SOUTHERN CONNECTICUT BANCORP INC
Form 10-Q
November 15, 2010

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

or

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

For the transition period from ___________________________ to ___________________________

Commission File Number: 0-49784

Southern Connecticut Bancorp, Inc.
(Exact name of registrant as specified in its charter)

Connecticut	06-1609692
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
215 Church Street, New Haven, Connecticut	06510
(Address of principal executive offices)	(Zip Code)

(203) 782-1100
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [ ] No [ ]

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

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

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

Yes [ ] No [X]

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

Class	Outstanding at November 15, 2010
Common Stock, $.01 par value per share	2,696,902 shares

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Part I - Financial Information

Item 1. Financial Statements

SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
September 30, 2010 and December 31, 2009

ASSETS	2010	2009
Cash and due from banks	$11,106,573	$2,541,557
Short-term investments	8,719,092	15,383,081
Cash and cash equivalents	19,825,665	17,924,638
Interest bearing certificates of deposit	99,344	347,331
Available for sale securities (at fair value)	3,031,709	2,219,751
Federal Home Loan Bank stock	66,100	66,100
Loans receivable		
Loans receivable	130,942,371	112,633,762
Allowance for loan losses	(2,907,561)	(2,768,567)
Loans receivable, net	128,034,810	109,865,195
Accrued interest receivable	596,862	480,497
Premises and equipment	2,282,536	2,485,797
Other assets held for sale	372,758	372,758
Other real estate owned	124,953	-
Other assets	1,940,405	1,848,111
Total assets	$156,375,142	$135,610,178
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits		
Noninterest bearing deposits	$30,539,259	$29,834,836
Interest bearing deposits	107,748,478	87,720,706
Total deposits	138,287,737	117,555,542
Repurchase agreements	453,307	294,332
Capital lease obligations	1,170,594	1,175,263
Accrued expenses and other liabilities	752,048	952,505
Total liabilities	140,663,686	119,977,642
Commitments and Contingencies		
Shareholders' Equity		
Preferred stock, no par value; shares authorized: 500,000; none issued	-	-
Common stock, par value $.01; shares authorized: 5,000,000; shares issued and outstanding: 2010 2,696,902; and 2009 2,695,902	26,969	26,959
Additional paid-in capital	22,565,383	22,560,100
Accumulated deficit	(6,880,796)	(6,942,727)

Accumulated other comprehensive loss - net unrealized loss on available for sale securities	(100)	(11,796)
Total shareholders' equity	15,711,456	15,632,536
Total liabilities and shareholders' equity	$156,375,142	$135,610,178

See Notes to Consolidated Financial Statements

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SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three Months and Nine Months Ended September 30, 2010 and 2009

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Interest Income:				
Interest and fees on loans	$1,946,695	$1,541,428	$5,561,488	$4,420,938
Interest on securities	1,996	17,985	10,998	106,543
Interest on Federal funds sold and short-term and other investments	25,332	58,697	67,082	163,310
Total interest income	1,974,023	1,618,110	5,639,568	4,690,791
Interest Expense:				
Interest expense on deposits	498,121	547,572	1,378,956	1,529,943
Interest expense on capital lease obligations	43,550	43,648	130,968	131,822
Interest expense on repurchase agreements and other borrowings	483	1,128	5,288	5,269
Total interest expense	542,154	592,348	1,515,212	1,667,034
Net interest income	1,431,869	1,025,762	4,124,356	3,023,757
Provision (credit) for loan losses	106,450	(137,255)	224,088	1,943,461
Net interest income after provision (credit) for loan losses	1,325,419	1,163,017	3,900,268	1,080,296
Noninterest Income:				
Service charges and fees	100,307	113,054	335,355	386,933
Gain on sale of available for sale securities	-	-	28,979	-
Other noninterest income	35,242	26,096	108,604	71,605
Total noninterest income	135,549	139,150	472,938	458,538
Noninterest Expenses:				
Salaries and benefits	743,292	751,142	2,262,303	2,294,451
Occupancy and equipment	165,886	160,000	492,560	501,691
Professional services	156,392	122,333	564,286	394,741
Data processing and other outside services	108,432	115,617	308,576	316,097
FDIC Insurance	60,179	51,923	169,543	194,431
Other operating expenses	200,116	97,921	514,007	399,089
Total noninterest expenses	1,434,297	1,298,936	4,311,275	4,100,500
Net income (loss)	$26,671	$3,231	$61,931	$(2,561,666)
Basic and diluted income (loss) per share	$0.01	$0.00	$0.02	$(0.95)

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
For the Nine Months Ended September 30, 2010 and 2009

	Number of Common Shares	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2008	2,688,152	$26,882	$22,521,164	$ (4,035,302)	$ 28,210	$18,540,954
Comprehensive loss:						
Net loss	-	-	-	(2,561,666)	-	(2,561,666)
Unrealized holding loss on available for sale securities, net of income taxes	-	-	-	-	(10,349)	(10,349)
Total comprehensive loss						(2,572,015)
Restricted stock compensation	1,750	17	40,902	-	-	40,919
Stock option compensation	-	-	(14,845)	-	-	(14,845)
Balance, September 30, 2009	2,689,902	$26,899	22,547,221	$ (6,596,968)	$ 17,861	$15,995,013
Balance, December 31, 2009	2,695,902	$26,959	$22,560,100	$ (6,942,727)	$ (11,796)	$15,632,536
Comprehensive income:						
Net income	-	-	-	61,931	-	61,931
Unrealized holding gain on available for sale securities	-	-	-	-	11,696	11,696
Total comprehensive income					-	73,627
Share based compensation:						
Restricted stock compensation	1,000	10	5,283	-	-	5,293
Balance, September 30, 2010	2,696,902	$26,969	$22,565,383	$ (6,880,796)	$ (100)	$15,711,456

See Notes to Consolidated Financial Statements

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SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2010 and 2009

	2010	2009
Cash Flows From Operations		
Net income (loss)	$61,931	$(2,561,666)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Amortization and accretion of premiums and discounts on investments, net	18,034	13,839
Provision for loan losses	224,088	1,943,461
Share based compensation	5,293	26,074
Gain on sale of available for sale securities	(28,979)	-
Depreciation and amortization	209,315	218,374
Increase in cash surrender of life insurance	(30,510)	(32,580)
Write-down of other assets held for sale	-	6,190
Changes in assets and liabilities:		
Decrease in deferred loan fees	(10,514)	(8,226)
Increase in accrued interest receivable	(116,365)	(12,330)
Increase in other assets	(61,784)	(47,862)
Decrease in accrued expenses and other liabilities	(200,457)	(42,733)
Net cash provided by (used in) operating activities	70,052	(497,459)
Cash Flows From Investing Activities		
Proceeds from maturities of interest bearing certificates of deposit	247,987	87,269
Purchases of available for sale securities	(55,664,463)	(7,456,165)
Principal repayments on available for sale securities	73,521	2
Proceeds from maturities / calls of available for sale securities	52,651,000	10,300,000
Proceeds from sales of available for sale securities	2,150,625	-
Net increase in loans receivable	(18,508,142)	(15,621,296)
Purchases of premises and equipment	(6,054)	(13,326)
Proceeds from the sale of OREO	-	528,250
Net cash used in investing activities	(19,055,526)	(12,175,266)
Cash Flows From Financing Activities		
Net increase in demand, savings and money market deposits	4,759,136	4,846,137
Net increase in certificates of deposit	15,973,059	20,662,898
Net increase in repurchase agreements	158,975	22,514
Principal repayments on capital lease obligations	(4,669)	(4,199)
Net cash provided by financing activities	20,886,501	25,527,350
Net increase in cash and cash equivalents	1,901,027	12,854,625
Cash and cash equivalents		
Beginning	17,924,638	13,904,889
Ending	$19,825,665	$26,759,514

(Continued)

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SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS, Continued

	2010	2009
Supplemental Disclosures of Cash Flow Information:		
Cash paid for:		
Interest	$1,464,639	$1,617,294
Income taxes	$750	$750
Supplemental Disclosures of Non-Cash Investing and Financing Activities:		
Transfer of loans receivable to other real estate owned	$124,953	$528,250
Unrealized holding gains on available for sale securities arising during the period	$11,696	$1,047

See Notes to Consolidated Financial Statements

Southern Connecticut Bancorp, Inc.
Notes to Consolidated Financial Statements
(Unaudited)

Note 1. Nature of Operations

Southern Connecticut Bancorp, Inc. (the "Company") is a bank holding company headquartered in New Haven, Connecticut that was incorporated on November 8, 2000. The Company's strategic objective is to serve as a bank holding company for a community-based commercial bank and a mortgage broker serving primarily New Haven County (the "Greater New Haven Market"). The Company owns 100% of the capital stock of The Bank of Southern Connecticut (the "Bank"), a Connecticut-chartered bank with its headquarters in New Haven, Connecticut, and 100% of the capital stock of SCB Capital Inc., operating under the name "Evergreen Financial Services" ("Evergreen"), which is licensed by the State of Connecticut Department of Banking to operate a mortage brokerage business and also operates from the Company's headquarters in New Haven, Connecticut. The Company and its subsidiaries focus on meeting the financial services needs of consumers and small to medium-sized businesses, professionals and professional corporations, and their owners and employees in the Greater New Haven Market.

The Bank operates branches at four locations, including downtown New Haven, the Amity/Westville section of New Haven, Branford and North Haven. The Bank's branches have a consistent, attractive appearance. Each location has an open lobby, comfortable waiting area, offices for the branch manager and a loan officer, and a conference room. The design of the branches complements the business development strategy of the Bank, affording an appropriate space to deliver personalized banking services in professional, confidential surroundings.

The Bank focuses on serving the banking needs of small to medium-sized businesses, professionals and professional corporations, and their owners and employees in the Greater New Haven Market. The Bank's target commercial customer has between $1.0 and $30.0 million in revenues, 15 to 150 employees, and borrowing needs of up to $3.0 million. The primary focus on this commercial market makes the Bank uniquely qualified to move deftly in responding to the needs of its clients. The Bank has been successful in winning business by offering a combination of competitive pricing for its services, quick decision making processes and a high level of personalized, "high touch" customer service.

On February 22, 2010, the Company entered into an Agreement and Plan of Merger with Naugatuck Valley Financial Corporation ("NVSL") and Newco, a corporation to be formed by NVSL to be the holding company for Naugatuck Valley Savings and Loan ("NVSL Bank"), pursuant to which the Company will merge with and into Newco, with Newco being the surviving corporation. The Agreement and Plan of Merger was subsequently amended on September 17, 2010 to amend the consideration to be paid in the merger, extend the deadline for closing the merger and amend the conditions under which NVSL would be obligated to pay a termination fee to the Company.

On November 12, 2010, the Company, NVSL and Newco entered into a Mutual Termination Agreement pursuant to which the parties mutually agreed to terminate the Agreement and Plan of Merger due to an inability to obtain regulatory approval of the proposed merger. In accordance with the terms and conditions of the Mutual Termination Agreement and the Agreement and Plan of Merger, as amended, NVSL paid a $350,000 termination fee to the Company on November 12, 2010, as reimbursement for the Company's transaction expenses.

Note 2. Basis of Financial Statement Presentation

The consolidated interim financial statements include the accounts of the Company and its subsidiaries. The consolidated interim financial statements and notes thereto have been prepared in conformity with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. All significant intercompany transactions have been eliminated in consolidation. Amounts in prior period financial statements are reclassified whenever necessary to conform to current period presentations. The results of operations for the three months and nine months ended September 30, 2010 are not necessarily indicative of the results which may be expected for the year as a whole. The accompanying consolidated financial statements and notes thereto should be read in conjunction with the audited financial statements of the Company and notes thereto as of December 31, 2009, filed with the Securities and Exchange Commission on Form 10-K on March 29, 2010.

Note 3. Available for Sale Securities

The amortized cost, gross unrealized gains, gross unrealized losses and approximate fair values of available for sale securities at September 30, 2010 and December 31, 2009 were as follows:

September 30, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury Bills	$3,000,000	$-	$(210)	$2,999,790
U.S. Government Agency Mortgage Backed Securities	31,809	-	110	31,919
	$3,031,809	$-	$(100)	$3,031,709

December 31, 2009	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government Agency Obligations	$2,126,216	$-	$(12,483)	$2,113,733
U.S. Government Agency Mortgage Backed Securities	105,331	687	-	106,018
	$2,231,547	$687	$(12,483)	$2,219,751

The amortized cost and fair value of available for sale debt securities at September 30, 2010 by contractual maturity are presented below. Actual maturities of mortgage-backed securities may differ from contractual maturities because the mortgages underlying the securities may be called or repaid without any penalties.

Because mortgage-backed securities are not due at a single maturity date, they are not included in the maturity categories in the following summary:

September 30, 2010	Amortized Cost	Fair Value
Maturity:		
Three months or less	$3,000,000	$2,999,790
Mortgage-backed securities	31,809	31,919
	$3,031,809	$3,031,709

Note 4. Loans Receivable

A summary of the Company's loan portfolio at September 30, 2010 and December 31, 2009 is as follows:

	2010	2009
Commercial loans secured by real estate	$73,268,630	$63,836,712
Commercial loans	54,232,855	43,893,191
Construction and land loans	3,202,997	4,607,905
Consumer installment loans	379,964	448,543
Total loans	131,084,446	112,786,351
Net deferred loan fees	(142,075)	(152,589)
Allowance for loan losses	(2,907,561)	(2,768,567)
Loans receivable, net	$128,034,810	$109,865,195

The following represents the activity in the allowance for loan losses for the nine months ended September 30, 2010 and 2009:

Allowance for Loan Losses

	2010	2009
Balance at beginning of year	$2,768,567	$1,183,369
Provision for loan losses	224,088	1,943,461
Recoveries of loans previously charged-off:		
Consumer	3,705	10,423
Total recoveries	3,705	10,423
Loans charged-off:		
Commercial loans secured by real estate	(84,387)	(413,839)
Commercial loans	-	(2,300)
Consumer	(4,412)	(1,339)
Total charge-offs	(88,799)	(417,478)
Balance at end of period	$2,907,561	$2,719,775
Net charge-offs to average loans	(0.07)%	(0.45)%

At September 30, 2010 and December 31, 2009, the unpaid principal balances of loans placed on nonaccrual status were $6,457,000 and $5,363,000, respectively. At September 30, 2010, one loan aggregating $280,000 was restructured and categorized as a “troubled debt restructuring.” Such loan is included in the balance of impaired loans below. There were no loans considered “troubled debt restructurings” at December 31, 2009. Accruing loans contractually past due 90 days or more were $416,000 and $484,000 at September 30, 2010 and December 31, 2009, respectively. Such loans are considered to be well secured and in the process of collection.

The following information relates to impaired loans as of September 30, 2010 and December 31, 2009:

	2010	2009
Impaired loans for which there is a specific allowance	$4,583,138	$4,634,634
Impaired loans for which there is no specific allowance	$2,161,384	$2,469,484
Allowance for loan losses related to impaired loans	$1,390,362	$1,489,255

Average recorded investment in impaired loans	$6,689,030	$5,775,813

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Note 5. Deposits

At September 30, 2010 and December 31, 2009, deposits consisted of the following:

	2010	2009
Noninterest bearing	$30,539,259	$29,834,836
Interest bearing:		
Checking	5,090,066	8,604,111
Money Market	33,948,972	26,434,495
Savings	2,437,685	2,383,404
Time certificates, less than $100,000 (1)	30,382,018	27,785,391
Time certificates, $100,000 or more (2)	35,889,737	22,513,305
Total interest bearing	107,748,478	87,720,706
Total deposits	$138,287,737	$117,555,542

(1) Included in time certificates of deposit, less than $100,000, at September 30, 2010 and December 31, 2009 were brokered deposits totaling $6,408,567 and $9,015,482, respectively.

(2) Included in time certificates of deposit, $100,000 or more, at September 30, 2010 and December 31, 2009 were brokered deposits totaling $7,716,722 and $4,991,718, respectively.

Note 6. Available Borrowings

The Bank is a member of the Federal Home Loan Bank of Boston (“FHLB”). At September 30, 2010, the Bank had the ability to borrow from the FHLB based on a certain percentage of the value of the Bank’s qualified collateral, as defined in the FHLB Statement of Products Policy, at the time of the borrowing. In accordance with an agreement with the FHLB, the qualified collateral must be free and clear of liens, pledges and encumbrances. There were no borrowings outstanding with the FHLB at September 30, 2010.

The Bank is required to maintain an investment in capital stock of the FHLB in an amount equal to a percentage of its outstanding mortgage loans and contracts secured by residential properties, including mortgage-backed securities. No ready market exists for FHLB stock and it has no quoted fair value. For disclosure purposes, such stock is assumed to have a fair value which is equal to cost based upon the redemption provisions of the FHLB.

Note 7. Income (Loss) Per Share

The Company is required to present basic income (loss) per share and diluted income (loss) per share in its statements of operations. Basic per share amounts are computed by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted per share amounts assume exercise of all potential common stock equivalents in weighted average shares outstanding, unless the effect is antidilutive. The Company is also required to provide a reconciliation of the numerator and denominator used in the computation of both basic and diluted income (loss) per share.

The following is information about the computation of income (loss) per share for the three and nine months ended September 30, 2010 and 2009:

Three Months Ended September 30,	2010			2009		
	Net Income	Weighted Average Shares	Amount Per Share	Net Income	Weighted Average Shares	Amount Per Share
Basic Income Per Share						
Income available to common shareholders	$26,671	2,696,902	$0.01	$3,231	2,689,902	$0.00
Effect of Dilutive Securities						
Warrants/Stock Options outstanding/Restricted Stock	-	252	-	-	2,016	-
Diluted Income Per Share						
Income available to common shareholders plus assumed conversions	$26,671	2,697,154	$0.01	$3,231	2,691,918	$0.00

Nine Months Ended September 30,	2010			2009		
	Net Income	Weighted Average Shares	Amount Per Share	Net Loss	Weighted Average Shares	Amount Per Share
Basic Income (Loss) Per Share						
Income (Loss) available to common shareholders	$61,931	2,696,448	$0.02	$(2,561,666)	2,689,400	$(0.95)
Effect of Dilutive Securities						
Warrants/Stock Options outstanding	-	1,454	-	-	-	-
Diluted Income (Loss) Per Share						
Income (Loss) available to common shareholders plus assumed conversions	$61,931	2,697,902	$0.02	$(2,561,666)	2,689,400	$(0.95)

For the nine months ended September 30, 2009, 6,605 shares that could potentially dilute basic EPS in the future were not included in the computation of diluted EPS because to do so would have been antidilutive for the period presented.

Note 8. Other Comprehensive Income (Loss)

Under guidance relating to reporting comprehensive income, certain transactions and other economic events that bypass the Company's income statement must be displayed as other comprehensive income. The Company's other comprehensive income, which is comprised solely of the change in unrealized gains on available for sale securities, was as follows:

Nine Months Ended September 30, 2010

	Before-Tax Amount	Taxes	Net-of-Tax Amount
Unrealized holding gains arising during period	$40,675	$-	$40,675
Reclassification adjustment for amounts recognized in net income	28,979	-	28,979
Unrealized holding gains on available for sale securities, net of taxes	$11,696	$-	$11,696

	Nine Months Ended September 30, 2009		
	Before-Tax Amount	Taxes	Net-of-Tax Amount
Unrealized holding gains arising during period	$1,047	$(11,396)	$(10,349)
Reclassification adjustment for amounts recognized in net income	-	-	-
Unrealized holding gains on available for sale securities, net of taxes	$1,047	$(11,396)	$(10,349)

Note 9. Financial Instruments with Off-Balance-Sheet Risk

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

The contractual amounts of commitments to extend credit represent the amounts of potential accounting loss should the contract be fully drawn upon, the customer defaults, and the value of any existing collateral becomes worthless. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments and evaluates each customer's creditworthiness on a case-by-case basis. The Company controls the credit risk of these financial instruments through credit approvals, credit limits, monitoring procedures and the receipt of collateral as necessary.

Financial instruments whose contract amounts repesent credit risk at September 30, 2010 and December 31, 2009 were as follows:

	September 30, 2010	December 31, 2009
Commitments to extend credit:		
Future loan commitments	$6,224,500	$5,054,000
Unused lines of credit	21,108,186	28,178,604
Financial standby letters of credit	3,355,769	3,358,597
Undisbursed construction loans	948,499	437,000
	$31,636,954	$37,028,201

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

Standby letters of credit are written commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The liability related to guarantees recorded at September 30, 2010 and December 31, 2009 was not significant.

Note 10. Fair Value

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. A description of the valuation methodologies used for assets and liabilities recorded at fair value, and for estimating fair value for financial and non-financial instruments not recorded at fair value, is set forth below.

Cash and due from banks, Federal funds sold, short-term investments, interest bearing certificates of deposit, accrued interest receivable, Federal Home Loan Bank stock, accrued interest payable and repurchase agreements

The carrying amount is a reasonable estimate of fair value. The Company does not record these assets at fair value on a recurring basis.

Available for sale securities

These financial instruments are recorded at fair value in the financial statements on a recurring basis. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted prices are not available, then fair values are estimated by using pricing models (i.e., matrix pricing) or quoted prices of securities with similar characteristics and are classified within Level 2 of the valuation hierarchy. Examples of such instruments include government agency bonds and mortgage-backed securities. Level 3 securities are securities for which significant unobservable inputs are utilized. Available-for-sale-securities are recorded at fair value on a recurring basis.

Loans receivable

For variable rate loans that reprice frequently and have no significant change in credit risk, carrying values are a reasonable estimate of fair values, adjusted for credit losses inherent in the portfolios. The fair value of fixed rate loans is estimated by discounting the future cash flows using estimated period end market rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, adjusted for credit losses inherent in the portfolios. The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for credit losses is established. The specific reserves for collateral dependent impaired loans are based on the fair value of collateral less estimated costs to sell. The fair value of collateral is determined based on appraisals. In some cases, adjustments are made to the appraised values due to various factors including age of the appraisal, age of comparables included in the appraisal, and known changes in the market and in the collateral. When significant adjustments are based on unobservable inputs, the resulting fair value measurement is categorized as a Level 3 measurement.

Servicing assets

The fair value is based on market prices for comparable servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The Company does not record these assets at fair value on a recurring basis.

Other assets held for sale and other real estate owned

Other assets held for sale represents real estate that is not intended for use in operations and real estate acquired through foreclosure, and are recorded at fair value on a nonrecurring basis. Fair value is based upon independent market prices, appraised values of the collateral or management’s estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company classifies the asset as Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company classifies the asset as Level 3.

Interest only strips

The fair value is based on a valuation model that calculates the present value of estimated future cash flows. The Company does not record these assets at fair value on a recurring basis.

Deposits

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

Off-balance-sheet instruments

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

In February 2010, the FASB issued guidance which amended the existing guidance related to Fair Value Measurements and Disclosures. The amendments will require the following new fair value disclosures:

- Separate disclosure of the significant transfers in and out of Level 1 and Level 2 fair value measurements, and a description of the reasons for the transfers; and

- In the rollforward of activity for Level 3 fair value measurements (significant unobservable inputs), purchases, sales, issuances, and settlements should be presented separately (on a gross basis rather than as one net number).

In addition, the amendments clarify existing disclosure requirements as follows:

- Fair value measurements and disclosures should be presented for each class of assets and liabilities within a line item in the statement of financial position; and

- Reporting entities should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements that fall in either Level 2 or Level 3.

The new disclosures and clarifications of existing disclosures were effective for the Company for the quarter ended March 31, 2010, except for the disclosures included in the rollforward of activity for Level 3 fair value measurements, for which the effective date is for fiscal years beginning after December 15, 2010 and for interim periods within those financial statements.

The following table details the financial instruments carried at fair value and measured at fair value on a recurring basis as of September 30, 2010 and December 31, 2009 and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine the fair value:

	Balance as of September 30, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Treasury Bills	$2,999,790	$2,999,790	$-	$ -
U.S. Government Agency Mortgage Backed Securities	31,919	-	31,919	-
Available for sale securities	$3,031,709	$2,999,790	$31,919	$ -

	Balance as of	Quoted Prices in	Significant Observable	Significant Unobservable

	December 31, 2009	Active Markets for Identical Assets (Level 1)	Inputs (Level 2)	Inputs (Level 3)
U.S. Government Agency Obligations - FNMA	$2,113,733	$-	$2,113,733	$ -
U.S. Government Agency Mortgage Backed Securities	106,018	-	106,018	-
Available for sale securities	$2,219,751	$-	$2,219,751	$ -

The following table details the financial instruments carried at fair value and measured at fair value on a nonrecurring basis as of September 30, 2010 and December 31, 2009 and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine the fair value:

	Balance as of September 30, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets held at fair value				
Impaired loans (1)	$3,127,329	$-	$-	$ 3,127,329

	Balance as of December 31, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans (1)	$3,097,995	$-	$-	$ 3,097,995

(1) Represents carrying value and related write-downs for which adjustments are based on appraised value. Management makes adjustments to the appraised values as necessary to consider declines in real estate values since the time of the appraisal. Such adjustments are based on management's knowledge of the local real estate markets.

The following table details the nonfinancial assets carried at fair value and measured at fair value on a nonrecurring basis as of September 30, 2010 and December 31, 2009 indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine the fair value:

	Balance as of September 30, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Other assets held for sale	$372,758	$-	$372,758	$ -
Other real estate owned	$124,953	$-	$-	$ 124,953

	Balance as of	Quoted Prices in	Significant Observable	Significant Unobservable

	December 31, 2009	Active Markets for Identical Assets (Level 1)	Inputs (Level 2)	Inputs (Level 3)
Other assets held for sale	$372,758	$-	$372,758	$ -

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

The estimated fair value amounts for September 30, 2010 and December 31, 2009 have been measured as of their respective periods and have not been reevaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than amounts reported at each period.

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

The following is a summary of the recorded book balances and estimated fair values of the Company's financial instruments at September 30, 2010 and December 31, 2009:

	September 30, 2010		December 31, 2009	
	Recorded Book Balance	Fair Value	Recorded Book Balance	Fair Value
Financial Assets:				
Cash and due from banks	$11,106,573	$11,106,573	$2,541,557	$2,541,557
Short-term investments	8,719,092	8,719,092	15,383,081	15,383,081
Interest bearing certificates of deposit	99,344	99,344	347,331	347,331
Available for sale securities	3,031,709	3,031,709	2,219,751	2,219,751
Federal Home Loan Bank stock	66,100	66,100	66,100	66,100
Loans receivable, net	128,034,810	131,477,000	109,865,195	111,191,000
Accrued interest receivable	596,862	596,862	480,497	480,497