

PATRIOT NATIONAL BANCORP INC

Form 10-Q

May 13, 2011

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q  
QUARTERLY REPORT UNDER SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the Quarter Ended March 31, 2011**

**Commission file number 000-29599**

**PATRIOT NATIONAL BANCORP, INC.**

(Exact name of registrant as specified in its charter)

Connecticut  
(State of incorporation)

900 Bedford Street, Stamford, Connecticut 06901  
(Address of principal executive offices)  
(203) 324-7500  
(Registrant's telephone number)

06-1559137  
(I.R.S. Employer Identification Number)

Check whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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  No

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

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes  No

State the number of shares outstanding of each of the registrant's classes of common equity, as of the latest practicable date.

Common stock, \$0.01 par value per share, 38,362,727 shares outstanding as of the close of business April 29, 2011.

---

Table of Contents

	Page
<u>Part I FINANCIAL INFORMATION</u>	
<u>Item 1. Consolidated Financial Statements</u>	3
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	33
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	47
<u>Item 4. Controls and Procedures</u>	48
<u>Part II OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	49
<u>Item 1A. Risk Factors</u>	49
<u>Item 6. Exhibits</u>	49
<u>Exhibit 31(1)</u>	
<u>Exhibit 31(2)</u>	
<u>Exhibit 32</u>	

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1: Consolidated Financial Statements****PATRIOT NATIONAL BANCORP, INC.****CONSOLIDATED BALANCE SHEETS**

	<b>March 31, 2011</b> <b>(Unaudited)</b>	December 31, 2010
<b>ASSETS</b>		
Cash and due from banks:		
Noninterest bearing deposits and cash	\$ 5,902,555	\$ 4,613,211
Interest bearing deposits	140,645,166	131,711,047
Federal funds sold	10,000,000	10,000,000
Short-term investments	501,074	453,400
 Total cash and cash equivalents	 157,048,795	 146,777,658
Securities:		
Available for sale securities, at fair value (Note 2)	38,539,143	40,564,700
Other Investments	3,500,000	3,500,000
Federal Reserve Bank stock, at cost	2,175,900	1,192,000
Federal Home Loan Bank stock, at cost	4,508,300	4,508,300
 Total securities	 48,723,343	 49,765,000
Loans receivable (net of allowance for loan losses: 2011: \$12,208,476, 2010: \$15,374,101) (Note 3)	466,869,274	534,531,213
Accrued interest and dividends receivable	2,325,703	2,512,186
Premises and equipment, net	4,915,587	5,270,312
Cash surrender value of life insurance	20,516,592	20,348,332
Other real estate owned	950,000	16,408,787
Deferred tax asset (Note 9)		
Other assets	8,365,016	8,711,366
 <b>Total assets</b>	 <b>\$ 709,714,310</b>	 <b>\$ 784,324,854</b>
 <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>Liabilities</b>		
Deposits (Note 4):		
Noninterest bearing deposits	\$ 55,691,927	\$ 51,058,373
Interest bearing deposits	525,591,104	595,750,456
 Total deposits	 581,283,031	 646,808,829
Borrowings:		
Repurchase agreements	7,000,000	7,000,000
Federal Home Loan Bank borrowings	50,000,000	50,000,000
 Total borrowings	 57,000,000	 57,000,000

Junior subordinated debt owed to unconsolidated trust	<b>8,248,000</b>	8,248,000
Accrued expenses and other liabilities	<b>4,990,464</b>	5,095,837
<b>Total liabilities</b>	<b>651,521,495</b>	717,152,666
Commitments (Note 7)		
<b>Shareholders equity</b>		
Preferred stock, no par value; 1,000,000 shares authorized, no shares issued and outstanding		
Common stock, \$.01 par value, 100,000,000 shares authorized; 38,374,432 shares issued; 38,362,727 shares outstanding	<b>383,744</b>	383,744
Additional paid-in capital	<b>105,050,433</b>	105,050,433
Accumulated deficit	<b>(48,381,943)</b>	(39,399,345)
Less: Treasury stock, at cost: 2011 and 2010 11,705 shares	<b>(160,025)</b>	(160,025)
Accumulated other comprehensive income	<b>1,300,606</b>	1,297,381
<b>Total shareholders equity</b>	<b>58,192,815</b>	67,172,188
<b>Total liabilities and shareholders equity</b>	<b>\$ 709,714,310</b>	\$ 784,324,854

See Accompanying Notes to Consolidated Financial Statements.

**Table of Contents**

**PATRIOT NATIONAL BANCORP, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**

	Three Months Ended March 31,	
	2011	2010
Interest and Dividend Income		
Interest and fees on loans	\$ 6,956,561	\$ 9,096,489
Interest on investment securities	274,183	489,564
Dividends on investment securities	69,901	69,286
Interest on federal funds sold	4,026	3,361
Other interest income	61,890	31,815
<b>Total interest and dividend income</b>	<b>7,366,561</b>	<b>9,690,515</b>
Interest Expense		
Interest on deposits	1,865,349	3,117,316
Interest on Federal Home Loan Bank borrowings	418,875	418,875
Interest on subordinated debt	70,398	69,333
Interest on other borrowings	76,082	76,081
<b>Total interest expense</b>	<b>2,430,704</b>	<b>3,681,605</b>
<b>Net interest income</b>	<b>4,935,857</b>	<b>6,008,910</b>
Provision for Loan Losses	6,981,629	727,000
<b>Net interest (loss) income after provision for loan losses</b>	<b>(2,045,772)</b>	<b>5,281,910</b>
Non-interest Income		
Mortgage brokerage referral fees	13,000	26,884
Loan application, inspection & processing fees	16,799	35,828
Fees and service charges	280,901	253,521
Earnings on cash surrender value of life insurance	168,260	130,111
Other income	103,890	92,124
<b>Total non-interest income</b>	<b>582,850</b>	<b>538,468</b>
Non-interest Expenses		
Salaries and benefits	3,214,515	3,361,284
Occupancy and equipment expense	1,354,567	1,416,150
Data processing	327,804	348,934
Advertising and promotional expenses	157,974	83,633

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Professional and other outside services	881,707	1,063,595
Loan administration and processing expenses	37,059	95,803
Regulatory assessments	611,268	694,843
Insurance expense	230,774	273,297
Other real estate operations	270,507	978,691
Material and communications	200,138	201,282
Other operating expenses	233,363	209,432
<b>Total non-interest expenses</b>	<b>7,519,676</b>	<b>8,726,944</b>
<b>Loss before income taxes</b>	<b>(8,982,598)</b>	<b>(2,906,566)</b>
Provision for Income Taxes		(225,000)
<b>Net loss</b>	<b>\$ (8,982,598)</b>	<b>\$ (3,131,566)</b>
<b>Basic and diluted loss per share</b>	<b>\$ (0.23)</b>	<b>\$ (0.66)</b>

See Accompanying Notes to Consolidated Financial Statements.

**Table of Contents**

**PATRIOT NATIONAL BANCORP, INC**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY**  
**(Unaudited)**

	Number of Shares	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive Income	Total
<b>Three months ended March 31, 2010</b>							
Balance at December 31, 2009	4,762,727	\$ 9,548,864	\$ 49,651,534	\$ (24,000,400)	\$ (160,025)	\$ 821,337	\$ 35,861,310
Comprehensive loss							
Net loss				(3,131,566)			(3,131,566)
Unrealized holding gain on available for sale securities, net of taxes						344,376	344,376
Total comprehensive loss							(2,787,190)
Balance, March 31, 2010	4,762,727	\$ 9,548,864	\$ 49,651,534	\$ (27,131,966)	\$ (160,025)	\$ 1,165,713	\$ 33,074,120
<b>Three months ended March 31, 2011</b>							
Balance at December 31, 2010	38,362,727	\$ 383,744	\$ 105,050,433	\$ (39,399,345)	\$ (160,025)	\$ 1,297,381	\$ 67,172,188
Comprehensive loss							
Net loss				(8,982,598)			(8,982,598)
Unrealized holding gain on available for sale						3,225	3,225



securities, net of  
taxes

Total  
comprehensive  
loss

(8,979,373)

Balance,

March 31, 2011 38,362,727 \$ 383,744 \$ 105,050,433 \$(48,381,943) \$(160,025) \$ 1,300,606 \$ 58,192,815

See Accompanying Notes to Consolidated Financial Statements.

Table of Contents

**PATRIOT NATIONAL BANCORP, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

	Three Months Ended March 31,	
	2011	2010
Cash Flows from Operating Activities:		
Net loss	\$ (8,982,598)	\$ (3,131,566)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization and accretion of investment premiums and discounts, net	54,861	45,171
Amortization and accretion of purchase loan premiums and discounts, net	2,514	1,338
Provision for loan losses	6,981,629	727,000
Amortization of core deposit intangible	3,753	3,975
Earnings on cash surrender value of life insurance	(168,260)	(130,111)
Depreciation and amortization	347,700	389,515
Loss on sale of other real estate owned	58,215	52,977
Impairment writedown on other real estate owned	165,764	701,197
Changes in assets and liabilities:		
Increase (decrease) in deferred loan fees	149,244	(134,918)
Decrease in accrued interest and dividends receivable	186,483	7,713
Decrease in other assets	342,597	853,474
(Decrease) increase in accrued expenses and other liabilities	(107,350)	401,878
<b>Net cash used in operating activities</b>	<b>(965,448)</b>	<b>(212,357)</b>
Cash Flows from Investing Activities:		
Purchases of available for sale securities		(15,162,500)
Principal repayments on available for sale securities	1,975,898	1,502,234
Proceeds from repurchase of excess stock by the Federal Reserve Bank	190,200	
Purchases of Federal Reserve Bank Stock	(1,174,100)	
Proceeds from sale of loans	46,440,794	
Net decrease in loans	14,087,758	19,670,978
Purchase of other real estate owned	(481,165)	
Proceeds from sale of other real estate owned	15,715,973	112,623
Refund (purchase) of bank premises and equipment	7,025	(24,634)
<b>Net cash provided by investing activities</b>	<b>76,762,383</b>	<b>6,098,701</b>
Cash Flows from Financing Activities:		
Net decrease in demand, savings and money market deposits	(7,445,003)	(8,359,465)
Net decrease in time certificates of deposits	(58,080,795)	(41,133,952)
<b>Net cash used in financing activities</b>	<b>(65,525,798)</b>	<b>(49,493,417)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>10,271,137</b>	<b>(43,607,073)</b>

Cash and Cash Equivalents:		
Beginning	146,777,658	107,799,432
Ending	\$ 157,048,795	\$ 64,192,359

**Table of Contents**

**PATRIOT NATIONAL BANCORP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS, Continued  
(Unaudited)**

	Three Months Ended March 31,	
	2011	2010
Supplemental Disclosures of Cash Flow Information		
Interest paid	\$ 2,355,998	\$ 3,658,816
Income taxes paid	\$ 8,534	\$ 2,080
Supplemental disclosures of noncash investing and financing activities:		
Unrealized holding gain on available for sale securities arising during the period	\$ 5,202	\$ 555,444

See Accompanying Notes to Consolidated Financial Statements.

**Table of Contents****PATRIOT NATIONAL BANCORP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)****Note 1: Basis of Financial Statement Presentation**

The Consolidated Balance Sheet at December 31, 2010 has been derived from the audited financial statements of Patriot National Bancorp, Inc. ( Bancorp or the Company ) at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

The accompanying unaudited financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The accompanying consolidated financial statements and related notes should be read in conjunction with the audited financial statements of Bancorp and notes thereto for the year ended December 31, 2010.

The information furnished reflects, in the opinion of management, all normal recurring adjustments necessary for a fair presentation of the results for the interim periods presented. The results of operations for the three months March 31, 2011 are not necessarily indicative of the results of operations that may be expected for the remainder of 2011.

**Note 2: Investment Securities**

The amortized cost, gross unrealized gains, gross unrealized losses and approximate fair values of available-for-sale securities at March 31, 2011 and December 31, 2010 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2011:				
U. S. Government agency mortgage-backed securities	\$ 34,541,671	\$ 738,434	\$ (2,929)	\$ 35,277,176
Auction rate preferred equity securities	1,899,720	1,362,247		3,261,967
	\$ 36,441,391	\$ 2,100,681	\$ (2,929)	\$ 38,539,143
December 31, 2010:				
U. S. Government agency mortgage-backed securities	\$ 36,572,430	\$ 900,286	\$ (838)	\$ 37,471,878
Auction rate preferred equity securities	1,899,720	1,193,102		3,092,822
	\$ 38,472,150	\$ 2,093,388	\$ (838)	\$ 40,564,700

**Table of Contents**

The following table presents the gross unrealized loss and fair value of Bancorp's available-for-sale securities, aggregated by the length of time the individual securities have been in a continuous loss position, at March 31, 2011 and December 31, 2010:

	<b>Less Than 12 Months</b>		<b>12 Months or More</b>		<b>Total</b>	
	<b>Fair</b>	<b>Unrealized</b>	<b>Fair</b>	<b>Unrealized</b>	<b>Fair</b>	<b>Unrealized</b>
	<b>Value</b>	<b>Loss</b>	<b>Value</b>	<b>Loss</b>	<b>Value</b>	<b>Loss</b>
March 31, 2011:						
U. S. Government mortgage - backed securities	\$ 340,570	\$ (2,929)	\$	\$	\$ 340,570	\$ (2,929)
Totals	\$ 340,570	\$ (2,929)	\$	\$	\$ 340,570	\$ (2,929)
December 31, 2010:						
U. S. Government mortgage - backed securities	\$ 86,375	\$ (838)	\$	\$	\$ 86,375	\$ (838)
Totals	\$ 86,375	\$ (838)	\$	\$	\$ 86,375	\$ (838)

At March 31, 2011, four securities had unrealized holding losses with aggregate depreciation of 0.86% from the amortized cost. There were no securities with unrealized losses greater than 5% of amortized cost. At December 31, 2010, two securities had unrealized losses with aggregate depreciation of 1.0% from the amortized cost. There were no securities with unrealized losses greater than 5% of amortized cost.

Bancorp performs a quarterly analysis of those securities that are in an unrealized loss position to determine if those losses qualify as other-than-temporary impairments. This analysis considers the following criteria in its determination: the ability of the issuer to meet its obligations, an impairment due to a deterioration in credit, management's plans and ability to maintain its investment in the security, the length of time and the amount by which the security has been in a loss position, the interest rate environment, the general economic environment and prospects or projections for improvement or deterioration.

Management believes that none of the unrealized losses on available-for-sale securities noted above are other than temporary due to the fact that they relate to interest rate changes on mortgage-backed securities issued by U.S. Government agencies. Management considers the issuers of the securities to be financially sound, and the Company expects to receive all contractual principal and interest related to these investments. Because the Company does not intend to sell the investments, and it is not more-likely-than-not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at March 31, 2011.

**Table of Contents**

The amortized cost and fair value of available-for-sale debt securities at March 31, 2011 by contractual maturity are presented below. Actual maturities of mortgage-backed securities may differ from contractual maturities because the mortgages underlying the securities may be called or repaid without any penalties. Because mortgage-backed securities are not due at a single maturity date, they are not included in the maturity categories in the following maturity summary:

	Amortized Cost	Fair Value
Maturity:		
> 10 years	\$	\$
Mortgage-backed securities	34,541,671	35,277,176
	Amortized Cost	Fair Value
Total	\$ 34,541,671	\$ 35,277,176
	Amortized Cost	Fair Value

**Note 3: Loans Receivable and Allowance for Loan Losses**

A summary of the Company's loan portfolio at March 31, 2011 and December 31, 2010 is as follows:

	March 31, 2011	December 31, 2010
Real Estate		
Commercial	\$ 212,785,433	\$ 228,842,489
Residential	157,743,571	187,058,318
Construction	39,639,058	63,889,083
Construction to permanent	10,315,902	10,331,043
Commercial	18,873,362	14,573,790
Consumer home equity	37,432,068	42,884,962
Consumer installment	2,047,248	1,932,763
Total Loans	478,836,642	549,512,448
Premiums on purchased loans	239,912	242,426
Net deferred costs	1,196	150,440
Allowance for loan losses	(12,208,476)	(15,374,101)
Loans receivable, net	\$ 466,869,274	\$ 534,531,213

The changes in the allowance for loan losses for the periods shown are as follows:

	Three months ended March 31,	
	2011	2010
Balance, beginning of period	\$ 15,374,101	\$ 15,794,118
Provision for loan losses	6,981,629	727,000
Loans charged-off	(4,153,547)	(1,583,247)
Recoveries of loans previously charged-off	20,606	123,925
Transferred to loans held-for-sale	(6,014,313)	
Balance, end of period	\$ 12,208,476	\$ 15,061,796





**Table of Contents**

At March 31, 2011 and December 31, 2010, the unpaid balances of loans delinquent 90 days or more and still accruing interest were \$223,289 and \$3,374,242, respectively. All borrowers of said loans at March 31, 2011 continue to make interest payments, but these loans have matured and were in the process of being renewed.

The unpaid principal balances of loans on nonaccrual status and considered impaired were \$32.5 million at March 31, 2011 and \$89.1 million at December 31, 2010. On March 24, 2011, the Bank completed the sale of certain non-performing assets that included 21 non-accruing loans with an aggregate net book value of \$52.4 million (net of related specific reserves) and 4 OREO properties with an aggregate carrying value of \$14.4 million. The sale of \$66.8 million of non-performing assets was consummated for a cash purchase price of \$60,602,036 which represented 90.7% of the Bank's net book value for these assets.

If non-accrual loans had been performing in accordance with their original terms, Bancorp would have recorded approximately \$1.0 million of additional income during the quarter ended March 31, 2011 and \$2.3 million during the quarter ended March 31, 2010.

For the three months ended March 31, 2011 and 2010, the interest collected and recognized as income on impaired loans was approximately \$431,000 and \$733,000, respectively.

At March 31, 2011, there were 16 loans totaling \$32.9 million that were considered troubled debt restructurings, all of which are included in impaired loans, as compared to December 31, 2010 when there were 19 loans totaling \$38.0 million, all of which were included in impaired loans. At March 31, 2011, 7 of the 16 loans aggregating \$18.0 million were accruing loans and 9 loans aggregating \$14.9 million were non-accruing loans.

The Company's lending activities are conducted principally in Fairfield and New Haven Counties in Connecticut and Westchester County, New York City and Long Island, New York. The Company grants commercial real estate loans, commercial business loans and a variety of consumer loans. In addition, the Company had granted loans for the construction of residential homes, residential developments and for land development projects. A moratorium on all new construction loans was instituted by management in July 2008. All residential and commercial mortgage loans are collateralized by first or second mortgages on real estate. The ability and willingness of borrowers to satisfy their loan obligations is dependent in large part upon the status of the regional economy and regional real estate market. Accordingly, the ultimate collectability of a substantial portion of the loan portfolio and the recovery of a substantial portion of any resulting real estate acquired is susceptible to changes in market conditions.

The Company has established credit policies applicable to each type of lending activity in which it engages, evaluates the creditworthiness of each customer and, in most cases, extends credit of up to 75% of the market value of the collateral at the date of the credit extension depending on the Company's evaluation of the borrower's creditworthiness and type of collateral. In the case of construction loans, the maximum loan-to-value was 65% of the as completed market value. The market value of collateral is monitored on an ongoing basis and additional collateral is obtained when warranted. Real estate is the primary form of collateral. Other important forms of collateral are accounts receivable, inventory, other business assets, marketable securities and time deposits. While collateral provides assurance as a secondary source of repayment, the Company ordinarily requires the primary source of repayment to be based on the borrower's ability to generate continuing cash flows on all loans not related to construction.

The Company does not have any lending programs commonly referred to as subprime lending. Subprime lending generally targets borrowers with weakened credit histories typically characterized by payment delinquencies, previous charge-offs, judgments, bankruptcies, or borrowers with questionable repayment capacity as evidenced by low credit scores or high debt-burdened ratios.

**Table of Contents**

The following table sets forth activity in our allowance for loan losses, by loan type, for the period ended March 31, 2011. The following table also details the amount of loans receivable, net, that are evaluated individually, and collectively, for impairment, and the related portion of allowance for loan losses that is allocated to each loan portfolio segment.

As of March 31, 2011	Commercial		Construction		Residential	Consumer	Unallocated	
	Commercial	Real Estate	Construction	Permanent				
Allowance for loan losses:								
Beginning balance	\$ 441,319	\$ 7,632,355	\$ 3,478,058	\$ 491,446	\$ 2,363,838	\$ 578,612	\$ 388,473	\$
		(934,588)	(1,760,760)		(1,458,199)			
	240		17,694			2,672		
Loans held-for sale		(963,461)	(1,369,354)		(3,681,498)			
	149,313	842,195	2,572,464	38,299	3,873,621	(128,576)	(365,687)	
Allowance:								
individually	\$ 590,872	\$ 6,576,501	\$ 2,938,102	\$ 529,745	\$ 1,097,762	\$ 452,708	\$ 22,786	\$
for impairment	\$ 78,286	\$ 1,887,042	\$ 1,657,278	\$ 187,094	\$	\$	\$	\$
collectively evaluated								
for impairment	\$ 512,586	\$ 4,689,459	\$ 1,280,824	\$ 342,651	\$ 1,097,762	\$ 452,708	\$ 22,786	\$
Allowance for Loan Losses	\$ 590,872	\$ 6,576,501	\$ 2,938,102	\$ 529,745	\$ 1,097,762	\$ 452,708	\$ 22,786	\$
Ending balance	\$ 18,873,362	\$ 212,785,433	\$ 39,639,058	\$ 10,315,902	\$ 157,743,571	\$ 39,479,316	\$	\$ 4
Allowance:								
individually	\$ 1,362,000	\$ 20,461,392	\$ 13,907,356	\$ 1,364,694	\$ 11,927,547	\$ 1,516,977	\$	\$
for impairment								
collectively	\$ 17,511,362	\$ 192,324,041	\$ 25,731,702	\$ 8,951,208	\$ 145,816,024	\$ 37,962,339	\$	\$ 4
evaluated for impairment								

**Table of Contents**

The Company monitors the credit quality of its loans receivable in an ongoing manner. Credit quality is monitored by reviewing certain credit quality indicators. Management has determined that loan-to-value ratios (LTVs), (at period end) and internally assigned risk ratings are the key credit quality indicators that best help management monitor the credit quality of the Company's loans receivable. Loan-to-value ratios used by management in monitoring credit quality are based on current period loan balances and original values at time of origination (unless a current appraisal has been obtained as a result of the loan being deemed impaired or the loan is a maturing construction loan).

The Company has a risk rating system as part of the risk assessment of its loan portfolio. The Company's lending officers are required to assign a risk rating to each loan in their portfolio at origination. When the lender learns of important financial developments, the risk rating is reviewed accordingly, and adjusted if necessary. Similarly, the Loan Committee can adjust a risk rating. The Director's Loan Committee, meets on a regular basis and reviews all loans rated special mention or worse. In addition, the Company engages a third party independent loan reviewer that performs semi-annual reviews of a sample of loans, validating the Bank's risk ratings assigned to such loans. The risk ratings play an important role in the establishment of the loan loss provision and to confirm the adequacy of the allowance for loan losses.

When assigning a risk rating to a loan, management utilizes the Bank's internal nine-point risk rating system. Loans deemed to be acceptable quality are rated 1 through 5, with a rating of 1 established for loans with minimal risk and borrowers exhibiting the strongest financial condition. Loans rated 1-5 are considered Pass. Loans that are deemed to be of questionable quality are rated 6 (special mention). An asset is considered special mention when it has a potential weakness based on objective evidence, but does not currently expose the Company to sufficient risk to warrant classification in one of the following categories. Loans with adverse classifications (substandard, doubtful or loss) are rated 7, 8 or 9, respectively. An asset is considered substandard if it is not adequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets have well defined weaknesses based on objective evidence, and are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted.

**Table of Contents**

The following table details the credit risk exposure of loans receivable, by loan type and credit quality indicator at March 31, 2011:

**CREDIT RISK PROFILE BY CREDITWORTHINESS CATEGORY**

Commercial Real Estate		Construction		Construction to Permanent		Residential Real Estate			
< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%	> 75%
\$ 125,971,796	\$ 9,408,746	\$ 627,784	\$	\$	\$	\$ 96,850,024	\$ 41,830,172	\$ 32,292,893	\$
27,115,428	4,661,064	11,897,872	4,485,209	1,709,333		521,451		274,340	3
15,266,412	30,361,987	5,693,859	16,934,334		8,606,569	3,659,013	14,882,911	99,235	1
\$ 168,353,636	\$ 44,431,797	\$ 18,219,515	\$ 21,419,543	\$ 1,709,333	\$ 8,606,569	\$ 101,030,488	\$ 56,713,083	\$ 32,666,468	\$ 5

**CREDIT RISK PROFILE**

	Commercial	Commercial Real Estate	Construction	Construction to Permanent	Residential Real Estate	Consumer	Totals
Performing	\$ 17,511,362	\$ 196,982,562	\$ 29,231,702	\$ 8,951,208	\$ 155,243,570	\$ 38,386,339	\$ 446,306,743
Non Performing	1,362,000	15,802,871	10,407,356	1,364,694	2,500,001	1,092,977	32,529,899
Total	\$ 18,873,362	\$ 212,785,433	\$ 39,639,058	\$ 10,315,902	\$ 157,743,571	\$ 39,479,316	\$ 478,836,642

**Table of Contents**

The following table details the credit risk exposure of loans receivable, by loan type and credit quality indicator at December 31, 2010:

**CREDIT RISK PROFILE BY CREDITWORTHINESS CATEGORY**

Commercial Real Estate		Construction		Construction to Permanent		Residential Real Estate		Consumer
< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%	>= 75%	< 75%
\$ 124,645,152	\$ 9,449,059	\$ 1,272,028	\$ 350,000	\$	\$	\$ 91,534,348	\$ 51,996,851	\$ 35,192,214
35,253,018	4,645,738	15,059,704	4,485,209	1,709,333		2,088,700	2,907,285	3,146,244
13,792,482	41,057,040	10,712,146	32,009,996		8,621,710	18,052,003	20,479,131	99,235
\$ 173,690,652	\$ 55,151,837	\$ 27,043,878	\$ 36,845,205	\$ 1,709,333	\$ 8,621,710	\$ 111,675,051	\$ 75,383,267	\$ 38,437,693

**CREDIT RISK PROFILE**

	Commercial	Commercial Real Estate	Construction	Construction to Permanent	Residential Real Estate	Consumer	Totals
Performing	\$ 13,358,840	\$ 202,054,317	\$ 33,003,060	\$ 8,951,208	\$ 159,270,574	\$ 43,724,749	\$ 460,362,748
Non Performing	1,214,950	26,788,172	30,886,023	1,379,835	27,787,744	1,092,976	89,149,700
Total	\$ 14,573,790	\$ 228,842,489	\$ 63,889,083	\$ 10,331,043	\$ 187,058,318	\$ 44,817,725	\$ 549,512,448

**Table of Contents**

Included in loans receivable are loans for which the accrual of interest income has been discontinued due to deterioration in the financial condition of the borrowers. The recorded balance of these nonaccrual loans was \$32.5 million and \$89.1 million at March 31, 2011, and December 31, 2010 respectively. Generally, loans are placed on non-accruing status when they become 90 days or more delinquent, or earlier if deemed appropriate, and remain on non-accrual status until they are brought current, have six months of performance under the loan terms, and factors indicating reasonable doubt about the timely collection of payments no longer exist. Therefore, loans may be current in accordance with their loan terms, or may be less than 90 days delinquent and still be on a non-accruing status. Additionally, certain loans that cannot demonstrate sufficient global cash flow to continue loan payments in the future and certain trouble debt restructures (TDRs) are placed on non-accrual status.

The following table sets forth the detail, and delinquency status, of non-accrual loans and past due loans at March 31, 2011:

	<b>Non-Accrual and Past Due Loans</b>						<b>Total Non-Accrual and Past Due Loans</b>
	<b>31-60 Days Past Due</b>	<b>61-90 Days Past Due</b>	<b>Greater Than 90 Days</b>	<b>Total Past Due</b>	<b>Current</b>	<b>&gt;90 Days Past Due and Accruing</b>	
<b>2011</b>							
Commercial Pass	\$	\$	\$	\$	\$	\$ 160,000	\$ 160,000
Special Mention						63,289	63,289
Substandard			797,088	797,088	564,912		1,362,000
Total Commercial	\$	\$	\$ 797,088	\$ 797,088	\$ 564,912	\$ 223,289	\$ 1,585,289
Commercial Real Estate							
Substandard	\$ 215,947	\$ 1,444,681	\$ 11,040,965	\$ 12,701,593	\$ 3,101,278	\$	\$ 15,802,871
Total Commercial Real Estate	\$ 215,947	\$ 1,444,681	\$ 11,040,965	\$ 12,701,593	\$ 3,101,278	\$	\$ 15,802,871
Construction							
Substandard	\$	\$ 2,562,975	\$ 3,103,580	\$ 5,666,555	\$ 4,740,801	\$	\$ 10,407,356
Total Construction	\$	\$ 2,562,975	\$ 3,103,580	\$ 5,666,555	\$ 4,740,801	\$	\$ 10,407,356
Construction to Permanent							
Substandard	\$	\$	\$	\$	\$ 1,364,694	\$	\$ 1,364,694
Total Construction to Permanent	\$	\$	\$	\$	\$ 1,364,694	\$	\$ 1,364,694
Residential Real Estate							
Substandard	\$	\$	\$ 2,500,001	\$ 2,500,001	\$	\$	\$ 2,500,001

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Total Residential							
Real Estate	\$	\$	\$ 2,500,001	\$ 2,500,001	\$	\$	\$ 2,500,001
Consumer							
Substandard	\$	\$	\$ 1,092,977	\$ 1,092,977	\$	\$	\$ 1,092,977
Total Consumer	\$	\$	\$ 1,092,977	\$ 1,092,977	\$	\$	\$ 1,092,977
Total	\$ 215,947	\$ 4,007,656	\$ 18,534,611	\$ 22,758,214	\$ 9,771,685	\$ 223,289	\$ 32,753,188

**Table of Contents**

The following table sets forth the detail, and delinquency status, of non-accrual loans and past due loans at December 31, 2010:

2010	Non-Accrual and Past Due Loans					>90 Days Past Due and Accruing	Total Non-Accrual and Past Due Loans
	31-60 Days Past Due	61-90 Days Past Due	Greater Than 90 Days	Total Past Due	Current		
Commercial Special Mention Substandard	\$ 350,000	\$ 100,000	\$ 698,767	\$ 1,148,767	\$ 66,183	\$ 63,289 175,000	\$ 63,289 1,389,950
Total Commercial	\$ 350,000	\$ 100,000	\$ 698,767	\$ 1,148,767	\$ 66,183	\$ 238,289	\$ 1,453,239
Commercial Real Estate Substandard	\$ 269,672	\$ 6,449,096	\$ 13,521,123	\$ 20,239,891	\$ 6,548,281	\$	\$ 26,788,172
Total Commercial Real Estate	\$ 269,672	\$ 6,449,096	\$ 13,521,123	\$ 20,239,891	\$ 6,548,281	\$	\$ 26,788,172
Construction Substandard	\$ 1,517,943	\$ 4,059,516	\$ 13,736,985	\$ 19,314,444	\$ 11,571,579	\$ 3,135,953	\$ 34,021,976
Total Construction	\$ 1,517,943	\$ 4,059,516	\$ 13,736,985	\$ 19,314,444	\$ 11,571,579	\$ 3,135,953	\$ 34,021,976
Construction to Permanent Substandard	\$	\$	\$	\$	\$ 1,379,835	\$	\$ 1,379,835
Total Construction to Permanent	\$	\$	\$	\$	\$ 1,379,835	\$	\$ 1,379,835
Residential Real Estate Substandard	\$	\$	\$ 15,897,248	\$ 15,897,248	\$ 11,890,496	\$	\$ 27,787,744
Total Residential Real Estate	\$	\$	\$ 15,897,248	\$ 15,897,248	\$ 11,890,496	\$	\$ 27,787,744
Consumer Substandard	\$	\$	\$ 1,092,976	\$ 1,092,976	\$	\$	\$ 1,092,976
Total Consumer	\$	\$	\$ 1,092,976	\$ 1,092,976	\$	\$	\$ 1,092,976



Total                    \$ 2,137,615   \$ 10,608,612   \$ 44,947,099   \$ 57,693,326   \$ 31,456,374   \$ 3,374,242   \$ 92,523,942

These non-accrual and past due amounts included loans deemed to be impaired of \$32.5 million and \$89.1 million at March 31, 2011, and December 31, 2010, respectively. Loans past due ninety days or more and still accruing interest were \$223,000 and \$3.4 million at March 31, 2011, and December 31, 2010 respectively, and consisted of loans that are current as to payment but past maturity where payoff is pending or in the process of renewal.

**Table of Contents**

The following table sets forth the detail and delinquency status of loans receivable, by performing and non-performing loans at March 31, 2011.

	Performing (Accruing) Loans					Total Performing Loans	Total Non-Accrual and Past Due Loans		Total Loans
	31-60 Days Past Due	61-90 Days Past Due	Greater Than 90 Days	Total Past Due	Current		Total Loans	Total Loans	
<b>2011</b>									
Commercial									
Pass	\$	\$	\$	\$	\$ 12,891,800	\$ 12,891,800	\$ 160,000	\$ 13,051,800	
Special Mention					815,498	815,498	63,289	878,787	
Substandard					3,580,775	3,580,775	1,362,000	4,942,775	
Total Commercial	\$	\$	\$	\$	\$ 17,288,073	\$ 17,288,073	\$ 1,585,289	\$ 18,873,362	
Commercial Real Estate									
Pass	\$	\$	\$	\$	\$ 135,380,542	\$ 135,380,542	\$	\$ 135,380,542	
Special Mention					31,776,492	31,776,492		31,776,492	
Substandard	1,236,000	915,762		2,151,762	27,673,766	29,825,528	15,802,871	45,628,399	
Total Commercial Real Estate	\$ 1,236,000	\$ 915,762	\$	\$ 2,151,762	\$ 194,830,800	\$ 196,982,562	\$ 15,802,871	\$ 212,785,433	
Construction									
Pass	\$	\$	\$	\$	\$ 627,784	\$ 627,784	\$	\$ 627,784	
Special Mention					16,383,081	16,383,081		16,383,081	
Substandard					12,220,837	12,220,837	10,407,356	22,628,193	
Total Construction	\$	\$	\$	\$	\$ 29,231,702	\$ 29,231,702	\$ 10,407,356	\$ 39,639,058	
Construction to Permanent									
Pass	\$	\$	\$	\$	\$	\$	\$	\$	
Special Mention					1,709,333	1,709,333		1,709,333	
Substandard					7,241,875	7,241,875	1,364,694	8,606,569	
Total Construction to Permanent	\$	\$	\$	\$	\$ 8,951,208	\$ 8,951,208	\$ 1,364,694	\$ 10,315,902	
Residential Real Estate									
Pass	\$	\$	\$	\$	\$ 138,680,196	\$ 138,680,196	\$	\$ 138,680,196	
Special Mention					521,451	521,451		521,451	
Substandard	2,907,285			2,907,285	13,134,638	16,041,923	2,500,001	18,541,924	
Total Residential Real Estate	\$ 2,907,285	\$	\$	\$ 2,907,285	\$ 152,336,285	\$ 155,243,570	\$ 2,500,001	\$ 157,743,571	
Consumer									
Pass	\$ 15,655	\$	\$	\$ 15,655	\$ 34,310,709	\$ 34,326,364	\$	\$ 34,326,364	
Special Mention					3,303,703	3,303,703		3,303,703	
Substandard	168,589			168,589	587,683	756,272	1,092,977	1,849,249	
Total Consumer	\$ 184,244	\$	\$	\$ 184,244	\$ 38,202,095	\$ 38,386,339	\$ 1,092,977	\$ 39,479,316	
Total	\$ 4,327,529	\$ 915,762	\$	\$ 5,243,291	\$ 440,840,163	\$ 446,083,454	\$ 32,753,188	\$ 478,836,642	



**Table of Contents**

The following table sets forth the detail and delinquency status of loans receivable, net, by performing and non-performing loans at December 31, 2010.

2010	Performing (Accruing) Loans				Total Performing Loans	Total Non- Accrual and Past Due Loans		Total Loans
	31-60 Days Past Due	Greater Than 60 Days	Total Past Due	Current				
Commercial Pass	\$	\$	\$	\$ 11,481,557	\$ 11,481,557	\$	\$ 11,481,557	
Special Mention				822,364	822,364	63,289	885,653	
Substandard				816,630	816,630	1,389,950	2,206,580	
Total Commercial	\$	\$	\$	\$ 13,120,551	\$ 13,120,551	\$ 1,453,239	\$ 14,573,790	
Commercial Real Estate Pass	\$	\$	\$	\$ 134,094,210	\$ 134,094,210	\$	\$ 134,094,210	
Special Mention				39,898,756	39,898,756		39,898,756	
Substandard				28,061,351	28,061,351	26,788,172	54,849,523	
Total Commercial Real Estate	\$	\$	\$	\$ 202,054,317	\$ 202,054,317	\$ 26,788,172	\$ 228,842,489	
Construction Pass	\$	\$	\$	\$ 1,622,029	\$ 1,622,029	\$	\$ 1,622,029	
Special Mention				19,544,913	19,544,913		19,544,913	
Substandard				8,700,165	8,700,165	34,021,976	42,722,141	
Total Construction	\$	\$	\$	\$ 29,867,107	\$ 29,867,107	\$ 34,021,976	\$ 63,889,083	
Construction to Permanent Pass	\$	\$	\$	\$	\$	\$	\$	
Special Mention				1,709,333	1,709,333		1,709,333	
Substandard	1,127,875		1,127,875	6,114,000	7,241,875	1,379,835	8,621,710	
Total Construction to Permanent	\$ 1,127,875	\$	\$ 1,127,875	\$ 7,823,333	\$ 8,951,208	\$ 1,379,835	\$ 10,331,043	
Residential Real Estate Pass	\$ 198,357	\$	\$ 198,357	\$ 143,332,842	\$ 143,531,199	\$	\$ 143,531,199	
Special Mention	2,907,285		2,907,285	2,088,700	4,995,985		4,995,985	
Substandard				10,743,390	10,743,390	27,787,744	38,531,134	
Total Residential Real Estate Consumer	\$ 3,105,642	\$	\$ 3,105,642	\$ 156,164,932	\$ 159,270,574	\$ 27,787,744	\$ 187,058,318	

Edgar Filing: PATRIOT NATIONAL BANCORP INC - Form 10-Q

Pass	\$	\$	\$	\$ 37,109,997	\$ 37,109,997	\$	\$ 37,109,997
Special Mention	168,589		168,589	5,857,276	6,025,865		6,025,865
Substandard				588,887	588,887	1,092,976	1,681,863
Total Consumer	\$ 168,589	\$	\$ 168,589	\$ 43,556,160	\$ 43,724,749	\$ 1,092,976	\$ 44,817,725
Total	\$ 4,402,106	\$	\$ 4,402,106	\$ 452,586,400	\$ 456,988,506	\$ 92,523,942	\$ 549,512,448

**Table of Contents**

The following table summarizes impaired loans as of March 31, 2011:

<b>2011</b>	<b>Recorded</b>	<b>Unpaid</b>	
	<b>Investment</b>	<b>Principal</b>	<b>Related</b>
		<b>Balance</b>	<b>Allowance</b>
With no related allowance recorded:			
Commercial	\$ 1,236,317	\$ 1,627,637	\$
Commercial Real Estate	8,616,291	9,119,235	
Construction	1,726,344	1,874,386	
Construction to Permanent			
Residential	11,927,547	12,047,680	
Consumer	1,516,977	1,939,800	
Total:	\$ 25,023,476	\$ 26,608,738	\$
With an allowance recorded:			
Commercial	\$ 125,683	\$ 141,149	\$ 78,286
Commercial Real Estate	11,845,101	15,272,361	1,887,042
Construction	12,181,012	14,535,354	1,657,278
Construction to Permanent	1,364,694	1,425,000	187,094
Residential			
Consumer			
Total:	\$ 25,516,490	\$ 31,373,864	\$ 3,809,700
Commercial	\$ 1,362,000	\$ 1,768,786	\$ 78,286
Commercial Real Estate	20,461,392	24,391,596	1,887,042
Construction	13,907,356	16,409,740	1,657,278
Construction to Permanent	1,364,694	1,425,000	187,094
Residential	11,927,547	12,047,680	
Consumer	1,516,977	1,939,800	
Total:	\$ 50,539,966	\$ 57,982,602	\$ 3,809,700

At March 31, 2011, the recorded investment of impaired loans was \$50.5 million, with related allowances of \$3.8 million.

Included in the table above at March 31, 2011, are 23 loans with carrying balances of \$25.0 million that required no specific reserves in our allowance for loan losses; 18 non-accruing loans aggregating \$13.9 million and 5 accruing TDR loans aggregating \$11.1 million. Loans that did not require specific reserves at March 31, 2011 have sufficient collateral values, less costs to sell, supporting the carrying balances of the loans. In some cases, there may be no specific reserves because the Company already charged-off the specific impairment. Once a borrower is in default, the Company is under no obligation to advance additional funds on unused commitments.

**Table of Contents****Note 4: Deposits**

The following table is a summary of Bancorp's deposits at:

	March 31, 2011	December 31, 2010
Non-interest bearing	\$ 55,691,927	\$ 51,058,373
Interest bearing		
NOW	25,161,243	19,297,225
Savings	57,979,524	57,041,943
Money market	73,803,322	92,683,478
Time certificates, less than \$100,000	219,759,502	251,296,558
Time certificates, \$100,000 or more	148,887,513	175,431,252
Total interest bearing	525,591,104	595,750,456
Total Deposits	\$ 581,283,031	\$ 646,808,829

Included in time certificates are certificates of deposit through the Certificate of Deposit Account Registry Service (CDARS) network of \$1,463,252 and \$2,879,838 at March 31, 2011 and December 31, 2010, respectively. These are considered brokered deposits. Pursuant to the Agreement discussed in Note 8, the Bank's participation in the CDARS program, as an issuer of deposits to customers of other banks in the CDARS program, may not exceed 10% of total deposits.

**Table of Contents****Note 5: Loss per share**

Bancorp is required to present basic income (loss) per share and diluted income (loss) per share in its consolidated statements of operations. Basic income (loss) per share amounts are computed by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted income (loss) per share reflects additional common shares that would have been outstanding if potentially dilutive common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by Bancorp relate to outstanding stock options and are determined using the treasury stock method. Bancorp is also required to provide a reconciliation of the numerator and denominator used in the computation of both basic and diluted loss per share.

The following is information about the computation of loss per share for the three months ended March 31, 2011 and 2010:

**Three months ended March 31, 2011**

	Net Loss	Weighted Average Common Shares O/S	Amount
Basic and Diluted Loss Per Share			
Loss attributable to common shareholders	\$ (8,982,598)	38,362,727	\$ (0.23)

**Three months ended March 31, 2010**

	Net Loss	Weighted Average Common Shares O/S	Amount
Basic and Diluted Loss Per Share			
Loss attributable to common shareholders	\$ (3,131,566)	4,762,727	\$ (0.66)

**Note 6: Other Comprehensive Income**

Other comprehensive income, which is comprised solely of the change in unrealized gains and losses on available-for-sale securities, is as follows:

	Three Months Ended March 31, 2011			Three Months Ended March 31, 2010		
	Before Tax		Net of Tax	Before Tax		Net of Tax
	Amount	Tax Effect	Amount	Amount	Tax Effect	Amount
Unrealized holding gains arising during the period	\$ 5,202	\$ (1,977)	\$ 3,225	\$ 555,443	\$ (211,067)	\$ 344,376
Reclassification adjustment for gains recognized in income						
Unrealized holding gains on available for sale securities, net of taxes	\$ 5,202	\$ (1,977)	\$ 3,225	\$ 555,443	\$ (211,067)	\$ 344,376





**Table of Contents****Note 7: Financial Instruments with Off-Balance Sheet Risk**

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

The contractual amounts of commitments to extend credit and standby letters of credit represent the amounts of potential accounting loss should: the contracts be fully drawn upon; the customers default; and the values of any existing collateral become worthless. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments and evaluates each customer's creditworthiness on a case-by-case basis. Management believes that the Company controls the credit risk of these financial instruments through credit approvals, credit limits, monitoring procedures and the receipt of collateral as deemed necessary.

Financial instruments whose contractual amounts represent credit risk at March 31, 2011 are as follows:

Commitments to extend credit:	
Future loan commitments	\$ 12,232,022
Home equity lines of credit	18,771,768
Unused lines of credit	12,914,391
Undisbursed construction loans	1,536,329
Financial standby letters of credit	52,000
	<b>\$ 45,506,510</b>

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

Standby letters of credit are written commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Newly issued or modified guarantees that are not derivative contracts are recorded on the Company's consolidated balance sheet at the fair value at inception. No liability related to guarantees was required to be recorded at March 31, 2011.

**Table of Contents****Note 8: Regulatory and Operational Matters**

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory; and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company's and the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). In addition, due to the Bank's asset profile and current economic conditions in its markets, the Bank's capital plan pursuant to the Agreement described below targets a minimum 9% Tier 1 leverage capital ratio.

In February 2009 the Bank entered into a formal written agreement (the "Agreement") with the Office of the Comptroller of the Currency (the "OCC"). Under the terms of the Agreement, the Bank has appointed a Compliance Committee of outside directors and the Chief Executive Officer. The Committee must report quarterly to the Board of Directors and to the OCC on the Bank's progress in complying with the Agreement. The Agreement requires the Bank to review, adopt and implement a number of policies and programs related to credit and operational issues. The Agreement further provides for certain asset growth restrictions for a limited period of time together with limitations on the acceptance of certain brokered deposits and the extension of credit to borrowers whose loans are criticized. The Bank may pay dividends during the term of the Agreement only with prior written permission from the OCC. The Agreement also requires that the Bank develop and implement a three-year capital plan. The Bank has taken or put into process many of the steps required by the Agreement, and does not anticipate that the restrictions included within the Agreement will impair its current business plan.

In June 2010 the Company entered into a formal written agreement (the "Reserve Bank Agreement") with the Federal Reserve Bank of New York (the "Reserve Bank"). Under the terms of the Reserve Bank Agreement, the Board of Directors of the Company are required to take appropriate steps to fully utilize the Company's financial and managerial resources to serve as a source of strength to the Bank including taking steps to insure that the Bank complies with the Agreement with the OCC. The Reserve Bank Agreement requires the Company to submit, adopt and implement a capital plan that is acceptable to the Reserve Bank. The Company must also report to the Reserve Bank quarterly on the Company's progress in complying with the Reserve Bank Agreement. The Agreement further provides for certain restrictions on the payment or receipt of dividends, distributions of interest or principal on subordinate debentures or trust preferred securities and the Company's ability to incur debt or to purchase or redeem its stock without the prior written approval of the Reserve Bank. The Company has taken or put into process many of the steps required by the Reserve Bank Agreement, and does not anticipate that the restrictions included within the Reserve Bank Agreement will impair its current business plan.

**Table of Contents**

The Company's and the Bank's actual capital amounts and ratios at March 31, 2011 and December 31, 2010 were:

(dollars in thousands)	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>March 31, 2011</b>						
The Company:						
Total Capital (to Risk Weighted Assets)	\$ 70,398	18.14%	\$ 31,047	8.00%	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	64,843	16.71%	15,522	4.00%	N/A	N/A
Tier 1 Capital (to Average Assets)	64,843	8.71%	29,779	4.00%	N/A	N/A
The Bank:						
Total Capital (to Risk Weighted Assets)	\$ 67,888	17.50%	\$ 31,035	8.00%	\$ 38,793	10.00%
Tier 1 Capital (to Risk Weighted Assets)	62,336	16.07%	15,516	4.00%	23,274	6.00%
Tier 1 Capital (to Average Assets)	62,336	8.38%	29,755	4.00%	37,193	5.00%
<b>December 31, 2010</b>						
The Company:						
Total Capital (to Risk Weighted Assets)	\$ 80,358	17.08%	\$ 37,643	8.00%	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	73,822	15.69%	18,822	4.00%	N/A	N/A
Tier 1 Capital (to Average Assets)	73,822	9.16%	32,219	4.00%	N/A	N/A
The Bank:						
Total Capital (to Risk Weighted Assets)	\$ 77,705	16.54%	\$ 37,582	8.00%	\$ 46,978	10.00%
Tier 1 Capital (to Risk Weighted Assets)	71,178	15.15%	18,791	4.00%	28,187	6.00%
Tier 1 Capital (to Average Assets)	71,178	8.84%	32,203	4.00%	40,253	5.00%

On October 15, 2010, the Company issued and sold to PNBK Holdings LLC, 33,600,000 shares of its common stock at a purchase price of \$1.50 per share. The shares sold to PNBK Holdings LLC represent 87.6% of the Company's current issued and outstanding common stock. Another factor of this transaction is that the Company has a new Chairman of the Board of Directors, as well as a new President and CEO. These changes to management are key components to the recovery plan and will help the Bank reach its goal of restored profitability.

**Table of Contents**

**Restrictions on dividends, loans and advances**

The Company's ability to pay dividends is dependent on the Bank's ability to pay dividends to the Company. Pursuant to the February 9, 2009 Agreement between the Bank and the OCC, the Bank can pay dividends to the Company only pursuant to a dividend policy requiring compliance with the Bank's OCC-approved capital program, in compliance with applicable law and with the prior written determination of no supervisory objection by the Assistant Deputy Comptroller. In addition to the Agreement, certain other restrictions exist regarding the ability of the Bank to transfer funds to the Company in the form of cash dividends, loans or advances. The approval of the OCC is required to pay dividends in excess of the Bank's earnings retained in the current year plus retained net earnings for the preceding two years. As of March 31, 2011, the Bank had an accumulated deficit; therefore, dividends may not be paid to the Company. The Bank is also prohibited from paying dividends that would reduce its capital ratios below minimum regulatory requirements.

The Company's ability to pay dividends and incur debt is also restricted by the Reserve Bank Agreement. Under the terms of the Reserve Bank Agreement, the Company has agreed that it shall not declare or pay any dividends or incur, increase or guarantee any debt without the prior written approval of the Reserve Bank and the Director of the Division of Banking Supervision and Regulation (the Director) of the Board of Governors.

Loans or advances to the Company from the Bank are limited to 10% of the Bank's capital stock and surplus on a secured basis.

**Recent Legislative Developments**

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Act) was signed into law on July 21, 2010. The Act is a significant piece of legislation that will have a major impact on the financial services industry, including the organization, financial condition and operations of banks and bank holding companies. Management is currently evaluating the impact of the Act; however, uncertainty remains as to its operational impact, which could have a material adverse impact on the Company's business, results of operations and financial condition. Many of the provisions of the Act are aimed at financial institutions that are significantly larger than the Company and the Bank. Notwithstanding this, there are many other provisions that the Company and the Bank are subject to and will have to comply with, including any new rules applicable to the Company and the Bank promulgated by the Bureau of Consumer Financial Protection, a new regulatory body dedicated to consumer protection. As rules and regulations are promulgated by the agencies responsible for implementing and enforcing the Act, the Company and the Bank will have to address each to ensure compliance with applicable provisions of the Act and compliance costs are expected to increase.

**Note 9: Income Taxes**

The determination of the amount of deferred tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. A valuation allowance related to deferred tax assets is required when it is considered more likely than not that all or part of the benefit related to such assets will not be realized. Management has reviewed the deferred tax position of the Company at March 31, 2011. The deferred tax position has been affected by several significant transactions in the past three years. These transactions include increased provision for loan losses, the increasing levels of non-accrual loans and other-than-temporary impairment write-offs of certain investments. As a result, the Company is in a cumulative net loss position at March 31, 2011, and under the applicable accounting guidance, has concluded that it is not more-likely-than-not that the Company will be able to realize its deferred tax assets and, accordingly, has established a full valuation allowance totaling \$16.9 million against its deferred tax asset at March 31, 2011. The valuation allowance is analyzed quarterly for changes affecting the deferred tax asset. If, in the future, the Company generates taxable income on a sustained basis, management's conclusion regarding the need for a deferred tax asset valuation allowance could change, resulting in the reversal of all or a portion of the deferred tax asset valuation allowance.

**Table of Contents**

As measured under the rules of the Tax Reform Act of 1986, the Company has undergone a greater than 50% change of ownership in 2010. Consequently, use of the Company's net operating loss carryforward and certain built-in deductions available against future taxable income in any one year may be limited. The maximum amount of carryforwards available in a given year is limited to the product of the Company's fair market value on the date of ownership change and the federal long-term tax-exempt rate, plus any limited carryforward not utilized in prior years. The Company is currently analyzing the impact of its recent ownership change. There is a full valuation allowance against the deferred tax assets as the Company does not believe that it is more likely than not that the Company will generate sufficient taxable income to realize the deferred tax assets. Accordingly, the Company does not believe the analysis will result in a material impact to the consolidated financial statements.

**Note 10: Fair Value and Interest Rate Risk**

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in certain instances, there are no quoted market prices for certain assets or liabilities. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the asset or liability.

Fair value measurements focus on exit prices in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment.

The Company's fair value measurements are classified into a fair value hierarchy based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. The three categories within the hierarchy are as follows:

- o *Level 1 Inputs* - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- o *Level 2 Inputs* - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.
- o *Level 3 Inputs* - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

**Table of Contents**

The fair value measurement level of an asset or liability within the fair value hierarchy is based on the lower level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

A description of the valuation methodologies used for assets and liabilities recorded at fair value, and for estimating fair value for financial and non-financial instruments not recorded at fair value, is set forth below.

***Cash and due from banks, federal funds sold, short-term investments and accrued interest receivable and payable:***

The carrying amount is a reasonable estimate of fair value. These financial instruments are not recorded at fair value on a recurring basis.

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

***Loans:*** For variable rate loans, which reprice frequently and have no significant change in credit risk, carrying values are a reasonable estimate of fair values, adjusted for credit losses inherent in the portfolios. The fair value of fixed rate loans is estimated by discounting the future cash flows using the period end rates, estimated by using local market data, at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, adjusted for credit losses inherent in the portfolios. The Company does not record loans at fair value on a recurring basis. However, from time to time, nonrecurring fair value adjustments to collateral-dependent impaired loans are recorded to reflect partial write-downs based on the observable market price or current appraised value of collateral. Fair values estimated in this manner do not fully incorporate an exit-price approach to fair value, but instead are based on a comparison to current market rates for comparable loans.

***Other Real Estate Owned:*** The fair values of the Company's other real estate owned ( OREO ) properties are based on the estimated current property valuations less estimated selling costs. When the fair value is based on current observable appraised values, OREO is classified within Level 2. The Company classifies OREO within Level 3 when unobservable adjustments are made to appraised values. The Company does not record other real estate owned at fair value on a recurring basis.

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

***Short-term borrowings:*** The carrying amounts of borrowings under short-term repurchase agreements and other short-term borrowings maturing within 90 days approximate their fair values. The Company does not record short-term borrowings at fair value on a recurring basis.

**Table of Contents**

**Junior Subordinated Debt:** Junior subordinated debt reprices quarterly and as a result the carrying amount is considered a reasonable estimate of fair value. The Company does not record junior subordinated debt at fair value on a recurring basis.

**Federal Home Loan Bank Borrowings:** The fair value of the advances is estimated using a discounted cash flow calculation that applies current Federal Home Loan Bank interest rates for advances of similar maturity to a schedule of maturities of such advances. The Company does not record these borrowings at fair value on a recurring basis.

**Other Borrowings:** The fair values of longer term borrowings and fixed rate repurchase agreements are estimated using a discounted cash flow calculation that applies current interest rates for transactions of similar maturity to a schedule of maturities of such transactions. The Company does not record these borrowings at fair value on a recurring basis.

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

The following table details the financial assets measured at fair value on a recurring basis as of March 31, 2011 and December 31, 2010, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine fair value:

	Quoted Prices in Active Markets for Identical Assets  (Level 1)	Significant Observable Inputs  (Level 2)	Significant Unobservable Inputs  (Level 3)	Balance  as of March 31, 2011
March 31, 2011				
Securities available for sale	\$	\$ 38,539,143	\$	\$ 38,539,143

	Quoted Prices in Active Markets for Identical Assets  (Level 1)	Significant Observable Inputs  (Level 2)	Significant Unobservable Inputs  (Level 3)	Balance  as of December 31, 2010
December 31, 2010				
Securities available for sale	\$	\$ 40,564,700	\$	\$ 40,564,700

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).



**Table of Contents**

The following tables reflect financial assets measured at fair value on a non-recurring basis as of March 31, 2011 and December 31, 2010, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	<b>Balance as of March 31, 2011</b>
<b>March 31, 2011</b>				
<b>Impaired Loans <sup>(1)</sup></b>	\$	\$	\$ 4,577,157	\$ 4,577,157
<b>Other real estate owned <sup>(2)</sup></b>	\$	\$	\$ 950,000	\$ 950,000
<b>December 31, 2010</b>				
<b>Impaired Loans <sup>(1)</sup></b>	\$	\$	\$ 30,999,865	\$ 30,999,865
<b>Other real estate owned <sup>(2)</sup></b>	\$	\$	\$ 10,103,199	\$ 10,103,199

(1) Represents carrying value for which adjustments are based on the appraised value of the collateral.

(2) Represents carrying value for which adjustments are based on the appraised value of the property.

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

The estimated fair value amounts have been measured as of March 31, 2011 and December 31, 2010 and have not been reevaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair value of these financial instruments subsequent to the respective reporting dates may be different than amounts reported on those dates.

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

**Table of Contents**

The following is a summary of the carrying amounts and estimated fair values of the Company's financial instruments at March 31, 2011 and December 31, 2010 (in thousands):

	March 31, 2011		December 31, 2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial Assets:</b>				
Cash and noninterest bearing balances due from banks	\$ 5,903	\$ 5,903	\$ 4,613	\$ 4,613
Interest-bearing deposits due from banks	140,645	140,645	131,711	131,711
Federal funds sold	10,000	10,000	10,000	10,000
Short-term investments	501	501	453	453
Other investments	3,500	3,500	3,500	3,500
Available-for-sale securities	38,539	38,539	40,565	40,565
Federal Reserve Bank stock	2,176	2,176	1,192	1,192
Federal Home Loan Bank stock	4,508	4,508	4,508	4,508
Loans receivable, net	466,869	476,967	534,531	542,360
Accrued interest receivable	2,326	2,326	2,512	2,512
<b>Financial Liabilities:</b>				
Demand deposits	\$ 55,692	\$ 55,692	\$ 51,058	\$ 51,058
Savings deposits	57,980	57,980	57,042	57,042
Money market deposits	73,803	73,803	92,683	92,683
NOW accounts	25,161	25,161	19,297	19,297
Time deposits	368,647	374,116	426,728	432,466
FHLB Borrowings	50,000	51,014	50,000	51,195
Securities sold under repurchase agreements	7,000	7,784	7,000	7,796
Subordinated debentures	8,248	8,248	8,248	8,248
Accrued interest payable	804	804	729	729

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Company's financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company's overall interest rate risk.

**Off-balance sheet instruments**

Loan commitments on which the committed interest rate is less than the current market rate were insignificant at March 31, 2011 and December 31, 2010. The estimated fair value of fee income on letters of credit at March 31, 2011 and December 31, 2010 was insignificant.

**Table of Contents**

**Note 11: Recent Accounting Pronouncements**

In February 2010, the FASB issued ASU No. 2010-06 Topic 820 Improving Disclosures about Fair Value Measurements which amended the existing guidance related to *Fair Value Measurements and Disclosures*. The amendments require the following new fair value disclosures:

Separate disclosure of the significant transfers into and out of Level 1 and Level 2 fair value measurements, and a description of the reasons for the transfers.

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

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

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

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

The new disclosures and clarifications of existing disclosures were effective for the Company beginning in the quarter ended March 31, 2010, except for the disclosures included in the roll forward of activity for Level 3 fair value measurements, for which the effective date is for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The Company adopted this guidance during the quarters ended March 31, 2010 and March 31, 2011 respectively, and has included these disclosures in these financial statements.

The FASB issued ASU No. 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* in July 2010. The amendments in this ASU apply to all entities, both public and nonpublic, with financing receivables, excluding short-term trade accounts receivable or receivables measured at fair value or lower of cost or fair value. The amendments in this ASU enhance disclosures about the credit quality of financing receivables and the allowance for credit losses. This ASU amends existing disclosure guidance to require entities to provide a greater level of disaggregated information about the credit quality of its financing receivables and its allowance for credit losses. In addition, this ASU requires entities to disclose credit quality indicators, past due information, and modifications of its financing receivables. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The adoption of this guidance did not have an impact on the Company's results of operations or financial position.

**Table of Contents****Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations****SAFE HARBOR STATEMENT UNDER PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

Certain statements contained in Bancorp's public reports, including this report, and in particular in Management's Discussion and Analysis of Financial Condition and Results of Operations, may be forward looking and subject to a variety of risks and uncertainties. These factors include, but are not limited to; (1) changes in prevailing interest rates which would affect the interest earned on Bancorp's interest earning assets and the interest paid on its interest bearing liabilities; (2) the timing of repricing of Bancorp's interest earning assets and interest bearing liabilities; (3) the effect of changes in governmental monetary policy; (4) the effect of changes in regulations applicable to Bancorp and the Bank and the conduct of its business; (5) changes in competition among financial service companies, including possible further encroachment of non-banks on services traditionally provided by banks; (6) the ability of competitors that are larger than Bancorp to provide products and services which it is impracticable for Bancorp to provide; (7) the state of the economy and real estate values in Bancorp's market areas, and the consequent effect on the quality of Bancorp's loans, customers, vendors and communities; (8) recent governmental initiatives that are expected to have a profound effect on the financial services industry and could dramatically change the competitive environment of Bancorp; (9) other legislative or regulatory changes, including those related to residential mortgages, changes in accounting standards, and Federal Deposit Insurance Corporation (FDIC) premiums that may adversely affect Bancorp.

Although Bancorp believes that it offers the loan and deposit products and has the resources needed for continued success, future revenues and interest spreads and yields cannot be reliably predicted. These trends may cause Bancorp to adjust its operations in the future. Because of the foregoing and other factors, recent trends should not be considered reliable indicators of future financial results or stock prices.

**CRITICAL ACCOUNTING POLICIES**

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and to disclose contingent assets and liabilities. Actual results could differ from those estimates. Management has identified the accounting for the allowance for loan losses, the analysis of its investment securities and the valuation of deferred income tax assets, as Bancorp's most critical accounting policies and estimates in that they are important to the portrayal of Bancorp's financial condition and results. They require management's most subjective and complex judgment as a result of the need to make an estimate about the effect of matters that are inherently uncertain. These accounting policies, including the nature of the estimates and types of assumptions used, are described throughout this Management's Discussion and Analysis.

**Summary**

Bancorp incurred a net loss of \$9.0 million (\$0.23 basic and diluted loss per share) for the quarter ended March 31, 2011, compared to a net loss of \$3.1 million (\$0.66 basic and diluted loss per share) for the quarter ended March 31, 2010. The primary reason for the decrease in the quarterly comparison is the \$6.2 million loss on the bulk sale of non-performing assets, as discussed in Note 3. Bancorp's net interest income for the quarter ended March 31, 2011 was \$4.9 million compared to \$6.0 million for the quarter ended March 31, 2010. Interest income and interest expense decreased by 23% and 34%, respectively, for the quarter ended March 31, 2011 compared to the quarter ended March 31, 2010. The decline in interest income is due primarily to lower average outstanding loan balances, high level of elevated liquidity and the income receipt of \$605,000 of past due interest on one loan for the quarter ended March 31, 2010. The significant decline in interest expense is primarily due to the reduction of total deposits and substantially lower interest rates paid on existing deposits.

Total assets decreased \$74.6 million from \$784.3 million at December 31, 2010 to \$709.7 million at March 31, 2011. Cash and cash equivalents increased \$10.3 million from \$146.8 million at December 31, 2010 to \$157.0 million at March 31, 2011. Available-for-sale securities decreased \$2.0 million from \$40.6 million at December 31, 2010 to \$38.5 million March 31, 2011. The net loan portfolio decreased \$67.7 million from \$534.5 million at December 31, 2010 to \$466.9 million at March 31, 2011. This decrease is primarily a result of a \$66.8 million bulk sale of non-performing assets, comprised of \$52.4 million of non-performing loans and \$14.4 million of other real estate owned. This was the result of management's strategic plan to dramatically lower the level of non-performing assets

and improve the overall credit quality, and significantly increase the level of earning assets. As a result of weak loan demand and currently high levels of balance sheet liquidity, the Bank continued to offer lower rates on deposit products. The overall cost of deposits decreased from 1.84% at March 31, 2010 to 1.34% at March 31, 2011. Deposits decreased \$65.5 million from \$646.8 million at December 31, 2010 to \$581.3 million at March 31, 2011. Borrowings remained unchanged compared to December 31, 2010.

**Table of Contents****Financial Condition*****Cash and Cash Equivalents***

Cash and cash equivalents increased \$10.3 million, or 7%, to \$157.0 million at March 31, 2011 compared to \$146.8 million at December 31, 2010. This increase is primarily the result of the bulk sale and lower outstanding loan balances, partially offset by lower deposit balances.

***Investments***

The following table is a summary of Bancorp's available-for-sale securities portfolio, at fair value, at the dates shown:

	March 31, 2011	December 31 2010
U. S. Government agency mortgage-backed securities	\$ 35,277,176	\$ 37,471,878
Auction rate preferred equity securities	3,261,967	3,092,822
Total Available-for-Sale Securities	\$ 38,539,143	\$ 40,564,700

Available-for-sale securities decreased \$2.0 million, or 5%, from \$40.6 million at December 31, 2010 to \$38.5 million at March 31, 2011. This decrease is primarily due to principal pay downs of \$2.0 million on mortgage backed securities.

**Table of Contents*****Loans***

The following table is a summary of Bancorp's loan portfolio at the dates shown:

	March 31, 2011	December 31, 2010
Real Estate		
Commercial	\$ 212,785,433	\$ 228,842,489
Residential	157,743,571	187,058,318
Construction	39,639,058	63,889,083
Construction to permanent	10,315,902	10,331,043
Commercial	18,873,362	14,573,790
Consumer home equity	37,432,068	42,884,962
Consumer installment	2,047,248	1,932,763
Total Loans	478,836,642	549,512,448
Premiums on purchased loans	239,912	242,426
Net deferred costs	1,196	150,440
Allowance for loan losses	(12,208,476)	(15,374,101)
Loans receivable, net	\$ 466,869,274	\$ 534,531,213

Bancorp's net loan portfolio decreased \$67.7 million, or 13%, from \$534.5 million at December 31, 2010 to \$466.9 million at March 31, 2011. The decrease is primarily a result of a bulk sale of non-performing assets and loan payoffs, including some that were impaired and on non-accrual status. Construction loans decreased by \$24.3 million, commercial real estate loans decreased by \$16.1 million, residential mortgages decreased by \$29.3 million and consumer home equity decreased by \$5.5 million, partially offset by increases to commercial loans of \$4.3 million. The net decrease in the portfolio also reflects net charge-offs for the quarter ended March 31, 2011 of \$4.1 million, of which specific reserves of \$3.4 million were related to loans in the bulk sale. In an effort to reduce its concentration in construction loans, Bancorp has continued its moratorium on originating new speculative construction loans.

On March 24, 2011, the Bank completed the sale of certain non-performing assets that included 21 non-accruing loans with an aggregate net book value of \$52.4 million (net of related specific reserves) and 4 OREO properties with an aggregate carrying value of \$14.4 million. The sale of \$66.8 million of non-performing assets was consummated for a cash purchase price of \$60.6 million which represented 90.7% of the Bank's net book value for these assets.

At March 31, 2011, the net loan to deposit ratio was 80% and the net loan to total assets ratio was 66%. At December 31, 2010, these ratios were 83% and 68%, respectively.

***Allowance for Loan Losses***

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

**Table of Contents**

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect a borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for loan losses decreased by \$3.2 million from December 31, 2010 to March 31, 2011 primarily due to net charge-offs of \$4.1 million, of which \$3.4 million were related to loans in the bulk sale. In addition, a provision of \$7.0 million was recorded, of which \$6.0 million related to loans transferred to held-for-sale in connection with the bulk loan sale.

The allowance consists of allocated and general components. The allocated component relates to loans that are considered impaired. For such impaired loans, an allowance is established when the discounted cash flows (or observable market price or collateral value if the loan is collateral dependent) of the impaired loan is lower than the carrying value of that loan. When a loan is placed on non-accrual status the loan is considered impaired. For collateral dependent loans, the appraised value is reduced by estimated selling costs and any senior liens and the result is compared to the principal loan balance to determine the impairment amount, if any. For loans that are not collateral dependent and for which a restructure is in place, the impairment is determined by using the discounted cash flow method which takes into account the difference between the original interest rate and the restructured rate.

The general component covers all other loans, segregated generally by loan type, and is based on historical loss experience with adjustments for qualitative factors which are made after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss data. In addition, a risk rating system is utilized to evaluate the general component of the allowance for loan losses. Management assigns risk ratings to all loans assigning ratings between one and nine, with a rating of one being the least risk, and a rating of nine reflecting the most risk or a complete loss. Risk ratings are assigned based upon the recommendations of the credit analyst and the originating loan officer and confirmed by the Loan Committee at the initiation of the transactions and are reviewed and changed, when necessary, during the life of the loan. Loans assigned a risk rating of six or above are monitored more closely by the credit administration officers and Loan Committee.

The allowance for loan losses reflects management's estimate of probable but unconfirmed losses inherent in the portfolio; such estimates are influenced by uncertainties in economic conditions, unfavorable information about a borrower's financial condition, delays in obtaining information, difficulty in identifying triggering events that correlate perfectly to subsequent loss rates, and risk factors that have not yet manifested themselves in loss allocation factors. Loan quality control is continually monitored by management, subject to oversight by the Board of Directors through its members who serve on the Loan Committee. Loan quality control is also reviewed by the full Board of Directors on a monthly basis and semi-annual loan reviews are performed by an independent external firm. The independent external loan review reports directly to the Audit Committee.



**Table of Contents**

The methodology for determining the adequacy of the allowance for loan losses has been consistently applied. Of the \$12.2 million allowance for loan losses as of the quarter ended March 31, 2011, \$3.8 million was attributed to collateral dependent impaired loans and \$8.4 million was the general reserve attributed to performing loans. The appraised values on impaired loans that are anticipated to become OREO in the coming quarter are adjusted based upon Bancorp's recent sales experience. As of March 31, 2011, the Bank's OREO sales experience has indicated that the ultimate sales prices of the underlying collateral have been 13% less than the appraisal amounts. The appraisal adjustment percentage is reviewed quarterly for those loans anticipated to become OREO in the subsequent quarter, based on an analysis of actual variances between appraised values as of the date the loan is transferred into OREO and the actual sales prices of the OREO properties. Generally, the sales prices have usually been below the appraised values due to the fact that buyers become aware that the Bank owns those properties and, therefore, attempt to offer less than fair market value. In the future, additional revisions may be made to the methodology and assumptions based on historical information related to charge-off and recovery experience and management's evaluation of the current loan portfolio, and prevailing internal and external factors including but not limited to current economic conditions and local real estate markets. The \$7.0 million provision for the quarter included \$6.0 million related to loans transferred to held-for-sale in connection with the bulk loan sale and \$967,000 was deemed necessary by management to maintain appropriate coverage after taking the net charge-offs of \$4.1 million of which \$3.4 million of specific reserves were related to loans in the bulk sale. The ratio of allowance for loan losses to total loans as of March 31, 2011 was 2.55% as compared to 2.80% as of December 31, 2010. Management believes that the decrease is warranted based upon the significant reduction on non-performing loans and charge-offs of specific reserves related to loans in the bulk sale.

The accrual of interest on loans is discontinued at the time a loan is 90 days past due unless the loan is well-secured and in process of collection. Consumer installment loans are typically charged off no later than 90 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful. Management considers all non-accrual loans and troubled debt restructured loans to be impaired. All interest accrued but not collected for loans that are placed on nonaccrual status is reversed against interest income. The interest on these loans is accounted for on the cash-basis method until qualifying for return to accrual status. Loans may be returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured after a six month seasoning period.

In most cases, loan payments that are past due less than 90 days, based on contractual terms, are considered collection delays and the related loans are not considered to be impaired. The Bank considers consumer installment loans to be pools of smaller balance homogeneous loans, which are collectively evaluated for impairment.

**Table of Contents**

The changes in the allowance for loan losses for the periods shown are as follows:

<i>(Thousands of dollars)</i>	Three months ended	
	March 31, 2011	March 31, 2010
Balance at beginning of period	\$ 15,374	\$ 15,794
Charge-offs	(4,154)	(1,583)
Recoveries	21	124
Net Charge-offs	(4,133)	(1,459)
Transferred to loans held-for-sale	(6,014)	
Provision charged to operations	6,981	727
Balance at end of period	\$ 12,208	\$ 15,062
Ratio of net charge-offs during the period to average loans outstanding during the period	0.78%	0.22%
Ratio of ALLL / Gross Loans	2.55%	2.35%

Based upon the overall assessment and evaluation of the loan portfolio, management believes the allowance for loan losses of \$12.2 million, at March 31, 2011, which represents 2.55% of gross loans outstanding, is adequate under prevailing economic conditions, to absorb existing losses in the loan portfolio. Bancorp has had six consecutive quarters of decreases in non-accrual loans.

***Non-Accrual, Past Due and Restructured Loans***

The following table presents non-accruing loans and loans past due 90 days or more and still accruing:

<i>(Thousands of dollars)</i>	March 31, 2011	December 31, 2010
Loans past due over 90 days still accruing	\$ 223	\$ 3,374
Non accruing loans	32,530	89,150
Total	\$ 32,753	\$ 92,524
% of Total Loans	6.84%	16.83%
% of Total Assets	4.61%	11.80%

Loans delinquent over 90 days and still accruing aggregating \$223,000 are comprised of 2 loans, both of which have matured and the borrowers continue to make payments. These loans are currently in the process of being renewed. Impaired loans, which are comprised of non-accruing loans and troubled debt restructured loans, decreased by \$50.1 million to \$50.5 million for the quarter ended March 31, 2011. Impaired loans are attributable to the lingering effects of the downturn in the economy, which has severely impacted the real estate market and placed unprecedented stress on credit markets. Residents of Fairfield County, Connecticut, many of whom are associated with the financial services industry, have been affected by the impact of the poor economy on employment and real estate values.



**Table of Contents**

The \$32.5 million of non-accrual loans at March 31, 2011 is comprised of exposure to 32 borrowers, for which a specific reserve of \$3.4 million has been established. All of the non-accruing loans are collateral dependent and are secured by residential or commercial real estate located within the Bank's market area. In all cases, the Bank has obtained appraisal reports from independent licensed appraisal firms and discounted those values for estimated selling costs to determine estimated impairment. Of the \$32.5 million of non-accrual loans at March 31, 2011, borrowers of 10 loans with aggregate balances of \$9.4 million continue to make loan payments and these loans are current within one month as to payments.

**Potential Problem Loans**

In addition to the above, there are \$69.7 million of substandard accruing loans comprised of 45 loans and \$54.6 million of special mention loans comprised of 53 loans for which management has a concern as to the ability of the borrowers to comply with the present repayment terms. All but \$3.1 million of the substandard accruing loans and all of the special mention loans continue to make timely payments and are within 30 days at March 31, 2011.

Bancorp has had five consecutive quarters of decreases in substandard-accrual loans.

**Other Real Estate Owned**

The following table is a summary of Bancorp's other real estate owned at the dates shown:

	March 31, 2011	December 31, 2010
Residential construction	\$	\$ 15,774,187
Land	950,000	634,600
Other real estate owned	\$ 950,000	\$ 16,408,787

The balance of other real estate owned at March 31, 2011 is comprised of one property with a carrying value of \$950,000 that was obtained through loan foreclosure proceedings. Included in the bulk sale of non-performing assets were four OREO properties with an aggregate carrying value of \$14.4 million.

**Deferred Taxes**

The determination of the amount of deferred tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. A valuation allowance related to deferred tax assets is required when it is considered more likely than not that all or part of the benefit related to such assets will not be realized. Management has reviewed the deferred tax position of Bancorp at March 31, 2011. The deferred tax position has been affected by several significant matters in the past three years. These matters include increased levels of provision for loan losses, the high levels of non-accrual loans and other-than-temporary impairment write-offs of certain investments. As a result, Bancorp is in a cumulative net loss position at March 31, 2011, and under the applicable accounting guidance, has concluded that it is not more-likely-than-not that the Company will be able to realize the deferred tax assets and accordingly has established a full valuation allowance totaling \$16.9 million against its net deferred tax asset at March 31, 2011. The valuation allowance is analyzed quarterly for changes affecting the deferred tax asset. If, in the future, Bancorp generates taxable income on a sustained basis, management's conclusion regarding the need for a deferred tax asset valuation allowance could change, resulting in the reversal of all or a portion of the deferred tax asset valuation allowance.

**Table of Contents*****Deposits***

The following table is a summary of Bancorp's deposits at the dates shown:

	March 31, 2011	December 31, 2010
Non-interest bearing	\$ 55,691,927	\$ 51,058,373
Interest bearing		
NOW	25,161,243	19,297,225
Savings	57,979,524	57,041,943
Money market	73,803,322	92,683,478
Time certificates, less than \$100,000	219,759,502	251,296,558
Time certificates, \$100,000 or more	148,887,513	175,431,252
Total interest bearing	525,591,104	595,750,456
Total Deposits	\$ 581,283,031	\$ 646,808,829

Total deposits decreased \$65.5 million, or 10%, from \$646.8 million at December 31, 2010 to \$581.3 million at March 31, 2011. Demand deposits increased \$4.6 million primarily as a result of increases in official checks and personal checking accounts of \$2.7 million and \$2.0 million respectively. Interest bearing accounts decreased \$70.2 million. This is primarily due to decreases in certificates of deposit (CD's) of \$58.1 million, which is a result of Bancorp intentionally allowing the higher rate CD's to runoff to help reduce the cost of funds and improve the interest spread; and, a decrease in money market accounts of \$18.9 million due to improved economic conditions in the overall financial markets. A larger number of our CD account holders had temporarily placed funds in money market accounts during the economic recession. These were partially offset by increases in NOW accounts of \$5.9 million and savings accounts of \$938,000.

***Borrowings***

At March 31, 2011, total borrowings were \$65.2 million and are unchanged compared to December 31, 2010. In addition to the outstanding borrowings disclosed in the consolidated balance sheet, the Bank has the ability to borrow approximately \$63 million in additional advances from the Federal Home Loan Bank of Boston, including a \$2.0 million overnight line of credit. The Bank has also established a line of credit at the Federal Reserve Bank.

**Table of Contents**

The subordinated debentures of \$8,248,000 are unsecured obligations of the Company and are subordinate and junior in right of payment to all present and future senior indebtedness of the Company. The Company has entered into a guarantee, which together with its obligations under the subordinated debentures and the declaration of trust governing the Trust, provides a full and unconditional guarantee of amounts on the capital securities. The subordinated debentures, which bear interest at three-month LIBOR plus 3.15% (3.4585% at March 31, 2011), matures on March 26, 2033. Beginning in the second quarter of 2009, the Company began deferring interest payments on the subordinated debentures as permitted under the terms of the debentures. The deferral in the first quarter of 2011 represented the eighth consecutive quarter of deferral. The Company continues to accrue and charge interest to operations. The Company may defer the payment of interest until March 2014, and all accrued interest must be paid prior to or at completion of the deferral period.

***Capital***

Capital decreased \$9.0 million compared to December 31, 2010 primarily as a result of the net loss of \$6.2 million on the bulk sale of non-performing assets and loss on continuing operations for the three months ended March 31, 2011.

***Off-Balance Sheet Arrangements***

Bancorp's off-balance sheet arrangements, which primarily consist of commitments to lend, increased by \$10.5 million from \$35.0 million at December 31, 2010 to \$45.5 million at March 31, 2011, due to increases of \$7.5 million in future loan commitments and \$5.2 million in unused lines of credit.

**Table of Contents****Results of Operations****Interest and dividend income and expense**

The following tables present average balance sheets (daily averages), interest income, interest expense and the corresponding yields earned and rates paid for major balance sheet components:

	Three months ended March 31,					
	Average Balance	2011 Interest Income/ Expense	Average Rate	Average Balance	2010 Interest Income/ Expense	Average Rate
<i>(dollars in thousands)</i>						
Interest earning assets:						
Loans	\$ 532,985	\$ 6,957	5.22%	\$ 654,046	\$ 9,097	5.56%
Investments	49,005	344	2.81%	66,391	559	3.37%
Interest bearing deposits in banks	99,270	62	0.25%	43,957	32	0.29%
Federal funds sold	10,000	4	0.16%	10,000	3	0.13%
Total interest earning assets	691,260	7,367	4.26%	774,394	9,691	5.01%
Cash and due from banks	20,101			20,268		
Premises and equipment, net	4,968			6,246		
Allowance for loan losses	(15,504)			(15,921)		
Other assets	45,888			49,605		
Total Assets	\$ 746,713			\$ 834,592		
Interest bearing liabilities:						
Deposits	\$ 557,135	\$ 1,865	1.34%	\$ 679,451	\$ 3,117	1.84%
FHLB advances	50,000	419	3.35%	50,000	419	3.36%
Subordinated debt	8,248	70	3.39%	8,248	69	3.35%
Other borrowings	7,000	77	4.42%	7,000	76	4.35%
Total interest bearing liabilities	622,383	2,431	1.56%	744,699	3,681	1.98%
Demand deposits	52,898			49,926		
Accrued expenses and other liabilities	5,995			4,681		
Shareholders' equity	65,437			35,286		
Total liabilities and equity	\$ 746,713			\$ 834,592		
Net interest income		\$ 4,936			\$ 6,010	
Interest margin			2.86%			3.10%

Interest spread

2.70%

3.03%



**Table of Contents**

The following rate volume analysis reflects the impact that changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities had on net interest income during the periods indicated. Information is provided in each category with respect to changes attributable to changes in volume (changes in volume multiplied by prior rate), changes attributable to changes in rates (changes in rates multiplied by prior volume) and the total net change. The change resulting from the combined impact of volume and rate is allocated proportionately to the change due to volume and the change due to rate.

	Three months ended March 31, 2011 vs 2010		
	Increase (decrease) in Interest Income/Expense		
	Due to change in:		
	Volume	Rate	Total
	<i>(dollars in thousands)</i>		
Interest earning assets:			
Loans	\$ (1,609)	\$ (531)	\$ (2,140)
Investments	(131)	(84)	(215)
Interest bearing deposits in banks	35	(5)	30
Federal funds sold		1	1
 Total interest earning assets	 (1,705)	 (619)	 (2,324)
 Interest bearing liabilities:			
Deposits	\$ (499)	\$ (753)	\$ (1,252)
FHLB advances		(0)	(0)
Subordinated debt		1	1
Other borrowings		1	1
 Total interest bearing liabilities	 (499)	 (751)	 (1,250)
 Net interest income	 \$ (1,206)	 \$ 132	 \$ (1,074)

For the quarter ended March 31, 2011, average interest earning assets decreased \$83.1 million, or 11%, to \$691.3 million from \$774.4 million for the quarter ended March 31, 2010, resulting in interest income for Bancorp of \$7.4 million compared to \$9.7 million for the same period in 2010. Interest and fees on loans decreased \$2.1 million, or 24%, from \$9.1 million for the quarter ended March 31, 2010 to \$7.0 million for the quarter ended March 31, 2011. This decrease is primarily the result of a \$121.1 million decrease in the average balance of the loan portfolio plus high levels of liquidity. When compared to the same period last year, interest income on investments decreased by 38% due to a decrease of \$17.4 million in the average balance of investments outstanding, and a decrease in the yield on the investment portfolio. Income on interest-bearing deposits in banks increased 94% for the quarter ended March 31, 2011 compared to the quarter ended March 31, 2010, which is reflective of an increase in the average balances due to excess funds being invested overnight in our Federal Reserve Bank account.

**Table of Contents**

Total interest expense for the quarter ended March 31, 2011 of \$2.4 million represents a decrease of \$1.3 million, or 34%, compared to interest expense of \$3.7 million for the same period last year. This decrease in interest expense is the result of a decrease in both interest rates paid and in the average balances of interest-bearing liabilities. Average balances of deposit accounts decreased \$122.3 million, or 18%, which is comprised primarily of decreases in certificates of deposit, money market, and savings accounts of \$82.0 million, \$31.1 million and \$7.0 million, respectively. In addition, significantly lower interest rates primarily contributed to the overall decrease of \$1.3 million in interest expense on deposits. Average FHLB advances remained constant at \$50 million and resulted in \$419,000 in interest expense, which is consistent with the same period last year. Interest expense on the junior subordinated debt and borrowed funds remained relatively flat.

As a result of the above, Bancorp's net interest income decreased \$1.1 million, or 18%, to \$4.9 million for the three months ended March 31, 2011 compared to \$6.0 million for the same period last year. The net interest margin for the three months ended March 31, 2011 was 2.86% as compared to 3.10% for the three months ended March 31, 2010 as a result of the various reasons mentioned above.

***Provision for Loan Losses***

Based on management's most recent evaluation of the adequacy of the allowance for loan losses, the provision for loan losses charged to operations for the three months ended March 31, 2011 was \$7.0 million compared to \$727,000 for the three months ended March 31, 2010 primarily due to \$6.0 million related to loans transferred to held-for-sale in connection with the bulk loan sale. The allowance for loan losses decreased by \$3.2 million from December 31, 2010 to March 31, 2011 due primarily to net charge-offs of \$4.1 million of which \$3.4 million were specific reserves related to loans in the bulk sale.

An analysis of the changes in the allowance for loan losses is presented under Allowance for Loan Losses.

***Non-interest income***

Non-interest income increased \$44,000 from \$538,000 for the quarter ended March 31, 2010 to \$583,000 for the quarter ended March 31, 2011. This is primarily due to an increase in earnings on the cash surrender value of life insurance.

***Non-interest expenses***

Non-interest expenses decreased \$1.2 million or 14% from \$8.7 million to \$7.5 million for the quarter ended March 31, 2011 as compared to the quarter ended March 31, 2010. Other real estate operations expenses decreased by \$708,000, which includes an impairment write-down on one property of \$166,000, and a net loss on sale of \$58,000 for six properties during the quarter ended March 31, 2011. Bancorp owned one property as of March 31, 2011, compared to eight properties for the same quarter last year. Salaries and benefits expense decreased \$147,000 for the quarter ended March 31, 2011 compared to the same period last year. Professional and other outside services, which are comprised primarily of audit and accounting fees, legal services and consulting fees, decreased \$182,000 from \$1.1 million for the quarter ended March 31, 2010, to \$882,000 for the quarter ended March 31, 2011. The decrease is primarily due to lower legal fees of \$196,000 due to the reduction of non-performing assets. Regulatory assessments decreased \$84,000 due to decreased FDIC premiums based on the lower level of deposit balances. Loan administration and processing expenses decreased \$59,000 to \$37,000 for the quarter ended March 31, 2011 compared to \$96,000 for the quarter ended March 31, 2010 due to a decrease in appraisal expenses. These were partially offset by increases in advertising and promotional expenses of \$74,000.

**Table of Contents****Liquidity**

Bancorp's liquidity ratio was 28% at March 31, 2011 compared to 16% at March 31, 2010. The liquidity ratio is defined as the percentage of liquid assets to total assets. The following categories of assets, as described in the accompanying consolidated balance sheets, are considered liquid assets: cash and due from banks, federal funds sold, short-term investments and available-for-sale securities. Liquidity is a measure of Bancorp's ability to generate adequate cash to meet financial obligations. The principal cash requirements of a financial institution are to cover downward fluctuations in deposit accounts and increases in its loan portfolio. Management believes Bancorp's short-term assets provide sufficient liquidity to cover loan demand, potential fluctuations in deposit accounts and to meet other anticipated cash operating requirements.

**Capital**

The following table illustrates Bancorp's regulatory capital ratios at March 31, 2011 and December 31, 2010 respectively:

	March 31, 2011	December 31, 2010
Tier 1 Leverage Capital	8.71%	9.16%
Tier 1 Risk-based Capital	16.71%	15.69%
Total Risk-based Capital	18.14%	17.08%

The following table illustrates the Bank's regulatory capital ratios at March 31, 2011 and December 31, 2010 respectively:

	March 31, 2011	December 31, 2010
Tier 1 Leverage Capital	8.38%	8.84%
Tier 1 Risk-based Capital	16.07%	15.15%
Total Risk-based Capital	17.50%	16.54%

Pursuant to the Securities Purchase Agreement among Patriot National Bancorp, Inc., Patriot National Bank and PNBK Holdings LLC dated December 16, 2009 (the "Securities Purchase Agreement"), the Company may pay one or more special stock dividends (a "Special Dividend") to stockholders in the form of Company common stock. The amount of that Special Dividend would be based upon the net recoveries received by the Bank during the period beginning after June 30, 2009 and ending on June 30, 2011 from the charged off portion of loans on the Bank's books on or prior to June 30, 2009, and would be determined by cash collections of those loans during that period, net of all fees and expenses.

As of March 31, 2011, the majority of loans related to the Special Dividend have been resolved with no net recoveries. Further, the amount of fees and expenses incurred to date materially exceed any potential recovery of the remaining loans. Accordingly, there will be no current or future dividend payments related to the Special Dividend.

**Table of Contents**

**IMPACT OF INFLATION AND CHANGING PRICES**

Bancorp's consolidated financial statements have been prepared in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the general levels of inflation. Interest rates do not necessarily move in the same direction or with the same magnitude as the prices of goods and services. Notwithstanding this, inflation can directly affect the value of loan collateral, in particular, real estate. Inflation, or disinflation, could significantly affect Bancorp's earnings in future periods.

**Table of Contents**

**Item 3: Quantitative and Qualitative Disclosures about Market Risk**

Market risk is defined as the sensitivity of income to fluctuations in interest rates, foreign exchange rates, equity prices, commodity prices and other market-driven rates or prices. Based upon the nature of Bancorp's business, the primary source of market risk is interest rate risk, which is the impact that changing interest rates have on current and future earnings. In addition, Bancorp's loan portfolio is primarily secured by real estate in the company's market area. As a result, the changes in valuation of real estate could also impact Bancorp's earnings.

**Qualitative Aspects of Market Risk**

Bancorp's goal is to maximize long term profitability while minimizing its exposure to interest rate fluctuations. The first priority is to structure and price Bancorp's assets and liabilities to maintain an acceptable interest rate spread while reducing the net effect of changes in interest rates. In order to accomplish this, the focus is on maintaining a proper balance between the timing and volume of assets and liabilities re-pricing within the balance sheet. One method of achieving this balance is to originate variable rate loans for the portfolio and purchase short-term investments to offset the increasing short term re-pricing of the liability side of the balance sheet. In fact, a number of the interest-bearing deposit products have no contractual maturity. Therefore, deposit balances may run off unexpectedly due to changing market conditions. Additionally, loans and investments with longer term rate adjustment frequencies are matched against longer term deposits and borrowings to lock in a desirable spread.

The exposure to interest rate risk is monitored by the Management Asset and Liability Committee consisting of senior management personnel. The Committee meets on a monthly basis, but may convene more frequently as conditions dictate. The Committee reviews the interrelationships within the balance sheet to maximize net interest income within acceptable levels of risk. This Committee reports to the Board of Directors on a monthly basis regarding its activities. In addition to the Management Asset and Liability Committee, there is a Board Asset and Liability Committee (ALCO), which meets quarterly. ALCO monitors the interest rate risk analyses, reviews investment transactions during the period and determines compliance with Bank policies.

**Quantitative Aspects of Market Risk**

In order to manage the risk associated with interest rate movements, management analyzes Bancorp's interest rate sensitivity position through the use of interest income simulation and GAP analysis. The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are interest sensitive. An asset or liability is said to be interest sensitive within a specific time period if it will mature or reprice within that time period.

Management's goal is to manage asset and liability positions to moderate the effects of interest rate fluctuations on net interest income. Interest income simulations are completed quarterly and presented to ALCO. The simulations provide an estimate of the impact of changes in interest rates on net interest income under a range of assumptions. Changes to these assumptions can significantly affect the results of the simulations. The simulation incorporates assumptions regarding the potential timing in the repricing of certain assets and liabilities when market rates change and the changes in spreads between different market rates.

Simulation analysis is only an estimate of Bancorp's interest rate risk exposure at a particular point in time. Management regularly reviews the potential effect changes in interest rates could have on the repayment of rate sensitive assets and funding requirements of rate sensitive liabilities.

**Table of Contents**

The table below sets forth examples of changes in estimated net interest income and the estimated net portfolio value based on projected scenarios of interest rate increases and decreases. The analyses indicate the rate risk embedded in Bancorp's portfolio at the dates indicated should all interest rates instantaneously rise or fall. The results of these changes are added to or subtracted from the base case; however, there are certain limitations to these types of analyses. Rate changes are rarely instantaneous and these analyses may also overstate the impact of short-term repricings. As a result of the historically low interest rate environment, the calculated effects of the 100 and 200 basis point downward shocks cannot absolutely reflect the risk to earnings and equity since the interest rates on certain balance sheet items have approached their minimums, and, therefore, it is not possible for the analyses to fully measure the entire impact of these downward shocks.

Net Interest Income and Economic Value  
Summary Performance

Projected Interest Rate Scenario	March 31, 2011 Net Interest Income			Net Portfolio Value		
	Estimated	\$ Change	%	Estimated	\$ Change	%
	Value	from Base	Change from Base	Value	from Base	Change from Base
+ 200	24,059	1,224	5.36%	56,635	(4,600)	-7.51%
+ 100	23,353	518	2.27%	59,042	(2,193)	-3.58%
BASE	22,835			61,235		
- 100	21,741	(1,094)	-4.79%	64,024	2,789	4.55%
- 200	20,724	(2,111)	-9.24%	69,514	8,279	13.52%

Projected Interest Rate Scenario	December 31, 2010 Net Interest Income			Net Portfolio Value		
	Estimated	\$ Change	%	Estimated	\$ Change	%
	Value	from Base	Change from Base	Value	from Base	Change from Base
+ 200	26,290	110	0.42%	63,164	(4,420)	-6.54%
+ 100	26,209	29	0.11%	65,502	(2,082)	-3.08%
BASE	26,180			67,584		
- 100	25,869	(311)	-1.19%	70,228	2,644	3.91%
- 200	25,068	(1,112)	-4.25%	75,096	7,512	11.12%

**Item 4: Controls and Procedures**

Based on an evaluation of the effectiveness of Bancorp's disclosure controls and procedures performed by Bancorp's management, with the participation of Bancorp's Chief Executive Officer and its Chief Financial Officer as of the end of the period covered by this report, Bancorp's Chief Executive Officer and Chief Financial Officer concluded that Bancorp's disclosure controls and procedures have been effective.

As used herein, "disclosure controls and procedures" means controls and other procedures of Bancorp that are designed to ensure that information required to be disclosed by Bancorp in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by Bancorp in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to Bancorp's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in Bancorp's internal controls over financial reporting identified in connection with the evaluation described in the preceding paragraph that occurred during Bancorp's fiscal quarter ended March 31, 2011 that has materially affected, or is reasonably likely to materially affect, Bancorp's internal controls over financial reporting.

**Table of Contents**

**PART II OTHER INFORMATION.**

**Item 1: Legal Proceedings**

Neither Bancorp nor the Bank has any pending legal proceedings, other than ordinary routine litigation incidental to its business, to which Bancorp or the Bank is a party or any of its property is subject.

**Item 1A: Risk Factors**

During the three months ended March 31, 2011, there were no material changes to the risk factors relevant to Bancorp's operations, which are described in the Annual Report on Form 10-K for the year ended December 31, 2010.

**Item 6: Exhibits**

No.	Description
2	Agreement and Plan of Reorganization dated as of June 28, 1999 between Bancorp and the Bank (incorporated by reference to Exhibit 2 to Bancorp's Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)).
3(i)	Certificate of Incorporation of Bancorp, (incorporated by reference to Exhibit 3(i) to Bancorp's Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)).
3(i)(A)	Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. dated July 16, 2004 (incorporated by reference to Exhibit 3(i)(A) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2004 (Commission File No. 000-29599)).
3(i)(B)	Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. dated June 15, 2006 (incorporated by reference to Exhibit 3(i)(B) to Bancorp's Quarterly Report of Form 10-Q for the quarter ended September 30, 2006 (commission File No. 000-29599)).



**Table of Contents**

No.	Description
3(i)(C)	Certificate of Amendment to the Certificate of Incorporation of Patriot National Bancorp, Inc., filed with the Secretary of State of the State of Connecticut on October 6, 2010 (incorporated by reference to Exhibit 3.1 to Bancorp's Current Report on Form 8-K dated October 20, 2010 (Commission File No. 000-29599)).
3(i)(D)	Registration Rights Agreement, dated as of October 15, 2010, by and between Patriot National Bancorp, Inc. and PNBK Holdings LLC (incorporated by reference to Exhibit 10.1 to Bancorp's Current Report on Form 8-K dated October 20, 2010 (Commission File No. 000-29599)).
3(ii)	Amended and Restated By-laws of Bancorp (incorporated by reference to Exhibit 3.2 to Bancorp's Current Report on Form 8-K dated December 26, 2007 (Commission File No. 1-32007))
10(a)(1)	2001 Stock Appreciation Rights Plan of Bancorp (incorporated by reference to Exhibit 10(a)(1) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2001 (Commission File No. 000-29599)).
10(a)(3)	Employment Agreement, dated as of October 23, 2000, as amended by a First Amendment, dated as of March 21, 2001, among the Bank, Bancorp and Charles F. Howell (incorporated by reference to Exhibit 10(a)(4) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2000 (Commission File No. 000-29599)).
10(a)(4)	Change of Control Agreement, dated as of January 1, 2007 among Angelo De Caro, and Patriot National Bank and Bancorp (incorporated by reference to Exhibit 10(a)(4) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2006 (Commission File No. 000-29599)).
10(a)(5)	Employment Agreement dated as of January 1, 2008 among Patriot National Bank, Bancorp and Robert F. O'Connell (incorporated by reference to Exhibit 10(a)(5) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2007 (Commission File No. 000-29599)).

**Table of Contents**

No.	Description
10(a)(6)	Change of Control Agreement, dated as of January 1, 2007 among Robert F. O'Connell, Patriot National Bank and Bancorp (incorporated by reference to Exhibit 10(a)(6) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2006 (Commission File No. 000-29599)).
10(a)(9)	License agreement dated July 1, 2003 between Patriot National Bank and L. Morris Glucksman (incorporated by reference to Exhibit 10(a)(9) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2003 (Commission File No. 000-29599)).
10(a)(10)	Employment Agreement dated as of January 1, 2007 among Patriot National Bank, Bancorp and Charles F. Howell (incorporated by reference to Exhibit 10(a)(10) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2006 (Commission File No. 000-29599)).
10(a)(11)	Change of Control Agreement, dated as of January 1, 2007 among Charles F. Howell, Patriot National Bank and Bancorp (incorporated by reference to Exhibit 10(a)(11) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2006 (Commission File No. 000-29599)).
10(a)(12)	2005 Director Stock Award Plan (incorporated by reference to Exhibit 10(a)(12) to Bancorp's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 (Commission File No. 000-29599)).
10(a)(13)	Change of Control Agreement, dated as of January 1, 2007 between Martin G. Noble and Patriot National Bank (incorporated by reference to Exhibit 10(a)(13) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2006 (Commission File No. 000-29599)).
10(a)(14)	Change of Control Agreement, dated as of January 1, 2007 among Philip W. Wolford, Patriot National Bank and Bancorp (incorporated by reference to Exhibit 10(a)(14) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2006 (Commission File No. 000-29599)).

**Table of Contents**

No.	Description
10(a)(15)	Formal Written Agreement between Patriot National Bank and the Office of the Comptroller of the Currency (incorporated by reference to Exhibit 10(a)(15) to Bancorp's Current Report on Form 8-K dated February 9, 2009 (Commission File No. 000-29599)).
10(a)(16)	Securities Purchase Agreement by and among Patriot National Bancorp, Inc., Patriot National Bank and PNBK Holdings LLC dated as of December 16, 2009 (incorporated by reference to Exhibit 10.1 to Bancorp's Current Report on Form 8-K dated December 17, 2009).
10(a)(17)	First Amendment to Securities Purchase Agreement by and among Patriot National Bancorp, Inc., Patriot National Bank and PNBK Holdings LLC dated as of May 3, 2010 (incorporated by reference to Exhibit 10(a) to Bancorp's Current Report on Form 8-K dated May 4, 2010).
10(a)(18)	Purchase and Sale Agreement, dated February 25, 2011, by and among Patriot National Bank, Pinpat Acquisition Corporation and ES Ventures One LLC (incorporated by reference to Exhibit 2.1 to Bancorp's Current Report on Form 8-K dated March 29, 2011).
10(a)(19)	Formal Written Agreement between Patriot National Bank and the Federal Reserve Bank of New York (as incorporated by reference to Exhibit 10(a)(16) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2010).
10(c)	1999 Stock Option Plan of the Bank (incorporated by reference to Exhibit 10(c) to Bancorp's Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)).
14	Code of Conduct for Senior Financial Officers (incorporated by reference to Exhibit 14 to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2004 (Commission File No. 000-29599)).
21	Subsidiaries of Bancorp (incorporated by reference to Exhibit 21 to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 1999 (Commission File No. 000-29599)).
31(1)	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31(2)	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32	Section 1350 Certifications

**Table of Contents**

**SIGNATURES**

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

Patriot National Bancorp, inc.  
(Registrant)

By: /s/ Robert F. O Connell  
Robert F. O Connell,  
Senior Executive Vice President  
Chief Financial Officer

(On behalf of the registrant and as  
chief financial officer)

May 13, 2011