First Internet Bancorp

Accountants' Report and Consolidated Financial Statements

December 31, 2011 and 2010

First Internet Bancorp
December 31, 2011 and 2010

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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, 2011 and 2010, 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, 2011 and 2010, 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 21, 2012

First Internet Bancorp

Consolidated Balance Sheets

December 31, 2011 and 2010

(Dollar Amounts in Thousands except per share data)

Assets

	2011	2010
Cash and due from banks	$ 1,582	$ 2,354
Interest-bearing demand deposits	33,196	30,063
Total cash and cash equivalents	34,778	32,417
Securities available for sale - at fair value (amortized cost of $147,386 in 2011 and $140,125 in 2010)	149,270	136,936
Loans held for sale	45,091	5,008
Loans receivable - net of allowance for loan losses of $5,656 and $6,845 at December 31, 2011 and 2010	329,570	299,545
Accrued interest receivable	2,129	2,095
Federal Home Loan Bank of Indianapolis stock	2,943	3,259
Bank-owned life insurance - at cash surrender value	8,161	7,869
Goodwill	4,687	4,687
Prepaid expenses and other assets	8,811	12,099
Total assets	$ 585,440	$ 503,915

Liabilities and Shareholders' Equity

	2011	2010
Liabilities		
Deposits	$ 486,665	$ 422,703
Advances from Federal Home Loan Bank	40,573	30,455
Accrued payroll and related expenses	1,153	563
Accrued interest payable	120	126
Accrued expenses and other liabilities	1,506	1,171
Total liabilities	530,017	455,018
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	41,306	41,246
Nonvoting common stock, no par value; 86,221 shares authorized; issued and outstanding	—	—
Retained earnings	12,897	9,711
Accumulated other comprehensive income (loss) (net of income taxes of $664 in 2011 and ($1,129) in 2010)	1,220	(2,060)
Total shareholders' equity	55,423	48,897
Total liabilities and shareholders' equity	$ 585,440	$ 503,915

First Internet Bancorp

Consolidated Statements of Operations
Years Ended December 31, 2011 and 2010
(Dollar Amounts in Thousands except per share data)

	2011	2010
Interest Income		
Securities	$ 5,128	$ 5,362
Loans	18,752	19,868
Federal funds sold and other short-term investments	64	66
Total interest income	23,944	25,296
Interest Expense		
Deposits	8,266	9,254
Other borrowed funds	1,355	1,531
Total interest expense	9,621	10,785
Net Interest Income	14,323	14,511
Provision for Loan Losses	2,440	927
Net Interest Income After Provision for Loan Losses	11,883	13,584
Noninterest Income		
Service charges and fees	1,157	1,267
Gain on loans sold	3,690	3,098
Other-than-temporary impairment		
Total loss related to other than temporarily impaired securities	(2,036)	(2,776)
Portion of loss recognized in other comprehensive income (loss)	1,410	1,867
Other-than-temporary impairment loss recognized in net income	(626)	(909)
Loss on asset disposals	(968)	(326)
Other	306	307
Total noninterest income	3,559	3,437
Noninterest Expense		
Salaries and employee benefits	5,311	4,795
Marketing, advertising and promotion	936	269
Consulting and professional fees	777	729
Data processing	915	964
Loan expenses	526	735
Premises and equipment	1,481	1,150
Deposit insurance premium	727	939
Other	810	789
Total noninterest expense	11,483	10,370
Income Before Income Taxes	3,959	6,651
Income Tax Provision	773	1,696
Net Income	$ 3,186	$ 4,955
Income Per Share of Common Stock		
Basic	$ 1.67	$ 2.61
Diluted	1.67	2.61
Weighted-Average Number of Common Shares Outstanding		
Basic	1,906,289	1,898,919
Diluted	1,906,289	1,898,919

First Internet Bancorp

Consolidated Statements of Shareholders' Equity
Years Ended December 31, 2011 and 2010
(Dollar Amounts in Thousands except per share data)

	Voting and Nonvoting Common Stock	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Shareholders' Equity
Balance, January 1, 2010	$ 41,186	$ (1,179)	$ 4,756	$ 44,763
Comprehensive income				
Net income			4,955	4,955
Unrealized loss on securities available for sale for which an other-than-temporary impairment has been recognized in income - net of income tax		(335)		(335)
Unrealized loss on securities available for sale - net of income tax		(546)		(546)
Total comprehensive income				4,074
Issuance of directors deferred stock rights	60			60
Balance, December 31, 2010	41,246	(2,060)	9,711	48,897
Comprehensive income				
Net income			3,186	3,186
Unrealized gain on securities available for sale for which an other-than-temporary impairment has been recognized in income - net of income tax		294		294
Unrealized gain on securities available for sale - net of income tax		2,986		2,986
Total comprehensive income				6,466
Issuance of directors deferred stock rights	60			60
Balance, December 31, 2011	$ 41,306	$ 1,220	$ 12,897	$ 55,423

See Notes to Consolidated Financial Statements

First Internet Bancorp

Consolidated Statements of Cash Flows
Years Ended December 31, 2011 and 2010
(Dollar Amounts in Thousands except per share data)

	2011	2010
Operating Activities		
Net income	$ 3,186	$ 4,955
Adjustments to reconcile net income to net cash from operating activities		
Depreciation	251	361
Amortization and accretion on securities	341	145
Amortization on FHLB prepayment penalties	118	88
Loss from disposal of fixed assets	64	15
Loss from real estate owned	346	102
Loss from impairment of other asset	368	—
Increase in cash surrender value of bank-owned life insurance	(292)	(294)
Provision for loan losses	2,440	927
Deferred income taxes	(938)	1,328
Director fees and officer compensation	60	60
Loss on other-than-temporary impairment of security	626	910
Gain from sale of available-for-sale securities	(84)	(7)
Changes in assets and liabilities		
Accrued interest receivable	(34)	161
Loans held for sale	(40,083)	2,161
Prepaid expenses and other assets	1,287	(208)
Accrued expenses and other liabilities	919	637
Net cash provided by (used in) operating activities	(31,425)	11,341
Investing Activities		
Net decrease in loans	25,499	54,535
Loans purchased	(59,660)	(52,393)
Proceeds from liquidation of real estate owned	2,046	640
Maturities of securities available for sale	58,383	32,968
Proceeds from sale of securities available for sale	11,350	3,056
Proceeds from redemption of FHLB stock	316	379
Purchase of securities available for sale	(77,877)	(41,788)
Capital expenditures	(233)	(780)
Net cash used in investing activities	(40,176)	(3,383)
Financing Activities		
Net increase in deposits	63,962	11,075
Repayment of FHLB advances	(5,000)	(28,633)
Proceeds from FHLB advances	15,000	12,000
Net cash provided by (used in) financing activities	73,962	(5,558)
Net Increase in Cash and Cash Equivalents	2,361	2,400
Cash and Cash Equivalents, Beginning of Year	32,417	30,017
Cash and Cash Equivalents, End of Year	$ 34,778	$ 32,417
Supplemental Disclosures of Cash Flows Information		
Cash paid during the year for interest	$ 9,627	$ 10,793
Cash paid during the year for taxes	614	1,110
Loans transferred to real estate owned	1,696	2,824

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).

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. The Bank is regulated by certain state and federal agencies and undergoes periodic examinations by those regulatory authorities.

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.

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 shareholders' 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 consolidated 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 operations 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

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balance adjusted for unearned income, charge-offs, the allowance for loan losses, any unamortized deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans.

For loans recorded at cost, interest income is accrued based on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, as well as premiums and discounts, are deferred and amortized as a level yield adjustment over the respective term of the loan.

Allowance for Loan Losses Methodology

Company policy is designed to ensure that an adequate allowance for loan losses ("ALLL") will be maintained. Primary responsibility for ensuring that the Company has processes in place to consistently assess the adequacy of the ALLL rests with the Board. The Board has charged the Chief Financial Officer ("CFO") with responsibility for establishing the methodology to be used and to assess the adequacy of the ALLL quarterly. Quarterly, the Board will review recommendations from the CFO to adjust the allowance as appropriate.

The methodology employed by the CFO for each portfolio segment will, at a minimum, contain the following:

1. Loans will be segmented by type of loan.
2. The required ALLL for types of performing homogeneous loans which do not have a specific reserve will be determined by applying a factor based on historical losses averaged over the past 12 months. In those instances, where the Company's historical experience is not available, the CFO will develop factors based on industry experience and best practices.
3. All criticized, classified and impaired loans will be tested for impairment by applying one of three methodologies:
    a. Present value of future cash flows;
    b. Fair value of collateral less cost to sell; or
    c. The loan's observable market price
4. All troubled debt restructurings ("TDR") are considered impaired loans.
5. Loans tested for impairment will be removed from other pools to prevent layering (double-counting).
6. The required ALLL for each group of loans will be added together to determine the total required ALLL for the Company. The required ALLL will be compared to the current ALLL to determine the provision required to increase the ALLL or credit to decrease the ALLL.

The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company over the prior 12 months. Management believes the historical loss experience methodology is appropriate in the current economic environment, as it captures loss rates that are comparable to the current period being analyzed.

We also factor in the following qualitative considerations:

1. Changes in policies and procedures;
2. Changes in national, regional and local economic and business conditions;
3. Changes in the composition and size of the portfolio and in the terms of loans;
4. Changes in the experience, ability and depth of lending management and other relevant staff;
5. Changes in the volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified or graded loans;
6. Changes in the quality of the Company's loan review system;
7. Changes in the value of underlying collateral for collateral-dependent loans;
8. The existence and effect of any concentration of credit and changes in the level of such concentrations; and
9. The effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the existing portfolio.

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 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, *Receivables*, 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.

Nonaccrual Loans

Any loan which becomes 90 days delinquent or has the full collection of principal and interest in doubt will be considered for nonaccrual status. At the time a loan is placed on nonaccrual, all accrued but unpaid interest will be reversed from interest income. Placing the loan on nonaccrual does not relieve the borrower of the obligation to repay interest. A loan placed on nonaccrual may be restored to accrual status when all delinquent principal and interest has been brought current, and the Company expects full payment of the remaining contractual principal and interest.

Impaired Loans

A loan is designated as impaired when, based on current information or events, it is probable that the Company will be unable to collect all amounts due (principal and interest) according to the contractual terms of the loan agreement. Payments with insignificant delays not exceeding 90 days outstanding are not considered impaired. Certain nonaccrual and substantially all delinquent loans may be considered to be impaired. Generally, loans are placed on nonaccrual status at 90 days past due and accrued interest is reversed against earnings, unless the loan is well-secured and in the process of collection. The accrual of interest on impaired and nonaccrual loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due.

Troubled Debt Restructurings (TDR)

The loan portfolio includes certain loans that have been modified in a TDR, where economic concessions have been granted to borrowers who have experienced financial difficulties. These concessions typically result from loss mitigation efforts and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Certain TDRs are classified as nonperforming at the time of restructuring and typically are returned to performing status after considering the borrower's sustained repayment performance for a reasonable period.

When loans are modified in a TDR, any possible impairment similar to other impaired loans is evaluated based on the present value of expected future cash flows, discounted at the contractual interest rate of the original loan agreement, or use the current fair value of the collateral, less selling costs for collateral dependent loans. If it is determined that the value of the modified loan is less than the recorded balance of the loan, impairment is recognized through a specific allowance or charge-off to the allowance. In periods subsequent to modification, all TDRs, including those that have payment defaults, are evaluated for possible impairment, and impairment is recognized through the allowance.

Policy for Charging Off Loans

A loan should be charged off at any point in time when it no longer can be considered a bankable asset, meaning collectable within the parameters of policy. A secured loan generally should be charged off to the estimated fair value of the collateral no later than when it is 120 days past due as to principal or interest. An unsecured loan generally should be charged off no later than when it is 180 days past due as to principal or interest. All charge-offs are approved by the Credit Review Committee.

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 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 $1,511 and $2,207 of real estate owned as of December 31, 2011 and 2010, 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.

(Dollar Amounts in Thousands except per share data)

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 2007.

ASC Topic 740-10, *Accounting for Uncertainty in Income Taxes*, 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 Per Share

Earnings 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, 2011 and 2010:

	2011	2010
Basic earnings per share		
Weighted-average common shares	1,906,289	1,898,919
Diluted earnings per share		
Weighted-average common shares	1,906,289	1,898,919
Dilutive effect of stock compensation	—	—
Dilutive effect of stock options	—	—
Weighted-average common and incremental shares	1,906,289	1,898,919
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	90,000	203,000

(Dollar Amounts in Thousands except per share data)

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, 2011, the Company has a stock-based employee compensation plan using the fair value recognition provisions of ASC Topic 718, *Stock Based Compensation*. The plan is described more fully in Note 9.

Comprehensive Income

Comprehensive income consists of net income 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, 2011 and 2010 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, 2011 and 2010, are as follows:

	2011	2010
Other comprehensive income (loss)		
Net unrealized holding gains on securities available for sale	$ 6,567	$ 510
Reclassification adjustment for gains realized	(84)	(7)
Net unrealized holding losses on securities available for sale for which an other-than-temporary impairment has been recognized in income	(2,036)	(2,776)
Reclassification adjustment for other-than-temporary impairment loss recognized in income	626	909
Other comprehensive income (loss) before tax	5,073	(1,364)
Income tax provision (benefit)	1,793	(483)
Other comprehensive income (loss) - net of tax	$ 3,280	$ (881)

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.

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 protracted economic decline continues to present 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. Furthermore, the Company's regulators could require material adjustments to asset values or the allowance for loan losses for regulatory capital purposes that could affect the Company's measurement of regulatory capital and compliance with the capital adequacy guidelines under the regulatory framework for prompt corrective action.

Reclassifications

Certain reclassifications have been made to the 2010 financial statements to conform to the 2011 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. At December 31, 2011, the Company's interest-bearing cash accounts did not exceed federally insured limits. Additionally, approximately $2 and $33,192 of cash is held by the FHLB of Indianapolis and Federal Reserve Bank of Chicago, respectively, which is not federally insured.

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, 2011 was $219.

(Dollar Amounts in Thousands except per share data)

Note 3: Securities

Securities at December 31, 2011 and 2010 are as follows:

2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available for sale				
U.S. government-sponsored enterprises	$ 24,685	$ 817	$ —	$ 25,502
Municipals	40,849	2,290	(378)	42,761
Mortgage-backed and asset-backed securities	73,204	2,512	(481)	75,235
Other securities	8,648	41	(2,917)	5,772
Total available for sale	$ 147,386	$ 5,660	$ (3,776)	$ 149,270

2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available for sale				
U.S. government-sponsored enterprises	$ 43,444	$ 263	$ (314)	$ 43,393
U.S. government treasuries	2,369	—	(37)	2,332
Municipals	42,463	270	(1,969)	40,764
Mortgage-backed and asset-backed securities	47,570	2,246	(835)	48,981
Other securities	4,279	12	(2,825)	1,466
Total available for sale	$ 140,125	$ 2,791	$ (5,980)	$ 136,936

The carrying value of securities at December 31, 2011 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	Available for Sale Fair Value
Within one year	$ 1,500	$ 1,542
One to five years	12,583	12,399
Five to ten years	13,709	14,246
After ten years	46,390	45,848
	74,182	74,035
Mortgage-backed and asset-backed securities	73,204	75,235
Totals	$ 147,386	$ 149,270

(Dollar Amounts in Thousands except per share data)

Gross gains of $98 and $7, and gross losses of $14 and $0 resulting from sales of available-for-sale securities were realized for 2011 and 2010, 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, 2011 and 2010 was $20,239 and $55,144, which is approximately 14% and 40%, 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, 2011 and 2010:

	2011					
	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:						
Municipals	221	(2)	4,687	(376)	4,908	(378)
Mortgage-backed and asset-backed securities	8,229	(20)	2,871	(461)	11,100	(481)
Other securities	3,761	(239)	470	(2,678)	4,231	(2,917)
	$ 12,211	$ (261)	$ 8,028	$ (3,515)	$ 20,239	$ (3,776)

	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	$ (312)	$ 466	$ (2)	$ 18,796	$ (314)
U.S. government treasuries	2,332	(37)	—	—	2,332	(37)
Municipals	24,785	(1,486)	3,108	(483)	27,893	(1,969)
Mortgage-backed and asset-backed securities	493	(10)	5,176	(825)	5,669	(835)
Other securities	—	—	454	(2,825)	454	(2,825)
	$ 45,940	$ (1,845)	$ 9,204	$ (4,135)	$ 55,144	$ (5,980)

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, 2011.

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, 2011.

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 par investment in I-PreTSL I B-2 pooled trust security. The unrealized loss was primarily caused by a 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, 2011. The second investment is discussed in the next section.

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 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, 2011.

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.

(Dollar Amounts in Thousands except per share data)

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, 2010	$ 300
Additions related to other-than-temporary losses not previously recognized	489
Additions related to increases in previously recognized other-than-temporary losses	420
December 31, 2010	1,209
Additions related to increases in previously recognized other-than-temporary losses	626
December 31, 2011	$ 1,835

Note 4: Loans Receivable

Categories of loans at December 31, include:

	2011	2010
Real estate loans		
Residential	$ 143,452	$ 106,729
Commercial	43,507	19,563
Total real estate loans	186,959	126,292
Commercial loans	2,063	4,919
Consumer loans	142,783	171,122
Total loans	331,805	302,333
Deferred loan origination costs and premiums and discounts on purchased loans	3,421	4,057
Allowance for loan losses	(5,656)	(6,845)
Total net loans	$ 329,570	$ 299,545

The risk characteristics of each loan portfolio segment are as follows:

Commercial Real Estate: These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts, and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's commercial real estate portfolio are diverse in terms of property type and geographic location. Management monitors and evaluates commercial real estate loans based on property financial performance, collateral value and other risk grade criteria. As a general rule, the Company avoids financing special use projects or properties outside of its designated marketing areas unless other underwriting factors are present to help mitigate risk. In addition, management tracks the level of owner-occupied commercial real estate loans versus nonowner occupied loans.

Commercial: Commercial loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected, and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Residential and Consumer: With respect to residential loans that are secured by 1-4 family residences and are generally owner occupied, the Company generally establishes a maximum loan-to-value ratio and requires private mortgage insurance if that ratio is exceeded. Home equity loans are typically secured by a subordinate interest in 1-4 family residences, and consumer loans are secured by consumer assets such as automobiles or recreational vehicles. Some consumer loans are unsecured, such as small installment loans and certain lines of credit. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Repayment can also be impacted by changes in property values on residential properties. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

(Dollar Amounts in Thousands except per share data)

The following tables present 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, 2011 and 2010:

2011	Residential Real Estate	Commercial Real Estate	Commercial	Consumer	Total
Allowance for loan losses:					
Balance, beginning of year	$ 2,135	$ 1,292	$ 608	$ 2,811	$ 6,846
Provision charged to expense	(366)	1,891	318	597	2,440
Losses charged off	(811)	(698)	(612)	(2,296)	(4,417)
Recoveries	141	—	19	627	787
Balance, end of year	1,099	2,485	333	1,739	5,656
Ending balance: individually evaluated for impairment	93	1,329	—	52	1,474
Ending balance: collectively evaluated for impairment	$ 1,006	$ 1,156	$ 333	$ 1,687	$ 4,182
Loans:					
Ending balance	$ 143,452	$ 43,507	$ 2,063	$ 142,783	$ 331,805
Ending balance: individually evaluated for impairment	1,693	7,634	—	499	9,826
Ending balance: collectively evaluated for impairment	$ 141,759	$ 35,873	$ 2,063	$ 142,284	$ 321,979

2010	Residential Real Estate	Commercial Real Estate	Commercial	Consumer	Total
Allowance for loan losses:					
Balance, beginning of year	$ 1,489	$ 3,491	$ 79	$ 5,038	$ 10,097
Provision charged to expense	1,683	(1,771)	590	426	928
Losses charged off	(1,158)	(445)	(61)	(3,399)	(5,063)
Recoveries	121	17	—	746	884
Balance, end of year	2,135	1,292	608	2,811	6,846
Ending balance: individually evaluated for impairment	723	883	540	151	2,297
Ending balance: collectively evaluated for impairment	$ 1,412	$ 409	$ 68	$ 2,660	$ 4,549
Loans:					
Ending balance	$ 106,729	$ 19,563	$ 4,919	$ 171,122	$ 302,333
Ending balance: individually evaluated for impairment	3,074	3,593	1,539	689	8,895
Ending balance: collectively evaluated for impairment	$ 103,655	$ 15,970	$ 3,380	$ 170,433	$ 293,438

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.
- 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.

(Dollar Amounts in Thousands except per share data)

The following tables present the credit risk profile of the Company's loan portfolio based on rating category and payment activity as of December 31, 2011 and 2010:

	2011 Commercial Real Estate	2011 Commercial
Rating:		
1-5 Pass	$ 34,172	$ 1,541
6 Special Mention	1,700	522
7 Substandard	7,635	—
8 Doubtful	—	—
Total	$ 43,507	$ 2,063

	2011 Residential Real Estate	2011 Consumer
Performing	$ 142,576	$ 142,559
Nonperforming (nonaccrual)	876	224
Total	$ 143,452	$ 142,783

	2010 Commercial Real Estate	2010 Commercial
Rating:		
1-5 Pass	$ 12,662	$ 3,370
6 Special Mention	3,704	10
7 Substandard	3,197	1,539
8 Doubtful	—	—
Total	$ 19,563	$ 4,919

	2010 Residential Real Estate	2010 Consumer
Performing	$ 103,888	$ 170,439
Nonperforming (nonaccrual)	2,841	683
Total	$ 106,729	$ 171,122

(Dollar Amounts in Thousands except per share data)

The following tables present the Company's loan portfolio aging analysis as of December 31, 2011 and 2010:

2011	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	$ 1,497	$ 666	$ 2,163	$ 141,289	$ 143,452	$ 876	$ 75
Commercial	—	7,523	7,523	35,984	43,507	7,523	—
Commercial	—	—	—	2,063	2,063	—	—
Consumer	1,922	206	2,128	140,655	142,783	224	56
Total	$ 3,419	$ 8,395	$ 11,814	$ 319,991	$ 331,805	$ 8,623	$ 131

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	$ 1,294	$ 3,211	$ 103,518	$ 106,729	$ 2,841	$ —
Commercial	—	1,410	1,410	18,153	19,563	3,593	900
Commercial	10	1,539	1,549	3,370	4,919	1,539	—
Consumer	3,212	382	3,594	167,528	171,122	683	30
Total	$ 5,139	$ 4,625	$ 9,764	$ 292,569	$ 302,333	$ 8,656	$ 930

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.

(Dollar Amounts in Thousands except per share data)

The following tables present the Company's impaired loans as of December 31, 2011 and 2010:

	2011				
	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Average Balance	Interest Income
Loans without a specific valuation allowance					
Residential real estate loans	$ 1,328	$ 1,529	$ —	$ 902	$ —
Commercial real estate loans	—	—	—	220	—
Commercial loans	—	—	—	208	—
Consumer loans	388	612	—	239	—
Loans with a specific valuation allowance					
Residential real estate loans	$ 365	$ 373	$ 93	$ 1,193	$ —
Commercial real estate loans	7,634	8,096	1,329	4,721	6
Commercial loans	—	—	—	645	—
Consumer loans	111	131	52	290	1
Total impaired loans					
Residential real estate loans	$ 1,693	$ 1,902	$ 93	$ 2,095	$ —
Commercial real estate loans	7,634	8,096	1,329	4,941	6
Commercial loans	—	—	—	853	—
Consumer loans	499	743	52	529	1

	2010		
	Recorded Balance	Unpaid Principal Balance	Specific Allowance
Loans without a specific valuation allowance			
Residential real estate loans	$ 1,148	$ 1,148	$ —
Commercial real estate loans	—	—	—
Commercial loans	842	842	—
Consumer loans	278	278	—
Loans with a specific valuation allowance			
Residential real estate loans	$ 1,926	$ 1,933	$ 723
Commercial real estate loans	3,593	3,750	883
Commercial loans	697	697	540
Consumer loans	411	411	151
Total impaired loans			
Residential real estate loans	$ 3,074	$ 3,080	$ 723
Commercial real estate loans	3,593	3,750	883
Commercial loans	1,539	1,539	540
Consumer loans	689	689	151

Average impaired loans outstanding totaled $8,418 and $8,104 for the years ended December 31, 2011 and 2010.

(Dollar Amounts in Thousands except per share data)

Loans classified as a troubled debt restructuring during the year ended December 31, 2011 are shown in the table below. These modifications consisted primarily of interest rate and maturity date concessions.

	2011		
	Modifications		
	Number	Recorded Balance Before	Recorded Balance After
Real estate loans:			
Commercial	—	$ —	$ —
Residential	3	751	751
Commercial loans	—	—	—
Consumer loans	11	196	123
Total	14	$ 947	$ 874

Troubled debt restructured loans which had payment defaults during the year ended December 31, 2011 are shown in the table below. Default occurs when a loan is 90 days or more past due or transferred to nonaccrual within 12 months of restructuring.

	2011	
	Number of Defaults	Recorded Balance
Real estate loans:		
Commercial	—	$ —
Residential	2	285
Commercial loans and leases	—	—
Consumer loans	6	45
Total	8	$ 330

(Dollar Amounts in Thousands except per share data)

Note 5: Equipment

Equipment included in other assets at December 31, 2011 and 2010 consists of the following:

	2011	2010
Furniture and equipment	$ 3,460	$ 3,409
Less accumulated depreciation	(2,667)	(2,534)
	$ 793	$ 875

Note 6: Goodwill

The change in the carrying amount of goodwill for the two years ended December 31, 2011 was:

Balance as of January 1, 2010	$ 4,687
Changes in goodwill during the year	—
Balance as of December 31, 2010	4,687
Changes in goodwill during the year	—
Balance as of December 31, 2011	$ 4,687

Note 7: Deposits

Deposits at December 31, 2011 and 2010 are as follows:

	2011	2010
Regular savings accounts	$ 7,773	$ 7,384
Noninterest-bearing demand deposit accounts	15,870	9,893
Interest-bearing demand deposit accounts	64,006	58,075
Money market accounts	165,561	132,031
Total transaction accounts	253,210	207,383
Certificates of deposits	209,762	187,292
Brokered deposits	23,898	28,284
Premiums on brokered deposits	(205)	(256)
Total deposits	$ 486,665	$ 422,703

Certificates of deposit in the amount of $100 or more totaled approximately $124,929 and $98,605 at December 31, 2011 and 2010, respectively.

(Dollar Amounts in Thousands except per share data)

A summary of certificate accounts by scheduled maturities at December 31, 2011 is as follows:

2012	$	77,429
2013		28,734
2014		28,602
2015		34,535
2016		58,738
Thereafter		5,622
	$	233,660

Note 8: FHLB Advances

The Company has outstanding FHLB advances of $40,573 and $30,455 as of December 31, 2011 and 2010, respectively. Advances, at interest rates from 0.49 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 $5,806 and $9,187 as of December 31, 2011 and 2010, respectively, and the fair value of investment securities pledged was approximately $53,117 and $46,321 as of December 31, 2011 and 2010, respectively. The FHLB advances are scheduled to mature according to the following schedule:

		Amount
2013	$	19,000
2014		5,000
2015		11,000
2016		3,000
Thereafter		3,000
		41,000
Deferred prepayment penalties on advance restructure		(427)
	$	40,573

Amounts advanced totaling $10,000 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.

(Dollar Amounts in Thousands except per share data)

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, 2011 and 2010, totaled approximately $137 and $117, 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, 2011 and the stock options outstanding at the end of the year:

	2011		
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Life (In Years)
Outstanding, beginning of year	202,500	$ 21.81	
Expired	(112,500)	23.75	
Outstanding, end of year	90,000	19.38	0.3
Exercisable, end of year	90,000	19.38	0.3

(Dollar Amounts in Thousands except per share data)

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 120,000 shares of common stock that may be issued pursuant to the Directors Deferred Stock Plan. During 2011, this amount was increased from 60,000 shares. 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 $108 and $114 in 2011 and 2010, respectively, of which $60 and $60 in 2011 and 2010, 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, 2011:

	Deferred Rights	Common Shares
Outstanding, beginning of year	32,173	
Granted	5,456	
Exercised	—	
Outstanding, end of year	37,629	

Note 10: Income Taxes

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

	2011	2010
Current	$ 1,711	$ 368
Deferred	(938)	1,328
Total	$ 773	$ 1,696

(Dollar Amounts in Thousands except per share data)

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

	2011	2010
Statutory rate times pre-tax income	$ 1,346	$ 2,261
Add (subtract) the tax effect of:		
Income from tax-exempt securities	(525)	(537)
State income tax, net of federal tax effect	31	61
Bank-owned life insurance	(99)	(100)
Other differences	20	11
Total income taxes	$ 773	$ 1,696

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

	2011	2010
Deferred tax assets (liabilities)		
Allowance for loan losses	$ 1,995	$ 2,423
Unrealized (gain) loss on available for sale securities	(664)	1,129
Other than temporarily impaired securities	432	428
Mark to market adjustments	17	(1,543)
Depreciation	(260)	(249)
Deferred compensation	409	337
Deferred loan origination fees	(59)	(50)
AMT credit carry forward	—	463
Prepaid assets	(89)	(65)
Other	421	184
Total deferred tax assets, net	$ 2,202	$ 3,057

Note 11: Related Party Transactions

At December 31, 2011 and 2010, 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 $50 and $241, 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.

Deposits from related parties held by the Company at December 31, 2011 and 2010 totaled $10,353 and $10,738, 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, 2011 and 2010, were approximately $128 and $150, 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. Furthermore, the Company's regulators could require adjustments to regulatory capital not reflected in these financial statements.

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).

(Dollar Amounts in Thousands except per share data)

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, 2011, 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		Minimum Capital Requirement		Minimum to be Well Capitalized Under Prompt Corrective Actions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2011:						
Total capital (to risk-weighted assets)						
Consolidated	$ 55,088	12.4%	$ 35,530	8.0%	N/A	N/A
Bank	53,793	12.2%	35,425	8.0%	$ 44,281	10.0%
Tier 1 capital (to risk-weighted assets)						
Consolidated	49,516	11.2%	17,765	4.0%	N/A	N/A
Bank	48,237	10.9%	17,712	4.0%	26,569	6.0%
Tier 1 capital (to average assets)						
Consolidated	49,516	8.7%	22,660	4.0%	N/A	N/A
Bank	48,237	8.5%	22,603	4.0%	28,254	5.0%
As of December 31, 2010:						
Total capital (to risk-weighted assets)						
Consolidated	$ 51,361	12.2%	$ 33,779	8.0%	N/A	N/A
Bank	49,929	11.9%	33,654	8.0%	$ 42,067	10.0%
Tier 1 capital (to risk-weighted assets)						
Consolidated	46,059	10.9%	16,889	4.0%	N/A	N/A
Bank	44,646	10.6%	16,827	4.0%	25,240	6.0%
Tier 1 capital (to average assets)						
Consolidated	46,059	9.4%	19,583	4.0%	N/A	N/A
Bank	44,646	9.1%	19,532	4.0%	24,415	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, 2011 and 2010, the Company had outstanding loan commitments totaling approximately $23,840 and $14,714, respectively.

(Dollar Amounts in Thousands except per share data)

The Company leases its office facility under an operating lease expiring July 31, 2018. The lease is 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
2012	$ 247
2013	299
2014	304
2015	310
2016	315
Thereafter	509
	$ 1,984

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 valuation methodologies and inputs 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.

(Dollar Amounts in Thousands except per share data)

Level 2 securities include U.S. government-sponsored enterprises, mortgage and asset-backed securities and obligations of state, municipals 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, 2011 and 2010:

		2011 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)
U.S. government-sponsored enterprises	$ 25,502	$ —	$ 25,502	$ —
Municipals	42,761	—	42,761	—
Mortgage-backed and asset-backed securities	75,235	—	75,235	—
Other securities	5,772	1,541	3,761	470
	$ 149,270	$ 1,541	$ 147,259	$ 470

(Dollar Amounts in Thousands except per share data)

		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)
U.S. government-sponsored enterprises	$ 43,393	$ —	$ 43,393	$ —
U.S. government treasuries	2,332	—	2,332	—
Municipals	40,764	—	40,764	—
Mortgage-backed and asset-backed securities	48,981	—	48,981	—
Other securities	1,466	1,012	—	454
	$ 136,936	$ 1,012	$ 135,470	$ 454

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:

	Securities Available for Sale
Balance, January 1, 2010	$ 1,609
Total realized and unrealized gains and losses	
Included in net income	(421)
Included in other comprehensive loss	(734)
Balance, December 31, 2010	454
Total realized and unrealized gains and losses	
Included in net income	(132)
Included in other comprehensive loss	148
Balance, December 31, 2011	$ 470

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, 2011 and 2010:

		2011 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	$ 7,309	$ —	$ —	$ 7,309

		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	$ 4,330	$ —	$ —	$ 4,330

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.

(Dollar Amounts in Thousands except per share data)

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, 2011 and 2010.

The following schedule includes the carrying value and estimated fair value of all financial assets and liabilities at December 31, 2011 and 2010:

	2011		2010	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Cash and cash equivalents	$ 34,778	$ 34,778	$ 32,417	$ 32,417
Securities available for sale	149,270	149,270	136,936	136,936
Loans held for sale	45,091	45,091	5,008	5,008
Loans receivable - net	329,570	322,557	299,545	286,218
Accrued interest receivable	2,129	2,129	2,095	2,095
FHLB stock	2,943	2,943	3,259	3,259
Deposits	486,665	493,692	422,703	429,440
FHLB advances	40,573	43,526	30,455	32,645
Accrued interest payable	120	120	126	126

Note 15: Subsequent Events

Subsequent events have been evaluated through the date of the Independent Accountants’ Report, which is the date the consolidated financial statements were available to be issued.