

OLD SECOND BANCORP INC  
Form 10-Q  
May 10, 2012  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended March 31, 2012

OR

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

For transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0 -10537

**OLD SECOND BANCORP, INC.**

(Exact name of Registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction  
of incorporation or organization)

**36-3143493**  
(I.R.S. Employer Identification Number)

**37 South River Street, Aurora, Illinois 60507**

(Address of principal executive offices) (Zip Code)

**(630) 892-0202**

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Indicate by check mark whether registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Act. (check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(do not check if a smaller reporting company)

Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: As of May 7, 2012, the Registrant had outstanding 14,084,328 shares of common stock, \$1.00 par value per share.

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**OLD SECOND BANCORP, INC.**

Form 10-Q Quarterly Report

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Table of Contents**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements****Old Second Bancorp, Inc. and Subsidiaries****Consolidated Balance Sheets***(In thousands, except share data)*

	(Unaudited) March 31, 2012	December 31, 2011
<b>Assets</b>		
Cash and due from banks	\$ 35,455	\$ 2,692
Interest bearing deposits with financial institutions	41,162	48,257
Cash and cash equivalents	76,617	50,949
Securities available-for-sale	359,371	307,564
Federal Home Loan Bank and Federal Reserve Bank stock	12,583	14,050
Loans held-for-sale	6,405	12,806
Loans	1,322,348	1,368,985
Less: allowance for loan losses	47,610	51,997
Net loans	1,274,738	1,316,988
Premises and equipment, net	49,830	50,477
Other real estate owned	101,680	93,290
Mortgage servicing rights, net	3,806	3,487
Core deposit and other intangible assets, net	4,483	4,678
Bank-owned life insurance (BOLI)	53,090	52,595
Other assets	38,945	34,534
Total assets	\$ 1,981,548	\$ 1,941,418
<b>Liabilities</b>		
Deposits:		
Noninterest bearing demand	\$ 369,619	\$ 361,963
Interest bearing:		
Savings, NOW, and money market	811,872	761,335
Time	582,379	617,483
Total deposits	1,763,870	1,740,781
Securities sold under repurchase agreements	1,804	901
Other short-term borrowings	15,000	
Junior subordinated debentures	58,378	58,378
Subordinated debt	45,000	45,000
Notes payable and other borrowings	500	500
Other liabilities	26,385	21,856
Total liabilities	1,910,937	1,867,416
<b>Stockholders Equity</b>		
Preferred stock	71,108	70,863
Common stock	18,729	18,628

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Additional paid-in capital	65,985	65,999
Retained earnings	12,916	17,107
Accumulated other comprehensive loss	(3,171)	(3,702)
Treasury stock	(94,956)	(94,893)
Total stockholders' equity	70,611	74,002
Total liabilities and stockholders' equity	\$ 1,981,548	\$ 1,941,418

	March 31, 2012				December 31, 2011			
	Preferred Stock	1	Common Stock	1	Preferred Stock	1	Common Stock	1
Par value	\$	1	\$	1	\$	1	\$	1
Liquidation value		1,000		n/a		1,000		n/a
Shares authorized		300,000		60,000,000		300,000		60,000,000
Shares issued		73,000		18,729,134		73,000		18,627,858
Shares outstanding		73,000		14,084,328		73,000		14,034,991
Treasury shares				4,644,806				4,592,867

See accompanying notes to consolidated financial statements.

Table of Contents**Old Second Bancorp, Inc. and Subsidiaries****Consolidated Statements of Operations***(In thousands, except share data)*

	(Unaudited) Three Months Ended March 31,	
	2012	2011
<b>Interest and dividend income</b>		
Loans, including fees	\$ 17,666	\$ 21,216
Loans held-for-sale	84	51
Securities:		
Taxable	1,498	878
Tax-exempt	103	142
Dividends from Federal Reserve Bank and Federal Home Loan Bank stock	74	69
Interest bearing deposits with financial institutions	25	70
Total interest and dividend income	19,450	22,426
<b>Interest expense</b>		
Savings, NOW, and money market deposits	300	576
Time deposits	2,605	3,993
Other short-term borrowings	3	
Junior subordinated debentures	1,197	1,113
Subordinated debt	237	203
Notes payable and other borrowings	4	4
Total interest expense	4,346	5,889
Net interest and dividend income	15,104	16,537
Provision for loan losses	6,084	4,000
Net interest and dividend income after provision for loan losses	9,020	12,537
<b>Noninterest income</b>		
Trust income	1,651	1,784
Service charges on deposits	1,831	1,817
Secondary mortgage fees	296	227
Mortgage servicing income	187	370
Net gain on sales of mortgage loans	2,647	1,236
Securities gains, net	101	139
Increase in cash surrender value of bank-owned life insurance	495	463
Debit card interchange income	760	700
Lease revenue from other real estate owned	1,179	520
Net gain on sale of other real estate owned	23	234
Litigation related income	116	
Other income	1,178	1,451
Total noninterest income	10,464	8,941
<b>Noninterest expense</b>		
Salaries and employee benefits	9,049	8,929
Occupancy expense, net	1,235	1,345
Furniture and equipment expense	1,155	1,460
FDIC insurance	1,000	1,739
General bank insurance	846	825
Amortization of core deposit and other intangible assets	195	229
Advertising expense	318	233
Debit card interchange expense	342	373
Legal fees	685	943

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Other real estate expense	4,654	5,314
Other expense	2,973	3,208
Total noninterest expense	22,452	24,598
Loss before income taxes	(2,968)	(3,120)
Benefit for income taxes		
<b>Net loss</b>	(2,968)	(3,120)
<b>Preferred stock dividends and accretion of discount</b>	1,223	1,159
<b>Net loss available to common shareholders</b>	\$ (4,191)	\$ (4,279)

**Share and per share information:**

Ending number of shares	14,084,328	14,034,991
Average number of shares	14,043,545	13,973,870
Diluted average number of shares	14,196,143	14,213,701
Basic loss per share	\$ (0.30)	\$ (0.30)
Diluted loss per share	(0.30)	(0.30)
Dividends paid per share		

See accompanying notes to consolidated financial statements.

Table of Contents**Old Second Bancorp, Inc. and Subsidiaries****Consolidated Statements of Comprehensive loss***(In thousands, except share data)*

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
Net loss	\$ (2,968)	\$ (3,120)
Unrealized holding gains (losses) on available-for-sale securities arising during the period		
U.S. Treasury	(5)	(5)
U.S. government agencies	(97)	(171)
U.S. government agency mortgage-backed States and political subdivisions	235	(692)
Corporate Bonds	(104)	380
Collateralized mortgage obligations	1,055	
Asset-backed securities	105	(40)
Collateralized debt obligations	98	
Equity securities	(283)	684
Total unrealized holding gains on available-for-sale securities arising during the period	6	6
Related tax (expense) benefit	1,004	162
Holding income after tax	(413)	8
	591	170
Less: Reclassification adjustment for the net gains and losses realized during the period		
Realized gains by security type:		
U.S. government agency mortgage-backed	101	
Collateralized mortgage obligations		139
Net realized gain	101	139
Income tax expense on net realized gains	(41)	(57)
Net realized gain after tax	60	82
Total other comprehensive income	531	88
Comprehensive loss	\$ (2,437)	\$ (3,032)

See accompanying notes to consolidated financial statements.



Table of Contents**Old Second Bancorp, Inc. and Subsidiaries****Consolidated Statements of Cash Flows**

(In thousands)

	(Unaudited) Three Months Ended March 31,	
	2012	2011
<b>Cash flows from operating activities</b>		
Net loss	\$ (2,968)	\$ (3,120)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	801	1,084
Change in market value on mortgage servicing rights	123	(62)
Provision for loan losses	6,084	4,000
Originations of loans held-for-sale	(64,140)	(48,517)
Proceeds from sales of loans held-for-sale	72,729	56,889
Net gain on sales of mortgage loans	(2,647)	(1,236)
Increase in cash surrender value of bank-owned life insurance	(495)	(463)
Change in accrued interest receivable and other assets	(4,635)	(5,157)
Change in accrued interest payable and other liabilities	3,420	513
Net premium amortization on securities	403	65
Securities gains, net	(101)	(139)
Amortization of core deposit and other intangible assets	195	229
Stock based compensation	87	238
Net gain on sale of other real estate owned	(23)	(234)
Write-down of other real estate owned	2,500	2,393
Net cash provided by operating activities	11,333	6,483
<b>Cash flows from investing activities</b>		
Proceeds from maturities and pre-refunds including pay down of securities available-for-sale	17,254	4,764
Proceeds from sales of securities available-for-sale	8,359	3,755
Purchases of securities available-for-sale	(76,819)	(2,000)
Net sales (purchases) of Federal Reserve Bank and Federal Home Loan Bank stock	1,467	(359)
Net change in loans	20,248	61,737
Investment in other real estate owned	(318)	(2,022)
Proceeds from sales of other real estate owned	5,369	9,357
Net purchases of premises and equipment	(154)	(94)
Net cash (used in) provided by investing activities	(24,594)	75,138
<b>Cash flows from financing activities</b>		
Net change in deposits	23,089	(6,179)
Net change in securities sold under repurchase agreements	903	(140)
Net change in other short-term borrowings	15,000	438
Purchase of treasury stock	(63)	(49)
Net cash provided by (used in) financing activities	38,929	(5,930)
Net change in cash and cash equivalents	25,668	75,691
Cash and cash equivalents at beginning of period	50,949	98,758
Cash and cash equivalents at end of period	\$ 76,617	\$ 174,449

	2012	2011
<b>Supplemental cash flow information</b>		

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Interest paid for deposits	\$	3,394	\$	4,893
Interest paid for borrowings		243		207
Non-cash transfer of loans to other real estate		15,918		19,451
Change in dividends declared not paid		978		929
Accretion on preferred stock warrants		245		230

See accompanying notes to consolidated financial statements.

Table of Contents**Old Second Bancorp, Inc. and Subsidiaries****Consolidated Statements of Changes in****Stockholders Equity**

(In thousands, except share data)

	Common Stock	Preferred Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Stockholders Equity
Balance, December 31, 2010	\$ 18,467	\$ 69,921	\$ 65,209	\$ 28,335	\$ (3,130)	\$ (94,844)	\$ 83,958
Net loss				(3,120)			(3,120)
Change in net unrealized loss on securities available- for-sale net of \$65 tax effect					88		88
Change in restricted stock	161		(161)				
Stock based compensation			238				238
Purchase of treasury stock						(49)	(49)
Preferred dividends declared and accrued (5% per preferred share)		230		(1,159)			(929)
Balance, March 31, 2011	\$ 18,628	\$ 70,151	\$ 65,286	\$ 24,056	\$ (3,042)	\$ (94,893)	\$ 80,186
Balance, December 31, 2011	\$ 18,628	\$ 70,863	\$ 65,999	\$ 17,107	\$ (3,702)	\$ (94,893)	\$ 74,002
Net loss				(2,968)			(2,968)
Change in net unrealized gain on securities available- for-sale, net of \$372 tax effect					531		531
Change in restricted stock	101		(101)				
Stock based compensation			87				87
Purchase of treasury stock						(63)	(63)
Preferred dividends declared and accrued (5% per preferred share)		245		(1,223)			(978)
Balance, March 31, 2012	\$ 18,729	\$ 71,108	\$ 65,985	\$ 12,916	\$ (3,171)	\$ (94,956)	\$ 70,611

See accompanying notes to consolidated financial statements.

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**Old Second Bancorp, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

(Table amounts in thousands, except per share data, unaudited)

**Note 1 Summary of Significant Accounting Policies**

The accounting policies followed in the preparation of the interim financial statements are consistent with those used in the preparation of the annual financial information. The interim financial statements reflect all normal and recurring adjustments, which are necessary, in the opinion of management, for a fair statement of results for the interim period presented. Results for the period ended March 31, 2012, are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. These interim financial statements should be read in conjunction with the audited financial statements and notes included in Old Second Bancorp, Inc.'s (the Company) annual report on Form 10-K for the year ended December 31, 2011. Unless otherwise indicated, amounts in the tables contained in the notes are in thousands. Certain items in prior periods have been reclassified to conform to the current presentation.

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States and follow general practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements. Future changes in information may affect these estimates, assumptions, and judgments, which, in turn, may affect amounts reported in the financial statements.

All significant accounting policies are presented in Note 1 to the consolidated financial statements included in the Company's annual report on Form 10-K for the year ended December 31, 2011. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined.

In May 2011, the FASB issued ASU No. 2011-04 Fair Value Measurement (Topic 820) - Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. ASU 2011-04 changes the wording used to describe many of the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements. Consequently, the amendments in this update result in common fair value measurement and disclosure requirements in GAAP and International Financial Reporting Standards. ASU 2011-04 is effective prospectively during interim and annual periods beginning on or after December 15, 2011. The Company has assessed the impact of ASU 2011-04 on its fair value disclosures and found no material impact on its fair value disclosures.

In June 2011, the FASB issued ASU No. 2011-05 Comprehensive Income (Topic 220) - Presentation of Comprehensive Income. ASU 2011-05 requires that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. Retrospective application of the standard is required. In December 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-12: Comprehensive Income (Topic 220) Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU No. 2011-05, to defer the effective date for the part of

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ASU No. 2011-05 that would require adjustments of items out of accumulated other income to be presented on the components of both net income and other comprehensive income in financial statements. The Company has included the consolidated statements of comprehensive income beginning this interim period. There was no impact on the consolidated statements of operations or balance sheets based on the adoption of this standard.

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**Note 2 Securities**

**Investment Portfolio Management**

Our investment portfolio serves the liquidity and income needs of the Company. While the portfolio serves as an important component of the overall liquidity management at the Bank, portions of the portfolio will also serve as income producing assets. The size of the portfolio will reflect liquidity needs, loan demand and interest income objectives.

Portfolio size and composition may be adjusted from time to time. While a significant portion of the portfolio will always consist of readily marketable securities to address liquidity, other parts of the portfolio may reflect funds invested pending future loan demand or to maximize interest income without undue interest rate risk.

Investments are comprised of debt securities and non-marketable equity investments. All debt securities are classified as available-for-sale and may be sold under our management and asset/liability management strategies. Securities available-for-sale are carried at fair value. Unrealized gains and losses on securities available-for-sale are reported as a separate component of equity. This balance sheet component will change as interest rates and market conditions change. Unrealized gains and losses are not included in the calculation of regulatory capital.

Non-marketable equity investments include Federal Home Loan Bank of Chicago ( FHLBC ) stock, Federal Reserve Bank of Chicago ( FRB ) stock and various other equity securities. FHLBC stock was recorded at a value of \$7.8 million at March 31, 2012, a decrease of \$1.5 million from December 31, 2011. FRB stock was recorded at \$4.8 million at March 31, 2012, which was unchanged from December 31, 2011. Our FHLB stock is necessary to maintain our program of access to FHLB advances. Management at the Bank evaluated the October 17, 2011, FHLBC Capital Plan and determined the best overall course was to accept the stock conversion as of January 1, 2012. Subsequently, Management redeemed excess stock the Bank held with the FHLBC reducing the value of stock held to \$7.8 million at February 15, 2012.

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The following table summarizes the amortized cost and fair value of the available-for-sale securities at March 31, 2012 and December 31, 2011 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive loss were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>March 31, 2012:</b>				
U.S. Treasury	\$ 1,501	\$ 18	\$	\$ 1,519
U.S. government agencies	45,147	194	(5)	45,336
U.S. government agency mortgage-backed States and political subdivisions	153,010	2,329	(661)	154,678
Corporate Bonds	14,166	1,577	(24)	15,719
Collateralized mortgage obligations	37,073	176	(89)	37,160
Asset-backed securities	47,542	366	(755)	47,153
Collateralized debt obligations	48,420	37	(353)	48,104
	17,903		(8,201)	9,702
	\$ 364,762	\$ 4,697	\$ (10,088)	\$ 359,371
<b>December 31, 2011:</b>				
U.S. Treasury	\$ 1,501	\$ 23	\$	\$ 1,524
U.S. government agencies	43,112	286		43,398
U.S. government agency mortgage-backed States and political subdivisions	152,473	1,553	(19)	154,007
Corporate Bonds	12,152	1,657		13,809
Collateralized mortgage obligations	32,357	14	(982)	31,389
Asset-backed securities	25,616	242	(736)	25,122
Collateralized debt obligations	28,755		(414)	28,341
	17,892		(7,918)	9,974
	\$ 313,858	\$ 3,775	\$ (10,069)	\$ 307,564

Securities valued at \$42.0 million as of March 31, 2012 (slightly up from \$40.9 million at year end 2011) were pledged to secure deposits and for other purposes.

At March 31, 2012 and December 31, 2011, collateralized debt obligations ( CDO ) held, as issued by Trapeza CDO XIII, Ltd, were greater than 10% of stockholders equity. Additional detailed information related to these securities is provided below.

The fair value, amortized cost and weighted average yield of debt securities at March 31, 2012, by contractual maturity, were as follows. Securities not due at a single maturity date, primarily mortgage-backed securities, collateralized debt obligations and equity securities are shown separately.

	Amortized Cost	Weighted Average Yield	Fair Value
Due in one year or less	\$ 475	4.36%	\$ 480
Due after one year through five years	70,216	2.29%	70,734
Due after five years through ten years	10,420	4.74%	11,046
Due after ten years	16,776	4.57%	17,474
	97,887	2.95%	99,734
Mortgage-backed securities	200,552	2.01%	201,831

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Asset-back securites	48,420	1.77%	48,104
Collateralized debt obligations	17,903	1.88%	9,702
	\$ 364,762	2.22%	\$ 359,371



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Securities with unrealized losses at March 31, 2012, and December 31, 2011, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

March 31, 2012	Less than 12 months in an unrealized loss position			Greater than 12 months in an unrealized loss position			Number of Securities	Total Unrealized Losses	Fair Value
	Number of Securities	Unrealized Losses	Fair Value	Number of Securities	Unrealized Losses	Fair Value			
U.S. government agencies	2	\$ 5	\$ 4,635		\$	\$	2	\$ 5	4,635
U.S. government agency mortgage-backed	4	661	30,330				4	661	30,330
States and political subdivisions	1	24	2,079				1	24	2,079
Corporate bonds	6	89	16,380				6	89	16,380
Collateralized mortgage obligations	11	755	33,050				11	755	33,050
Asset-backed securities	6	353	27,167				6	353	27,167
Collateralized debt obligations				2	8,201	9,702	2	8,201	9,702
	30	\$ 1,887	\$ 113,641	2	\$ 8,201	\$ 9,702	32	\$ 10,088	\$ 123,343

December 31, 2011	Less than 12 months in an unrealized loss position			Greater than 12 months in an unrealized loss position			Number of Securities	Total Unrealized Losses	Fair Value
	Number of Securities	Unrealized Losses	Fair Value	Number of Securities	Unrealized Losses	Fair Value			
U.S. government agency mortgage-backed	4	\$ 19	\$ 27,935		\$	\$	4	\$ 19	\$ 27,935
Corporate bonds	11	982	28,605				11	982	28,605
Collateralized mortgage obligations	3	736	9,032				3	736	9,032
Asset-backed securities	4	414	28,341				4	414	28,341
Collateralized debt obligations				2	7,918	9,974	2	7,918	9,974
	22	\$ 2,151	\$ 93,913	2	\$ 7,918	\$ 9,974	24	\$ 10,069	\$ 103,887

Recognition of other-than-temporary impairment was not necessary in the three months ended March 31, 2012, or the year ended December 31, 2011. The changes in fair values related primarily to interest rate fluctuations and were generally not related to credit quality deterioration, although the amount of deferrals and defaults in the pooled collateralized debt obligations increased in the period from December 31, 2011 to March 31, 2012.

Uncertainty in the financial markets in the periods presented has resulted in reduced liquidity for certain investments, particularly the CDO securities. In the case of the CDO securities fair value measurement, management included a risk premium adjustment as of March 31, 2012, to reflect an estimated yield that a market participant would demand because of uncertainty in cash flows, based on incomplete and sporadic levels of market activity. Accordingly, management continues to designate these securities as level 3 securities as described in Note 15 of this quarterly report as of March 31, 2012. Management does not have the intent to sell the above securities and it is more likely than not the Company will not sell the securities before recovery of its cost basis.



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Below is additional information as it relates to the collateralized debt obligation, Trapeza 2007-13A, which is secured by a pool of trust preferred securities issued by trusts sponsored by multiple financial institutions. This collateralized debt obligation was rated AAA at the time of purchase by the Company.

	Amortized	Fair	Gross	S&P	Number of	Issuance	Issuance	Issuance	Issuance
	Cost	Value	Unrealized	Credit	Banks in	Deferrals & Defaults	Collateral	Excess Subordination	Collateral
			Loss	Rating (1)	Issuance	Amount	%	Amount	%
<b>March 31, 2012</b>									
Class A1	\$ 9,113	\$ 5,350	\$ (3,763)	CCC+	63	\$ 217,750	29.0%	\$ 177,635	23.7%
Class A2A	8,790	4,352	(4,438)	CCC-	63	217,750	29.0%	80,635	10.8%
	\$ 17,903	\$ 9,702	\$ (8,201)						
<b>December 31, 2011</b>									
Class A1	\$ 9,136	\$ 5,584	\$ (3,552)	CCC+	63	\$ 212,750	28.4%	\$ 181,630	24.2%
Class A2A	8,756	4,390	(4,366)	CCC-	63	212,750	28.4%	84,630	11.3%
	\$ 17,892	\$ 9,974	\$ (7,918)						

(1) Moody's credit rating for class A1 and A2A were Baa2 and Ba2, respectively, as of March 31, 2012, and December 31, 2011. The Fitch ratings for class A1 and A2A were BBB and B, respectively, as of March 31, 2012, and December 31, 2011.

**Note 3 Loans**

Major classifications of loans were as follows:

	March 31, 2012	December 31, 2011
Commercial	\$ 103,203	\$ 98,099
Real estate - commercial	676,297	704,492
Real estate - construction	60,285	71,436
Real estate - residential	464,596	477,200
Consumer	3,544	3,789
Overdraft	234	457
Lease financing receivables	1,944	2,087
Other	12,211	11,498
	1,322,314	1,369,058
Net deferred loan cost (fees)	34	(73)
	\$ 1,322,348	\$ 1,368,985

It is the policy of the Company to review each prospective credit in order to determine an adequate level of security or collateral was obtained prior to making a loan. The type of collateral, when required, will vary from liquid assets to real estate. The Company's access to collateral, in the event of borrower default, is assured through adherence to state lending laws, the Company's lending standards and credit monitoring procedures. The Bank generally makes loans solely within its market area. There are no significant concentrations of loans where the customers ability to honor loan terms is dependent upon a single economic sector, although the real estate related categories listed above represent 90.8% and 91.5% of the portfolio at March 31, 2012, and December 31, 2011, respectively. The Company remains committed to overseeing and

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managing its loan portfolio to reduce its real estate credit concentrations in accordance with the requirements of the Consent Order with the Bank and the Office of the Comptroller of the Currency ( OCC ). Regulatory and Capital matters including the Consent Order are discussed in more detail in Note 14 of the consolidated financial statements included in this report.

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Aged analysis of past due loans by class of loans were as follows:

<b>March 31, 2012</b>	<b>30-59 Days Past Due</b>	<b>60-89 Days Past Due</b>	<b>90 Days or Greater Past Due</b>	<b>Total Past Due</b>	<b>Current</b>	<b>Nonaccrual</b>	<b>Total Financing Receivables</b>	<b>Recorded Investment 90 days or Greater Past Due and Accruing</b>
Commercial	\$ 51	\$	\$ 90	\$ 141	\$ 103,849	\$ 1,157	\$ 105,147	\$ 90
Real estate - commercial								
Owner occupied general purpose	764		758	1,522	133,860	6,490	141,872	758
Owner occupied special purpose	456			456	170,322	15,589	186,367	
Non-owner occupied general purpose	650			650	132,920	22,397	155,967	
Non-owner occupied special purpose					106,626	631	107,257	
Retail properties					40,893	11,667	52,560	
Farm			693	693	30,552	1,029	32,274	693
Real estate - construction								
Homebuilder	53			53	8,017	7,200	15,270	
Land					8,361	1,288	9,649	
Commercial speculative					5,042	10,672	15,714	
All other	176			176	17,247	2,229	19,652	
Real estate - residential								
Investor	405		170	575	160,544	15,529	176,648	170
Owner occupied	3,376			3,376	118,955	12,608	134,939	
Revolving and junior liens	1,431	70		1,501	148,673	2,835	153,009	
Consumer	4	1		5	3,539		3,544	
All other					12,479		12,479	
	\$ 7,366	\$ 71	\$ 1,711	\$ 9,148	\$ 1,201,879	\$ 111,321	\$ 1,322,348	\$ 1,711

<b>December 31, 2011</b>	<b>30-59 Days Past Due</b>	<b>60-89 Days Past Due</b>	<b>90 Days or Greater Past Due</b>	<b>Total Past Due</b>	<b>Current</b>	<b>Nonaccrual</b>	<b>Total Financing Receivables</b>	<b>Recorded Investment 90 days or Greater Past Due and Accruing</b>
Commercial	\$ 161	\$ 20	\$	\$ 181	\$ 98,840	\$ 1,165	\$ 100,186	\$
Real estate - commercial								
Owner occupied general purpose	912			912	137,250	12,744	150,906	
Owner occupied special purpose		39		39	172,624	16,564	189,227	
Non-owner occupied general purpose	471		318	789	147,099	12,893	160,781	318
Non-owner occupied special purpose					107,425	1,814	109,239	
Retail properties					42,535	15,897	58,432	
Farm	197			197	34,136	1,574	35,907	
Real estate - construction								
Homebuilder					8,725	10,193	18,918	
Land					7,976	2,025	10,001	
Commercial speculative		669		669	5,154	14,217	20,040	
All other		74		74	17,714	4,689	22,477	
Real estate - residential								
Investor	338	3,562		3,900	162,101	15,111	181,112	
Owner occupied	3,414	573		3,987	119,266	15,059	138,312	

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Revolving and junior liens	1,525	166		1,691	153,244	2,841	157,776	
Consumer	8			8	3,781		3,789	
All other					11,882		11,882	
	\$ 7,026	\$ 5,103	\$ 318	\$ 12,447	\$ 1,229,752	\$ 126,786	\$ 1,368,985	\$ 318

Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The Bank had no commitments to any borrower whose loans were classified as impaired at March 31, 2012.

**Credit Quality Indicators:**

The Company categorizes loans into Credit risk categories based on current financial information, overall debt service coverage, comparison against industry averages, historical payment experience, and current economic trends. Each loan and loan relationship is examined. This analysis includes loans with outstanding loans or commitments greater than \$50,000 and excludes homogeneous loans such as home

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equity line of credit and residential mortgages. Loans with a classified risk rating are reviewed quarterly regardless of size or loan type. The Company uses the following definitions for classified risk ratings:

**Special Mention.** Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan at some future date.

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

**Doubtful.** Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Credits that are not covered by the definitions above are pass credits, which are not considered to be adversely rated. Loans listed as not rated have outstanding loans or commitments less than \$50,000 or are included in groups of homogeneous loans.

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Credit Quality Indicators by class of loans as were as follows:

<b>March 31, 2012</b>	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard (1)</b>	<b>Doubtful</b>	<b>Total</b>
Commercial	\$ 87,308	\$ 16,134	\$ 1,705	\$	\$ 105,147
Real estate - commercial					
Owner occupied general purpose	119,839	7,541	14,492		141,872
Owner occupied special purpose	153,279	5,336	27,752		186,367
Non-owner occupied general purpose	99,111	16,687	40,169		155,967
Non-owner occupied special purpose	90,313	11,531	5,413		107,257
Retail Properties	27,964	7,445	17,151		52,560
Farm	23,006	5,605	3,663		32,274
Real estate - construction					
Homebuilder	3,672	2,851	8,747		15,270
Land	5,309	530	3,810		9,649
Commercial speculative	1,373		14,341		15,714
All other	16,587	802	2,263		19,652
Real estate - residential					
Investor	126,150	18,278	32,220		176,648
Owner occupied	117,756	419	16,764		134,939
Revolving and junior liens	148,388	247	4,374		153,009
Consumer	3,534		10		3,544
All other	11,366	1,113			12,479
Total	\$ 1,034,955	\$ 94,519	\$ 192,874	\$	\$ 1,322,348

<b>December 31, 2011</b>	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard (1)</b>	<b>Doubtful</b>	<b>Total</b>
Commercial	\$ 94,456	\$ 3,350	\$ 2,380	\$	\$ 100,186
Real estate - commercial					
Owner occupied general purpose	115,175	11,695	24,036		150,906
Owner occupied special purpose	154,650	5,254	29,323		189,227
Non-owner occupied general purpose	102,178	19,292	39,311		160,781
Non-owner occupied special purpose	85,931	6,017	17,291		109,239
Retail Properties	26,391	11,660	20,381		58,432
Farm	26,629	5,605	3,673		35,907
Real estate - construction					
Homebuilder	4,206	2,905	11,807		18,918
Land	3,755	3,032	3,214		10,001
Commercial speculative	1,306		18,734		20,040
All other	17,448	303	4,726		22,477
Real estate - residential					
Investor	119,494	28,478	33,140		181,112
Owner occupied	118,658	271	19,383		138,312
Revolving and junior liens	151,928	821	5,027		157,776
Consumer	3,776		13		3,789
All other	10,755	1,127			11,882
Total	\$ 1,036,736	\$ 99,810	\$ 232,439	\$	\$ 1,368,985

(1) The substandard credit quality indicator includes both potential problem loans that are currently performing and nonperforming loans





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Impaired loans by class of loan as of March 31, 2012 were as follows:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Year to date March 31, 2012 Average Recorded Investment	Interest Income Recognized
<b>With no related allowance recorded</b>					
Commercial	\$ 510	\$ 546	\$	\$ 511	\$
Commercial real estate					
Owner occupied general purpose	4,320	5,486		4,540	
Owner occupied special purpose	11,204	17,762		11,905	
Non-owner occupied general purpose	11,659	14,778		9,980	45
Non-owner occupied special purpose	207	209		794	
Retail properties	11,667	17,934		8,126	
Farm	340	342		709	
Construction					
Homebuilder	8,256	10,209		9,464	27
Land	584	584		1,305	
Commercial speculative	6,018	8,869		7,783	
All other	2,127	2,395		3,218	
Residential					
Investor	3,852	13,376		3,417	2
Owner occupied	13,167	15,287		12,523	22
Revolving and junior liens	1,610	1,933		1,549	
Consumer					
Total impaired loans with no recorded allowance	75,521	109,710		75,824	96
<b>With an allowance recorded</b>					
Commercial	647	743	389	650	
Commercial real estate					
Owner occupied general purpose	2,170	2,355	637	5,078	
Owner occupied special purpose	4,385	5,161	151	4,171	
Non-owner occupied general purpose	14,515	15,691	3,515	11,456	
Non-owner occupied special purpose	424	434	115	429	
Retail properties				5,656	
Farm	689	693	150	592	
Construction					