements.

Item 1B. Unresolved Staff Comments

None

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Item 2. Properties

The following table provides certain summary information with respect to the principal properties that we leased as of December 31, 2010:

Location	Function	Expiration Date
401 Charmany Drive, Madison, WI	Full service banking location of First Business Bank and office of First Business Financial Services, Inc.	2028
18500 W. Corporate Drive, Brookfield, WI	Full service banking location of First Business Bank - Milwaukee	2020
3913 West Prospect Avenue, Appleton, WI	Loan production office of First Business Bank	2017
230 Ohio Street, Oshkosh, WI	Loan production office of First Business Bank	2017
300 N. Broadway, Green Bay, WI	Loan production office of First Business Bank	2014

FBB also conducts trust and investment business from a limited purpose branch located at 3500 University Avenue, Madison, Wisconsin. Office space is also leased in Burnsville, Minnesota, Independence, Ohio, St. Louis, Missouri, Southfield, Michigan and Chicago, Illinois under short-term lease agreements, which have terms of less than one year, for the purpose of generating asset-based lending opportunities.

Item 3. Legal Proceedings

We believe that no litigation is threatened or pending in which we face potential loss or exposure which could materially affect our consolidated financial position, consolidated results of operations or cash flows. Since our subsidiaries act as depositories of funds and trust agents, they are occasionally named as defendants in lawsuits involving claims to the ownership of funds in particular accounts. This and other litigation is incidental to our business.

Item 4. Reserved

PART II.

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The common stock of FBFS is traded on the Nasdaq National Market under the symbol FBIZ . As of January 31, 2011, there were 439 registered shareholders of record of FBFS common stock. Certain of the Corporation s shares are held in nominee or street name and the number of beneficial owners of such shares is approximately 411.

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The following table presents the range of high and low closing sale prices of our common stock for each quarter within the two most recent fiscal years, according to information available, and cash dividends declared for the years ended December 31, 2010 and 2009, respectively.

	High	Low	Dividend Declared
2010			
1st Quarter	$ 10.35	$ 9.60	$ 0.07
2nd Quarter	11.00	9.70	0.07
3rd Quarter	9.70	8.67	0.07
4th Quarter	14.90	8.80	0.07
2009			
1st Quarter	$ 15.08	$ 10.50	$ 0.07
2nd Quarter	13.95	10.45	0.07
3rd Quarter	11.72	7.70	0.07
4th Quarter	10.42	9.10	0.07

The timing and amount of future dividends are at the discretion of the Board of Directors of the Corporation (the Board) and will depend upon the consolidated earnings, financial condition, liquidity and capital requirements of the Corporation and its subsidiaries, the amount of cash dividends paid to the Corporation by its subsidiaries, applicable government regulations and policies, supervisory actions and other factors considered relevant by the Board. **Refer to Item 1, Business Supervision and Regulation** for additional discussion regarding the limitations on dividends and other capital contributions by the Banks to the Corporation. The Board anticipates it will continue to pay dividends in amounts determined based on the above factors.

The following table summarizes compensation plans under which equity securities of the registrant are authorized for issuance as of December 31, 2010.

Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants, and rights. (a)	Weighted-average exercise price of outstanding options, warrants, and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	138,766	$ 22.09	74,507

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Issuer Purchases of Securities

Period	Total Number of Shares Purchased(1)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs(2)
October 1 31, 2010	333	$ 9.05		$ 177,150
November 1 30, 2010				177,150
December 1 31, 2010				177,150

(1) The shares in this column represent the 333 shares that were surrendered to us to satisfy income tax withholding obligations in connection with the vesting of restricted shares during the three months ended December 31, 2010.

(2) On November 20, 2007, the Corporation publicly announced a stock repurchase program whereby the Corporation would repurchase up to approximately $1,000,000 of the Corporation s outstanding stock. As of December 31, 2010, approximately $177,150 remains available to repurchase the Corporation s outstanding stock. There currently is no expiration date to this stock repurchase program.

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Item 6. Selected Financial Data

Three Year Comparison of Selected Consolidated Financial Data

	As of and for the Year Ended December 31, 2010	2009	2008
	(Dollars In Thousands, Except Share Data)		
FOR THE YEAR:			
Interest income	$ 56,626	$ 56,356	$ 59,773
Interest expense	24,675	28,322	33,515
Net interest income	31,951	28,034	26,258
Provision for loan and lease losses	7,044	8,225	4,299
Non-interest income	6,743	6,450	5,105
Non-interest expense	25,465	23,810	20,841
Goodwill impairment	2,689		
Loss on foreclosed properties	206	691	1,043
Income tax expense	2,349	717	2,056
Net income	$ 941	$ 1,041	$ 3,124
Yield on earning assets	5.39%	5.57%	6.39%
Cost of funds	2.57	3.03	3.89
Interest rate spread	2.82	2.53	2.50
Net interest margin	3.04	2.77	2.81
Return on average assets	0.09	0.10	0.32
Return on average equity	1.67	1.90	6.11
ENDING BALANCE SHEET:			
Total assets	$ 1,107,057	$ 1,117,436	$ 1,010,786
Securities	153,379	122,286	109,124
Loans and leases, net	860,935	839,807	840,546
Deposits	988,298	984,374	838,874
FHLB advances and other borrowings	41,504	57,515	94,526
Junior subordinated notes	10,315	10,315	10,315
Stockholders equity	55,335	54,393	53,006
FINANCIAL CONDITION ANALYSIS:			
Allowance for loan and lease losses to year-end loans	1.85%	1.65%	1.39%
Allowance to non-accrual loans and leases	42.37	50.76	72.74
Net charge-offs to average loans and leases	0.57	0.69	0.28
Non-accrual loans to gross loans and leases	4.37	3.26	1.91
Average equity to average assets	5.11	5.19	5.27
STOCKHOLDERS DATA:			
Basic earnings per common share(1)	$ 0.37	$ 0.41	$ 1.24
Diluted earnings per common share(1)	0.37	0.41	1.24

Book value per share at end of period	21.30	21.42	20.82
Dividend declared per share	0.28	0.28	0.28
Dividend payout ratio	75.68%	68.29%	22.58%
Shares outstanding	2,597,820	2,539,306	2,545,546

(1) Basic and diluted earnings per share reflect earnings per common share as calculated under the two-class method due to the existence of participating securities.

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

When used in this report, and in any oral statements made with the approval of an authorized executive officer, the words or phrases may, could, should, hope, might, believe, expect, plan, assume, intend, estima likely, or similar expressions are intended to identify forward-looking statements. Such statements are subject to risks and uncertainties, including, without limitation, changes in economic conditions in the market area of FBB or FBB Milwaukee, changes in policies by regulatory agencies, fluctuation in interest rates, demand for loans in the market area of FBB or FBB Milwaukee, borrowers defaulting in the repayment of loans and competition. These risks could cause actual results to differ materially from what FBFS has anticipated or projected. These risk factors and uncertainties should be carefully considered by our shareholders and potential investors. See **Item 1A Risk Factors** for discussion relating to risk factors impacting the Corporation. Investors should not place undue reliance on any such forward-looking statements, which speak only as of the date made. The factors described within this Form 10-K could affect the financial performance of FBFS and could cause actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods.

Where any such forward-looking statement includes a statement of the assumptions or bases underlying such forward-looking statement, FBFS cautions that, while its management believes such assumptions or bases are reasonable and are made in good faith, assumed facts or bases can vary from actual results, and the differences between assumed facts or bases and actual results can be material, depending on the circumstances. Where, in any forward-looking statement, an expectation or belief is expressed as to future results, such expectation or belief is expressed in good faith and believed to have a reasonable basis, but there can be no assurance that the expected result will be achieved or accomplished.

FBFS does not intend to, and specifically disclaims any obligation to, update any forward-looking statements.

The following discussion and analysis is intended as a review of significant events and factors affecting the financial condition and results of operations of FBFS for the periods indicated. The discussion should be read in conjunction with the Consolidated Financial Statements and the Notes thereto and the Selected Consolidated Financial Data presented in this Form 10-K.

Overview

Our principal business is conducted by FBB and FBB Milwaukee and certain subsidiaries of FBB and consists of a full range of commercial banking products and services tailored to meet the financial service needs of small and medium size businesses, business owners, executives, professionals, and high net worth individuals. Products include commercial lending, asset-based lending, equipment financing, trust and investment services, treasury management services and a broad range of deposit products. Our operating philosophy is focused on local decision making and local client service from each of our primary banking locations in Madison, Brookfield and Appleton, Wisconsin combined with the efficiency of centralized administrative functions such as support for information technology, loan support and deposit support, finance and accounting and human resources. We believe we have a unique niche business banking model and we consistently operate within this niche. This allows us to provide a great deal of expertise in offering financial solutions to our clients with an experienced staff who serve our clients on an ongoing basis.

Beginning in 2008, continuing throughout 2009 and 2010, the U.S. and world economies have experienced unprecedented changes in the capital and credit markets that have adversely affected the U.S. banking industry. The turmoil in the credit and capital markets has adversely impacted real estate values, businesses and the demand for credit, and the overall economic climate. Many financial institutions have sought merger partners or buyers, been forced to raise additional capital or forced into FDIC receivership by their primary regulator. The U.S. government has instituted several programs to stabilize the U.S. financial system and/or stimulate the U.S. economy that, among other things, were directed at increasing the capital bases of financial institutions.

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The current economic environment presents significant challenges for us and our industry. We believe that our historic loan and investment policies and underwriting practices, which we believe to be conservative, have left us relatively well-positioned in the current economic climate as compared to many U.S. financial institutions.

Our profitability depends on our ability to execute our strategic plan. Our plan emphasizes improving the overall quality of our loan and lease portfolio, minimizing loan and lease loss specific reserves and charge-offs, generating organic growth in our loan and lease portfolios, increasing our market share of in-market core deposits and increasing fee income. Given a troubled economy throughout 2010, there were limited opportunities to grow the loan and lease portfolios of the Banks with appropriate quality and there was additional stress on our loan and lease portfolios. Therefore, our focus in 2010 was to closely monitor our loan portfolio, work through identified credit issues, maintain adequate capital levels and build prudent liquidity to be able to position the Banks for a return to a growth strategy and navigate through the economic turmoil. While our long term strategic plan remains the same, current weak economic conditions will dictate similar areas of focus in the near term.

As of December 31, 2010, our capital position and the capital position of each of our Banks is greater than regulatory minimum requirements and each of our Bank s regulatory capital is greater than the level required to be well capitalized under prompt corrective action requirements. See Item 1. Business Supervision and Regulation Prompt Corrective Action.

Operational highlights

Our total assets decreased slightly to $1.107 billion as of December 31, 2010, a 0.9% decrease, from $1.117 billion at December 31, 2009. We experienced moderate growth in our loan and lease portfolio. Net loans and leases receivable increased $21.1 million, or 2.5%, to $860.9 million as of December 31, 2010 from $839.8 million as of December 31, 2009. We also experienced growth in our investment portfolio. Securities available for sale increased $31.1 million, or 25.4%, to $153.4 million at December 31, 2010 from $122.3 million at December 31, 2009. The growth in these asset classes is primarily offset by a reduction of our on-balance sheet liquidity.

As of December 31, 2010, our short-term investments, which consists primarily of interest bearing deposits held at the Federal Reserve Bank of Chicago (FRB), was $41.4 million. This is a decline of 60.3% from $104.2 million at December 31, 2009. We used short-term investments for a variety of purposes including asset growth as well as not replacing Federal Home Loan Bank advances that matured. We continue to view liquidity and safety and soundness to be a priority; however, have taken measures to balance that priority and profitability.

Net income for the year ended December 31, 2010 was $941,000 compared to $1.0 million for the year ending December 31, 2009. During the year ended December 31, 2010, specifically in June 2010, we recorded an impairment of goodwill in an amount of $2.7 million. The goodwill impairment is an accounting adjustment that does not affect cash flows, liquidity, regulatory capital, regulatory capital ratios, or the future operations of our Corporation. Also, the goodwill impairment is not deductible for income tax purposes, so there is no income tax benefit associated with the impairment.

Net income excluding the impact of goodwill impairment for the year ended December 31, 2010 was $3.6 million, an increase of $2.6 million, from $1.0 million for the year ended December 31, 2009. The increase in net income excluding the impact of goodwill impairment is primarily attributable to improved net interest revenue and lower provision for loan and lease losses partially offset by increases in FDIC insurance expense and compensation expense.

Diluted earnings per common share for the year ended December 31, 2010 was $0.37 compared to diluted earnings per common share of $0.41 for the year ended December 31, 2009. Diluted earnings per share for the year ended December 31, 2010 includes a $1.05 per share goodwill impairment charge. Excluding the impairment of goodwill, diluted earnings per common share was $1.42 for the year ended December 31, 2010. Return on average equity was 1.67% in 2010 compared to 1.90% in 2009. Excluding the goodwill impairment, return on average equity was 6.46% for the year ended December 31, 2010.

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- Top line revenue, which consists of net interest revenue and non-interest income, increased 12.2% to $38.7 million for the year ended December 31, 2010 compared to $34.5 million for the year ended December 31, 2009.
- Our net interest margin increased to 3.04% for the year ended December 31, 2010 as compared to 2.77% for the year ended December 31, 2009.
- Provision for loan and lease losses was $7.0 million for the year ended December 31, 2010 compared to $8.2 million for the year ended December 31, 2009. Allowance for loan and lease losses as a percentage of total loans was 1.85% as of December 31, 2010 as compared to 1.65% as of December 31, 2009.
- Non-accrual loans and leases increased approximately $10.6 million, or 38.0%, to $38.4 million as of December 31, 2010 from $27.8 million as of December 31, 2009.
- Our average in market deposits increased $31.3 million, or 6.9% to $486.6 million for the year ended December 31, 2010 from $455.3 million for the year ended December 31, 2009.

In the bullet points above for the year ended December 31, 2010, we present (1) net income and earnings per share, in each case excluding the goodwill impairment and (2) annualized return on average assets and annualized return on average equity, calculated using net income excluding goodwill impairment. Each of these presented measures is a non-GAAP measure. We use these measures because we believe they provide greater comparability of the financial performance to all periods presented.

Results of Operations

Comparison of the Years Ended December 31, 2010 and 2009

Top Line Revenue. Top line revenue is comprised of net interest income and non-interest income. This measurement is also commonly referred to as operating revenue. Top line revenue grew by approximately 12.2% from the prior year. The components of top line revenue were as follows:

	For the Year Ended December 31,		
	2010	2009	Change
	(Dollars In Thousands)		
Net interest income	$ 31,951	$ 28,034	14.0%
Non-interest income	6,743	6,450	4.5
Total top line revenue	$ 38,694	$ 34,484	12.2

Adjusted Net Income. Adjusted net income is comprised of our net income as presented under generally accepted accounting principles (GAAP) adjusted for the after tax effects of the provision for loan and lease losses, actual net charge-offs incurred during the year and other one-time unusual events including but not limited to impairment of goodwill. Adjusted net income allows our management team to better analyze the growth of our earnings, including a comparison to our benchmark peers, without the impact that the loan and lease provision may have on net income in periods of rapid growth or reduction in the loan and lease portfolio. Institutions with different loan and lease growth rates may not have comparable provisions for loan and lease loss amounts and net charge-off activity. In our judgment, presenting net income excluding the after tax effects of the provision for loan and lease losses and including actual net charge-offs allows investors to trend, analyze and benchmark our results of operations in a more meaningful manner. Adjusted net income is a non-GAAP financial measure that does not represent and should not be considered as an alternative to net income derived in accordance with GAAP. Due primarily to improved top line revenue and a lower level of loan and lease charge-off activity, our adjusted net income has improved by 104.3% for the year ended December 31, 2010 compared to the prior year.

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A reconciliation of net income to adjusted net income is as follows:

	For the Year Ended December 31,		
	2010	2009	Change
	(Dollars in Thousands)		
Net income, presented under US GAAP	$ 941	$ 1,041	(9.6)%
Add back:			
Provision for loan and lease losses, after tax	4,346	5,000	(13.1)
Goodwill impairment	2,689		*
Less:			
Net charge-offs, net of tax	3,021	3,616	(16.5)
Adjusted net income	$ 4,955	$ 2,425	104.3%

* Not meaningful

Return on Equity. Return on equity for the year ended December 31, 2010 was 1.67% compared to 1.90% for the year ended December 31, 2009. The decline in the return on equity was related to the decrease in net income. The change in net income is attributable to various factors including increased net interest income caused by increased net interest margins and a reduction in the amount of loan and lease loss provision, offset by the goodwill impairment recognized in 2010 along with other factors discussed throughout this Annual Report on Form 10-K. The goodwill impairment is an accounting adjustment that does not affect cash flows, liquidity, regulatory capital, regulatory capital ratios, or the future operations of our Corporation. Management has primarily focused its attention on the return on equity excluding the $2.7 million goodwill impairment to analyze the improvement in profitability of the Corporation from the comparable reporting periods of the prior year. Excluding the $2.7 million goodwill impairment charge, return on equity for the year ended December 31, 2010 was 6.46%. We view return on equity as an important measurement for monitoring profitability and we are continuing to focus on improving our return to our shareholders by enhancing the overall profitability of our client relationships, controlling our expenses and minimizing our costs of credit. See Operational Highlights of this section for a discussion of our net income excluding goodwill impairment, a non-GAAP financial measure, used in the above calculation of return on equity excluding goodwill impairment.

Net Interest Income. Net interest income is dependent on the amounts of and yields on interest-earning assets as compared to the amounts of and rates on interest-bearing liabilities. Net interest income is sensitive to changes in market rates of interest and the asset/liability management strategies used by management in responding to such changes.

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The table below provides information with respect to (1) the change in interest income attributable to changes in rate (changes in rate multiplied by prior volume), (2) the change in interest income attributable to changes in volume (changes in volume multiplied by prior rate) and (3) the change in rate/volume (changes in rate multiplied by changes in volume) for the year ended December 31, 2010 compared to the year ended December 31, 2009.

Rate/Volume Analysis

	Increase (Decrease) for the Year Ended December 31, 2010 Compared to 2009			
	Rate	Volume	Rate/ Volume	Net
	(In Thousands)			
Interest-Earning Assets				
Commercial real estate and other mortgage loans	$ 574	$ 120	$ 2	$ 696
Commercial and industrial loans	91	525	3	619
Direct financing leases	30	(384)	(6)	(360)
Other loans	(273)	(217)	59	(431)
Total loans and leases receivable	422	44	58	524
Mortgage-related securities	(1,087)	1,030	(233)	(290)
Investment securities				
FHLB Stock				
Short-term investments	(1)	37		36
Total net change in income on interest-earning assets	(666)	1,111	(175)	270
Interest-Bearing Liabilities				
NOW accounts	(33)	31	(4)	(6)
Money market	(623)	603	(128)	(148)
Certificates of deposit	(373)	(864)	113	(1,124)
Brokered certificates of deposit	(3,038)	797	(132)	(2,373)
Total deposits	(4,067)	567	(151)	(3,651)
FHLB advances	21	(255)	(5)	(239)
Other borrowings	339	(82)	(14)	243
Junior subordinated notes				
Total net change in expense on interest-bearing liabilities	(3,707)	230	(170)	(3,647)
Net change in net interest income	$ 3,041	$ 881	$ (5)	$ 3,917

The table below shows our average balances, interest, average rates, net interest margin and the spread between combined average rates earned on our interest-earning assets and cost of interest-bearing liabilities for the periods indicated. The average balances are derived from average daily balances.

	For the Year Ended December 31,					
	2010			2009		
	Average balance	Interest	Average yield/ cost	Average balance	Interest	Average yield/ cost
	(Dollars In Thousands)					
Interest-Earning Assets						
Commercial real estate and other mortgage loans	$ 598,068	$ 33,490	5.60%	$ 595,885	$ 32,794	5.50%
Commercial and industrial loans	221,323	16,441	7.43	214,212	15,822	7.39
Direct financing leases	23,429	1,487	6.35	29,577	1,847	6.24
Other loans	16,914	574	3.39	21,583	1,005	4.66
Total loans and leases receivable(1)	859,734	51,992	6.05	861,257	51,468	5.98
Mortgage-related securities(2)	138,637	4,513	3.26	114,151	4,803	4.21
Federal Home Loan Bank stock	2,367			2,367		
Short-term investments	49,878	121	0.24	34,762	85	0.24
Total interest-earning assets	1,050,616	56,626	5.39	1,012,537	56,356	5.57
Non-interest-earning assets	48,813			40,779		
Total assets	$ 1,099,429			$ 1,053,316		
Interest-Bearing Liabilities						
NOW accounts	$ 74,784	260	0.35	$ 67,061	266	0.40
Money market	258,569	2,805	1.08	214,751	2,953	1.38
Certificates of deposit	84,828	1,723	2.03	121,801	2,847	2.34
Brokered certificates of deposit	480,709	15,959	3.32	460,691	18,332	3.98
Total interest-bearing deposits	898,890	20,747	2.31	864,304	24,398	2.82
FHLB advances	13,414	641	4.78	18,873	880	4.66
Other borrowings	39,010	2,175	5.58	40,738	1,932	4.74
Junior subordinated notes	10,315	1,112	10.78	10,315	1,112	10.78
Total interest-bearing liabilities	961,629	24,675	2.57	934,230	28,322	3.03
Demand deposits	68,430			51,665		
Non-interest-bearing liabilities	13,153			12,733		

Total liabilities	1,043,212			998,628		
Stockholders equity	56,217			54,688		
Total liabilities and stockholders equity	$ 1,099,429			$ 1,053,316		
Net interest income		$ 31,951			$ 28,034	
Net interest spread			2.82%			2.53%
Net interest-earning assets	$ 88,987			$ 78,307		
Net interest margin			3.04%			2.77%
Average interest-earning assets to average interest-bearing liabilities	109.25%			108.38%		
Return on average assets	0.09			0.10		
Return on average equity	1.67			1.90		
Average equity to average assets	5.11			5.19		
Non-interest expense to average assets	2.58			2.33		

(1) The average balances of loans and leases include non-performing loans and leases. Interest income related to non-performing loans and leases is recognized when collected.

(2) Includes amortized cost of basis of assets held and available for sale.

Net interest income increased by $3.9 million, or 14.0%, during the year ended December 31, 2010 compared to the year ended December 31, 2009. The increase in net interest income is primarily attributable to favorable rate variances from lower cost of deposits. Overall, favorable rate variances added $3.0 million to net interest income. The Federal Reserve held interest rates constant across the twelve months ended December 31, 2010 and 2009. Therefore, the majority of the increase in net interest income associated with rate variances was caused by pricing deposits and loans commensurate with current market conditions and demands along with replacing higher yielding maturing brokered certificates of deposits at lower current market rates.

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Net interest margin increased 27 basis points to 3.04% for the year ended December 31, 2010 from 2.77% for the year ended December 31, 2009. The improvement in net interest margin is primarily due to a 46 basis point decline in the cost of interest-bearing liabilities to 2.57% for the year ended December 31, 2010 from 3.03% for the comparable period of 2009. This was partially offset by a decline of 18 basis points in the yield on average earning assets to 5.39% for the year ended December 31, 2010 from 5.57% for the year ended December 31, 2009.

The yield on average earning assets for the year ended December 31, 2010 was negatively affected by the overall change in the investment portfolio. We have invested in collateralized mortgage obligations with structured cash flow payments. The cash flows generated from these expected prepayments are typically reinvested in additional collateralized mortgage obligations. Given the low interest rate environment, the overall coupon on new security purchases has typically been lower than the rates on securities that experience prepayments. This has caused the investment yield to decline by approximately 95 basis points for the year ended December 31, 2010 compared to the year ended December 31, 2009. The yield on loans and leases receivable increased seven basis points to 6.05% for the year ended December 31, 2010 from 5.98% for the comparable period of 2009. The improvement in yields on the loan and lease portfolio is mainly the result of pricing and mix of the loan and lease portfolio. We continue to improve our credit spreads on our fixed rate loan portfolio commensurate with current economic conditions and market demands. We have also continued to increase the dollar amount and number of variable rate loans with interest rate floors in excess of current market rates. The overall yield on the loan and lease portfolio is negatively affected by the increased average balances of non-accrual loans.

The overall weighted average rate paid on interest-bearing liabilities was 2.57% for the year ended December 31, 2010, a decrease of 46 basis points from 3.03% for the year ended December 31, 2009. The decrease in the overall rate on the interest-bearing liabilities was caused primarily by the replacement of maturing certificates of deposits, including brokered certificates of deposits, at lower current market rates.

Provision for Loan and Lease Losses. The provision for loan and lease losses totaled $7.0 million and $8.2 million for the years ended December 31, 2010 and 2009, respectively. Our provision for loan and lease losses is dependent on credit quality and determined based upon the inherent credit risk and other subjective factors pursuant to our allowance for loan and lease loss methodology, the magnitude of net charge-offs recorded in the period and the amount of reserves established for impaired loans that present collateral shortfall positions. To establish the appropriate level of the allowance for loan and lease losses, we regularly review our historical charge-off migration analysis and an analysis of the current level and trend of several factors that we believe may indicate losses in the four primary segments of our loan and lease portfolio. These factors include delinquencies, volume, average size, average risk rating, technical defaults, unemployment rates, geographic concentrations, industry concentrations, loans and leases on internal monitoring reports, experience in the credit granting functions, changes in underwriting standards, and level of non-performing assets and related fair value of underlying collateral. While we made no significant changes to our loan and lease policies in 2010 or 2009, current economic conditions have caused us to add additional rigor to our underwriting and monitoring processes.

During the years ended December 31, 2010 and 2009, the factors influencing the provision for loan and lease losses were the following:

	For the year ended December 31, 2010	For the year ended December 31, 2009
Changes in the provision for loan and lease losses associated with:		
Establishment/modification of specific reserves on impaired loans, net	$ 3,323	$ 1,581
Subjective factor changes	213	1,118
Charge-offs in excess of specific reserves	3,499	4,951
Recoveries	(313)	(155)
Change in inherent risk of the loan and lease portfolio	322	730

Total provision for loan and lease losses	$ 7,044	$ 8,225

Refer to **Allowance for Loan and Lease Losses** for further information.

Non-Interest Income. Non-interest income, consisting primarily of fees earned for trust and investment services, service charges and fees on deposits and loans and income from bank-owned life insurance, increased by $293,000, or 4.5%, to $6.7 million for the year ended December 31, 2010, from $6.5 million for the year ended December 31, 2009.

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Trust and investment services fee income increased by $428,000, or 22.5%, to $2.3 million for the year ended December 31, 2010 compared to $1.9 million for the year ended December 31, 2009. Trust and investment services fee income is driven by the amount of assets under management and administration which is influenced by the timing and volatility of the equity markets coupled with our ability to continue to add clients to our portfolio. At December 31, 2010, we had $399.4 million of trust assets under management compared to $323.3 million at December 31, 2009. Assets under administration were $127.5 million at December 31, 2010 compared to $124.2 million at December 31, 2009. Our sales pipeline continues to be strong and we expect to continue to increase our assets under management, but we also expect that assets under management and trust and investment services fee income will continue to be affected by market volatility for the foreseeable future.

Loan fees increased by approximately $131,000, or 11.8%, to $1.2 million for the year ended December 31, 2010 from $1.1 million for the year ended December 31, 2009. Loan fees represent non-deferrable fees earned on loan activity and the revenue generated through the collateral audit process we perform to ensure the integrity of the collateral associated with our asset-based loans. The increase in loan fees was primarily related to additional audit fee income recognized along with an increase of other asset based loan fees collected.

During the third quarter of 2009, we sold approximately $15.0 million of collateralized mortgage obligations of government-sponsored enterprises in an effort to modify the overall risk profile of our investment portfolio. A net gain of approximately $322,000 was recognized on the sale of these securities. Proceeds from the sale of these securities were used to purchase collateralized mortgage obligations of government agencies, or Government National Mortgage Association (GNMA) securities. GNMA securities are guaranteed by the U.S. federal government which reduces our overall exposure to other than temporary losses and they have favorable capital treatment under the regulatory guidelines. No securities were sold during the year ended December 31, 2010.

Non-Interest Expense. Non-interest expense increased by $3.9 million, or 15.8%, to $28.4 million for the year ended December 31, 2010 from $24.5 million for the comparable period of 2009, primarily due to an impairment of goodwill, increased FDIC insurance expense and compensation expense, partially offset by decreased collateral liquidation costs and losses on foreclosed properties.

During the year ended December 31, 2010, specifically during the second quarter of 2010, we recorded a goodwill impairment of $2.7 million. Our stock price has consistently traded below book value since December 2007. We evaluated the impact of the negative economic environment and its downward pressure on the reporting unit s asset quality and financial performance, and considered the impact on the future cash flows of the reporting unit, in addition to reconciling the calculated values of all of its reporting units to our market capitalization. After considering the factors noted above, management concluded that the fair value of the reporting unit was less than the carrying value. Management completed the second step of the annual goodwill impairment test to measure the amount of the impairment and concluded that an impairment equivalent to the entire carrying value of the goodwill was warranted.

FDIC insurance expense was $3.1 million for the year ended December 31, 2010 compared to $2.2 million for the year ended December 31, 2009. The increase in FDIC insurance expense reflects an increase in the deposit insurance rate in general, an increase in TAGP premium rates, as well as an increase in the deposit assessment base on each of the respective quarter end reporting periods when compared to the same period of the prior year. We actively participated in the TAGP for all of 2009 and 2010. The Banks assessment rate depends on the risk category to which they are assigned which will influence the amount of FDIC insurance paid. Assessment rates for deposit insurance currently range from seven to 77.5 basis points of total deposits. The Banks are well-capitalized, however, the specific supervisory risk category to which the Banks are assigned by the FDIC is confidential and may not be disclosed. On December 30, 2009, the Banks prepaid their estimated regular insurance assessment for 2010, 2011 and 2012. The prepaid assessment was based upon the Banks assessment rate in effect on September 30, 2009 and may be exhausted earlier than 2012 based upon actual levels of deposits, related risk ratings and the impacts of the FDIC s Final Assessments Rule that was issued on February 9, 2011. As of December 31, 2010, $2.5 million of the prepaid FDIC insurance payment is remaining. The pre-payment is reflected as a prepaid asset in other assets in our consolidated balance sheet and will be expensed over the coverage periods. With the issuance of the FDIC s Final Assessments Rule on February 9, 2011, we do not expect FDIC insurance expense to continue at the increased levels in the future.

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Compensation expense increased by $904,000, or 7.3%, to $13.3 million for the year ended December 31, 2010 from $12.4 million for the year ended December 31, 2009. The overall increase in compensation expense primarily relates to the level of the non-equity incentive compensation accrual recorded. To determine the level of non-equity incentive compensation to record, we compared our net income, excluding the impacts of the goodwill impairment, to our established plan criteria. Due to the improved net income under this calculation, we accrued for a higher level of performance-based compensation in 2010 as compared to 2009. The goodwill impairment is an accounting adjustment that does not affect cash flows, liquidity, regulatory capital, regulatory capital ratios, or the future operations of our Corporation.

Collateral liquidation costs associated with certain of our problem commercial loans for the year ended December 31, 2010 were $1.2 million, a decrease of 12.8%, from $1.3 million for the year ended December 31, 2009. These expenses represent costs incurred to mitigate our risk of loss on our impaired loans. Collateral liquidation costs include legal expenses, rent expenses, shipping costs, warranty expenses, property or real estate taxes incurred by our clients and other necessary expenses required to protect our security interests. As we continue to have an elevated amount of impaired loans, we are incurring costs to evaluate and implement individual exit strategies for the impaired loans. The amount of collateral liquidation costs are influenced by the timing and level of effort required for each individual loan. Our ability to recoup these costs from our clients is uncertain and therefore we have expensed them as incurred through our consolidated results of operations.

During the year ended December 31, 2010, we recognized a net loss on foreclosed properties of $206,000 compared to a loss of $691,000 for the year ended December 31, 2009. We continue to be successful in disposing of our foreclosed properties and have recognized net gains of approximately $120,000 on disposition of assets during 2010 compared to a net loss of $166,000 on disposition of assets during 2009. We continue, however, to see further declines in real estate values on our foreclosed properties. As a result, we recorded an impairment adjustment of $326,000 during the year ended December 31, 2010 compared to impairment of $525,000 during the year ended December 31, 2009.

Income Taxes. Income tax expense was $2.3 million for the year ended December 31, 2010 compared to $717,000, for the year ended December 31, 2009. During the year ended December 31, 2010, we recorded a goodwill impairment of $2.7 million. The goodwill impairment is treated as a permanent difference and is not deductible for income tax purposes. Therefore, the increase in tax expense is related to the increase in net income before the goodwill impairment.

Financial Condition

December 31, 2010

General. At December 31, 2010 our total assets were $1.107 billion, a decrease of $10.4 million, or 0.9%, from $1.117 billion at December 31, 2009. We experienced moderate growth in our loan and lease portfolio. Net loans and leases receivable increased by $21.1 million, or 2.5%, to $860.9 million as of December 31, 2010 from $839.8 million as of December 31, 2009. We also experienced growth in our investment portfolio. Securities available for sale increased by $31.1 million, or 25.4%, to $153.4 million at December 31, 2010 from $122.3 million at December 31, 2009. The growth in these asset classes is primarily offset by a reduction of our short-term investments. As of December 31, 2010, our short-term investments were $41.4 million, representing a decline of 60.3% from $104.2 million of short-term investments at December 31, 2009.

Short-term investments. Short-term investments decreased by $62.8 million, or 60.3%, to $41.4 million at December 31, 2010 from $104.2 million at December 31, 2009. Our short-term investments primarily consist of interest-bearing deposits held at the FRB. We used short-term investments for a variety of purposes throughout 2010 including funding asset growth as well as not replacing FHLB advances that matured. We value the safety and soundness provided by the FRB, and in this difficult environment, we continue to view on-balance sheet liquidity as a critical element to maintaining appropriate levels of cash to meet our obligations. As of December 31, 2010, management believes our level of on-balance sheet liquidity was adequate to meet our short-term liquidity needs.

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Securities. Securities available-for-sale increased by $31.1 million to $153.4 million at December 31, 2010 from $122.3 million at December 31, 2009, primarily due to purchases of collateralized mortgage obligations issued by government agencies, primarily GNMA, and increases in market valuation on the portfolio of securities we hold. Securities are classified as either available-for-sale, held-to-maturity or trading. Available-for-sale securities are carried at fair value, with the unrealized gains and losses, net of tax, reported as a separate component of stockholders equity. We did not hold any securities designated as held-to-maturity or trading as of December 31, 2010 and 2009. Our available-for-sale portfolio primarily consists of collateralized mortgage obligations and is used to provide an additional source of liquidity, while contributing to the earnings potential of the Banks assets. We purchase investment securities intended to protect our net interest margin while maintaining an acceptable risk profile. Mortgage-related securities, including collateralized mortgage obligations, are subject to risks based upon the future performance of underlying mortgage loans for these securities. The overall credit risk associated with these investments as it relates to our investment portfolio is minimal as we primarily purchase investments which are guaranteed by GNMA. We may also purchase securities insured by the Federal Home Loan Mortgage Corporation (FHLMC) or Federal National Mortgage Association (FNMA). In addition, we believe collateralized mortgage obligations represent attractive investments due to the wide variety of maturity and repayment characteristics that allow us to better match our liability structure. Of the total available-for-sale mortgage securities we held at December 31, 2010, $152.8 million, or 99.6% were issued by GNMA. None of the securities within our portfolio are collateralized by sub-prime mortgages. We do not hold any FHLMC or FNMA preferred stock. GNMA securities are guaranteed by the U.S. federal government and provide favorable capital treatment. There were no sales of securities during the year ended December 31, 2010. Throughout 2009, we sold approximately $15.0 million of FHLMC and FNMA securities. The sales of these securities resulted in a net gain on sale of securities available for sale of approximately $322,000.

Risks associated with our mortgage related securities portfolio are prepayment risk, extension risk and interest rate risk. Should general interest rates decline, the mortgage-related securities portfolio would be subject to prepayments caused by borrowers seeking lower financing rates. Conversely, an increase in general interest rates could cause the mortgage-related securities portfolio to be subject to a longer term to maturity caused by borrowers being less likely to prepay their loans. Such a rate increase could also cause the fair value of the mortgage related securities portfolio to decline. Given the current economic condition and increased rates of foreclosures, prepayment speeds become less predictable.

Investment objectives are formed to meet liquidity requirements and generate a favorable return on investments without compromising other business objectives and levels of interest rate risk and credit risk. Consideration is also given to investment portfolio concentrations. Federal and state chartered banks are allowed to invest in various types of assets, including U.S. Treasury obligations, securities of various federal agencies, state and municipal obligations, mortgage-related securities, certain time deposits of insured financial institutions, repurchase agreements, loans of federal funds, and, subject to certain limits, corporate debt and equity securities, commercial paper and mutual funds. Our investment policy provides that we will not engage in any practice that the Federal Financial Institutions Examination Council considers an unsuitable investment practice. These objectives are formalized and documented in our investment policy which is approved by the Banks Boards of Directors (Boards) on an annual basis. Management, as authorized by the Boards, implements this policy. The Boards review investment activity on a monthly basis.

At December 31, 2010, $30.8 million of our mortgage-related securities were pledged to secure our various obligations or secure unused borrowing capacity with the FHLB.

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The table below sets forth information regarding the amortized cost and fair values of our investments and mortgage-related securities at the dates indicated.

	As of December 31,			
	2010		2009	
	Amortized cost	Fair value	Amortized cost	Fair value
	(In Thousands)			
Securities available-for-sale				
Collateralized mortgage obligations government agencies	$ 149,948	$ 152,776	$ 116,109	$ 118,509
Collateralized mortgage obligations government sponsored enterprises	591	603	3,729	3,777
	$ 150,539	$ 153,379	$ 119,838	$ 122,286

The following table sets forth the contractual maturity and weighted average yield characteristics of the fair value of our debt securities at December 31, 2010, classified by remaining contractual maturity. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay obligations without call or prepayment penalties.

	Less than One Year		One to Five Years		Five to Ten Years		Over Ten Years		
	Balance	Weighted Average Yield	Balance	Weighted Average Yield	Balance	Weighted Average Yield	Balance	Weighted Average Yield	Total
	(Dollars In Thousands)								
Available-for-sale									
Collateralized mortgage obligations government agencies	$	%	$ 626	5.14%	$ 1,553	3.21%	$ 150,597	3.34%	$ 152,776
Collateralized mortgage obligations government sponsored enterprises					603	3.42			603
	$		$ 626	5.14	$ 2,156	3.27	$ 150,597	3.34	$ 153,379

We currently do not hold any tax-exempt securities; therefore, all yields presented are based on a tax equivalent basis.

Derivative Activities. The Banks investment policies allow the Banks to participate in hedging strategies or use financial futures, options or forward commitments or interest rate swaps with prior Board approval. The Banks utilize, from time to time, derivative instruments in the course of their asset/liability management. As of December 31, 2010, the Banks did not hold any derivative instruments that were designated as cash flow or fair value hedges. The current derivative portfolio consisted primarily of interest rate swaps offered directly to qualified commercial borrowers which allowed the Banks to provide a fixed rate alternative to their clients while mitigating interest rate risk by keeping a variable rate loan in their portfolios. The Banks economically hedge client derivative transactions by entering into equal and offsetting interest rate swap contracts executed with dealer counterparties. The economic hedge with the dealer counterparties allows the Banks to primarily offset the fixed rate interest rate risk. Derivative transactions executed through this program are not designated as accounting hedge relationships and are marked-to

market through earnings each period.
As of December 31, 2010, the aggregate amortizing notional value of interest rate swaps with various commercial borrowers was approximately $50.8 million. We receive fixed rates and pay floating rates based upon LIBOR on the swaps with commercial borrowers. These swaps mature between August 2013 and April 2019. At December 31, 2010, the fair value of the swaps with commercial borrowers was approximately $2.8 million and was included in accrued interest receivable and other assets. On the offsetting swap contracts with dealer counterparties, we pay fixed rates and receive floating rates based upon LIBOR. These interest rate swaps mature between August 2013 and April 2019. Dealer counterparty swaps were reported on our balance sheet as a net derivative liability of $2.8 million due to master netting and settlement contracts with dealer counterparties and is included in accrued interest payable and other liabilities as of December 31, 2010.

Loans and Leases Receivable. Total net loans and leases increased by $21.1 million, or 2.5% to $860.9 million at December 31, 2010 from $839.8 at December 31, 2009. Gross loans increased by approximately $23.5 million while the allowance for loan and lease losses increased by $2.1 million. We principally originate commercial and industrial loans and commercial real estate loans. The overall mix of our portfolio has remained consistent in 2010 when compared to 2009 with approximately 70% of our loan and lease portfolio concentrated in commercial real estate loans primarily in our owner occupied and non-owner occupied classes. Economic conditions and demand for new loans remained weak in the geographic markets we serve during the year ended December 31, 2010; however, we believe we are beginning to see signs of improvement in certain market segments. We are also seeing opportunities to increase our market share by successfully attracting top quality clients from our competitors. We continue to compete for fewer high quality loan opportunities with other lenders which has put pressure on our ability to grow our loan and lease portfolio at growth rates we experienced prior to 2009. We remain committed to our underwriting standards and continue to seek high quality assets to continue our growth plan.

We have a concentration in commercial real estate loans. Commercial real estate lending typically involves larger loan principal amounts than that for residential mortgage loans or consumer loans. Commercial real estate loans have historically been viewed as having more inherent risk of default implying a higher potential loss on an individual loan basis. The repayment of these loans generally is dependent on sufficient income from the properties securing the loans to cover operating expenses and debt service. Payments on loans secured by commercial real estate are often dependent upon the successful operation and management of the properties therefore repayment of these loans may be affected by factors outside the borrower s control, including adverse conditions in the real estate market or the economy. In the event that the cash flow from the property is reduced, the borrower s ability to repay the loan could be impacted. The deterioration of one or more of these loans could cause a significant increase in our percentage of non-performing loans. An increase in non-performing loans results in a loss of earnings from these loans and could result in an increase in the provision for loan and lease loss and an increase in charge-offs, all of which could have a material adverse impact on our net income. Please refer to **Item 1A Risk Factors Our loan portfolio has a concentration of commercial real estate.**

Loan Portfolio Composition. The following table presents information concerning the composition of the Banks consolidated loans and leases held for investment at the dates indicated.

	As of December 31,					
	2010		2009		2008	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(Dollars In Thousands)					
Commercial real estate loans:						
Owner occupied	$ 152,560	17.38%	$ 170,477	19.95%	$ 158,107	18.54%
Non-owner occupied	307,307	35.00	271,329	31.75	231,987	27.20
Construction and land development	61,645	7.02	64,194	7.51	84,778	9.94
Multi-family	43,012	4.90	43,959	5.14	42,514	4.99
1-4 family	53,849	6.13	56,131	6.58	51,542	6.04
Total commercial real estate loans	618,373	70.43	606,090	70.93	568,928	66.71
Commercial and industrial	225,921	25.73	199,661	23.66	232,350	27.24
Direct financing leases, net	19,288	2.20	27,607	3.24	29,722	3.48
Consumer and other loans:						
Home equity and second mortgage	5,091	0.58	7,879	0.92	7,386	0.87
Consumer and other	9,315	1.06	13,260	1.55	14,445	1.69
Total consumer and other loans	14,406	1.64	21,139	2.47	21,831	2.56
Gross loans and leases receivable	877,988	100.00%	854,497	100.00%	852,831	100.00%
Contras to loans and leases:						
Allowance for loan and lease losses	(16,271)		(14,124)		(11,846)	
Deferred loan fees	(782)		(566)		(439)	
Loans and leases receivable, net	$ 860,935		$ 839,807		$ 840,546	

The following table shows the scheduled contractual maturities of the Banks consolidated gross loans and leases held for investment, as well as the dollar amount of such loans and leases which are scheduled to mature after one year which have fixed or adjustable interest rates, as of December 31, 2010.

	Amounts Due				Interest terms on amounts due after one year	
	In One Year or Less	After One Year through Five Years	After Five Years	Total	Fixed Rate	Variable Rate
			(In Thousands)			
Commercial real estate						
Owner-occupied	$ 40,746	$ 88,771	$ 23,043	$ 152,560	$ 80,837	$ 30,977
Non-owner occupied	72,511	176,385	58,411	307,307	168,541	66,255
Construction and land development	33,752	22,243	5,650	61,645	13,251	14,642
Multi-family	19,527	18,042	5,443	43,012	13,617	9,868
1-4 family	30,600	18,781	4,468	53,849	22,043	1,206
Commercial and industrial	115,694	101,189	9,038	225,921	51,125	59,102
Direct Financing Leases	2,031	16,429	828	19,288	17,257	
Consumer and other	9,646	4,760		14,406	4,586	174
	$ 324,507	$ 446,600	$ 106,881	$ 877,988	$ 371,257	$ 182,224

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Commercial Real Estate Loans. The Banks originate owner occupied and non-owner occupied commercial real estate loans which have fixed or adjustable rates and terms of generally up to five years and amortizations of up to twenty-five years on existing commercial real estate and new construction. The Banks also originate loans to construct commercial properties and complete land development projects. The Banks construction loans generally have terms of six to 24 months with fixed or adjustable interest rates and fees that are due at the time of origination. Loan proceeds are disbursed in increments as construction progresses and as project inspections warrant. Multi-family loans are primarily secured by apartment buildings and are primarily located in Dane and Waukesha counties. One to four family first mortgage loans are primarily secured by single family homes that are held for investment by our clients.

Commercial and Industrial Loans. The Banks commercial and industrial loan portfolio is comprised of loans for a variety of purposes which generally are secured by inventory, accounts receivable, equipment, machinery and other corporate assets and are advanced within limits prescribed by our loan policy. The majority of such loans are secured and typically backed by personal guarantees of the owners of the borrowing business.

Of the $225.9 million of commercial and industrial loans, including asset based loans, outstanding as of December 31, 2010; $90.8 million were originated by FBCC, our asset-based lending subsidiary. These asset-based loans are typically secured by accounts receivable, inventories or equipment. Asset-based borrowers are usually highly leveraged and/or have inconsistent historical earnings. Therefore, these loans generally have higher interest rates, non-origination fees collected in lieu of interest and are accompanied by close monitoring of assets. Asset-based loans secured by real estate amounted to $15.3 million as of December 31, 2010 and are included in the owner-occupied commercial real estate loan portfolio.

Leases. Leases originated through FBEF are originated with a fixed rate and typically a term of seven years or less. It is customary in the leasing industry to provide 100% financing, however, FBEF will, from time-to-time, require a down payment or lease deposit to provide a credit enhancement. All equipment leases must have an additional insured endorsement and a loss payable clause in the interest of FBEF and must carry sufficient physical damage and liability insurance.

FBEF leases machinery and equipment to clients under leases which qualify as direct financing leases for financial reporting and as operating leases for income tax purposes. Under the direct financing method of accounting, the minimum lease payments to be received under the lease contract, together with the estimated unguaranteed residual value (approximating 3 to 20% of the cost of the related equipment), are recorded as lease receivables when the lease is signed and the lease property is delivered to the client. The excess of the minimum lease payments and residual values over the cost of the equipment is recorded as unearned lease income. Unearned lease income is recognized over the term of the lease on a basis which results in a level rate of return on the unrecovered lease investment. Lease payments are recorded when due under the lease contract. Residual value is the estimated fair market value of the equipment on lease at lease termination. In estimating the equipment s fair value, FBEF relies on historical experience by equipment type and manufacturer, published sources of used equipment pricing, internal evaluations and, where available, valuations by independent appraisers, adjusted for known trends.

Consumer and Other Mortgage Loans. The Banks originate a small amount of consumer loans consisting of home equity, second mortgage, credit card and other personal loans for professional and executive clients of the Banks.

Net Fee Income from Lending Activities. The Banks defer loan and lease origination and commitment fees and certain direct loan and lease origination costs and amortize the net amount as an adjustment to the related loan and lease yields. The Banks also receive other fees and charges relating to existing loans, which include prepayment penalties, loan monitoring fees, late charges and fees collected in connection with loan modifications.

Loan and Lease Delinquencies. The Banks place loans and leases on non-accrual status when, in the judgment of management, the probability of collection of interest is deemed to be insufficient to warrant further accrual. Previously accrued but unpaid interest is deducted from interest income at that time. As a matter of policy, the Banks do not accrue interest on loans or leases past due beyond 90 days and in some instances sooner than 90 days if it is probable that payments will not be collected as scheduled. Loans on non-accrual status are considered impaired.

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The following table sets forth information relating to delinquent loans and leases at the dates indicated.

	As of December 31,					
	2010		2009		2008	
Days past due	Balance	% of Gross Loans and Leases	Balance	% of Gross Loans and Leases	Balance	% of Gross Loans and Leases
			(Dollars in Thousands)			
30 to 59 days	$ 1,712(2)	0.19%	$ 9,162(4)	1.07%	$ 2,512	0.29%
60 to 89 days	2,173(3)	0.25		0.00	175	0.02
90 days and over (1)	13,064	1.49	3,938	0.46	4,316	0.51
	$ 16,949	1.93	$ 13,100	1.53%	$ 7,003	0.82%

(1) Includes loans and leases contractually 90 days past due and which were placed on non-accrual status.

(2) Approximately $1.0 million of the outstanding balance of this category was considered impaired as of December 31, 2010.

(3) Approximately $1.7 million of the outstanding balance of this category was considered impaired as of December 31, 2010.

(4) Approximately $3.9 million of the outstanding balance of this category was considered impaired as of December 31, 2009

Non-performing Assets and Impaired Loans and Leases. Credit underwriting through a committee process is a key component of the operating philosophy of our Corporation. Business development officers have relatively low individual lending authority limits, therefore requiring that a significant portion of our new credit extensions be approved through various committees depending on the type of loan or lease, amount of the credit, and the related complexities of each proposal. During the economic recession additional monitoring controls have been implemented to assist us in the early identification of problem loans. We believe the early detection of problems results in the most optimal situation for us to mitigate our risk of loss. Through proactive monitoring of the loan and lease portfolio, we are able to identify weakening of key performance indicators based upon our clients financial statements and declining market values of real estate used as collateral. These factors contribute to an increase in the number and amount of loans on management attention watch lists and consequently an increase in the number and amount of loans on non-accrual status. Non-accrual loans and leases are considered an indicator of potential future losses. We believe the diligence involved in our underwriting, credit approval and loan monitoring processes provides for strong controls to minimize the deterioration of the quality of the loan and lease portfolio; however, we face increasing credit risk as macro economic and political developments impact and may continue to impact the banking industry and the welfare of our clients.

Non-performing assets consisted of non-accrual loans and leases and foreclosed properties totaling $40.2 million, or 3.63%, of total assets as of December 31, 2010. This is an increase in non-performing assets of 36.1% from December 31, 2009. Non-performing assets were $29.5 million, or 2.64%, of total assets at December 31, 2009. The increase in non-performing assets was the result of continued identification of additional loans and leases for which the borrowers are having difficulties making the required principal and interest payments based upon factors including but not limited to the ability to sell land, inadequate cash flow from the operations of the underlying businesses, or final determinations by our clients to file bankruptcy. We have therefore classified these loans as impaired and have placed them in a non-accrual status and have ceased the accrual of interest on the identified loans or leases as of the effective date of the impairment identification. Impaired loans and leases exhibit weaknesses that inhibit repayment in compliance with the original note or lease terms; however, the measurement of impairment on loans and leases may not always result in a specific reserve included in the allowance for loan and lease losses. We calculate the amount of the impairment utilizing various methods appropriate to the loan or lease being evaluated, including the present value of expected future cash flows discounted at the loan s or lease s effective interest rate or an evaluation of the fair value, less costs to sell, of collateral for collateral dependent loans. A charge-off is recorded or a specific reserve is established for the amount of the measured impairment.

As part of underwriting process as well as our ongoing monitoring efforts, we try to ensure that we have adequate collateral to protect our interest in the related loan or lease. As a result of this practice, a significant portion of our non-performing loans or leases either do not require specific reserves or require only a minimal amount of specific reserve as we believe the loans and leases are adequately collateralized as of the measurement period. This practice leads to a declining allowance for loan and lease loss to non-accrual loans and leases ratio. We then reserve for any shortfalls based upon our collateral evaluation. We expect current economic conditions to remain the same for the near term. As a result, we believe that we will continue to experience elevated levels of impaired loans and leases.

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The composition of on nonperforming asset portfolio as of the specified dates was as follows:

	As of December 31, 2010	2009	2008
	(Dollars In Thousands)		
Non-accrual loans and leases			
Commercial real estate:			
Owner occupied	$ 6,283	$ 7,996	$
Non-owner occupied	5,144	486	2,979
Construction and land development	9,275	3,317	5,279
Multi-family	4,186	1,760	
1-4 family	4,237	3,015	2,082
Total commercial real estate	29,125	16,574	10,340
Commercial and industrial	6,436	7,086	5,412
Direct financing leases, net		1	24
Home equity and second mortgage	939	872	379
Consumer and other loans	1,906	3,292	130
Total non-accrual loans and leases	38,406	27,825	16,285
Foreclosed properties, net	1,750	1,671	3,011
Total non-performing assets	$ 40,156	$ 29,496	$ 19,296
Performing troubled debt restructurings	$ 718	$	$
Total non-accrual loans and leases to total loans and leases	4.37%	3.26%	1.91%
Total non-performing assets to total assets	3.63	2.64	1.91
Allowance for loan and lease losses to total loans and leases	1.85	1.65	1.39
Allowance for loan and lease losses to non-accrual loans and leases	42.37	50.76	72.74

Additional information about impaired loans as of and for the years ended December 31, 2010 and 2009 was as follows:

	As of December 31, 2010	2009
	(In Thousands)	
Impaired loans and leases with no impairment reserves	$ 19,749	$ 13,243
Impaired loans and leases with impairment reserves required	19,375	14,582
Total impaired loans and leases	39,124	27,825
Less:		
Impairment reserve (included in allowance for loan and lease losses)	3,459	1,846
Net impaired loans and leases	$ 35,665	$ 25,979
Average impaired loans and leases	29,714	$ 20,395

(7) Note in case there is any significant change in the shareholders equity: None

SUPPORT DOCUMENTATION (CONSOLIDATED)

1. Consolidated Financial Results and Forecasts

	Yen (millions)			
	For the nine months ended December 31, 2010		For the nine months ended December 31, 2011	
		(%)		(%)
Net sales	204,569	12.5	223,673	9.3
Domestic	33,423	8.3	38,551	15.3
Overseas	171,146	13.4	185,122	8.2
Operating income	32,828	39.5	38,557	17.5
Income before income taxes	32,401	22.7	36,012	11.1
Net income attributable to Makita Corporation	23,134	36.8	24,712	6.8
Earning per share (Basic)				
Net income attributable to Makita Corporation common shareholders (Yen)	167.93		179.47	
Number of Employees	11,595		12,477	

	Yen (millions)					
	For the year ended March 31, 2011		For the six months ended September 30, 2011		For the year ending March 31, 2012 (Forecasts)	
		(%)		(%)		(%)
Net sales	272,630	10.9	153,036	14.4	287,000	5.3
Domestic	46,065	7.9	25,263	13.9	52,000	12.9
Overseas	226,565	11.5	127,773	14.5	235,000	3.7
Operating income	41,909	37.9	26,953	23.4	46,500	11.0
Income before income taxes	42,730	27.5	24,514	12.7	44,000	3.0
Net income attributable to Makita Corporation	29,905	34.4	17,104	13.1	30,000	0.3
Earning per share (Basic)						
Net income attributable to Makita Corporation common shareholders (Yen)	217.08		124.16		219.54	
Number of Employees	12,054		12,177			

Notes:

1. The table above shows the changes in the percentage ratio of Net sales, Operating income, Income before income taxes, and Net income attributable to Makita Corporation against the corresponding period of the previous year.
2. Please refer to Qualitative Information on Consolidated Financial Performance Forecasts on page 4.

2. Consolidated Net Sales by Region

	Yen (millions)							
	For the nine months ended December 31, 2010		For the nine months ended December 31, 2011		For the year ended March 31, 2011		For the six months ended September 30, 2011	
		(%)		(%)		(%)		(%)
Japan	33,423	8.3	38,551	15.3	46,065	7.9	25,263	13.9
Europe	86,479	7.8	93,666	8.3	115,977	6.3	64,604	13.3
North America	28,773	7.3	28,189	(2.0)	37,111	7.5	19,822	7.3
Asia	17,753	37.7	19,813	11.6	23,073	25.6	14,136	24.1
Other regions	38,141	23.1	43,454	13.9	50,404	22.5	29,211	18.1
Central and South America	15,171	28.3	18,117	19.4	20,295	33.3	12,618	31.1
Oceania	11,969	19.1	14,039	17.3	15,383	17.3	9,586	21.5
The Middle East and Africa	11,001	20.6	11,298	2.7	14,726	15.1	7,007	(3.0)
Total	204,569	12.5	223,673	9.3	272,630	10.9	153,036	14.4

Note: The table above sets forth Makita s consolidated net sales by region based on the customer s location for the periods presented. Accordingly, it differs from operating segment information on page 9. The table above shows the changes in the percentage ratio of Net sales against the corresponding period of the previous year.

3. Exchange Rates

	Yen				
	For the nine months ended December 31, 2010	For the nine months ended December 31, 2011	For the year ended March 31, 2011	For the six months ended September 30, 2011	For the year ending March 31, 2012 (Forecasts)
Yen/U.S. Dollar	86.84	78.96	85.73	79.74	78
Yen/Euro	113.27	110.60	113.12	113.72	107

Note: The above forecasts are based on the assumption of exchange rates of 76 yen to the U.S. dollar and 95 yen to the euro for the three months period ending March 31, 2012.

4. Production Ratio (unit basis)

	For the nine months ended December 31, 2010 Composition ratio	For the nine months ended December 31, 2011 Composition ratio	For the year ended March 31, 2011 Composition ratio	For the six months ended September 30, 2011 Composition ratio
Domestic	15.1%	12.5%	14.5%	12.6%
Overseas	84.9%	87.5%	85.5%	87.4%

5. Consolidated Capital Expenditures, Depreciation and Amortization, and R&D cost

	Yen (millions)				
	For the nine months ended December 31, 2010	For the nine months ended December 31, 2011	For the year ended March 31, 2011	For the six months ended September 30, 2011	For the year ending March 31, 2012 (Forecasts)
Capital expenditures	7,769	10,406	9,742	5,820	13,000
Depreciation and amortization	5,615	5,264	7,557	3,474	7,500
R&D cost	5,425	6,101	7,283	3,978	8,500