STEWARDSHIP FINANCIAL CORP
Form 10-Q
August 15, 2011

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

FORM 10-Q

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

For the quarterly period ended June 30, 2011

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

For the transition period from _________to_________

Commission file number 0-21855

Stewardship Financial Corporation
(Exact name of registrant as specified in its charter)

New Jersey (State or other jurisdiction of incorporation or organization)	22-3351447 (I.R.S. Employer Identification No.)
630 Godwin Avenue, Midland Park, NJ (Address of principal executive offices)	07432 (Zip Code)

(201) 444-7100
(Registrant’s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by a checkmark 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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (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 oNo x

The number of shares outstanding, net of treasury stock, of the Issuer's Common Stock, no par value, as of August 8, 2011 was 5,855,047.

Stewardship Financial Corporation

INDEX

Index

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

Stewardship Financial Corporation and Subsidiary
Consolidated Statements of Financial Condition
(Unaudited)

	June 30, 2011	December 31, 2010
Assets		
Cash and due from banks	$24,839,000	$19,838,000
Other interest-earning assets	1,027,000	145,000
Cash and cash equivalents	25,866,000	19,983,000
Securities available for sale	145,891,000	138,628,000
Securities held to maturity; estimated fair value of $43,698,000 (2011) and $47,316,000 (2010)	41,426,000	45,394,000
FHLB-NY stock, at cost	2,491,000	2,497,000
Loans, net of allowance for loan losses of $11,230,000 (2011) and $8,490,000 (2010)	457,329,000	443,245,000
Mortgage loans held for sale	-	9,818,000
Premises and equipment, net	6,209,000	6,395,000
Accrued interest receivable	2,803,000	2,806,000
Other real estate owned	275,000	615,000
Bank owned life insurance	9,981,000	9,819,000
Other assets	8,118,000	8,918,000
Total assets	$700,389,000	$688,118,000
Liabilities and stockholders' equity		
Liabilities		
Deposits:		
Noninterest-bearing	$114,518,000	$99,723,000
Interest-bearing	473,900,000	475,880,000
Total deposits	588,418,000	575,603,000
Federal Home Loan Bank of New York Advances	33,000,000	36,000,000
Subordinated debentures	7,217,000	7,217,000
Securities sold under agreements to repurchase	15,791,000	14,642,000
Accrued interest payable	898,000	977,000
Accrued expenses and other liabilities	1,418,000	1,547,000
Total liabilities	646,742,000	635,986,000
Commitments and contingencies	-	-
Stockholders' equity		
Preferred stock, no par value; 2,500,000 shares authorized; 10,000 shares		

issued and outstanding at June 30, 2011 and December 31, 2010		
Liquidation preference of $10,000,000	9,827,000	9,796,000
Common stock, no par value; 10,000,000 shares authorized;		
5,850,558 and 5,847,844 shares issued: 5,850,558 and 5,846,927 shares		
outstanding at June 30, 2011 and December 31, 2010, respectively	40,540,000	40,516,000
Treasury stock, 917 shares outstanding at December 31, 2010	-	(13,000)
Retained earnings	2,161,000	1,959,000
Accumulated other comprehensive income (loss), net	1,119,000	(126,000)
Total stockholders' equity	53,647,000	52,132,000
Total liabilities and stockholders' equity	$700,389,000	$688,118,000

See notes to unaudited consolidated financial statements.

Index

Stewardship Financial Corporation and Subsidiary
Consolidated Statements of Income
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Interest income:				
Loans	$6,666,000	$6,693,000	$13,106,000	$13,567,000
Securities held to maturity				
Taxable	177,000	376,000	360,000	798,000
Non-taxable	221,000	233,000	444,000	464,000
Securities available for sale				
Taxable	878,000	825,000	1,717,000	1,705,000
Non-taxable	52,000	38,000	96,000	87,000
FHLB dividends	30,000	32,000	68,000	69,000
Other interest-earning assets	9,000	4,000	17,000	6,000
Total interest income	8,033,000	8,201,000	15,808,000	16,696,000
Interest expense:				
Deposits	1,280,000	1,729,000	2,569,000	3,549,000
Borrowed money	532,000	549,000	1,069,000	1,045,000
Total interest expense	1,812,000	2,278,000	3,638,000	4,594,000
Net interest income before provision for loan losses	6,221,000	5,923,000	12,170,000	12,102,000
Provision for loan losses	1,915,000	4,705,000	3,590,000	6,255,000
Net interest income after provision for loan losses	4,306,000	1,218,000	8,580,000	5,847,000
Noninterest income:				
Fees and service charges	538,000	503,000	1,049,000	972,000
Bank owned life insurance	81,000	81,000	161,000	167,000
Gain on sales of mortgage loans	186,000	66,000	590,000	121,000
Gain on calls and sales of securities	21,000	474,000	21,000	802,000
Other	117,000	123,000	206,000	196,000
Total noninterest income	943,000	1,247,000	2,027,000	2,258,000
Noninterest expenses:				
Salaries and employee benefits	2,261,000	1,948,000	4,497,000	4,074,000
Occupancy, net	475,000	481,000	1,020,000	970,000
Equipment	238,000	277,000	496,000	586,000
Data processing	338,000	327,000	675,000	652,000
FDIC insurance premium	147,000	237,000	401,000	461,000
Charitable contributions	75,000	(15,000)	175,000	150,000
Other	1,002,000	916,000	1,956,000	1,702,000
Total noninterest expenses	4,536,000	4,171,000	9,220,000	8,595,000
Income (loss) before income tax expense (benefit)	713,000	(1,706,000)	1,387,000	(490,000)
Income tax expense (benefit)	128,000	(641,000)	319,000	(296,000)
Net income (loss)	585,000	(1,065,000)	1,068,000	(194,000)
Dividends on preferred stock and accretion	138,000	138,000	276,000	275,000

Net income (loss) available to common stockholders	$447,000	$(1,203,000)	$792,000	$(469,000)
Basic earnings (loss) per common share	$0.08	$(0.21)	$0.14	$(0.08)
Diluted earnings (loss) per common share	$0.08	$(0.21)	$0.14	$(0.08)
Weighted average number of common shares outstanding	5,850,506	5,842,366	5,850,116	5,841,176
Weighted average number of diluted common shares outstanding	5,850,506	5,842,366	5,850,116	5,841,176

See notes to unaudited consolidated financial statements.

2

Index

Stewardship Financial Corporation and Subsidiary
Consolidated Statement of Changes in Stockholders' Equity
(Unaudited)

Six Months Ended June 30, 2011

	Preferred Stock	Common Stock Shares	Common Stock Amount	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss) Net	Total
Balance -- December 31, 2010	$ 9,796,000	5,846,927	$ 40,516,000	$ 1,959,000	$ (13,000)	$ (126,000)	$ 52,132,000
Cash dividends paid on common stock	-	-	-	(585,000)	-	-	(585,000)
Payment of discount on dividend reinvestment plan	-	-	(10,000)	-	-	-	(10,000)
Cash dividends accrued on preferred stock	-	-	-	(250,000)	-	-	(250,000)
Common stock issued under stock plans	-	3,631	12,000	-	13,000	-	25,000
Stock option compensation expense	-	-	22,000	-	-	-	22,000
Accretion of discount on preferred stock	26,000	-	-	(26,000)	-		-
Amortization of issuance costs	5,000	-	-	(5,000)	-		-
Comprehensive income:							
Net income	-	-	-	1,068,000	-	-	1,068,000
Change in unrealized holding gains on securities available for sale arising during the period (net of taxes of $819,000)	-	-	-	-	-	1,292,000	1,292,000

Reclassification adjustment for gains in net income (net of taxes of $8,000)	-	-	-	-	-	(13,000)	(13,000)
Change in fair value of interest rate swap (net of taxes of $23,000)	-	-	-	-	-	(34,000)	(34,000)
Total comprehensive income							2,313,000
Balance -- June 30, 2011	$ 9,827,000	5,850,558	$ 40,540,000	$ 2,161,000	$ -	$ 1,119,000	$ 53,647,000

Six Months Ended June 30, 2010

	Preferred Stock	Common Stock Shares	Common Stock Amount	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss) Net	Total
Balance -- December 31, 2009	$ 9,736,000	5,834,515	$ 40,415,000	$ 2,922,000	$ -	$ 438,000	$ 53,511,000
Cash dividends paid on common stock	-	-	-	(1,051,000)	-	-	(1,051,000)
Payment of discount on dividend reinvestment plan	-	-	(19,000)	-	-	-	(19,000)
Cash dividends accrued on preferred stock	-	-	-	(250,000)	-	-	(250,000)
Common stock issued under stock plans	-	3,037	24,000	-	-	-	24,000
Stock option compensation expense	-	-	26,000	-	-	-	26,000
Stock options exercised	-	9,376	55,000	-	(43,000)	-	12,000
Accretion of discount on preferred stock	25,000	-	-	(25,000)	-		-

Amortization of issuance costs	5,000	-	-	(5,000)	-		-
Comprehensive income:							
Net loss	-	-	-	(194,000)	-	-	(194,000)
Change in unrealized holding gains on securities available for sale arising during the period (net of taxes of $904,000)	-	-	-	-	-	1,405,000	1,405,000
Reclassification adjustment for gains in net income (net of taxes of $316,000)	-	-	-	-	-	(486,000)	(486,000)
Change in fair value of interest rate swap (net of taxes of $186,000)	-	-	-	-	-	(280,000)	(280,000)
Total comprehensive income							445,000
Balance -- June 30, 2010	$ 9,766,000	5,846,928	$ 40,501,000	$ 1,397,000	$ (43,000)	$ 1,077,000	$ 52,698,000

See notes to unaudited consolidated financial statements.

3

Index

Stewardship Financial Corporation and Subsidiary
Consolidated Statements of Comprehensive Income
(Unaudited)

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Net income (loss)	$585,000	$(1,065,000)	$1,068,000	$(194,000)
Other comprehensive income (loss):				
Change in unrealized holding gains on securities available for sale arising during the period	2,221,000	1,437,000	2,111,000	2,309,000
Reclassification adjustment for gains in net income	(21,000)	(474,000)	(21,000)	(802,000)
Net unrealized gains	2,200,000	963,000	2,090,000	1,507,000
Tax effect	(858,000)	(381,000)	(811,000)	(588,000)
Net unrealized gains, net of tax amount	1,342,000	582,000	1,279,000	919,000
Change in fair value of interest rate swap	(155,000)	(291,000)	(57,000)	(466,000)
Tax effect	62,000	116,000	23,000	186,000
Change in fair value of interest rate swap, net of tax amount	(93,000)	(175,000)	(34,000)	(280,000)
Total other comprehensive income	1,249,000	407,000	1,245,000	639,000
Total comprehensive income (loss)	$1,834,000	$(658,000)	$2,313,000	$445,000

The following is a summary of the accumulated other comprehensive income balances, net of tax.

	6/30/2011	12/31/2010
Unrealized gain on securities available for sale	$1,552,000	$272,000
Unrealized loss on fair value of interest rate swap	(433,000)	(398,000)
Accumulated other comprehensive income, net	$1,119,000	$(126,000)

See notes to unaudited consolidated financial statements.

Index

Stewardship Financial Corporation and Subsidiary
Consolidated Statements of Cash Flows
(Unaudited)

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Cash flows from operating activities:		
Net income (loss)	$ 1,068,000	$ (194,000)
Adjustments to reconcile net income (loss) to		
net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	300,000	416,000
Amortization of premiums and accretion of discounts, net	637,000	370,000
Accretion of deferred loan fees	(20,000)	(55,000)
Provision for loan losses	3,590,000	6,255,000
Originations of mortgage loans held for sale	(35,536,000)	(14,952,000)
Proceeds from sale of mortgage loans	45,944,000	12,674,000
Gain on sales of mortgage loans	(590,000)	(121,000)
Gain on sales and calls of securities	(21,000)	(802,000)
Deferred income tax benefit	(1,188,000)	(791,000)
Decrease in accrued interest receivable	3,000	315,000
Decrease in accrued interest payable	(79,000)	(258,000)
Earnings on bank owned life insurance	(161,000)	(167,000)
Stock option expense	22,000	26,000
(Increase) decrease in other assets	1,150,000	(993,000)
Decrease in other liabilities	(163,000)	(800,000)
Net cash provided by operating activities	14,956,000	923,000
Cash flows from investing activities:		
Purchase of securities available for sale	(21,306,000)	(58,544,000)
Proceeds from maturities and principal repayments on securities available for sale	9,602,000	7,708,000
Proceeds from sales and calls on securities available for sale	6,032,000	39,951,000
Purchase of securities held to maturity	-	(5,566,000)
Proceeds from maturities and principal repayments on securities held to maturity	2,851,000	2,553,000
Proceeds from calls on securities held to maturity	1,000,000	13,735,000
Sale of FHLB-NY stock	6,000	730,000
Net increase in loans	(17,654,000)	(2,088,000)
Additions to premises and equipment	(114,000)	(194,000)
Proceeds from sale of other real estate owned	366,000	-
Net cash used in investing activities	(19,217,000)	(1,715,000)
Cash flows from financing activities:		
Net increase in noninterest-bearing deposits	14,795,000	12,618,000
Net increase (decrease) in interest-bearing deposits	(1,980,000)	18,635,000
Net increase in securities sold under agreements to repurchase	1,149,000	4,000
Net decrease in short term borrowings	-	(18,600,000)
Repayment of long term borrowings	(3,000,000)	-
Cash dividends paid on common stock	(585,000)	(1,051,000)
Cash dividends paid on preferred stock	(250,000)	(250,000)

Payment of discount on dividend reinvestment plan	(10,000)	(19,000)
Exercise of stock options	-	12,000
Issuance of common stock	25,000	24,000
Net cash provided by financing activities	10,144,000	11,373,000
Net increase in cash and cash equivalents	5,883,000	10,581,000
Cash and cash equivalents - beginning	19,983,000	8,871,000
Cash and cash equivalents - ending	$25,866,000	$19,452,000

Index

Stewardship Financial Corporation and Subsidiary
Consolidated Statements of Cash Flows (continued)
(Unaudited)

	Six Months Ended June 30,	
	2011	2010
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	$ 3,717,000	$ 4,852,001
Cash paid during the period for income taxes	$ 1,215,000	$ 1,930,001

See notes to unaudited consolidated financial statements.

Index

Stewardship Financial Corporation and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2011
(Unaudited)

Note 1. Summary of Significant Accounting Policies

Certain information and footnote disclosures normally included in the unaudited consolidated financial statements prepared in accordance with U.S. generally accepting accounting principles ("GAAP") have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Stewardship Financial Corporation Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the SEC on March 30, 2011 (the "2010 Annual Report").

Principles of consolidation

The consolidated financial statements include the accounts of Stewardship Financial Corporation and its wholly owned subsidiary, Atlantic Stewardship Bank (the "Bank"), together referred to as "the Corporation". The Bank includes its wholly owned subsidiaries, Stewardship Investment Corporation, Stewardship Realty LLC, Atlantic Stewardship Insurance Company, LLC and several other subsidiaries formed to hold title to properties acquired through deed in lieu of foreclosure. The Bank's subsidiaries have an insignificant impact on the daily operations. All intercompany accounts and transactions have been eliminated in the consolidated financial statements. Certain prior period amounts have been reclassified to conform to the current presentation.

The consolidated financial statements of the Corporation have been prepared in conformity with GAAP. In preparing the financial statements, management is required to make estimates and assumptions, based on available information, that affect the amounts reported in the financial statements and disclosures provided. Actual results could differ significantly from those estimates.

Material estimates

Material estimates that are particularly susceptible to significant changes relate to the determination of the allowance for loan losses and fair value of financial instruments. Management believes that the allowance for loan losses is adequate. While management uses available information to recognize probable incurred losses on loans, future additions to the allowance for loan losses may be necessary based on changes in economic conditions in the market area.

Basis of presentation

The interim unaudited consolidated financial statements included herein have been prepared in accordance with instructions for Form 10-Q and the rules and regulations of the SEC and, therefore, do not include information or footnotes necessary for a complete presentation of consolidated financial condition, results of operations, and cash flows in conformity with GAAP. However, all adjustments, consisting only of normal recurring adjustments, which in the opinion of management are necessary for a fair presentation of the interim consolidated financial statements, have been included. The results of operations for the six months ended June 30, 2011 are not necessarily indicative of the results which may be expected for the entire year.

Derivatives

Derivative financial instruments are recognized as assets or liabilities at fair value. The Corporation's derivative consists of an interest rate swap agreement, which is used as part of its asset liability management strategy to help manage interest rate risk related to its subordinated debentures issued in 2003 to Stewardship Statutory Trust I (the "Trust"), a statutory business trust (see Note 8 to the Notes to the Audited Consolidated Financial Statements of the Corporation contained in the 2010 Annual Report). The Corporation does not use derivatives for trading purposes.

The Corporation designated the hedge as a cash flow hedge, which is a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability. For a cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. Net cash settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged.

Index

The Corporation formally documented the risk-management objective and the strategy for undertaking hedge transactions at the inception of the hedging relationship. This documentation includes linking the fair value of cash flow hedge to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Corporation formally assessed, both at the hedge's inception and on an ongoing basis, whether the derivative instrument used is highly effective in offsetting changes in fair values or cash flows of the hedged items.

When a cash flow hedge is discontinued but the hedged cash flows or forecasted transactions are still expected to occur, gains or losses that would be accumulated in other comprehensive income are amortized into earnings over the same periods in which the hedged transactions will affect earnings.

Recent Accounting Pronouncements

In April 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2011-02, "Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring". This ASU provides additional guidance for companies when determining whether a loan modification constitutes a troubled debt restructuring. This ASU also provides additional disclosure requirements. The guidance on identifying and disclosing troubled debt restructurings is effective for interim and annual periods beginning on or after June 15, 2011 and applies retroactively to restructurings occurring on or after the beginning of the year. The guidance on measuring the impairment of a receivable restructured in a troubled debt restructuring is effective on a prospective basis. The adoption of this ASU did not have a significant impact on the Corporation's consolidated financial statements.

In June 2011, the FASB issued ASU 2011-04, "Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs." This ASU represents the converged guidance of the FASB and the International Accounting Standards Board ("the Boards") on fair value measurement. The collective efforts of the Boards and their staffs, reflected in ASU 2011-04, have resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term "fair value." The Boards have concluded the common requirements will result in greater comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and International Financial Reporting Standards. The amendments of this ASU are to be applied prospectively. The guidance is effective for interim and annual periods beginning after December 15, 2011. Early adoption is not permitted. The Corporation does not expect the adoption of this ASU to have a significant impact on the Corporation's consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income". This ASU provides that an entity that reports items of other comprehensive income has the option to present comprehensive income in either one or two consecutive financial statements. The guidance is effective for interim and annual periods beginning after December 15, 2011. Early adoption is allowed. The Corporation does not expect the adoption of this ASU to have a significant impact on the Corporation's consolidated financial statements.

Index

Note 2. Securities – Available for Sale and Held to Maturity

The fair value of the available for sale securities and the related gross unrealized gains and losses recognized in accumulated other comprehensive income were as follows:

	June 30, 2011			
	Amortized	Gross Unrealized		Fair
	Cost	Gains	Losses	Value
U.S. Treasury	$15,185,000	$246,000	$-	$15,431,000
U.S. government-sponsored agencies	14,075,000	172,000	35,000	14,212,000
Obligations of state and political subdivisions	6,159,000	215,000	26,000	6,348,000
Mortgage-backed securities - residential	104,716,000	2,027,000	109,000	106,634,000
Other equity investments	3,211,000	55,000	-	3,266,000
	$143,346,000	$2,715,000	$170,000	$145,891,000

	December 31, 2010			
	Amortized	Gross Unrealized		Fair
	Cost	Gains	Losses	Value
U.S. Treasury	$9,141,000	$109,000	$1,000	$9,249,000
U.S. government-sponsored agencies	13,600,000	97,000	111,000	13,586,000
Obligations of state and political subdivisions	4,219,000	79,000	19,000	4,279,000
Mortgage-backed securities - residential	108,078,000	1,169,000	920,000	108,327,000
Other equity investments	3,135,000	52,000	-	3,187,000
	$138,173,000	$1,506,000	$1,051,000	$138,628,000

The following is a summary of the held to maturity securities and related unrecognized gains and losses:

	June 30, 2011			
	Amortized	Gross Unrecognized		Fair
	Cost	Gains	Losses	Value
U.S. government-sponsored agencies	$2,788,000	$105,000	-	$2,893,000
Obligations of state and political subdivisions	25,724,000	1,360,000	-	27,084,000
Mortgage-backed securities - residential	12,914,000	807,000	-	13,721,000
	$41,426,000	$2,272,000	$-	$43,698,000

	December 31, 2010			
	Amortized	Gross Unrecognized		Fair
	Cost	Gains	Losses	Value
U.S. government-sponsored agencies	$4,208,000	$146,000	$-	$4,354,000
Obligations of state and political subdivisions	26,148,000	1,046,000	20,000	27,174,000
Mortgage-backed securities - residential	15,038,000	750,000	-	15,788,000

	$45,394,000	$1,942,000	$20,000	$47,316,000

The following tables summarize the fair value and unrealized losses of those investment securities which reported an unrealized loss at June 30, 2011 and December 31, 2010, and if the unrealized loss was continuous for the twelve months prior to June 30, 2011 and December 31, 2010.

Index

Available for Sale

June 30, 2011	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury	$-	-	-	-	$-	$-
U.S. government-sponsored agencies	2,465,000	(35,000)	-	-	2,465,000	(35,000)
Obligations of state and political subdivisions	1,169,000	(26,000)	-	-	1,169,000	(26,000)
Mortgage-backed securities - residential	13,917,000	(109,000)	-	-	13,917,000	(109,000)
Other equity investments	-	-	-	-	-	-
Total temporarily impaired securities	$17,551,000	$(170,000)	$-	$-	$17,551,000	$(170,000)

December 31, 2010	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury	$1,522,000	$(1,000)	$-	$-	$1,522,000	$(1,000)
U.S. government-sponsored agencies	3,418,000	(111,000)	-	-	3,418,000	(111,000)
Obligations of state and political subdivisions	1,153,000	(19,000)	-	-	1,153,000	(19,000)
Mortgage-backed securities - residential	39,179,000	(920,000)	-	-	39,179,000	(920,000)
Other equity investments	-	-	-	-	-	-
Total temporarily impaired securities	$45,272,000	$(1,051,000)	$-	$-	$45,272,000	$(1,051,000)

Held to Maturity

June 30, 2011	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses
U.S. government-sponsored agencies	$-	-	-	-	$-	$ -
Obligations of state and political subdivisions	-	-	-	-	-	-
Mortgage-backed securities - residential	-	-	-	-	-	-
Total temporarily impaired securities	$-	$ -	$-	$ -	$-	$ -

December 31, 2010	Less than 12 Months		12 Months or Longer		Total	

	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses
U.S. government-sponsored agencies	$-	$ -	$-	$ -	$-	$ -
Obligations of state and political subdivisions	1,403,000	(20,000)	-	-	1,403,000	(20,000)
Mortgage-backed securities - residential	-	-	-	-	-	-
Total temporarily impaired securities	$1,403,000	$ (20,000)	$-	$ -	$1,403,000	$ (20,000)

10

Index

Other-Than-Temporary-Impairment

At June 30, 2011 there were no securities in a continuous loss position for 12 months or longer. The Corporation's unrealized losses are primarily due to the changes in interest rates and other market conditions. These securities have not been considered other than temporarily impaired as scheduled principal and interest payments have been made and management anticipates collecting the entire principal balance as scheduled. Because the decline in fair value is attributable to changes in market conditions, and not credit quality, and because the Corporation does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery, the Corporation does not consider these securities to be other-than-temporarily impaired at June 30, 2011.

Note 3. Loans and Allowance for Loan Losses

The following table sets forth the composition of loans:

	June 30, 2011	December 31, 2010
Commercial:		
Secured by real estate	$65,787,000	$65,200,000
Other	43,249,000	44,327,000
Commercial real estate	249,433,000	219,875,000
Construction:		
Commercial	21,075,000	28,652,000
Residential	276,000	875,000
Residential real estate	45,026,000	42,145,000
Consumer:		
Secured by real estate	42,474,000	49,360,000
Other	1,288,000	1,280,000
Other	60,000	152,000
Total gross loans	468,668,000	451,866,000
Less: Deferred loan fees, net of costs	109,000	131,000
Allowance for loan losses	11,230,000	8,490,000
	11,339,000	8,621,000
Loans, net	$457,329,000	$443,245,000

Index

Activity in the allowance for loan losses is summarized as follows:

	For the three months ended June 30, 2011							
	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer	Other Loans	Unallocated	Total
Balance, beginning of period	$4,979,000	$3,305,000	$ 752,000	$ 288,000	$532,000	$3,000	$ 14,000	$9,873,000
Provision charged to operations	850,000	1,180,000	(168,000)	131,000	(71,000)	6,000	(12,000)	1,916,000
Loans charged off	260,000	288,000	14,000	-	1,000	5,000	-	568,000
Recoveries of loans charged off	8,000	-	-	-	-	1,000		9,000
Balance, end of period	$5,577,000	$4,197,000	$ 570,000	$ 419,000	$460,000	$5,000	$ 2,000	$11,230,000

	For the six months ended June 30, 2011							
	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer	Other Loans	Unallocated	Total
Balance, beginning of period	$ 3,745,000	$ 3,112,000	$ 930,000	$ 184,000	$ 510,000	$ 2,000	$ 7,000	$ 8,490,000
Provision charged to operations	2,201,000	1,477,000	(337,000)	235,000	10,000	9,000	(5,000)	3,590,000
Loans charged off	388,000	392,000	23,000	-	60,000	8,000	-	871,000
Recoveries of loans charged off	19,000	-	-	-	-	2,000		21,000
Balance, end of period	$ 5,577,000	$ 4,197,000	$ 570,000	$ 419,000	$ 460,000	$ 5,000	$ 2,000	$ 11,230,000

	For the three months ended June	For the six months ended June 30, 2010

	30, 2010	
Balance, beginning of period	$8,174,000	$6,920,000
Provision charged to operations	4,705,000	6,255,000
Loans charged off	4,145,000	4,514,000
Recoveries of loans charged off	11,000	84,000
Balance, end of period	$8,745,000	$8,745,000

Index

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on the impairment method as of June 30, 2011 and December 31, 2010.

	June 30, 2011							
	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer	Other Loans	Unallocated	Total
Allowance for loan losses: Ending allowance balance attributable to loans								
Individually evaluated for impairment	$2,124,000	$485,000	$21,000	$133,000	$-	$-	$-	$2,763,000
Collectively evaluated for impairment	3,453,000	3,712,000	549,000	286,000	460,000	5,000	2,000	8,467,000
Total ending allowance balance	$5,577,000	$4,197,000	$570,000	$419,000	$460,000	$5,000	$2,000	$11,230,000
Loans:								
Loans individually evaluated for impairment	$8,384,000	$14,772,000	$2,273,000	$1,106,000	$826,000	$-	$-	$27,361,000
Loans collectively evaluated for impairment	100,652,000	234,661,000	19,078,000	43,920,000	42,936,000	60,000	-	441,307,000
Total ending loan balance	$109,036,000	$249,433,000	$21,351,000	$45,026,000	$43,762,000	$60,000	$-	$468,668,000

Index

	December 31, 2010							
	Commercial	Commercial Real Estate	Construction	Residential Real Estate	Consumer	Other Loans	Unallocated	Total
Allowance for loan losses:								
Ending allowance balance attributable to loans								
Individually evaluated for impairment	$1,336,000	$276,000	$29,000	$3,000	$-	$-	$-	$1,644,000
Collectively evaluated for impairment	2,409,000	2,836,000	901,000	181,000	510,000	2,000	7,000	6,846,000
Total ending allowance balance	$3,745,000	$3,112,000	$930,000	$184,000	$510,000	$2,000	$7,000	$8,490,000
Loans:								
Loans individually evaluated for impairment	$7,852,000	$10,540,000	$2,303,000	$1,106,000	$829,000	$-	$-	$22,630,000
Loans collectively evaluated for impairment	101,675,000	209,335,000	27,224,000	41,039,000	49,811,000	152,000	-	429,236,000
Total ending loan balance	$109,527,000	$219,875,000	$29,527,000	$42,145,000	$50,640,000	$152,000	$-	$451,866,000

The following table presents the recorded investment in nonaccrual loans in the periods indicated:

	June 30, 2011	December 31,

		2010
Commercial:		
Secured by real estate	$6,546,000	$5,924,000
Other	1,728,000	1,798,000
Commercial real estate	11,355,000	10,540,000
Construction:		
Commercial	1,997,000	2,020,000
Residential	276,000	283,000
Residential real estate	1,106,000	1,106,000
Consumer:		
Secured by real estate	826,000	829,000
Other	-	-
Other	-	-
Total nonperfoming loans	$23,834,000	$22,500,000

Index

The following presents loans individually evaluated for impairment by class of loans as of the periods indicated:

	At June 30, 2011		
	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
With no related allowance recorded:			
Commercial:			
Secured by real estate	$3,715,000	$2,721,000	
Other	484,000	460,000	
Commercial real estate	10,309,000	9,255,000	
Construction:			
Commercial	1,965,000	1,631,000	
Residential	277,000	276,000	
Residential real estate	-	-	
Consumer:			
Secured by real estate	1,035,000	826,000	
Other	-	-	
Other	-	-	
With an allowance recorded:			
Commercial:			
Secured by real estate	3,971,000	3,825,000	$1,378,000
Other	1,384,000	1,378,000	746,000
Commercial real estate	6,018,000	5,517,000	485,000
Construction:			
Commercial	544,000	366,000	21,000
Residential	-	-	-
Residential real estate	1,131,000	1,106,000	133,000
Consumer:			
Secured by real estate	-	-	-
Other	-	-	-
Other	-	-	-
Total nonperfoming loans	$30,833,000	$27,361,000	$2,763,000

15

Index

	Three months ended June 30, 2011		Six months ended June 30, 2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Commercial:				
Secured by real estate	$2,032,000	$-	$1,658,000	$-
Other	374,000	2,000	455,000	4,000
Commercial real estate	6,908,000	10,000	6,005,000	10,000
Construction:				
Commercial	1,566,000	-	1,545,000	-
Residential	278,000	-	279,000	-
Residential real estate	144,000	-	334,000	-
Consumer:				
Secured by real estate	828,000	-	828,000	-
Other	-	-	-	-
Other	-	-	-	-
With an allowance recorded:				
Commercial:				
Secured by real estate	4,311,000	-	4,545,000	-
Other	1,470,000	-	1,416,000	-
Commercial real estate	6,434,000	-	6,403,000	-
Construction:				
Commercial	441,000	-	466,000	-
Residential	-	-	-	-
Residential real estate	963,000	-	772,000	-
Consumer:				
Secured by real estate	-	-	-	-
Other	-	-	-	-
Other	-	-	-	-
Total nonperfoming loans	$25,749,000	$12,000	$24,706,000	$14,000

Index

	At and for the year ended December 31, 2010				
	Unpaid Principal Balance	Recorded In vestment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial:					
Secured by real estate	$1,037,000	$911,000			
Other	646,000	618,000			
Commercial real estate	4,808,000	4,199,000			
Construction:					
Commercial	1,540,000	1,504,000			
Residential	284,000	283,000			
Residential real estate	716,000	716,000			
Consumer:					
Secured by real estate	1,037,000	829,000			
Other	-	-			
Other	-	-			
With an allowance recorded:					
Commercial:					
Secured by real estate	6,056,000	5,013,000	$730,000		
Other	1,311,000	1,310,000	606,000		
Commercial real estate	6,777,000	6,341,000	276,000		
Construction:					
Commercial	959,000	516,000	29,000		
Residential	-	-	-		
Residential real estate	415,000	390,000	3,000		
Consumer:					
Secured by real estate	-	-	-		
Other	-	-	-		
Other	-	-	-		
Total nonperfoming loans	$25,586,000	$22,630,000	$1,644,000	$23,766,000	$216,000

Index

The following table presents the aging of the recorded investment in past due loans by class of loans as of June 30, 2011 and December 31, 2010. Nonaccrual loans are included in the disclosure by payment status.

	June 30, 2011					
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial:						
Secured by real estate	$510,000	$275,000	$6,050,000	$6,835,000	$58,952,000	$65,787,000
Other	65,000	-	1,727,000	1,792,000	41,457,000	43,249,000
Commercial real estate:	622,000	72,000	12,872,000 (1)	13,566,000	235,867,000	249,433,000
Construction:						
Commercial	-	1,095,000	902,000	1,997,000	19,078,000	21,075,000
Residential	-	-	276,000	276,000	-	276,000
Residential real estate	-	-	1,106,000	1,106,000	43,920,000	45,026,000
Consumer:						
Secured by real estate	478,000	155,000	826,000	1,459,000	41,015,000	42,474,000
Other	-	7,000	-	7,000	1,281,000	1,288,000
Other	-	-	-	-	60,000	60,000
Total	$1,675,000	$1,604,000	$23,759,000	$27,038,000	$441,630,000	$468,668,000

(1) The $12,872,000 includes a single loan with a recorded investment of $2.342 000, representing the only loan in the Corporation's portfolio that was past due 90 days or more and accruing.

	December 31, 2010					
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial:						
Secured by real estate	$490,000	$4,014,000	$2,296,000	$6,800,000	$58,400,000	$65,200,000
Other	-	-	1,798,000	1,798,000	42,529,000	44,327,000
Commercial real estate:	1,789,000	2,324,000	6,650,000	10,763,000	209,112,000	219,875,000
Construction:						
Commercial	-	2,731,000	916,000	3,647,000	25,005,000	28,652,000
Residential	-	-	283,000	283,000	592,000	875,000
Residential real estate	-	458,000	1,106,000	1,564,000	40,581,000	42,145,000
Consumer:						
Secured by real estate	114,000	449,000	829,000	1,392,000	47,968,000	49,360,000
Other	3,000	-	-	3,000	1,277,000	1,280,000
Other	-	-	-	-	152,000	152,000
Total	$2,396,000	$9,976,000	$13,878,000	$26,250,000	$425,616,000	$451,866,000

Troubled Debt Restructurings

At June 30, 2011 and December 31, 2010, the Corporation had $3,527,000 and $130,000, respectively, of loans whose terms have been modified in troubled debt restructurings. All of these loans are performing in accordance with their new terms. Specific reserves of $24,000 have been allocated for the troubled debt restructurings at June 30, 2011. No reserves were deemed necessary at December 31, 2010. As of June 30, 2011 and December 31, 2010, the Corporation has not committed any additional funds to customers with outstanding loans that are classified as troubled debt restructurings.

Credit Quality Indicators

The Corporation categorizes loans into risk categories based on relevant information about the ability of the borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Corporation analyzes loans individually by classifying

Index

the loans as to credit risk. This analysis includes non-homogeneous loans, such as commercial, commercial real estate and commercial construction loans. This analysis is performed at the time the loan is originated and annually thereafter. The Corporation uses the following definitions for risk ratings.

Special Mention – A Special Mention asset has potential weaknesses that deserve management's close attention, which, if left uncorrected, may result in deterioration of the repayment prospects for the asset or the Bank's credit position at some future date. Special Mention assets are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification. While potentially weak, the borrower is currently marginally acceptable and loss of principal or interest is not presently envisioned.

Substandard – Substandard loans are inadequately protected by the current net worth and paying capacity of the obligor or by the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the repayment and liquidation of the debt. These loans are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful – A loan with all weaknesses inherent in those classified as Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently know facts, conditions, and values, highly questionable or improbable. The likelihood of loss is extremely high, but because of certain important and reasonably specific factors, an estimated loss is deferred until a more exact status can be determined.

Loss – A loan classified Loss is considered uncollectible and of such little value that its continuance as an asset is not warranted. This classification does not necessarily mean that an asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off a basically worthless asset even though partial recovery may be effected in the future.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. As of June 30, 2011 and December 31, 2010, and based on the most recent analysis performed at those times, the risk category of loans by class is as follows:

	June 30, 2011					
	Pass	Special Mention	Substandard	Doubtful	Loss	Total
Commercial:						
Secured by real estate	$59,004,000	$954,000	$2,631,000	$3,198,000	$-	$65,787,000
Other	41,412,000	573,000	-	1,264,000	-	43,249,000
Commercial real estate:	234,662,000	4,350,000	9,639,000	782,000	-	249,433,000
Construction:						
Commercial	19,077,000	1,096,000	902,000	-	-	21,075,000
Residential	-	276,000	-	-	-	276,000
Total	$354,155,000	$7,249,000	$13,172,000	$5,244,000	$-	$379,820,000

	December 31, 2010					
	Pass	Special Mention	Substandard	Doubtful	Loss	Total
Commercial:						
Secured by real estate	$59,206,000	$4,173,000	$1,801,000	$-	$20,000	$65,200,000

Other	42,399,000	618,000	-	1,267,000	43,000	44,327,000
Commercial real estate:	209,512,000	4,668,000	5,695,000	-	-	219,875,000
Construction:						
Commercial	26,631,000	1,614,000	407,000	-	-	28,652,000
Residential	592,000	283,000	-	-	-	875,000
Total	$338,340,000	$11,356,000	$7,903,000	$1,267,000	$63,000	$358,929,000

19

Index

For residential real estate and consumer loan segments, the Corporation also evaluates credit quality based on payment activity. The following table presents the recorded investment in residential real estate and consumer loans based on payment activity as of June 30, 2011 and December 31, 2010. For purposes of the following table, Nonperforming means loans that are 30 days or more past due:

	June 30, 2011		
	Performing	Nonperforming	Total
Residential real estate	$43,920,000	$ 1,106,000	$45,026,000
Consumer:			
Secured by real estate	41,170,000	1,304,000	42,474,000
Other	1,288,000	-	1,288,000
Total	$86,378,000	$ 2,410,000	$88,788,000

	December 31, 2010		
	Performing	Nonperforming	Total
Residential real estate	$40,581,000	$ 1,564,000	$42,145,000
Consumer:			
Secured by real estate	47,968,000	1,392,000	49,360,000
Other	1,277,000	3,000	1,280,000
Total	$89,826,000	$ 2,959,000	$92,785,000

Note 4. Interest Rate Swap

The Corporation utilizes interest rate swap agreements as part of its asset liability management strategy to help manage its interest rate risk position. The notional amount of the interest rate swaps does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest rate swap agreements.

Interest Rate Swap Designated as Cash Flow Hedge: During the second quarter of 2009, the Corporation entered into a swap with an effective date of March 17, 2010. An interest rate swap with a notional amount of $7 million was designated as a cash flow hedge of the subordinated debentures and was determined to be fully effective during the three and six months ended June 30, 2011. As such, no amount of ineffectiveness has been included in net income. Therefore, the aggregate fair value of the swap is recorded in other assets (liabilities) with changes in fair value recorded in other comprehensive income (loss). The amount included in accumulated other comprehensive income (loss) would be reclassified to current earnings should the hedge no longer be considered effective. The Corporation expects the hedge to remain fully effective during the remaining term of the swap. As of June 30, 2011, the interest rate swap is secured by investment securities with a fair value of $1,035,000.

Summary information about the interest rate swap designated as a cash flow hedge as of June 30, 2011 is as follows:

Notional amount	$7,000,000
Pay rate	7.00%
Receive rate	3 month LIBOR plus 2.95%
Maturity	March 17, 2016
Fair value	$(721,000)

The net expense recorded on the swap transaction totaled $67,000 and $132,000 for the three and six months ended June 30, 2011, respectively, and is reported as a component of interest expense – borrowed money. The net expense recorded on the swap transaction totaled $66,000 and $78,000 for the three and six months ended June 30, 2010, respectively.

The fair value of the interest rate swap of ($721,000) and ($664,000) at June 30, 2011 and December 31, 2010, respectively, was included in accrued expenses and other liabilities on the Consolidated Statements of Financial Condition.

The following table presents the net gains (losses) recorded in accumulated other comprehensive income and the Consolidated Statements of Income relating to the cash flow derivative instruments for the periods indicated.

Index

	For the six months ended June 30, 2011		
	Amount of gain (loss) recognized in OCI (Effective Portion)	Amount of gain (loss) reclassified from OCI to interest income	Amount of gain (loss) recognized in other noninterest income (Ineffective Portion)
Interest rate contract	$(34,000)	$-	$-

	For the six months ended June 30, 2010		
	Amount of gain (loss) recognized in OCI (Effective Portion)	Amount of gain (loss) reclassified from OCI to interest income	Amount of gain (loss) recognized in other noninterest income (Ineffective Portion)
Interest rate contract	$(280,000)	$-	$-

Note 5. Fair Value of Financial Instruments

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity’s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair values of investment securities are determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities’ relationship to other benchmark quoted securities (Level 2 inputs).

The interest rate swaps are reported at fair values obtained from brokers who utilize internal models with observable market data inputs to estimate the values of these instruments (Level 2 inputs).

The Corporation measures impairment of collateralized loans based on the estimated fair value of the collateral less estimated costs to sell, incorporating assumptions that experienced parties might use in estimating the value of such collateral (Level 3 inputs).

Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below:

Index

	Carrying Value	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		At June 30, 2011		
Assets:				
Available for sale securities				
U.S. Treasuries	$15,431,000	$-	15,431,000	$ -
U.S. government - sponsered agencies	14,212,000	-	14,212,000	-
Obligations of state and political subdivisions	6,348,000	-	6,348,000	-
Mortgage-backed securities - residential	106,634,000	-	106,634,000	-
Other equity investments	3,266,000	-	3,266,000	-
Total available for sale securities	$145,891,000	$-	$145,891,000	$ -
Liabilities:				
Interest rate swap	$721,000	$-	$721,000	$ -
		At December 31, 2010		
Assets:				
Available for sale securities				
U.S. Treasuries	$9,249,000	$-	$9,249,000	$ -
U.S. government - sponsered agencies	13,586,000	-	13,586,000	-
Obligations of state and political subdivisions	4,279,000	-	4,279,000	-
Mortgage-backed securities - residential	108,327,000	-	108,327,000	-
Other equity investments	3,187,000	-	3,187,000	-
Total available for sale securities	$138,628,000	$-	$138,628,000	$ -
Liabilities:				
Interest rate swap	$664,000	$-	$664,000	$ -

Index

Assets and Liabilities Measured on a Non-Recurring Basis

Assets and liabilities measured at fair value on a non-recurring basis are summarized below:

	Carrying Value	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		At June 30, 2011		
Assets:				
Impaired loans				
Commercial:				
Secured by real estate	$419,000	$-	$-	$ 419,000
Other	-	-	-	-
Commercial real estate	1,235,000	-	-	1,235,000
Construction:				
Commercial	345,000	-	-	345,000
Residential real estate	973,000	-	-	973,000
	$2,972,000	$-	$-	$ 2,972,000
		At December 31, 2010		
Assets:				
Impaired loans				
Commercial:				
Secured by real estate	$1,725,000	$-	$-	$ 5,326,000
Other	-	-	-	704,000
Commercial real estate	2,426,000	-	-	6,065,000
Construction:				
Commercial	487,000	-	-	487,000
Residential real estate	387,000	-	-	387,000
	$5,025,000	$-	$-	$ 12,969,000

Collateral dependent impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a recorded investment of $3,272,000 at June 30, 2011, with a valuation allowance of $300,000, resulting in an additional provision for loan losses of $712,000 for the six months ended June 30, 2011.

Collateral dependent impaired loans had a recorded investment of $5,152,000 with a valuation allowance of $127,000, resulting in an additional provision for loan losses of $413,000 for year ended December 31, 2010.

Fair value estimates, methods and assumptions are set forth below for the Corporation’s financial instruments.

Index

	June 30, 2011		December 31, 2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(Dollars in thousands)			
Financial assets:				
Cash and cash equivalents	$25,866,000	$25,866,000	$19,983,000	$19,983,000
Securities available for sale	145,891,000	145,891,000	138,628,000	138,628,000
Securities held to maturity	41,426,000	43,698,000	45,394,000	47,316,000
FHLB-NY stock	2,491,000	N/A	2,497,000	N/A
Net loans	457,329,000	458,195,000	443,245,000	445,671,000
Accrued interest receivable	2,803,000	2,803,000	2,806,000	2,806,000
Financial liabilities:				
Deposits	588,418,000	591,129,000	575,603,000	577,485,000
FHLB-NY Advances	33,000,000	34,369,000	36,000,000	33,892,000
Securities sold under agreements to repurchase	15,791,000	15,791,000	14,642,000	14,642,000
Subordinated debenture	7,217,000	7,218,000	7,217,000	6,803,000
Accrued interest payable	898,000	898,000	977,000	977,000
Interest rate swap	721,000	721,000	664,000	664,000

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents – The carrying amount approximates fair value.
Securities available for sale and held to maturity – The methods for determining fair values were described previously.
FHLB-NY stock – It is not practicable to determine the fair value of stock of the Federal Home Loan Bank of New York ("FHLB-NY") due to restrictions placed on the transferability of the stock.
Net loans – Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as residential and commercial mortgages, commercial and other installment. The fair value of loans is estimated by discounting cash flows using estimated marked discount rates which reflect the credit and interest rate risk inherent in the loans.
Accrued interest receivable – The carrying amount approximates fair value.
Deposits – The fair value of deposits, with no stated maturity, such as noninterest-bearing demand deposits, savings, NOW and money market accounts, is equal to the amount payable on demand. The fair value of the certificates of deposit is based on the discounted value of cash flows. The discount rate is estimated using marked discount rates which reflect interest rate risk inherent in the certificates of deposit.
FHLB-NY advances – With respect to the FHLB-NY borrowings, the carrying amount of the borrowings which mature in one day approximates fair value. For borrowings with a longer maturity, the fair value is based on the discounted value of cash flows. The discount rate is estimated using market discount rates which reflect the interest rate risk inherent in the term borrowings.
Securities sold under agreements to repurchase – The carrying value approximates fair value due to the relatively short time before maturity.
Subordinated debenture – The fair value of the subordinated debenture is based on the discounted value of cash flows. The discount rate is estimated using market rates which reflect the interest rate risk inherent in the debenture.
Accrued interest payable – The carrying amount approximates fair value.
Interest rate swap – The methods for determining fair values were described previously.
Commitments to extend credit – The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit worthiness of the counter parties, and at June 30, 2011 and December 31, 2010 the fair value of such commitments were not

material.

Limitations

The preceding fair value estimates were made at June 30, 2011 and December 31, 2010 based on pertinent market data and relevant information on the financial instruments. These estimates do not include any premiums or discounts that could result from an offer to sell at one time the Corporation's entire holdings of a particular financial instrument or category thereof. Since no market exists for a substantial portion of the Corporation's financial instruments, fair value estimates were necessarily based on judgments with respect to future expected loss experience, current economic conditions, risk assessments of various financial instruments, and other factors. Given the subjective nature of these estimates, the uncertainties surrounding them and the matters of significant judgment that must be applied, these fair

Index

value estimates cannot be calculated with precision. Modifications in such assumptions could meaningfully alter these estimates.

Since these fair value approximations were made solely for on and off balance sheet financial instruments at June 30, 2011 and December 31, 2010, no attempt was made to estimate the value of anticipated future business. Furthermore, certain tax implications related to the realization of unrealized gains and losses could have a substantial impact on these fair value estimates and have not been incorporated into the estimates.

Note 6. Earnings Per Share

Basic earnings per share is calculated by dividing net income available to common shareholders by the average daily number of common shares outstanding during the period. Common stock equivalents are not included in the calculation. Diluted earnings per share is computed similar to that of basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if all potential dilutive common shares were issued.

The following reconciles the income available to common shareholders (numerator) and the weighted average common stock outstanding (denominator) for both basic and diluted earnings per share.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	(in thousands, except per share data)			
Net income (loss)	$585	$(1,065)	$1,068	$(194)
Dividends on preferred stock and accretion	138	138	276	275
Net income (loss) available to common stockholders	$447	$(1,203)	$792	$(469)
Weighted average shares	5,851	5,842	5,850	5,841
Effect of dilutive stock options	N/A	N/A	N/A	N/A
Total weighted average dilutive shares	5,851	5,842	5,850	5,841
Basic earnings (loss) per common share	$0.08	$(0.21)	$0.14	$(0.08)
Diluted earnings (loss) per common share	$0.08	$(0.21)	$0.14	$(0.08)

For periods in which a loss is reported, the impact of dilutive stock options and common stock warrants is not considered as the result would be antidilutive. For the three and six months ended June 30, 2011, stock options to purchase 64,728 average shares of common stock were not considered in computing diluted earnings per share of common stock because they were antidilutive. Stock options to purchase average shares of common stock of 71,613 and 71,922 were not considered in computing diluted earnings per share for the three and six months ended June 30, 2010, respectively, because they were antidilutive. The U.S. Treasury's warrant to purchase 133,475 average shares of common stock in both the three and six month periods ended June 30, 2011 was not considered in computing diluted earnings per common share because it was antidilutive.

Index

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

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain "forward looking statements" with respect to Stewardship Financial Corporation (the "Corporation") within the meaning of the Private Securities Litigation Reform Act of 1995, which forward looking statements may be identified by the use of such words as "believe," "expect," "anticipate," "should," "plan," "estimate," and "potential." Examples of forward looking statements include, but are not limited to, estimates with respect to the financial condition, results of operations and business of the Corporation that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include: changes in general, economic and market conditions, legislative and regulatory conditions, or the development of an interest rate environment that adversely affects the Corporation's interest rate spread or other income anticipated from operations and investments. As used in this Form 10-Q, "we", "us" and "our" refer to Stewardship Financial Corporation and its consolidated subsidiary, Atlantic Stewardship Bank, depending on the context.

Critical Accounting Policies and Estimates

"Management's Discussion and Analysis of Financial Condition and Results of Operations," as well as disclosures found elsewhere in this Quarterly Report on Form 10-Q, are based upon the Corporation's consolidated financial statements, which have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP"). The preparation of these financial statements requires the Corporation to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Note 1 to the Corporation's Audited Consolidated Financial Statements for the year ended December 31, 2010 included in the 2010 Annual Report contains a summary of the Corporation's significant accounting policies. Management believes the Corporation's policy with respect to the methodology for the determination of the allowance for loan losses involves a higher degree of complexity and requires management to make difficult and subjective judgments, which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could materially impact results of operations. This critical policy and its application are periodically reviewed with the Audit Committee and the Board of Directors.

The allowance for loan losses is based upon management's evaluation of the adequacy of the allowance, including an assessment of known and inherent risks in the portfolio, giving consideration to the size and composition of the loan portfolio, actual loan loss experience, level of delinquencies, detailed analysis of individual loans for which full collectability may not be assured, the existence and estimated net realizable value of any underlying collateral and guarantees securing the loans, and current economic and market conditions. Although management uses the best information available, the level of the allowance for loan losses remains an estimate, which is subject to significant judgment and short-term change. Various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to make additional provisions for loan losses based upon information available to them at the time of their examination. Furthermore, the majority of the Corporation's loans are secured by real estate in the State of New Jersey. Accordingly, the collectability of a substantial portion of the carrying value of the Corporation's loan portfolio is susceptible to changes in local market conditions and may be adversely affected should real estate values decline or the northern New Jersey area experience adverse economic changes. Future adjustments to the allowance for loan losses may be necessary due to economic, operating, regulatory and other conditions beyond the Corporation's control.

Financial Condition

Total assets increased $12.3 million, or 1.8%, to $700.4 million at June 30, 2011 from $688.1 million at December 31, 2010. Cash and cash equivalents increased $5.9 million to $25.9 million at June 30, 2011 from $20.0 million at December 31, 2010, reflecting planned additional liquidity. Securities available for sale increased $7.3 million to $145.9 million while securities held to maturity decreased $4.0 million to $41.4 million. Net loans increased $14.1 million from $443.2 million at December 31, 2010 to $457.3 million at June 30, 2011. Increases due to new loans originated were partially offset by a $2.7 million net increase in the allowance for loan losses and regular principal payments and payoffs during the six months ended June 30, 2011. There were no loans held for sale at June 30, 2011 compared to $9.8 million at December 31, 2011. Rising mortgage interest rates during the early part of 2011 had contributed to a slowdown in loan application volume and by June 30, 2011, all mortgage loan applications which had funded were and sold. With a more recent decline in mortgage interest rate, there has again been a current increase in loan application volume.

Deposits totaled $588.4 million at June 30, 2011, an increase of $12.8 million, or 2.2%, from $575.6 million at December 31, 2010. The growth in deposits consisted of a $14.8 million increase in noninterest-bearing accounts partially offset by a $2.0 million decrease in interest-bearing accounts.

Index

FHLB – NY advances were $33.0 million at June 30, 2011 compared to $36.0 million at December 31, 2010. The decrease in these borrowings was the result of an increase in deposits which was used to pay down maturing advances.

Results of Operations

General

The Corporation reported net income of $585,000, or $0.08 diluted earnings per common share for the three months ended June 30, 2011, compared to a net loss of $1.1 million, or a $0.21 loss per diluted common share for the three months ended June 30, 2010. For the six months ended June 30, 2011, the Corporation reported net income of $1.1 million, or $0.14 diluted earnings per common share. These results compare to a net loss was $194,000, or $0.08 per diluted common share for the six months ended June 30, 2010.

Net Interest Income

Net interest income for the three and six months ended June 30, 2011 was $6.2 million and $12.2 million, respectively, compared to $5.9 million and $12.1 million recorded in the prior year periods. The increases in the current year periods are primarily due to a decline in the cost of interest bearing liabilities. The net interest rate spread and net yield on interest earning assets for the three months ended June 30, 2011 were 3.62% and 3.89%, respectively, compared to 3.48% and 3.84% for the three months ended June 30, 2010. For the six months ended June 30, 2011, the net interest rate spread and net yield on interest earning assets were 3.61% and 3.86%, respectively, compared to 3.61% and 3.96% for the six months ended June 30, 2010. The net yield on interest earning assets during the current year periods reflects a decline in loan interest rates and yields on securities offset by a decline in the interest rates on deposits and borrowings.

The following table reflects the components of the Corporation's net interest income for the three and six months ended June 30, 2011 and 2010 including: (1) average assets, liabilities and stockholders' equity based on average daily balances, (2) interest income earned on interest-earning assets and interest expense paid on interest-bearing liabilities, (3) average yields earned on interest-earning assets and average rates paid on interest-bearing liabilities, and (4) net yield on interest-earning assets. Nontaxable income from investment securities and loans is presented on a tax-equivalent basis assuming a statutory tax rate of 34% for the periods presented. This was accomplished by adjusting non-taxable income upward to make it equivalent to the level of taxable income required to earn the same amount after taxes.

Index

Analysis of Net Interest Income (Unaudited)
For the Three Months Ended June 30

	2011			2010		
	Average Balance	Interest Income/ Expense	Average Rates Earned/ Paid	Average Balance	Interest Income/ Expense	Average Rates Earned/ Paid
	(Dollars in thousands)					
Assets						
Interest-earning assets:						
Loans (1) (2)	$463,938	$6,677	5.77 %	$461,879	$6,703	5.82 %
Taxable investment securities (1)	159,968	1,085	2.72	138,948	1,234	3.56
Tax-exempt investment securities (1) (2)	31,878	405	5.10	31,376	397	5.08
Other interest-earning assets	1,045	9	3.45	1,233	4	1.30
Total interest-earning assets	656,829	8,176	4.99	633,436	8,338	5.28
Non-interest-earning assets:						
Allowance for loan losses	(10,274)			(7,543)		
Other assets	50,898			42,156		
Total assets	$697,453			$668,049		
Liabilities and Stockholders' Equity						
Interest-bearing liabilities:						
Interest-bearing demand deposits	$248,327	$484	0.78 %	$236,358	$825	1.40 %
Savings deposits	52,262	34	0.26	48,404	51	0.42
Time deposits	173,542	762	1.76	165,097	853	2.07
Repurchase agreements	16,428	184	4.49	15,400	184	4.79
FHLB-NY borrowing	33,001	222	2.70	36,263	239	2.64
Subordinated debenture	7,217	126	7.00	7,217	126	7.00
Total interest-bearing liabilities	530,777	1,812	1.37	508,739	2,278	1.80
Non-interest-bearing liabilities:						
Demand deposits	110,758			99,926		
Other liabilities	2,502			4,968		
Stockholders' equity	53,416			54,416		
Total liabilities and stockholders' equity	$697,453			$668,049		
Net interest income (taxable equivalent basis)		6,364			6,060	
Tax Equivalent adjustment		(143)			(137)	

Net interest income	$6,221		$5,923	
Net interest spread (taxable equivalent basis)	3.62	%	3.48	%
Net yield on interest-earning assets (taxable equivalent basis) (3)	3.89	%	3.84	%

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(1) For purpose of these calculations, nonaccruing loans are included in the average balance. Loans and total interest-earning assets are net of unearned income. Securities are included at amortized cost.

(2) The tax equivalent adjustments are based on a marginal tax rate of 34%.

(3) Net interest income (taxable equivalent basis) divided by average interest-earning assets.

Index

Analysis of Net Interest Income (Unaudited)
For the Six Months Ended June 30,

	2011				2010			
	Average Balance	Interest Income/ Expense	Average Rates Earned/ Paid		Average Balance	Interest Income/ Expense	Average Rates Earned/ Paid	
	(Dollars in thousands)							
Assets								
Interest-earning assets:								
Loans (1) (2)	$460,133	$13,128	5.75	%	$461,950	$13,589	5.93	%
Taxable investment securities (1)	157,651	2,145	2.74		136,149	2,573	3.81	
Tax-exempt investment securities (1) (2)	31,456	801	5.14		31,839	811	5.14	
Other interest-earning assets	730	17	4.70		679	6	1.78	
Total interest-earning assets	649,970	16,091	4.99		630,617	16,979	5.43	
Non-interest-earning assets:								
Allowance for loan losses	(9,529)				(7,427)			
Other assets	51,374				39,845			
Total assets	$691,815				$663,035			
Liabilities and Stockholders' Equity								
Interest-bearing liabilities:								
Interest-bearing demand deposits	$248,843	$959	0.78	%	$229,562	$1,595	1.40	%
Savings deposits	50,326	65	0.26		47,855	100	0.42	
Time deposits	174,416	1,545	1.79		168,198	1,854	2.22	
Repurchase agreements	15,540	365	4.74		15,399	365	4.78	
FHLB-NY borrowing	34,128	454	2.68		41,013	486	2.39	
Subordinated debenture	7,217	250	6.99		7,217	194	5.42	
Total interest-bearing liabilities	530,470	3,638	1.38		509,244	4,594	1.82	
Non-interest-bearing liabilities:								
Demand deposits	105,566				94,987			
Other liabilities	2,813				4,434			
Stockholders' equity	52,966				54,370			
Total liabilities and stockholders' equity	$691,815				$663,035			
Net interest income (taxable equivalent basis)		12,453				12,385		

Tax Equivalent adjustment	(283)		(283)	
Net interest income	$12,170		$12,102	
Net interest spread (taxable equivalent basis)		3.61 %		3.61 %
Net yield on interest-earning assets (taxable equivalent basis) (3)		3.86 %		3.96 %

(1) For purpose of these calculations, nonaccruing loans are included in the average balance. Loans and total interest-earning assets are net of unearned income. Securities are included at amortized cost.

(2) The tax equivalent adjustments are based on a marginal tax rate of 34%.

(3) Net interest income (taxable equivalent basis) divided by average interest-earning assets.

Index

For the three months ended June 30, 2011, total interest income, on a tax equivalent basis, decreased $162,000 to $8.176 million, or 1.9%, when compared to the same prior year period. The decrease was due to a decrease in yields on interest-earning assets partially offset by an increase in the average balance of interest-earning assets. Total interest income on a tax equivalent basis decreased $888,000 to $16.091 million for the six months ended June 30, 2011, or 5.2%, compared to the same period for 2010. Consistent with the three month period, the decrease in the current six month period is due to a decrease in the overall yield on interest-earning assets, partially offset by an increase in the average interest-earning assets. The average rate earned on interest-earning assets was 4.99% for both the three and six months ended June 30, 2011 compared to an average rate of 5.28% and 5.43% for the three and six months ended June 30, 2010, respectively. The decline in the asset yield reflects the effect of a prolonged low interest rate environment as well as the impact of nonaccrual loans. Average interest-earning assets increased $23.4 million and $19.4 million for the three and six months ended June 30, 2011, respectively, when compared to the same prior year periods.

Interest paid on deposits and borrowed money decreased $466,000, or 20.5%, to $1.812 million and $956,000, or 20.8%, to $3.638 million for the three and six months ended June 30, 2011 compared to the same periods for 2010. The declines are due to general decreases in rates paid on deposits and borrowings, partially offset by increases in average interest-bearing liabilities. The average balance of total interest-bearing deposits and borrowings increased $22.0 million and $21.2 million for the three and six months ended June 30, 2011, respectively, from the comparable 2010 periods. For the three months ended June 30, 2011, the total cost for interest-bearing liabilities declined to 1.37% representing a 43 basis point decline when compared to the same prior year period. Yields on deposits and borrowed money decreased 44 basis points from 1.82% for the six month period ended June 30, 2010 to 1.38% for the comparable period in 2011.

Provision for Loan Losses

The Corporation maintains an allowance for loan losses at a level considered by management to be adequate to cover the probable incurred losses associated with its loan portfolio. On an ongoing basis, management analyzes the adequacy of this allowance by considering the nature and volume of the Corporation’s loan activity, financial condition of the borrower, fair market value of the underlying collateral, and changes in general market conditions. Additions to the allowance for loan losses are charged to operations in the appropriate period. Actual loan losses, net of recoveries, serve to reduce the allowance. The appropriate level of the allowance for loan losses is based on estimates, and ultimate losses may vary from current estimates.

The loan loss provision totaled $1.915 million and $3.590 million for the three and six months ended June 30, 2011, respectively, compared to $4.705 million and $6.255 million for the three and six months ended June 30, 2010, respectively. Nonaccrual loans of $23.8 million at June 30, 2011 reflected a slight increase from $22.5 million of nonaccrual loans at December 31, 2010, but are comparable to $24.0 million at March 31, 2011. The allowance for loan losses related to the impaired loans increased from $413,000 at December 31, 2010 to $712,000 at June 30, 2011. During the first six months of 2011, the Corporation charged off loans totaling $871,000 and recovered $21,000 in previously charged off loans compared to $4.5 million and $84,000, respectively, during the same period in 2010. Approximately $2.1 million of the charge offs in 2010 were related to a loan to one borrower.

The current period loan loss provision primarily is indicative of continuing economic conditions that have contributed to an increase in loan delinquencies and the softness in the real estate market. The Corporation monitors its loan portfolio and intends to continue to provide for loan loss reserves based on its ongoing periodic review of the loan portfolio and general market conditions.

See “Asset Quality” section below for a summary of the allowance for loan losses and nonperforming assets.

Noninterest Income

Noninterest income was $943,000 and $2.0 million for the three and six months ended June 30, 2011, respectively, compared to $1.2 million and $2.3 million for the comparable prior year periods, respectively. An increase in the fees and service charges in the current year periods is primarily due to growth in the deposit base. Gains on sales of mortgage loans totaled $186,000 and $590,000 for the three and six months ended June 30, 2011, respectively, an increase from $66,000 and $121,000 for the three and six months ended June 30, 2010, respectively, due to an increase in mortgage activity resulting from lower mortgage loan interest rates in the 2011 periods and the Corporation's promotion of a no-cost closing program. Prior year noninterest income included gains on calls and sales of securities of $474,000 and $802,000 for the three and six months ended June 30, 2010, respectively while only $21,000 of gains on calls and sales of securities were realized in the comparable current year periods.

Index

Noninterest Expense

Noninterest expenses for the three and six months ended June 30, 2011 were $4.5 million and $9.2 million, respectively. For the comparable prior year periods, noninterest expenses were $4.2 million and $8.6 million, respectively. A higher level of expense associated with charitable contributions reflects the increased level of net income for the current year periods. In addition, the increase in noninterest expenses in the current year periods reflects the costs, such as legal and other collection-related expenses, incurred in connection with management of nonperforming assets. Partially offsetting these expense increases is a decrease in the FDIC insurance premiums reflecting a recent change in the quarterly assessment base.

Income Tax Expense

Income tax expense totaled $128,000 and $319,000 for the three and six months ended June 30, 2011, respectively. In the prior year, for the three and six months ended June 30, 2010, the Corporation recorded an income tax benefit of $641,000 and $296,000, respectively. The effective tax rate for the three and six months ended June 30, 2011 of 18.0% and 23.0%, respectively, reflects a decrease in our overall projected effective tax rate as a result of our tax exempt income representing a larger percentage of pretax income due to lower projected earnings. The tax benefit for the three and six months ended June 30, 2010 reflects the utilization of a capital loss carryforward to offset the taxability of a portion of the gain on calls and sales of securities. In addition, the tax benefit in these prior year periods also reflects a decrease in the overall projected effective tax rate as a result of our tax exempt income representing a larger percentage of pretax income due to lower projected earnings.

Asset Quality

The Corporation's principal earning asset is its loan portfolio. Inherent in the lending function is the risk of deterioration in the borrowers' ability to repay loans under existing loan agreements. Because of this risk, reserves are maintained to absorb probable incurred loan losses. In determining the adequacy of the allowance for loan losses, management of the Corporation considers the risks inherent in its loan portfolio and changes in the nature and volume of its loan activities, along with general economic and real estate market conditions. Although management attempts to establish a reserve sufficient to offset probable incurred losses in the portfolio, changes in economic conditions, regulatory policies and borrowers' performance could require future changes to the allowance.

Risk elements include nonaccrual loans, past due and restructured loans, potential problem loans, loan concentrations and other real estate owned. The following table shows the composition of nonperforming assets at the end of the last four quarters:

	June 30, 2011	March 31, 2011	December 31, 2010	September 30, 2010
Nonaccrual loans (1)	$23,834	$24,010	$22,500	$24,334
Loans past due 90 days or more and accruing (2)	2,342	-	-	10
Restructured loans	3,527	120	130	140
Total nonperforming loans	29,703	24,130	22,630	24,484
Other real estate owned	275	313	615	356
Total nonperforming assets	$29,978	$24,443	$23,245	$24,840
Allowance for loan losses	$11,230	$9,874	$8,490	$9,327

Nonperforming loans to total gross loans	6.34	%	5.25	%	5.01	%	5.43	%
Nonperforming assets to total assets	4.28	%	3.49	%	3.38	%	3.65	%
Allowance for loan losses to total gross loans	2.40	%	2.15	%	1.88	%	2.07	%
Allowance for loan losses to nonperforming loans	37.81	%	40.92	%	37.52	%	38.09	%

(1) Generally represents loans as to which the payment of principal or interest is in arrears for a period of more than 90 days. Interest previously accrued on these loans and not yet paid is reversed and charged against income during the current period. Interest earned thereafter is only included in income to the extent that it is received in cash.

(2) Represents loans as to which payment of principal or interest is contractually past due 90 days or more but which are currently accruing income at the contractually stated rates. A determination is made to continue accruing income on those loans which are sufficiently collateralized and on which management believes all interest and principal owed will be collected.

Index

A loan is generally placed on nonaccrual when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The identification of nonaccrual loans reflects careful monitoring of the loan portfolio. The Corporation has been diligent and proactive in identifying and dealing with problem credits and is focused on resolving the nonperforming loans and mitigating future losses in the portfolio. All delinquent loans continue to be reviewed by management on a biweekly basis.

The nonaccrual loans are comprised of 61 loans, primarily commercial real estate loans, commercial loans and construction loans. While the Corporation maintains strong underwriting requirements, the number and amount of nonaccrual loans is reflective of the prolonged weakened economic conditions and the corresponding effects it has had on our commercial borrowers and the current real estate environment. Certain loans, including restructured loans, are current, but in accordance with applicable guidance and cautious review, management has continued to keep these loans on nonaccrual.

Since December 31, 2010, nonaccrual loans have increased $1.3 million to $23.8 million at the end of the most recent quarter but have decreased slightly from $24.0 million at March 31, 2011. The ratio of allowance for loan losses to nonperforming loans increased slightly to 37.81% at June 30, 2011 from 37.52% at December 31, 2010, but reflects a decrease from 40.92% at March 31, 2011. The ratio of allowance for loan losses to nonperforming loans is reflective of detailed analysis and the probable incurred losses we have identified with these nonperforming loans. In calculating this metric, the effect of an increase in the allowance for loan losses has been offset by an increase in loans past due 90 days or more and accruing and restructured loans.

At June 30, 2011, the $2.3 million of loans past due 90 days or more and accruing represents a single loan for which a contract for sale of the underlying collateral is pending, with such sale expected to occur in the very near future, with the Corporation receiving a full payoff, including all accrued interest and principal outstanding.

Included in restructured loans as of June 30, 2011 is a loan for $2.3 million for which the estate of our borrower was provided with a forbearance to allow time to market for sale the underlying commercial real estate collateral. A contract for the sale of the property is currently pending, whereby upon closing of the sale transaction, the Corporation will collect all outstanding principal and accrued interest owed under the loan. The June 30, 2011 balance in restructured loans also includes two loans to a related borrower for $1.1 million. While these loans are current under their restructured terms, because of the below market rate of interest, these loans will continue to be reflected as restructured loans in accordance with accounting practices.

Evaluation of all nonperforming loans includes the updating of appraisals and specific evaluation of such loans to determine estimated cash flows from business and/or collateral. We have assessed these loans for collectability and considered, among other things, the borrower's ability to repay, the value of the underlying collateral, and other market conditions to ensure the allowance for loan losses is adequate to absorb probable incurred losses. The majority of our nonperforming loans are secured by real estate collateral. While our nonperforming loans have remained elevated from historic levels since March 31, 2010, the underlying collateral coverage for a considerable portion of the nonperforming loans supports the significant collection of our principal, and therefore, we do not estimate a proportionate upward trending in losses.

At June 30, 2011 the level of loans past due 30-89 days was $3.3 million, an improvement from $13.0 million at March 31, 2011 and $12.4 million at December 31, 2010. The Corporation will continue to monitor delinquencies for early identification of new problem loans. As such, the entire commercial construction portfolio is being actively monitored.

The Corporation maintains an allowance for loan losses at a level considered by management to be adequate to cover the probable incurred losses associated with its loan portfolio. The Corporation's policy with respect to the methodology for the determination of the allowance for loan losses involves a high degree of complexity and requires management to make difficult and subjective judgments. The adequacy of the allowance for loan losses is based upon management's evaluation of the known and inherent risks in the portfolio, consideration to the size and composition of the loan portfolio, actual loan loss experience, the level of delinquencies, detailed analysis of individual loans for which full collectability may not be assured, the existence and estimated net realizable value of any underlying collateral and guarantees securing the loans, and current economic and market conditions.

In establishing the allowance for loan losses, the Corporation utilizes a two tier approach by: (1) identifying problem loans and allocating specific loss allowances on such loans and (2) establishing a general valuation allowance on the remainder of its loan portfolio. The Corporation maintains a loan review system that allows for a periodic review of its loan portfolio and the early identification of potential problem loans. Such a system takes into consideration, among other things, delinquency status, size of loans, type of collateral and financial condition of the borrowers.

Index

Allocations of specific loan loss allowances are established for identified loans based on a review of various information including appraisals of underlying collateral. Appraisals are performed by independent licensed appraisers to determine the value of impaired, collateral-dependent loans. Appraisals are periodically updated to ascertain any further decline in value. General loan loss allowances are based upon a combination of factors including, but not limited to, actual loss experience, composition of the loan portfolio, current economic conditions and management's judgment.

Primarily as a result of the continuing higher level of nonperforming loans, the Corporation continues to record an elevated provision for loan losses. For the three and six months ended June 30, 2011, the provision for loan losses was \$1.915 million and \$3.590 million, respectively. The prior year provision for loan losses was \$4.705 million and \$6.255 million for the three and six months ended June 30 2010, respectively. The total allowance for loan losses increased to 2.40% of total loans from a comparable ratio of 2.15% at March 31, 2011 and 1.88% at December 31, 2010.

When it is probable that some portion or all of a loan balance will not be collected, that amount is charged off as a loss against the allowance for loan losses. After net chargeoffs of \$559,000 and \$850,000 for the three and six months ended June 30, 2011, respectively, the allowance for loan losses totaled \$11.2 million as of June 30, 2011 compared to \$9.9 million and \$8.5 million as of March 31, 2011 and December 31, 2010, respectively. In general, the chargeoffs reflect partial writedowns on nonaccrual loans due to the initial evaluation of market values of the underlying real estate collateral in accordance with Accounting Standards Codification 310-40. While we have taken the conservative position of partial and full chargeoffs on loans, we continue to aggressively pursue collection, including legal action.

As of June 30, 2011, there were \$28.5 million of other loans not included in the above table, compared to \$22.2 million and \$23.9 million at March 31, 2011 and December 31, 2010, respectively, where credit conditions of borrowers caused management to have concerns about the possibility of the borrowers not complying with the present terms and conditions of repayment and which may result in disclosure of such loans as nonperforming at a future date. These loans have been considered by management in conjunction with the analysis of the adequacy of the allowance for loan losses.

The Corporation's lending activities are concentrated in loans secured by real estate located in northern New Jersey. Accordingly, the collectability of a substantial portion of the Corporation's loan portfolio is susceptible to changes in real estate market conditions in northern New Jersey.

Capital Adequacy

The Corporation is subject to capital adequacy guidelines promulgated by the Board of Governors of the Federal Reserve System ("FRB"). The Bank is subject to similar capital adequacy requirements imposed by the Federal Deposit Insurance Corporation. The FRB has issued regulations to define the adequacy of capital based upon the sensitivity of assets and off-balance sheet exposures to risk factors. Four categories of risk weights (0%, 20%, 50%, and 100%) were established to be applied to different types of balance sheet assets and off-balance sheet exposures. The aggregate of the risk-weighted items (risk-based assets) is the denominator of the ratio; the numerator of the ratio is risk-based capital. Under the regulations, risk-based capital has been classified into two categories. Tier 1 capital includes common and qualifying perpetual preferred shareholders' equity less goodwill. Tier 2 capital includes mandatory convertible debt, allowance for loan losses, subject to certain limitations, and certain subordinated and term debt securities. Total qualifying capital consists of Tier 1 capital and Tier 2 capital; however; the amount of Tier 2 capital may not exceed the amount of Tier 1 capital. At June 30, 2011, the minimum risk-based capital requirements to be considered adequately capitalized were 4% for Tier 1 capital and 8% for total capital.

Index

Federal banking regulators have also adopted leverage capital guidelines to supplement the risk-based measures. The leverage ratio is determined by dividing Tier 1 capital as defined under the risk-based guidelines by average total assets (non risk-adjusted) for the preceding quarter. At June 30, 2011 the minimum leverage ratio requirement to be considered well capitalized was 4%. The following table summarizes the capital ratios for the Corporation and the Bank at June 30, 2011.

	Actual		Required for Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Regulations	
Leverage ratio						
Corporation	8.53	%	4.00	%	N/A	
Bank	8.11	%	4.00	%	5.00	%
Risk-based capital						
Tier I						
Corporation	12.01	%	4.00	%	N/A	
Bank	11.38	%	4.00	%	6.00	%
Total						
Corporation	13.27	%	8.00	%	N/A	
Bank	12.65	%	8.00	%	10.00	%

Liquidity and Capital Resources

The Corporation's primary sources of funds are deposits, amortization and prepayments of loans and mortgage-backed securities, maturities of investment securities and funds provided from operations. While scheduled loan and mortgage-backed securities amortization and maturities of investment securities are a relatively predictable source of funds, deposit flow and prepayments on loans and mortgage-backed securities are greatly influenced by market interest rates, economic conditions and competition. The Corporation's liquidity, represented by cash and cash equivalents, is a product of its operating, investing and financing activities.

The primary source of cash from operating activities is net income. Liquidity management is both a daily and long-term function of business management. Excess liquidity is generally invested in interest-earning cash accounts or in short-term investments, such as federal funds sold.

Cash and cash equivalents increased $5.9 million during the first six months of 2011. Net operating and financing activities provided $15.0 million and $10.1 million, respectively, while investing activities used $19.2 million.

We anticipate that the Corporation will have sufficient funds available to meet its current contractual commitments. Should we need temporary funding, the Corporation has the ability to borrow overnight with the FHLB-NY. The overall borrowing capacity is contingent on available collateral to secure borrowings and the ability to purchase additional activity-based capital stock of the FHLB-NY. In addition, the Corporation has available overnight variable repricing lines of credit with other correspondent banks totaling $16.0 million on an unsecured basis.

With respect to the payment of dividends on common stock, the Corporation has historically paid a quarterly cash dividend, however management recognizes that the payment of future dividends could be impacted by losses or reduced earnings and the Corporation cannot assure the payment of future dividends.

Index

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

Not applicable to smaller reporting companies.

ITEM 4. Controls and Procedures

Evaluation of internal controls and procedures

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our principal executive officer and principal financial officer have concluded that our internal disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

Changes in Internal Controls over Financial Reporting

Pursuant to Rule 13a-15(d) under the Exchange Act, our management, with the participation of our principal executive officer and principal financial officer, has evaluated our internal controls over financial reporting and based upon such evaluation concluded that there were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended June 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Index

Part II -- Other Information

Item 6. Exhibits

See Exhibit Index following this report.

Index

SIGNATURES

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

Stewardship Financial Corporation

Date: August 15, 2011

By: /s/ Paul Van Ostenbridge
Paul Van Ostenbridge
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 15, 2011

By: /s/ Claire M. Chadwick
Claire M. Chadwick
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

Index

EXHIBIT INDEX

Exhibit Number	Description of Exhibits
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002