First Federal of Northern Michigan Bancorp, Inc.
Form 10-Q
August 11, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2011

OR

¨ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____________________________ to ____________________________

Commission File Number 000-31957

FIRST FEDERAL OF NORTHERN MICHIGAN BANCORP, INC.
(Exact name of registrant as specified in its charter)

Maryland	32-0135202
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

100 S. Second Avenue, Alpena, Michigan 49707
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (989) 356-9041

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 x 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). Yesx No ¨

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

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

Common Stock, Par Value $0.01	Outstanding at August 10, 2011
(Title of Class)	2,884,049 shares

FIRST FEDERAL OF NORTHERN MICHIGAN BANCORP, INC.
FORM 10-Q
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When used in this Form 10-Q or future filings by First Federal of Northern Michigan Bancorp, Inc. (the "Company") with the Securities and Exchange Commission ("SEC"), in the Company's press releases or other public or stockholder communications, or in oral statements made with the approval of an authorized executive officer, the words or phrases "would be," "will allow," "intends to," "will likely result," "are expected to," "will continue," "is anticipated," "estimate," "project," or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995.

The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and to advise readers that various factors, including regional and national economic conditions, changes in levels of market interest rates, credit and other risks of lending and investment activities and competitive and regulatory factors, could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from those anticipated or projected.

The Company does not undertake, and specifically disclaims any obligation, to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

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PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

First Federal of Northern Michigan Bancorp, Inc. and Subsidiaries
Consolidated Balance Sheet

	June 30, 2011 (Unaudited)	December 31, 2010
ASSETS		
Cash and cash equivalents:		
Cash on hand and due from banks	$3,951,713	$ 1,889,999
Overnight deposits with FHLB	34,756	72,658
Total cash and cash equivalents	3,986,469	1,962,657
Securities AFS	47,671,712	35,301,238
Securities HTM	2,485,000	2,520,000
Loans held for sale	550,613	-
Loans receivable, net of allowance for loan losses of $2,190,949 and $2,831,332 as of June 30, 2011 and December 31, 2010, respectively	144,825,894	157,143,918
Foreclosed real estate and other repossessed assets	4,625,417	2,818,343
Federal Home Loan Bank stock, at cost	3,266,100	3,775,400
Premises and equipment	5,924,907	6,026,793
Accrued interest receivable	1,158,565	1,230,938
Intangible assets	481,081	627,306
Prepaid FDIC premiums	852,890	967,143
Deferred tax asset	471,751	659,194
Other assets	2,623,837	2,700,034
Total assets	$218,924,236	$ 215,732,964
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits	$156,110,486	$ 155,465,896
Advances from borrowers for taxes and insurance	370,215	130,030
Federal Home Loan Bank Advances	32,000,000	29,000,000
REPO Sweep Accounts	4,847,231	6,172,362
Accrued expenses and other liabilities	1,530,196	1,728,735
Total liabilities	194,858,128	192,497,023
Stockholders' equity:		
Common stock ($0.01 par value 20,000,000 shares authorized 3,191,799 shares issued)	31,918	31,918
Additional paid-in capital	23,851,341	23,822,152
Retained earnings	2,661,488	2,238,064
Treasury stock at cost (307,750 shares)	(2,963,918)	(2,963,918)
Unearned compensation	(556)	(38,382)
Accumulated other comprehensive income	485,835	146,107
Total stockholders' equity	24,066,108	23,235,941

Total liabilities and stockholders' equity	$218,924,236	$ 215,732,964

See accompanying notes to consolidated financial statements.

First Federal of Northern Michigan Bancorp, Inc. and Subsidiaries
Consolidated Statement of Income

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2011	2010	2011	2010
	(Unaudited)		(Unaudited)	
Interest income:				
Interest and fees on loans	$2,317,197	$2,552,986	$4,590,517	$5,093,399
Interest and dividends on investments				
Taxable	134,402	106,843	229,217	239,406
Tax-exempt	40,011	58,455	80,339	111,267
Interest on mortgage-backed securities	199,702	165,313	383,068	321,846
Total interest income	2,691,312	2,883,597	5,283,141	5,765,918
Interest expense:				
Interest on deposits	407,875	601,733	845,128	1,239,557
Interest on borrowings	172,681	298,657	340,755	617,239
Total interest expense	580,556	900,390	1,185,883	1,856,796
Net interest income	2,110,756	1,983,207	4,097,258	3,909,122
Provision for loan losses	(19,238)	594,840	48,120	605,928
Net interest income after provision for loan losses	2,129,994	1,388,367	4,049,138	3,303,194
Non-interest income:				
Service charges and other fees	181,228	199,340	345,719	403,514
Mortgage banking activities	182,463	315,223	418,446	563,315
Gain on sale of investments	-	447,387	-	496,817
Net gain (loss) on sale of premises and equipment, real estate owned and other repossessed assets	(37,756)	42,691	(46,431)	53,867
Other	67,048	260,723	124,601	326,336
Total non-interest income	392,983	1,265,364	842,335	1,843,849
Non-interest expense:				
Compensation and employee benefits	1,159,252	1,194,299	2,328,188	2,365,241
FDIC Insurance Premiums	51,170	94,348	122,387	188,548
Advertising	33,817	36,103	56,838	55,992
Occupancy	267,652	288,237	537,694	600,813
Amortization of intangible assets	73,112	73,112	146,225	146,225
Service bureau charges	79,292	86,114	155,498	165,696
Professional services	133,570	149,091	221,147	252,202
Other	462,389	515,103	900,072	850,786
Total non-interest expense	2,260,254	2,436,407	4,468,049	4,625,503
Income before income tax benefit	262,723	217,324	423,424	521,540
Income tax benefit	-	(101,913)	-	-
Net Income	$262,723	$319,237	$423,424	$521,540
Per share data:				

Net income per share				
Basic	$0.09	$0.11	$0.15	$0.18
Diluted	$0.09	$0.11	$0.15	$0.18
Weighted average number of shares outstanding				
Basic and diluted	2,884,049	2,884,249	2,884,049	2,884,249
Dividends per common share	$-	$-	$-	$-

See accompanying notes to consolidated financial statements.

First Federal of Northern Michigan Bancorp Inc. and Subsidiaries
Consolidated Statement of Changes in Stockholders' Equity (Unaudited)

	Common Stock	Treasury Stock	Additional Paid-in Capital	Unearned Compensation	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance at December 31, 2010	$31,918	$(2,963,918)	$23,822,152	$ (38,382)	$2,238,064	$ 146,107	$23,235,941
Treasury Stock at Cost	-	-	-	-	-	-	-
Stock-based compensation	-	-	29,189	37,826	-	-	67,015
Net income for the period	-	-	-	-	423,424	-	423,424
Change in unrealized gain: on available-for-sale securities (net of tax of $175,011)	-	-	-	-	-	339,728	339,728
Total comprehensive income	-	-	-	-	-	-	763,152
Balance at June 30, 2011	$31,918	$(2,963,918)	$23,851,341	$ (556)	$2,661,488	$ 485,835	$24,066,108

See accompanying notes to the consolidated financial statements.

First Federal of Northern Michigan Bancorp, Inc. and Subsidiaries
Consolidated Statement of Cash Flows

	For Six Months Ended June 30, 2011	2010
	(Unaudited)	
Cash Flows from Operating Activities:		
Net income	$423,424	$521,540
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	360,115	410,565
Provision for loan loss	48,120	605,928
Amortization and accretion on securities	133,688	60,794
Gain on sale of investment securities	-	(496,817)
Stock-based compensation	67,015	109,429
Gain on sale of loans held for sale	(162,421)	(225,014)
Originations of loans held for sale	(11,516,189)	(17,133,098)
Proceeds from sale of loans held for sale	11,127,997	16,639,206
Gain on sale of fixed assets	(990)	(9,423)
Net change in		
Accrued interest receivable	72,373	132,706
Other assets	568,753	867,161
Prepaid FDIC insurance premiums	114,253	179,338
Deferred income tax expense (benefit)	187,443	(84,193)
Accrued expenses and other liabilities	(198,539)	194,306
Net cash provided by operating activities	1,225,042	1,772,428
Cash Flows from Investing Activities:		
Net decrease in loans (loans originated, net of principal payments)	9,795,262	6,787,517
Proceeds from maturity and sale of available-for-sale securities	3,374,182	19,558,755
Proceeds from sale of property and equipment	1,480	30,874
Purchase of securities	(15,328,604)	(18,604,083)
Purchase of premises and equipment	(112,494)	(11,086)
Proceeds from sale of Federal Home Loan Bank Stock	509,300	-
Net cash (used for) provided by investing activities	(1,760,874)	7,761,977
Cash Flows from Financing Activities:		
Net increase/(decrease) in deposits	644,590	(273,222)
Net decrease in Repo Sweep accounts	(1,325,131)	(162,167)
Net increase in advances from borrowers	240,185	268,295
Advances from Federal Home Loan Bank and notes payable	7,350,000	11,925,000
Repayments of Federal Home Loan Bank advances and notes payable	(4,350,000)	(18,955,927)
Net cash provided by (used for) financing activities	2,559,644	(7,198,021)
Net increase in cash and cash equivalents	2,023,812	2,336,384
Cash and cash equivalents at beginning of period	1,962,657	3,099,058
Cash and cash equivalents at end of period	$3,986,469	$5,435,442
Supplemental disclosure of cash flow information:		

Cash paid during the period for		
Interest	$1,203,998	$1,929,931
Income taxes	-	-
Transfers of loans to foreclosed real estate and repossessed assets	2,474,642	208,902

See accompanying notes to the consolidated financial statements.

FIRST FEDERAL OF NORTHERN MICHIGAN BANCORP, INC.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1—BASIS OF FINANCIAL STATEMENT PRESENTATION

The accompanying unaudited condensed consolidated interim financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and with the instructions to Form 10-Q. Accordingly, certain information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements are not included herein. The interim financial statements should be read in conjunction with the financial statements of First Federal of Northern Michigan Bancorp, Inc. and Subsidiaries and the notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2010.

All adjustments, consisting only of normal recurring adjustments, which in the opinion of management are necessary for a fair presentation of financial position, results of operations and cash flows, have been made. The results of operations for the three and six months ended June 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

Note 2— PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of First Federal of Northern Michigan Bancorp, Inc., First Federal of Northern Michigan, and the Bank's wholly owned subsidiaries, Financial Services & Mortgage Corporation ("FSMC") and FFNM Agency, Inc. FSMC invests in real estate, which includes leasing, selling, developing, and maintaining real estate properties. The main activity of FFNM Agency is to collect the stream of income associated with the sale of the Blue Cross/Blue Shield override to the Grotenhuis Group (as discussed further below). All significant intercompany balances and transactions have been eliminated in the consolidation.

Note 3—SECURITIES

Investment securities have been classified according to management's intent. The carrying value and estimated fair value of securities are as follows:

	June 30, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
	(in thousands)			
Securities Available for Sale				
U.S. Government and agency obligations	$ 14,396	$ 85	$ -	14,481
Municipal obligations	7,976	288	-	8,264
Mortgage-backed securities	24,562	372	(8)	24,926
Equity securities	2	-	(1)	1
Total	$ 46,936	$ 745	$ (9)	$ 47,672

Securities Held to Maturity				
Municipal obligations	$ 2,485	$ 159	$ (1)	$ 2,643

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	December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
	(in thousands)			
Securities Available for Sale				
U.S. Government and agency obligations	$ 4,518	$ 44	$ -	4,562
Municipal obligations	4,875	171	-	5,046
Mortgage-backed securities	25,684	83	(75)	25,692
Equity securities	3	-	(2)	1
Total	$ 35,080	$ 298	$ (77)	$ 35,301
Securities Held to Maturity				
Municipal obligations	$ 2,520	$ 90	$ (15)	$ 2,595

The amortized cost and estimated market value of securities at June 30, 2011, by contract maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities with no specified maturity date are separately stated.

	June 30, 2011	
	Amortized Cost	Market Value
	(in thousands)	
Available For Sale:		
Due in one year or less	$ 1,557	$ 1,561
Due after one year through five years	13,871	14,030
Due in five year through ten years	6,528	6,671
Due after ten years	416	483
Subtotal	22,372	22,745
Equity securities	2	1
Mortgage-backed securities	24,562	24,926
Total	$ 46,936	$ 47,672
Held To Maturity:		
Due in one year or less	$ 90	$ 91
Due after one year through five years	395	424
Due in five year through ten years	645	695
Due after ten years	1,355	1,433
Total	$ 2,485	$ 2,643

At June 30, 2011 and December 31, 2010, securities with a carrying value of $35,833,000 and $34,981,000, respectively, were pledged to secure certain deposit accounts, FHLB advances and our line of credit at the Federal

Reserve.

Gross proceeds from the sale of securities for the six-months ended June 30, 2011 and 2010 were $0 and $10,354,000, respectively, resulting in gross gains of $0 and $497,000, respectively and gross losses of $0 and $0, respectively.

The following is a summary of temporarily impaired investments that have been impaired for less than and more than twelve months as of June 30, 2011 and December 31, 2010:

June 30, 2011 (in thousands)	Fair Value	Gross Unrealized Losses <12 months	Fair Value	Gross Unrealized Losses > 12 months
Available For Sale:				
U.S. Government and agency obligations	$ -	$ -	$ -	$ -
Municipal obligations	-	-	-	-
Mortgage-backed securities	1,658	(8)	-	-
Equity securities	-	-	2	(1)
Total	$ 1,658	$ (8)	$ 2	$ (1)
Held to Maturity:				
Municipal obligations	$ -	$ -	$ 29	$ (1)

December 31, 2010 (in thousands)	Fair Value	Gross Unrealized Losses <12 months	Fair Value	Gross Unrealized Losses > 12 months
Available For Sale:				
U.S. Government and agency obligations	$ -	$ -	$ -	$ -
Municipal obligations	-	-	-	-
Mortgage-backed securities	12,626	(75)	-	-
Equity securities	3	(2)	-	-
Total	$ 12,629	$ (77)	$ -	$ -
Held to Maturity:				
Municipal obligations	$ 382	$ (13)	$ 28	$ (2)

The unrealized losses on the securities held in the portfolio are not considered other than temporary and have not been recognized into income. This decision is based on the Company's ability and intent to hold any potentially impaired security until maturity. The performance of the security is based on the contractual terms of the agreement, the extent of the impairment and the financial condition and credit quality of the issuer. The decline in market value is considered temporary and a result of changes in interest rates and other market variables.

Note 4—LOANS

The following table sets forth the composition of our loan portfolio by loan type at the dates indicated.

	At June 30, 2011	At December 31, 2010
	(in thousands)	
Real estate loans:		
Residential mortgage	$ 65,060	$ 71,697
Commercial loans:		
Secured by real estate	57,465	61,010
Other	8,208	8,848
Total commercial loans	65,673	69,858
Consumer loans:		
Secured by real estate	15,056	16,547
Other	1,474	2,118
Total consumer loans	16,530	18,665
Total gross loans	$ 147,263	$ 160,220
Less:		
Net deferred loan fees	(246)	(245)
Allowance for loan losses	(2,191)	(2,831)
Total loans, net	$ 144,826	$ 157,144

The following table illustrates the contractual aging of the recorded investment in past due loans by class of loans as of June 30, 2011 and December 31, 2010:

As of June 30, 2011

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
Commercial Real Estate:							
Commercial Real Estate - construction	$ -	$ -	$ 290	$ 290	$ 70	$ 360	$ -
Commercial Real Estate - other	447	-	514	961	56,144	57,105	-
Commercial - non real estate	-	-	-	-	8,208	8,208	-
Consumer:							
Consumer - Real Estate	272	112	158	542	14,514	15,056	-
Consumer - Other	17	13	1	31	1,443	1,474	1
Residential:							
Residential	2,935	1,191	2,771	6,897	58,163	65,060	340
Total	$ 3,671	$ 1,316	$ 3,734	$ 8,721	$ 138,542	$ 147,263	$ 341

As of December 31, 2010

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
Commercial Real Estate:							
Commercial Real Estate - construction	$ -	$ -	$ 1,772	$ 1,772	$ 1,498	$ 3,270	$ -
Commercial Real Estate - other	891	488	784	2,163	55,577	57,740	82
Commercial - non real estate	-	6	-	6	8,842	8,848	-
Consumer:							
Consumer - Real Estate	650	108	205	963	15,584	16,547	-
Consumer - Other	27	14	2	43	2,075	2,118	2
Residential:							
Residential	3,919	2,056	2,434	8,409	63,288	71,697	282
Total	$ 5,487	$ 2,672	$ 5,197	$ 13,356	$ 146,864	$ 160,220	$ 366

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The Bank uses an eight tier risk rating system to grade its commercial loans. The grade of a loan may change during the life of the loans. The risk ratings are described as follows:

Risk Grade 1 (Excellent) - Prime loans based on liquid collateral, with adequate margin or supported by strong financial statements. Probability of serious financial deterioration is unlikely. High liquidity, minimum risk, strong ratios, and low handling costs are common to these loans. This classification also includes all loans secured by certificates of deposit or cash equivalents.

Risk Grade 2 (Good) - Desirable loans of somewhat less stature than Grade 1, but with strong financial statements. Probability of serious financial deterioration is unlikely. These loans possess a sound repayment source (and/or a secondary source). These loans represent less than the normal degree of risk associated with the type of financing contemplated.

Risk Grade 3 (Satisfactory) - Satisfactory loans of average risk – may have some minor deficiency or vulnerability to changing economic conditions, but still fully collectible. There may be some minor weakness but with offsetting features or other support readily available. These loans present a normal degree of risk associated with the type of financing. Actual and projected indicators and market conditions provide satisfactory assurance that the credit shall perform in accordance with agreed terms.

Risk Grade 4 (Acceptable) - Loans considered satisfactory, but which are of slightly “below average” credit risk due to financial weaknesses or uncertainty. The loans warrant a somewhat higher than average level of monitoring to insure that weaknesses do not advance. The level of risk is considered acceptable and within normal underwriting guidelines, so long as the loan is given the proper level of management supervision.

Risk Grade 4.5 (Monitored) - Loans are considered “below average” and monitored more closely due to some credit deficiency that poses additional risk but is not considered adverse to the point of being a “classified” credit. Possible reasons for additional monitoring may include characteristics such as temporary negative debt service coverage due to weak economic conditions, borrower may have experienced recent losses from operations, declining equity and/or increasing leverage, or marginal liquidity that may affect long-term sustainability. Loans of this grade have a higher degree of risk and warrant close monitoring to insure against further deterioration.
In any tables presented subsequently, Risk Grade 4.5 credits are included with Risk Grade 4 credits.

Risk Grade 5 (Other Assets Especially Mentioned) (OAEM) - Loans which possess some credit deficiency or potential weakness, which deserve close attention, but which do not yet warrant substandard classification. Such loans pose unwarranted financial risk that, if not corrected, could weaken the loan and increase risk in the future.

Risk Grade 6 (Substandard) - Loans are “substandard” whose full, final collectability does not appear to be a matter of serious doubt, but which nevertheless portray some form of well defined weakness that requires close supervision by Bank management. The noted weaknesses involve more than normal banking risk. One or more of the following characteristics may be exhibited in loans classified Substandard: (1) Loans possess a defined credit weakness and the likelihood that the loan shall be paid from the primary source of repayment is uncertain; (2) Loans are not adequately protected by the current net worth and/or paying capacity of the obligor; (3) primary source of repayment is gone, and the Bank is forced to rely on a secondary source of repayment such as collateral liquidation or guarantees; (4) distinct possibility that the Bank shall sustain some loss if deficiencies are not corrected; (5) unusual courses of action are needed to maintain a high probability of repayment; (6) the borrower is not generating enough cash flow to repay loan principal, however, continues to make interest payments; (7) the Bank is forced into a subordinated or unsecured position due to flaws in documentation; (8) loans have been restructured so that payment schedules, terms, and collateral represent concessions to the borrower when compared to normal loan terms; (9) the Bank is contemplating foreclosure or legal action due to the apparent deterioration in the loan; or (10) there is a significant deterioration in the market conditions and the borrower is highly vulnerable to these conditions.

Grade 7 (Doubtful) - Loans have all the weaknesses of those classified Substandard. Additionally, however, these weaknesses make collection or liquidation in full, based on existing conditions, improbable. Loans in this category are typically not performing in conformance with established terms and conditions. Full repayment is considered "Doubtful", but extent of loss is not currently determinable.

Risk Grade 8 (Loss) - Loans are considered uncollectible and of such little value, that continuing to carry them as an asset on the Bank's financial statements is not feasible.

The following table presents the risk category of loans by class of loans based on the most recent analysis performed and the contractual aging as of June 30, 2011 and December 31, 2010:

As of June 30, 2011

Loan Grade	Commercial Real Estate Construction	Commercial Real Estate Other	Commercial
1-2	$ -	$ -	$ 2
3	70	13,169	2,793
4	-	30,362	5,049
5	-	5,179	364
6	290	8,395	-
7	-	-	-
8	-	-	-
Total	$ 360	$ 57,105	$ 8,208

As of December 31, 2010

Loan Grade	Commercial Real Estate Construction	Commercial Real Estate Other	Commercial
1-2	$ -	$ -	$ 5
3	70	12,411	2,958
4	1,428	33,754	5,631
5	-	3,245	248
6	1,772	8,330	6
7	-	-	-
8	-	-	-
Total	$ 3,270	$ 57,740	$ 8,848

For residential real estate and other consumer credit the Company also evaluates credit quality based on the aging status of the loan and by payment activity. Loans 60 or more days past due are monitored by the collection committee.

The following tables present the risk category of loans by class based on the most recent analysis performed as of June 30, 2011 and December 31, 2010:

As of June 30, 2011	As of December 31, 2010
Residential	Residential

Grade		Grade	
Pass	$ 61,774	Pass	$ 68,301
Special Mention	-	Special Mention	-
Substandard	3,286	Substandard	3,396
Total	$ 65,060	Total	$ 71,697

As of June 30, 2011

	Consumer - Real Estate	Consumer - Other
Performing	$ 14,880	$ 1,468
Nonperforming	176	7
Total	$ 15,056	$ 1,475

As of December 31, 2010

	Consumer - Real Estate	Consumer - Other
Performing	$ 16,341	$ 2,116
Nonperforming	206	2
Total	$ 16,547	$ 2,118

The following table presents the recorded investment in non-accrual loans by class as of June 30, 2011 and December 31, 2010:

	As of June 30, 2011
Commercial Real Estate:	
Commercial Real Estate - construction	$ 290
Commercial Real Estate - other	514
Commercial	-
Consumer:	
Consumer - real estate	176
Consumer - other	6
Residential:	
Residential	2,946
Total	$ 3,932

	As of December 31, 2010
Commercial Real Estate:	
Commercial Real Estate - construction	$ 1,772
Commercial Real Estate - other	1,148
Commercial	-
Consumer:	
Consumer - real estate	206
Consumer - other	-

Residential:		
Residential		3,114
Total	$	6,240

The key features of the Company's loan modifications are determined on a loan-by-loan basis. Generally, our restructurings have related to interest rate reductions and loan term extensions. In the past the Company has granted reductions in interest rates, payment extensions and short-term payment forbearances as a means to maximize collectability of troubled credits. The Company has not forgiven principal to date, although this would be considered if necessary to ensure the long-term collectability of the loan. The Company's loan modifications are typically short-term in nature, although the Company would consider a long-term modification to ensure the long-term collectability of the credit. In general, a borrower must make at least six consecutive timely payments before the Company would consider a return of a restructured loan to accruing status in accordance with Federal Deposit Insurance Corporation guidelines regarding restoration of credits to accrual status.

The Bank has classified approximately $1,415,000 of its impaired loans as troubled debt restructurings as of June 30, 2011, as noted in the table below:

As of June 30, 2011

	Number of Contracts	Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Commercial Real Estate - Construction	-	-	-
Commercial Real Estate - Other	3	1,488	1,415
Commercial - non real estate	-	-	-
Residential	-	-	-

	Number of Contracts	Recorded Investment
Troubled Debt Restructurings That Subsequently Defaulted		
Commercial Real Estate - Construction	-	-
Commercial Real Estate - Other	-	-
Commercial - non real estate	-	-
Residential	-	-

For the majority of the Bank's impaired loans, the Bank will apply the observable market price methodology. However, the Bank may also utilize a measurement incorporating the present value of expected future cash flows discounted at the loan's effective rate of interest. To determine observable market price, collateral asset values securing an impaired loan are periodically evaluated. Maximum time of re-evaluation is every 12 months. In this process, third party evaluations are obtained and heavily relied upon. Until such time that updated evaluations are received, the Bank may discount the collateral value used.

The Bank uses the following guidelines as stated in policy to determine when to realize a charge-off, whether a partial or full loan balance. A charge down in whole or in part is realized when unsecured consumer loans, credit card credits and overdraft lines of credit reach 90 days delinquency. At 120 days delinquency, secured consumer loans are charged down to the value of collateral, if repossession of the collateral is assured and/or in the process of repossession.

Consumer mortgage loan deficiencies are charged down upon the sale of the collateral or sooner upon the recognition of collateral deficiency. Commercial credits are charged down at 90 days delinquency, unless an established and approved work-out plan is in place or litigation of the credit will likely result in recovery of the loan balance. Upon notification of bankruptcy, unsecured debt is charged off. Additional charge-offs may be realized as further unsecured positions are recognized.

The following table presents loans individually evaluated for impairment by class of loans as of June 30, 2011 and December 31, 2010:

As of June 30, 2011

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$ -	$ -	$ -	$ -	$ -
Commercial Real Estate - Construction	-	-	-	-	-
Commercial Real Estate - Other	60	60	-	60	-
Consumer - Real Estate	68	68	-	70	-
Consumer - Other	6	6	-	7	-
Residential	2,527	2,451	-	2,460	-
With a specific allowance recorded:					
Commercial	-	-	-	-	-
Commercial Real Estate - Construction	290	290	150	290	-
Commercial Real Estate - Other	1,236	1,236	245	1,239	-
Consumer - Real Estate	109	108	20	108	-
Consumer - Other	-	-	-	-	-
Residential	495	495	129	494	-
Totals:					
Commercial	$ -	$ -	$ -	$ -	$ -
Commercial Real Estate - Construction	$ 290	$ 290	$ 150	$ 290	$ -
Commercial Real Estate - Other	$ 1,296	$ 1,296	$ 245	$ 1,299	$ -
Consumer - Real Estate	$ 177	$ 176	$ 20	$ 178	$ -
Consumer - Other	$ 6	$ 6	$ -	$ 7	$ -
Residential	$ 3,022	$ 2,946	$ 129	$ 2,954	$ -

As of December 31, 2010

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$ -	$ -	$ -	$ -	$ -
	-	-	-	-	-

Commercial Real Estate - Construction					
Commercial Real Estate - Other	822	674	-	667	-
Consumer - Real Estate	124	123	-	193	-
Consumer - Other	-	-	-	-	-
Residential	1,842	1,770	-	1,803	-
With a specific allowance recorded:					
Commercial	-	-	-	-	-
Commercial Real Estate - Construction	3,449	1,772	305	1,805	-
Commercial Real Estate - Other	586	474	89	1,132	-
Consumer - Real Estate	83	83	25	14	-
Consumer - Other	-	-	-	-	-
Residential	1,416	1,344	165	1,330	-
Totals:					
Commercial	$ -	$ -	$ -	$ -	$ -
Commercial Real Estate - Construction	$ 3,449	$ 1,772	$ 305	$ 1,805	$ -
Commercial Real Estate - Other	$ 1,408	$ 1,148	$ 89	$ 1,132	$ -
Consumer - Real Estate	$ 207	$ 206	$ 25	$ 207	$ -
Consumer - Other	$ -	$ -	$ -	$ -	$ -
Residential	$ 3,258	$ 3,114	$ 165	$ 3,133	$ -

The ALLL has a direct impact on the provision expense. An increase in the ALLL is funded through recoveries and provision expense.

Activity in the allowance for loan and lease losses was as follows for the quarter and year ended June 30, 2011 and December 31, 2010, respectively:

For the Six Months Ended June 30, 2011

	Commercial Construction	Commercial Real Estate	Commercial	Consumer Real Estate	Consumer	Residential	Unallocated	Total
Allowance for credit losses:								
Beginning Balance	$ 535	$ 1,281	$ 192	$ 228	$ 59	$ 536	$ -	$2,831
Charge-offs	(94)	(119)	(6)	(83)	(18)	(404)	-	$(724)
Recoveries	-	3	-	23	7	3	-	$36
Provision	(277)	(103)	(34)	50	(26)	438	-	$48
Ending Balance	$ 164	$ 1,062	$ 152	$ 218	$ 22	$ 573	$ -	$2,191
Ending balance: individually evaluated for impairment	$ 150	$ 245	$ -	$ 20	$ -	$ 129	$ -	$544
Ending balance: loans collectively evaluated for impairment	$ 14	$ 817	$ 152	$ 198	$ 22	$ 444	$ -	$1,647
Ending balance: loans acquired with deteriorated credit quality	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$-
Financing Receivables:								
Ending Balance	$ 360	$ 57,105	$ 8,208	$ 15,056	$ 1,474	$ 65,060	$ -	$147,263
Ending balance: individually evaluated for impairment	$ 290	$ 1,296	$ -	$ 176	$ 6	$ 2,946	$ -	$4,714
Ending balance: loans collectively evaluated for impairment	$ 70	$ 55,809	$ 8,208	$ 14,880	$ 1,468	$ 62,114	$ -	$142,549
Ending balance: loans acquired with deteriorated credit quality	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$-

For the Year Ended December 31, 2010

	Commercial Construction	Commercial Real Estate	Commercial	Consumer Real Estate	Consumer	Residential	Unallocated	Total

Allowance for credit losses:								
Beginning Balance	$ 997	$ 1,513	$ 245	$ 211	$ 45	$ 649	$ -	$3,660
Charge-offs	(1,013)	(512)	-	(220)	(99)	(258)	-	(2,102)
Recoveries	60	85	-	14	11	2	-	172
Provision	491	195	(53)	223	102	143	-	1,101
Ending Balance	$ 535	$ 1,281	$ 192	$ 228	$ 59	$ 536	$ -	$2,831
Ending balance: individually evaluated for impairment	$ 305	$ 89	$ -	$ 25	$ -	$ 165	$ -	$584
Ending balance: loans collectively evaluated for impairment	$ 230	$ 1,192	$ 192	$ 203	$ 59	$ 371	$ -	$2,247
Ending balance: loans acquired with deteriorated credit quality	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$-
Financing Receivables:								
Ending Balance	$ 3,270	$ 57,740	$ 8,848	$ 16,547	$ 2,118	$ 71,697	$ -	$160,220
Ending balance: individually evaluated for impairment	$ 1,772	$ 1,148	$ -	$ 206	$ -	$ 3,114	$ -	$6,240
Ending balance: loans collectively evaluated for impairment	$ 1,498	$ 56,592	$ 8,848	$ 16,341	$ 2,118	$ 68,583	$ -	$153,980
Ending balance: loans acquired with deteriorated credit quality	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$-

Note 5—DIVIDENDS

We suspended our quarterly dividend effective for the quarter ended December 31, 2008. We are dependent primarily upon the Bank for earnings and funds to pay dividends on common stock. The payment of dividends also is subject to legal and regulatory restrictions. Any reinstatement of dividends in the future will depend, in large part, on the Bank's earnings, capital requirements, financial condition and other factors considered by the Board of Directors.

Note 6—STOCK-BASED COMPENSATION

Effective January 1, 2006, the Company adopted Statement of FASB ASC 718-10 “Shareholder Based Payments”, which requires that the grant-date fair value of awarded stock options be expensed over the requisite service period. The Company’s 1996 Stock Option Plan (the “1996 Plan”), which was approved by shareholders, permits the grant of share options to its employees for up to 127,491 shares of common stock (adjusted for the exchange ratio applied in the Company’s 2005 stock offering and related second-step conversion). The Company’s 2006 Stock-Based Incentive Plan (the “2006 Plan”), which was approved by the shareholders on May 17, 2006, permits the award of up to 242,740 shares of common stock of which the maximum number to be granted as Stock Options is 173,386 and the maximum that can be granted as Restricted Stock Awards is 69,354. Option awards are granted with an exercise price equal to the market price of the Company’s stock at the date of grant; those option awards generally vest based on five years of continual service and have ten year contractual terms. Certain options provide for accelerated vesting if there is a change in control (as defined in the Plans).

During the three and six months ended June 30, 2011, no shares were awarded under the Recognition and Retention Plan (“RRP”). Shares issued under the RRP and exercised pursuant to the exercise of the stock option plan may be either authorized but unissued shares or reacquired shares held by the Company as treasury stock.

Stock Options - A summary of option activity under the Plans during the six months ended June 30, 2011 is presented below:

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2011	186,132	$ 9.47		
Granted	0	N/A		
Exercised	0	N/A		
Forfeited or expired	0	N/A		
Oustanding at June 30, 2011	186,132	$ 9.47	4.81	$ 0
Options Exercisable at June 30, 2011	184,652	$ 9.48	4.75	$ 0

The aggregate intrinsic value of outstanding options shown in the table above represents the total pretax intrinsic value (i.e. the difference between the Company’s closing stock price of $3.75 on June 30, 2011 and the exercise price times the number of shares) that would have been received by the option holder had all option holders exercised their options on June 30, 2011. This amount changes based on the fair market value of the stock.

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As of June 30, 2011 there was $2,000 of total unrecognized compensation cost, net of expected forfeitures, related to nonvested options under the Plans. That cost is expected to be recognized over a weighted-average period of 1.0 years. The total fair value of options vested during the six months ended June 30, 2011 was $135,992.

A summary of the status of the Company's nonvested options as of June 30, 2011, and changes during the six months ended June 30, 2011, is presented below:

Weighted-Average