

First Internet Bancorp

Accountants' Report and Consolidated Financial Statements

December 31, 2010 and 2009

First Internet Bancorp
December 31, 2010 and 2009

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Independent Accountants' Report

Audit Committee, Board of Directors and Shareholders
First Internet Bancorp
Indianapolis, Indiana

We have audited the accompanying consolidated balance sheets of First Internet Bancorp as of December 31, 2010 and 2009, and the related consolidated statements of operations, shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of First Internet Bancorp as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

BKD, LLP

Indianapolis, Indiana
February 22, 2011

First Internet Bancorp
Consolidated Balance Sheets
December 31, 2010 and 2009

Assets

	<u>2010</u>	<u>2009</u>
Cash and due from banks	\$ 2,353,951	\$ 1,047,797
Interest-bearing demand deposits	<u>30,062,672</u>	<u>28,968,247</u>
Total cash and cash equivalents	32,416,623	30,016,044
Securities available for sale - at fair value (amortized cost of \$140,124,957 in 2010 and \$135,408,555 in 2009)	136,936,295	133,583,840
Loans held for sale	5,008,138	7,168,658
Loans receivable - net of allowance for loan losses of \$6,845,416 and \$10,096,813 at December 31, 2010 and 2009	299,545,308	305,439,038
Accrued interest receivable	2,095,292	2,256,728
Federal Home Loan Bank of Indianapolis stock	3,258,600	3,637,600
Bank-owned life insurance - at cash surrender value	7,868,699	7,574,415
Goodwill	4,687,349	4,687,349
Prepaid expenses and other assets	<u>12,098,984</u>	<u>10,251,650</u>
 Total assets	 <u>\$ 503,915,288</u>	 <u>\$ 504,615,322</u>

Liabilities and Shareholders' Equity

Liabilities

Deposits	\$ 422,702,556	\$ 411,627,338
Advances from Federal Home Loan Bank	30,454,832	47,000,000
Accrued payroll and related expenses	563,529	454,340
Accrued interest payable	125,983	133,722
Accrued expenses and other liabilities	<u>1,170,743</u>	<u>636,074</u>
Total liabilities	<u>455,017,643</u>	<u>459,851,474</u>

Shareholders' Equity

Preferred stock, no par value; 4,913,779 shares authorized; issued and outstanding - none		
Voting common stock, no par value; 45,000,000 shares authorized; 1,871,590 shares issued and outstanding	41,246,247	41,186,247
Nonvoting common stock, no par value; 86,221 shares authorized; issued and outstanding	—	—
Retained earnings	9,711,385	4,756,725
Accumulated other comprehensive loss (net of income taxes of \$1,128,675 in 2010 and \$645,592 in 2009)	<u>(2,059,987)</u>	<u>(1,179,124)</u>
Total shareholders' equity	<u>48,897,645</u>	<u>44,763,848</u>
 Total liabilities and shareholders' equity	 <u>\$ 503,915,288</u>	 <u>\$ 504,615,322</u>

First Internet Bancorp
Consolidated Statements of Operations
Years Ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Interest Income		
Securities	\$ 5,362,594	\$ 7,113,782
Loans	19,867,622	21,433,143
Federal funds sold and other short-term investments	<u>66,170</u>	<u>60,491</u>
Total interest income	<u>25,296,386</u>	<u>28,607,416</u>
Interest Expense		
Deposits	9,254,175	12,776,116
Other borrowed funds	<u>1,531,163</u>	<u>2,083,241</u>
Total interest expense	<u>10,785,338</u>	<u>14,859,357</u>
Net Interest Income	14,511,048	13,748,059
Provision for Loan Losses	<u>927,272</u>	<u>11,563,786</u>
Net Interest Income After Provision for Loan Losses	<u>13,583,776</u>	<u>2,184,273</u>
Noninterest Income		
Service charges and fees	1,267,311	1,395,464
Gain on loans sold	3,097,932	1,826,637
Other-than-temporary impairment		
Total loss related to other than temporarily impaired securities	(2,776,209)	(1,648,440)
Portion of loss recognized in other comprehensive loss	<u>1,866,646</u>	<u>1,348,440</u>
Other-than-temporary impairment loss recognized in net loss	(909,563)	(300,000)
Loss on asset disposals	(325,807)	(336,754)
Other	<u>306,908</u>	<u>317,984</u>
Total noninterest income	<u>3,436,781</u>	<u>2,903,331</u>
Noninterest Expense		
Salaries and employee benefits	4,795,355	3,814,910
Marketing, advertising and promotion	269,454	278,117
Consulting and professional fees	729,301	620,346
Data processing	963,935	968,722
Loan expenses	734,544	378,006
Premises and equipment	1,149,715	1,399,651
Deposit insurance premium	939,321	1,065,715
Other	<u>788,384</u>	<u>815,876</u>
Total noninterest expense	<u>10,370,009</u>	<u>9,341,343</u>
Income (Loss) Before Income Taxes	6,650,548	(4,253,739)
Income Tax Provision (Benefit)	<u>1,695,888</u>	<u>(2,135,711)</u>
Net Income (Loss)	<u>\$ 4,954,660</u>	<u>\$ (2,118,028)</u>
Income (Loss) Per Share of Common Stock		
Basic	\$ 2.61	\$ (1.12)
Diluted	2.61	(1.12)
Weighted-Average Number of Common Shares Outstanding		
Basic	1,898,919	1,892,082
Diluted	1,898,919	1,892,082

First Internet Bancorp
Consolidated Statements of Shareholders' Equity
Years Ended December 31, 2010 and 2009

	Voting and Nonvoting Common Stock	Accumulated Other Comprehensive Loss	Retained Earnings	Total Shareholders' Equity
Balance, January 1, 2009	\$ 41,068,447	\$ (2,531,873)	\$ 6,874,753	\$ 45,411,327
Issuance of common stock for officer compensation	72,800			72,800
Comprehensive loss				
Net loss			(2,118,028)	(2,118,028)
Unrealized loss on securities available for sale for which an other- than-temporary impairment has been recognized in income (loss) - net of income tax		(871,357)		(871,357)
Unrealized gain on securities available for sale - net of income tax		2,224,106		<u>2,224,106</u>
Total comprehensive loss				(765,279)
Issuance of directors deferred stock rights	<u>45,000</u>			<u>45,000</u>
Balance, December 31, 2009	41,186,247	(1,179,124)	4,756,725	44,763,848
Comprehensive income				
Net income			4,954,660	4,954,660
Unrealized loss on securities available for sale for which an other- than-temporary impairment has been recognized in income (loss) - net of income tax		(334,779)		(334,779)
Unrealized loss on securities available for sale - net of income tax		(546,084)		<u>(546,084)</u>
Total comprehensive income				4,073,797
Issuance of directors deferred stock rights	<u>60,000</u>			<u>60,000</u>
Balance, December 31, 2010	<u>\$ 41,246,247</u>	<u>\$ (2,059,987)</u>	<u>\$ 9,711,385</u>	<u>\$ 48,897,645</u>

First Internet Bancorp
Consolidated Statements of Cash Flows
Years Ended December 31, 2010 and 2009

	2010	2009
Operating Activities		
Net income (loss)	\$ 4,954,660	\$ (2,118,028)
Adjustments to reconcile net income to net cash from operating activities		
Depreciation	361,204	605,657
Amortization and accretion on securities	145,087	230,144
Amortization on FHLB prepayment penalties	87,828	—
Loss from disposal of fixed assets	15,207	19,113
Loss from real estate owned	102,334	27,170
Increase in cash surrender value of bank-owned life insurance	(294,284)	(307,154)
Provision for loan and lease losses	927,272	11,563,786
Deferred income taxes	1,328,454	(2,990,890)
Director fees and officer compensation	60,000	117,800
Loss on other-than-temporary impairment of security	909,563	300,000
Gain from sale of available-for-sale securities	(6,597)	(54,324)
Changes in assets and liabilities		
Accrued interest receivable	161,436	517,520
Loans held for sale	2,160,520	(2,965,468)
Prepaid expenses and other assets	(207,515)	(3,137,579)
Accrued expenses and other liabilities	<u>636,119</u>	<u>(166,458)</u>
Net cash provided by operating activities	<u>11,341,288</u>	<u>1,641,289</u>
Investing Activities		
Net decrease in loans	54,535,284	28,172,031
Loans purchased	(52,392,511)	(25,384,651)
Proceeds from liquidation of real estate owned	640,096	622,182
Maturities of securities available for sale	32,967,514	50,489,795
Proceeds from sale of securities available for sale	3,056,000	4,537,750
Proceeds from redemption of FHLB stock	379,000	—
Purchase of securities available for sale	(41,787,969)	(18,155,548)
Capital expenditures	<u>(780,345)</u>	<u>(72,173)</u>
Net cash provided by (used in) investing activities	<u>(3,382,931)</u>	<u>40,209,386</u>
Financing Activities		
Net increase (decrease) in deposits	11,075,218	(27,614,468)
Repayment of FHLB advances	(28,632,996)	(17,700,000)
Proceeds from FHLB advances	<u>12,000,000</u>	<u>7,700,000</u>
Net cash used in financing activities	<u>(5,557,778)</u>	<u>(37,614,468)</u>
Net Increase in Cash and Cash Equivalents	2,400,579	4,236,207
Cash and Cash Equivalents, Beginning of Year	<u>30,016,044</u>	<u>25,779,837</u>
Cash and Cash Equivalents, End of Year	<u>\$ 32,416,623</u>	<u>\$ 30,016,044</u>
Supplemental Disclosures of Cash Flow Information		
Cash paid during the year for interest	\$ 10,793,077	\$ 14,881,664
Cash paid during the year for taxes	1,109,669	1,654,000
Loans transferred to real estate owned	2,823,685	377,062

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2010 and 2009

Note 1: Summary of Significant Accounting Policies

The accounting policies of First Internet Bancorp (Company) conform to accounting principles generally accepted in the United States of America. A summary of the Company's significant accounting policies follows:

Description of Business

The Company was incorporated on September 15, 2005, and was approved to consummate a plan of exchange on March 21, 2006, whereas the Company became a single-bank holding company with 100% ownership in First Internet Bank of Indiana (Bank) and Landmark Mortgage Company (LMC).

The Bank was incorporated on October 28, 1998, and was approved to accept FDIC insured deposits on December 28, 1998. The Bank commenced operations to the public on February 22, 1999. The Bank provides commercial and retail banking, with operations conducted on the World Wide Web (Internet) at www.firstib.com and through its corporate office located in Indianapolis, Indiana. The majority of the Bank's income is derived from retail lending activities and investments in securities. The Bank is subject to competition from other financial institutions and is regulated by certain state and federal agencies and undergoes periodic examinations by those regulatory authorities. LMC was engaged in brokering mortgage loans between borrowers and lending institutions for a fee. LMC was merged out of existence effective May 31, 2009 when it was absorbed into the Company.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiary. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Estimates most susceptible to change in the near term include the allowance for loan losses and the fair value of securities available for sale.

First Internet Bancorp

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

Securities

The Company classifies its securities in one of three categories and accounts for the investments as follows:

- Securities that the Company has the positive intent and ability to hold to maturity are classified as “securities held to maturity” and reported at amortized cost.
- Securities that are acquired and held principally for the purpose of selling them in the near term with the objective of generating economic profits on short-term differences in market characteristics are classified as “securities held for trading” and reported at fair value, with unrealized gains and losses included in earnings.
- Securities not classified as either held to maturity or trading securities are classified as “securities available for sale” and reported at fair value, with unrealized gains and losses, after applicable taxes, excluded from earnings and reported in a separate component of stockholders’ equity. Declines in the value of debt securities and marketable equity securities that are considered to be other than temporary are recorded as an other-than-temporary impairment of securities available for sale with the unrealized losses recorded in the statements of operations.

Interest and dividend income, adjusted by amortization of premium or discount, is included in earnings using the effective interest rate method. Purchases and sales of securities are recorded in the consolidated balance sheets on the trade date. Gains and losses from security sales or disposals are recognized as of the trade date in the consolidated statements of income for the period in which securities are sold or otherwise disposed of. Gains and losses on sales of securities are determined on the specific-identification method.

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to noninterest income. Gains and losses on loan sales are recorded in noninterest income, and direct loan origination costs and fees are deferred at origination of the loan and are recognized in noninterest income upon sale of loan.

Revenue Recognition

Interest income on loans is based on the principal balance outstanding and is recognized as earned on the interest method, except for interest on loans on nonaccrual status, which is recorded as a reduction of loan principal when received.

Premiums and discounts are amortized using the effective interest rate method.

Loan fees, net of certain direct origination costs, primarily salaries and wages, are deferred and amortized to interest income as a yield adjustment over the life of the loan.

Loans are placed on nonaccrual status when management believes that the borrower’s financial condition, after giving consideration to economic and business conditions and collection efforts, is such that collection of interest is doubtful. Loans are charged against the allowance for loan losses when management believes that the collectibility of principal is unlikely.

First Internet Bancorp
Notes to Consolidated Financial Statements
December 31, 2010 and 2009

Provision for Loan Losses

A provision for estimated losses on loans is charged to operations based upon management's evaluation of the potential losses. Such an evaluation, which includes a review of all loans for which full collectibility may not be reasonably assured considers, among other matters, the estimated net realizable value of the underlying collateral, as applicable, economic conditions, loan and lease loss experience and other factors that are particularly susceptible to changes that could result in a material adjustment in the near term. While management endeavors to use the best information available in making its evaluations, future allowance adjustments may be necessary if economic conditions change substantially from the assumptions used in making the evaluations.

ASC Topic 310 requires that impaired loans be measured based on the present value of expected future cash flows discounted at the loans effective interest rates or the fair value of the underlying collateral and allows existing methods for recognizing interest income.

Federal Home Loan Bank (FHLB) Stock

Federal law requires a member institution of the FHLB system to hold common stock of its district FHLB according to a predetermined formula. This investment is stated at cost, which represents redemption value, and may be pledged as collateral for FHLB advances.

Real Estate Owned

Real estate owned represents real estate acquired through foreclosure or deed in lieu of foreclosure and is recorded at its fair value less estimated costs to sell. When property is acquired, it is recorded at its fair value at the date of acquisition, with any resulting write-down charged against the allowance for loan and lease losses. Any subsequent deterioration of the property is charged directly to operating expense. Costs relating to the development and improvement of real estate owned are capitalized, whereas costs relating to holding and maintaining the property are charged to expense as incurred. The Company has \$2,207,000 and \$126,000 of real estate owned as of December 31, 2010 and 2009, respectively.

Equipment

Equipment is stated at cost, less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives, which range from three to five years.

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Income Taxes

Deferred income tax assets and liabilities reflect the impact of temporary differences between amounts of assets and liabilities for financial reporting purposes and the basis of such assets and liabilities as measured by tax laws and regulations. Deferred income tax expense or benefit is based upon the change in deferred tax assets and liabilities from period to period, subject to an ongoing assessment of realization of deferred tax assets. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Company files income tax returns in the U.S. federal and Indiana jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local examinations by tax authorities for years before 2006.

ASC Topic 740-10 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company did not identify any uncertain tax positions that it believes should be recognized in the consolidated financial statements.

Earnings (Loss) Per Share

Earnings (loss) per share of common stock are based on the weighted-average number of basic shares and dilutive shares outstanding during the year.

The following is a reconciliation of the weighted-average common shares for the basic and diluted earnings per share computations for the years ended December 31, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Basic earnings per share		
Weighted-average common shares	<u>1,898,919</u>	<u>1,892,082</u>
Diluted earnings per share		
Weighted-average common shares	1,898,919	1,892,082
Dilutive effect of stock compensation	—	—
Dilutive effect of stock options	<u>—</u>	<u>—</u>
Weighted-average common and incremental shares	<u>1,898,919</u>	<u>1,892,082</u>
Number of stock options excluded from the calculation of earnings per share as the options' exercise prices were greater than the average market price of the Company's common stock	<u>202,500</u>	<u>202,500</u>

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Notes to Consolidated Financial Statements
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Dividend Restrictions

Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the Company or by the Company to shareholders.

Stock Compensation

At December 31, 2010, the Company has a stock-based employee compensation plan using the fair value recognition provisions of ASC Topic 718. The plan is described more fully in Note 9.

Comprehensive Income (Loss)

Comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale, which are also recognized as separate components of equity. Accumulated other comprehensive income (loss) at December 31, 2010 and 2009 is solely related to unrealized gains and losses on investment securities.

Reclassification adjustments have been determined for all components of other comprehensive income or loss reported in the consolidated statements of changes in shareholders' equity. Amounts presented within those statements for the years ended December 31, 2010 and 2009, are as follows:

	<u>2010</u>	<u>2009</u>
Other comprehensive income (loss)		
Net unrealized holding gains	\$ 509,297	\$ 3,527,912
Unrealized loss on securities available for sale for which an other-than-temporary impairment has been recognized in income	(1,866,646)	(1,348,440)
Gains realized	<u>(6,597)</u>	<u>(54,324)</u>
Other comprehensive income (loss) before tax	(1,363,946)	2,125,148
Income tax provision (benefit)	<u>(483,083)</u>	<u>772,399</u>
Other comprehensive income (loss) - net of tax	<u>\$ (880,863)</u>	<u>\$ 1,352,749</u>

Statements of Cash Flows

Cash and cash equivalents are defined to include cash on-hand, noninterest and interest-bearing amounts due from other banks and federal funds sold. Generally, federal funds are sold for one-day periods. The Company reports net cash flows for customer loan transactions and deposit transactions.

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Bank-Owned Life Insurance

Bank-owned life insurance policies are carried at their cash surrender value. The Company recognizes tax-free income from the periodic increases in the cash surrender value of these policies and from death benefits.

Goodwill

Goodwill is tested annually for impairment. If the implied fair value of goodwill is lower than its carrying amount, goodwill impairment is indicated and goodwill is written down to its implied fair value. Subsequent increases in goodwill value are not recognized in the consolidated financial statements.

Current Economic Conditions

The current economic environment presents financial institutions with circumstances and challenges which in some cases have resulted in large declines in the fair values of investments and other assets, constraints on liquidity and significant credit quality problems. Due to national, state and local economic conditions, values for commercial and development real estate have declined significantly, and the market for these properties is depressed. The accompanying consolidated financial statements have been prepared using values and information currently available to the Company. Given the volatility of current economic conditions, the values of assets and liabilities recorded in the consolidated financial statements could change rapidly, resulting in material future adjustments in asset values, the allowance for loan losses and capital that could negatively impact the Company's ability to meet regulatory capital requirements and maintain sufficient liquidity.

Reclassifications

Certain reclassifications have been made to the 2009 financial statements to conform to the 2010 financial statement presentation. These reclassifications had no effect on net income.

Note 2: Cash and Cash Equivalents

Effective July 21, 2010, the FDIC's insurance limits were permanently increased to \$250,000. At December 31, 2010, the Company's interest-bearing cash accounts do not exceed federally insured limits. Additionally, approximately \$1,000 and \$30,062,000 of cash is held by the FHLB of Indianapolis and Federal Reserve Bank of Chicago, which is not federally insured.

Pursuant to legislation enacted in 2010, the FDIC will fully insure all noninterest-bearing transaction accounts beginning December 31, 2010 through December 31, 2012, at all FDIC-insured institutions.

The Company is required to maintain reserve funds in cash and/or on deposit with the Federal Reserve Bank. The reserve required at December 31, 2010 was \$182,000.

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Notes to Consolidated Financial Statements
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Note 3: Securities

Securities at December 31, 2010 and 2009 are as follows:

	Amortized Cost	2010 Gross Unrealized		Fair Value
		Gains	Losses	
Securities available for sale				
U.S. government-sponsored enterprises	\$ 43,443,768	\$ 263,094	\$ (314,435)	\$ 43,392,427
U.S. government treasuries	2,369,015	—	(36,990)	2,332,025
Municipals	42,463,248	270,770	(1,968,949)	40,765,069
Mortgage-backed and asset-backed securities	47,569,675	2,245,823	(835,289)	48,980,209
Other securities	<u>4,279,251</u>	<u>12,241</u>	<u>(2,824,927)</u>	<u>1,466,565</u>
Total available for sale	\$ <u>140,124,957</u>	\$ <u>2,791,928</u>	\$ <u>(5,980,590)</u>	\$ <u>136,936,295</u>

	Amortized Cost	2009 Gross Unrealized		Fair Value
		Gains	Losses	
Securities available for sale				
U.S. government-sponsored enterprises	\$ 14,599,505	\$ 39,166	\$ (89,439)	\$ 14,549,232
Municipals	42,960,805	511,425	(679,496)	42,792,734
Mortgage-backed and asset-backed securities	70,077,957	2,302,027	(1,671,224)	70,708,760
Other securities	<u>7,770,288</u>	<u>1,883</u>	<u>(2,239,057)</u>	<u>5,533,114</u>
Total available for sale	\$ <u>135,408,555</u>	\$ <u>2,854,501</u>	\$ <u>(4,679,216)</u>	\$ <u>133,583,840</u>

The carrying value of securities at December 31, 2010 is shown below by their contractual maturity date. Actual maturities will differ because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale	
	Amortized Cost	Fair Value
Within one year	\$ 1,000,000	\$ 1,012,241
One to five years	8,773,686	8,841,817
Five to ten years	30,244,183	30,203,130
After ten years	<u>52,537,413</u>	<u>47,898,898</u>
	92,555,282	87,956,086
Mortgage-backed and asset-backed securities	<u>47,569,675</u>	<u>48,980,209</u>
Totals	\$ <u>140,124,957</u>	\$ <u>136,936,295</u>

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Notes to Consolidated Financial Statements

December 31, 2010 and 2009

Gross gains of \$7,000 and \$54,000, and gross losses of \$0 and \$0 resulting from sales of available-for-sale securities were realized for 2010 and 2009, respectively.

Certain investments in debt securities are reported in the consolidated financial statements at an amount less than their historical cost. Total fair value of these investments at December 31, 2010 and 2009 was \$55,145,000 and \$40,759,000, which is approximately 40% and 31%, respectively, of the Company's available-for-sale investment portfolio. These declines primarily resulted from fluctuations in market interest rates after purchase.

Except as discussed below, management believes the declines in fair value for these securities are temporary.

Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment is identified.

The following tables show the Company's investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2010 and 2009:

	2010					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available for sale:						
U.S. government-sponsored enterprises	\$ 18,330,435	\$ (312,041)	\$ 466,486	\$ (2,394)	\$ 18,796,921	\$ (314,435)
U.S. government treasuries	2,332,025	(36,990)	-	-	2,332,025	(36,990)
Municipals	24,784,798	(1,485,949)	3,108,292	(483,000)	27,893,090	(1,968,949)
Mortgage-backed and asset-backed securities	493,244	(10,017)	5,175,827	(825,272)	5,669,071	(835,289)
Other securities	—	—	454,324	(2,824,927)	454,324	(2,824,927)
	<u>\$ 45,940,502</u>	<u>\$ (1,844,997)</u>	<u>\$ 9,204,929</u>	<u>\$ (4,135,593)</u>	<u>\$ 55,145,431</u>	<u>\$ (5,980,590)</u>

	2009					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available for sale:						
U.S. government-sponsored enterprises	\$ 1,980,100	\$ (19,900)	\$ 6,112,403	\$ (69,539)	\$ 8,092,503	\$ (89,439)
Municipals	13,622,531	(263,244)	5,291,850	(416,252)	18,914,381	(679,496)
Mortgage-backed and asset-backed securities	764,792	(10,959)	8,456,079	(1,660,265)	9,220,871	(1,671,224)
Other securities	—	—	4,531,230	(2,239,057)	4,531,230	(2,239,057)
	<u>\$ 16,367,423</u>	<u>\$ (294,103)</u>	<u>\$ 24,391,562</u>	<u>\$ (4,385,113)</u>	<u>\$ 40,758,985</u>	<u>\$ (4,679,216)</u>

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U.S. Government-Sponsored Enterprises and Treasuries

The unrealized losses on the Company's investments in direct obligations of U.S. government-sponsored enterprises and treasuries were caused by interest rate changes. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other than temporarily impaired at December 31, 2010.

Municipals

The unrealized losses on the Company's investments in municipal securities were caused by interest rate changes. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other than temporarily impaired at December 31, 2010.

Mortgage-Backed Securities

The unrealized losses on the Company's investment in mortgage-backed securities were caused by interest rate changes. The Company expects to recover the amortized cost basis over the term of the securities. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other than temporarily impaired at December 31, 2010.

Other Securities

The Company's unrealized loss on investments in other securities is primarily made up of two investments. The first investment is a \$2,000,000 par investment in I-PreTSL I B-2 pooled trust security. The unrealized loss was primarily caused by a recent sector downgrade by several industry analysts. The Company currently expects to recover the entire amortized cost basis of the investment. The determination of no credit loss was calculated by comparing expected discounted cash flows based on performance indicators of the underlying assets in the security to the carrying value of the investment. Because the Company does not intend to sell the investment and it is not more likely than not the Company will be required to sell the investment before recovery of its amortized cost basis, which may be maturity, it does not consider the remainder of the investment to be other than temporarily impaired at December 31, 2010. The second investment is discussed in the next section.

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Other-Than-Temporary Impairment

The Company routinely conducts periodic reviews to identify and evaluate investment securities to determine whether an other-than-temporary impairment has occurred. Economic models are used to determine whether an other-than-temporary impairment has occurred on these securities.

An other-than-temporary impairment has been recognized on a \$2,000,000 par investment in ALESCO IV Series B2 pooled trust security. The unrealized loss was primarily caused by (a) a decrease in performance and (b) a sector downgrade by several industry analysts. The Company currently expects ALESCO IV to settle the security at a price less than the amortized cost basis of the investment (that is, the Company expects to recover less than the entire amortized cost basis of the security). The Company has recognized a loss equal to the credit loss, establishing a new, lower amortized cost basis. The credit loss was calculated by comparing expected discounted cash flows based on performance indicators of the underlying assets in the security to the carrying value of the investment. Because the Company does not intend to sell the investment and it is not more likely than not the Company will be required to sell the investment before recovery of its new, lower amortized cost basis, which may be maturity, it does not consider the remainder of the investment in ALESCO IV to be other than temporarily impaired at December 31, 2010.

For identified mortgage-backed securities in the investment portfolio, an extensive, quarterly review is conducted to determine if an other-than-temporary impairment has occurred. Various inputs to the economic models are used to determine if an unrealized loss is other than temporary. The most significant inputs are voluntary prepay rates, default rates, liquidation rates and loss severity.

To determine if the unrealized loss for mortgage-backed securities is other than temporary, the Company projects total estimated defaults of the underlying assets (mortgages) and multiplies that calculated amount by an estimate of realizable value upon sale in the marketplace (severity) in order to determine the projected collateral loss. The Company also evaluates the current credit enhancement underlying the bond to determine the impact on cash flows. If the Company determines that a given mortgage-backed security position will be subject to a write-down or loss, the Company records the expected credit loss as a charge to earnings.

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Credit Losses Recognized on Investments

Certain debt securities have experienced fair value deterioration due to credit losses, as well as due to other market factors, but are not otherwise other than temporarily impaired.

The following table provides information about debt securities for which only a credit loss was recognized in income and other losses are recorded in other comprehensive loss.

	Accumulated Credit Losses
Credit losses on debt securities held	
January 1, 2009	\$ —
Additions related to other-than-temporary losses not previously recognized	300,000
December 31, 2009	300,000
Additions related to other-than-temporary losses not previously recognized	488,814
Additions related to increases in previously recognized other-than-temporary losses	420,749
December 31, 2010	\$ <u>1,209,563</u>

Note 4: Loans Receivable

Categories of loans at December 31, include:

	2010	2009
Real estate loans		
Residential	\$ 106,729,238	\$ 80,780,472
Commercial	19,562,674	20,212,004
Total real estate loans	126,291,912	100,992,476
Commercial loans	4,919,165	3,779,068
Consumer loans	171,121,877	205,702,195
Total loans	302,332,954	310,473,739
Deferred loan origination costs and premiums and discounts on purchased loans	4,057,770	5,062,112
Allowance for loan and lease losses	(6,845,416)	(10,096,813)
Total net loans	\$ <u>299,545,308</u>	\$ <u>305,439,038</u>

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

	2010					2009 Total
	Residential Real Estate	Commercial Real Estate	Commercial	Consumer	Total	
Allowance for loan losses:						
Balance, beginning of year	\$ 1,489,270	\$ 3,490,995	\$ 78,608	\$ 5,037,940	\$ 10,096,813	\$ 4,616,006
Provision charged to expense	1,682,616	(1,770,877)	589,569	425,964	927,272	11,563,786
Losses charged off	(1,157,561)	(445,447)	(60,942)	(3,399,123)	(5,063,073)	(7,003,139)
Recoveries	<u>121,380</u>	<u>16,850</u>	<u>—</u>	<u>746,174</u>	<u>884,404</u>	<u>920,160</u>
Balance, end of year	2,135,705	1,291,521	607,235	2,810,955	6,845,416	<u>\$ 10,096,813</u>
Ending balance: individually evaluated for impairment	<u>722,993</u>	<u>883,233</u>	<u>540,498</u>	<u>150,610</u>	<u>2,297,334</u>	
Ending balance: collectively evaluated for impairment	<u>\$ 1,412,712</u>	<u>\$ 408,288</u>	<u>\$ 66,737</u>	<u>\$ 2,660,345</u>	<u>\$ 4,548,082</u>	
Loans:						
Ending balance	\$ 106,729,238	\$ 19,562,674	\$ 4,919,165	\$ 171,121,877	\$ 302,332,954	
Ending balance: individually evaluated for impairment	<u>3,073,798</u>	<u>3,593,233</u>	<u>1,538,898</u>	<u>688,977</u>	<u>8,894,906</u>	
Ending balance: collectively evaluated for impairment	<u>\$ 103,655,440</u>	<u>\$ 15,969,441</u>	<u>\$ 3,380,267</u>	<u>\$ 170,432,900</u>	<u>\$ 293,438,048</u>	

The Company utilizes a risk grading matrix to assign a risk grade to each of its commercial loans. Loans are graded on a scale of 1 to 8. A description of the general characteristics of the 8 risk grades is as follows:

- Grades 1 & 2 - These grades are assigned to loans with very high credit quality borrowers of investment or near investment grade or where the loan is primarily secured by cash or conservatively margined high quality marketable securities. These borrowers are generally publicly traded, have significant capital strength, possess investment grade public debt ratings, demonstrate low leverage, exhibit stable earnings and growth and have ready access to various financing alternatives.
- Grades 3 & 4 - Loans assigned these grades include loans to borrowers possessing solid credit quality with acceptable risk. Borrowers in these grades are differentiated from higher grades on the basis of size (capital and/or revenue), leverage, asset quality, stability of the industry or specific market area and quality/coverage of collateral. These borrowers generally have a history of consistent earnings and reasonable leverage.
- Grade 5 - This grade includes “pass grade” loans to borrowers which require special monitoring because of deteriorating financial results, declining credit ratings, decreasing cash flow, increasing leverage, marginal collateral coverage or industry stress that has resulted or may result in a changing overall risk profile.

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- Grade 6 - This grade is for “Special Mention” loans in accordance with regulatory guidelines. This grade is intended to include loans to borrowers whose credit quality has clearly deteriorated and where risk of further decline is possible unless active measures are taken to correct the situation. Weaknesses are considered potential at this state and are not yet fully defined.
- Grade 7 - This grade includes “Substandard” loans in accordance with regulatory guidelines. Loans categorized in this grade possess a well-defined credit weakness and the likelihood of repayment from the primary source is uncertain. Significant financial deterioration has occurred and very close attention is warranted to ensure the full repayment without loss. Collateral coverage may be marginal and the accrual of interest has been suspended.
- Grade 8 - This grade includes “Doubtful” loans in accordance with regulatory guidelines. Such loans have been placed on nonaccrual status and may be heavily dependent upon collateral possessing a value that is difficult to determine or based upon some near-term event which lacks clear certainty. These loans have all of the weaknesses of those classified as Substandard, however, based on existing conditions, these weaknesses make full collection of the principal balance highly improbable.

The following table presents the credit risk profile of the Company’s loan portfolio based on rating category and payment activity as of December 31, 2010:

	Commercial Real Estate	Commercial
Rating:		
1-5 Pass	\$ 12,662,229	\$ 3,370,395
6 Special Mention	3,703,690	9,872
7 Substandard	3,196,755	1,538,898
8 Doubtful	<u>—</u>	<u>—</u>
Total	<u>\$ 19,562,674</u>	<u>\$ 4,919,165</u>
	Residential Real Estate	Consumer
Performing	\$ 103,888,268	\$ 170,438,617
Nonperforming	<u>2,840,970</u>	<u>683,260</u>
Total	<u>\$ 106,729,238</u>	<u>\$ 171,121,877</u>

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The following table presents the Company's loan portfolio aging analysis as of December 31, 2010:

	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans Receivable	Nonaccrual Loans	Total Loans 90 Days or More Past Due and Accruing
Real estate loans							
Residential	\$ 1,917,302	\$ 1,294,104	\$ 3,211,406	\$ 103,517,832	\$ 106,729,238	\$ 2,840,970	\$ —
Commercial	—	1,410,107	1,410,107	18,152,567	19,562,674	3,593,233	899,947
Commercial	9,872	1,538,898	1,548,770	3,370,395	4,919,165	1,538,898	—
Consumer	<u>3,211,809</u>	<u>381,934</u>	<u>3,593,743</u>	<u>167,528,134</u>	<u>171,121,877</u>	<u>683,260</u>	<u>30,297</u>
Total	<u>\$ 5,138,983</u>	<u>\$ 4,625,043</u>	<u>\$ 9,764,026</u>	<u>\$ 292,568,928</u>	<u>\$ 302,332,954</u>	<u>\$ 8,656,361</u>	<u>\$ 930,244</u>

At December 31, 2010 and 2009, accruing loans past due 90 days or more totaled \$930,000 and \$119,000, respectively. Nonaccruing loans, which include all impaired loans, at December 31, 2010 and 2009 were \$8,656,000 and \$10,300,000, respectively.

A loan is considered impaired, in accordance with the impairment accounting guidance (ASC 310-10-35-16), when based on current information and events, it is probable the Company will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include nonperforming commercial loans but also include loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection.

The following table presents the Company's impaired loans as of December 31, 2010:

	Recorded Balance	Unpaid Principal Balance	Specific Allowance
Loans without a specific valuation allowance			
Residential real estate loans	\$ 1,147,500	\$ 1,147,500	—
Commercial real estate loans	—	—	—
Commercial loans	841,892	841,892	—
Consumer loans	278,153	278,153	—
Loans with a specific valuation allowance			
Residential real estate loans	\$ 1,926,298	\$ 1,932,990	\$ 722,993
Commercial real estate loans	3,593,233	3,750,160	883,233
Commercial loans	697,006	697,006	540,498
Consumer loans	410,824	410,824	150,610
Total impaired loans			
Residential real estate loans	\$ 3,073,798	\$ 3,080,490	\$ 722,993
Commercial real estate loans	3,593,233	3,750,160	883,233
Commercial loans	1,538,898	1,538,898	540,498
Consumer loans	688,977	688,977	150,610

Impaired loans totaled \$8,895,000 and \$4,839,000 at December 31, 2010 and 2009, respectively. An allowance for loan losses of \$2,297,000 and \$3,676,000 related to impaired loans was recorded at December 31, 2010 and 2009, respectively. Average impaired loans outstanding totaled \$8,104,000 and \$4,563,000 for the years ended December 31, 2010 and 2009, respectively.

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Note 5: Equipment

Equipment included in other assets at December 31, 2010 and 2009 consists of the following:

	<u>2010</u>	<u>2009</u>
Furniture and equipment	\$ 3,409,471	\$ 2,874,277
Less accumulated depreciation	<u>(2,533,687)</u>	<u>(2,402,427)</u>
	<u>\$ 875,784</u>	<u>\$ 471,850</u>

Note 6: Goodwill

The change in the carrying amount of goodwill for the two years ended December 31, 2010 was:

Balance as of January 1, 2009	\$ 4,687,349
Changes in goodwill during the year	<u>—</u>
Balance as of December 31, 2009	4,687,349
Changes in goodwill during the year	<u>—</u>
Balance as of December 31, 2010	<u>\$ 4,687,349</u>

Note 7: Deposits

Deposits at December 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Regular savings accounts	\$ 7,384,049	\$ 6,074,613
Noninterest-bearing demand deposit accounts	9,893,280	7,675,998
Interest-bearing demand deposit accounts	58,074,632	53,108,261
Money market accounts	<u>132,031,263</u>	<u>114,873,684</u>
Total transaction accounts	207,383,224	181,732,556
Certificates of deposits	187,291,846	199,247,992
Brokered deposits	28,283,590	30,843,620
Premiums on brokered deposits	<u>(256,104)</u>	<u>(196,830)</u>
Total deposits	<u>\$ 422,702,556</u>	<u>\$ 411,627,338</u>

Certificates of deposit in the amount of \$100,000 or more totaled approximately \$98,605,000 and \$88,305,000 at December 31, 2010 and 2009, respectively.

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A summary of certificate accounts by scheduled maturities at December 31, 2010 is as follows:

2011	\$ 101,482,446
2012	30,598,062
2013	16,669,018
2014	22,647,275
2015	31,289,514
Thereafter	<u>12,889,121</u>
	<u>\$ 215,575,436</u>

Note 8: FHLB Advances

The Company has outstanding FHLB advances of \$30,455,000 and \$47,000,000 as of December 31, 2010 and 2009, respectively. Advances, at interest rates from 2.96 to 4.57 percent, are subject to restrictions or penalties in the event of prepayment. The advances are collateralized by mortgage loans pledged and held by the Company and investment securities pledged by the Company and held in safekeeping with the FHLB. Mortgage loans pledged, were approximately \$9,187,000 and \$12,059,000 as of December 31, 2010 and 2009, respectively, and the fair value of investment securities pledged was approximately \$46,321,000 and \$50,209,000 as of December 31, 2010 and 2009, respectively. The FHLB advances are scheduled to mature according to the following schedule:

	<u>Amount</u>
2013	\$ 9,000,000
2014	5,000,000
2015	11,000,000
Thereafter	<u>6,000,000</u>
	31,000,000
Deferred prepayment penalties on advance restructure	<u>(545,168)</u>
	<u>\$ 30,454,832</u>

Amounts advanced totaling \$10,000,000 are subject to an option for the FHLB to convert the entire advance to a periodic adjustable rate one year after the date of the advance. If the FHLB exercises its option to convert the advance to an adjustable rate, the advance will be pre-payable at the Company's option, at par without a penalty fee.

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Note 9: Benefit Plans

401(k) Plan

The Company has a 401(k) plan established for substantially all full-time employees, as defined. Employee contributions are limited to the maximum established by the Internal Revenue Service on an annual basis. The Company has elected to match contributions equal to 100% of the first 1% of employee deferrals and then 50% on deferrals over 1% up to a maximum of 6% of an individual's total eligible salary, as defined by the plan. Employer-matching contributions begin vesting after one year at a rate of 50% per year of employment and are fully vested after the completion of two years of service. Contributions each year during the years ended December 31, 2010 and 2009, totaled approximately \$117,000 and \$98,000, respectively.

Employment Agreements

The Company has entered into employment agreements with certain officers that provide for the continuation of salary and certain benefits for a specified period of time under certain conditions. Under the terms of the agreements, these payments could occur in the event of a change in control of the Company, as defined, along with other specific conditions.

Stock Options

The Company has a qualified stock option plan for Directors and key employees of the Company (Stock Option Plan) and has reserved 400,000 shares of common stock that may be issued pursuant to the Stock Option Plan. The option exercise price per share is the fair value of a share on the date of grant, and the stock options become exercisable in a series of three equal and successive annual installments, with the first one-third vesting at the end of one year measured from the grant date of the option. Each option grant expires within ten years of the grant date. The options are nontransferable and are forfeited upon termination of employment.

The following is an analysis of activity in the Stock Option Plan for the period ended December 31, 2010 and the stock options outstanding at the end of the year:

	Shares	2010 Weighted- Average Exercise Price	Weighted- Average Remaining Life (In Years)
Outstanding, beginning of year	202,500	\$ 21.81	
Expired	<u>—</u>		
Outstanding, end of year	<u>202,500</u>	21.81	<u>0.7</u>
Exercisable, end of year	<u>202,500</u>	21.81	<u>0.7</u>

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Directors Deferred Stock Plan

The Company has adopted a stock compensation plan for members of the Board of Directors (Directors Deferred Stock Plan). The Company has reserved 60,000 shares of common stock that may be issued pursuant to the Directors Deferred Stock Plan. The plan provides directors the option to elect to receive up to 100% of their annual retainer in either common stock or deferred stock rights. Monthly meeting fees are paid in cash. The deferred stock right is payable to the director on the basis of one common share for each deferred stock right. Director compensation totaled \$114,000 and \$276,000 in 2010 and 2009, respectively, of which \$60,000 and \$45,000 in 2010 and 2009, respectively, were paid in either common stock or deferred stock rights. The common stock and deferred stock rights are granted on January 1 at fair value and vest from January 1st until December 31st. The Company recognizes compensation expense ratably over the vesting period based upon the fair value of the stock on the grant date.

The following is an analysis of deferred stock rights and common stock related to the Directors Deferred Stock Plan for the year ended December 31, 2010:

	Deferred Rights	Common Shares
Outstanding, beginning of year	23,149	
Granted	9,024	
Exercised	—	
Outstanding, end of year	32,173	

Note 10: Income Taxes

The provision (credit) for income taxes consists of the following:

	2010	2009
Current	\$ 367,434	\$ 855,179
Deferred	1,328,454	(2,990,890)
Total	\$ 1,695,888	\$ (2,135,711)

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Income tax provision (credit) is reconciled to the 34% statutory rate applied to pre-tax income (loss) as follows:

	2010	2009
Statutory rate times pre-tax income (loss)	\$ 2,261,186	\$ (1,446,271)
Add (subtract) the tax effect of:		
Income from tax-exempt securities	(537,275)	(539,319)
State income tax, net of federal tax effect	61,222	(32,205)
Bank-owned life insurance	(100,056)	(104,432)
Other differences	10,811	(13,484)
Total income taxes	\$ 1,695,888	\$ (2,135,711)

The net deferred tax asset at December 31 consists of the following:

	2010	2009
Deferred tax assets (liabilities)		
Allowance for loan losses	\$ 2,423,051	\$ 3,557,612
Depreciation	(248,623)	(21,867)
Deferred compensation	336,849	290,486
Deferred loan origination fees	(49,693)	(62,293)
AMT credit carry forward	463,000	220,482
Prepaid assets	(65,350)	(106,096)
Other	197,396	23,475
Total deferred tax assets, net	\$ 3,056,630	\$ 3,901,799

Note 11: Related Party Transactions

At December 31, 2010 and 2009, certain directors, executive officers and/or companies in which these individuals had a 10% or more beneficial ownership were indebted to the Company in the aggregate amount of approximately \$241,000 and \$291,000, respectively.

In management's opinion, such loans and other extensions of credit and deposits were made in the ordinary course of business and were made on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons. Further, in management's opinion, these loans did not involve more than normal risk of collectibility or present other unfavorable features.

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Deposits from related parties held by the Company at December 31, 2010 and 2009 totaled \$10,738,000 and \$10,836,000, respectively.

The Company's card processing services are provided by OneBridge, which is controlled by a shareholder of the Company. Total expenses incurred related to card processing provided by OneBridge during the years ended December 31, 2010 and 2009, were approximately \$150,000 and \$148,000, respectively.

Note 12: Regulatory Capital Requirements

The Company is subject to regulatory capital requirements administered by federal banking regulatory 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 consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures that have been established by regulation to ensure capital adequacy, require the Company to maintain minimum capital amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). However, the Bank has an agreement with the FDIC as of December 31, 2010 to maintain a minimum Tier I capital to average assets ratio of 8% and a minimum total capital to risk weighted assets ratio of 11%.

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To be categorized as well capitalized, the Company must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. As of December 31, 2010, the most recent notification from the FDIC categorized the Company as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Company's categories.

	Actual Amount	Ratio	Minimum Capital Requirement Amount	Ratio	Minimum to be Well Capitalized Under Prompt Corrective Actions Amount	Ratio
As of December 31, 2010:						
Total capital (to risk-weighted assets)						
Consolidated	\$ 51,361,000	12.2%	\$ 33,779,000	8.0%	N/A	N/A
Bank	49,929,000	11.9%	33,654,000	8.0%	\$ 42,067,000	10.0%
Tier 1 capital (to risk-weighted assets)						
Consolidated	46,059,000	10.9%	16,889,000	4.0%	N/A	N/A
Bank	44,646,000	10.6%	16,827,000	4.0%	25,240,000	6.0%
Tier 1 capital (to average assets)						
Consolidated	46,059,000	9.4%	19,583,000	4.0%	N/A	N/A
Bank	44,646,000	9.1%	19,532,000	4.0%	24,415,000	5.0%
As of December 31, 2009:						
Total capital (to risk-weighted assets)						
Consolidated	\$ 43,684,000	11.0%	\$ 31,667,000	8.0%	N/A	N/A
Bank	41,968,000	10.6%	31,612,000	8.0%	\$ 39,515,000	10.0%
Tier 1 capital (to risk-weighted assets)						
Consolidated	38,671,000	9.8%	15,834,000	4.0%	N/A	N/A
Bank	36,964,000	9.4%	15,806,000	4.0%	23,709,000	6.0%
Tier 1 capital (to average assets)						
Consolidated	38,671,000	7.7%	20,044,000	4.0%	N/A	N/A
Bank	36,964,000	7.4%	20,017,000	4.0%	25,022,000	5.0%

Note 13: Commitments and Credit Risk

In the normal course of business, the Company makes various commitments to extend credit which are not reflected in the accompanying consolidated financial statements. At December 31, 2010 and 2009, the Company had outstanding loan commitments totaling approximately \$14,714,000 and \$14,391,000, respectively.

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The Company leases its office facilities under operating leases expiring between November 18, 2014 and July 31, 2018. The leases are subject to additional rentals based on building operating costs and property taxes in excess of specified amounts. Future minimum cash lease payments are as follows:

	Amount
2011	\$ 141,209
2012	327,990
2013	379,926
2014	378,362
2015	309,471
Thereafter	823,512
	\$ 2,360,470

Note 14: Fair Value of Financial Instruments

ASC Topic 820, *Fair Value Measurements*, defines fair value as 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. Topic 820 also specifies a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Following is a description of the inputs and valuation methodologies used for assets measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy.

Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid mutual funds. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows.

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Level 2 securities include U.S. government agency securities, mortgage and asset-backed securities and obligations of state, municipalities and certain corporate securities. Matrix pricing is a mathematical technique widely used in the banking industry to value investment securities without relying exclusively on quoted prices for specific investment securities but rather relying on the investment securities' relationship to other benchmark quoted investment securities.

In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy and include certain other securities. Fair values are calculated using discounted cash flows. Discounted cash flows are calculated based off of the anticipated future cash flows updated to incorporate loss severities and volatility. Rating agency and industry research reports as well as default and deferral activity are reviewed and incorporated into the calculation.

The following tables present the fair value measurements of securities available for sale recognized in the accompanying consolidated balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2010 and 2009:

	2010			
	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. government-sponsored enterprises	\$ 43,392,427	\$ —	\$ 43,392,427	\$ —
U.S. government treasuries	2,332,025	—	2,332,025	—
Municipals	40,765,069	—	40,765,069	—
Mortgage-backed and asset-backed securities	48,980,209	—	48,980,209	—
Other securities	<u>1,466,565</u>	<u>1,012,241</u>	<u>—</u>	<u>454,324</u>
	<u>\$ 136,936,295</u>	<u>\$ 1,012,241</u>	<u>\$ 135,469,730</u>	<u>\$ 454,324</u>

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	2009			
	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. government-sponsored enterprises	\$ 14,549,232	\$ —	\$ 14,549,232	\$ —
Municipals	42,792,734	—	42,792,734	—
Mortgage-backed and asset-backed securities	70,708,760	—	70,708,760	—
Corporate bonds and other securities	<u>5,533,114</u>	<u>1,001,883</u>	<u>2,922,070</u>	<u>1,609,161</u>
	<u>\$ 133,583,840</u>	<u>\$ 1,001,883</u>	<u>\$ 130,972,796</u>	<u>\$ 1,609,161</u>

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying consolidated balance sheets using significant unobservable (Level 3) inputs:

	<u>Securities Available for Sale</u>
Balance, January 1, 2009	\$ 2,636,400
Total realized and unrealized gains and losses	
Included in net loss	(300,000)
Included in other comprehensive loss	<u>(727,239)</u>
Balance, December 31, 2009	1,609,161
Total realized and unrealized gains and losses	
Included in net income	(420,749)
Included in other comprehensive loss	<u>(734,088)</u>
Balance, December 31, 2010	<u>\$ 454,324</u>

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Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a nonrecurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy.

Impaired Loans

Loans for which it is probable that the Company will not collect all principal and interest due according to contractual terms are measured for impairment. Allowable methods for determining the amount of impairment include estimating fair value using the fair value of the collateral for collateral dependent loans.

If the impaired loan is identified as collateral dependent, then the fair value method of measuring the amount of impairment is utilized. This method requires obtaining a current independent appraisal of the collateral and applying a discount factor to the value.

Impaired loans that are collateral dependent are classified within Level 3 of the fair value hierarchy when impairment is determined using the fair value method.

The following tables present the fair value measurements of impaired loans recognized in the accompanying consolidated balance sheets measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2010 and 2009:

	2010			
	Fair Value Measurements Using			
Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Impaired loans	\$ <u>4,330,028</u>	\$ <u>—</u>	\$ <u>—</u>	\$ <u>4,330,028</u>

	2009			
	Fair Value Measurements Using			
Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Impaired loans	\$ <u>3,246,224</u>	\$ <u>—</u>	\$ <u>—</u>	\$ <u>3,246,224</u>

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The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying consolidated balance sheets at amounts other than fair value.

Cash and Cash Equivalents

For these instruments, the carrying amount is a reasonable estimate of fair value.

Loans Held For Sale

The fair value of these financial instruments approximates carrying value.

Loans Receivable

The fair value of loans receivable is estimated by discounting future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and remaining maturities.

Accrued Interest Receivable

The fair value of these financial instruments approximates carrying value.

Federal Home Loan Bank Stock

The carrying amount approximates fair value.

Deposits

The fair value of noninterest-bearing demand deposits and savings and NOW accounts is the amount payable as of the reporting date. The fair value of fixed maturity certificates of deposit is estimated using rates currently offered for deposits of similar remaining maturities.

FHLB Advances

The fair value of fixed rate advances is estimated using rates currently offered for similar remaining maturities.

Accrued Interest Payable

The fair value of these financial instruments approximates carrying value.

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Commitments

The fair value of commitments to extend credit are based on fees currently charged to enter into similar agreements with similar maturities and interest rates. The Company determined that the fair value of commitments was zero based on the contractual value of outstanding commitments at December 31, 2010 and 2009.

The following schedule includes the carrying value and estimated fair value of all financial assets and liabilities at December 31, 2010 and 2009:

	2010		2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 32,416,623	\$ 32,416,623	\$ 30,016,044	\$ 30,016,044
Securities available for sale	136,936,295	136,936,295	133,583,840	133,583,840
Loans held for sale	5,008,138	5,008,138	7,168,658	7,168,658
Loans receivable - net	299,545,308	286,218,054	305,439,038	295,985,606
Accrued interest receivable	2,095,292	2,095,292	2,256,728	2,256,728
FHLB stock	3,258,600	3,258,600	3,637,600	3,637,600
Deposits	422,702,556	429,439,997	411,627,338	418,084,256
FHLB advances	30,454,832	32,645,170	47,000,000	48,509,617
Accrued interest payable	125,983	125,983	133,722	133,722

Note 15: Subsequent Events

Subsequent events have been evaluated through February 22, 2011, which is the date the consolidated financial statements were available to be issued.