BERKSHIRE BANCORP INC /DE/
Form 10-Q
November 14, 2011

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, 2011

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: 0-13649

BERKSHIRE BANCORP INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	94-2563513
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
160 Broadway, New York, New York	10038
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone Number, Including Area Code: (212) 791-5362

N/A

(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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. (See 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 ¨	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

As of November 11, 2011, there were 14,443,183 outstanding shares of the issuer's Common Stock, $.10 par value.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES

FORWARD-LOOKING STATEMENTS

Forward-Looking Statements. Statements in this Quarterly Report on Form 10-Q that are not based on historical fact may be "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "believe", "may", "will", "expect", "estimate", "anticipate", "continue" or similar terms identify forward-looking statements. A wide variety of factors could cause the actual results and experiences of Berkshire Bancorp Inc. (the "Company") to differ materially from the results expressed or implied by the Company's forward-looking statements. Some of the risks and uncertainties that may affect operations, performance, results of the Company's business, the interest rate sensitivity of its assets and liabilities, and the adequacy of its loan loss allowance, include, but are not limited to: (i) deterioration in local, regional, national or global economic conditions which could result, among other things, in an increase in loan delinquencies, a decrease in property values, or a change in the housing turnover rate; (ii) changes in market interest rates or changes in the speed at which market interest rates change; (iii) changes in laws and regulations affecting the financial services industry; (iv) changes in competition; (v) changes in consumer preferences, (vi) changes in banking technology; (vii) ability to maintain key members of management, (viii) possible disruptions in the Company's operations at its banking facilities, (ix) cost of compliance with new corporate governance requirements, rules and regulations, and other factors referred to in this Quarterly Report and in Item 1A, "Risk Factors", of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

Certain information customarily disclosed by financial institutions, such as estimates of interest rate sensitivity and the adequacy of the loan loss allowance, are inherently forward-looking statements because, by their nature, they represent attempts to estimate what will occur in the future.

The Company cautions readers not to place undue reliance upon any forward-looking statement contained in this Quarterly Report. Forward-looking statements speak only as of the date they were made and the Company assumes no obligation to update or revise any such statements upon any change in applicable circumstances.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
QUARTERLY REPORT ON FORM 10-Q

INDEX

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands)
(unaudited)

	September 30, 2011	December 31, 2010
ASSETS		
Cash and due from banks	$ 6,012	$ 4,920
Interest bearing deposits	80,885	74,197
Total cash and cash equivalents	86,897	79,117
Investment Securities:		
Available-for-sale	406,135	341,564
Held-to-maturity, fair value of $302 in 2011 and $316 in 2010	304	319
Total investment securities	406,439	341,883
Loans, net of unearned income	331,031	366,305
Less: allowance for loan losses	(17,730)	(16,105)
Net loans	313,301	350,200
Accrued interest receivable	3,275	3,578
Premises and equipment, net	7,247	7,815
Other receivable	—	10,047
Other assets	35,447	37,257
Total assets	$ 852,606	$ 829,897
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	$ 78,257	$ 73,609
Interest bearing	571,980	596,527
Total deposits	650,237	670,136
Securities sold under agreements to repurchase	50,000	50,000
Borrowings	7,285	10,657
Subordinated debt	22,681	22,681
Accrued interest payable	2,624	2,743
Other liabilities	5,768	2,047
Total liabilities	738,595	758,264
Stockholders' equity		
Preferred stock - $.01 Par value:		
Authorized — 2,000,000 shares		
Issued — 60,000 shares		
Outstanding —		
September 30, 2011, 60,000 shares		
December 31, 2010, 60,000 shares		
Common stock - $.10 par value		
Authorized — 25,000,000 shares		
Issued — 7,698,285 shares		
Outstanding —		
September 30, 2011, 7,054,183 shares		
December 31, 2010, 7,054,183 shares	770	770

Additional paid-in capital	150,985	150,985
Accumulated Deficit	(21,518)	(65,123)
Accumulated other comprehensive loss, net	(9,816)	(8,589)
Treasury Stock at cost		
September 30, 2011, 644,102 shares	(6,411)	(6,411)
December 31, 2010, 644,102 shares		
Total stockholders' equity	114,011	71,633
Total liabilities and stockholders' equity	$ 852,606	$ 829,897

The accompanying notes are an integral part of these statements

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands, Except Per Share Data)
(unaudited)

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2011	2010	2011	2010
INTEREST INCOME				
Loans, including related fees	$5,229	$6,295	$16,406	$19,301
Investment securities	3,240	3,542	9,901	11,062
Interest bearing deposits	65	41	199	157
Total interest income	8,534	9,878	26,506	30,520
INTEREST EXPENSE				
Deposits	1,503	1,748	4,612	5,961
Securities sold under agreements to repurchase	481	507	1,475	1,507
Interest expense on borrowings	240	283	752	1,222
Total interest expense	2,224	2,538	6,839	8,690
Net interest income	6,310	7,340	19,667	21,830
PROVISION FOR LOAN LOSSES	—	1,500	1,600	4,250
Net interest income after provision for loan losses	6,310	5,840	18,067	17,580
NON-INTEREST INCOME				
Service charges on deposit accounts	127	135	364	391
Investment securities gains	1,100	62	963	464
Gain on sale of foreclosed real estate, net	—	—	—	229
Other income	82	109	43,246	306
Total non-interest income	1,309	306	44,573	1,390
NON-INTEREST EXPENSE				
Total other than temporary impairment ("OTTI") charges on securities	—	—	—	1,202
Less non-credit portion of OTTI recorded in other comprehensive loss	—	—	—	—
Net OTTI recognized in earnings	—	—	—	1,202
Salaries and employee benefits	2,243	2,388	7,077	7,136
Net occupancy expense	921	534	1,986	1,647
Equipment expense	76	90	236	273
FDIC assessment	300	438	952	1,374
Data processing expense	74	124	335	376
Other	728	2,332	2,475	4,028
Total non-interest expense	4,342	5,906	13,061	16,036
Income before provision for taxes	3,277	240	49,579	2,934
Provision (benefit) for income taxes	281	(1,391)	2,374	(476)
Net income	$2,996	$1,631	$47,205	$3,410
Dividends on preferred stock	1,200	1,200	3,600	3,600
Income (loss) allocated to common stockholders	$1,796	$431	$43,605	$(190)
Net income (loss) per common share:				

Basic	$.25	$.06	$6.18	$(.03)
Diluted	$.25	$.06	$6.18	$(.03)
Number of shares used to compute net income (loss) per common share:				
Basic	7,054	7,054	7,054	7,054
Diluted	7,054	7,054	7,054	7,054

The accompanying notes are an integral part of these statements.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For The Nine Months Ended September 30, 2011 and 2010
(In Thousands)
(Unaudited)

	Common Shares	Preferred Shares	Common Stock Par Value	Preferred Stock Par Value	Additional paid-in capital	Accumulated other comprehensive (loss), net	Retained Earnings/ (Accumulated deficit)	Treasury stock	Comprehensive income (loss)	Total stockholders' equity
Balance at December 31, 2009	7,698	60	$ 770	$ 1	$ 150,985	$ (13,276)	$ (46,833)	$ (6,411)		$ 85,236
Net income							3,410		3,410	3,410
Other comprehensive income net of taxes						3,543			3,543	3,543
Comprehensive income									$ 6,953	
Cash dividends - Preferred Stock							(3,600)			(3,600)
Balance at September 30, 2010	7,698	60	$ 770	$ 1	$ 150,985	$ (9,733)	$ (47,023)	$ (6,411)		$ 88,589
Balance at December 31, 2010	7,698	60	$ 770	$ 1	$ 150,985	$ (8,589)	$ (65,123)	$ (6,411)		$ 71,633
Net income							47,205		47,205	47,205
Other comprehensive loss net of taxes						(1,227)			(1,227)	(1,227)
Comprehensive income									$ 45,978	
Cash dividends - Preferred Stock							(3,600)			(3,600)
Balance at September 30, 2011	7,698	60	$ 770	$ 1	$ 150,985	$ (9,816)	$ (21,518)	$ (6,411)		$ 114,011

The accompanying notes are an integral part of these statements.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	For The Nine Months Ended September 30, 2011	2010
Cash flows from operating activities:		
Net income	$ 47,205	$ 3,410
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Realized gains on investment securities	(963)	(464)
Gain on sale of foreclosed real estate	—	(229)
Other than temporary impairment charges on securities	—	1,202
Net amortization of premiums of investment securities	838	1,709
Depreciation and amortization	352	387
Provision for loan losses	1,600	4,250
Decrease in accrued interest receivable	303	376
Decrease in other assets	11,857	4,571
Increase in accrued interest payable and other liabilities	2	154
Net cash provided by operating activities	61,194	15,366
Cash flows from investing activities:		
Investment securities available for sale		
Purchases	(385,431)	(187,057)
Sales, maturities and calls	319,758	189,074
Investment securities held to maturity		
Maturities	15	16
Net decrease in loans	35,299	41,046
Proceeds from sale of foreclosed real estate	—	12,548
Sale (acquisition) of premises and equipment	216	(151)
Net cash (used in) provided by investing activities	(30,143)	55,476

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

(unaudited)

	For The Nine Months Ended September 30,	
	2011	2010
Cash flows from financing activities:		
Net increase in non interest bearing deposits	4,648	10,704
Net decrease in interest bearing deposits	(24,547)	(42,758)
Repayment of borrowings	(3,372)	(19,244)
Dividends paid on preferred stock	—	(3,600)
Net cash (used in) financing activities	(23,271)	(54,898)
Net increase in cash and cash equivalents	7,780	15,944
Cash and cash equivalents at beginning of period	79,117	60,803
Cash and cash equivalents at end of period	$ 86,897	$ 76,747
Supplemental disclosure of cash flow information:		
Cash used to pay interest	$ 6,536	$ 9,595
Cash used to pay income taxes, net of refunds	$ (2,810)	$ (1,080)
Schedule of non-cash investing activities:		
Transfer from loans to real estate owned	$ —	$ 12,318
Schedule of non-cash financing activities:		
Dividends declared and not paid	$ 3,600	$ —

The accompanying notes are an integral part of these statements.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2011 and 2010
(unaudited)

Note 1. General

Berkshire Bancorp Inc., a Delaware corporation, is a bank holding company registered under the Bank Holding Company Act of 1956. References herein to "Berkshire", the "Company" or "we" and similar pronouns, shall be deemed to refer to Berkshire Bancorp Inc. and its wholly-owned consolidated subsidiaries unless the context otherwise requires. Berkshire's principal activity is the ownership and management of its indirect wholly-owned subsidiary, The Berkshire Bank (the "Bank"), a New York State chartered commercial bank. The Bank is owned through Berkshire's wholly-owned subsidiary, Greater American Finance Group, Inc. ("GAFG").

The accompanying financial statements of Berkshire Bancorp Inc. and subsidiaries includes the accounts of the parent company, Berkshire Bancorp Inc., and its wholly-owned subsidiaries: The Berkshire Bank, GAFG and East 39, LLC.

We have prepared the accompanying financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") for interim financial reporting. These consolidated financial statements, including the notes thereto, are unaudited and, in our opinion, include all adjustments, consisting of normal recurring adjustments and accruals, necessary for a fair presentation of our consolidated balance sheets, operating results, and cash flows for the periods presented. Operating results for the periods presented are not necessarily indicative of the results that may be expected for the remaining quarters of fiscal 2011 due to a variety of factors. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP") have been omitted in accordance with the rules and regulations of the SEC. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company's 2010 Annual Report on Form 10-K.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 2. Earnings Per Share

Basic earnings per common share is calculated by dividing income available to common stockholders by the weighted average common stock outstanding, excluding stock options from the calculation. As of and for the nine-month periods ended September 30, 2011 and 2010, there were no potential dilutive shares. The following tables present the Company's calculation of income per common share:

	For The Three Months Ended					
	September 30, 2011			September 30, 2010		
	Income (numerator)	Shares (denominator)	Per share amount	Income (numerator)	Shares (denominator)	Per share amount
	(In thousands, except per share data)					
Basic earnings per common share						
Net income	$2,996			$1,631		
Dividends paid to preferred shareholders	(1,200)			(1,200)		
Net income available to common stockholders	$1,796	7,054	$.25	$431	7,054	$.06

	For The Nine Months Ended					
	September 30, 2011			September 30, 2010		
	Income (numerator)	Shares (denominator)	Per share amount	Income (numerator)	Shares (denominator)	Per share amount
	(In thousands, except per share data)					
Basic earnings (loss) per common share						
Net income (loss)	$47,205			$3,410		
Dividends paid to preferred shareholders	(3,600)			(3,600)		
Net income (loss) available to common stockholders	$43,605	7,054	$6.18	$(190)	7,054	$(.03)

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 3. Loan Portfolio

The following table sets forth information concerning the Company's loan portfolio by type of loan at the dates indicated:

	September 30, 2011		December 31, 2010	
	Amount	% of Total	Amount	% of Total
	(Dollars in thousands)			
Commercial and Industrial and Finance Leases	$ 21,092	6.4 %	$ 19,321	5.3 %
Secured by real estate				
Residential	107,989	32.5	114,594	31.2
Multi family	6,869	2.1	5,865	1.6
Commercial real estate and construction	194,865	58.7	226,667	61.7
Consumer	1,038	0.3	795	0.2
Total loans	331,853	100.0 %	367,242	100.0 %
Deferred loan fees	(822)		(937)	
Allowance for loan losses	(17,730)		(16,105)	
Loans, net	$ 313,301		$ 350,200	

The Bank had $6.3 million and $1.5 million of non-accrual loans as of September 30, 2011 and December 31, 2010, respectively, and $0 and $495,000 of loans delinquent more than ninety days and still accruing interest at September 30, 2011 and December 31, 2010, respectively. The Bank did not foreclose on any loans during the nine months ended September 30, 2011. During the nine months ended September 30, 2010, the Bank foreclosed on a real estate loan in the amount of $12.3 million. In April 2010, the Bank sold its interest in this foreclosed loan for $12.6 million.

The Bank classified $3.6 million and $1.9 million of the non-accrual loans as impaired loans at September 30, 2011 and December 31, 2010, respectively. However, no specific reserves for impaired loans was made because the collateral underlying the impaired loans was deemed to be sufficient to cover any loss in the event of a default. Therefore, the allowance for loan loss is includable in the calculation of regulatory capital up to a maximum of 125% of risk-weighted assets or approximately $5.2 million and $5.8 million at September 30, 2011 and December 31, 2010, respectively.

Average impaired loans for the three and nine months ended September 30, 2011 and 2010 were approximately $3.7 million and $2.6 million, respectively, and $3.7 million and $8.1 million, respectively. Interest income that would have been recognized had these loans performed in accordance with their contractual terms was $6,000 and $9,000 for the three and nine months ended September 30, 2011, respectively, and $49,000 and $450,000 for the three and nine months ended September 30, 2010, respectively.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 3. - (continued)

The following table sets forth information concerning activity in the Company's allowance for loan losses for the indicated periods.

	For The Three Months Ended		For The Nine Months Ended	
	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
	(In thousands)			
Balance at beginning of period	$ 17,730	$ 13,105	$ 16,105	$ 11,416
Provision charged to operations	—	1,500	1,600	4,250
Loans charge-offs	—	—	(2)	(1,066)
Recoveries	—	—	27	5
Balance at end of period	$ 17,730	$ 14,605	$ 17,730	$ 14,605

Allowance for Credit Losses and Recorded Investment in Financing Receivables

The qualitative factors are determined based on the various risk characteristics of each loan class. Relevant risk characteristics are as follows:

Commercial and industrial loans - Loans in this class are made to businesses. Generally these loans are secured by assets of the business and repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer and/or business spending will have an effect on the credit quality in this loan class.

Commercial real estate - Loans in this class include income-producing investment properties and owner-occupied real estate used for business purposes. The underlying properties are generally located in our primary market area. The cash flows of the income producing investment properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates, which in turn, will have an effect on credit quality. In the case of owner-occupied real estate used for business purposes a weakened economy and resultant decreased consumer and/or business spending will have an adverse effect on credit quality.

Construction loans - Loans in this class primarily include land loans to local individuals, contractors and developers for developing the land for sale or for the purpose of making improvements thereon. Repayment is derived from sale of the lots/units including any pre-sold units. Credit risk is affected by market conditions, time to sell at an adequate price and cost overruns. To a lesser extent this class includes commercial development projects we finance which in most cases have an interest-only phase during construction and then convert to permanent financing. Credit risk is affected by cost overruns, market conditions and the availability of permanent financing, to the extent such permanent financing is not being provided by us.

Residential real estate - Loans in this class are made to and secured by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this loan class. The Company generally does not originate loans with a loan-to-value ratio greater than 80 percent and does not grant subprime loans.

12

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 3. - (continued)

Multi-Family real estate - Loans in this class are made to and secured by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this loan class. The Company generally does not originate loans with a loan-to-value ratio greater than 80 percent and does not grant subprime loans.

Consumer loans - Loans in this class may be either secured or unsecured and repayment is dependent on the credit quality of the individual borrower and, if applicable, sale of the collateral securing the loan (such as automobile or other secured assets). Therefore the overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this loan class.

Financing Leases - Loans in this class may be either secured or unsecured and repayment is dependent on the credit quality of the individual borrower and, if applicable, sale of the collateral securing the loan (such as equipment or other secured assets). Therefore the overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this loan class.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 3. - (continued)

Allowance for Credit Losses and Recorded Investment in Loans
For the Nine Months Ended September 30, 2011
(In thousands)

	Commercial & Industrial	Commercial Real Estate	Construction	Multi Family	Residential Real Estate	Consumer	Finance Leases	Unallocated	Total
Allowance for credit losses:									
Beginning balance	$ 417	$ 8,610	$ 2,784	$ 147	$ 2,066	$ 25	$ 419	$ 1,637	$ 16,105
Charge-offs	(2)								(2)
Recoveries	27								27
Provision	440	(1,877)	(593)	69	3,751	(1)	(279)	90	1,600
Ending balance	$ 882	$ 6,733	$ 2,191	$ 216	$ 5,817	$ 24	$ 140	$ 1,727	$ 17,730
Ending balance: individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Ending balance: collectively evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 17,730
Financing Receivables:									
Ending balance	$ 15,423	$ 180,732	$ 14,133	$ 6,869	$ 107,989	$ 1,038	$ 5,669	$ 0	$ 331,853
Ending balance: individually evaluated for impairment	$ 0	$ 1,338	$ 0	$ 0	$ 2,307	$ 0	$ 0	$ 0	$ 3,645
Ending balance: collectively evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 328,208

The Company believes the unallocated amount included in the allowance for credit losses is appropriate given the nature of the portfolio with the size of individual loans and the current economy's impact on the real estate market. The Company will continue to closely monitor the environment and loan portfolio and make adjustments when appropriate.

The $2.3 million of residential impaired loans and the $1.3 million of commercial real estate impaired loans were identified as troubled debt restructurings ("TDRs"). TDRs are the result of an economic concession being granted to borrowers experiencing financial difficulties. Certain TDRs are classified as nonperforming at the time of restructuring and may only return to performing status after considering the borrower's sustained repayment performance under the revised payment terms for a reasonable period, generally six months. We evaluated all of the impaired loans by analyzing the collateral value and by evaluating the discounted cash flow. Based on the nature of the modifications no impairment was required.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 3. - (continued)

Allowance for Credit Losses and Recorded Investment in Loans
For the Year Ended December 31, 2010
(In thousands)

	Commercial & Industrial	Commercial Real Estate	Construction	Multi Family	Residential Real Estate	Consumer	Finance Leases	Unallocated	Total
Allowance for credit losses:									
Beginning balance	$ 1,349	$ 2,592	$ 3,211	$ 30	$ 763	$ 57	$ 115	$ 3,299	$ 11,416
Charge-offs	(300)	(766)				(1)			(1,067)
Recoveries	6								6
Provision	(638)	6,784	(427)	117	1,303	(31)	304	(1,662)	5,750
Ending balance	$ 417	$ 8,610	$ 2,784	$ 147	$ 2,066	$ 25	$ 419	$ 1,637	$ 16,105
Ending balance: individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Ending balance: collectively evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 16,105
Financing Receivables:									
Ending balance	$ 10,498	$ 193,500	$ 33,167	$ 5,865	$ 114,594	$ 795	$ 8,823	$ 0	$ 367,242
Ending balance: individually evaluated for impairment	$ 0	$ 816	$ 0	$ 0	$ 1,998	$ 0	$ 0	$ 0	$ 2,814
Ending balance: collectively evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 364,428

The $2.0 million of residential impaired loans were identified as troubled debt restructurings ("TDRs") at December 31, 2010. TDRs are the result of an economic concession being granted to borrowers experiencing financial difficulties. Certain TDRs are classified as nonperforming at the time of restructuring and may only return to performing status after considering the borrower's sustained repayment performance under the revised payment terms for a reasonable period, generally six months. We evaluated all of the impaired loans by analyzing the collateral value and by evaluating the discounted cash flow. Based on the nature of the modifications no impairment was required.

15

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 3. - (continued)

Age Analysis of Past Due Loans
As of September 30, 2011
(In thousands)

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Loans > 90 Days and Accruing
Commercial & industrial	$ —	$ —	$—	$—	$15,423	$15,423	$ —
Construction	—	24	122	146	13,987	14,133	—
Commercial real estate	13	—	—	13	180,719	180,732	—
Consumer	1	—	—	1	497	498	—
Overdrafts	—	—	—	—	540	540	—
Residential - prime	—	—	6,167	6,167	101,822	107,989	—
Residential - multi family	—	—	—	—	6,869	6,869	—
Finance leases	—	—	—	—	5,669	5,669	—
Total	$ 14	$ 24	$6,289	$6,327	$325,526	$331,853	$ —

Age Analysis of Past Due Loans
As of December 31, 2010
(In thousands)

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Loans > 90 Days and Accruing
Commercial & industrial	$ 251	$ —	$166	$417	$10,081	$10,498	$ 29
Construction	900	—	—	900	32,267	33,167	—
Commercial real estate	1,356	2,000	—	3,356	190,144	193,500	—
Consumer	—	—	15	15	780	795	11
Residential - prime	404	387	695	1,486	113,108	114,594	451
Residential - multi family	—	—	—	—	5,865	5,865	—
Finance leases	—	—	—	—	8,823	8,823	—
Total	$ 2,911	$ 2,387	$876	$6,174	$361,068	$367,242	$ 491

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 3. - (continued)

Impaired Loans
For the Nine Months Ended September 30, 2011
(In thousands)

	Recorded Loan	Unpaid Principal Balance	Related Allowance	Average Recorded Loan	Interest Income Recognized	Interest Income Foregone
With no related allowance recorded:						
Commercial & industrial	$—	$—	$ —	$—	$ —	$—
Construction	—	—	—	—	—	—
Commercial real estate	1,338	1,338	—	1,343	68	—
Consumer	—	—	—	—	—	—
Residential - prime	2,307	2,307	—	2,313	76	9
Residential - multi family	—	—	—	—	—	—
Finance leases	—	—	—	—	—	—
Total	$3,645	$3,645	$ —	$3,656	$ 144	$9
Commercial	1,338	1,338	—	1,343	68	—
Consumer	—	—	—	—	—	—
Residential	2,307	2,307	—	2,313	76	9

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 3. - (continued)

Impaired Loans
For the Year Ended December 31, 2010
(In thousands)

	Recorded Loan	Unpaid Principal Balance	Related Allowance	Average Recorded Loan	Interest Income Recognized	Interest Income Foregone
With no related allowance recorded:						
Commercial & industrial	$—	$—	$ —	$292	$ —	$22
Construction	—	—	—	4,211	—	303
Commercial real estate	816	816	—	400	99	—
Consumer	—	—	—	—	—	—
Residential - prime	1,998	1,998	—	963	125	—
Residential - multi family	—	—	—	—	—	—
Finance leases	—	—	—	—	—	—
Total	$2,814	$2,814	$ —	$5,866	$ 224	$325
Commercial	816	816	—	4,903	99	325
Consumer	—	—	—	—	—	—
Residential	1,998	1,998	—	963	125	—

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 3. - (continued)

Loans on Nonaccrual Status
As of

	September 30, 2011	December 31, 2010
	(In thousands)	
Commercial & industrial	$ 146	$ 137
Construction	—	—
Commercial real estate	—	—
Consumer	—	—
Residential	6,167	1,380
Residential - multi family	—	—
Finance leases	—	—
Total	$ 6,313	$ 1,517

Credit Exposure
Credit Risk Profile by Internally Assigned Grades
As of September 30, 2011
(In thousands)

	Commercial & Industrial	Commercial Real Estate Construction	Commercial Real Estate Other
Grade:			
Pass	$ 15,219	$ 7,247	$ 129,986
Watch	—	—	8,196
Special Mention	—	6,886	11,032
Substandard	204	—	31,518
Doubtful	—	—	—
Total	$ 15,423	$ 14,133	$ 180,732

	Residential	Residential Multi Family
Grade:		
Pass	$ 99,626	$ 6,869
Watch	712	—
Special Mention	1,484	—
Substandard	6,167	—
Total	$ 107,989	$ 6,869

	Consumer Overdrafts	Consumer Other	Finance Leases
Performing	$ 540	$ 481	$ 5,669

Nonperforming	—	17	—
Total	$ 540	$ 498	$ 5,669

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 3. - (continued)

Credit Exposure
Credit Risk Profile by Internally Assigned Grades
For the Year Ended December 31, 2010
(In thousands)

	Commercial & Industrial	Commercial Real Estate Construction	Commercial Real Estate Other
Grade:			
Pass	$ 10,344	$ 23,085	$ 151,200
Watch	—	—	8,624
Special Mention	—	10,082	15,344
Substandard	154	—	18,332
Total	$ 10,498	$ 33,167	$ 193,500

	Residential	Residential Multi Family
Grade:		
Pass	$ 106,165	$ 5,865
Watch	336	—
Special Mention	5,929	—
Substandard	2,164	—
Total	$ 114,594	$ 5,865

	Consumer Overdrafts	Consumer Other	Finance Leases
Performing	$ 61	$ 719	$ 8,823
Nonperforming	4	11	—
Total	$ 65	$ 730	$ 8,823

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 3. - (continued)

The Company utilizes a grade risk rating system for commercial and industrial, commercial real estate and construction loans.

On a quarterly basis, or more often if needed, the Company formally reviews the ratings on all classified commercial and industrial, commercial real estate and construction loans. Semi-annually, the Company engages an independent third-party to review a significant portion of loans within these segments. Management uses the results of these reviews as part of its periodic review process.

Loan Modification
September 30, 2011
(Dollars in Thousands)

	For the Three Months Ended September 30, 2011			For the Nine Months Ended September 30, 2011		
Troubled Debt Restructuring	Number of Loans	Pre-Modification Outstanding Recorded Loans	Post-Modification Outstanding Recorded Loans	Number of Loans	Pre-Modification Outstanding Recorded Loans	Post-Modification Outstanding Recorded Loans
Residential – prime	1	$ 62	$ 62	3	$ 869	$ 869
Commercial Real Estate	-	-	-	-	-	-
	1	$ 62	$ 62	3	$ 869	$ 869

	As of September 30, 2011		
Troubled Debt Restructuring	Number of Loans	Pre-Modification Outstanding Recorded Loans	Post-Modification Outstanding Recorded Loans
Residential – prime	7	$ 2,306	$ 2,306
Commercial Real Estate	3	1,343	1,343
	10	$ 3,649	$ 3,649

Note 4. Investment Securities

The following is a summary of held to maturity investment securities:

	September 30, 2011			
	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In thousands)			
U.S. Government Agencies	$ 304	$ 1	$ (3)	$ 302

	December 31, 2010			
	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In thousands)			
U.S. Government Agencies	$ 319	$ 1	$ (4)	$ 316

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 4. - (continued)

The following is a summary of available-for-sale investment securities:

	September 30, 2011			
	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In thousands)			
U.S. Treasury Notes	$80,095	$145	$ —	$80,240
U.S. Government Agencies	110,770	724	(30)	111,464
Mortgage-backed securities	148,934	2,740	(600)	151,074
Corporate notes	13,190	94	(66)	13,218
Municipal securities	2,670	64	(126)	2,608
Auction rate securities	65,700	—	(20,583)	45,117
Marketable equity securities and other	2,563	99	(248)	2,414
Totals	$423,922	$3,866	$ (21,653)	$406,135

	December 31, 2010			
	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In thousands)			
U.S. Treasury Notes	$50,015	$61	$ —	$50,076
U.S. Government Agencies	88,469	591	(1,533)	87,527
Mortgage-backed securities	117,724	4,099	(686)	121,137
Corporate notes	13,773	44	(639)	13,178
Single Issuer Trust Preferred CDO	1,023	271	—	1,294
Pooled Trust Preferred CDO	6,459	—	(6,000)	459
Municipal securities	2,632	102	(46)	2,688
Auction rate securities	73,993	397	(12,311)	62,079
Marketable equity securities and other	2,810	316	—	3,126
Totals	$356,898	$5,881	$ (21,215)	$341,564

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 4. - (continued)

Management uses a multi-factor approach to determine whether each investment security in an unrealized loss position is other-than-temporarily impaired ("OTTI"). An unrealized loss position exists when the current fair value of an investment is less than its amortized cost basis. The valuation factors utilized by management incorporate the ideas and concepts outlined in relevant accounting guidance. These include such factors as:

*The length of time and the extent to which the market value has been less than cost;

*The financial condition of the issuer of the security as well as the near and long-term prospect for the issuer;

*The rating of the security by a national rating agency;

*Historical volatility and movement in the fair market value of the security; and

*Adverse conditions relative to the security, issuer or industry.

The following table shows the outstanding auction rate securities aggregated by type of underlying collateral at September 30, 2011 and December 31, 2010:

	September 30, 2011		December 31, 2010	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)			
Federal Home Loan Mortgage Corporation Preferred Shares	$ —	$ —	$ 693	$ 1,089
Preferred Shares of Money Center Banks	63,700	43,117	71,300	58,990
Public Utility Debt and Equity Securities	2,000	2,000	2,000	2,000
Totals	$ 65,700	$ 45,117	$ 73,993	$ 62,079

In accordance with ASC 320-10, Investment - Debt and Equity Securities, Management's impairment analysis for the corporate and auction rate securities that were in a loss position as of September 30, 2011 began with management's determination that it had the intent to hold these securities for sufficient time to recover the cost basis. Management also concluded that it was unlikely that it would be required to sell any of the securities before recovery of the cost basis.

At September 30, 2011 and December 31, 2010, the amortized cost of our auction rate securities was $65.7 million and $74.0 million, respectively. The fair value of the auction rate securities was $45.1 million and $62.1 million at September 30, 2011 and December 31, 2010, respectively.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 4. - (continued)

The fair value of the auction rate securities is determined by management valuing the underlying security. The auction rate securities allow for conversion to the underlying preferred security after two failed auctions. As of September 30, 2011, there have been more than two failed auctions for all outstanding auction rate securities. It is our intention to continue to hold these securities and not convert to the underlying preferred securities. We also perform a discounted cash flow analysis, but we considered the market value of the underlying preferred shares to be more objective and relevant in pricing auction rate securities.

In determining whether there is OTTI, management considers the factors noted above. The financial performance indicators we review include, but are not limited to, net earnings, change in liquidity, and change in cash from operating activities, and, for money center banks, the regulatory capital ratios and the allowance for loan losses to the nonperforming loans. Through September 30, 2011, the auction rate securities have continued to pay interest at the highest rate as stipulated in the original prospectus, except for the auction rate securities collateralized by the Federal Home Loan Mortgage Corporation Preferred Shares which were sold for a gain of $2.8 million during the quarter ended June 30, 2011. Currently, the interest rate paid approximates the rate paid on money market deposit accounts.

At September 30, 2011 and December 31, 2010, we had four auction rate securities and six auction rate securities, respectively, with an aggregate fair market value of $15.2 million and $21.0 million, respectively, which were below investment grade.

Based upon our methodology for determining the fair value of the auction rate securities, we concluded that as of September 30, 2011, the unrealized loss of approximately $10.8 million on the four auction rate securities is due to the market interest volatility, the continued illiquidity of the auction rate markets, and uncertainty in the financial markets as there has not been a deterioration in the credit quality of the issuer of the auction rate securities or a downgrade of additional auction rate securities from investment grade. It is not more likely than not that the Company would be required to sell the auction rate securities prior to recovery of the unrealized loss, nor does the Company intend to sell the security at the present time.

During both the nine months ended September 30, 2011 and the year ended December 31, 2010, no auction rate securities were redeemed.

At December 31, 2010, we had one pooled trust preferred CDO ("TPCDO") with an amortized cost of $6.5 million and a fair value of $459,000. The TPCDO was sold during the quarter ended June 30, 2011 with a realized loss of $4.2 million recorded in our financial statements.

We owned a Class B tranche of the TPCDO, which was considered below investment grade at December 31, 2010. In determining whether there was OTTI, management obtained discounted cash flow scenarios from independent third parties and used the most conservative result in order to value the TPCDO, which we believe also reflects the most likely expected cash flow. Based upon the discounted cash flow analysis, no additional credit related OTTI charges were recognized prior to the sale of the TPCDO.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 4. - (continued)

During the nine months ended September 30, 2011, two of the Company's auction rate securities collateralized by preferred shares of money center banks with a fair value of $8.2 million were downgraded to below investment grade.

At September 30, 2011 and December 31, 2010, the Company owned preferred and common stock (collectively "equity securities"). The fair value of the equity securities at September 30, 2011 decreased by approximately $712,000 from the fair value at December 31, 2010.

The Company has investments in certain debt securities that have unrealized losses or may be otherwise impaired, but an OTTI has not been recognized in the financial statements as management believes the decline is due to the credit markets coupled with the interest rate environment.

The following table indicates the length of time individual securities that we consider temporarily impaired have been in a continuous unrealized loss position at September 30, 2011 (in thousands):

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Description of Securities						
U.S. Treasury Notes	$—	$ —	$—	$ —	$—	$ —
U.S. Government Agencies	8,512	3	15,000	27	23,512	30
Mortgage-backed securities	47,798	251	8,286	349	56,084	600
Corporate notes	1,686	20	3,647	46	5,333	66
Auction rate securities	—	—	43,117	20,583	43,117	20,583
Municipal securities	722	125	—	—	722	125
Subtotal, debt securities	58,718	399	70,050	21,005	128,768	21,404
Marketable equity securities and other	—	—	716	249	716	249
Total temporarily impaired securities	$58,718	$ 399	$70,766	$ 21,254	$129,484	$ 21,653

The Company had a total of 57 debt securities with a fair market value of $128.8 million which were temporarily impaired at September 30, 2011. The total unrealized loss on these securities was $21.4 million, which is attributable to the market interest volatility, the continued illiquidity of the debt markets, and uncertainty in the financial markets. It is not more likely than not that we would sell these securities before maturity, and we have the intent to hold all of these securities to maturity and will not be required to sell these securities, due to our ratio of cash and cash equivalents of approximately 10.2% of total assets at September 30, 2011. Therefore, the unrealized losses associated with these securities are not considered to be other than temporary.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 4. - (continued)

The amortized cost and fair value of investment securities available for sale and held to maturity, by contractual maturity, at September 30, 2011 are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	September 30, 2011			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)			
Due in one year or less	$31,044	$31,106	$—	$—
Due after one through five years	87,681	88,128	—	—
Due after five through ten years	36,774	37,298	—	—
Due after ten years	200,160	202,072	304	302
Auction rate securities	65,700	45,117	—	—
Marketable equity securities and other	2,563	2,414	—	—
Totals	$423,922	$406,135	$304	$302

Gross gains realized on the sales of investment securities for the nine months ended September 30, 2011 and 2010 were approximately $7.3 million and $516,000, respectively. Gross losses realized for the nine months ended September 30, 2011 and 2010 were approximately $6.3 million and $52,000, respectively. The single issuer trust preferred security was sold in the nine months ended September 30, 2011 with a realized loss of $4.2 million recorded in our financial statements.

At both September 30, 2011 and December 31, 2010, securities sold under agreements to repurchase with a book value of $50.0 million were outstanding. The book value of the securities pledged for these repurchase agreements was $57.1 million and $58.2 million, respectively. As of September 30, 2011 and December 31, 2010, the Company owned investment securities issued by FNMA, GNMA and FHLMC with a carrying value that exceeded 10% of shareholders' equity.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 5. Deposits

The following table summarizes the composition of the average balances of major deposit categories:

	Nine Months Ended September 30, 2011		Twelve Months Ended December 31, 2010	
	Average Amount	Average Yield	Average Amount	Average Yield
	(Dollars in thousands)			
Demand deposits	$ 78,306	—	$ 69,963	—
NOW and money market	25,565	0.38 %	22,274	0.30 %
Savings deposits	187,987	0.45	196,598	0.71
Time deposits	383,221	1.34	400,586	1.52
Total deposits	$ 675,079	0.90 %	$ 689,421	1.09 %

Note 6. Comprehensive Income (Loss)

The Company follows the provisions of FASB ASC 220, Comprehensive Income, ("ASC 220") which includes net income as well as certain other items which result in a change to equity during the period. The following table presents the components of comprehensive income (loss):

	For The Nine Months Ended					
	September 30, 2011			September 30, 2010		
	Before tax amount	Tax (expense) benefit	Net of tax amount	Before tax amount	Tax (expense) benefit	Net of tax amount
	(In thousands)					
Unrealized gains (losses) on investment securities:						
Unrealized holding gains (losses) arising during period	$(3,008)	$1,203	$(1,805)	$5,447	$(2,327)	$3,120
Less reclassification adjustment for gains (losses) realized in net income	963	(385)	578	(738)	315	(423)
Unrealized gain (loss) on investment securities	(2,045)	818	(1,227)	6,185	(2,642)	3,543
Other comprehensive income (loss), net	$(2,045)	$818	$(1,227)	$6,185	$(2,642)	$3,543

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 7. Fair Value of Financial Instruments

The Company is required to disclose the estimated fair value of its assets and liabilities considered to be financial instruments. For the Company, as for most financial institutions, the majority of its assets and liabilities are considered financial instruments. However, many such instruments lack an available trading market, as characterized by a willing buyer and seller engaging in an exchange transaction. Also, it is the Company's general practice and intent to hold its financial instruments to maturity and not to engage in trading or sales activities, except for certain loans. Therefore, the Company had to use significant estimations and present value calculations to prepare this disclosure.

Changes in the assumptions or methodologies used to estimate fair values may materially affect the estimated amounts. Also, there may not be reasonable comparability between institutions due to the wide range of permitted assumptions and methodologies in the absence of active markets. This lack of uniformity gives rise to a high degree of subjectivity in estimating financial instrument fair values.

Estimated fair values have been determined by the Company using the best available data and an estimation methodology suitable for each category of financial instruments. The estimation methodologies used, the estimated fair values, and recorded book balances at September 30, 2011 and December 31, 2010 are outlined below.

	September 30, 2011		December 31, 2010	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
	(In thousands)			
Investment securities	$ 406,439	$ 406,437	$ 341,883	$ 341,880
Loans, net of unearned income	331,031	340,285	366,305	371,110
Time Deposits	372,066	374,248	384,301	386,446
Repurchase Agreements	50,000	52,516	50,000	51,661
Borrowings	7,285	7,472	10,657	10,876
Subordinated debt	22,681	22,681	22,681	22,681

For cash and cash equivalents, the recorded book values of $86.9 million and $79.1 million at September 30, 2011 and December 31, 2010, respectively, approximates fair value.

The estimated fair values of investment securities are based on quoted market prices, if available. Estimated fair values are based on quoted market prices of comparable instruments if quoted market prices are not available. Estimated fair values are also determined using unobservable inputs that are supported by little or no market values and significant assumptions and estimates.

The net loan portfolio at September 30, 2011 and December 31, 2010 has been valued using a present value discounted cash flow where market prices were not available. The discount rate used in these calculations is the estimated current market rate adjusted for credit risk. The carrying value of accrued interest approximates fair value.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 7. - (continued)

The estimated fair values of demand deposits (i.e. interest (checking) and non-interest bearing demand accounts, savings and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amounts). The carrying amount of accrued interest payable approximates its fair value. The fair value of time deposits have been valued using net present value discounted cash flow.

The fair value of commitments to extend credit is estimated based upon the amount of unamortized deferred loan commitment fees. The fair value of letters of credit is based upon the amount of unearned fees plus the estimated cost to terminate letters of credit. Fair values of unrecognized financial instruments, including commitments to extend credit, and the fair value of letters of credit are considered immaterial.

The fair value of interest rate caps, included in borrowings, are based upon the estimated amount the Company would receive or pay to terminate the contracts or agreements, taking into account current interest rates and, when appropriate, the current creditworthiness of the counterparties. The aggregate fair value for the interest rate caps was approximately $600 and $26,000 at September 30, 2011 and December 31, 2010, respectively.

The fair value of the borrowings and subordinated debt approximates the carrying value due to the re-pricing of the debt.

FASB ASC 820, "Fair Value Measurements and Disclosure", ("ASC 820") defines fair value, establishes a framework for measuring fair value, and expands disclosure about fair value. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value. A financial instrument's level within the fair value hierarchy is based on the lowest level of input significant to the fair value measurement. There have been no material changes in valuation techniques as a result of the adoption of ASC 820.

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

Level 2 - Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities in active markets; quoted prices in markets that are not active for identical or similar assets or liabilities; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 - Unobservable inputs that are supported by little or no market activity and significant to the fair value of the assets or liabilities that are developed using the reporting entities' estimates and assumptions, which reflect those that market participants would use.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 7. - (continued)

Assets and Liabilities Measured at Fair Value on a Recurring Basis

A description of the valuation methodologies used for financial instruments measured at fair value on a recurring basis, as well as the classification of the instruments pursuant to the valuation hierarchy, are as follows:

Securities Available for Sale

When quoted market prices are available in an active market, securities are classified within Level 1 of the fair value hierarchy. If quoted market prices are not available or accessible, then fair values are estimated using pricing models, matrix pricing, or discounted cash flow models. The fair values of securities estimated using pricing models or matrix pricing are generally classified within Level 2 of the fair value hierarchy. When discounted cash flow models are used there is omitted activity or less transparency around inputs to the valuation and securities are classified within Level 3 of the fair value hierarchy.

Level 1 securities generally include equity securities valued based on quoted market prices in active markets. Level 2 instruments include U.S. government agency obligations, state and municipal bonds, mortgage-backed securities, collateralized mortgage obligations and corporate bonds. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Level 3 securities available for sale consist of instruments that are not readily marketable and may only be redeemed with the issuer at par such as Federal Home Loan Bank and Federal Reserve Bank stock. These securities are valued at par value.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 7. - (continued)

Assets measured at fair value during the nine months ended September 30, 2011 and during fiscal year 2010 are summarized below.

	At September 30, 2011 Fair Value Measurement Using			
	Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance September 30, 2011
	(Dollars in thousands)			
Assets				
Impaired Loans (1)	$ —	$ —	$ 3,645	$ 3,645
Investment securities available for sale: (2)				
U.S. Treasury Notes	80,240	—	—	80,240
U.S. Government Agencies	—	111,464	—	111,464
Mortgage-backed securities	—	151,074	—	151,074
Corporate notes	13,218	—	—	13,218
Municipal securities	2,608	—	—	2,608
Auction rate securities	—	—	45,117	45,117
Marketable equity securities and other	926	1,488	—	2,414
Total Investment securities available for sale	96,992	264,026	45,117	406,135
Total assets	$ 96,992	$ 264,026	$ 48,762	$ 409,780

(1) Non-recurring basis
(2) Recurring basis

The fair value of real estate owned is determined by appraisals, which is then adjusted for the costs associated with liquidating the property. We measure real estate owned on a nonrecurring basis with Level 3 inputs. At both September 30, 2011 and December 31, 2010, the Company had no real estate owned.

The fair value of the derivative is approximately $600 and valued as a Level 3 input. Further disclosures are not included because they were not deemed material.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 7. - (continued)

	At December, 31, 2010 Fair Value Measurement Using			
	Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance December 31, 2010
	(Dollars in thousands)			
Assets				
Impaired Loans (1)	$—	$ —	$ 2,814	$ 2,814
Investment securities available for sale: (2)				
U.S. Treasury Notes	50,076	—	—	50,076
U.S. Government Agencies	24,930	62,597	—	87,527
Mortgage-backed securities	—	121,137	—	121,137
Corporate notes	10,246	2,932	—	13,178
Single Issuer Trust Preferred CDO	—	1,294	—	1,294
Pooled Trust Preferred CDO	—	459	—	459
Municipal securities	—	2,688	—	2,688
Auction rate securities	—	—	62,079	62,079
Marketable equity securities and other	—	3,126	—	3,126
Total Investment securities available for sale	85,252	194,233	62,079	341,564
Total assets	$85,252	$ 194,233	$ 64,893	$ 344,378

(1) Non-recurring basis
(2) Recurring basis

The fair value of the derivative is approximately $26,000 and valued as a Level 3 input. Further disclosures are not included because they were not deemed material.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 7. - (continued)

Assets and Liabilities Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3)

The following table presents a reconciliation for assets measured at fair value on a recurring basis for which the Company has utilized significant unobservable inputs (Level 3).

(Dollars in thousands)	Investment Securities Available for Sale
Balance, January 1, 2011	$ 62,079
Total gains/losses (realized/unrealized)	
Included in earnings	—
Included in other comprehensive income	(8,669)
Sales	(8,293)
Redemptions (Transfer to Other Real Estate Owned)	—
Interest	—
Other than temporary impairment expense	—
Capital deductions for operating expenses	—
Balance, September 30, 2011	$ 45,117
The amount of total gains (losses) for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at September 30, 2011	$ —

Note 8. New Accounting Pronouncements

In January 2010, the FASB issued Accounting Standards Update ("ASU") No. 2010-06, which amends the authoritative accounting guidance under ASC Topic 820. The update requires the following additional disclosures: (1) separately disclose the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers; and (2) separately disclose information about purchases, sales, issuances and settlements in the reconciliation for fair value measurements using Level 3. The update provides for amendments to existing disclosures as follows: (1) fair value measurement disclosures are to be made for each class of assets and liabilities; and (2) disclosures are to be made about valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. The update also includes conforming amendments to guidance on employers' disclosures about postretirement benefit plan assets. The update is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Adoption of this update did not have a material effect on the Company's results of operations or financial condition.

33

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 8. - (continued)

In January 2011, the FASB issued ASU No. 2011-01, which temporarily delays the effective date of the required disclosures about troubled debt restructurings contained in ASU No. 2010-20. The delay is intended to allow the FASB additional time to deliberate what constitutes a troubled debt restructuring. All other amendments contained in ASU No. 2010-20 are effective as issued. Adoption of this update did not have a material effect on the Company's results of operations or financial condition.

In April 2011, the FASB issued ASU No. 2011-02, which amends the authoritative accounting guidance under ASC Topic 310 "Receivables." The update provides clarifying guidance as to what constitutes a troubled debt restructuring. The update provides clarifying guidance on a creditor's evaluation of the following: (1) how a restructuring constitutes a concession; and (2) if the debtor is experiencing financial difficulties. The amendments in this update are effective for the first interim or annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. In addition, disclosures about troubled debt restructurings which were delayed by the issuance of ASU NO. 2011-01, are effective for interim and annual periods beginning on or after June 15, 2011. Adoption of this update is not expected to have a material effect on the Company's results of operations or financial condition.

In April 2011, the FASB issued ASU No. 2011-03, which amends the accounting for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The amendments remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. ASU No. 2011-03 is effective for the first interim or annual period beginning on or after December 15, 2011. Adoption of this update did not have a material effect on the Company's results of operations or financial condition.

In May 2011, the FASB issued ASU No. 2011-04, which results in common fair value measurement and disclosure requirements for US GAAP and International Financial Reporting Standards. ASU No. 2011-04 is effective for the first interim or annual period beginning after December 15, 2011. Adoption of this update is not expected to have a material effect on the Company's results of operations or financial condition but may have an effect on disclosures.

In June 2011, the FASB issued ASU No. 2011-05 in order to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. This standard eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. This update requires all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. This update is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted because compliance with the amendments is already permitted. Adoption of this update is not expected to have a material effect on the Company's results of operations or financial condition.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 9. Subsequent Events

On October 31, 2011, all 60,000 outstanding shares of the Company's 8% Non-Cumulative Mandatorily Convertible Perpetual Series A Preferred Stock (the "Preferred Stock") were mandatorily converted into 7,389,000 shares of the Common Stock, $.10 par value, of the Company (the "Common Stock") at a conversion rate of 123.15 shares of Common Stock for each share of Preferred Stock converted, in accordance with the Certificate of Designation of the Preferred Stock.

We evaluated subsequent events under ASC Topic 855, Subsequent Events. We did not identify any items which would require disclosure in or adjustment to the interim financial statements except as disclosed in Form 10-Q as of and for the period ended September 30, 2011.

Internal Control Over Financial Reporting

The objective of the Company's Internal Control Program is to allow the Bank and management to comply with Part 363 of the FDIC's regulations ("FDICIA") and to allow the Company to comply with Sections 302 and 404 of the Sarbanes-Oxley Act of 2002 ("SOX"). In November 2005, the FDIC amended Part 363 of its regulations by raising the asset-size threshold from $500 million to $1 billion for internal control assessments by management and external auditors. The final rule was effective December 28, 2005.

Section 302 of SOX requires the CEOs and CFOs of the Company to (i) certify that the annual and quarterly reports filed with the Securities and Exchange Commission are accurate and (ii) acknowledge that they are responsible for establishing, maintaining and periodically evaluating the effectiveness of the disclosure controls and procedures. Section 404 of SOX requires management to (i) report on internal control over financial reporting, (ii) assess the effectiveness of such internal controls, and (iii) obtain an external auditor's report on management's assessment of its internal control.

The Company is not an accelerated filer as defined in Rule 12b-2 of the Securities Exchange Act of 1934. On October 2, 2009, the SEC issued a final extension of SOX 404(b) for non-accelerated filers, which would have required them to first comply with the provisions of Section 404(b) of SOX with respect to fiscal years ending on or after June 15, 2010. Section 404(b) of SOX requires a registrant to provide an attestation report on management's assessment of internal controls over financial reporting by the registrant's external auditor.

Therefore, the Company would have been required to obtain an external auditor's attestation report on internal control over financial reporting for the fiscal year ended December 31, 2010. However, on July 21, 2010, President Obama signed the Dodd-Frank Act into law. The Dodd-Frank Act includes a provision which permanently exempts non-accelerated filers, including the Company, from the requirement to obtain an external audit on the effectiveness of internal financial reporting controls provided in Section 404(b) of SOX. Disclosure of management's attestations on internal control over financial reporting under Section 404(a) of SOX is still required. See the Section of this Report entitled "Business - The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010."

The Committee of Sponsoring Organizations (COSO) methodology may be used to document and test the internal controls pertaining to the accuracy of Company issued financial statements and related disclosures. COSO requires a review of the control environment (including anti-fraud and audit committee effectiveness), risk assessment, control activities, information and communication, and ongoing monitoring.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Executive Summary

We are a Delaware corporation organized in March 1979, and a bank holding company registered under the Bank Holding Company Act of 1956. We acquired The Berkshire Bank (the "Bank"), our indirect wholly-owned subsidiary in March 1999. The Bank was organized in 1987 as a New York State chartered commercial bank. Our principal activity is the ownership and management of the Bank. Our activities are primarily funded by cash on hand, rental income, income from our portfolio of investment securities and dividends, if any, received from the Bank. Our common stock is traded on the NASDAQ Stock Market under the symbol "BERK."

The Bank's principal business consists of gathering deposits from the general public and investing those deposits together with funds generated from ongoing operations and borrowings, primarily in residential and commercial loans, debt obligations issued by the U.S. Government and its agencies, debt obligations of business corporations, and mortgage-backed securities. The Bank operates from seven deposit-taking offices in New York City, four deposit-taking offices in Orange and Sullivan Counties, New York, and one deposit-taking office in Teaneck, New Jersey. The Bank's revenues are derived principally from interest on loans, and interest and dividends on investments in the securities portfolio. The Bank's primary regulator is the New York State Banking Department. Deposits are insured to the maximum allowable amount by the Federal Deposit Insurance Corporation. The Bank is a member of the Federal Home Loan Bank system.

Our results of operations depend primarily on net interest income, which is the difference between the income earned on our interest-earning assets and the cost of our interest-bearing liabilities. Net interest income is the result of our interest rate margin, which is the difference between the average yield earned on interest-earning assets and the average cost of interest-bearing liabilities, adjusted for the difference in the average balance of interest-earning assets as compared to the average balance of interest-bearing liabilities. We also generate non-interest income from loan fees, service charges on deposit accounts, mortgage servicing fees, and other fees, dividends on Federal Home Loan Bank of New York ("FHLB-NY") stock and net gains and losses on sales of securities and loans. Our operating expenses consist principally of employee compensation and benefits, occupancy and equipment costs, other general and administrative expenses and income tax expense. Our results of operations also can be significantly affected by our periodic provision for loan losses and specific provision for losses on loans.

On July 21, 2010 the Dodd-Frank Act was signed into law by President Obama. The Dodd-Frank Act represents a comprehensive overhaul of the financial services industry within the United States, establishes a new federal Bureau, and will require the Bureau and other federal agencies to implement many new and significant rules and regulations. At this time, it is difficult to predict the extent to which the Dodd-Frank Act or the resulting rules and regulations will impact our business. Compliance with these new laws and regulations will likely result in additional costs, and may adversely impact our results of operations, financial condition or liquidity.

Our investment policy, approved by the Board of Directors, is designed primarily to manage the interest rate sensitivity of our overall assets and liabilities, to generate a favorable return without incurring undue interest rate and credit risk, to complement our lending activities and to provide and maintain liquidity. In establishing our investment strategies, we consider our business and growth strategies, the economic environment, out interest rate risk exposure, our interest rate sensitivity "gap" position, the types of securities to be held, and other factors. We classify our investment securities as available for sale.

We recorded a provision for loan losses of $0 and $1.6 million during the three and nine-month periods ended September 30, 2011, respectively, compared to a provision for loan losses of $1.5 million and $4.3 million during the three and nine-month periods ended September 30, 2010, respectively. The decrease in the provision for loan losses was deemed appropriate as a result of the regular quarterly analysis of the allowance for loan losses. The regular quarterly analysis is based on management's evaluation of the risk inherent in the various components of the loan portfolio and other factors, including historical loan loss experience (which is updated at least annually), changes in the composition and volume of the portfolio, collection policies and experience, trends in the volume of non-accrual loans and regional and national economic conditions. See "Provision for Loan Losses" below in this Item 2 for further discussion of the allowance for loan losses.

On May 16, 2011, we entered into a settlement agreement with the selling financial institution of the auction rate securities in the Bank's investment portfolio. Pursuant to the agreement, in settlement of all claims made by the Bank, the institution paid to the Bank the sum of $42.5 million, which is recorded in other income on the Statement of Operations.

During the nine months ended September 30, 2010, we recorded a $1.2 million other than temporary impairment ("OTTI") charge on two auction rate securities which had Freddie Mac preferred shares as the underlying collateral. The OTTI charge was deemed appropriate due to the significant decline in the price of the Freddie Mac shares with little expectation of recovery in the near term. No such OTTI charges were recorded during the nine months ended September 30, 2011, during which time we sold the Freddie Mac securities and realized a gain of $2.8 million which has been recorded in our Statement of Operations.

Net income, before dividends on our Series A Preferred Stock and before the provision for income taxes, for the three and nine months ended September 30, 2011 was $3.3 million and $49.6 million, respectively, compared to net income before dividends on our Series A Preferred Stock and before the provision for income taxes, of $240,000 and $2.9 million for the three and nine months ended September 30, 2010. Net income allocated to common stockholders, after dividends on our Series A Preferred Stock and provision for income taxes, was $1.8 million and $43.6 million for the three and nine months ended September 30, 2011, respectively, compared to net income allocated to common stockholders, after dividends on our Series A Preferred Stock and benefit from income taxes,of $431,000 for the three months ended September 30, 2010 and a net loss allocated to common stockholders, after dividends on our Series A Preferred Stock and benefit from income taxes, of $190,000 for the nine months ended September 30, 2010.

The following discussion and analysis is intended to provide a better understanding of the consolidated financial condition and results of operations of Berkshire Bancorp Inc. and subsidiaries. All references to earnings per share, unless stated otherwise, refer to earnings per diluted share. References to Notes herein are references to the "Notes to Consolidated Financial Statements" of the Company located in Item 1 herein.

Critical Accounting Policies, Judgments and Estimates

The accounting and reporting policies of the Company conform with accounting principles generally accepted in the United States of America ("GAAP") and general practices within the financial services industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

The Company considers that the determination of the allowance for loan losses involves a higher degree of judgment and complexity than any of its other significant accounting policies. The allowance for loan losses is calculated with the objective of maintaining a reserve level believed by management to be sufficient to absorb estimated credit losses. Management's determination of the adequacy of the allowance is based on periodic evaluations of the loan portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires material estimates, including, among others, expected default probabilities, loss given default, the amounts and timing of expected future cash flows on impaired loans, mortgages, and general amounts for historical loss experience. The process also considers economic conditions, uncertainties in estimating losses and inherent risks in the loan portfolio. All of these factors may be susceptible to significant change. To the extent actual outcomes differ from management estimates, additional provisions for loan losses may be required that would adversely impact earnings in future periods. See "Provision for Loan Losses" below in this Item 2 for further discussion of the allowance for loan losses.

The Company recognizes deferred tax assets and liabilities for the future tax effects of temporary differences, net operating loss carryforwards and tax credits. Deferred tax assets are subject to management's judgment based upon available evidence that future realization is more likely than not. If management determines that the Company may be unable to realize all or part of net deferred tax assets in the future, a direct charge to income tax expense may be required to reduce the recorded value of the net deferred tax asset to the expected realizable amount.

The Company conducts a periodic review and evaluation of its securities portfolio, taking into account the severity and duration of each unrealized loss, as well as management's intent and ability to hold the security until the unrealized loss is substantially eliminated, in order to determine if a decline in market value of any security below its carrying value is either temporary or other than temporary. Unrealized losses on held-to-maturity securities that are deemed temporary are disclosed but not recognized. Unrealized losses on debt or equity securities available-for-sale that are deemed temporary are excluded from net income and reported net of deferred taxes as other comprehensive income or loss. All unrealized losses that are deemed other than temporary on either available-for-sale or held-to-maturity securities are recognized immediately as a reduction of the carrying amount of the security, with a charge recorded in the Company's consolidated statements of operations.

The following table presents the total dollar amount of interest income from average interest-earning assets and the resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed in both dollars and rates.

	For The Three Months Ended September 30, 2011				2010			
	Average Balance	Interest and Dividends	Average Yield/Rate		Average Balance	Interest and Dividends	Average Yield/Rate	
	(Dollars in Thousands)							
INTEREST-EARNING ASSETS:								
Loans (1)	$332,246	$ 5,229	6.30	%	$379,983	$ 6,295	6.63	%
Investment securities	418,746	3,240	3.09		354,049	3,542	4.00	
Other (2)(5)	108,682	65	0.24		64,543	41	0.25	
Total interest-earning assets	859,674	8,534	3.97		798,575	9,878	4.95	
Noninterest-earning assets	29,937				59,125			
Total Assets	$889,611				$857,700			
INTEREST-BEARING LIABILITIES:								
Interest bearing deposits	219,882	236	0.43	%	222,710	333	0.60	%
Time deposits	377,837	1,267	1.34		392,832	1,415	1.44	
Other borrowings	80,437	721	3.59		84,918	790	3.72	
Total interest-bearing liabilities	678,156	2,224	1.31		700,460	2,538	1.45	
Demand deposits	78,270				70,865			
Noninterest-bearing liabilities	11,751				7,603			
Stockholders' equity (5)	121,434				78,772			
Total liabilities and stockholders' equity	$889,611				$857,700			
Net interest income		$ 6,310				$ 7,340		
Interest-rate spread (3)			2.66	%			3.50	%
Net interest margin (4)			2.94	%			3.68	%
Ratio of average interest-earning assets to average interest bearing liabilities	1.27				1.14			

(1) Includes nonaccrual loans.
(2) Includes interest-bearing deposits, federal funds sold and securities purchased under agreements to resell.
(3) Interest-rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest bearing liabilities.
(4) Net interest margin is net interest income as a percentage of average interest-earning assets.
(5) Average balances are daily average balances except for the parent company which have been calculated on a monthly basis.

39

	For The Nine Months Ended September 30, 2011				2010			
	Average Balance	Interest and Dividends	Average Yield/Rate		Average Balance	Interest and Dividends	Average Yield/Rate	
			(Dollars in Thousands)					
INTEREST-EARNING ASSETS:								
Loans (1)	$343,668	$ 16,406	6.37	%	$397,356	$ 19,301	6.48	%
Investment securities	390,962	9,901	3.38		361,229	11,062	4.08	
Other (2)(5)	93,964	199	0.28		68,364	157	0.30	
Total interest-earning assets	828,594	26,506	4.27		826,949	30,520	4.92	
Noninterest-earning assets	30,799				59,838			
Total Assets	$859,393				$886,787			
INTEREST-BEARING LIABILITIES:								
Interest bearing deposits	213,552	754	0.47	%	226,120	1,237	0.73	%
Time deposits	383,221	3,858	1.34		404,980	4,724	1.56	
Other borrowings	81,567	2,227	3.64		93,399	2,729	3.90	
Total interest-bearing liabilities	678,340	6,839	1.34		724,499	8,690	1.60	
Demand deposits	78,306				69,545			
Noninterest-bearing liabilities	7,970				7,940			
Stockholders' equity (5)	94,777				84,803			
Total liabilities and stockholders' equity	$859,393				$886,787			
Net interest income		$ 19,667				$ 21,830		
Interest-rate spread (3)			2.93	%			3.32	%
Net interest margin (4)			3.16	%			3.52	%
Ratio of average interest-earning assets to average interest bearing liabilities	1.22				1.14			

(1) Includes nonaccrual loans.
(2) Includes interest-bearing deposits, federal funds sold and securities purchased under agreements to resell.
(3) Interest-rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest bearing liabilities.
(4) Net interest margin is net interest income as a percentage of average interest-earning assets.
(5) Average balances are daily average balances except for the parent company which have been calculated on a monthly basis.

Results of Operations

Results of Operations for the Three and Nine Months Ended September 30, 2011 Compared to the Three and Nine Months Ended September 30, 2010.

Net Income (Loss) Allocated to Common Stockholders. Net income allocated to common stockholders for the three and nine-month periods ended September 30, 2011 was $1.8 million and $43.6 million, respectively, or $.25 and $6.18 per common share, respectively. Net income allocated to common stockholders for the three-month period ended September 30, 2010 was $431,000, or $.06 per common share. Net loss allocated to common stockholders for the nine-month period ended September 30, 2010 was $190,000, or $.03 per common share. The net income allocated to common stockholders reported for the three months ended September 30, 2011 includes (i) dividends accrued on our Series A Preferred Stock of $1.2 million, or $.17 per common share and (ii) provision for income taxes of $281,000, or $.04 per common share. The net income allocated to common stockholders reported for the nine months ended September 30, 2011 includes (i) dividends accrued on our Series A Preferred Stock of $3.6 million, or $.51 per common share, (ii) a provision for income taxes of $2.4 million, or $.34 per common share, and (iii) a one-time settlement payment of $42.5 million, or $6.02 per common share.

The net income allocated to common stockholders reported for the three months ended September 30, 2010 includes (i) dividends accrued on our Series A Preferred Stock of $1.2 million, or $.17 per common share, and (ii) income tax benefit of $1.4 million, or $.20 per common share. The net loss allocated to common stockholders for the nine months ended September 30, 2010 includes (i) OTTI charges of $1.2 million, or $.17 per common share, (ii) dividends accrued on our Series A Preferred Stock of $3.6 million, or $.51 per common share, and (iii) income tax benefit of $476,000, or $.07 per common share.

The Company's net income is largely dependent on interest rate levels, the demand for the Company's loan and deposit products and the strategies employed to manage the interest rate and other risks inherent in the banking business.

Net Interest Income. The Company's primary source of revenue is net interest income, or the difference between interest income earned on earning-assets, such as loans and investment securities, and interest expense on interest-bearing liabilities such as deposits and borrowings. The amount of interest income is dependent upon many factors including: (i) the amount of interest-earning assets that the Company can maintain based upon its funding sources; (ii) the relative amounts of interest-earning assets versus interest-bearing liabilities; and (iii) the difference between the yields earned on those assets and the rates paid on those liabilities. Non-performing loans adversely affect net interest income because they must still be funded by interest-bearing liabilities, but they do not provide interest income. Furthermore, when we designate an asset as non-performing, all interest which has been accrued but not actually received is deducted from current period income, further reducing net interest income.

For the three and nine months ended September 30, 2011, net interest income was $6.3 million and $19.7 million, respectively, compared to net interest income of $7.3 million and $21.8 million for the three and nine months ended September 30, 2010. The decrease in net interest income was primarily due to the decrease in the average yields earned on interest-earning assets during the three and nine months ended September 30, 2011, partially offset by the increase in the average amounts of interest-earning assets and the decrease in the average amounts and the average rates paid on interest-bearing liabilities.

The average yields earned on interest-earning assets declined to 3.97% and 4.27% during the three and nine months ended September 30, 2011, respectively, from 4.95% and 4.92% during the three and nine months ended September 30, 2010, respectively. The average rates paid on interest-bearing liabilities declined to 1.31% and 1.34% during the three and nine months ended September 30, 2011, respectively, from 1.45% and 1.60% during the three and nine months ended September 30, 2010, respectively. The Company's interest-rate spread, the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities, decline to 2.66% and 2.93% during the three and nine months September 30, 2011, respectively, from 3.50% and 3.32% during the three and nine months ended September 30, 2010, respectively.

Net Interest Margin. Net interest margin, or annualized net interest income as a percentage of average interest-earning assets, was 2.94% and 3.16% for the three and nine months ended September 30, 2011, respectively, compared to 3.68% and 3.52% during the three and nine months ended September 30, 2010. We seek to secure and retain customer deposits with competitive products and rates, while making strategic use of the prevailing interest rate environment to borrow funds at what we believe to be attractive rates. We invest such deposits and borrowed funds in a prudent mix of fixed and adjustable rate loans, investment securities and short-term interest-earning assets. The decrease in net interest margin is primarily due to the decrease in the average amounts of higher yielding loans as a percentage of the total mix of interest-earning assets.

Interest Income. Total interest income for the quarter ended September 30, 2011 decreased by $1.4 million to $8.5 million from $9.9 million for the quarter ended September 30, 2010. The decrease in total interest income was due to the decrease in the average yield earned on the average amount of interest-earning assets to 3.97% during the 2011 quarter from 4.95% during the 2009 quarter, and the decrease in the average amount of higher yielding loans to $332.2 million during the 2011 quarter from $380.0 million during the 2010 quarter, partially offset by the increase in the average amount of interest-earning assets

Total interest income for the nine months ended September 30, 2011 decreased by $4.0 million to $26.5 million from $30.5 million for the nine months ended September 30, 2010. The decrease in total interest income was due to the decrease in the average yield earned on the average amount of interest-earning assets to 4.27% during the nine-month period of 2011 from 4.92% during the nine-month period of 2010 and the decrease in the average amount of higher yielding loans to $343.7 million during the nine-month period of 2011 from $397.4 million during the nine-month period of 2010.

The following tables present the composition of interest income for the indicated periods:

	Three Months Ended September 30,			
	2011		2010	
	Interest Income	% of Total	Interest Income	% of Total
	(In thousands, except percentages)			
Loans	$ 5,229	61.27 %	$ 6,295	63.72 %
Investment Securities	3,240	37.97	3,542	35.86
Other	65	0.76	41	0.42
Total Interest Income	$ 8,534	100.00 %	$ 9,878	100.00 %

	Nine Months Ended September 30,			
	2011		2010	
	Interest Income	% of Total	Interest Income	% of Total
	(In thousands, except percentages)			
Loans	$ 16,406	61.90 %	$ 19,301	63.24 %
Investment Securities	9,901	37.35	11,062	36.25
Other	199	0.75	157	0.51
Total Interest Income	$ 26,506	100.00%	$ 30,520	100.00%

Loans, which are inherently risky and therefore command a higher return than our portfolio of investment securities and other interest-earning assets, decreased to 38.6% and 41.5% of total average interest-earning assets during the three and nine months ended September 30, 2010, respectively, from 47.6% and 48.1% of total interest-earning assets during the three and nine months ended September 30, 2010, respectively. The average amounts of investment securities increased to 48.7% and 47.2% of total average interest-earning assets during the three and nine months ended September 30, 2011, respectively, from 44.3% and 43.7% of total interest-earning assets during the three and nine months ended September 30, 2010, respectively. While we actively seek to originate new loans with qualified borrowers who meet the Bank's underwriting standards, our strategy has been to maintain those standards, sacrificing some current income to avoid possible large future losses in the loan portfolio.

At September 30, 2011 and 2010, total non-performing loans were $6.3 million and $2.0 million, respectively, all of which were non-accrual loans. Additions to non-performing loans, were such additions to occur, would have an adverse effect on our results of operations.

Federal Home Loan Bank Stock. The Bank owns stock of the Federal Home Loan Bank New York ("FHLB-NY") which is necessary for it to be a member of the FHLB-NY. Membership requires the purchase of stock equal to 1% of the Bank's residential mortgage loans or 5% of the outstanding borrowings, whichever is greater. The stock is redeemable at par, therefore, its cost is equivalent to its redemption value. The Bank's ability to redeem FHLB-NY shares is dependent upon the redemption practices of the FHLB-NY. At September 30, 2011, the FHLB-NY neither placed restrictions on redemption of shares in excess of a member's required investment in stock, nor stated that it will cease paying dividends. The Bank did not consider this asset impaired at either September 30, 2011 or December 31, 2010.

Interest Expense. Total interest expense for the quarter ended September 30, 2011 decreased by $300,000 to $2.2 million from $2.5 million for the quarter ended September 30, 2010. The decrease in interest expense was due to the decrease in the average amounts of interest-bearing liabilities to $678.2 million from $700.5 million during the three months ended September 30, 2011 and 2010, respectively, and the decrease in the average rates paid on interest-bearing liabilities to 1.31% during the 2011 quarter from 1.45% during the 2010 quarter.

Total interest expense for the nine-month period ended September 30, 2011 decreased by $1.9 million to $6.8 million from $8.7 million for the nine-month period ended September 30, 2010. The decrease in interest expense was due to the decrease in the average amounts of interest-bearing liabilities to $678.3 million and $724.5 million during the nine-month periods ended September 30, 2011 and 2010, respectively, and the decrease in the average rates paid on such liabilities to 1.34% from 1.60% during the nine-month periods ended September 30, 2011 and 2010, respectively.

The following tables present the components of interest expense as of the dates indicated:

	Three Months Ended September 30,			
	2011		2010	
	Interest Expense	% of Total	Interest Expense	% of Total
	(In thousands, except percentages)			
Interest-Bearing Deposits	$ 236	10.61 %	$ 333	13.12 %
Time Deposits	1,267	56.97	1,415	55.75
Other Borrowings	721	32.42	790	31.13
Total Interest Expense	$ 2,224	100.00 %	$ 2,538	100.00 %

	Nine Months Ended September 30,			
	2011		2010	
	Interest Expense	% of Total	Interest Expense	% of Total
	(In thousands, except percentages)			
Interest-Bearing Deposits	$ 754	11.03 %	$ 1,237	14.23 %
Time Deposits	3,858	56.41	4,724	54.37
Other Borrowings	2,227	32.56	2,729	31.40
Total Interest Expense	$ 6,839	100.00 %	$ 8,690	100.00 %

Non-Interest Income. Non-interest income consists primarily of realized gains on sales of marketable securities and service fee income. In May 2011, we entered into a settlement agreement with the selling financial institution of the auction rate securities in the Bank's investment portfolio. Pursuant to the agreement, the institution paid to the Bank the sum of $42.5 million. This amount has been included in other non-interest income. For the three and nine months ended September 30, 2011, non-interest income amounted to $1.3 million and $44.6 million, or $2.1 million excluding the $42.5 million settlement, respectively, compared to non-interest income of $306,000 and $1.4 million for the three and nine months ended September 30, 2010, respectively.

Non-Interest Expense. Non-interest expense includes salaries and employee benefits, occupancy and equipment expenses, legal and professional fees, OTTI charges on investment securities and other operating expenses associated with the day-to-day operations of the Company. Total non-interest expense decreased by $1.6 million to $4.3 million for the quarter ended September 30, 2011 from $5.9 million for the quarter ended September 30, 2010. The decrease was primarily due to the decrease in other non-interest expenses.

Total non-interest expense decreased by $2.9 million to $13.1 million for the nine months ended September 30, 2011 from $16.0 million for nine months ended September 30, 2010. The decrease was primarily due to the absence of OTTI charges on investment securities in 2011 compared to the $1.2 million OTTI charge on investment securities recorded in 2010 and the $1.5 million decrease in other non-interest expense during the nine months ended September 30, 2011.

The following tables present the components of non-interest expense as of the dates indicated:

	Three Months Ended September 30,			
	2011		2010	
	Non-Interest Expense	% of Total	Non-Interest Expense	% of Total
	(In thousands, except percentages)			
Salaries and Employee Benefits	$ 2,243	51.66 %	$ 2,388	40.43 %
Net Occupancy Expense	921	21.21	534	9.04
Equipment Expense	76	1.75	90	1.52
FDIC Assessment	300	6.91	438	7.42
Data Processing Expense	74	1.70	124	2.10
Other	728	16.77	2,332	39.49
Total Non-Interest Expense	$ 4,342	100.00 %	$ 5,906	100.00 %

	Nine Months Ended September 30,			
	2011		2010	
	Non-Interest Expense	% of Total	Non-Interest Expense	% of Total
	(In thousands, except percentages)			
Salaries and Employee Benefits	$ 7,077	54.18 %	$ 7,136	44.50 %
Net Occupancy Expense	1,986	15.21	1,647	10.27
Equipment Expense	236	1.81	273	1.70
FDIC Assessment	952	7.29	1,374	8.57
Data Processing Expense	335	2.56	376	2.34
Other than temporary impairment charge on securities	—	0.00	1,202	7.50
Other	2,475	18.95	4,028	25.12
Total Non-Interest Expense	$ 13,061	100.00 %	$ 16,036	100.00 %

Provision for Income Tax. During the three and nine-month periods ended September 30, 2011, the Company recorded income tax expense of $281,000 and $2.4 million, respectively. In May 2011, the Company received a taxable settlement of $42.5 million and offset this amount by sales of securities that previously had significant OTTI charges. These sales created a net taxable loss position for the nine months ended September 30, 2011 and therefore increased the Company's net operating loss carryforwards which may be used to offset current federal tax expense. The tax expense recorded in 2011 mainly relates to changes in deferred taxes.

During the three and nine-month periods ended September 30, 2010 the Company recorded a benefit for income taxes of $1.4 million and $476,000, respectively. During the three and nine-month periods ended September 30, 2010, the Company recorded tax benefits related to certain deferred tax items mainly related to provisions for loan losses which are deferred for tax purposes.

Issuer Purchases of Equity Securities

On May 15, 2003, The Company's Board of Directors authorized the purchase of up to an additional 450,000 shares of its Common Stock in the open market, from time to time, depending upon prevailing market conditions, thereby increasing the maximum number of shares which may be purchased by the Company from 1,950,000 shares of Common Stock to 2,400,000 shares of Common Stock. Since 1990 through September 30, 2011, the Company has purchased a total of 1,898,909 shares of its Common Stock. We did not repurchase shares of the Company's Common Stock during the first three quarters of 2011. At September 30, 2011, there were 501,091 shares of Common Stock which may yet be purchased under our stock repurchase plan.

Provision for Loan Losses. The allowance for loan losses is the estimated amount considered necessary to cover credit losses inherent in the loan portfolio at the balance sheet date. The allowance is established through the provision for loan losses that is charged against income. In determining the allowance for loan losses, management makes significant estimates which involve a high degree of judgment, subjectivity of the assumptions utilized, and potential for changes in the economic environment that could result in changes to the amount of the recorded allowance for loan losses.

The allowance for loan losses has been determined in accordance with U.S. GAAP, principally FASB ASC 450, "Contingencies", ("ASC 450") and FASB ASC 310, "Receivables", ("ASC 310"). Under the above accounting principles, we are required to maintain an allowance for probable losses at the balance sheet date. We are responsible for the timely and periodic determination of the amount of the allowance required. Management believes that the allowance for loan losses is adequate to cover specifically identifiable losses, as well as estimated losses inherent in our portfolio for which certain losses are probable but not specifically identifiable.

Management performs a monthly evaluation of the adequacy of the allowance for loan losses. The analysis of the allowance for loan losses has two components: specific and general reserves. Specific reserves are made for loans determined to be impaired. Impairment is measured by determining the present value of expected future cash flows or, as a practical expedient for collateral-dependent loans, the fair value of the collateral adjusted for market conditions and selling expenses. The Bank considers its investment in one-to-four family real estate loans and consumer loans to be smaller balance homogeneous loans and therefore excluded from separate identification for evaluation of impairment. These homogeneous loan groups are evaluated for impairment on a collective basis under FASB ASC 310.

The general reserve is determined by segregating the remaining loans by type of loan, risk weighting (if applicable) and payment history. Management also analyzes historical loss experience, delinquency trends, general economic conditions, geographic concentrations, and industry and peer comparisons. This analysis establishes factors that are applied to the loan segments to determine the amount of the general reserves. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revisions based upon changes in economic and real estate market conditions. Actual loan losses may be significantly more than the allowance for loan losses management has established which could have a material negative effect on the Company's financial results.

On a monthly basis, the Bank's management committee reviews the current status of various loan assets in order to evaluate the adequacy of the allowance for loan losses. In this evaluation process, specific loans are analyzed to determine their potential risk of loss. This process includes all loans, concentrating on non-accrual and classified loans. Each non-accrual or classified loan is evaluated for potential loss exposure. Any shortfall results in a recommendation of a specific allowance if the likelihood of loss is evaluated as probable. To determine the adequacy of collateral on a particular loan, an estimate of the fair market value of the collateral is based on the most current appraised value available. This appraised value is then reduced to reflect estimated liquidation expenses.

As a substantial amount of our loan portfolio is collateralized by real estate, appraisals of the underlying value of property securing loans are critical in determining the amount of the allowance required for specific loans. Assumptions for appraisal valuations are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly impact the valuation of a property securing a loan and the related allowance determined. The assumptions supporting such appraisals are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable on the related loans. Based on the composition of our loan portfolio, management believes the primary risks are increases in interest rates, a decline in the economy, generally, and a decline in real estate market values in the New York metropolitan area. Any one or combination of these events may adversely affect our loan portfolio resulting in increased delinquencies, loan losses and future levels of loan loss provisions. Management believes the allowance for loan losses reflects the inherent credit risk in our portfolio, the level of our non-performing loans and our charge-off experience.

A loan is considered nonperforming when it becomes delinquent ninety days or when other adverse factors become known to us. We generally order updated appraisals from independent third party licensed appraisers at the time the loan is identified as nonperforming. Depending upon the property type, we receive appraisals within thirty to ninety days from the date the appraisals are ordered. Upon receipt of the appraisal, which is discounted by us to take account of estimated selling and other holding costs, we compare the adjusted appraisal amount to the carrying amount of the real estate dependent loan and record any impairment through the allowance for loan loss at that time.

The majority of our real estate dependent loans are concentrated in the New York City metropolitan area, we do not make adjustments to the appraisals for this concentration. We do not increase the appraised value of any property. Any adjustments we make to the appraisals are to decrease the appraised value due to selling and other holding costs.

Although management believes that we have established and maintained the allowance for loan losses at adequate levels, additions may be necessary if future economic and other conditions differ substantially from the current operating environment. Although management uses what it believes is the best information available, the level of the allowance for loan losses remains an estimate that is subject to significant judgment and short-term change. In addition, the Federal Deposit Insurance Corporation, New York State Banking Department, and other regulatory bodies, as an integral part of their examination process, will periodically review our allowance for loan losses. Such agencies may require us to recognize adjustments to the allowance based on its judgments about information available to them at the time of their examination.

The following table sets forth information with respect to activity in the Company's allowance for loan losses during the periods indicated (in thousands, except percentages):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Average loans outstanding	$ 332,246	$ 379,983	$ 343,668	$ 397,356
Allowance at beginning of period	17,730	13,105	16,105	11,416
Charge-offs:				
Commercial and other loans	—	—	2	300
Real estate loans	—	—	—	766
Total loans charged-off	—	—	2	1,066
Recoveries:				
Commercial and other loans	—	—	27	5
Real estate loans	—	—	—	—
Total loans recovered	—	—	27	5
Net recoveries (charge-offs)	—	—	25	(1,061)
Provision for loan losses charged to operating expenses	—	1,500	1,600	4,250
Allowance at end of period	17,730	14,605	17,730	14,605
Ratio of net recoveries (charge-offs) to average loans outstanding	0.00 %	0.00 %	0.01 %	(0.27)%
Allowance as a percent of total loans	5.34 %	3.88 %	5.34 %	2.43 %
Total loans at end of period	$ 331,853	$ 376,874	$ 331,853	$ 376,874

Loan Portfolio.

Loan Portfolio Composition. The Company's loans consist primarily of mortgage loans secured by residential and non-residential properties as well as commercial loans which are either unsecured or secured by personal property collateral. Most of the Company's loans are either made to individuals or personally guaranteed by the principals of the business to which the loan is made. At September 30, 2011 and December 31, 2010, the Company had loans, net of unearned income, of $331.0 million and $366.3 million, respectively, and an allowance for loan losses of $17.7 million and $16.1 million, respectively. From time to time, the Bank may originate residential mortgage loans, sell them on the secondary market, normally recognizing fee income in connection with the sale.

Interest rates on loans are affected by the demand for loans, the supply of money available for lending, credit risks, the rates offered by competitors and other conditions. These factors are in turn affected by, among other things, economic conditions, monetary policies of the federal government, and legislative tax policies.

In order to manage interest rate risk, the Bank focuses its efforts on loans with interest rates that adjust based upon changes in the prime rate or changes in United States Treasury or similar indices. Generally, credit risks on adjustable-rate loans are somewhat greater than on fixed-rate loans primarily because, as interest rates rise, so do borrowers' payments, increasing the potential for default. The Bank seeks to impose appropriate loan underwriting standards in order to protect against these and other credit related risks associated with its lending operations.

In addition to analyzing the income and assets of its borrowers when underwriting a loan, the Bank obtains independent appraisals on all material real estate in which the Bank takes a mortgage. The Bank generally obtains title insurance in order to protect against title defects on mortgaged property.

Commercial Mortgage Loans. The Bank originates commercial mortgage loans secured by office buildings, retail establishments, multi-family residential real estate and other types of commercial property. Substantially all of the properties are located in the New York City metropolitan area.

The Bank generally makes commercial mortgage loans with loan to value ratios not to exceed 75% and with terms to maturity that do not exceed 15 years. Loans secured by commercial properties generally involve a greater degree of risk than one-to four-family residential mortgage loans. Because payments on such loans are often dependent on successful operation or management of the properties, repayment may be subject, to a greater extent, to adverse conditions in the real estate market or the economy. The Bank seeks to minimize these risks through its underwriting policies. The Bank evaluates the qualifications and financial condition of the borrower, including credit history, profitability and expertise, as well as the value and condition of the underlying property. The factors considered by the Bank include net operating income; the debt coverage ratio (the ratio of cash net income to debt service); and the loan to value ratio. When evaluating the borrower, the Bank considers the financial resources and income level of the borrower, the borrower's experience in owning or managing similar property and the Bank's lending experience with the borrower. The Bank's policy requires borrowers to present evidence of the ability to repay the loan without having to resort to the sale of the mortgaged property. The Bank also seeks to focus its commercial mortgage loans on loans to companies with operating businesses, rather than passive real estate investors.

Commercial Loans. The Bank makes commercial loans to businesses for inventory financing, working capital, machinery and equipment purchases, expansion, and other business purposes. These loans generally have higher yields than mortgage loans, with maturities of one year, after which the borrower's financial condition and the terms of the loan are re-evaluated. At September 30, 2011 and December 31, 2010, $21.1 million and $19.3 million, respectively, or 6.4% and 5.3%, respectively, of the Company's total loan portfolio consisted of such loans.

Commercial loans tend to present greater risks than mortgage loans because the collateral, if any, tends to be rapidly depreciable, difficult to sell at full value and is often easier to conceal. In order to limit these risks, the Bank evaluates these loans based upon the borrower's ability to repay the loan from ongoing operations. The Bank considers the business history of the borrower and perceived stability of the business as important factors when considering applications for such loans. Occasionally, the borrower provides commercial or residential real estate collateral for such loans, in which case the value of the collateral may be a significant factor in the loan approval process.

Residential Mortgage Loans (1 to 4 family loans). The Bank makes residential mortgage loans secured by first liens on one-to-four family owner-occupied or rental residential real estate. At September 30, 2011 and December 31, 2010, $108.0 million and $114.6 million, respectively, or 32.5% and 31.2%, respectively, of the Company's total loan portfolio consisted of such loans. The Bank offers both adjustable rate mortgages ("ARMS") and fixed-rate mortgage loans. The relative proportion of fixed-rate loans versus ARMs originated by the Bank depends principally upon current customer preference, which is generally driven by economic and interest rate conditions and the pricing offered by the Bank's competitors. At September 30, 2011, 14% of the Bank's residential one-to-four family owner-occupied first mortgage portfolio were ARMs and 86% were fixed-rate loans. At December 31, 2010, approximately 14% of the Bank's residential one-to-four family owner-occupied first mortgage portfolio were ARMs and 86% were fixed-rate loans. The percentage represented by fixed-rate loans tends to increase during periods of low interest rates. The ARMs generally carry annual caps and life-of-loan ceilings, which limit interest rate adjustments.

The Bank's residential loan underwriting criteria are generally comparable to those required by Fannie Mae and other major secondary market loan purchasers. Generally, ARM credit risks are somewhat greater than fixed-rate loans primarily because, as interest rates rise, the borrowers' payments rise, increasing the potential for default. The Bank's teaser rate ARMs (ARMs with low initial interest rates that are not based upon the index plus the margin for determining future rate adjustments) were underwritten based on the payment due at the fully-indexed rate.

In addition to verifying income and assets of borrowers, the Bank obtains independent appraisals on all residential first mortgage loans and title insurance is required at closing. Private mortgage insurance is required on all loans with a loan-to-value ratio in excess of 80% and the Bank requires real estate tax escrows on such loans. Real estate tax escrows are voluntary on residential mortgage loans with loan-to-value ratios of 80% or less.

Fixed-rate residential mortgage loans are generally originated by the Bank for terms of 15 to 30 years. Although 30 year fixed-rate mortgage loans may adversely affect our net interest income in periods of rising interest rates, the Bank originates such loans to satisfy customer demand. Such loans are generally originated at initial interest rates which exceed the fully indexed rate on ARMs offered at the same time. Fixed-rate residential mortgage loans originated by the Bank generally include due-on-sale clauses, which permit the Bank to demand payment in full if the borrower sells the property without the Bank's consent.

Due-on-sale clauses are an important means of adjusting the rates on the Bank's fixed-rate mortgage loan portfolio, and the Bank will generally exercise its rights under these clauses if necessary to maintain market yields.

ARMs originated in recent years have interest rates that adjust annually based upon the movement of the one year treasury bill constant maturity index, plus a margin of 2.00% to 2.75%. These loans generally have a maximum interest rate adjustment of 2% per year, with a lifetime maximum interest rate adjustment, measured from the initial interest rate, of 5.5% or 6.0%.

The Bank offers a variety of other loan products including residential single family construction loans to persons who intend to occupy the property upon completion of construction, home equity loans secured by junior mortgages on one-to-four family owner-occupied residences, and short-term fixed-rate consumer loans either unsecured or secured by monetary assets such as bank deposits and marketable securities or personal property. At September 30, 2011 and December 31, 2010, $202.8 million and $233.3 million, respectively, or 61.1% and 63.5%, respectively, of the Company's total loan portfolio consisted of such other loan products.

Origination of Loans. Loan originations can be attributed to depositors, retail customers, phone inquiries, advertising, the efforts of the Bank's loan officers, and referrals from other borrowers, real estate brokers and builders. The Bank originates loans primarily through its own efforts, occasionally obtaining loan opportunities as a result of referrals from loan brokers.

At September 30, 2011, the Bank was generally not permitted to make loans to one borrower in excess of approximately $21.1 million, with an additional amount of approximately $14.1 million being permitted if secured by readily marketable collateral. The Bank was also not permitted to make any single loan in an amount in excess of approximately $21.1 million. At September 30, 2011, the Bank was in compliance with these standards.

Delinquency Procedures. When a borrower fails to make a required payment on a loan, the Bank attempts to cause the deficiency to be cured by contacting the borrower. The Bank reviews past due loans on a case by case basis, taking the action it deems appropriate in order to collect the amount owed. Litigation may be necessary if other procedures are not successful. Judicial resolution of a past due loan can be delayed if the borrower files a bankruptcy petition because collection action cannot be continued unless the Bank first obtains relief from the automatic stay provided by the Bankruptcy Code.

If a non-mortgage loan becomes delinquent and satisfactory arrangements for payment cannot be made, the Bank seeks to realize upon any personal property collateral to the extent feasible and collect any remaining amount owed from the borrower through legal proceedings, if necessary.

It is the Bank's policy to discontinue accruing interest on a loan when it is 90 days past due or if management believes that continued interest accruals are unjustified. The Bank may continue interest accruals if a loan is more than 90 days past due if the Bank determines that the nature of the delinquency and the collateral are such that collection of the principal and interest on the loan in full is reasonably assured. When the accrual of interest is discontinued, all accrued but unpaid interest is charged against current period income. Once the accrual of interest is discontinued, the Bank records interest as and when received until the loan is restored to accruing status. If the Bank determines that collection of the loan in full is in reasonable doubt, then amounts received are recorded as a reduction of principal until the loan is returned to accruing status.

Capital Adequacy

Quantitative measures established by regulations to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets, and of Tier I capital to average assets. Management believes that, as of September 30, 2011, the Bank meets all capital adequacy requirements to which it is subject.

As of September 30, 2011, the Bank met all regulatory requirements for classification as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the following table. There are no conditions or events since that date that management believes have changed the Bank's category.