

FIDELITY SOUTHERN CORP

Form 10-Q

November 14, 2011

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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 September 30, 2011**

**Commission File Number: 001-34981**

**Fidelity Southern Corporation**

(Exact name of registrant as specified in its charter)

Georgia

(State or other jurisdiction of incorporation or organization)

58-1416811

(I.R.S. Employer Identification No.)

3490 Piedmont Road, Suite 1550, Atlanta GA  
(Address of principal executive offices)

30305

(Zip Code)

(404) 639-6500

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See 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

Smaller Reporting Company

(Do not check if a 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.

Class  
Common Stock, no par value

Shares Outstanding at October 31, 2011  
13,048,328



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**PART I FINANCIAL INFORMATION**  
**Item 1. Financial Statements**  
**FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

|  | (Unaudited)<br>September<br>30,<br>2011 | December 31,<br>2010 |
|--|---|----------------------|
|  | <i>(Dollars in thousands)</i>           |                      |
| <b>Assets</b>  |   |                      |
| Cash and due from banks  | \$ 114,837                              | \$ 45,761            |
| Interest-bearing deposits with banks   | 2,587                                   | 1,481                |
| Federal funds sold   | 810                                     | 517                  |
| Cash and cash equivalents  | 118,234                                 | 47,759               |
| Investment securities available-for-sale (amortized cost of \$233,691 and \$160,740 at September 30, 2011 and December 31, 2010, respectively)     | 238,488                                 | 161,478              |
| Investment securities held-to-maturity (approximate fair value of \$10,525 and \$14,926 at September 30, 2011 and December 31, 2010, respectively) | 9,680                                   | 14,110               |
| Investment in FHLB stock   | 6,413                                   | 6,542                |
| Loans held-for-sale (loans at fair value: \$71,063 at September 30, 2011; \$155,029 at December 31, 2010)  | 125,268                                 | 209,898              |
| Loans  | 1,500,094                               | 1,403,372            |
| Allowance for loan losses  | (29,381)                                | (28,082)             |
| Loans, net of allowance for loan losses  | 1,470,713                               | 1,375,290            |
| Premises and equipment, net  | 22,057                                  | 19,510               |
| Other real estate, net   | 24,494                                  | 20,525               |
| Accrued interest receivable  | 7,825                                   | 7,990                |
| Bank owned life insurance  | 31,183                                  | 30,275               |
| Other assets   | 55,320                                  | 51,923               |
| Total Assets   | \$ 2,109,675                            | \$ 1,945,300         |
| <b>Liabilities</b>   |   |                      |
| Deposits:  |   |                      |
| Noninterest-bearing demand deposits  | \$ 247,660                              | \$ 185,614           |
| Interest-bearing deposits:   |   |                      |
| Demand and money market  | 447,154                                 | 427,590              |
| Savings  | 401,759                                 | 398,012              |
| Time deposits, \$100,000 and over  | 322,251                                 | 246,317              |
| Other time deposits  | 346,693                                 | 355,715              |
| Total deposits   | 1,765,517                               | 1,613,248            |
| Other short-term borrowings  | 40,011                                  | 32,977               |
| Subordinated debt  | 67,527                                  | 67,527               |

|                          |                  |           |
|--------------------------|------------------|-----------|
| Other long-term debt     | <b>52,500</b>    | 75,000    |
| Accrued interest payable | <b>2,078</b>     | 2,973     |
| Other liabilities        | <b>19,030</b>    | 13,064    |
| <b>Total liabilities</b> | <b>1,946,663</b> | 1,804,789 |

**Shareholders Equity**

|   |                     |              |
|---|---------------------|--------------|
| Preferred stock, no par value. Authorized 10,000,000; 48,200 shares issued and outstanding  | <b>46,240</b>       | 45,578       |
| Common stock, no par value. Authorized 50,000,000; issued and outstanding 13,034,346 and 10,829,492 at September 30, 2011 and December 31, 2010 | <b>72,320</b>       | 57,542       |
| Unrealized gain on investments, net of tax  | <b>2,974</b>        | 458          |
| Retained earnings   | <b>41,478</b>       | 36,933       |
| <b>Total shareholders equity</b>  | <b>163,012</b>      | 140,511      |
| <b>Total liabilities and shareholders equity</b>  | <b>\$ 2,109,675</b> | \$ 1,945,300 |

*See accompanying notes to consolidated financial statements*

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**FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**(UNAUDITED)**

|  | Nine Months Ended<br>September 30,                   |           | Three Months Ended<br>September 30, |           |
|--|--|-----------|-------------------------------------|-----------|
|  | 2011   | 2010      | 2011                                | 2010      |
|  | <i>(Dollars in thousands, except per share data)</i> |           |                                     |           |
| <b>Interest income</b>                                     |  |           |                                     |           |
| Loans, including fees                                      | \$ 64,302  | \$ 64,886 | \$ 21,258                           | \$ 22,068 |
| Investment securities                                      | 4,994  | 6,350     | 1,592                               | 1,602     |
| Federal funds sold and bank deposits                       | 199  | 149       | 109                                 | 43        |
| Total interest income                                      | <b>69,495</b>  | 71,385    | <b>22,959</b>                       | 23,713    |
| <b>Interest expense</b>                                    |  |           |                                     |           |
| Deposits   | 12,790   | 18,732    | 3,810                               | 5,507     |
| Short-term borrowings                                      | 512  | 898       | 168                                 | 185       |
| Subordinated debt  | 3,365  | 3,378     | 1,122                               | 1,138     |
| Other long-term debt                                       | 1,056  | 1,135     | 304                                 | 446       |
| Total interest expense                                     | <b>17,723</b>  | 24,143    | <b>5,404</b>                        | 7,276     |
| <b>Net interest income</b>                                 | <b>51,772</b>  | 47,242    | <b>17,555</b>                       | 16,437    |
| Provision for loan losses                                  | <b>15,025</b>  | 10,150    | <b>4,400</b>                        | 5,025     |
| <b>Net interest income after provision for loan losses</b> | <b>36,747</b>  | 37,092    | <b>13,155</b>                       | 11,412    |
| <b>Noninterest income</b>                                  |  |           |                                     |           |
| Service charges on deposit accounts                        | 2,995  | 3,291     | 1,023                               | 1,072     |
| Other fees and charges                                     | 1,929  | 1,596     | 676                                 | 553       |
| Mortgage banking activities                                | 16,629   | 14,842    | 5,186                               | 7,042     |
| Indirect lending activities                                | 4,310  | 3,397     | 1,600                               | 1,200     |
| SBA lending activities                                     | 6,592  | 1,797     | 756                                 | 951       |
| Bank owned life insurance                                  | 979  | 980       | 326                                 | 324       |
| Securities gains   | 1,078  | 2,291     |                                     |           |
| Other  | 1,246  | 1,122     | 411                                 | 419       |
| Total noninterest income                                   | <b>35,758</b>  | 29,316    | <b>9,978</b>                        | 11,561    |
| <b>Noninterest expense</b>                                 |  |           |                                     |           |
| Salaries and employee benefits                             | 34,115   | 30,634    | 11,652                              | 11,729    |
| Furniture and equipment                                    | 2,280  | 2,002     | 737                                 | 684       |
| Net occupancy  | 3,389  | 3,374     | 1,094                               | 1,159     |
| Communication  | 1,636  | 1,390     | 541                                 | 471       |
| Professional and other services                            | 4,119  | 3,391     | 1,474                               | 1,279     |

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|   |                   |            |                   |            |
|---|-------------------|------------|-------------------|------------|
| Other real estate expense                                   | <b>5,567</b>      | 5,939      | <b>1,316</b>      | 1,412      |
| FDIC insurance premiums                                     | <b>2,136</b>      | 2,657      | <b>428</b>        | 890        |
| Other   | <b>8,531</b>      | 6,409      | <b>3,173</b>      | 2,355      |
| Total noninterest expense                                   | <b>61,773</b>     | 55,796     | <b>20,415</b>     | 19,979     |
| Income before income tax expense                            | <b>10,732</b>     | 10,612     | <b>2,718</b>      | 2,994      |
| Income tax expense  | <b>3,166</b>      | 3,467      | <b>608</b>        | 913        |
| <b>Net income</b>   | <b>7,566</b>      | 7,145      | <b>2,110</b>      | 2,081      |
| Preferred stock dividends                                   | <b>(2,469)</b>    | (2,469)    | <b>(823)</b>      | (823)      |
| <b>Net income available to common equity</b>                | <b>\$ 5,097</b>   | \$ 4,676   | <b>\$ 1,287</b>   | \$ 1,258   |
| Earnings per share:   |                   |            |                   |            |
| Basic earnings per share                                    | <b>\$ 0.43</b>    | \$ 0.43    | <b>\$ 0.10</b>    | \$ 0.12    |
| Diluted earnings per share                                  | <b>\$ 0.38</b>    | \$ 0.39    | <b>\$ 0.09</b>    | \$ 0.10    |
| Weighted average common shares<br>outstanding-basic         | <b>11,862,364</b> | 10,819,597 | <b>13,031,875</b> | 10,819,597 |
| Weighted average common shares<br>outstanding-fully diluted | <b>13,348,764</b> | 12,118,745 | <b>14,410,371</b> | 12,118,745 |

*See accompanying notes to consolidated financial statements.*



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**FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

|   | <b>Nine Months Ended</b> |               |
|---|--------------------------|---------------|
|   | <b>September 30,</b>     |               |
|   | <b>2011</b>              | <b>2010</b>   |
|   | <i>(In thousands)</i>    |               |
| <b>Operating Activities</b>   |                          |               |
| Net income  | \$ 7,566                 | \$ 7,145      |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                          |               |
| Provision for loan losses   | 15,025                   | 10,150        |
| Depreciation and amortization of premises and equipment                                     | 1,515                    | 1,344         |
| Other amortization  | 2,190                    | 1,372         |
| Reserve for impairment of other real estate   | 3,532                    | 3,588         |
| Share-based compensation  | 23                       | 186           |
| Proceeds from sales of loans  | 1,036,728                | 829,134       |
| Proceeds from sales of other real estate  | 11,950                   | 10,118        |
| Loans originated for resale   | (932,597)                | (874,641)     |
| Gain on loan sales  | (19,501)                 | (9,756)       |
| Gain on sales of investment securities  | (1,078)                  | (2,291)       |
| Gain on sales of other real estate  | (547)                    | (541)         |
| Increase in cash value of bank owned life insurance   | (908)                    | (909)         |
| Net increase in deferred income taxes   | (1,608)                  | (2,097)       |
| Changes in assets and liabilities which provided (used) cash:                               |                          |               |
| Accrued interest receivable   | 165                      | (316)         |
| Other assets  | (4,758)                  | 5,759         |
| Accrued interest payable  | (895)                    | (1,833)       |
| Other liabilities   | 5,966                    | 3,907         |
| <br>Net cash provided by (used in) operating activities                                     | <br>122,768              | <br>(19,681)  |
| <b>Investing Activities</b>   |                          |               |
| Purchases of investment securities available-for-sale                                       | (171,838)                | (230,141)     |
| Purchases of investment in FHLB stock   |                          | (90)          |
| Proceeds from sale of investment securities available-for-sale                              | 32,781                   | 94,676        |
| Maturities and calls of investment securities held-to-maturity                              | 4,437                    | 3,643         |
| Maturities and calls of investment securities available-for-sale                            | 66,414                   | 123,921       |
| Redemption of investment in FHLB stock  | 129                      | 315           |
| Net increase in loans   | (129,353)                | (89,605)      |
| Capital improvements to other real estate   |                          | (350)         |
| Purchases of premises and equipment   | (4,062)                  | (2,481)       |
| <br>Net cash used in investing activities   | <br>(201,492)            | <br>(100,112) |
| <b>Financing Activities</b>   |                          |               |
| Net increase in transactional accounts  | 85,357                   | 132,047       |

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|  |                   |           |
|--|-------------------|-----------|
| Net increase (decrease) in time deposits             | <b>66,912</b>     | (121,598) |
| Net (decrease) increase in borrowings                | <b>(15,466)</b>   | 5,845     |
| Dividends paid                                       | <b>(135)</b>      | (6)       |
| Proceeds from the issuance of common stock           | <b>14,338</b>     | 2,195     |
| Preferred stock dividends paid                       | <b>(1,807)</b>    | (1,807)   |
| Net cash provided by financing activities            | <b>149,199</b>    | 16,676    |
| Net increase (decrease) in cash and cash equivalents | <b>70,475</b>     | (103,117) |
| Cash and cash equivalents, beginning of period       | <b>47,759</b>     | 171,120   |
| Cash and cash equivalents, end of period             | <b>\$ 118,234</b> | \$ 68,003 |
| Supplemental disclosures of cash flow information:   |                   |           |
| Cash paid during the period for:                     |                   |           |
| Interest   | <b>\$ 18,618</b>  | \$ 25,976 |
| Income taxes   | <b>\$ 8,886</b>   | \$ 2,278  |
| Non-cash transfers to other real estate              | <b>\$ 18,904</b>  | \$ 12,287 |
| Accretion on U.S. Treasury preferred stock           | <b>\$ 662</b>     | \$ 662    |
| Loans transferred from held-for-sale                 | <b>\$ 1,586</b>   | \$ 3,884  |

*See accompanying notes to consolidated financial statements.*

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**FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)  
SEPTEMBER 30, 2011**

**1. Basis of Presentation**

The accompanying unaudited consolidated financial statements include the accounts of Fidelity Southern Corporation and its wholly owned subsidiaries ( Fidelity ). Fidelity Southern Corporation ( FSC ) owns 100% of Fidelity Bank (the Bank ), and LionMark Insurance Company, an insurance agency offering consumer credit related insurance products. FSC also owns five subsidiaries established to issue trust preferred securities, which entities are not consolidated for financial reporting purposes in accordance with Accounting Standards Codification ( ASC ) 942-810-55, as FSC is not the primary beneficiary. The Company , as used herein, includes FSC and its subsidiaries, unless the context otherwise requires.

These unaudited consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles followed within the financial services industry for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required for complete financial statements.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the periods covered by the statements of income. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of mortgage loans held-for-sale, the calculations of and the amortization of capitalized servicing rights, the valuation of net deferred income taxes and the valuation of real estate or other assets acquired in connection with foreclosures or in satisfaction of loans. In addition, the actual lives of certain amortizable assets and income items are estimates subject to change. The Company principally operates in one business segment, which is community banking.

In the opinion of management, all adjustments considered necessary for a fair presentation of the financial position and results of operations for the interim periods have been included. All such adjustments are normal recurring accruals. Certain previously reported amounts have been reclassified to conform to current presentation. These reclassifications had no impact on previously reported net income, or shareholders' equity or cash flows. The Company's significant accounting policies are described in Note 1 of the Notes to Consolidated Financial Statements included in our 2010 Annual Report on Form 10-K filed with the Securities and Exchange Commission. There were no new accounting policies or changes to existing policies adopted in the first nine months of 2011, which had a significant effect on the results of operations or statement of financial condition. For interim reporting purposes, the Company follows the same basic accounting policies and considers each interim period as an integral part of an annual period.

Operating results for the nine month period ended September 30, 2011, are not necessarily indicative of the results that may be expected for the year ended December 31, 2011. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K and Annual Report to Shareholders for the year ended December 31, 2010.

**2. Shareholders' Equity**

The Board of Governors of the Federal Reserve System (the FRB ) is the primary regulator of FSC, a bank holding company. The Bank is a state chartered commercial bank subject to Federal and state statutes applicable to banks chartered under the banking laws of the State of Georgia and to banks whose deposits are insured by the Federal Deposit Insurance Corporation (the FDIC ), the Bank's primary Federal regulator. The Bank is a wholly owned subsidiary of the Company. The Bank's state regulator is the Georgia Department of Banking and Finance (the GDBF ). The FDIC and the GDBF examine and evaluate the financial condition, operations, and policies and procedures of state chartered commercial banks, such as the Bank, as part of their legally prescribed oversight responsibilities. The FRB, FDIC, and GDBF have established capital adequacy requirements as a function of their oversight of bank holding companies and state chartered banks. Each bank holding company and each bank must maintain certain

minimum capital ratios. At September 30, 2011 and December 31, 2010, the Company exceeded all capital ratios required by the FRB, FDIC, and GDBF to be considered well capitalized.

In May 2011, the Company increased capital \$14.4 million in a private placement of common stock. The 2,167,166 shares were sold for \$6.65 per share, with no investor purchasing shares resulting in beneficial ownership of more than 9.9% of the Company's common stock.

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Earnings per share were calculated as follows:

|   | <b>For the Quarter Ended September 30,</b>           |             |
|---|--|-------------|
|   | <b>2011</b>  | <b>2010</b> |
|   | <i>(Dollars in thousands, except per share data)</i> |             |
| Net income  | \$ 2,110   | \$ 2,081    |
| Less dividends on preferred stock and accretion of discount | (823)  | (823)       |
| Net income available to common equity                       | \$ 1,287   | \$ 1,258    |
| Average common shares outstanding                           | 12,967   | 10,550      |
| Effect of stock dividends                                   | 65   | 266         |
| Average common shares outstanding basic                     | 13,032   | 10,816      |
| Dilutive stock options and warrants                         | 1,378  | 1,378       |
| Average common shares outstanding dilutive                  | 14,410   | 12,194      |
| Earnings per share basic                                    | \$ 0.10  | \$ 0.12     |
| Earnings per share dilutive                                 | \$ 0.09  | \$ 0.10     |
|   | <b>For the Nine Months Ended September</b>           |             |
|   | <b>30,</b>   |             |
|   | <b>2011</b>  | <b>2010</b> |
|   | <i>(Dollars in thousands, except per share data)</i> |             |
| Net income  | \$ 7,566   | \$ 7,145    |
| Less dividends on preferred stock and accretion of discount | (2,469)  | (2,469)     |
| Net income available to common equity                       | \$ 5,097   | \$ 4,676    |
| Average common shares outstanding                           | 11,803   | 10,659      |
| Effect of stock dividends                                   | 59   | 161         |
| Average common shares outstanding basic                     | 11,862   | 10,820      |
| Dilutive stock options and warrants                         | 1,487  | 1,299       |
| Average common shares outstanding dilutive                  | 13,349   | 12,119      |
| Earnings per share basic                                    | \$ 0.43  | \$ 0.43     |

|                             |    |             |    |      |
|-----------------------------|----|-------------|----|------|
| Earnings per share dilutive | \$ | <b>0.38</b> | \$ | 0.39 |
|-----------------------------|----|-------------|----|------|

Average number of shares for 2011 and 2010 includes participating securities related to unvested restricted stock awards. There were 150,907 in common stock options with an average exercise price of \$18.37 at September 30, 2011, and 158,407 in options with an average price of \$18.38 at September 30, 2010, which would have been included in the calculation of dilutive earnings per share except that to do so would have an anti-dilutive impact on earnings per share.

### **3. Contingencies**

Due to the nature of their activities, the Company and its subsidiaries are at times engaged in various legal proceedings that arise in the course of normal business, some of which were outstanding as of September 30, 2011. While it is difficult to predict or determine the outcome of these proceedings, it is the opinion of management, after consultation with its legal counsel, that the ultimate liabilities, if any, will not have a material adverse impact on the Company's consolidated results of operations, financial position, or cash flows.

### **4. Comprehensive Income**

Comprehensive income includes net income and other comprehensive income (loss), related to unrealized gains and losses on investment securities classified as available-for-sale. All other comprehensive income (loss) items are tax effected at a rate of 38% for each period.

During the third quarter and first nine months of 2011, other comprehensive income net of tax was \$1.7 million and \$2.5 million, respectively. Other comprehensive income, net of tax, was \$292,000 and \$1.6 million for the comparable periods in 2010. Comprehensive income for the third quarter and first nine months of 2011 was \$3.8 million and \$10.1 million, respectively, compared to \$2.4 million and \$8.8 million for the same periods in 2010.

**Table of Contents****5. Share-Based Compensation**

The Company's 1997 Stock Option Plan authorized the grant of options to management personnel for up to 500,000 shares of the Company's common stock. All options granted have three year to eight year terms and vest and become fully exercisable at the end of three years to five years of continued employment. No options may be or were granted after June 30, 2007, under this plan.

The Fidelity Southern Corporation Equity Incentive Plan (the 2006 Incentive Plan), as amended, permits the grant of stock options, stock appreciation rights, restricted stock and other incentive awards ( Incentive Awards ). Pursuant to an amendment to the Plan adopted by the shareholders on April 26, 2011, the maximum number of shares of the Company's common stock that may be issued under the 2006 Incentive Plan is 2,250,000 shares, all of which may be stock options. Generally, no award shall be exercisable or become vested or payable more than 10 years after the date of grant. Options granted under the 2006 Incentive Plan have four year terms and become fully exercisable at the end of three years of continued employment. Incentive awards available under the 2006 Incentive Plan totaled 212,227 shares at September 30, 2011.

In the first quarter of 2010, FSC granted 154,078 restricted shares of common stock under the 2006 Equity Incentive Plan to certain employees. The stock was granted at \$4.50 per share, vests 40% after two years and then 20% per year through five years and will be fully vested after January 22, 2015. The restricted stock is subject to section 111 of the Emergency Economic Stabilization Act of 2008, as amended by the American Recovery and Reinvestment Act of 2009 and regulations issued by the Department of the Treasury. At September 30, 2011, there was \$451,000 in remaining unrecognized compensation cost related to the restricted stock.

A summary of option activity as of September 30, 2011, and changes during the nine month period then ended is presented below:

|                                   | Number of<br>share<br>options | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Terms | Aggregate<br>Intrinsic<br>Value |
|-----------------------------------|-------------------------------|--|--|---------------------------------|
| Outstanding at January 1, 2011    | 492,239                       | \$ 8.59                                  |  |                                 |
| Granted                           |                               |  |  |                                 |
| Exercised                         | 334                           | 8.57                                     |  |                                 |
| Forfeited                         | 121,000                       | 18.70                                    |  |                                 |
| Outstanding at September 30, 2011 | 370,905                       | \$ 5.30                                  | 1.8 years  | \$ 434,000                      |
| Exercisable at September 30, 2011 | 370,905                       | \$ 5.30                                  | 1.8 years  | \$ 434,000                      |

Share-based compensation expense was not significant for the three month and nine month periods ended September 30, 2011.

**6. Fair Value Election and Measurement**

The Company adopted the provisions of SFAS No. 157, Fair Value Measurements, now codified in FASB ASC 820-10-35, for financial assets and financial liabilities, which establishes a common definition of fair value and framework for measuring fair value under U.S. GAAP. Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. FASB ASC 820-10-35 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820-10-35 are described below:

Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 Quoted prices in markets that are not active, or inputs that are observable, either directly, for substantially the full term of the asset or liability;

Level 3 Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).



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A financial instrument's level within the hierarchy is based on the lowest level of input that is significant to the fair value measurement.

In certain circumstances, fair value enables a company to more accurately align its financial performance with the economic value of hedged assets. Fair value enables a company to mitigate the non-economic earnings volatility caused from financial assets and financial liabilities being carried at different bases of accounting, as well as to more accurately portray the active and dynamic management of a company's balance sheet.

In accordance with SFAS No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities" which is now codified in ASC 825-10-25, the Company has elected to record mortgage loans held-for-sale at fair value. The following is a description of mortgage loans held-for-sale as of September 30, 2011, including the specific reasons for electing fair value and the strategies for managing these assets on a fair value basis.

**Mortgage Loans Held-for-Sale**

The Company records mortgage loans held-for-sale at fair value in order to eliminate the complexities and inherent difficulties of achieving hedge accounting and to better align reported results with the underlying economic changes in value of the loans and related hedge instruments. This election impacts the timing and recognition of origination fees and costs, as well as servicing value. Specifically, origination fees and costs, which had been appropriately deferred under SFAS No. 91 "Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases" now codified in ASC 310-20-25 and previously recognized as part of the gain/loss on sale of the loans, are now recognized in earnings at the time of origination. Interest income on mortgage loans held-for-sale is recorded on an accrual basis in the consolidated statement of income under the heading "Interest income - loans, including fees". The servicing value is included in the fair value of the Interest Rate Lock Commitments (IRLCs) with borrowers. The mark to market adjustments related to loans held-for-sale and the associated economic hedges are captured in mortgage banking activities.

**Valuation Methodologies and Fair Value Hierarchy**

The primary financial instruments that the Company carries at fair value include investment securities, IRLCs, derivative instruments, and loans held-for-sale. Classification in the fair value hierarchy of financial instruments is based on the criteria set forth in SFAS No. 157, now codified in FASB ASC 820-10-35.

Debt securities issued by U.S. Government corporations and agencies, debt securities issued by states and political subdivisions, and agency residential mortgage backed securities classified as available-for-sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. The investments in the Company's portfolio are generally not quoted on an exchange but are actively traded in the secondary institutional markets.

The fair value of mortgage loans held-for-sale is based on what secondary markets are currently offering for portfolios with similar characteristics predominantly consisting of those conforming to government sponsored entity or agency standards. The fair value measurements consider observable data that may include market trade pricing from brokers and the mortgage-backed security markets. As such, the Company classifies these loans as Level 2.

The Company classifies IRLCs on residential mortgage loans held-for-sale, which are derivatives under SFAS No. 133 now codified in ASC 815-10-15, on a gross basis within other liabilities or other assets. The fair value of these commitments, while based on interest rates observable in the market, is highly dependent on the ultimate closing of the loans. These "pull-through" rates are based on both the Company's historical data and the current interest rate environment and reflect the Company's best estimate of the likelihood that a commitment will ultimately result in a closed loan. As a result of the adoption of Staff Accounting Bulletin No. 109 ("SAB No. 109"), the loan servicing value is also included in the fair value of IRLCs. Because these inputs are not transparent in market trades, IRLCs are considered to be Level 3 assets.

Derivative instruments are primarily transacted in the secondary mortgage and institutional dealer markets and priced with observable market assumptions at a mid-market valuation point, with appropriate valuation adjustments for liquidity and credit risk. For purposes of valuation adjustments to its derivative positions under FASB ASC 820-10-35, the Company has evaluated liquidity premiums that may be demanded by market participants, as well as

the credit risk of its counterparties and its own credit if applicable. To date, no material losses due to a counterparty's inability to pay any net uncollateralized position has been incurred.

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The credit risk associated with the underlying cash flows of an instrument carried at fair value was a consideration in estimating the fair value of certain financial instruments. Credit risk was considered in the valuation through a variety of inputs, as applicable, including, the actual default and loss severity of the collateral, and level of subordination. The assumptions used to estimate credit risk applied relevant information that a market participant would likely use in valuing an instrument. Because mortgage loans held-for-sale are sold within a few weeks of origination, it is unlikely to demonstrate any of the credit weaknesses discussed above and as a result, there were no credit related adjustments to fair value at September 30, 2011.

The following tables present financial assets measured at fair value at September 30, 2011 and December 31, 2010, on a recurring basis and the change in fair value for those specific financial instruments in which fair value has been elected at September 30, 2011 and 2010. The changes in the fair value of economic hedges were also recorded in mortgage banking activities and are designed to partially offset the change in fair value of the mortgage loans held-for-sale and interest rate lock commitments referenced in the tables below.

|   | <b>Fair Value Measurements at<br/>September 30, 2011</b>                        |   |  |  |
|---|---|---|--|--|
|   | <b>Assets<br/>Measured<br/>at<br/>Fair Value<br/>September<br/>30,<br/>2011</b> | <b>Quoted<br/>Prices<br/>in Active<br/>Markets<br/>for<br/>Identical<br/>Assets<br/>(Level 1)</b> | <b>Significant<br/>Other<br/>Observable<br/>Inputs<br/>(Level 2)</b> | <b>Significant<br/>Unobservable<br/>Inputs<br/>(Level 3)</b> |
| Debt securities issued by U.S. Government corporations and agencies | \$ 66,634   | \$  | \$ 66,634  | \$   |
| Debt securities issued by states and political subdivisions         | 11,867  |   | 11,867   |  |
| Residential mortgage-backed securities Agency                       | 159,987   |   | 159,987  |  |
| Mortgage loans held-for-sale  | 71,063  |   | 71,063   |  |
| Other Assets <sup>(1)</sup>   | 6,467   |   |  | 6,467  |
| Other Liabilities <sup>(1)</sup>                                    | 2,624   |   |  | 2,624  |

(1) This amount includes mortgage related interest rate lock commitments and derivative financial instruments to hedge interest rate risk. Interest rate lock commitments were recorded on a gross basis.

|  | <b>Fair Value Measurements at<br/>December 31, 2010</b>               |   |  |  |
|--|---|---|--|--|
|  | <b>Assets<br/>Measured<br/>at<br/>Fair Value<br/>December<br/>31,</b> | <b>Quoted<br/>Prices<br/>in Active<br/>Markets<br/>for<br/>Identical<br/>Assets</b> | <b>Significant<br/>Other<br/>Observable<br/>Inputs</b> | <b>Significant<br/>Unobservable<br/>Inputs</b> |

|   | <b>2010</b> | <b>(Level 1)</b>      | <b>(Level 2)</b> | <b>(Level 3)</b> |
|---|-------------|-----------------------|------------------|------------------|
|   |             | <i>(In thousands)</i> |                  |                  |
| Debt securities issued by U.S. Government corporations and agencies | \$ 26,336   | \$                    | \$ 26,336        | \$               |
| Debt securities issued by states and political subdivisions         | 11,330      |                       | 11,330           |                  |
| Residential mortgage-backed securities Agency                       | 123,812     |                       | 123,812          |                  |
| Mortgage loans held-for-sale  | 155,029     |                       | 155,029          |                  |
| Other Assets <sup>(1)</sup>   | 6,627       |                       |                  | 6,627            |
| Other Liabilities <sup>(1)</sup>                                    | 446         |                       |                  | 446              |

(1) This amount includes mortgage related interest rate lock commitments and derivative financial instruments to hedge interest rate risk. Interest rate lock commitments were recorded on a gross basis.

**For Items Measured at Fair Value  
Pursuant to  
Election of the Fair Value Option: Fair  
Value Gain  
related to Mortgage Banking Activities for  
the  
Three Months Ended  
September 30,                      September 30,  
2011                                      2010  
*(In thousands)***

|                              |    |              |    |         |
|------------------------------|----|--------------|----|---------|
| Mortgage loans held-for-sale | \$ | <b>1,321</b> | \$ | (1,262) |
|------------------------------|----|--------------|----|---------|

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**For Items Measured at Fair Value  
Pursuant to  
Election of the Fair Value Option: Fair  
Value Gain  
related to Mortgage Banking Activities for  
the  
Nine Months Ended  
September 30,                      September 30,  
2011    2010  
(In thousands)**

Mortgage loans held-for-sale \$            3,924            \$            2,365  
The tables below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (level 3) during the three and nine months ended September 30, 2011 and 2010.

|   | <b>Other<br/>Assets<sup>(1)</sup></b> | <b>Other<br/>Liabilities<sup>(1)</sup></b> |
|---|---------------------------------------|--|
|   | <i>(In thousands)</i>                 |  |
| Beginning Balance July 1, 2011                              | \$    1,809                           | \$        (8)                              |
| Total gains (losses) included in earnings: <sup>(2)</sup>   |                                       |  |
| Issuances   | 6,467                                 | (2,624)                                    |
| Settlements and closed loans                                | (1,275)                               |  |
| Expirations   | (534)                                 | 8  |
| Total gains (losses) included in other comprehensive income |                                       |  |
| Ending Balance September 30, 2011 <sup>(3)</sup>            | \$    6,467                           | \$    (2,624)                              |

(1) Includes mortgage related interest rate lock commitments and derivative financial instruments entered into to hedge interest rate risk.

(2) Amounts included in earnings are recorded in mortgage banking activities.

(3) Represents the amount included in earnings attributable to the changes in unrealized gains/losses relating to IRLCs and derivatives still held at period end.

|   | <b>Other<br/>Assets<sup>(1)</sup></b> | <b>Other<br/>Liabilities<sup>(1)</sup></b> |
|---|---------------------------------------|--|
|   | <i>(In thousands)</i>                 |  |
| Beginning Balance January 1, 2011                         | \$    6,627                           | \$    (446)                                |
| Total gains (losses) included in earnings: <sup>(2)</sup> |                                       |  |
| Issuances   | 10,032                                | (2,856)                                    |

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|   |         |     |
|---|---------|-----|
| Settlements and closed loans                                | (2,785) | 178 |
| Expirations   | (7,407) | 500 |
| Total gains (losses) included in other comprehensive income |         |     |

|  |          |            |
|--|----------|------------|
| Ending Balance September 30, 2011 <sup>(3)</sup> | \$ 6,467 | \$ (2,624) |
|--|----------|------------|

- (1) Includes mortgage related interest rate lock commitments and derivative financial instruments entered into to hedge interest rate risk.
- (2) Amounts included in earnings are recorded in mortgage banking activities.
- (3) Represents the amount included in earnings attributable to the changes in unrealized gains/losses relating to IRLCs and derivatives still held at period end.

|   | <b>Other<br/>Assets<sup>(1)</sup></b> | <b>Other<br/>Liabilities<sup>(1)</sup></b> |
|---|---------------------------------------|--|
|   | <i>(In thousands)</i>                 |  |
| Beginning Balance July 1, 2010                              | \$ 2,447                              | \$ (2,714)                                 |
| Total gains (losses) included in earnings: <sup>(2)</sup>   |                                       |  |
| Issuances   | 2,768                                 | (714)                                      |
| Settlements and closed loans                                | (1,864)                               | 2  |
| Expirations   | (583)                                 | 2,712                                      |
| Total gains (losses) included in other comprehensive income |                                       |  |
| Ending Balance September 30, 2010 <sup>(3)</sup>            | \$ 2,768                              | \$ (714)                                   |

- (1) Includes mortgage related interest rate lock commitments and derivative financial instruments entered into to hedge interest rate risk.
- (2) Amounts included in earnings are recorded in mortgage banking activities.
- (3) Represents the amount included in earnings attributable to the changes in unrealized gains/losses relating to IRLCs and derivatives still held at period end.

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|   | <b>Other<br/>Assets<sup>(1)</sup></b> | <b>Other<br/>Liabilities<sup>(1)</sup></b> |
|---|---------------------------------------|--|
|   | <i>(In thousands)</i>                 |  |
| Beginning Balance January 1, 2010                           | \$ 1,778                              | \$ (55)                                    |
| Total gains (losses) included in earnings: <sup>(2)</sup>   |                                       |  |
| Issuances   | 6,503                                 | (3,465)                                    |
| Settlements and closed loans                                | (2,524)                               | 48   |
| Expirations   | (2,989)                               | 2,758                                      |
| Total gains (losses) included in other comprehensive income |                                       |  |
| Ending Balance September 30, 2010 <sup>(3)</sup>            | \$ 2,768                              | \$ (714)                                   |

(1) Includes mortgage related interest rate lock commitments and derivative financial instruments entered into to hedge interest rate risk.

(2) Amounts included in earnings are recorded in mortgage banking activities.

(3) Represents the amount included in earnings attributable to the changes in unrealized gains/losses relating to IRLCs and derivatives still held at period end.

The following tables present the assets that are measured at fair value on a non-recurring basis by level within the fair value hierarchy as reported on the consolidated statements of financial position at September 30, 2011, and December 31, 2010.

| <b>Fair Value Measurements at September 30, 2011</b> |   |  |  |                                |
|--|---|--|--|--------------------------------|
|  | <b>Quoted Prices<br/>in<br/>Active Markets<br/>for<br/>Identical Assets</b> | <b>Significant<br/>Other<br/>Observable<br/>Inputs<br/>Level 2</b> | <b>Significant<br/>Unobservable<br/>Inputs<br/>Level 3</b> | <b>Valuation<br/>Allowance</b> |
|  | <b>Total</b>  | <b>Level 1</b>   | <b>Level 3</b>   | <b>Allowance</b>               |
|  | <i>(In thousands)</i>   |  |  |                                |
| Impaired loans                                       | \$ 59,160   | \$   | \$ 59,160  | \$ (7,778)                     |
| ORE  | 24,494  | \$   | 24,494   | (6,638)                        |
| Mortgage servicing rights                            | 8,675   | \$   | 8,675  | (2,144)                        |
| SBA servicing rights                                 | 5,876   | \$   | 5,876  | (333)                          |

**Fair Value Measurements at December 31, 2010**

|  | <b>Quoted Prices<br/>in<br/>Active Markets<br/>for</b> | <b>Significant<br/>Other</b> | <b>Significant<br/>Unobservable</b> |
|--|--|------------------------------|-------------------------------------|
|  | <b>Level 1</b>   | <b>Level 2</b>               | <b>Level 3</b>                      |

|                           | <b>Total</b> | <b>Identical Assets<br/>Level 1</b> | <b>Observable<br/>Inputs<br/>Level 2<br/>(In thousands)</b> | <b>Inputs<br/>Level 3</b> | <b>Valuation<br/>Allowance</b> |
|---------------------------|--------------|-------------------------------------|---|---------------------------|--------------------------------|
| Impaired loans            | \$ 79,954    | \$                                  | \$  | \$ 79,954                 | \$ (6,218)                     |
| ORE                       | 20,525       |                                     |   | 20,525                    | (6,403)                        |
| Mortgage servicing rights | 5,495        |                                     |   | 5,495                     | (85)                           |
| SBA servicing rights      | 2,624        |                                     |   | 2,624                     | (203)                          |

Impaired loans are evaluated and valued at the time the loan is identified as impaired, at the lower of cost or fair value. Fair value is measured based on the value of the collateral securing these loans and is classified as a Level 3 in the fair value hierarchy. Collateral may include real estate or business assets, including equipment, inventory and accounts receivable. The value of real estate collateral is determined based on an appraisal by qualified licensed appraisers hired by the Company. If significant, the value of business equipment is based on an appraisal by qualified licensed appraisers hired by the Company otherwise, the equipment's net book value on the business financial statements is the basis for the value of business equipment. Inventory and accounts receivable collateral are valued based on independent field examiner review or aging reports. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business. Impaired loans are evaluated on at least a quarterly basis for additional impairment and adjusted accordingly.



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Mortgage servicing rights are initially recorded at fair value when mortgage loans are sold servicing retained. These assets are then amortized in proportion to and over the period of estimated net servicing income. On a monthly basis these servicing assets are assessed for impairment based on fair value. Management determines fair value by stratifying the servicing portfolio into homogeneous subsets with unique behavior characteristics, converting those characteristics into income and expense streams, adjusting those streams for prepayments, present valuing the adjusted streams, and combining the present values into a total. If the cost basis of any loan stratification tranche is higher than the present value of the tranche, an impairment is recorded.

SBA servicing rights are initially recorded at fair value when loans are sold servicing retained. These assets are then amortized in proportion to and over the period of estimated net servicing income. On a monthly basis these servicing assets are assessed for impairment based on fair value. Management determines fair value by stratifying the servicing portfolio into homogeneous subsets with unique behavior characteristics, converting those characteristics into income and expense streams, adjusting those streams for prepayments, present valuing the adjusted streams, and combining the present values into a total. If the cost basis of any loan stratification tranche is higher than the present value of the tranche, an impairment is recorded.

Foreclosed assets in Other Real Estate are adjusted to fair value upon transfer of the loans to foreclosed assets. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value less estimated selling costs. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset as nonrecurring Level 3. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business.

The following tables present the difference between the aggregate fair value and the aggregate unpaid principal balance of loans held-for-sale for which the fair value option has been elected as of September 30, 2011 and December 31, 2010. The tables also include the difference between aggregate fair value and the aggregate unpaid principal balance of loans that are 90 days or more past due, as well as loans in nonaccrual status.

|                            | <b>Aggregate<br/>Fair<br/>Value<br/>September<br/>30, 2011</b> | <b>Aggregate Unpaid<br/>Principal Balance<br/>Under<br/>FVO September 30,<br/>2011<br/><i>(In thousands)</i></b> | <b>Fair Value<br/>Over<br/>Unpaid<br/>Principal</b>  |
|----------------------------|--|--|--|
| Loans held-for-sale        | \$ 71,063  | \$ 69,081  | \$ 1,982   |
| Past due loans of 90+ days |  |  |  |
| Nonaccrual loans           |  |  |  |
|                            | <b>Aggregate<br/>Fair Value<br/>December<br/>31, 2010</b>      | <b>Aggregate Unpaid<br/>Principal Balance<br/>Under<br/>FVO December 31,<br/>2010<br/><i>(In thousands)</i></b>  | <b>Fair Value<br/>Under<br/>Unpaid<br/>Principal</b> |
| Loans held-for-sale        | \$ 155,029   | \$ 156,971   | \$ (1,942)   |
| Past due loans of 90+ days |  |  |  |

Nonaccrual loans

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SFAS No. 107, Disclosures about Fair Value of Financial Instruments, ( SFAS No. 107 ) as amended by FASB Staff Position No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments now codified in ASC 825-10-50 requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on settlements using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets, and, in many cases, could not be realized in immediate settlement of the instrument. ASC 825-10-50 excludes certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

|  | September 30, 2011    |              | December 31, 2010  |              |
|--|-----------------------|--------------|--------------------|--------------|
|  | Carrying<br>Amount    | Fair Value   | Carrying<br>Amount | Fair Value   |
|  | <i>(In thousands)</i> |              |                    |              |
| <b>Financial Instruments (Assets):</b>                           |                       |              |                    |              |
| Cash and due from banks  | \$ 117,424            | \$ 117,424   | \$ 47,242          | \$ 47,242    |
| Federal funds sold   | 810                   | 810          | 517                | 517          |
| Investment securities available-for-sale                         | 238,488               | 238,488      | 161,478            | 161,478      |
| Investment securities held-to-maturity                           | 9,680                 | 10,525       | 14,110             | 14,926       |
| Investment in FHLB stock   | 6,413                 | 6,413        | 6,542              | 6,542        |
| Total loans <sup>(1)</sup>                                       | 1,595,981             | 1,475,337    | 1,585,188          | 1,469,404    |
| Total financial instruments (assets)                             | 1,968,796             | \$ 1,848,997 |                    | \$ 1,700,109 |
| Non-financial instruments (assets)                               | 140,879               |              | 130,223            |              |
| Total assets   | \$ 2,109,675          |              | \$ 1,945,300       |              |
| <b>Financial Instruments (Liabilities):</b>                      |                       |              |                    |              |
| Noninterest-bearing demand deposits                              | \$ 247,660            | \$ 247,660   | \$ 185,614         | \$ 185,614   |
| Interest-bearing deposits  | 1,517,857             | 1,526,412    | 1,427,634          | 1,433,558    |
| Total deposits   | 1,765,517             | 1,774,072    | 1,613,248          | 1,619,172    |
| Short-term borrowings  | 40,011                | 40,229       | 32,977             | 32,977       |
| Subordinated debt  | 67,527                | 59,158       | 67,527             | 63,279       |
| Other long-term debt   | 52,500                | 52,193       | 75,000             | 75,457       |
| Total financial instruments (liabilities)                        | 1,925,555             | \$ 1,925,652 | 1,788,752          | \$ 1,790,885 |
| Non-financial instruments (liabilities and shareholders' equity) | 184,120               |              | 156,548            |              |
| Total liabilities and shareholders' equity                       | \$ 2,109,675          |              | \$ 1,945,300       |              |

(1)

Includes \$71,063 and \$155,029 in mortgage loans held-for-sale at fair value at September 30, 2011 and December 31, 2010, respectively.

The carrying amounts reported in the consolidated balance sheets for cash, due from banks, and Federal funds sold approximate the fair values of those assets. For investment securities, fair value equals quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities or dealer quotes.

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type. The fair value of performing loans is calculated by discounting scheduled cash flows through the remaining maturities using estimated market discount rates that reflect the credit and interest rate risk inherent in the loans along with a market risk premium and liquidity discount.

Fair value for significant nonperforming loans is estimated taking into consideration recent external appraisals of the underlying collateral for loans that are collateral dependent. If appraisals are not available or if the loan is not collateral dependent, estimated cash flows are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows, and discount rates are judgmentally determined using available market information and specific borrower information.

The fair value of deposits with no stated maturities, such as noninterest-bearing demand deposits, savings, interest-bearing demand, and money market accounts, is equal to the amount payable on demand. The fair value of time deposits is based on the discounted value of contractual cash flows based on the discounted rates currently offered for deposits of similar remaining maturities.

The carrying amounts reported in the consolidated balance sheets for short-term debt generally approximate those liabilities fair values with the exception of FHLB advances which are estimated based on the current rates offered to us for debt of the same remaining maturity.

The fair value of the Company's long-term debt is estimated based on the quoted market prices for the same or similar issues or on the current rates offered to us for debt of the same remaining maturities.

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For off-balance sheet instruments, fair values are based on rates currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing for loan commitments and letters of credit. Fees related to these instruments were immaterial at September 30, 2011 and December 31, 2010, and the carrying amounts represent a reasonable approximation of their fair values. Loan commitments, letters and lines of credit, and similar obligations typically have variable interest rates and clauses that deny funding if the customer's credit quality deteriorates. Therefore, the fair values of these items are not significant and are not included in the foregoing schedule.

This presentation excludes certain nonfinancial instruments. The disclosures also do not include certain intangible assets, such as customer relationships, and deposit base intangibles. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

**7. Derivative Financial Instruments**

The Company maintains a risk management program to manage interest rate risk and pricing risk associated with its mortgage lending activities. The risk management program includes the use of forward contracts and other derivatives that are recorded in the financial statements at fair value and are used to offset changes in value of the mortgage inventory due to changes in market interest rates. As a normal part of its operations, the Company enters into derivative contracts to economically hedge risks associated with overall price risk related to IRLCs and mortgage loans held-for-sale carried at fair value under ASC 825-10-25. Fair value changes occur as a result of interest rate movements as well as changes in the value of the associated servicing. Derivative instruments used include forward sale commitments and IRLCs. All derivatives are carried at fair value in the Consolidated Balance Sheets in other assets or other liabilities. A gross loss of \$2.3 million for the first nine months of 2011 associated with the forward sales commitments and IRLCs, is recorded in the Consolidated Statements of Income in mortgage banking activities. The Company's risk management derivatives are based on underlying risks primarily related to interest rates and forward sales commitments. Forwards are contracts for the delayed delivery or net settlement of an underlying instrument, such as a mortgage loan, in which the seller agrees to deliver on a specified future date, either a specified instrument at a specified price or yield or the net cash equivalent of an underlying instrument. These hedges are used to preserve the Company's position relative to future sales of loans to third parties in an effort to minimize the volatility of the expected gain on sale from changes in interest rate and the associated pricing changes.

**Credit and Market Risk Associated with Derivatives**

Derivatives expose the Company to credit risk. If the counterparty fails to perform, the credit risk at that time would be equal to the net derivative asset position, if any, for that counterparty. The Company minimizes the credit or repayment risk in derivative instruments by entering into transactions with high quality counterparties that are reviewed periodically by the Company's Risk Management area.

The Company's derivative positions as of September 30, 2011, were as follows:

|                                | <b>Contract or<br/>Notional<br/>Amount<br/>(In thousands)</b> |
|--------------------------------|---|
| Forward rate commitments       | \$ 295,558  |
| Interest rate lock commitments | 229,844   |
| Total derivatives contracts    | \$ 525,402  |

**Table of Contents****8. Investments**

Investment securities at September 30, 2011 and December 31, 2010, are summarized as follows:

|   | September 30, 2011    |            | December 31, 2010 |            |
|---|-----------------------|------------|-------------------|------------|
|   | Amortized<br>Cost     | Fair Value | Amortized<br>Cost | Fair Value |
|   | <i>(In thousands)</i> |            |                   |            |
| <b>Available-for-Sale:</b>                                |                       |            |                   |            |
| Obligations of U.S. Government corporations and agencies: |                       |            |                   |            |
| Due in less than one year                                 | \$ 20,000             | \$ 20,160  | \$ 10,000         | \$ 10,039  |
| Due after one year through five years                     | 46,135                | 46,474     | 16,135            | 16,297     |
| Municipal securities:                                     |                       |            |                   |            |
| Due in less than one year                                 | 501                   | 505        |                   |            |
| Due after one year through five years                     | 5,644                 | 5,788      | 5,592             | 5,482      |
| Due five years through ten years                          | 5,559                 | 5,574      | 6,113             | 5,848      |
| Residential mortgage-backed securities-agency:            |                       |            |                   |            |
| Due after one year through five years                     | 140,606               | 144,110    | 118,958           | 119,962    |
| Due five years through ten years                          | 15,246                | 15,877     | 3,942             | 3,850      |
|   | \$ 233,691            | \$ 238,488 | \$ 160,740        | \$ 161,478 |
| <b>Held-to-Maturity:</b>                                  |                       |            |                   |            |
| Residential mortgage-backed securities-agency:            |                       |            |                   |            |
| Due in less than one year                                 | \$                    | \$         | \$ 1,770          | \$ 1,785   |
| Due after one year through five years                     | 9,680                 | 10,525     | 12,340            | 13,141     |
|   | \$ 9,680              | \$ 10,525  | \$ 14,110         | \$ 14,926  |

The Bank sold five securities available-for-sale totaling \$32.8 million during the nine month period ended September 30, 2011. Proceeds received totaled \$33.9 million for a gross gain of \$1.1 million. The Bank sold 16 securities held-for-sale totaling \$98.3 million during the nine month period ended September 30, 2010. Proceeds received totaled \$100.6 million for a gross gain of \$2.3 million. The Bank had six securities for a total of \$53.2 million called during the nine month period ended September 30, 2011. Fourteen securities for a total of \$110.7 million were called during the nine months ended September 30, 2010. There were no investments held in trading accounts during 2011 and 2010.

|  | September 30, 2011    |                              |                               |                                       |            |
|--|-----------------------|------------------------------|-------------------------------|---------------------------------------|------------|
|  | Amortized<br>Cost     | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Other than<br>Temporary<br>Impairment | Fair Value |
|  | <i>(In thousands)</i> |                              |                               |                                       |            |
| <b>Available-for-Sale:</b>                               |                       |                              |                               |                                       |            |
| Obligations of U.S. Government corporations and agencies | \$ 66,135             | \$ 512                       | \$ (13)                       | \$                                    | \$ 66,634  |
| Municipal securities                                     | 11,704                | 321                          | (158)                         |                                       | 11,867     |

|   |                   |                 |                 |           |                   |
|---|-------------------|-----------------|-----------------|-----------|-------------------|
| Residential mortgage-backed securities agency | <b>155,852</b>    | <b>4,135</b>    |                 |           | <b>159,987</b>    |
|   | <b>\$ 233,691</b> | <b>\$ 4,968</b> | <b>\$ (171)</b> | <b>\$</b> | <b>\$ 238,488</b> |

**Held-to-Maturity:**

|   |                 |               |           |           |                  |
|---|-----------------|---------------|-----------|-----------|------------------|
| Residential mortgage-backed securities agency | <b>\$ 9,680</b> | <b>\$ 845</b> | <b>\$</b> | <b>\$</b> | <b>\$ 10,525</b> |
|   | <b>\$ 9,680</b> | <b>\$ 845</b> | <b>\$</b> | <b>\$</b> | <b>\$ 10,525</b> |

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|  | December 31, 2010 |                              |  |                                       | Fair Value |
|--|-------------------|------------------------------|--|---------------------------------------|------------|
|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses<br><i>(In thousands)</i> | Other than<br>Temporary<br>Impairment |            |
| <b>Available-for-Sale:</b>                               |                   |                              |  |                                       |            |
| Obligations of U.S. Government corporations and agencies | \$ 26,135         | \$ 201                       | \$   | \$                                    | \$ 26,336  |
| Municipal securities                                     | 11,705            | 20                           | (395)  |                                       | 11,330     |
| Residential mortgage-backed securities agency            | 122,900           | 1,557                        | (645)  |                                       | 123,812    |
|  | \$ 160,740        | \$ 1,778                     | \$ (1,040)   | \$                                    | \$ 161,478 |
| <b>Held-to-Maturity:</b>                                 |                   |                              |  |                                       |            |
| Residential mortgage-backed securities agency            | \$ 14,110         | \$ 816                       | \$   | \$                                    | \$ 14,926  |

The following table reflects the gross unrealized losses and fair values of investment securities with unrealized losses at September 30, 2011 and December 31, 2010, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss and temporarily impaired position:

|   | September 30, 2011              |                      |                                   |                      |
|---|---------------------------------|----------------------|-----------------------------------|----------------------|
|   | 12 Months or Less<br>Fair Value | Unrealized<br>Losses | More Than 12 Months<br>Fair Value | Unrealized<br>Losses |
| <i>(In thousands)</i>                         |                                 |                      |                                   |                      |
| <b>Available-for-Sale:</b>                    |                                 |                      |                                   |                      |
| U.S. Government corporations and agencies     | \$ 9,987                        | \$ 13                | \$                                | \$                   |
| Municipal securities                          |                                 |                      | 887                               | 158                  |
| Residential mortgage-backed securities agency |                                 |                      |                                   |                      |
|   | \$ 9,987                        | \$ 13                | \$ 887                            | \$ 158               |
| <b>Held-to-Maturity:</b>                      |                                 |                      |                                   |                      |
| Residential mortgage-backed securities agency | \$                              | \$                   | \$                                | \$                   |

|   | December 31, 2010               |                      |                                   |                      |
|---|---------------------------------|----------------------|-----------------------------------|----------------------|
|   | 12 Months or Less<br>Fair Value | Unrealized<br>Losses | More Than 12 Months<br>Fair Value | Unrealized<br>Losses |
| <i>(In thousands)</i>                     |                                 |                      |                                   |                      |
| <b>Available-for-Sale:</b>                |                                 |                      |                                   |                      |
| U.S. Government corporations and agencies | \$                              | \$                   | \$                                | \$                   |
| Municipal securities                      | 9,491                           | 280                  | 929                               | 115                  |



|  |        |           |        |        |        |  |
|--|--------|-----------|--------|--------|--------|--|
| Residential mortgage-backed securities | agency | 52,983    | 645    |        |        |  |
|  |        | \$ 62,474 | \$ 925 | \$ 929 | \$ 115 |  |

**Held-to-Maturity:**

|  |        |    |    |    |    |
|--|--------|----|----|----|----|
| Residential mortgage-backed securities | agency | \$ | \$ | \$ | \$ |
|--|--------|----|----|----|----|

If fair value of a debt security is less than its amortized cost basis at the balance sheet date, management must determine if the security has an other than temporary impairment ( OTTI ). If management does not expect to recover the entire amortized cost basis of a security, an OTTI has occurred. If management s intention is to sell the security, an OTTI has occurred. If it is more likely than not that management will be required to sell a security before the recovery of the amortized cost basis, an OTTI has occurred. The Company will recognize the full OTTI in earnings if it intends to sell a security or will more likely than not be required to sell the security. Otherwise, an OTTI will be separated into the amount representing a credit loss and the amount related to all other factors. The amount of an OTTI related to credit losses will be recognized in earnings. The amount related to other factors will be recognized in other comprehensive income, net of taxes.

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There was one municipal investment security in a continuous unrealized loss position for 40 months at September 30, 2011 and for 31 months at December 31, 2010. Although under pressure from the recent recession, the unrealized loss position resulted not from credit quality issues, but from market interest rate increases over the interest rates prevalent at the time the security was purchased, and is considered temporary. In determining other-than-temporary impairment losses on municipal securities, management primarily considers the credit rating of the municipality itself as the primary source of repayment and secondarily the financial viability of the insurer of the obligation.

**9. Loans**

Loans outstanding, by class, are summarized as follows:

|                        | <b>September<br/>30,<br/>2011</b> | <b>December 31,<br/>2010</b> |
|------------------------|-----------------------------------|------------------------------|
|                        | <i>(In thousands)</i>             |                              |
| Commercial loans       | \$ 392,289                        | \$ 384,220                   |
| SBA loans              | 89,537                            | 94,282                       |
| Total commercial loans | <b>481,826</b>                    | 478,502                      |
| Construction           | <b>92,967</b>                     | 115,224                      |
| Indirect loans         | <b>815,238</b>                    | 695,754                      |
| Installment loans      | <b>19,111</b>                     | 20,431                       |
| Total consumer loans   | <b>834,349</b>                    | 716,185                      |
| First mortgage loans   | <b>32,974</b>                     | 34,367                       |
| Second mortgage loans  | <b>57,978</b>                     | 59,094                       |
| Total mortgage loans   | <b>90,952</b>                     | 93,461                       |
| Total loans            | <b>\$ 1,500,094</b>               | \$ 1,403,372                 |

Loans held-for-sale at September 30, 2011 and December 31, 2010 are shown in the table below:

|                                  | <b>September<br/>30,<br/>2011</b> | <b>December 31,<br/>2010</b> |
|----------------------------------|-----------------------------------|------------------------------|
|                                  | <i>(In thousands)</i>             |                              |
| SBA loans                        | \$ 24,205                         | \$ 24,869                    |
| Real estate mortgage residential | <b>71,063</b>                     | 155,029                      |
| Consumer installment loans       | <b>30,000</b>                     | 30,000                       |
| Total                            | <b>\$ 125,268</b>                 | \$ 209,898                   |

Nonaccrual loans, segregated by class of loans, were as follows:

|                        | <b>September<br/>30,<br/>2011</b> | <b>December 31,<br/>2010</b> |
|------------------------|-----------------------------------|------------------------------|
|                        | <i>(In thousands)</i>             |                              |
| Commercial loans       | \$ 3,149                          | \$ 2,269                     |
| SBA loans              | 15,769                            | 14,024                       |
| Total commercial loans | <b>18,918</b>                     | 16,293                       |
| Construction           | <b>35,474</b>                     | 54,117                       |
| Indirect loans         | 1,333                             | 1,551                        |
| Installment loans      | 1,729                             | 112                          |
| Total consumer loans   | <b>3,062</b>                      | 1,663                        |
| First mortgage loans   | <b>2,466</b>                      | 3,833                        |
| Second mortgage loans  | 1,064                             | 639                          |
| Total mortgage loans   | <b>3,530</b>                      | 4,472                        |
| Loans                  | <b>\$ 60,984</b>                  | \$ 76,545                    |

\* Approximately \$55 million and \$58 million in loan balances were past due 90 days or more at September 30, 2011 and December 31, 2010, respectively.

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Loans delinquent 30-89 days and troubled debt restructured loans accruing interest, segregated by class of loans at September 30, 2011 and December 31, 2010, were as follows:

|                       | September 30, 2011                   |   | December 31, 2010                    |   |
|-----------------------|--------------------------------------|---|--------------------------------------|---|
|                       | Accruing<br>Delinquent<br>30-89 Days | Troubled<br>Debt<br>Restructured<br>Loans<br>Accruing | Accruing<br>Delinquent<br>30-89 Days | Troubled<br>Debt<br>Restructured<br>Loans<br>Accruing |
|                       | <i>(In thousands)</i>                |   |                                      |   |
| Commercial loans      | \$ 1,295                             | \$ 9,904  | \$ 2,075                             | \$ 3,152  |
| SBA loans             |                                      |   | 698                                  |   |
| Construction loans    | 627                                  |   | 1,064                                | 6,243   |
| Indirect loans        | 2,604                                | 2,851   | 4,936                                |   |
| Installment loans     | 313                                  | 23  | 265                                  |   |
| First mortgage loans  | 717                                  |   | 723                                  |   |
| Second mortgage loans | 1,554                                |   | 822                                  |   |
| Total                 | \$ 7,110                             | \$ 12,778   | \$ 10,583                            | \$ 9,395  |

There were no loans greater than 90 days delinquent and still accruing at September 30, 2011 and December 31, 2010. Troubled Debt Restructurings ( TDRs ) are loans in which the borrower is experiencing financial difficulty and the Company has granted an economic concession to the borrower. Prior to modifying a borrower's loan terms, the Company performs an evaluation of the borrower's financial condition and ability to service under the potential modified loan terms. The types of concessions granted are generally interest rate reductions or term extensions. If a loan is accruing at the time of modification, the loan remains on accrual status and is subject to the Company's charge-off and nonaccrual policies. If a loan is on nonaccrual before it is determined to be a TDR then the loan remains on nonaccrual. TDRs may be returned to accrual status if there has been at least a six month sustained period of repayment performance by the borrower. Generally, once a loan becomes a TDR, it is probable that the loan will likely continue to be reported as a TDR for the life of the loan. Interest income recognition on impaired loans is dependent upon nonaccrual status. The Company adopted ASU 2011-02 A Creditor's Determination of whether a Restructuring is a Troubled Debt Restructuring for the period ended September 30, 2011 (see Note 11).

During the periods ended September 30, 2011 and 2010, certain loans were modified resulting in TDRs. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan or an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk.

The following table presents loans by class which were modified as TDRs that occurred during the three and nine months ended September 30, 2011 and 2010 along with the type of modification.

|                  | Troubled Debt<br>Restructured<br>During the Quarter<br>Ended<br>September 30, 2011 |      | Troubled Debt Restructured<br>During the Nine Months<br>Ended September 30, 2011 |      |
|------------------|--|------|--|------|
|                  | Interest<br>Rate   | Term | Interest<br>Rate   | Term |
|                  | <i>(In thousands)</i>  |      |  |      |
| Commercial loans | \$   | \$   | \$ 9,904   | \$   |
| SBA loans        |  |      |  |      |

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|                       |    |          |           |    |       |
|-----------------------|----|----------|-----------|----|-------|
| Construction          |    |          | 5,812     |    |       |
| Indirect loans        |    | 2,978    |           |    | 2,987 |
| Installment loans     |    | 23       |           |    | 23    |
| First mortgage loans  |    |          |           |    |       |
| Second mortgage loans |    |          |           |    |       |
| Total                 | \$ | \$ 3,001 | \$ 15,716 | \$ | 3,010 |

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The following table presents the amount of loans which were restructured in the previous twelve months and which defaulted within each period.

|                       | <b>Troubled Debt Restructured<br/>During<br/>the Twelve Months Ended<br/>September 30, 2011 and<br/>Defaulting<br/>During</b> |   |
|-----------------------|---|---|
|                       | <b>The Three<br/>Months<br/>Ended<br/>Sept. 30,<br/>2011</b>  | <b>The Nine<br/>Months<br/>Ended<br/>Sept. 30, 2011</b> |
|                       | <i>(In thousands)</i>   |   |
| Commercial loans      | \$  | \$  |
| SBA loans             |   |   |
| Construction          | 82  | 5,410   |
| Indirect loans        | 253   | 284   |
| Installment loans     |   |   |
| First mortgage loans  |   |   |
| Second mortgage loans |   |   |
| <br>                  |   |   |
| Total                 | \$ 335  | \$ 5,694  |

Note: A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

The Company had TDRs with a balance of \$21.3 million and \$14.5 million at September 30, 2011 and December 31, 2010, respectively. There were charge-offs of TDR loans of \$443,000 and \$4.4 million for the quarter ended September 30, 2011 and the nine months ended September 30, 2011, respectively. There were charge-offs of TDR loans of \$190,000 and \$496,000 for the quarter ended September 30, 2010 and the nine months ended September 30, 2010, respectively. The Company is not committed to lend additional amounts as of September 30, 2011 and December 31, 2010 to customers with outstanding loans that are classified as TDRs. Charge-offs on such loans are factored into the rolling historical loss rate, which is used in the calculation of the allowance for loan losses. Loans and allowance for loan loss individually and collectively evaluated by portfolio segment follow below:

|                           | <b>Three Months Ended September 30, 2011</b> |                     |                 |                 |                    |              |
|---------------------------|--|---------------------|-----------------|-----------------|--------------------|--------------|
|                           | <b>Commercial</b>                            | <b>Construction</b> | <b>Consumer</b> | <b>Mortgage</b> | <b>Unallocated</b> | <b>Total</b> |
|                           | <i>(In thousands)</i>                        |                     |                 |                 |                    |              |
| Beginning balance         | \$ 7,755                                     | \$ 10,315           | \$ 7,600        | \$ 2,642        | \$ 1,489           | \$ 29,801    |
| Charge-offs               | (389)  | (3,542)             | (896)           | (432)           |                    | (5,259)      |
| Recoveries                | 60   | 115                 | 223             | 41              |                    | 439          |
| <br>                      |  |                     |                 |                 |                    |              |
| Net Charge-offs           | (329)  | (3,427)             | (673)           | (391)           |                    | (4,820)      |
| Provision for loan losses | 897  | 2,716               | 354             | 467             | (34)               | 4,400        |

|                |          |          |          |          |          |           |
|----------------|----------|----------|----------|----------|----------|-----------|
| Ending Balance | \$ 8,323 | \$ 9,604 | \$ 7,281 | \$ 2,718 | \$ 1,455 | \$ 29,381 |
|----------------|----------|----------|----------|----------|----------|-----------|

**Three Months Ended September 30, 2010**

|                           | <b>Commercial</b>     | <b>Construction</b> | <b>Consumer</b> | <b>Mortgage</b> | <b>Unallocated</b> | <b>Total</b> |
|---------------------------|-----------------------|---------------------|-----------------|-----------------|--------------------|--------------|
|                           | <i>(In thousands)</i> |                     |                 |                 |                    |              |
| Beginning balance         | \$ 6,029              | \$ 9,599            | \$ 9,018        | \$ 1,165        | \$ 1,293           | \$ 27,104    |
| Charge-offs               | (246)                 | (2,198)             | (1,568)         | (137)           |                    | (4,149)      |
| Recoveries                | 20                    | 98                  | 192             | 3               |                    | 313          |
| Net Charge-offs           | (226)                 | (2,100)             | (1,376)         | (134)           |                    | (3,836)      |
| Provision for loan losses | 854                   | 2,971               | 806             | 515             | (121)              | 5,025        |
| Ending Balance            | \$ 6,657              | \$ 10,470           | \$ 8,448        | \$ 1,546        | \$ 1,172           | \$ 28,293    |

**Nine Months Ended September 30, 2011**

|                           | <b>Commercial</b>     | <b>Construction</b> | <b>Consumer</b> | <b>Mortgage</b> | <b>Unallocated</b> | <b>Total</b> |
|---------------------------|-----------------------|---------------------|-----------------|-----------------|--------------------|--------------|
|                           | <i>(In thousands)</i> |                     |                 |                 |                    |              |
| Beginning balance         | \$ 7,532              | \$ 9,286            | \$ 7,598        | \$ 2,570        | \$ 1,096           | \$ 28,082    |
| Charge-offs               | (978)                 | (9,704)             | (3,286)         | (731)           |                    | (14,699)     |
| Recoveries                | 85                    | 219                 | 626             | 43              |                    | 973          |
| Net Charge-offs           | (893)                 | (9,485)             | (2,660)         | (688)           |                    | (13,726)     |
| Provision for loan losses | 1,684                 | 9,803               | 2,343           | 836             | 359                | 15,025       |
| Ending Balance            | \$ 8,323              | \$ 9,604            | \$ 7,281        | \$ 2,718        | \$ 1,455           | \$ 29,381    |

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|                           | <b>Nine Months Ended September 30, 2010</b> |                     |                 |                 |                    |              |
|---------------------------|---|---------------------|-----------------|-----------------|--------------------|--------------|
|                           | <b>Commercial</b>                           | <b>Construction</b> | <b>Consumer</b> | <b>Mortgage</b> | <b>Unallocated</b> | <b>Total</b> |
|                           | <i>(In thousands)</i>                       |                     |                 |                 |                    |              |
| Beginning balance         | \$ 5,468                                    | \$ 11,436           | \$ 10,772       | \$ 1,093        | \$ 1,303           | \$ 30,072    |
| Charge-offs               | (466)                                       | (6,529)             | (5,463)         | (266)           |                    | (12,724)     |
| Recoveries                | 23  | 206                 | 562             | 4               |                    | 795          |
| Net Charge-offs           | (443)                                       | (6,323)             | (4,901)         | (262)           |                    | (11,929)     |
| Provision for loan losses | 1,632                                       | 5,357               | 2,577           | 715             | (131)              | 10,150       |
| Ending Balance            | \$ 6,657                                    | \$ 10,470           | \$ 8,448        | \$ 1,546        | \$ 1,172           | \$ 28,293    |

|                                       | <b>September 30, 2011</b> |                     |                 |                 |                    |              |
|---------------------------------------|---------------------------|---------------------|-----------------|-----------------|--------------------|--------------|
|                                       | <b>Commercial</b>         | <b>Construction</b> | <b>Consumer</b> | <b>Mortgage</b> | <b>Unallocated</b> | <b>Total</b> |
|                                       | <i>(In thousands)</i>     |                     |                 |                 |                    |              |
| Individually evaluated for impairment | \$ 1,509                  | \$ 6,303            | \$ 1,302        | \$ 970          | \$                 | \$ 10,084    |
| Collectively evaluated for impairment | 6,814                     | 3,301               | 5,979           | 1,748           | 1,455              | 19,297       |
| Total allowance for loan losses       | \$ 8,323                  | \$ 9,604            | \$ 7,281        | \$ 2,718        | \$ 1,455           | \$ 29,381    |
| Individually evaluated for impairment | \$ 35,843                 | \$ 44,638           | \$ 1,942        | \$ 3,323        |                    | \$ 85,746    |
| Collectively evaluated for impairment | 445,983                   | 48,329              | 832,407         | 87,629          |                    | 1,414,348    |
| Total loans                           | \$ 481,826                | \$ 92,967           | \$ 834,349      | \$ 90,952       |                    | \$ 1,500,094 |

|                                       | <b>December 31, 2010</b> |                     |                 |                 |                    |              |
|---------------------------------------|--------------------------|---------------------|-----------------|-----------------|--------------------|--------------|
|                                       | <b>Commercial</b>        | <b>Construction</b> | <b>Consumer</b> | <b>Mortgage</b> | <b>Unallocated</b> | <b>Total</b> |
|                                       | <i>(In thousands)</i>    |                     |                 |                 |                    |              |
| Individually evaluated for impairment | \$ 1,808                 | \$ 5,603            | \$ 253          | \$ 1,221        | \$                 | \$ 8,885     |
| Collectively evaluated for impairment | 5,724                    | 3,683               | 7,345           | 1,349           | 1,096              | 19,197       |
| Total allowance for loan losses       | \$ 7,532                 | \$ 9,286            | \$ 7,598        | \$ 2,570        | \$ 1,096           | \$ 28,082    |
| Individually evaluated for impairment | \$ 34,280                | \$ 69,619           | \$ 484          | \$ 4,690        |                    | \$ 109,073   |
|                                       | 444,222                  | 45,605              | 715,701         | 88,771          |                    | 1,294,299    |



Collectively evaluated for  
impairment

Total loans                                   \$ 478,502   \$ 115,224   \$ 716,185   \$ 93,461                                   \$ 1,403,372

Impaired loans are evaluated based on the present value of expected future cash flows discounted at the loan's original effective interest rate, or at the loan's observable market price, or the fair value of the collateral, if the loan is collateral dependent. Impaired loans are specifically reviewed loans for which it is probable that the Bank will be unable to collect all amounts due according to the terms of the loan agreement. A specific valuation allowance is required to the extent that the estimated value of an impaired loan is less than the recorded investment. FASB ASC 310-10-35, formerly known as SFAS No. 114, Accounting by Creditors for Impairment of a Loan, does not apply to large groups of smaller balance, homogeneous loans, such as consumer installment loans, and which are collectively evaluated for impairment. Smaller balance commercial loans are also excluded from the application of the statement. Interest on impaired loans is reported on the cash basis as received when the full recovery of principal and interest is anticipated, or after full principal and interest has been recovered when collection of interest is in question.

Impaired loans, by class, are shown below.

|  | September 30, 2011  |                                  |                      | December 31, 2010   |                                  |                      |
|--|---------------------|----------------------------------|----------------------|---------------------|----------------------------------|----------------------|
|  | Unpaid<br>Principal | Amortized<br>Cost <sup>(1)</sup> | Related<br>Allowance | Unpaid<br>Principal | Amortized<br>Cost <sup>(1)</sup> | Related<br>Allowance |
| <i>(In thousands)</i>                    |                     |                                  |                      |                     |                                  |                      |
| <b>Impaired Loans with<br/>Allowance</b> |                     |                                  |                      |                     |                                  |                      |
| Commercial loans                         | \$ 7,938            | \$ 7,938                         | \$ 973               | \$ 3,138            | \$ 3,108                         | \$ 1,307             |
| SBA loans                                | 6,207               | 4,220                            | 536                  | 4,532               | 4,441                            | 501                  |
| Construction loans                       | 46,969              | 41,676                           | 6,303                | 68,670              | 50,077                           | 5,603                |
| Indirect loans                           | 488                 | 488                              | 135                  | 484                 | 484                              | 253                  |
| Installment loans                        | 1,445               | 1,415                            | 1,167                |                     |                                  |                      |
| First mortgage loans                     | 1,909               | 1,907                            | 417                  | 3,047               | 3,033                            | 716                  |
| Second mortgage loans                    | 910                 | 879                              | 553                  | 586                 | 576                              | 505                  |
| Loans                                    | \$ 65,866           | \$ 58,523                        | \$ 10,084            | \$ 80,457           | \$ 61,719                        | \$ 8,885             |

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|   | September 30, 2011    |                               |                   | December 31, 2010 |                               |                   |
|---|-----------------------|-------------------------------|-------------------|-------------------|-------------------------------|-------------------|
|   | Unpaid Principal      | Amortized Cost <sup>(1)</sup> | Related Allowance | Unpaid Principal  | Amortized Cost <sup>(1)</sup> | Related Allowance |
|   | <i>(In thousands)</i> |                               |                   |                   |                               |                   |
| <b>Impaired Loans with No Allowance</b> |                       |                               |                   |                   |                               |                   |
| Commercial loans                        | \$ 8,779              | \$ 8,754                      | \$                | \$ 11,053         | \$ 11,041                     | \$                |
| SBA loans                               | 16,004                | 14,931                        |                   | 16,102            | 15,690                        |                   |
| Construction loans                      | 5,224                 | 2,962                         |                   | 21,790            | 19,542                        |                   |
| Indirect loans                          |                       |                               |                   |                   |                               |                   |
| Installment loans                       | 38                    | 39                            |                   |                   |                               |                   |
| First mortgage loans                    | 536                   | 537                           |                   | 1,013             | 984                           |                   |
| Second mortgage loans                   |                       |                               |                   | 97                | 97                            |                   |
| Loans                                   | \$ 30,581             | \$ 27,223                     | \$                | \$ 50,055         | \$ 47,354                     | \$                |

(1) Amortized cost reflects charge-offs that have been recognized plus other amounts that have been applied to reduce net book balance.

Average impaired loans and interest income recognized, by class, are summarized below.

|                       | Three Months Ended September 30, 2011 |  |   | Three Months Ended September 30, 2010 |  |   |
|-----------------------|---------------------------------------|--|---|---------------------------------------|--|---|
|                       | Average Impaired Loans                | Interest Income Recognized on Impaired Loans | Cash basis Interest Income Recognized on Impaired Loans | Average Impaired Loans                | Interest Income Recognized on Impaired Loans | Cash basis Interest Income Recognized on Impaired Loans |
|                       | <i>(In thousands)</i>                 |  |   |                                       |  |   |
| Commercial loans      | \$ 16,188                             | \$ 15  | \$  | \$ 3,951                              | \$ 48  | \$  |
| SBA loans             | 20,578                                | 292  |   | 15,051                                | 312  |   |
| Construction loans    | 47,808                                | 95   |   | 60,487                                | 49   |   |
| Indirect loans        | 515                                   | 16   |   | 479                                   | 19   |   |
| Installment loans     | 1,454                                 | 14   |   | 1,188                                 | 42   |   |
| First mortgage loans  | 2,663                                 | 13   |   | 2,291                                 | 4  |   |
| Second mortgage loans | 882                                   |  |   | 324                                   |  |   |
|                       | \$ 90,088                             | \$ 445                                       | \$  | \$ 83,771                             | \$ 474                                       | \$  |

|  | Nine Months Ended September 30, 2011 |                 |                            | Nine Months Ended September 30, 2010 |                 |                            |
|--|--------------------------------------|-----------------|----------------------------|--------------------------------------|-----------------|----------------------------|
|  | Average                              | Interest Income | Cash basis Interest Income | Average                              | Interest Income | Cash basis Interest Income |
|  |                                      |                 |                            |                                      |                 |                            |

|                       | Impaired<br>Loans     | Recognized<br>on<br>Impaired<br>Loans | Recognized<br>on<br>Impaired<br>Loans | Impaired<br>Loans | Recognized<br>on<br>Impaired<br>Loans | Recognized<br>on<br>Impaired<br>Loans |
|-----------------------|-----------------------|---------------------------------------|---------------------------------------|-------------------|---------------------------------------|---------------------------------------|
|                       | <i>(In thousands)</i> |                                       |                                       |                   |                                       |                                       |
| Commercial loans      | \$ 16,521             | \$ 42                                 | \$                                    | \$ 2,353          | \$ 135                                | \$                                    |
| SBA loans             | 19,783                | 802                                   |                                       | 12,589            | 587                                   |                                       |
| Construction loans    | 56,022                | 315                                   |                                       | 66,478            | 187                                   |                                       |
| Indirect loans        | 527                   | 57                                    |                                       | 749               | 55                                    |                                       |
| Installment loans     | 897                   | 39                                    |                                       | 589               | 70                                    |                                       |
| First mortgage loans  | 3,082                 | 46                                    |                                       | 2,245             | 8                                     |                                       |
| Second mortgage loans | 722                   |                                       |                                       | 357               |                                       |                                       |
|                       | \$ 97,554             | \$ 1,301                              | \$                                    | \$ 85,360         | \$ 1,042                              | \$                                    |

The Bank uses an asset quality ratings system to assign a numeric indicator of the credit quality and level of existing credit risk inherent in a loan. These ratings are adjusted periodically as the Bank becomes aware of changes in the credit quality of the underlying loans. The following are definitions of the asset ratings.

Rating #1 (High Quality) Loans rated 1 are of the highest quality. This category includes loans that have been made to borrower s exhibiting strong profitability and stable trends with a good track record. The borrower s balance sheet indicates a strong liquidity and capital position. Industry outlook is good with the borrower performing as well as or better than the industry. Little credit risk appears to exist.

Rating #2 (Good Quality) A 2 rated loan represents a good business risk with relatively little credit risk apparent.

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Rating #3 (Average Quality) A 3 rated loan represents an average business risk and credit risk within normal credit standards.

Rating #4 (Acceptable Quality) A 4 rated loan represents acceptable business and credit risks. However, the risk exceeds normal credit standards. Weaknesses exist and are considered offset by other factors such as management, collateral or guarantors.

Rating #5 (Special Mention) A special mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or deterioration in the Bank's credit position at some future date. Special mention assets are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

Rating #6 (Substandard Assets) A Substandard Asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified will have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Rating #7 (Doubtful Assets) Doubtful Assets have all the weaknesses inherent in one classified 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.

Rating #8 (Loss Assets) Loss Assets are considered uncollectable and of such little value that their continuance as recorded assets is not warranted. This classification does not mean that the Loss Asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer charging off this substantially worthless asset, even though partial recovery may be realized in the future.

The table below shows the weighted average asset rating by class as of September 30, 2011 and December 31, 2010.

|                       | <b>Weighted Average Asset Rating</b> |                                  |
|-----------------------|--------------------------------------|----------------------------------|
|                       | <b>September<br/>30,<br/>2011</b>    | <b>December<br/>31,<br/>2010</b> |
| Commercial loans      | <b>3.84</b>                          | 3.87                             |
| SBA loans             | <b>4.37</b>                          | 4.36                             |
| Construction loans    | <b>5.03</b>                          | 5.06                             |
| Indirect loans        | <b>3.02</b>                          | 3.03                             |
| Installment loans     | <b>3.66</b>                          | 3.56                             |
| First mortgage loans  | <b>3.08</b>                          | 3.05                             |
| Second mortgage loans | <b>3.17</b>                          | 3.18                             |

The Bank uses FICO scoring to help evaluate the likelihood borrowers will pay their credit obligations as agreed. The weighted-average FICO score for the indirect loan portfolio, included in consumer installment loans, was 739 and 726 at September 30, 2011 and December 31, 2010, respectively.

**10. Certain Transfers of Financial Assets**

The Company has transferred certain residential mortgage loans, SBA loans, and indirect loans in which the Company has continuing involvement to third parties. The Company has not engaged in securitization activities with respect to such loans. All such transfers have been accounted for as sales by the Company. The Company's continuing involvement in such transfers has been limited to certain servicing responsibilities. The Company is not required to provide additional financial support to any of these entities, nor has the Company provided any support it was not obligated to provide. Servicing rights may give rise to servicing assets, which are initially recognized at fair value, subsequently amortized, and tested for impairment. Gains or losses upon sale, in addition to servicing fees and collateral management fees, are recorded in noninterest income.

The majority of the indirect automobile loan pools and certain SBA and residential mortgage loans are sold with servicing retained. When the contractually specific servicing fees on loans sold servicing retained are expected to be more than adequate compensation to a servicer for performing the servicing, a capitalized servicing asset is recognized based on fair value. When the expected costs to a servicer for performing loan servicing are not expected to

adequately compensate a servicer, a capitalized servicing liability is recognized based on fair value. The Company has no servicing liabilities. Servicing assets and servicing liabilities are amortized over the expected lives of the serviced loans utilizing the interest method. Management makes certain estimates and assumptions related to costs to service varying types of loans and pools of loans, prepayment speeds, the projected lives of loans and pools of loans sold servicing retained, and discount factors used in calculating the present values of servicing fees projected to be received.

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At September 30, 2011 and December 31, 2010, the total fair value of servicing for mortgage loans was \$8.8 million and \$6.3 million, respectively. The fair value of servicing for SBA loans at September 30, 2011 and December 31, 2010, was \$5.9 million and \$3.8 million, respectively. To estimate the fair values of these servicing assets, consideration was given to dealer indications of market value, where applicable, as well as the results of discounted cash flow models using key assumptions and inputs for prepayment rates, credit losses, and discount rates. Carrying value of these servicing assets is shown below.

|                    | <b>September<br/>30,<br/>2011</b> | <b>December 31,<br/>2010</b> |
|--------------------|-----------------------------------|------------------------------|
|                    | <i>(In thousands)</i>             |                              |
| Mortgage servicing | \$ 8,675                          | \$ 5,495                     |
| SBA servicing      | 4,934                             | 2,624                        |
| Indirect servicing | 467                               | 405                          |
|                    | <b>\$ 14,076</b>                  | <b>\$ 8,524</b>              |

There are two primary classes of loan servicing rights for which the Company separately manages the economic risks: residential mortgage and SBA. Residential mortgage servicing rights and SBA loan servicing rights are initially recorded at fair value and then accounted for at the lower of cost or market and amortized in proportion to, and over the estimated period that net servicing income is expected to be received based on projections of the amount and timing of estimated future net cash flows. The amount and timing of estimated future net cash flows are updated based on actual results and updated projections. The Company periodically evaluates its loan servicing rights for impairment.

**Residential Mortgage Loans**

The Company typically sells first lien residential mortgage loans to third party investors including Fannie Mae. Certain of these loans are exchanged for cash and servicing rights, which generate servicing assets for the Company. The servicing assets are recorded initially at fair value. As seller, the Company has made certain standard representations and warranties with respect to the originally transferred loans. The Company estimates its reserves under such arrangements predominantly based on prior experience. To date, the Company's estimate of reserve, actual buy-backs as well as asserted claims under these provisions have been de minimus.

During the nine months ended September 30, 2011 and 2010, the Company sold residential mortgage loans with unpaid principal balances of \$532 million and \$194 million, respectively on which the Company retained the related mortgage servicing rights (MSRs) and receives servicing fees. At September 30, 2011 and December 31, 2010, the approximate weighted average servicing fee was .25% of the outstanding balance of the residential mortgage loans. The weighted average coupon interest rate on the portfolio of mortgage loans serviced for others was 4.46% and 4.43% at September 30, 2011 and December 31, 2010, respectively.

The following is an analysis of the activity in the Company's residential MSR and impairment for the quarters ended September 30, 2011 and 2010:

|  | <b>Quarter Ended<br/>September 30,</b> |             | <b>Nine Months Ended September<br/>30,</b> |             |
|--|--|-------------|--|-------------|
|  | <b>2011</b>                            | <b>2010</b> | <b>2011</b>                                | <b>2010</b> |
|  | <i>(In thousands)</i>                  |             |  |             |
| <b>Residential Mortgage Servicing Rights</b> |  |             |  |             |
| Beginning carrying value                     | \$ 8,832                               | \$ 1,082    | \$ 5,495                                   | \$ 875      |
| Additions                                    | 2,341                                  | 1,713       | 6,151                                      | 2,051       |
| Amortization                                 | (414)                                  | (88)        | (912)                                      | (177)       |
| Impairment, net                              | (2,084)                                | (227)       | (2,059)                                    | (269)       |

|                       |    |              |    |       |    |              |    |       |
|-----------------------|----|--------------|----|-------|----|--------------|----|-------|
| Ending carrying value | \$ | <b>8,675</b> | \$ | 2,480 | \$ | <b>8,675</b> | \$ | 2,480 |
|-----------------------|----|--------------|----|-------|----|--------------|----|-------|

|  | <b>Quarter Ended<br/>September 30,</b> |              | <b>Nine Months Ended September<br/>30,</b> |              |
|--|--|--------------|--|--------------|
|  | <b>2011</b>                            | <b>2010</b>  | <b>2011</b>                                | <b>2010</b>  |
|  | <i>(In thousands)</i>                  |              |  |              |
| <b>Residential Mortgage Servicing Impairment</b> |  |              |  |              |
| Beginning balance                                | \$                                     | <b>60</b>    | \$   | 124          |
| Additions  |  | <b>2,085</b> |  | 229          |
| Recoveries                                       |  | <b>(1)</b>   |  | (2)          |
| Ending balance                                   | \$                                     | <b>2,144</b> | \$   | 351          |
|  |  |              | \$   | <b>2,144</b> |
|  |  |              | \$   | 352          |

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The Company uses assumptions and estimates in determining the impairment of capitalized MSR's. These assumptions include prepayment speeds and discount rates commensurate with the risks involved and comparable to assumptions used by market participants to value and bid MSR's available for sale in the market. At September 30, 2011, the sensitivity of the current fair value of the residential mortgage servicing rights to immediate 10% and 20% adverse changes in key economic assumptions are included in the accompanying table.

|   | <b>September<br/>30, 2011</b> | <b>December 31,<br/>2010</b> |
|---|-------------------------------|------------------------------|
|   | <i>(Dollars in thousands)</i> |                              |
| <b>Residential Mortgage Servicing Rights</b>          |                               |                              |
| Fair Value of Residential Mortgage Servicing Rights   | \$ 8,785                      | \$ 6,280                     |
| Composition of Residential Loans Serviced for Others: |                               |                              |
| Fixed-rate mortgage loans                             | 98%                           | 97%                          |
| Adjustable-rate mortgage loans                        | 2%                            | 3%                           |
| Total   | 100%                          | 100%                         |
| Weighted Average Remaining Term                       | 25.3 years                    | 25.3 years                   |
| Prepayment Speed                                      | 17.48%                        | 8.89%                        |
| Effect on fair value of a 10% increase                | \$ (233)                      | \$ (213)                     |
| Effect on fair value of a 20% increase                | (454)                         | (408)                        |
| Weighted Average Discount Rate                        | 8.57%                         | 9.34%                        |
| Effect on fair value of a 10% increase                | \$ (453)                      | \$ (189)                     |
| Effect on fair value of a 20% increase                | (860)                         | (364)                        |

The sensitivity calculations above are hypothetical and should not be considered to be predictive of future performance. As indicated, changes in value based on adverse changes in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in value may not be linear. Also, in this table, the effect of an adverse variation in a particular assumption on the value of the MSR's is calculated without changing any other assumption; while in reality, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower prepayments), which may magnify or counteract the effect of the change.

Information about the asset quality of mortgage loans managed by the Company is shown below.

|                                      | <b>September 30, 2011</b>   |                          |            | <b>YTD<br/>Charge-offs</b> |
|--------------------------------------|-----------------------------|--------------------------|------------|----------------------------|
|                                      | <b>Unpaid<br/>Principal</b> | <b>Delinquent (days)</b> |            |                            |
|                                      |                             | <b>30 to 89</b>          | <b>90+</b> |                            |
|                                      | <i>(In thousands)</i>       |                          |            |                            |
| Loan Servicing Portfolio             | \$ 1,005,599                | \$ 251                   | \$ 416     | \$                         |
| Mortgage Loans Held-for-Sale         | 71,063                      |                          |            |                            |
| Mortgage Loans Held-for-Investment   | 26,813                      | 587                      | 280        | 464                        |
| Total Residential Mortgages Serviced | \$ 1,103,475                | \$ 838                   | \$ 696     | \$ 464                     |

**SBA Loans**

Certain transfers of SBA loans were executed with third parties. These SBA loans, which are typically partially guaranteed or otherwise credit enhanced, are generally secured by business property such as inventory, equipment and accounts receivable. As seller, the Company made certain representations and warranties with respect to the originally



transferred loans. The Company has not incurred any material losses with respect to such representations and warranties.

In 2010, consistent with the updated guidance on accounting for transfers of financial assets, because the Company warranted the borrower would make all scheduled payments for the first 90 days following the sale of certain SBA loans, certain loan sales were accounted for as secured borrowings which resulted in an increase in Cash for the proceeds of the borrowing and an increase in Other Short-Term Borrowings on the Consolidated Balance Sheet. No gain or loss was recognized for the proceeds of secured borrowings. When the 90 day warranty period expired, the secured borrowing was reduced, loans were reduced, and a gain or loss on sale was recorded in SBA Lending Activities in the Consolidated Statement of Income. In the first quarter of 2011, the 90 day warranty following the sale was removed, and the Bank began recognizing gains on sales of SBA loans concurrent with the sales transaction.

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During the nine months ended September 30, 2011 and 2010, the Company sold SBA loans with unpaid principal balances of \$76 million and \$16 million, respectively. The Company retained the related loan servicing rights and receives servicing fees. At September 30, 2011 and December 31, 2010, the approximate weighted average servicing fee as a percentage of the outstanding balance of the SBA loans was .90% and .94%, respectively. The weighted average coupon interest rate on the portfolio of loans serviced for others was 4.74% and 4.24% at September 30, 2011 and December 31, 2010, respectively.

The following is an analysis of the activity in the Company's SBA loan servicing rights and impairment for the quarters ended September 30, 2011 and 2010:

|                                  | Quarter Ended<br>September 30, |          | Nine Months Ended September<br>30, |          |
|----------------------------------|--------------------------------|----------|------------------------------------|----------|
|                                  | 2011                           | 2010     | 2011                               | 2010     |
|                                  | <i>(In thousands)</i>          |          |                                    |          |
| <b>SBA Loan Servicing Rights</b> |                                |          |                                    |          |
| Beginning carrying value         | \$ 4,767                       | \$ 2,196 | \$ 2,624                           | \$ 2,405 |
| Additions                        | 326                            | 424      | 2,941                              | 651      |
| Amortization                     | (180)                          | (105)    | (505)                              | (489)    |
| Impairment, net                  | 21                             | (36)     | (126)                              | (88)     |
| Ending carrying value            | \$ 4,934                       | \$ 2,479 | \$ 4,934                           | \$ 2,479 |

|  | Quarter Ended<br>September 30, |        | Nine Months Ended September<br>30, |        |
|--|--------------------------------|--------|------------------------------------|--------|
|  | 2011                           | 2010   | 2011                               | 2010   |
|  | <i>(In thousands)</i>          |        |                                    |        |
| <b>SBA Servicing Rights Impairment</b> |                                |        |                                    |        |
| Beginning balance                      | \$ 350                         | \$ 147 | \$ 203                             | \$ 95  |
| Additions                              | 143                            | 49     | 341                                | 158    |
| Recoveries                             | (164)                          | (13)   | (215)                              | (70)   |
| Ending balance                         | \$ 329                         | \$ 183 | \$ 329                             | \$ 183 |

SBA loan servicing rights are recorded on the Consolidated Balance Sheet at the lower of cost or market and are amortized in proportion to, and over the estimated period that, net servicing income is expected to be received based on projections of the amount and timing of estimated future net cash flows. The amount and timing of estimated future net cash flows are updated based on actual results and updated projections. The Company periodically evaluates its loan servicing rights for impairment.

The Company uses assumptions and estimates in determining the impairment of capitalized SBA loan servicing rights. These assumptions include prepayment speeds and discount rates commensurate with the risks involved and comparable to assumptions used by market participants to value and bid servicing rights available for sale in the market. At September 30, 2011, the sensitivity of the current fair value of the SBA loan servicing rights to immediate 10% and 20% adverse changes in key economic assumptions are included in the accompanying table.

|                                    | September<br>30, 2011         | December 31,<br>2010 |
|------------------------------------|-------------------------------|----------------------|
|                                    | <i>(Dollars in thousands)</i> |                      |
| <b>SBA Loan Servicing Rights</b>   |                               |                      |
| Fair Value of SBA Servicing Rights | \$ 5,876                      | \$ 3,816             |

Composition of SBA Loans Serviced for Others:

|                           |      |      |
|---------------------------|------|------|
| Fixed-rate SBA loans      | 0%   | 0%   |
| Adjustable-rate SBA loans | 100% | 100% |
| Total                     | 100% | 100% |

|                                 |            |            |
|---------------------------------|------------|------------|
| Weighted Average Remaining Term | 19.7 years | 20.0 years |
|---------------------------------|------------|------------|

|  |          |         |
|--|----------|---------|
| Prepayment Speed                       | 5.60%    | 4.32%   |
| Effect on fair value of a 10% increase | \$ (143) | \$ (88) |
| Effect on fair value of a 20% increase | (281)    | (171)   |

|  |          |          |
|--|----------|----------|
| Weighted Average Discount Rate         | 4.80%    | 4.35%    |
| Effect on fair value of a 10% increase | \$ (173) | \$ (160) |
| Effect on fair value of a 20% increase | (336)    | (244)    |

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The sensitivity calculations above are hypothetical and should not be considered to be predictive of future performance. As indicated, changes in value based on adverse changes in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in value may not be linear. Also in this table, the effect of an adverse variation in a particular assumption on the value of the SBA servicing rights is calculated without changing any other assumption; while in reality, changes in one factor may magnify or counteract the effect of the change.

Information about the asset quality of SBA loans managed by Fidelity is shown below.

|                                   | September 30, 2011    |                   |          | YTD<br>Charge-offs |
|-----------------------------------|-----------------------|-------------------|----------|--------------------|
|                                   | Unpaid<br>Principal   | Delinquent (days) |          |                    |
|                                   |                       | 30 to 89          | 90+      |                    |
|                                   | <i>(In thousands)</i> |                   |          |                    |
| SBA Serviced for Others Portfolio | \$ 159,035            | \$ 332            | \$       | \$                 |
| SBA Loans Held-for-Sale           | 24,205                |                   |          |                    |
| SBA Loans Held-for-Investment     | 89,536                | 1,914             | 2,125    | 635                |
| Total SBA Loans Serviced          | \$ 272,776            | \$ 2,246          | \$ 2,125 | \$ 635             |

**Indirect Loans**

The Bank purchases, on a nonrecourse basis, consumer installment contracts secured by new and used vehicles purchased by consumers from franchised motor vehicle dealers and selected independent dealers located throughout the Southeast. A portion of the indirect automobile loans the Bank originates is sold with servicing retained. Certain of these loans are exchanged for cash and servicing rights, which generate servicing assets for the Company. The servicing assets are recorded initially at fair value and subsequently amortized and evaluated for impairment. As seller, the Company has made certain standard representations and warranties with respect to the originally transferred loans. The estimate of reserve related to this liability, amount of loans repurchased, as well as asserted claims under these provisions, have been de minimus.

**11. Recent Accounting Pronouncements**

In January 2010, the FASB issued ASU 2010-06, an update to ASC 820-10, *Fair Value Measurements*. This update adds a new requirement to disclose transfers in and out of level 1 and level 2, along with the reasons for the transfers, and requires a gross presentation of purchases and sales of level 3 activities. Additionally, the update clarifies that entities provide fair value measurement disclosures for each class of assets and liabilities and that entities provide enhanced disclosures around level 2 valuation techniques and inputs. The Company adopted the disclosure requirements for level 1 and level 2 transfers and the expanded fair value measurement and valuation disclosures effective January 1, 2010. The disclosure requirements for level 3 activities were effective on January 1, 2011. The adoption of ASU 2010-06 had no impact on the Company's financial position and statement of income.

In February 2010, the FASB issued ASU No. 2010-09 an update to *Subsequent Events (Topic 855)* to clarify that an SEC filer must evaluate subsequent events through the date the financial statements are issued. The update removes the requirement for SEC filers to disclose the date through which subsequent events were evaluated. ASU No. 2010-09 was effective upon issuance and was adopted by the Company immediately. This ASU did not have a material impact on the Company's financial condition and statements of income.

In April 2010, the FASB issued ASU No. 2010-18 *Effect of a Loan Modification When the Loan is Part of a Pool That is Accounted for as a Single Asset* which clarifies that modifications of loans that are accounted for within a pool under Subtopic 310-30, which provides guidance on accounting for acquired loans that have evidence of credit deterioration upon acquisition, do not result in the removal of those loans from the pool even if the modification would otherwise be considered a troubled debt restructuring. This ASU is effective for modifications of loans accounted for within pools occurring in the first interim period ending after July 15, 2010.

This ASU did not have a material impact on the Company's financial position and statement of income.

In July 2010, the FASB issued ASU No. 2010-20 Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses which amends Topic 310 to improve the disclosures that an entity provides about the credit quality of its financing receivables and the related allowance for credit losses. As a result of these amendments, an entity is required to disaggregate by portfolio segment or class certain existing disclosures and provide certain new disclosures about its financing receivables and related allowance for credit losses. For public entities, the disclosures as of the end of a reporting period were effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period were effective for interim and annual reporting periods beginning on or after December 15, 2010. These disclosures are included in Note 9.

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In April 2011, the FASB issued ASU No. 2011-02 *A Creditors Determination of Whether a Restructuring Is a Troubled Debt Restructuring* which clarifies a creditor's determination of whether it has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring constitutes a troubled debt restructuring. This ASU is effective for the first interim or annual period beginning after June 15, 2011. The Company has made the proper disclosure in these interim financial statement footnotes. The adoption of this ASU did not have a material impact on the Company's financial position or statement of income.

In April 2011, the FASB issued ASU No. 2011-03 *Reconsideration of Effective Control for Repurchase Agreements* which removes from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. This ASU is effective for the first interim or annual period beginning on or after December 15, 2011. The Company does not expect the adoption of this ASU to have a material impact on its financial position and statement of income.

In May 2011, the FASB issued ASU No. 2011-04 *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* which result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs by changing the wording used to describe many of the requirements in U.S. GAAP and is generally not intended to result in a change in the application of the requirements. This ASU is effective for the first interim or annual period beginning on or after December 15, 2011. The Company does not expect the adoption of this ASU to have a material impact on its financial position and statement of income.

In June 2011, the FASB issued ASU No. 2011-05 *Presentation of Comprehensive Income* which gives an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The ASU does not change the items that must be reported in other comprehensive income. This ASU is effective for the first interim or annual period beginning on or after December 15, 2011. The Company does not expect the adoption of this ASU to have a material impact on its financial position and statement of income.

**12. Subsequent Event**

On October 21, 2011, the Bank entered into a Purchase and Assumption Agreement ( *Agreement* ) with the FDIC, as Receiver of Decatur First Bank, Decatur, Georgia, and the FDIC, acting in its corporate capacity, pursuant to which the Bank acquired certain assets, and assumed substantially all of the deposits and certain liabilities, of Decatur First Bank.

Under the terms of the Agreement, the Bank acquired approximately \$179.0 million in assets, including approximately \$94.7 million in loans, and also assumed approximately \$180.1 million in liabilities, including approximately \$169.9 million in customer deposits. To settle the transaction, the FDIC made a cash payment to the Bank totaling \$10.0 million. The Bank also has entered into a shared loss agreement pursuant to which the FDIC has agreed to certain reimbursements to the Bank for net losses incurred for loans and securities acquired in the transaction as described in the Company's Form 8-K dated October 21, 2011, filed with the SEC.

**Table of Contents*****Item 2. Management's Discussion and Analysis of  
Financial Condition and Results of Operations***

The following analysis reviews important factors affecting our financial condition at September 30, 2011, compared to December 31, 2010, and compares the results of operations for the third quarter and nine months ended September 30, 2011 and 2010. These comments should be read in conjunction with our consolidated financial statements and accompanying notes appearing in this report and the Risk Factors set forth in our Annual Report on Form 10-K for the year ended December 31, 2010. All percentage and dollar variances noted in the following analysis are calculated from the balances presented in the accompanying consolidated financial statements.

**Forward-Looking Statements**

This report on Form 10-Q may include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that reflect our current expectations relating to present or future trends or factors generally affecting the banking industry and specifically affecting our operations, markets and products. Without limiting the foregoing, the words believes, expects, anticipates, estimates, projects, intends, and similar expressions are intended to identify forward-looking statements. These forward-looking statements are based upon assumptions we believe are reasonable and may relate to, among other things, the deteriorating economy and its impact on operating results and credit quality, the adequacy of the allowance for loan losses, changes in interest rates, and litigation results. These forward-looking statements are subject to risks and uncertainties. Actual results could differ materially from those projected for many reasons, including without limitation, changing events and trends that have influenced our assumptions.

These trends and events include (1) risks associated with our loan portfolio, including difficulties in maintaining quality loan growth, greater loan losses than historic levels, the risk of an insufficient allowance for loan losses, and expenses associated with managing nonperforming assets, unique risks associated with our construction and land development loans, our ability to maintain and service relationships with automobile dealers and indirect automobile loan purchasers, and our ability to profitably manage changes in our indirect automobile lending operations; (2) risks associated with adverse economic conditions, including risk of a continued decline in real estate values in the Atlanta, Georgia, metropolitan area and in eastern and northern Florida markets, conditions in the financial markets and economic conditions generally and the impact of recent efforts to address difficult market and economic conditions; a stagnant economy and its impact on operations and credit quality, the impact of a recession on our consumer loan portfolio and its potential impact on our commercial portfolio, changes in the interest rate environment and their impact on our net interest margin, and inflation; (3) risks associated with government regulation and programs, including risks arising from the terms of the U.S. Treasury Department's (the Treasury's) equity investment in us, and the resulting limitations on executive compensation imposed through our participation in the TARP Capital Purchase Program, uncertainty with respect to future governmental economic and regulatory measures, including the ability of the Treasury to unilaterally amend any provision of the purchase agreement we entered into as part of the TARP Capital Purchase Program, the winding down of governmental emergency measures intended to stabilize the financial system, and numerous legislative proposals to further regulate the financial services industry, the impact of and adverse changes in the governmental regulatory requirements affecting us, and changes in political, legislative and economic conditions; (4) the ability to maintain adequate liquidity and sources of liquidity; (5) our ability to maintain sufficient capital and to raise additional capital; (6) the accuracy and completeness of information from customers and our counterparties; (7) the effectiveness of our controls and procedures; (8) our ability to attract and retain skilled people; (9) greater competitive pressures among financial institutions in our market; (10) failure to achieve the revenue increases expected to result from our investments in our growth strategies, including our branch additions and in our transaction deposit and lending businesses; (11) the volatility and limited trading of our common stock; and (12) the impact of dilution on our common stock; (13) our ability to fully integrate, and to integrate successfully, the branches acquired through an FDIC assisted transaction into the Bank's operations; (14) the risk that FDIC-assisted acquisitions may not produce revenue or earnings enhancements or cost savings at levels or within timeframes originally anticipated and may result in unforeseen integration difficulties; (15) the risk that changes in national and local economic conditions could lead to higher loan charge-offs in connection with our FDIC-assisted transactions, all of which may not be supported by loss-sharing agreements with the FDIC.

This list is intended to identify some of the principal factors that could cause actual results to differ materially from those described in the forward-looking statements included herein and are not intended to represent a complete list of all risks and uncertainties in our business. Investors are encouraged to read the related section in our 2010 Annual Report on Form 10-K, including the Risk Factors set forth therein. Additional information and other factors that could affect future financial results are included in our filings with the Securities and Exchange Commission.

**Critical Accounting Policies**

Our accounting and reporting policies are in accordance with U.S. generally accepted accounting principles and conform to general practices within the financial services industry. Our financial position and results of operations are affected by management's application of accounting policies, including estimates, assumptions and judgments made to arrive at the carrying value of assets and liabilities and amounts reported for revenues, expenses and related disclosures. Different assumptions in the application of these policies, or conditions significantly different from certain assumptions, could result in material changes in our consolidated financial position or consolidated results of operations. Critical accounting and reporting policies include those related to the allowance for loan losses, fair value of mortgage loans held-for-sale, the capitalization of servicing assets and liabilities and the related amortization, loan related revenue recognition, and income taxes. Our accounting policies are fundamental to understanding our consolidated financial position and consolidated results of operations. Significant accounting policies have been periodically discussed and reviewed with and approved by the Board of Directors.

Our critical accounting policies that are highly dependent on estimates, assumptions, and judgment are substantially unchanged from the descriptions included in the notes to consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2010.

**Results of Operations**

**Net Income**

For the third quarter of 2011, the Company recorded net income of \$2.1 million compared to net income of \$2.1 million for the third quarter of 2010. Net income available to common equity was \$1.3 million for both quarters ended September 30, 2011 and 2010. Basic and diluted earnings per share for the third quarter of 2011 were \$0.10 and \$0.09, respectively, compared to \$0.12 and \$0.10, respectively, for the three months ended September 30, 2010.



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Net income for the nine months ended September 30, 2011 was \$7.6 million compared to \$7.1 million for the same period in 2010. Net income available to common equity was \$5.1 million and \$4.7 million for the nine month period ended September 30, 2011 and 2010, respectively. Basic and diluted earnings per share for the first nine months of 2011 were \$0.43 and \$0.38, respectively, compared to \$0.43 and \$0.39 for the nine months ended September 30, 2010. The increase in net income for the nine months ended September 30, 2011, compared to the same period in 2010 was primarily due to a \$4.5 million increase in net interest income and a \$6.4 million increase in noninterest income somewhat offset by a \$4.9 million increase in provision for loan loss and a \$6.0 million increase in noninterest expense.

Details of the changes in the various components of net income are further discussed below.

**Net Interest Income**

|                                 | Quarter Ended                 |                    |                | Quarter Ended      |                    |                |
|---------------------------------|-------------------------------|--------------------|----------------|--------------------|--------------------|----------------|
|                                 | September 30, 2011            |                    |                | September 30, 2010 |                    |                |
|                                 | Average<br>Balance            | Income/<br>Expense | Yield/<br>Rate | Average<br>Balance | Income/<br>Expense | Yield/<br>Rate |
|                                 | <i>(Dollars in thousands)</i> |                    |                |                    |                    |                |
| <b>Assets</b>                   |                               |                    |                |                    |                    |                |
| <b>Interest-earning assets:</b> |                               |                    |                |                    |                    |                |
| Loans, net of unearned income:  |                               |                    |                |                    |                    |                |
| Taxable                         | \$ 1,579,629                  | \$ 21,208          | 5.33%          | \$ 1,504,460       | \$ 22,015          | 5.81%          |
| Tax-exempt <sup>(1)</sup>       | 5,018                         | 77                 | 6.14%          | 5,252              | 82                 | 6.20%          |
| Total loans                     | 1,584,647                     | 21,285             | 5.33%          | 1,509,712          | 22,097             | 5.81%          |
| Investment securities:          |                               |                    |                |                    |                    |                |
| Taxable                         | 202,678                       | 1,470              | 2.90%          | 181,018            | 1,480              | 3.27%          |
| Tax-exempt <sup>(2)</sup>       | 11,704                        | 184                | 6.30%          | 11,705             | 183                | 6.25%          |
| Total investment securities     | 214,382                       | 1,654              | 3.09%          | 192,723            | 1,663              | 3.46%          |
| Interest-bearing deposits       |                               |                    |                |                    |                    |                |
| Federal funds sold              | 169,864                       | 109                | 0.25%          | 69,789             | 43                 | 0.24%          |
|                                 | 985                           |                    | 0.05%          | 642                |                    | 0.07%          |
| Total interest-earning assets   | 1,969,878                     | 23,048             | 4.64%          | 1,772,866          | \$ 23,803          | 5.33%          |
| <b>Noninterest-earning:</b>     |                               |                    |                |                    |                    |                |
| Cash and due from banks         | 14,807                        |                    |                | 13,723             |                    |                |
| Allowance for loan losses       | (28,945)                      |                    |                | (26,825)           |                    |                |
| Premises and equipment, net     | 21,490                        |                    |                | 19,037             |                    |                |
| Other real estate               | 23,094                        |                    |                | 21,573             |                    |                |
| Other assets                    | 87,814                        |                    |                | 75,724             |                    |                |
| Total assets                    | \$ 2,088,138                  |                    |                | \$ 1,876,098       |                    |                |

**Liabilities and shareholders equity****Interest-bearing liabilities:**

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|  |              |           |       |              |           |       |
|--|--------------|-----------|-------|--------------|-----------|-------|
| Demand deposits                                | \$ 431,245   | \$ 482    | 0.44% | \$ 394,658   | \$ 984    | 0.99% |
| Savings deposits                               | 410,570      | 547       | 0.53% | 386,382      | 1,184     | 1.22% |
| Time deposits                                  | 670,506      | 2,781     | 1.65% | 599,788      | 3,339     | 2.21% |
| Total interest-bearing deposits                | 1,512,321    | 3,810     | 1.00% | 1,380,828    | 5,507     | 1.58% |
| Federal funds purchased                        | 32           |           | 0.91% |              |           | %     |
| Securities sold under agreements to repurchase | 17,331       | 9         | 0.21% | 24,097       | 142       | 2.34% |
| Other short-term borrowings                    | 22,500       | 159       | 2.81% | 4,076        | 43        | 4.12% |
| Subordinated debt                              | 67,527       | 1,122     | 6.59% | 67,527       | 1,138     | 6.69% |
| Long-term debt                                 | 52,500       | 304       | 2.29% | 70,924       | 446       | 2.49% |
| Total interest-bearing liabilities             | 1,672,211    | 5,404     | 1.28% | 1,547,452    | 7,276     | 1.87% |
| <b>Noninterest-bearing:</b>                    |              |           |       |              |           |       |
| Demand deposits                                | 223,372      |           |       | 172,785      |           |       |
| Other liabilities                              | 31,427       |           |       | 17,917       |           |       |
| Shareholders' equity                           | 161,128      |           |       | 137,944      |           |       |
| Total liabilities and shareholders' equity     | \$ 2,088,138 |           |       | \$ 1,876,098 |           |       |
| Net interest income/spread                     |              | \$ 17,644 | 3.36% |              | \$ 16,527 | 3.46% |
| Net interest margin                            |              |           | 3.55% |              |           | 3.70% |

- (1) Interest income includes the effect of taxable equivalent adjustment for 2011 and 2010 of \$27,000 and \$29,000, respectively.
- (2) Interest income includes the effect of taxable-equivalent adjustment for 2011 and 2010 of \$62,000 and \$61,000, respectively.

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|  | Year To Date                  |                    |                |                    |                    |                |
|--|-------------------------------|--------------------|----------------|--------------------|--------------------|----------------|
|  | September 30, 2011            |                    |                | September 30, 2010 |                    |                |
|  | Average<br>Balance            | Income/<br>Expense | Yield/<br>Rate | Average<br>Balance | Income/<br>Expense | Yield/<br>Rate |
|  | <i>(Dollars in thousands)</i> |                    |                |                    |                    |                |
| <b>Assets</b>                                  |                               |                    |                |                    |                    |                |
| <b>Interest-earning assets:</b>                |                               |                    |                |                    |                    |                |
| Loans, net of unearned income:                 |                               |                    |                |                    |                    |                |
| Taxable  | \$ 1,567,097                  | \$ 64,151          | 5.47%          | \$ 1,444,046       | \$ 64,727          | 5.99%          |
| Tax-exempt <sup>(1)</sup>                      | 5,068                         | 232                | 6.14%          | 5,280              | 242                | 6.16%          |
| Total loans                                    | 1,572,165                     | 64,383             | 5.47%          | 1,449,326          | 64,969             | 5.99%          |
| Investment securities:                         |                               |                    |                |                    |                    |                |
| Taxable  | 201,923                       | 4,628              | 3.06%          | 222,756            | 5,985              | 3.58%          |
| Tax-exempt <sup>(2)</sup>                      | 11,704                        | 551                | 6.28%          | 11,706             | 547                | 6.22%          |
| Total investment securities                    | 213,627                       | 5,179              | 3.24%          | 234,462            | 6,532              | 3.72%          |
| Interest-bearing deposits                      |                               |                    |                |                    |                    |                |
| Federal funds sold                             | 118,981                       | 199                | 0.22%          | 84,792             | 149                | 0.23%          |
|  | 874                           |                    | 0.06%          | 616                |                    | 0.08%          |
| Total interest-earning assets                  | 1,905,647                     | 69,761             | 4.89%          | 1,769,196          | \$ 71,650          | 5.41%          |
| <b>Noninterest-earning:</b>                    |                               |                    |                |                    |                    |                |
| Cash and due from banks                        | 13,963                        |                    |                | 8,906              |                    |                |
| Allowance for loan losses                      | (28,772)                      |                    |                | (28,227)           |                    |                |
| Premises and equipment, net                    | 20,565                        |                    |                | 18,696             |                    |                |
| Other real estate                              | 21,497                        |                    |                | 23,786             |                    |                |
| Other assets                                   | 85,889                        |                    |                | 77,488             |                    |                |
| Total assets                                   | \$ 2,018,789                  |                    |                | \$ 1,869,845       |                    |                |
| <b>Liabilities and shareholders equity</b>     |                               |                    |                |                    |                    |                |
| <b>Interest-bearing liabilities:</b>           |                               |                    |                |                    |                    |                |
| Demand deposits                                | \$ 421,133                    | \$ 1,852           | 0.59%          | \$ 314,666         | \$ 2,215           | 0.94%          |
| Savings deposits                               | 411,980                       | 2,782              | 0.90%          | 427,488            | 4,684              | 1.46%          |
| Time deposits                                  | 640,285                       | 8,156              | 1.70%          | 648,487            | 11,833             | 2.44%          |
| Total interest-bearing deposits                | 1,473,398                     | 12,790             | 1.16%          | 1,390,641          | 18,732             | 1.80%          |
| Federal funds purchased                        | 11                            |                    | 0.91%          | 989                | 7                  | 0.94%          |
| Securities sold under agreements to repurchase | 19,566                        | 199                | 1.36%          | 22,556             | 319                | 1.89%          |
| Other short-term borrowings                    | 14,744                        | 313                | 2.84%          | 19,377             | 572                | 3.94%          |
| Subordinated debt                              | 67,527                        | 3,365              | 6.66%          | 67,527             | 3,378              | 6.69%          |

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|  |              |           |       |              |           |       |
|--|--------------|-----------|-------|--------------|-----------|-------|
| Long-term debt                             | 60,256       | 1,056     | 2.34% | 57,052       | 1,135     | 2.66% |
| Total interest-bearing liabilities         | 1,635,502    | 17,723    | 1.45% | 1,558,142    | 24,143    | 2.07% |
| <b>Noninterest-bearing:</b>                |              |           |       |              |           |       |
| Demand deposits                            | 206,566      |           |       | 163,476      |           |       |
| Other liabilities                          | 26,582       |           |       | 14,749       |           |       |
| Shareholders' equity                       | 150,139      |           |       | 133,478      |           |       |
| Total liabilities and shareholders' equity | \$ 2,018,789 |           |       | \$ 1,869,845 |           |       |
| Net interest income/spread                 |              | \$ 52,038 | 3.44% |              | \$ 47,507 | 3.34% |
| Net interest margin                        |              |           | 3.65% |              |           | 3.59% |

(1) Interest income includes the effect of taxable equivalent adjustment for 2011 and 2010 of \$81,000 and \$83,000, respectively.

(2) Interest income includes the effect of taxable-equivalent adjustment for 2011 and 2010 of \$185,000 and \$182,000, respectively.

Net interest income for the three months ended September 30, 2011, increased \$1.1 million or 6.8% to \$17.6 million compared to the same period in 2010. The cost of funds on total interest bearing liabilities decreased 59 basis points to 1.28% for the third quarter of 2011 compared to the same period in 2010 as a result of a continued reduction in deposit interest rates in response to the market and our local competition. The average balance of interest-earning assets increased by \$197.0 million or 11.1% to \$1.970 billion for the third quarter of 2011, when compared to the same period in 2010. The yield on interest-earning assets for the third quarter of 2011 was 4.64%, a decrease of 69 basis points when compared to the yield on interest-earning assets for the same period in 2010. The average balance of loans outstanding for the third quarter of 2011 increased \$74.9 million or 5.0% to \$1.585 billion when compared to the same period in 2010. The increase in the loan portfolio was led by growth in the indirect lending portfolio due to competitive pricing in the marketplace and a general recovery of automobile sales. The yield on average loans outstanding for the quarter ended September 30, 2011 decreased 48 basis points to 5.33% when compared to the same period in 2010. Also contributing to the reduction in yield on earning assets was a \$100.1 million or 143.4% increase in average investment in interest-bearing deposits which yielded .25% due to strong core deposit growth.

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Net interest income for the first nine months ended September 30, 2011, increased \$4.5 million or 9.6% to \$51.8 million compared to the same period in 2010. The cost of funds on total interest bearing liabilities decreased 62 basis points to 1.45% for the first nine months of 2011 compared to the same period in 2010 as a result of a continued reduction in deposit interest rates. The average balance of interest-earning assets increased by \$136.5 million or 7.7% to \$1.906 billion for the first nine months of 2011, when compared to the same period in 2010. The yield on interest-earning assets for the first nine months of 2011 was 4.89%, a decrease of 52 basis points when compared to the yield on interest-earning assets for the same period in 2010. The average balance of loans outstanding for the first nine months of 2011 increased \$122.8 million or 8.5% to \$1.572 billion when compared to the same period in 2010 led by an increase in the indirect lending portfolio.

The Bank manages its net interest spread and net interest margin based primarily on its loan and deposit pricing. As part of management's concerted effort to reduce the cost of funds on deposits, there was a shift in the mix of deposits from higher cost certificate of deposits to lower cost savings and money market accounts. Management will continue to review its deposit pricing in 2011 and forecasts a continued decrease to cost of funds as higher priced certificates of deposit and brokered deposits mature and reset to lower interest rates.

**Provision for Loan Losses**

The allowance for loan losses is established and maintained through provisions charged to operations. Such provisions are based on management's evaluation of the loan portfolio including loan portfolio concentrations, current economic conditions, past loan loss experience, adequacy of underlying collateral, and such other factors which, in management's judgment, require consideration in estimating loan losses. Loans are charged off or charged down when, in the opinion of management, such loans are deemed to be uncollectible or not fully collectible. Subsequent recoveries are added to the allowance.

For all loan categories, historical loan loss experience, adjusted for changes in the risk characteristics of each loan category, current trends, and other factors, is used to determine the level of allowance required. Additional amounts are allocated based on the probable losses of individual impaired loans and the effect of economic conditions on both individual loans and loan categories. Since the allocation is based on estimates and subjective judgment, it is not necessarily indicative of the specific amounts of losses that may ultimately occur.

The allowance for loan losses for homogenous pools is allocated to loan types based on historical net charge-off rates adjusted for any current trends or other factors. The specific allowance for individually reviewed nonperforming loans and loans having greater than normal risk characteristics is based on a specific loan impairment analysis which in many cases relies predominantly on the adequacy of loan collateral.

In determining the appropriate level for the allowance, management ensures that the overall allowance appropriately reflects a margin for the imprecision inherent in most estimates of the range of probable credit losses. This additional amount, if any, is reflected in the overall allowance. Management believes the allowance for loan losses is adequate to provide for losses inherent in the loan portfolio at September 30, 2011 (see Asset Quality).

The provision for loan losses for the third quarter and first nine months of 2011 was \$4.4 million and \$15.0 million, respectively, compared to \$5.0 million and \$10.2 million for the same periods in 2010. The year to date increase was primarily a result of an increase in general reserves related to growth in the loan portfolio, and an increase in net charge-offs. From January 1, 2008 to September 30, 2011, net charge-offs were \$84.7 million and the Company recorded an aggregate provision for loan losses of \$97.5 million. For every dollar of net charge-offs realized, the Company recorded \$1.15 in provision during this period.

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The following schedule summarizes changes in the allowance for loan losses for the periods indicated:

|   | <b>Nine Months Ended</b>      |               | <b>Year Ended</b> |
|---|-------------------------------|---------------|-------------------|
|   | <b>September 30,</b>          |               | <b>December</b>   |
|   | <b>2011</b>                   | <b>2010</b>   | <b>31,</b>        |
|   | <b>(Dollars in thousands)</b> |               |                   |
| Balance at beginning of period                                      | \$ 28,082                     | \$ 30,072     | \$ 30,072         |
| Charge-offs:  |                               |               |                   |
| Commercial, financial and agricultural                              | 265                           | 144           | 883               |
| SBA   | 713                           | 322           | 381               |
| Real estate-construction  | 9,704                         | 6,529         | 11,274            |
| Real estate-mortgage  | 731                           | 266           | 656               |
| Consumer installment  | 3,286                         | 5,463         | 7,086             |
| <b>Total charge-offs</b>  | <b>14,699</b>                 | <b>12,724</b> | <b>20,280</b>     |
| Recoveries:   |                               |               |                   |
| Commercial, financial and agricultural                              | 7                             | 23            | 23                |
| SBA   | 78                            |               | 5                 |
| Real estate-construction  | 219                           | 206           | 361               |
| Real estate-mortgage  | 43                            | 4             | 8                 |
| Consumer installment  | 626                           | 562           | 768               |
| <b>Total recoveries</b>   | <b>973</b>                    | <b>795</b>    | <b>1,165</b>      |
| <b>Net charge-offs</b>  | <b>13,726</b>                 | <b>11,929</b> | <b>19,115</b>     |
| <b>Provision for loan losses</b>                                    | <b>15,025</b>                 | <b>10,150</b> | <b>17,125</b>     |
| Balance at end of period  | \$ 29,381                     | \$ 28,293     | \$ 28,082         |
| <br>  |                               |               |                   |
| Annualized ratio of net charge-offs to average loans                | <b>1.26%</b>                  | 1.22%         | 1.44%             |
| <br>  |                               |               |                   |
| Allowance for loan losses as a percentage of loans at end of period | <b>1.96%</b>                  | 2.09%         | 2.00%             |

SBA loan net charge-offs were \$635,000 for the first nine months of 2011 compared to \$322,000 for the same period in 2010. Nonaccrual loans increased from \$12.7 million at September 30, 2010 to \$15.8 million at September 30, 2011. Management expects fourth quarter charge-offs to be consistent with the first nine months of 2011.

Construction loan net charge-offs were \$9.5 million in the first nine months of 2011 compared to \$6.3 million in the same period in 2010. Management will continue to monitor closely and aggressively address credit quality and trends in the residential construction loan portfolio.

Substantially all of the consumer installment loan net charge-offs in the first nine months of 2011 and 2010 were from the indirect automobile loan portfolio. Consumer installment loan net charge-offs decreased \$2.2 million to \$2.7 million for the nine months ended September 30, 2011, compared to the same period in 2010 as the overall

economy showed signs of improvement. The annualized ratio of net charge-offs to average consumer loans outstanding was .47% and 1.06% during the first nine months of 2011 and 2010, respectively.

**Noninterest Income**

Noninterest income for the third quarter of 2011 was \$10.0 million compared to \$11.6 million for the same period in 2010, a decrease of \$1.6 million for the three month period. The decrease is primarily the result of a decrease in mortgage banking activities. For the nine month period ended September 30, 2011, compared to 2010, noninterest income increased \$6.4 million to \$35.8 million. The increase was a result of higher income from SBA lending activities, higher income from mortgage banking activities, and increased income from indirect lending activities somewhat offset by lower securities gains.

For the third quarter and first nine months of 2011 compared to the same periods in 2010, income from SBA lending activities decreased \$195,000 and increased \$4.8 million to \$756,000 and \$6.6 million, respectively. The increase for the nine month period was primarily due to an increase in the gain on loans sold. SBA loans sold totaled \$8.1 million and \$76.5 million for the third quarter and first nine months of 2011 compared to \$9.8 million and \$16.3 million sold in the third quarter and first nine months of 2010. The increase for the nine month period was somewhat due to the updated accounting guidance for transfers of financial assets effective January 1, 2010. In addition, with the improvement in credit markets, demand for loan sales and therefore the market price and profit on loan sales continued to improve in 2011.

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Income from mortgage banking activities decreased \$1.9 million to \$5.2 million for the quarter ended September 30, 2011 compared to the same period in 2010 primarily due to a \$1.9 million increase in the impairment against the mortgage servicing asset as a result of historically low mortgage interest rates and higher prepayments. Income from mortgage banking activities increased \$1.8 million to \$16.6 million for the nine months ended September 30, 2011 compared to the same period in 2010 due to the \$2.6 million increase in the gain on loans sold, net of a \$711,000 decrease in other fee income primarily caused by the mortgage servicing impairment. Mortgage loans sold totaled \$842 million for the first nine months of 2011 compared to \$749 million sold for the same period in 2010. Historically low interest rates and an increase in origination staff contributed to the increase in volume of loans originated.

Income from indirect lending activities increased \$400,000 and \$913,000 to \$1.6 million and \$4.3 million, respectively, for the quarter and nine months ended September 30, 2011 compared to the same periods in 2010. The increases were primarily due to an increase in the gain on loans sold. Indirect lending loans sold totaled \$38.9 million and \$95.7 million for the third quarter and first nine months of 2011 compared to \$15.9 million and \$51.3 million sold in the third quarter and first nine months of 2010.

Securities gains decreased \$1.2 million to \$1.1 million for the first nine months of 2011 compared to the same period in 2010 because of a decrease in the volume of securities sold for the periods. In 2011, the Bank sold \$31.7 million compared to \$98.3 million for 2010.

**Noninterest Expense**

Noninterest expense was \$20.4 million for the third quarter of 2011, compared to \$20.0 million for the same period in 2010, an increase of \$436,000 or 2.2%. For the nine months ended September 30, 2011, noninterest expense increased \$6.0 million to \$61.8 million compared to the same period in 2010. For the third quarter, the increase was a result of higher other operating expense which increased \$818,000 or 34.7% due to higher legal expense, higher losses and reserves primarily related to the establishment of certain mortgage lending reserves, and higher credit reporting expense due to loan growth in the mortgage division. Somewhat offsetting this increase was a decrease in FDIC insurance expense of \$462,000 to \$428,000 as a result of a reduction in the FDIC assessment rate and base. For the nine months ended September 30, 2011, the increase was a result of higher salaries and benefits expense which increased \$3.5 million or 11.4% as a result of the expansion of the mortgage division and an increase in lenders in the SBA, Commercial, Private Banking and Indirect Auto Lending divisions. Other operating expense increased \$2.1 million or 33.1% due to higher legal expense, insurance expense, higher credit reporting expense due to loan growth in the mortgage division and an increase in advertising expense. Details of ORE expense are presented below.

|                           | Three Months Ended September 30, |        |          |        | Nine Months Ended September 30, |        |          |        |
|---------------------------|----------------------------------|--------|----------|--------|---------------------------------|--------|----------|--------|
|                           | 2011                             |        | 2010     |        | 2011                            |        | 2010     |        |
|                           | \$                               | %      | \$       | %      | \$                              | %      | \$       | %      |
|                           | <i>(Dollars in thousands)</i>    |        |          |        |                                 |        |          |        |
| Writedown of ORE          | \$ 677                           | 51.4%  | \$ 698   | 49.5%  | \$ 3,347                        | 60.1%  | \$ 3,681 | 62.0%  |
| ORE real property taxes   | 115                              | 8.7    | 159      | 11.3   | 374                             | 6.7    | 546      | 9.2    |
| Foreclosure expense       | 241                              | 18.3   | 354      | 25.1   | 1,081                           | 19.4   | 1,116    | 18.8   |
| ORE misc. expense         | 283                              | 21.6   | 200      | 14.1   | 765                             | 13.8   | 596      | 10.0   |
| Other real estate expense | \$ 1,316                         | 100.0% | \$ 1,411 | 100.0% | \$ 5,567                        | 100.0% | \$ 5,939 | 100.0% |

**Provision for Income Taxes**

The provision for income taxes for the third quarter of 2011 was \$608,000, compared to \$913,000 for the same period in 2010. For the nine month period ended September 30, 2011, provision for income taxes was \$3.2 million compared to \$3.5 million for the nine month period ended September 30, 2010. The decreased income tax expense for the third quarter of 2011 was primarily the result of a decrease in income before taxes. The effective income tax rate at September 30, 2011, differs from the statutory rate primarily due to benefits related to increases in the cash surrender value of life insurance.



Taxes are accounted for in accordance with ASC 740-10-05. Under the liability method, deferred tax assets and liabilities ( net DTA ) are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. A charge to establish a valuation allowance is recognized if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) some portion or all of the deferred tax assets will not be realized.

Four sources of taxable income are considered in determining whether a valuation allowance is required, included as set forth within ASC 740: taxable income in prior years, future reversals of existing taxable temporary differences, tax planning strategies and future taxable income. Management has concluded that it will more likely than not realize the benefit of its net DTA as of September 30, 2011, based to a large extent on its reliance on projections of future taxable income. Management believes that sufficient taxable income will be present in near term future periods to fully realize these net DTAs.

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***Financial Condition***

Total assets were \$2.110 billion at September 30, 2011, compared to \$1.945 billion at December 31, 2010, an increase of \$164.4 million, or 8.5%. This increase was due to an increase of \$96.7 million in loans, \$77.0 in investments available-for-sale, and \$70.5 million in cash and cash equivalents somewhat offset by a \$84.6 million decrease in loans held-for-sale.

Loans increased \$96.7 million or 6.9% to \$1.500 billion at September 30, 2011, compared to \$1.403 billion at December 31, 2010. The increase in loans was primarily the result of an increase in consumer loans of \$118.2 million or 16.5% to \$834.3 million. Consumer installment loans increased as the Bank grew its indirect automobile loan portfolio by expanding its lending area. Somewhat offsetting these increases was a decrease in real estate construction loans of \$22.3 million or 19.3% to \$93.0 million. As the slow real estate market continued during the first nine months of 2011, demand for construction loans continued to be limited and the portfolio balance continued to decrease including \$18.9 million in loans that were transferred to other real estate.

Investment securities available-for-sale increased \$77.0 million or 47.7% to \$238.5 million at September 30, 2011, compared to December 31, 2010. The Company completed several investment purchases and sales in an effort to extend the maturity of the portfolio, to enact tax strategies and to improve the risk based capital requirement profile of the investment portfolio. Six agency step-up securities totaling \$53.2 million were called. In addition, the Bank sold \$31.7 million in agency mortgage-backed securities in 2011. To replace the securities sold and called, the Bank purchased \$171.8 million in new securities including \$78.6 million in GNMA securities and \$93.2 million in FHLB step-up securities. These purchases were primarily funded with excess liquidity generated by core deposit growth. Cash and cash equivalents increased \$70.5 million or 147.6% to \$118.2 million at September 30, 2011, compared to December 31, 2010. This balance varies with the Bank's liquidity needs and is influenced by scheduled loan closings, investment purchases, timing of customer deposits, and loan sales.

Loans held-for-sale decreased \$84.6 million or 40.3% to \$125.3 million at September 30, 2011, compared to December 31, 2010. The decrease was due primarily to a decrease in mortgage loans held-for-sale as a result of increased sales to FNMA and increased frequency of loan sales.

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The following schedule summarizes our total loans at September 30, 2011 and December 31, 2010:

|                             | September<br>30,<br>2011 | December 31,<br>2010 |
|-----------------------------|--------------------------|----------------------|
|                             | <i>(In thousands)</i>    |                      |
| <b>Loans:</b>               |                          |                      |
| Commercial                  | \$ 392,289               | \$ 384,220           |
| SBA loans                   | 89,537                   | 94,282               |
| Total commercial loans      | 481,826                  | 478,502              |
| Construction                | 92,967                   | 115,224              |
| Indirect loans              | 815,238                  | 695,754              |
| Installment loans           | 19,111                   | 20,431               |
| Total consumer loans        | 834,349                  | 716,185              |
| First mortgage loans        | 32,974                   | 34,367               |
| Second mortgage loans       | 57,978                   | 59,094               |
| Total mortgage loan         | 90,952                   | 93,461               |
| Loans                       | 1,500,094                | 1,403,372            |
| Allowance for loan losses   | (29,381)                 | (28,082)             |
| Loans, net of allowance     | \$ 1,470,713             | \$ 1,375,290         |
| <b>Total Loans:</b>         |                          |                      |
| Loans                       | \$ 1,500,094             | \$ 1,403,372         |
| <b>Loans Held-for-Sale:</b> |                          |                      |
| Residential mortgage        | 71,063                   | 155,029              |
| Indirect                    | 30,000                   | 30,000               |
| SBA                         | 24,205                   | 24,869               |
|                             | 125,268                  | 209,898              |
|                             | \$ 1,625,362             | \$ 1,613,270         |

**Asset Quality**

The following schedule summarizes our asset quality at September 30, 2011 and December 31, 2010:

|  | September<br>30, | December 31, |
|--|------------------|--------------|
|--|------------------|--------------|

|  | <b>2011</b>                   | <b>2010</b> |
|--|-------------------------------|-------------|
|  | <i>(Dollars in thousands)</i> |             |
| <b>Nonperforming assets:</b>   |                               |             |
| Nonaccrual loans   | \$ 60,984                     | \$ 76,545   |
| Repossessions  | 1,077                         | 1,119       |
| Other real estate  | 24,494                        | 20,525      |
| Total nonperforming assets   | <b>86,555</b>                 | 98,189      |
| Other classified assets  | <b>31,435</b>                 | 39,221      |
| Total classified assets  | \$ 117,990                    | \$ 137,410  |
| Includes SBA guaranteed loans of approximately                       | \$ 8,641                      | \$ 7,818    |
| Loans 90 days past due and still accruing                            | \$ 422                        | \$          |
| Allowance for loan losses  | \$ 29,381                     | \$ 28,082   |
| Ratio of loans past due and still accruing to loans                  | <b>0.03%</b>                  | %           |
| Ratio of nonperforming assets to total loans, ORE, and repossessions | <b>5.24%</b>                  | 6.01%       |
| Allowance to period-end loans  | <b>1.96%</b>                  | 2.00%       |
| Allowance to nonaccrual loans and repossessions (coverage ratio)     | <b>0.47x</b>                  | .36x        |
| Classified assets to tier one capital and allowance for loan losses  | <b>48.86%</b>                 | 66.56%      |

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The \$61.0 million in nonaccrual loans at September 30, 2011, included \$35.5 million in residential construction related loans, \$18.9 million in commercial and SBA loans and \$6.6 million in retail and consumer loans. Of the \$35.5 million in residential construction related loans on nonaccrual, \$9.6 million was related to 64 single family construction loans with completed homes and homes in various stages of completion, \$16.4 million was related to 640 single family developed lots, and \$9.5 million related to other loans.

The \$24.5 million in other real estate at September 30, 2011, was made up of twelve commercial properties with a balance of \$8.0 million and the remainder were residential construction related balances which consisted of \$5.4 million in 60 residential single family homes completed or substantially completed, \$9.4 million in 460 single family developed lots, and \$1.7 million in two parcels of undeveloped land.

The Bank makes standard representations and warranties in the normal course of selling mortgage loans in the secondary market. We have not experienced any material repurchase requests as a result of these obligations related to the representations and warranties. The Bank does not securitize the mortgages it originates.

**Deposits**

|                                      | September 30, 2011           |        | December 31, 2010 |        |
|--------------------------------------|------------------------------|--------|-------------------|--------|
|                                      | \$                           | %      | \$                | %      |
|                                      | <i>(Dollars in millions)</i> |        |                   |        |
| Core deposits <sup>(1)</sup>         | \$ 1,414.1                   | 80.1%  | \$ 1,304.5        | 80.9%  |
| Time deposits greater than \$100,000 | 322.3                        | 18.3   | 246.3             | 15.2   |
| Brokered deposits                    | 29.1                         | 1.6    | 62.5              | 3.9    |
| Total deposits                       | \$ 1,765.5                   | 100.0% | \$ 1,613.3        | 100.0% |

(1) Core deposits include noninterest-bearing demand, money market and interest-bearing demand, savings deposits, and time deposits less than \$100,000.

Total deposits at September 30, 2011, were \$1.766 billion compared to \$1.613 billion at December 31, 2010, a \$152.3 million or 9.4% increase. Along with the increase in total deposits, the designed change to the deposit mix and interest rate paid on deposits demonstrates the Company's commitment to improved net interest margin and liquidity. Time deposits greater than \$100,000 increased \$75.9 million or 30.8% to \$322.3 million. Noninterest-bearing demand deposits increased \$62.0 million or 33.4% to \$247.7 million. Interest-bearing demand deposits increased \$19.6 million or 4.6% to \$447.2 million. Time deposits greater than \$100,000 increased as management began to prepare for future increases in interest rates by lengthening deposit maturities. Noninterest-bearing demand accounts increased primarily due to unlimited protection from the FDIC under the Temporary Liquidity Guarantee Program as well as increases in deposits associated with mortgage and SBA escrow accounts. Interest-bearing demand accounts increased as customers continued to stay liquid in the historically low interest rate environment.

**Other Long-Term Debt**

Other long-term debt decreased \$22.5 million or 30.0% to \$52.5 million at September 30, 2011, compared to \$75.0 million at December 31, 2010. The decrease is a result of the reclassification of three FHLB advances totaling \$22.5 million from long-term borrowings to short-term borrowings. A \$5.0 million 3.29% FHLB advance maturing March 12, 2012, a \$2.5 million 3.25% FHLB advances maturing April 2, 2012, and a \$15.0 million 2.56% FHLB advance maturing April 13, 2012 were reclassified during the first nine months of 2011.

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|  | <b>September<br/>30,<br/>2011</b> | <b>December 31,<br/>2010</b> |
|--|-----------------------------------|------------------------------|
|  | <i>(In thousands)</i>             |                              |
| <b>Long-Term Debt</b>  |                                   |                              |
| FHLB three year Fixed Rate Advance with interest at 1.76% maturing July 16, 2013   | \$ 25,000                         | \$ 25,000                    |
| FHLB four year Fixed Rate Advance with interest at 3.2875% maturing March 12, 2012   |                                   | 5,000                        |
| FHLB five year European Convertible Advance with interest at 2.395% maturing March 12, 2013, with a one-time FHLB conversion option to reprice to a three-month LIBOR-based floating rate at the end of two years  | 5,000                             | 5,000                        |
| FHLB five year European Convertible Advance with interest at 2.79% maturing March 12, 2013, with a one-time FHLB conversion option to reprice to a three-month LIBOR-based floating rate at the end of three years | 5,000                             | 5,000                        |
| FHLB four year Fixed Rate Credit Advance with interest at 3.24% maturing April 2, 2012   |                                   | 2,500                        |
| FHLB five year European Convertible Advance with interest at 2.40% maturing April 3, 2013, with a one-time FHLB conversion option to reprice to a three-month LIBOR-based floating rate at the end of two years    | 2,500                             | 2,500                        |
| FHLB four year Fixed Rate Credit Advance with interest at 2.90% maturing March 11, 2013  | 15,000                            | 15,000                       |
| FHLB three year Fixed Rate Credit Advance with interest at 2.56% maturing April 13, 2012   |                                   | 15,000                       |
| Total long-term debt   | \$ 52,500                         | \$ 75,000                    |

**Subordinated Debt**

The Company has five unconsolidated business trust ( trust preferred ) subsidiaries that are variable interest entities. The Company s subordinated debt consists of the outstanding obligations of the five trust preferred issues and the amounts to fund the investments in the common stock of those entities.

The following schedule summarizes our subordinated debt at September 30, 2011:

| <b>Type</b>     | <b>Issued<sup>(1)</sup></b> | <b>Subordinated<br/>Debt</b>  | <b>Interest Rate</b> |
|-----------------|-----------------------------|-------------------------------|----------------------|
|                 |                             | <i>(Dollars in thousands)</i> |                      |
| Trust Preferred |                             | \$ 10,825                     | Fixed @ 10.875%      |

|                 |                    |           |                                    |
|-----------------|--------------------|-----------|------------------------------------|
|                 | March 8,<br>2000   |           |                                    |
| Trust Preferred | July 19,<br>2000   | 10,309    | Fixed @ 11.045%                    |
| Trust Preferred | June 26,<br>2003   | 15,464    | Variable @<br>3.45% <sup>(2)</sup> |
| Trust Preferred | March 17,<br>2005  | 10,310    | Variable @<br>2.24% <sup>(3)</sup> |
| Trust Preferred | August 20,<br>2007 | 20,619    | Fixed @<br>6.620% <sup>(4)</sup>   |
|                 |                    | \$ 67,527 |                                    |

- (1) Each trust preferred security has a final maturity thirty years from the date of issuance.
- (2) Reprices quarterly at a rate 310 basis points over three month LIBOR and is subject to refinancing or repayment at par with regulatory approval.
- (3) Reprices quarterly at a rate 189 basis points over three month LIBOR.
- (4) Five year fixed rate, and then reprices quarterly at a rate 140 basis points over three month LIBOR.

#### **Liquidity and Capital Resources**

Market and public confidence in our financial strength and that of financial institutions in general will largely determine the access to appropriate levels of liquidity. This confidence is significantly dependent on our ability to maintain sound credit quality and the ability to maintain appropriate levels of capital resources.

Liquidity is defined as the ability to meet anticipated customer demands for funds under credit commitments and deposit withdrawals at a reasonable cost and on a timely basis. Management measures the liquidity position by giving consideration to both on-balance sheet and off-balance sheet sources of and demands for funds on a daily and weekly basis. In addition, because FSC is a separate entity and apart from the Bank, it must provide for its own liquidity. FSC is responsible for the payment of dividends declared for its common and preferred shareholders, and interest and principal on any outstanding debt or trust preferred securities.

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Sources of the Bank's liquidity include cash and cash equivalents, net of Federal requirements to maintain reserves against deposit liabilities; investment securities eligible for sale or pledging to secure borrowings from dealers and customers pursuant to securities sold under agreements to repurchase ( repurchase agreements ); loan repayments; loan sales; deposits and certain interest-sensitive deposits; brokered deposits; a collateralized line of credit at the Federal Reserve Bank of Atlanta ( FRB ) Discount Window; a collateralized line of credit from the Federal Home Loan Bank of Atlanta ( FHLB ); and borrowings under unsecured overnight Federal funds lines available from correspondent banks. Substantially all of FSC's liquidity is obtained from subsidiary service fees and dividends from the Bank, which is limited by applicable law. The principal demands for liquidity are new loans, anticipated fundings under credit commitments to customers and deposit withdrawals.

Management seeks to maintain a stable net liquidity position while optimizing operating results, as reflected in net interest income, the net yield on interest-earning assets and the cost of interest-bearing liabilities in particular. Our Asset/Liability Management Committee ( ALCO ) meets regularly to review the current and projected net liquidity positions and to review actions taken by management to achieve this liquidity objective. Managing the levels of total liquidity, short-term liquidity, and short-term liquidity sources continues to be an important exercise because of the coordination of the projected mortgage, SBA and indirect automobile loan production and sales, loans held-for-sale balances, and individual loans and pools of loans sold anticipated to increase from time to time during the year. In addition to the ability to increase brokered deposits and retail deposits, as of September 30, 2011, we had the following sources of available unused liquidity:

|  | <b>September 30,<br/>2011</b> |
|--|-------------------------------|
|  | <i>(In thousands)</i>         |
| Unpledged securities   | \$ 119,000                    |
| FHLB advances  | 11,000                        |
| FRB lines  | 275,000                       |
| Unsecured Federal funds lines                                  | 47,000                        |
| Additional FRB line based on eligible but unpledged collateral | 356,000                       |
| <br>   |                               |
| Total sources of available unused liquidity                    | \$ 808,000                    |

The Company's net liquid asset ratio, defined as federal funds sold, investments maturing within 30 days, unpledged securities, available unsecured federal funds lines of credit, FHLB borrowing capacity and available brokered certificates of deposit divided by total assets was 15.3% at September 30, 2010, 16.1% at December 31, 2010 and 24.2% at September 30, 2011.

**Shareholders' Equity**

Shareholders' equity was \$163.0 million at September 30, 2011, and \$140.5 million at December 31, 2010. The increase in shareholders' equity in the first nine months of 2011 was primarily the result of a private placement of common stock in May 2011 of \$14.4 million and net income for the first nine months of 2011.

At September 30, 2011 and December 31, 2010, the Company exceeded all minimum capital ratios required by the FRB, as reflected in the following schedule:

| <b>Capital Ratios:</b> | <b>FRB<br/>Minimum<br/>Capital Ratio</b> | <b>September<br/>30,<br/>2011</b> | <b>December<br/>31,<br/>2010</b> |
|------------------------|--|-----------------------------------|----------------------------------|
| Leverage               | 4.00%                                    | 10.16%                            | 9.36%                            |
| Risk-Based Capital     |  |                                   |                                  |
| Tier I                 | 4.00                                     | 12.35                             | 10.87                            |
| Total                  | 8.00                                     | 14.31                             | 13.28                            |





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The following table sets forth the capital requirements for the Bank under FDIC regulations and the Bank's capital ratios at September 30, 2011 and December 31, 2010, respectively:

| <b>Capital Ratios:</b> | <b>FDIC<br/>Regulations<br/>Well<br/>Capitalized</b> | <b>September<br/>30,<br/>2011</b> | <b>December<br/>31,<br/>2010</b> |
|------------------------|--|-----------------------------------|----------------------------------|
| Leverage               | 5.00%  | <b>9.38%</b>                      | 9.49%                            |
| Risk-Based Capital     |  |                                   |                                  |
| Tier I                 | 6.00   | <b>11.39</b>                      | 11.02                            |
| Total                  | 10.00  | <b>13.23</b>                      | 12.89                            |

On October 14, 2008, the U.S. Treasury announced the Troubled Asset Relief Program ( TARP ) Capital Purchase Program (the Program ). On December 19, 2008, as part of the Program, Fidelity entered into a Letter Agreement ( Letter Agreement ) and a Securities Purchase Agreement Standard Terms with the Treasury, pursuant to which Fidelity agreed to issue and sell, and the Treasury agreed to purchase (1) 48,200 shares of Fidelity's Fixed Rate Cumulative Perpetual Preferred Stock, Series A, having a liquidation preference of \$1,000 per share, and (2) a ten-year warrant to purchase up to 2,266,458 shares of the Company's common stock at an exercise price of \$3.19 per share, for an aggregate purchase price of \$48.2 million in cash. Pursuant to the terms of the Letter Agreement, the ability of Fidelity to declare or pay dividends or distributions of its common stock is subject to restrictions, including a restriction against increasing dividends from the last quarterly cash dividend per share (\$.01) declared on the common stock prior to December 19, 2008, as adjusted for subsequent stock dividends and other similar actions. In addition, as long as the preferred shares are outstanding, dividends payments are prohibited until all accrued and unpaid dividends are paid on such preferred stock, subject to certain limited exceptions. This restriction will terminate on the third anniversary of the date of issuance, December 19, 2011, of the preferred shares or, if earlier, the date on which the preferred shares have been redeemed in whole or the Treasury has transferred all of the preferred shares to third parties.

During 2010 and the first six months of 2011, we did not pay any cash dividends on our common stock. On July 21, 2011, the Board of Directors reinstated the cash dividend by declaring a \$.01 dividend per share on common stock payable on August 16, 2011, to shareholders of record on August 1, 2011. On October 20, 2011, the Board of Directors declared a cash dividend of \$.01 per share on common stock payable on November 14, 2011 to shareholders of record on November 1, 2011. Dividends for the remainder of 2011 will be reviewed, declared and paid consistent with current earnings, capital requirements and forecasts of future earnings.

**Market Risk**

Our primary market risk exposures are credit risk and interest rate risk and, to a lesser extent, liquidity risk. We have little or no risk related to trading accounts, commodities, or foreign exchange.

Interest rate risk is the exposure of a banking organization's financial condition and earnings ability to withstand adverse movements in interest rates. Accepting this risk can be an important source of profitability and shareholder value; however, excessive levels of interest rate risk can pose a significant threat to assets, earnings, and capital. Accordingly, effective risk management that maintains interest rate risk at prudent levels is essential to our success. ALCO, which includes senior management representatives, monitors and considers methods of managing the rate and sensitivity repricing characteristics of the balance sheet components consistent with maintaining acceptable levels of changes in portfolio values and net interest income with changes in interest rates. The primary purposes of ALCO are to manage interest rate risk consistent with earnings and liquidity, to effectively invest our capital, and to preserve the value created by our core business operations. Our exposure to interest rate risk compared to established tolerances is reviewed on at least a quarterly basis by our Board of Directors.

Evaluating a financial institution's exposure to changes in interest rates includes assessing both the adequacy of the management process used to control interest rate risk and the organization's quantitative levels of exposure. When assessing the interest rate risk management process, we seek to ensure that appropriate policies, procedures,

management information systems, and internal controls are in place to maintain interest rate risk at prudent levels with consistency and continuity. Evaluating the quantitative level of interest rate risk exposure requires us to assess the existing and potential future effects of changes in interest rates on our consolidated financial condition, including capital adequacy, earnings, liquidity, and, where appropriate, asset quality.

Interest rate sensitivity analysis, referred to as equity at risk, is used to measure our interest rate risk by computing estimated changes in earnings and the net present value of our cash flows from assets, liabilities, and off-balance sheet items in the event of a range of assumed changes in market interest rates. Net present value represents the market value of portfolio equity and is equal to the market value of assets minus the market value of liabilities, with adjustments made for off-balance sheet items. This analysis assesses the risk of loss in the market risk sensitive instruments in the event of a sudden and sustained 200, 300 and 400 basis point increase or decrease in market interest rates.

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Our policy states that a negative change in net present value (equity at risk) as a result of an immediate and sustained 200 basis point increase or decrease in interest rates should not exceed the lesser of 2% of total assets or 15% of total regulatory capital. It also states that a similar increase or decrease in interest rates should not negatively impact net interest income or net income by more than 5% or 15%, respectively.

The most recent rate shock analysis indicated that the effects of an immediate and sustained increase or decrease of 200 basis points in market rates of interest would fall within policy parameters and approved tolerances for equity at risk, net interest income, and net income.

Rate shock analysis provides only a limited, point in time view of interest rate sensitivity. The gap analysis also does not reflect factors such as the magnitude (versus the timing) of future interest rate changes and asset prepayments. The actual impact of interest rate changes upon earnings and net present value may differ from that implied by any static rate shock or gap measurement. In addition, net interest income and net present value under various future interest rate scenarios are affected by multiple other factors not embodied in a static rate shock or gap analysis, including competition, changes in the shape of the Treasury yield curve, divergent movement among various interest rate indices, and the speed with which interest rates change.

**Interest Rate Sensitivity**

The major elements used to manage interest rate risk include the mix of fixed and variable rate assets and liabilities and the maturity and repricing patterns of these assets and liabilities. We perform a quarterly review of assets and liabilities that reprice and the time bands within which the repricing occurs. Balances generally are reported in the time band that corresponds to the instrument's next repricing date or contractual maturity, whichever occurs first. However, fixed rate indirect automobile loans, mortgage-backed securities, and residential mortgage loans are primarily included based on scheduled payments with a prepayment factor incorporated. Through such analyses, we monitor and manage our interest sensitivity gap to minimize the negative effects of changing interest rates.

The interest rate sensitivity structure within our balance sheet at September 30, 2011, indicated a cumulative net interest sensitivity asset gap of 10.59% when projecting out six months. When projecting forward one year, there was a cumulative net interest sensitivity asset gap of 8.47%. This information represents a general indication of repricing characteristics over time; however, the sensitivity of certain deposit products may vary during extreme swings in the interest rate cycle. Since all interest rates and yields do not adjust at the same velocity, the interest rate sensitivity gap is only a general indicator of the potential effects of interest rate changes on net interest income. Our policy states that the cumulative gap at six months and one year should generally not exceed 15% and 10%, respectively. The Bank was within established tolerances at September 30, 2011.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

See Item 2 Market Risk and Interest Rate Sensitivity for quantitative and qualitative discussion about our market risk.

**Item 4. Controls and Procedures****Evaluation of Disclosure Controls and Procedures**

Pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, Fidelity's management supervised and participated in an evaluation, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures (as defined under Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based on, or as of the date of, that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

**Changes in Internal Control over Financial Reporting**

There has been no change in the Company's internal control over financial reporting during the three months ended September 30, 2011, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.



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**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

We are a party to claims and lawsuits arising in the course of normal business activities. Although the ultimate outcome of all claims and lawsuits outstanding as of September 30, 2011, cannot be ascertained at this time, it is the opinion of management that these matters, when resolved, will not have a material adverse effect on our results of operations or financial condition.

**Item 1A. Risk Factors**

While the Company attempts to identify, manage, and mitigate risks and uncertainties associated with its business to the extent practical under the circumstances, some level of risk and uncertainty will always be present. Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2010, describes some of the risks and uncertainties associated with our business. These risks and uncertainties have the potential to materially affect our cash flows, results of operations, and financial condition. We do not believe that there have been any material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2010.

**Item 6. Exhibits**

(a) Exhibits. The following exhibits are filed as part of this Report.

- 3(a) Amended and Restated Articles of Incorporation of Fidelity Southern Corporation, as amended effective December 16, 2008 (incorporated by reference from Exhibit 3(a) to Fidelity Southern Corporation's Annual Report on Form 10-K for the year ended December 31, 2009)
- 3(b) By-Laws of Fidelity Southern Corporation, as amended (incorporated by reference from Exhibit 3.2 to Fidelity Southern Corporation's Form 8-k filed November 18, 2010)
- 31.1 Certification of Principal Executive Officer pursuant to Securities Exchange Act Rules 13a-14 and 15d-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Principal Financial Officer pursuant to Securities Exchange Act Rules 13a-14 and 15d-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FIDELITY SOUTHERN CORPORATION  
(Registrant)

Date: November 8, 2011

BY: /s/ James B. Miller, Jr.  
James B. Miller, Jr.  
Chief Executive Officer

Date: November 8, 2011

BY: /s/ Stephen H. Brolly  
Stephen H. Brolly  
Chief Financial Officer

