

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**

	March 31, 2011 (Unaudited)	December 31, 2010
ASSETS		
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
Total assets	\$ 709,714,310	\$ 784,324,854
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities		
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	8,248,000	8,248,000
Accrued expenses and other liabilities	4,990,464	5,095,837
Total liabilities	651,521,495	717,152,666
Commitments (Note 7)		
Shareholders equity		
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	383,744	383,744
Additional paid-in capital	105,050,433	105,050,433
Accumulated deficit	(48,381,943)	(39,399,345)
Less: Treasury stock, at cost: 2011 and 2010 11,705 shares	(160,025)	(160,025)
Accumulated other comprehensive income	1,300,606	1,297,381
Total shareholders equity	58,192,815	67,172,188
Total liabilities and shareholders equity	\$ 709,714,310	\$ 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
Total interest and dividend income	7,366,561	9,690,515
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
Total interest expense	2,430,704	3,681,605
Net interest income	4,935,857	6,008,910
Provision for Loan Losses	6,981,629	727,000
Net interest (loss) income after provision for loan losses	(2,045,772)	5,281,910
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
Total non-interest income	582,850	538,468
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

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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
Total non-interest expenses	7,519,676	8,726,944
Loss before income taxes	(8,982,598)	(2,906,566)
Provision for Income Taxes		(225,000)
Net loss	\$ (8,982,598)	\$ (3,131,566)
Basic and diluted loss per share	\$ (0.23)	\$ (0.66)

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
Three months ended March 31, 2010							
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
Three months ended March 31, 2011							
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
Net cash used in operating activities	(965,448)	(212,357)
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)
Net cash provided by investing activities	76,762,383	6,098,701
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)
Net cash used in financing activities	(65,525,798)	(49,493,417)
Net increase (decrease) in cash and cash equivalents	10,271,137	(43,607,073)

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:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
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 evaluated	\$ 17,511,362	\$ 192,324,041	\$ 25,731,702	\$ 8,951,208	\$ 145,816,024	\$ 37,962,339	\$	\$ 4
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%	>
\$ 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:

	Non-Accrual and Past Due Loans						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	>90 Days Past Due and Accruing	
2011							
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

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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	
2011									
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	\$ 3,105,642	\$	\$ 3,105,642	\$ 156,164,932	\$ 159,270,574	\$ 27,787,744	\$ 187,058,318	
Consumer								

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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:

2011	Recorded Investment	Unpaid Principal Balance	Related Allowance
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 Residential	1,364,694	1,425,000	187,094
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 Residential	1,364,694	1,425,000	187,094
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
	\$ 45,506,510

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
March 31, 2011						
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%
December 31, 2010						
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:

	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				
Impaired Loans ⁽¹⁾	\$	\$	\$ 4,577,157	\$ 4,577,157
Other real estate owned ⁽²⁾	\$	\$	\$ 950,000	\$ 950,000
December 31, 2010				
Impaired Loans ⁽¹⁾	\$	\$	\$ 30,999,865	\$ 30,999,865
Other real estate owned ⁽²⁾	\$	\$	\$ 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
Financial Assets:				
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
Financial Liabilities:				
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: