SOUTHERN CONNECTICUT BANCORP INC
Form 10-Q
November 15, 2010

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

or

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

For the transition period from ___________________________ to ___________________________

Commission File Number: 0-49784

Southern Connecticut Bancorp, Inc.
(Exact name of registrant as specified in its charter)

Connecticut (State or other jurisdiction of incorporation or organization)	06-1609692 (I.R.S. Employer Identification No.)
215 Church Street, New Haven, Connecticut (Address of principal executive offices)	06510 (Zip Code)

(203) 782-1100
(Registrant's telephone number, including area code)

Not Applicable
(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 [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 the definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ]		Accelerated filer [ ]
Non-accelerated filer [ ]	(Do not check if a smaller reporting company)	Smaller reporting company [X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

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

Class	Outstanding at November 15, 2010
Common Stock, $.01 par value per share	2,696,902 shares

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Part I - Financial Information

Item 1. Financial Statements

SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
September 30, 2010 and December 31, 2009

ASSETS	2010	2009
Cash and due from banks	$11,106,573	$2,541,557
Short-term investments	8,719,092	15,383,081
Cash and cash equivalents	19,825,665	17,924,638
Interest bearing certificates of deposit	99,344	347,331
Available for sale securities (at fair value)	3,031,709	2,219,751
Federal Home Loan Bank stock	66,100	66,100
Loans receivable		
Loans receivable	130,942,371	112,633,762
Allowance for loan losses	(2,907,561)	(2,768,567)
Loans receivable, net	128,034,810	109,865,195
Accrued interest receivable	596,862	480,497
Premises and equipment	2,282,536	2,485,797
Other assets held for sale	372,758	372,758
Other real estate owned	124,953	-
Other assets	1,940,405	1,848,111
Total assets	$156,375,142	$135,610,178
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits		
Noninterest bearing deposits	$30,539,259	$29,834,836
Interest bearing deposits	107,748,478	87,720,706
Total deposits	138,287,737	117,555,542
Repurchase agreements	453,307	294,332
Capital lease obligations	1,170,594	1,175,263
Accrued expenses and other liabilities	752,048	952,505
Total liabilities	140,663,686	119,977,642
Commitments and Contingencies		
Shareholders' Equity		
Preferred stock, no par value; shares authorized: 500,000; none issued	-	-
Common stock, par value $.01; shares authorized: 5,000,000; shares issued and outstanding: 2010 2,696,902; and 2009 2,695,902	26,969	26,959
Additional paid-in capital	22,565,383	22,560,100
Accumulated deficit	(6,880,796)	(6,942,727)

Accumulated other comprehensive loss - net unrealized loss on available for sale securities	(100)	(11,796)
Total shareholders' equity	15,711,456	15,632,536
Total liabilities and shareholders' equity	$156,375,142	$135,610,178

See Notes to Consolidated Financial Statements

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SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three Months and Nine Months Ended September 30, 2010 and 2009

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Interest Income:				
Interest and fees on loans	$1,946,695	$1,541,428	$5,561,488	$4,420,938
Interest on securities	1,996	17,985	10,998	106,543
Interest on Federal funds sold and short-term and other investments	25,332	58,697	67,082	163,310
Total interest income	1,974,023	1,618,110	5,639,568	4,690,791
Interest Expense:				
Interest expense on deposits	498,121	547,572	1,378,956	1,529,943
Interest expense on capital lease obligations	43,550	43,648	130,968	131,822
Interest expense on repurchase agreements and other borrowings	483	1,128	5,288	5,269
Total interest expense	542,154	592,348	1,515,212	1,667,034
Net interest income	1,431,869	1,025,762	4,124,356	3,023,757
Provision (credit) for loan losses	106,450	(137,255)	224,088	1,943,461
Net interest income after provision (credit) for loan losses	1,325,419	1,163,017	3,900,268	1,080,296
Noninterest Income:				
Service charges and fees	100,307	113,054	335,355	386,933
Gain on sale of available for sale securities	-	-	28,979	-
Other noninterest income	35,242	26,096	108,604	71,605
Total noninterest income	135,549	139,150	472,938	458,538
Noninterest Expenses:				
Salaries and benefits	743,292	751,142	2,262,303	2,294,451
Occupancy and equipment	165,886	160,000	492,560	501,691
Professional services	156,392	122,333	564,286	394,741
Data processing and other outside services	108,432	115,617	308,576	316,097
FDIC Insurance	60,179	51,923	169,543	194,431
Other operating expenses	200,116	97,921	514,007	399,089
Total noninterest expenses	1,434,297	1,298,936	4,311,275	4,100,500
Net income (loss)	$26,671	$3,231	$61,931	$(2,561,666)
Basic and diluted income (loss) per share	$0.01	$0.00	$0.02	$(0.95)

See Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
For the Nine Months Ended September 30, 2010 and 2009

	Number of Common Shares	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2008	2,688,152	$26,882	$22,521,164	$ (4,035,302)	$ 28,210	$18,540,954
Comprehensive loss:						
Net loss	-	-	-	(2,561,666)	-	(2,561,666)
Unrealized holding loss on available for sale securities, net of income taxes	-	-	-	-	(10,349)	(10,349)
Total comprehensive loss						(2,572,015)
Restricted stock compensation	1,750	17	40,902	-	-	40,919
Stock option compensation	-	-	(14,845)	-	-	(14,845)
Balance, September 30, 2009	2,689,902	$26,899	22,547,221	$ (6,596,968)	$ 17,861	$15,995,013
Balance, December 31, 2009	2,695,902	$26,959	$22,560,100	$ (6,942,727)	$ (11,796)	$15,632,536
Comprehensive income:						
Net income	-	-	-	61,931	-	61,931
Unrealized holding gain on available for sale securities	-	-	-	-	11,696	11,696
Total comprehensive income					-	73,627
Share based compensation:						
Restricted stock compensation	1,000	10	5,283	-	-	5,293
Balance, September 30, 2010	2,696,902	$26,969	$22,565,383	$ (6,880,796)	$ (100)	$15,711,456

See Notes to Consolidated Financial Statements

SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2010 and 2009

	2010	2009
Cash Flows From Operations		
Net income (loss)	$61,931	$(2,561,666)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Amortization and accretion of premiums and discounts on investments, net	18,034	13,839
Provision for loan losses	224,088	1,943,461
Share based compensation	5,293	26,074
Gain on sale of available for sale securities	(28,979)	-
Depreciation and amortization	209,315	218,374
Increase in cash surrender of life insurance	(30,510)	(32,580)
Write-down of other assets held for sale	-	6,190
Changes in assets and liabilities:		
Decrease in deferred loan fees	(10,514)	(8,226)
Increase in accrued interest receivable	(116,365)	(12,330)
Increase in other assets	(61,784)	(47,862)
Decrease in accrued expenses and other liabilities	(200,457)	(42,733)
Net cash provided by (used in) operating activities	70,052	(497,459)
Cash Flows From Investing Activities		
Proceeds from maturities of interest bearing certificates of deposit	247,987	87,269
Purchases of available for sale securities	(55,664,463)	(7,456,165)
Principal repayments on available for sale securities	73,521	2
Proceeds from maturities / calls of available for sale securities	52,651,000	10,300,000
Proceeds from sales of available for sale securities	2,150,625	-
Net increase in loans receivable	(18,508,142)	(15,621,296)
Purchases of premises and equipment	(6,054)	(13,326)
Proceeds from the sale of OREO	-	528,250
Net cash used in investing activities	(19,055,526)	(12,175,266)
Cash Flows From Financing Activities		
Net increase in demand, savings and money market deposits	4,759,136	4,846,137
Net increase in certificates of deposit	15,973,059	20,662,898
Net increase in repurchase agreements	158,975	22,514
Principal repayments on capital lease obligations	(4,669)	(4,199)
Net cash provided by financing activities	20,886,501	25,527,350
Net increase in cash and cash equivalents	1,901,027	12,854,625
Cash and cash equivalents		
Beginning	17,924,638	13,904,889
Ending	$19,825,665	$26,759,514

(Continued)

SOUTHERN CONNECTICUT BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS, Continued

	2010	2009
Supplemental Disclosures of Cash Flow Information:		
Cash paid for:		
Interest	$1,464,639	$1,617,294
Income taxes	$750	$750
Supplemental Disclosures of Non-Cash Investing and Financing Activities:		
Transfer of loans receivable to other real estate owned	$124,953	$528,250
Unrealized holding gains on available for sale securities arising during the period	$11,696	$1,047

See Notes to Consolidated Financial Statements

Southern Connecticut Bancorp, Inc.
Notes to Consolidated Financial Statements
(Unaudited)

Note 1. Nature of Operations

Southern Connecticut Bancorp, Inc. (the "Company") is a bank holding company headquartered in New Haven, Connecticut that was incorporated on November 8, 2000. The Company's strategic objective is to serve as a bank holding company for a community-based commercial bank and a mortgage broker serving primarily New Haven County (the "Greater New Haven Market"). The Company owns 100% of the capital stock of The Bank of Southern Connecticut (the "Bank"), a Connecticut-chartered bank with its headquarters in New Haven, Connecticut, and 100% of the capital stock of SCB Capital Inc., operating under the name "Evergreen Financial Services" ("Evergreen"), which is licensed by the State of Connecticut Department of Banking to operate a mortage brokerage business and also operates from the Company's headquarters in New Haven, Connecticut. The Company and its subsidiaries focus on meeting the financial services needs of consumers and small to medium-sized businesses, professionals and professional corporations, and their owners and employees in the Greater New Haven Market.

The Bank operates branches at four locations, including downtown New Haven, the Amity/Westville section of New Haven, Branford and North Haven. The Bank's branches have a consistent, attractive appearance. Each location has an open lobby, comfortable waiting area, offices for the branch manager and a loan officer, and a conference room. The design of the branches complements the business development strategy of the Bank, affording an appropriate space to deliver personalized banking services in professional, confidential surroundings.

The Bank focuses on serving the banking needs of small to medium-sized businesses, professionals and professional corporations, and their owners and employees in the Greater New Haven Market. The Bank's target commercial customer has between $1.0 and $30.0 million in revenues, 15 to 150 employees, and borrowing needs of up to $3.0 million. The primary focus on this commercial market makes the Bank uniquely qualified to move deftly in responding to the needs of its clients. The Bank has been successful in winning business by offering a combination of competitive pricing for its services, quick decision making processes and a high level of personalized, "high touch" customer service.

On February 22, 2010, the Company entered into an Agreement and Plan of Merger with Naugatuck Valley Financial Corporation ("NVSL") and Newco, a corporation to be formed by NVSL to be the holding company for Naugatuck Valley Savings and Loan ("NVSL Bank"), pursuant to which the Company will merge with and into Newco, with Newco being the surviving corporation. The Agreement and Plan of Merger was subsequently amended on September 17, 2010 to amend the consideration to be paid in the merger, extend the deadline for closing the merger and amend the conditions under which NVSL would be obligated to pay a termination fee to the Company.

On November 12, 2010, the Company, NVSL and Newco entered into a Mutual Termination Agreement pursuant to which the parties mutually agreed to terminate the Agreement and Plan of Merger due to an inability to obtain regulatory approval of the proposed merger. In accordance with the terms and conditions of the Mutual Termination Agreement and the Agreement and Plan of Merger, as amended, NVSL paid a $350,000 termination fee to the Company on November 12, 2010, as reimbursement for the Company's transaction expenses.

Note 2. Basis of Financial Statement Presentation

The consolidated interim financial statements include the accounts of the Company and its subsidiaries. The consolidated interim financial statements and notes thereto have been prepared in conformity with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. All significant intercompany transactions have been eliminated in consolidation. Amounts in prior period financial statements are reclassified whenever necessary to conform to current period presentations. The results of operations for the three months and nine months ended September 30, 2010 are not necessarily indicative of the results which may be expected for the year as a whole. The accompanying consolidated financial statements and notes thereto should be read in conjunction with the audited financial statements of the Company and notes thereto as of December 31, 2009, filed with the Securities and Exchange Commission on Form 10-K on March 29, 2010.

Note 3. Available for Sale Securities

The amortized cost, gross unrealized gains, gross unrealized losses and approximate fair values of available for sale securities at September 30, 2010 and December 31, 2009 were as follows:

September 30, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury Bills	$3,000,000	$-	$(210)	$2,999,790
U.S. Government Agency Mortgage Backed Securities	31,809	-	110	31,919
	$3,031,809	$-	$(100)	$3,031,709

December 31, 2009	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government Agency Obligations	$2,126,216	$-	$(12,483)	$2,113,733
U.S. Government Agency Mortgage Backed Securities	105,331	687	-	106,018
	$2,231,547	$687	$(12,483)	$2,219,751

The amortized cost and fair value of available for sale debt securities at September 30, 2010 by contractual maturity are presented below. Actual maturities of mortgage-backed securities may differ from contractual maturities because the mortgages underlying the securities may be called or repaid without any penalties.

Because mortgage-backed securities are not due at a single maturity date, they are not included in the maturity categories in the following summary:

September 30, 2010	Amortized Cost	Fair Value
Maturity:		
Three months or less	$3,000,000	$2,999,790
Mortgage-backed securities	31,809	31,919
	$3,031,809	$3,031,709

Note 4. Loans Receivable

A summary of the Company's loan portfolio at September 30, 2010 and December 31, 2009 is as follows:

	2010	2009
Commercial loans secured by real estate	$73,268,630	$63,836,712
Commercial loans	54,232,855	43,893,191
Construction and land loans	3,202,997	4,607,905
Consumer installment loans	379,964	448,543
Total loans	131,084,446	112,786,351
Net deferred loan fees	(142,075)	(152,589)
Allowance for loan losses	(2,907,561)	(2,768,567)
Loans receivable, net	$128,034,810	$109,865,195

The following represents the activity in the allowance for loan losses for the nine months ended September 30, 2010 and 2009:

Allowance for Loan Losses

	2010	2009
Balance at beginning of year	$2,768,567	$1,183,369
Provision for loan losses	224,088	1,943,461
Recoveries of loans previously charged-off:		
Consumer	3,705	10,423
Total recoveries	3,705	10,423
Loans charged-off:		
Commercial loans secured by real estate	(84,387)	(413,839)
Commercial loans	-	(2,300)
Consumer	(4,412)	(1,339)
Total charge-offs	(88,799)	(417,478)
Balance at end of period	$2,907,561	$2,719,775
Net charge-offs to average loans	(0.07)%	(0.45)%

At September 30, 2010 and December 31, 2009, the unpaid principal balances of loans placed on nonaccrual status were $6,457,000 and $5,363,000, respectively. At September 30, 2010, one loan aggregating $280,000 was restructured and categorized as a “troubled debt restructuring.” Such loan is included in the balance of impaired loans below. There were no loans considered “troubled debt restructurings” at December 31, 2009. Accruing loans contractually past due 90 days or more were $416,000 and $484,000 at September 30, 2010 and December 31, 2009, respectively. Such loans are considered to be well secured and in the process of collection.

The following information relates to impaired loans as of September 30, 2010 and December 31, 2009:

	2010	2009
Impaired loans for which there is a specific allowance	$4,583,138	$4,634,634
Impaired loans for which there is no specific allowance	$2,161,384	$2,469,484
Allowance for loan losses related to impaired loans	$1,390,362	$1,489,255

Average recorded investment in impaired loans	$6,689,030	$5,775,813

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Note 5. Deposits

At September 30, 2010 and December 31, 2009, deposits consisted of the following:

	2010	2009
Noninterest bearing	$30,539,259	$29,834,836
Interest bearing:		
Checking	5,090,066	8,604,111
Money Market	33,948,972	26,434,495
Savings	2,437,685	2,383,404
Time certificates, less than $100,000 (1)	30,382,018	27,785,391
Time certificates, $100,000 or more (2)	35,889,737	22,513,305
Total interest bearing	107,748,478	87,720,706
Total deposits	$138,287,737	$117,555,542

(1) Included in time certificates of deposit, less than $100,000, at September 30, 2010 and December 31, 2009 were brokered deposits totaling $6,408,567 and $9,015,482, respectively.

(2) Included in time certificates of deposit, $100,000 or more, at September 30, 2010 and December 31, 2009 were brokered deposits totaling $7,716,722 and $4,991,718, respectively.

Note 6. Available Borrowings

The Bank is a member of the Federal Home Loan Bank of Boston (“FHLB”). At September 30, 2010, the Bank had the ability to borrow from the FHLB based on a certain percentage of the value of the Bank’s qualified collateral, as defined in the FHLB Statement of Products Policy, at the time of the borrowing. In accordance with an agreement with the FHLB, the qualified collateral must be free and clear of liens, pledges and encumbrances. There were no borrowings outstanding with the FHLB at September 30, 2010.

The Bank is required to maintain an investment in capital stock of the FHLB in an amount equal to a percentage of its outstanding mortgage loans and contracts secured by residential properties, including mortgage-backed securities. No ready market exists for FHLB stock and it has no quoted fair value. For disclosure purposes, such stock is assumed to have a fair value which is equal to cost based upon the redemption provisions of the FHLB.

Note 7. Income (Loss) Per Share

The Company is required to present basic income (loss) per share and diluted income (loss) per share in its statements of operations. Basic per share amounts are computed by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted per share amounts assume exercise of all potential common stock equivalents in weighted average shares outstanding, unless the effect is antidilutive. The Company is also required to provide a reconciliation of the numerator and denominator used in the computation of both basic and diluted income (loss) per share.

The following is information about the computation of income (loss) per share for the three and nine months ended September 30, 2010 and 2009:

Three Months Ended September 30,	2010			2009		
	Net Income	Weighted Average Shares	Amount Per Share	Net Income	Weighted Average Shares	Amount Per Share
Basic Income Per Share						
Income available to common shareholders	$26,671	2,696,902	$0.01	$3,231	2,689,902	$0.00
Effect of Dilutive Securities						
Warrants/Stock Options outstanding/Restricted Stock	-	252	-	-	2,016	-
Diluted Income Per Share						
Income available to common shareholders plus assumed conversions	$26,671	2,697,154	$0.01	$3,231	2,691,918	$0.00

Nine Months Ended September 30,	2010			2009		
	Net Income	Weighted Average Shares	Amount Per Share	Net Loss	Weighted Average Shares	Amount Per Share
Basic Income (Loss) Per Share						
Income (Loss) available to common shareholders	$61,931	2,696,448	$0.02	$(2,561,666)	2,689,400	$(0.95)
Effect of Dilutive Securities						
Warrants/Stock Options outstanding	-	1,454	-	-	-	-
Diluted Income (Loss) Per Share						
Income (Loss) available to common shareholders plus assumed conversions	$61,931	2,697,902	$0.02	$(2,561,666)	2,689,400	$(0.95)

For the nine months ended September 30, 2009, 6,605 shares that could potentially dilute basic EPS in the future were not included in the computation of diluted EPS because to do so would have been antidilutive for the period presented.

Note 8. Other Comprehensive Income (Loss)

Under guidance relating to reporting comprehensive income, certain transactions and other economic events that bypass the Company's income statement must be displayed as other comprehensive income. The Company's other comprehensive income, which is comprised solely of the change in unrealized gains on available for sale securities, was as follows:

Nine Months Ended September 30, 2010

	Before-Tax Amount	Taxes	Net-of-Tax Amount
Unrealized holding gains arising during period	$40,675	$-	$40,675
Reclassification adjustment for amounts recognized in net income	28,979	-	28,979
Unrealized holding gains on available for sale securities, net of taxes	$11,696	$-	$11,696

	Nine Months Ended September 30, 2009		
	Before-Tax Amount	Taxes	Net-of-Tax Amount
Unrealized holding gains arising during period	$1,047	$(11,396)	$(10,349)
Reclassification adjustment for amounts recognized in net income	-	-	-
Unrealized holding gains on available for sale securities, net of taxes	$1,047	$(11,396)	$(10,349)

Note 9. Financial Instruments with Off-Balance-Sheet Risk

In the normal course of business, the Company is a party to financial instruments with off-balance-sheet risk to meet the financing needs of its customers. These financial instruments include commitments to extend credit and involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the financial statements. The contractual amounts of these instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The contractual amounts of commitments to extend credit represent the amounts of potential accounting loss should the contract be fully drawn upon, the customer defaults, and the value of any existing collateral becomes worthless. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments and evaluates each customer's creditworthiness on a case-by-case basis. The Company controls the credit risk of these financial instruments through credit approvals, credit limits, monitoring procedures and the receipt of collateral as necessary.

Financial instruments whose contract amounts repesent credit risk at September 30, 2010 and December 31, 2009 were as follows:

	September 30, 2010	December 31, 2009
Commitments to extend credit:		
Future loan commitments	$6,224,500	$5,054,000
Unused lines of credit	21,108,186	28,178,604
Financial standby letters of credit	3,355,769	3,358,597
Undisbursed construction loans	948,499	437,000
	$31,636,954	$37,028,201

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments to extend credit generally have fixed expiration dates or other termination clauses and may require payment of a fee by the borrower. Since these commitments could expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based upon management's credit evaluation of the counterparty. Collateral held varies, but may include residential and commercial property, deposits and securities.

Standby letters of credit are written commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The liability related to guarantees recorded at September 30, 2010 and December 31, 2009 was not significant.

Note 10. Fair Value

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. A description of the valuation methodologies used for assets and liabilities recorded at fair value, and for estimating fair value for financial and non-financial instruments not recorded at fair value, is set forth below.

Cash and due from banks, Federal funds sold, short-term investments, interest bearing certificates of deposit, accrued interest receivable, Federal Home Loan Bank stock, accrued interest payable and repurchase agreements

The carrying amount is a reasonable estimate of fair value. The Company does not record these assets at fair value on a recurring basis.

Available for sale securities

These financial instruments are recorded at fair value in the financial statements on a recurring basis. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted prices are not available, then fair values are estimated by using pricing models (i.e., matrix pricing) or quoted prices of securities with similar characteristics and are classified within Level 2 of the valuation hierarchy. Examples of such instruments include government agency bonds and mortgage-backed securities. Level 3 securities are securities for which significant unobservable inputs are utilized. Available-for-sale-securities are recorded at fair value on a recurring basis.

Loans receivable

For variable rate loans that reprice frequently and have no significant change in credit risk, carrying values are a reasonable estimate of fair values, adjusted for credit losses inherent in the portfolios. The fair value of fixed rate loans is estimated by discounting the future cash flows using estimated period end market rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, adjusted for credit losses inherent in the portfolios. The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for credit losses is established. The specific reserves for collateral dependent impaired loans are based on the fair value of collateral less estimated costs to sell. The fair value of collateral is determined based on appraisals. In some cases, adjustments are made to the appraised values due to various factors including age of the appraisal, age of comparables included in the appraisal, and known changes in the market and in the collateral. When significant adjustments are based on unobservable inputs, the resulting fair value measurement is categorized as a Level 3 measurement.

Servicing assets

The fair value is based on market prices for comparable servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The Company does not record these assets at fair value on a recurring basis.

Other assets held for sale and other real estate owned

Other assets held for sale represents real estate that is not intended for use in operations and real estate acquired through foreclosure, and are recorded at fair value on a nonrecurring basis. 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 classifies the asset as 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 classifies the asset as Level 3.

Interest only strips

The fair value is based on a valuation model that calculates the present value of estimated future cash flows. The Company does not record these assets at fair value on a recurring basis.

Deposits

The fair value of demand deposits, savings and money market deposits is the amount payable on demand at the reporting date. The fair value of certificates of deposit is estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities, estimated using local market data, to a schedule of aggregated expected maturities on such deposits. The Company does not record deposits at fair value on a recurring basis.

Off-balance-sheet instruments

Fair values for the Company's off-balance-sheet instruments (lending commitments) are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The Company does not record its off-balance-sheet instruments at fair value on a recurring basis.

In February 2010, the FASB issued guidance which amended the existing guidance related to Fair Value Measurements and Disclosures. The amendments will require the following new fair value disclosures:

- Separate disclosure of the significant transfers in and out of Level 1 and Level 2 fair value measurements, and a description of the reasons for the transfers; and

- In the rollforward of activity for Level 3 fair value measurements (significant unobservable inputs), purchases, sales, issuances, and settlements should be presented separately (on a gross basis rather than as one net number).

In addition, the amendments clarify existing disclosure requirements as follows:

- Fair value measurements and disclosures should be presented for each class of assets and liabilities within a line item in the statement of financial position; and

- Reporting entities should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements that fall in either Level 2 or Level 3.

The new disclosures and clarifications of existing disclosures were effective for the Company for the quarter ended March 31, 2010, except for the disclosures included in the rollforward of activity for Level 3 fair value measurements, for which the effective date is for fiscal years beginning after December 15, 2010 and for interim periods within those financial statements.

The following table details the financial instruments carried at fair value and measured at fair value on a recurring basis as of September 30, 2010 and December 31, 2009 and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine the fair value:

	Balance as of September 30, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Treasury Bills	$2,999,790	$2,999,790	$-	$ -
U.S. Government Agency Mortgage Backed Securities	31,919	-	31,919	-
Available for sale securities	$3,031,709	$2,999,790	$31,919	$ -

	Balance as of	Quoted Prices in	Significant Observable	Significant Unobservable

	December 31, 2009	Active Markets for Identical Assets (Level 1)	Inputs (Level 2)	Inputs (Level 3)
U.S. Government Agency Obligations - FNMA	$2,113,733	$-	$2,113,733	$ -
U.S. Government Agency Mortgage Backed Securities	106,018	-	106,018	-
Available for sale securities	$2,219,751	$-	$2,219,751	$ -

The following table details the financial instruments carried at fair value and measured at fair value on a nonrecurring basis as of September 30, 2010 and December 31, 2009 and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine the fair value:

	Balance as of September 30, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets held at fair value				
Impaired loans (1)	$3,127,329	$-	$-	$ 3,127,329

	Balance as of December 31, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans (1)	$3,097,995	$-	$-	$ 3,097,995

(1) Represents carrying value and related write-downs for which adjustments are based on appraised value. Management makes adjustments to the appraised values as necessary to consider declines in real estate values since the time of the appraisal. Such adjustments are based on management's knowledge of the local real estate markets.

The following table details the nonfinancial assets carried at fair value and measured at fair value on a nonrecurring basis as of September 30, 2010 and December 31, 2009 indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine the fair value:

	Balance as of September 30, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Other assets held for sale	$372,758	$-	$372,758	$ -
Other real estate owned	$124,953	$-	$-	$ 124,953

	Balance as of	Quoted Prices in	Significant Observable	Significant Unobservable

	December 31, 2009	Active Markets for Identical Assets (Level 1)	Inputs (Level 2)	Inputs (Level 3)
Other assets held for sale	$372,758	$-	$372,758	$ -

The Company discloses fair value information about financial instruments, whether or not recognized in the statement of financial condition, for which it is practicable to estimate that value. Certain financial instruments are excluded from disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The estimated fair value amounts for September 30, 2010 and December 31, 2009 have been measured as of their respective periods and have not been reevaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than amounts reported at each period.

The information presented should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only required for a limited portion of the Company’s assets and liabilities. Due to the wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company’s disclosures and those of other companies may not be meaningful.

The following is a summary of the recorded book balances and estimated fair values of the Company's financial instruments at September 30, 2010 and December 31, 2009:

	September 30, 2010		December 31, 2009	
	Recorded Book Balance	Fair Value	Recorded Book Balance	Fair Value
Financial Assets:				
Cash and due from banks	$11,106,573	$11,106,573	$2,541,557	$2,541,557
Short-term investments	8,719,092	8,719,092	15,383,081	15,383,081
Interest bearing certificates of deposit	99,344	99,344	347,331	347,331
Available for sale securities	3,031,709	3,031,709	2,219,751	2,219,751
Federal Home Loan Bank stock	66,100	66,100	66,100	66,100
Loans receivable, net	128,034,810	131,477,000	109,865,195	111,191,000
Accrued interest receivable	596,862	596,862	480,497	480,497
Servicing rights	13,988	31,611	17,248	32,261
Interest only strips	17,830	26,995	22,176	26,709
Financial Liabilities:				
Noninterest-bearing deposits	30,539,259	30,539,259	29,834,836	29,834,836
Interest bearing checking accounts	5,090,066	5,090,066	8,604,111	8,604,111
Money market deposits	33,948,972	33,948,972	26,434,495	26,434,495
Savings deposits	2,437,685	2,437,685	2,383,404	2,383,404
Time certificates of deposits	66,271,755	67,612,000	50,298,696	51,377,000
Repurchase agreements	453,307	453,307	294,332	294,332
Accrued interest payable	252,362	252,362	201,789	201,789

Unrecognized financial instruments

Loan commitments on which the committed interest rate is less than the current market rate are insignificant at September 30, 2010 and December 31, 2009.

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, fair values of the Company's financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and by investing in securities with terms that mitigate the Company's overall interest rate risk.

Note 11. Segment Reporting

The Company has three reporting segments for purposes of reporting business line results, Community Banking, Mortgage Brokerage and the Holding Company. The Community Banking segment is defined as all operating results of the Bank. The Mortgage Brokerage segment is defined as the results of Evergreen and the Holding Company segment is defined as the results of Southern Connecticut Bancorp on an unconsolidated or standalone basis. The following represents the operating results and total assets for the segments of the Company as of and for the three months and nine months ended September 30, 2010 and September 30, 2009, respectively. The Company uses an internal reporting system to generate information by operating segment. Estimates and allocations are used for noninterest expenses.

Three Months Ended September 30, 2010	Community Banking	Mortgage Brokerage	Holding Company	Elimination Entries	Consolidated Total
Net interest income	$1,417,995	$12,244	$1,630	$-	$1,431,869
Provision for loan losses	106,450	-	-	-	106,450
Net interest income after provision for loan losses	1,311,545	12,244	1,630	-	1,325,419
Noninterest income (expense)	133,101	(3,552)	6,000	-	135,549
Noninterest expense	1,356,046	46,856	31,395	-	1,434,297
Net income (loss)	88,600	(38,164)	(23,765)	-	26,671
Total assets as of September 30, 2010	155,443,199	107,555	15,739,107	(14,914,719)	156,375,142

Three Months Ended September 30, 2009	Community Banking	Mortgage Brokerage	Holding Company	Elimination Entries	Consolidated Total
Net interest income	$997,486	$25,844	$2,432	$-	$1,025,762
Credit for loan losses	(137,255)	-	-	-	(137,255)
Net interest income after credit for loan losses	1,134,741	25,844	2,432	-	1,163,017
Noninterest income (expense)	139,150	(3,552)	-	-	135,598
Noninterest expense	1,215,987	62,447	16,950	-	1,295,384
Net income (loss)	57,904	(40,155)	(14,518)	-	3,231
Goodwill	-	238,440	-	-	238,440
Total assets as of September 30, 2009	136,404,711	350,950	16,002,114	(14,891,141)	137,866,634

Nine Months Ended September 30, 2010	Community Banking	Mortgage Brokerage	Holding Company	Elimination Entries	Consolidated Total
Net interest income	$4,087,233	$32,791	$4,332	$-	$4,124,356
Provision for loan losses	224,088	-	-	-	224,088
Net interest income after provision for loan losses	3,863,145	32,791	4,332	-	3,900,268
Noninterest income (expense)	465,594	(10,656)	18,000	-	472,938
Noninterest expense	4,065,908	154,105	91,262	-	4,311,275
Net income (loss)	262,831	(131,970)	(68,930)	-	61,931
Total assets as of September 30, 2010	155,443,199	107,555	15,739,107	(14,914,719)	156,375,142

Nine Months Ended September 30, 2009	Community Banking	Mortgage Brokerage	Holding Company	Elimination Entries	Consolidated Total
Net interest income	$2,964,446	$51,701	$7,610	$-	$3,023,757
Provision for loan losses	1,943,461	-	-	-	1,943,461
Net interest income after provision for loan losses	1,020,985	51,701	7,610	-	1,080,296
Noninterest income (expense)	458,538	(10,656)	-	-	447,882
Noninterest expense	3,811,112	165,608	113,124	-	4,089,844
Net loss	(2,331,589)	(124,563)	(105,514)	-	(2,561,666)
Goodwill	-	238,440	-	-	238,440
Total assets as of September 30, 2009	136,404,711	350,950	16,002,114	(14,891,141)	137,866,634

Note 12.Commitments and Contingencies

Litigation

At September 30, 2010, neither the Company nor any subsidiary was involved in any pending legal proceedings believed by management to be material to the Company's financial condition or results of operations. Periodically, there have been various claims and lawsuits against the Company, such as claims to enforce liens, condemnation proceedings on properties in which the Company holds security interests, claims involving the making and servicing of real property loans and other issues incident to the Company's business. However, neither the Company nor any subsidiary is a party to any pending legal proceedings that management believes would have a material adverse effect on the Company's financial condition, results of operations or cash flows.

Note 13. Recent Accounting Pronouncements

In January 2010, the FASB issued guidance to improve disclosures about fair value measurements which requires new disclosures on transfers into and out of Level 1 and 2 measurements of the fair value hierarchy and requires separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. It also clarifies existing fair value disclosures relating to the level of disaggregation and inputs and valuation techniques used to measure fair value. It is effective for the first reporting period (including interim periods) beginning after December 15, 2009, except for the requirement to provide the Level 3 activity of purchases, sales, issuances, and settlements on a gross basis, which will be effective for fiscal years beginning after December 15, 2010. The adoption of this pronouncement did not have a material impact on the Company's consolidated financial statements.

The FASB issued ASU No. 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses in July 2010. The amendments in this ASU apply to all entities, both public and nonpublic, with financing receivables, excluding short-term trade accounts receivable or receivables measured at fair value or lower of cost or fair value. The amendments in this ASU enhance disclosures about the credit quality of financing receivables and the allowance for credit losses. This ASU amends existing disclosure guidance to require entities to provide a greater level of disaggregated information about the credit quality of its financing receivables and its allowance for credit losses. In addition, this ASU requires entities to disclose credit quality indicators, past due information, and modifications of its financing receivables. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. This ASU encourages, but does not require, comparative disclosures for earlier reporting periods that ended before initial adoption. However, entities should provide comparative disclosures for those reporting periods ending after initial adoption.

In June 2009, the FASB issued a new guidance for accounting for transfers of financial assets. The objective of this guidance is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. Additionally, on and after the effective date, the concept of a qualifying special-purpose entity is no longer relevant for accounting purposes. Therefore, formerly qualifying special-purpose entities (as defined under previous accounting standards) are evaluated for consolidation by reporting entities on and after the effective date in accordance with the applicable consolidation guidance. If the evaluation on the effective date results in consolidation, the reporting entity must apply the transition guidance provided in the pronouncement that requires consolidation. This standard is effective for the first reporting period (including interim periods) beginning after November 15, 2009 and was applied to transfers occurring on or after the effective date. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

Item 2. Management's Discussion and Analysis of Financial Condition And Results of Operations

The following discussion and analysis is intended to assist you in understanding the financial condition and results of operations of the Company. This discussion should be read in conjunction with the accompanying unaudited financial statements as of and for the three and nine months ended September 30, 2010 and 2009 together with the audited financial statements as of and for the year ended December 31, 2009, included in the Company's Form 10-K filed with the Securities and Exchange Commission on March 29, 2010.

Summary

As of September 30, 2010, the Company had $156.4 million of total assets, $130.9 million of gross loans receivable, and $138.3 million of total deposits. Total equity capital at September 30, 2010 was $15.7 million, and the Company's Tier I Leverage Capital Ratio was 9.93%.

The Company had net income for the quarter ended September 30, 2010 of $27,000 (or basic and diluted earnings per share of $0.01), compared to net income of $3,000 (or basic and diluted income per share of $0.00) for the third quarter of 2009.

During the third quarter of 2010, net income was negatively impacted by $98,000 for merger related legal, accounting and advisory costs.

The Company's operating results for the third quarter of 2010 compared to the same period of 2009 were influenced by the following factors:

- Net interest income increased due to the combined effects of increases in asset volumes, higher yields on interest earning assets and lower costs on interest bearing liabilities, offset partially by increases in liability volumes;
- Provision for loan losses increased during the third quarter of 2010 primarily due to an increase in the general component of the allowance, which was attributable to growth in the Bank's loan portfolio. During the three months ended September 30, 2009, the credit to the provision for loan losses was primarily related to net decreases to the specific allowances on certain impaired loans resulting from payments received in excess of amounts previously estimated;
- Noninterest income decreased because of a decline in service charges and fees resulting from changes in the business practices of customers of the Bank, partially offset by an increase in rental income and an increase in other fees on loans; and
- Noninterest expenses increased, as noted above, primarily due to an increase in legal and professional fees incurred relating to the proposed merger with Naugatuck Valley Financial Corporation which was mutually terminated by the merger parties on November 12, 2010 due to an inability to obtain regulatory approval of the transaction.

The Company had net income during the nine months ended September 30, 2010 of $62,000 (or basic and diluted earnings per share of $0.02), compared to a net loss of $2,562,000 (or basic and diluted loss per share of $0.95) for the same period in 2009.

During the first nine months of 2010, net income was negatively impacted by $364,000 for merger related legal, accounting and advisory costs.

The Company's increase in earnings during the nine months ended September 30, 2010, as compared to the same period in 2009, was due to the combined effects of a $1,719,000 decrease in the provision for loan losses recorded by the Bank to $224,000 for the nine months ended September 30, 2010, compared to a provision for loan losses of $1,943,000 for the same period in 2009; and a $1,100,000 increase in net interest income. Net interest income increased due to increases in asset volumes, higher yields on interest earning assets and lower costs on interest bearing liabilities, which were partially offset by increases in liability volumes. The provision for loan losses during the first nine months of 2009 was related to a group of ten impaired loans that were severely impacted by prevailing economic conditions in 2009.

In addition to the impact of the provision for loan losses and growth in the loan portfolio, the operating results for the first nine months of 2010 compared to the same period of 2009 were influenced by the following factors:

- Noninterest income increased because of recognition of a gain on the sale of an available for sale security, as well as increases in rental income and an increase in servicing income on SBA loans. These increases were partially offset by decreases in service charges and fees resulting from changes in the business practices of customers of the Bank; and
- Noninterest expenses, as noted above, increased due to legal and professional fees incurred relating to the proposed merger with Naugatuck Valley Financial Corporation, which was mutually terminated by the merger parties on November 12, 2010 due to an inability to obtain regulatory approval of the transaction, partially offset by lower salaries and benefits expense and a decrease in the cost of FDIC Insurance related to a special one-time assessment incurred during the first nine months of 2009.

Critical Accounting Policy

In the ordinary course of business, the Company makes a number of estimates and assumptions relating to reporting results of operations and financial condition in preparing its financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ significantly from those estimates under different assumptions and conditions. The Company believes the following discussion addresses the Company's only critical accounting policy, which is the policy that is most important to the portrayal of the Company's financial condition and results of operations, and requires management's most difficult, subjective and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. The Company has reviewed this critical accounting policy and estimate with its audit committee. Refer to the discussion below under "Allowance for Loan Losses" and Note 1 to the audited financial statements as of and for the year ended December 31, 2009 included in the Company's Form 10-K filed with the Securities and Exchange Commission on March 29, 2010.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific and general components. The specific component relates to loans that are considered impaired. For such impaired loans, an allowance is established when the discounted cash flows (or observable market price or collateral value if the loan is collateral dependent) of the impaired loan is lower than the carrying value of that loan. The general component covers all other loans, segregated generally by loan type, and is based on historical loss experience with adjustments for qualitative factors which are made after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss data.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and real estate loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Impaired loans also include loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer installment loans for impairment disclosures, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

Based upon this evaluation, management believes the allowance for loan losses of $2,908,000 or 2.22% of gross loans receivable at September 30, 2010 is adequate, under prevailing economic conditions, to absorb losses on existing loans. At December 31, 2009, the allowance for loan losses was $2,769,000 or 2.46% of gross loans receivable.

The $139,000 increase in the allowance during the nine months ended September 30, 2010 was attributable to a $238,000 increase in the general component of the allowance and a $99,000 decrease in the specific component of the allowance. The increase in the general component of the reserve was due to increased loan volume and an increase in classified loans. The decrease in the specific component was related to a $129,000 decrease in the reserve required for loans that were impaired at both September 30, 2010 and December 31, 2009, partially offset by a $32,000 increase for loans classified as impaired during 2010.

The accrual of interest on loans is discontinued at the time the loan is 90 days past due unless the loan is well-secured and in process of collection. Consumer installment loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual status or charged-off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not collected for loans that are placed on nonaccrual status or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis method until these loans qualify for return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Management considers all non-accrual loans and troubled-debt restructured loans to be impaired. In most cases, loan payments that are past due less than 90 days and the related loans are not considered to be impaired.

Recent Accounting Changes

In January 2010, the FASB issued guidance to improve disclosures about fair value measurements which requires new disclosures on transfers into and out of Level 1 and 2 measurements of the fair value hierarchy and requires separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. It also clarifies existing fair value disclosures relating to the level of disaggregation and inputs and valuation techniques used to measure fair value. It is effective for the first reporting period (including interim periods) beginning after December 15, 2009, except for the requirement to provide the Level 3 activity of purchases, sales, issuances, and settlements on a gross basis, which will be effective for fiscal years beginning after December 15, 2010. The adoption of this pronouncement did not have a material impact on the Company’s consolidated financial statements.

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In June 2009, the FASB issued new guidance for accounting for transfers of financial assets. The objective of this guidance is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. Additionally, on and after the effective date, the concept of a qualifying special-purpose entity is no longer relevant for accounting purposes. Therefore, formerly qualifying special-purpose entities (as defined under previous accounting standards) are evaluated for consolidation by reporting entities on and after the effective date in accordance with the applicable consolidation guidance. If the evaluation on the effective date results in consolidation, the reporting entity must apply the transition guidance provided in the pronouncement that requires consolidation. This standard is effective for the first reporting period (including interim periods) beginning after November 15, 2009 and are applied to transfers occurring on or after the effective date. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

Comparison of Financial Condition as of September 30, 2010 versus December 31, 2009

General

The Company's total assets were $156.4 million at September 30, 2010, an increase of $20.8 million from $135.6 million at December 31, 2009. The Bank's net loans receivable increased to $128.0 million at September 30, 2010 from $109.9 million at December 31, 2009, and cash and cash equivalents, including short term investments, increased to $19.8 million as of September 30, 2010 from $17.9 million as of December 31, 2009. Total deposits increased to $138.3 million as of September 30, 2010 from $117.6 million as of December 31, 2009. The increase in deposit liabilities combined with decreases in lower yielding short-term investments funded the growth in net loans receivable and cash and cash equivalents during the nine months ended September 30, 2010.

Short-term investments

Short-term investments, consisting of money market investments, were $8.7 million at September 30, 2010, compared to a balance of $15.4 million as of December 31, 2009. This $6.7 million decrease in short-term investments from December 31, 2009 was attributable to growth in the Bank's loan portfolio.

Investments

Available for sale securities, consisting of U.S. Treasury Bills, U.S. government agency obligations and agency issued mortgage-backed securities, were $3.0 million at September 30, 2010, compared to a balance of $2.2 million as of December 31, 2009. The Company uses its available for sale securities portfolio to meet pledge requirements for public deposits and repurchase agreements. The $800,000 increase in available for sale securities was in response to increased pledge requirements at September 30, 2010. The Company classifies its securities as "available for sale" to provide greater flexibility to respond to changes in interest rates as well as future liquidity needs.

Loans

Interest income on loans is the most important component of our net interest income. The loan portfolio is the largest component of earning assets, and it therefore generates the largest portion of revenues. The Company's net loan portfolio was $128.0 million at September 30, 2010 versus $109.9 million at December 31, 2009, an increase of $18.1 million. The Company attributes the loan growth during the first nine months of 2010 to the success of the Bank's loan business development program in generating loan demand to small to medium-sized businesses. The Bank's loans have been made to borrowers primarily in the New Haven, Connecticut market area. There are no other significant loan concentrations in the loan portfolio.

Allowance for Loan Losses and Non-Accrual, Past Due and Restructured Loans

Allowance for Loan Losses

The following represents the activity in the allowance for loan losses for the nine months ended September 30, 2010 and 2009:

	2010	2009
Balance at beginning of year	$2,768,567	$1,183,369
Provision for loan losses	224,088	1,943,461
Recoveries of loans previously charged-off:		
Consumer	3,705	10,423
Total recoveries	3,705	10,423
Loans charged-off:		
Commercial loans secured by real estate	(84,387)	(413,839)
Commercial loans	-	(2,300)
Consumer	(4,412)	(1,339)
Total charge-offs	(88,799)	(417,478)
Balance at end of period	$2,907,561	$2,719,775
Net charge-offs to average loans	(0.07)%	(0.45)%

Non-Accrual, Past Due and Restructured Loans

The following represents non-accrual, past due and restructured loans at September 30, 2010 and December 31, 2009:

	September 30, 2010	December 31, 2009
Non-accrual loans	$6,456,525	$5,363,061
Accruing loans contractually past due 90 days or more		
Loans past due 90 days or more and still accruing	$416,220	$483,897

The $1.1 million increase in non-accrual loans at September 30, 2010 compared to December 31, 2009, primarily relates to one loan that had been classified as an impaired and accruing loan at December 31, 2009. Management believes there exists sufficient collateral for the collection of principal and accrued interest on the loan. However as the loan is past due 90 days or more at September 30, 2010 and the timing of the payment is not certain, the loan has been classified as non-accrual at September 30, 2010. At September 30, 2010, there was one loan aggregating $280,000 that was considered to be a "troubled debt restructuring." At December 31, 2009 there were no loans considered to be "troubled debt restructurings."

Deposits

Total deposits were $138.3 million at September 30, 2010 as compared to total deposits of $117.6 million at December 31, 2009. Non-interest bearing deposits were $30.5 million at September 30, 2010, an increase of $700,000 (2.4%) from $29.8 million at December 31, 2009. Total interest bearing checking, money market and savings deposits increased $4.1 million or 11.0% to $41.5 million at September 30, 2010 from $37.4 million at December 31,

2009. Time deposits increased to $66.3 million at September 30, 2010 from $50.3 million at December 31, 2009, a $16.0 million or 31.8% increase. Included in time deposits at September 30, 2010 and December 31, 2009 was $14.1 million and $14.0 million, respectively, in brokered deposits, which included the Company's placement of $2.9 million and $3.4 million in customer deposits; and purchase of $4.0 million and $3.5 million in brokered certificates of deposit through the CDARS program at September 30, 2010 and December 31, 2009, respectively. The CDARS program offers the Bank both reciprocal and one way swap programs which allow customers to enjoy additional FDIC insurance for deposits that might not otherwise be eligible for FDIC insurance and gives the Bank additional access to funding.

The Bank maintains relationships with several deposit brokers and could continue to utilize the services of one or more of such brokers if management determines that issuing brokered certificates of deposit would be in the best interest of the Bank and the Company.

The Greater New Haven Market is highly competitive. The Bank faces competition from a large number of banks (ranging from small community banks to large international banks), credit unions, and other providers of financial services. The level of rates offered by the Bank reflects the high level of competition in our market.

Other

Repurchase agreement balances totaled $453,000 at September 30, 2010 as compared to $294,000 at December 31, 2009. The increase was due to normal customer activity.

Results of Operations: Comparison of Results for the three months and nine months ended September 30, 2010 and 2009

General

The Company had net income for the quarter ended September 30, 2010 of $27,000 (or basic and diluted earnings per share of $0.01), compared to net income of $3,000 (or basic and diluted income per share of $0.00) for the third quarter of 2009.

During the third quarter of 2010, net income was negatively impacted by $98,000 for merger related legal, accounting and advisory costs.

The Company's operating results for the third quarter of 2010 compared to the same period of 2009 were influenced by the following factors:

- Net interest income increased due to the combined effects of increases in asset volumes, higher yields on interest earning assets and lower costs on interest bearing liabilities, offset partially by increases in liability volumes;
- Provision for loan losses increased during the third quarter of 2010 primarily due to an increase in the general component of the allowance, which was attributable to growth in the Bank's loan portfolio. During the three months ended September 30, 2009, the credit to the provision for loan losses was primarily related to net decreases to the specific allowances on certain impaired loans resulting from payments received in excess of amounts previously estimated;
- Noninterest income decreased because of a decline in service charges and fees resulting from changes in the business practices of customers of the Bank, partially offset by an increase in rental income and an increase in other fees on loans; and
- Noninterest expenses increased, as noted above, primarily due to an increase in legal and professional fees incurred relating to the proposed merger with Naugatuck Valley Financial Corporation, which was mutually terminated by the merger parties on November 12, 2010 due to an inability to obtain regulatory approval of the transaction.

The Company earned net income during the nine months ended September 30, 2010 of $62,000 (or basic and diluted earnings per share of $0.02), compared to a net loss of $2,562,000 (or basic and diluted loss per share of $0.95) for the same period in 2009.

During the first nine months of 2010, net income was negatively impacted by $364,000 for merger related legal, accounting and advisory costs.

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The Company's increase in earnings during the nine months ended September 30, 2010, as compared to the same period in 2009, was due to the combined effects of a $1,719,000 decrease in the provision for loan losses recorded by the Bank to $224,000 for the nine months ended September 30, 2010, compared to a provision for loan losses of $1,943,000 for the same period in 2009; and a $1,100,000 increase in net interest income. Net interest income increased due to increases in asset volumes, higher yields on interest earning assets and lower costs on interest bearing liabilities, which were partially offset by increases in liability volumes. The provision for loan losses during the first nine months of 2009 was related to a group of ten impaired loans that were severely impacted by prevailing economic conditions in 2009.

In addition to the impact of the provision for loan losses and growth in the loan portfolio, the operating results for the first nine months of 2010 compared to the same period of 2009 were influenced by the following factors:

- Noninterest income increased because of recognition of a gain on the sale of an available for sale security, as well as increases in rental income and servicing income on SBA loans. These increases were partially offset by decreases in service charges and fees resulting from changes in the business practices of customers of the Bank; and
- Noninterest expenses, as noted above, increased due to legal and professional fees incurred relating to the proposed merger with Naugatuck Valley Financial Corporation, which was mutually terminated by the merger parties on November 12, 2010 due to an inability to obtain regulatory approval of the transaction, partially offset by lower salaries and benefits expense and a decrease in the cost of FDIC Insurance related to a special onetime assessment incurred during the first nine months of 2009.

Net Interest Income

The principal source of revenue for the Bank is net interest income. The Bank's net interest income is dependent primarily upon the difference or spread between the average yield earned on loans receivable and securities and the average rate paid on deposits and borrowings, as well as the relative amounts of such assets and liabilities. The Bank, like other banking institutions, is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different times, or on a different basis, than its interest-earning assets.

For the quarter ended September 30, 2010, net interest income was $1,432,000 versus $1,026,000 for the same period in 2009. The $406,000 or 39.6% increase was the result of a $356,000 increase in interest income and a $50,000 decrease in interest expense. This net increase was primarily the result of an increase in interest earning assets, as well as favorable changes in rates on both interest earning assets and interest bearing liabilities, partially offset by increased costs attributable to growth in interest bearing liabilities.

The Company's average total interest earning assets were $142.6 million during the quarter ended September 30, 2010 compared to $131.0 million for the same period in 2009, an increase of $11.6 million or 8.9%. The increase in average interest earning assets of $11.6 million was comprised of increases in average balances of loans of $29.3 million and investments of $1.1 million, partially offset by decreases in average balances of short-term and other investments of $18.8 million.

The yield on average interest earning assets for the quarter ended September 30, 2010 was 5.49% compared to 4.90% for the same period in 2009, an increase of 59 basis points. The increase in the yield on average earning assets was attributable to growth in the Bank's higher yielding loan portfolio and reductions in lower yielding short-term investments.

The combined effects of the $11.6 million increase in average balances of interest earning assets and the 59 basis point increase in yield on average interest earning assets resulted in the $356,000 increase in interest income for the quarter ended September 30, 2010 compared to the quarter ended September 30, 2009.

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The average balance of the Company's interest bearing liabilities was $111.6 million during the quarter ended September 30, 2010 compared to $93.2 million for the quarter ended September 30, 2009, an increase of $18.4 million or 19.7%. The cost of average interest bearing liabilities decreased 59 basis points to 1.93% for the quarter ended September 30, 2010 compared to 2.52% for the same period in 2009, which was primarily due to a general decrease in market interest rates.

The combined effects of the 59 basis point decrease in cost of average interest bearing liabilities and the $18.4 million increase in average balances of interest bearing liabilities resulted in the $50,000 decrease in interest expense for the quarter ended September 30, 2010 compared to the quarter ended September 30, 2009.

For the nine months ended September 30, 2010, net interest income was $4,124,000 versus $3,024,000 for the same period in 2009. The $1,100,000 or 36.4% increase was the result of a $948,000 increase in interest income and a $152,000 decrease in interest expense. This net increase was primarily the result of an increase in interest earning assets, as well as favorable changes in rates on both interest earning assets and interest bearing liabilities, partially offset by increased costs on interest bearing liabilities. The increase in the yield on average earning assets reflects the growth in the Bank's loan portfolio combined with the impact of reductions in interest income during 2009 related to the increase in non-performing assets.

The Company's average total interest earning assets were $135.7 million during the nine months ended September 30, 2010 compared to $119.9 million for the same period in 2009, an increase of $15.8 million or 13.2%. The increase in average interest earning assets of $15.8 million was comprised of increases in average balances of loans of $27.1 million, partially offset by decreases in average balances of short-term and other investments of $11.2 million.

The yield on average interest earning assets for the nine months ended September 30, 2010 was 5.56% compared to 5.23% for the same period in 2009, an increase of 33 basis points. The increase in the yield on average earning assets was attributable to growth in the Bank's higher yielding loan portfolio and reductions in lower yielding short-term investments.

The combined effects of the $15.8 million increase in average balances of interest earning assets and the 33 basis point increase in yield on average interest earning assets resulted in the $948,000 increase in interest income for the nine months ended September 30, 2010 compared to the nine months ended September 30, 2009.

The average balance of the Company's interest bearing liabilities was $100.8 million during the nine months ended September 30, 2010 compared to $83.3 million for the nine months ended September 30, 2009, an increase of $17.5 million or 21%. The cost of average interest bearing liabilities decreased 67 basis points to 2.01% for the nine months ended September 30, 2010 compared to 2.68% for the same period in 2009, which was primarily due to a general decrease in market interest rates.

The combined effects of the 67 basis point decrease in cost of average interest bearing liabilities and the $17.5 million increase in average balances of interest bearing liabilities resulted in the $152,000 decrease in interest expense for the nine months ended September 30, 2010 compared to the nine months ended September 30, 2009.

Average Balances, Yields, and Rates

The following table presents average balance sheets (daily averages), interest income, interest expense, and the corresponding annualized rates on earning assets and rates paid on interest bearing liabilities for the three months ended September 30, 2010 and 2009.

Distribution of Assets, Liabilities and Shareholders' Equity;
Interest Rates and Interest Differential

	2010				2009				
(Dollars in thousands)	Average Balance	Interest Income/ Expense	Average Rate		Average Balance	Interest Income/ Expense	Average Rate		Increases (Decreases) in Interest Income/Expense
Interest earning assets									
Loans (1)	$128,856	$1,947	5.99	%	$99,523	$1,541	6.14	%	$ 406
Short-term and other investments	9,569	25	1.04	%	28,420	59	0.82	%	(34)
Investments	4,215	2	0.19	%	3,086	18	2.31	%	(16)
Total interest earning assets	142,640	1,974	5.49	%	131,029	1,618	4.90	%	356
Cash and due from banks	13,228				4,530				
Premises and equipment, net	2,326				2,589				
Allowance for loan losses	(2,874)				(2,841)				
Other	2,836				2,309				
Total assets	$158,156				$137,616				
Interest bearing liabilities									
Time certificates	$69,284	392	2.24	%	$53,653	418	3.09	%	(26)
Savings deposits	2,482	4	0.64	%	2,146	5	0.92	%	(1)
Money market /checking deposits	36,486	102	1.12	%	35,292	124	1.39	%	(22)
Capital lease obligations	1,172	44	14.89	%	1,178	44	14.82	%	-
Repurchase agreements	2,138	-	0.00	%	895	1	0.44	%	(1)
Total interest bearing liabilities	111,562	542	1.93	%	93,164	592	2.52	%	(50)
Non-interest bearing deposits	30,029				27,401				
Accrued expenses and other liabilities	742				1,115				
Shareholder's equity	15,823				15,936				
Total liabilities and equity	$158,156				$137,616				
Net interest income		$1,432				$1,026			$ 406

Interest spread	3.56 %	2.38 %
Interest margin	3.98 %	3.11 %

(1) Includes nonaccruing loans.

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Changes in Assets and Liabilities and Fluctuations in Interest Rates

The following table summarizes the variance in interest income and interest expense for the three months ended September 30, 2010 and 2009 resulting from changes in assets and liabilities and fluctuations in interest rates earned and paid. The changes in interest attributable to both rate and volume have been allocated to both rate and volume on a pro rata basis.

	Three Months Ended September 30, 2010 vs 2009		
	Due to Change in Average		Increase
(Dollars in thousands)	Volume	Rate	(Decrease)
Interest earning assets			
Loans	$444	$(38)	$406
Short-term and other investments	(46)	12	(34)
Investments	5	(21)	(16)
Total interest earning assets	403	(47)	356
Interest bearing liabilities			
Time certificates	105	(131)	(26)
Savings deposits	1	(2)	(1)
Money market / checking deposits	4	(26)	(22)
Repurchase agreements	-	(1)	(1)
Total interest bearing liabilities	110	(160)	(50)
Net interest income	$293	$113	$406

Average Balances, Yields, and Rates

The following table presents average balance sheets (daily averages), interest income, interest expense, and the corresponding annualized rates on earning assets and rates paid on interest bearing liabilities for the nine months ended September 30, 2010 and 2009.

Distribution of Assets, Liabilities and Shareholders' Equity;
Interest Rates and Interest Differential

	2010				2009				
(Dollars in thousands)	Average Balance	Interest Income/ Expense	Average Rate		Average Balance	Interest Income/ Expense	Average Rate		Increases (Decreases) in Interest Income/Expense
Interest earning assets									
Loans (1)	$121,603	$5,561	6.11	%	$94,512	$4,421	6.25	%	$ 1,140
Short-term and other investments	10,508	67	0.85	%	21,746	163	1.00	%	(96)
Investments	3,605	11	0.41	%	3,613	107	3.96	%	(96)
Total interest earning assets	135,716	5,639	5.56	%	119,871	4,691	5.23	%	948
Cash and due from banks	8,000				4,413				
Premises and equipment, net	2,392				2,658				
Allowance for loan losses	(2,809)				(2,455)				
Other	2,786				2,313				
Total assets	$146,085				$126,800				
Interest bearing liabilities									
Time certificates	$60,271	1,080	2.40	%	$45,732	1,095	3.20	%	(15)
Savings deposits	2,403	12	0.67	%	1,807	16	1.18	%	(4)
Money market /checking deposits	34,934	287	1.10	%	33,889	419	1.65	%	(132)
Capital lease obligations	1,173	131	14.93	%	1,179	132	14.97	%	(1)
Repurchase agreements	2,009	5	0.33	%	710	5	0.94	%	-
Total interest bearing liabilities	100,790	1,515	2.01	%	83,317	1,667	2.68	%	(152)
Non-interest bearing deposits	28,677				25,580				
Accrued expenses and other	847				1,088				

liabilities						
Shareholder's equity	15,770			16,815		
Total liabilities and equity	$146,084			$126,800		
Net interest income		$4,124			$3,024	$ 1,100
Interest spread			3.55 %			2.55 %
Interest margin			4.06 %			3.37 %

(1) Includes nonaccruing loans.

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Changes in Assets and Liabilities and Fluctuations in Interest Rates

The following table summarizes the variance in interest income and interest expense for the nine months ended September 30, 2010 and 2009 resulting from changes in assets and liabilities and fluctuations in interest rates earned and paid. The changes in interest attributable to both rate and volume have been allocated to both rate and volume on a pro rata basis.

	Nine Months Ended September 30, 2010 vs 2009		
	Due to Change in Average		Increase
(Dollars in thousands)	Volume	Rate	(Decrease)
Interest earning assets			
Loans	$1,241	$(101)	$1,140
Short-term and other investments	(74)	(22)	(96)
Investments	-	(96)	(96)
Total interest earning assets	1,167	(219)	948
Interest bearing liabilities			
Time certificates	299	(314)	(15)
Savings deposits	4	(8)	(4)
Money market / checking deposits	13	(145)	(132)
Capital lease obligations	(1)	-	(1)
Repurchase agreements	5	(5)	-
Total interest bearing liabilities	320	(472)	(152)
Net interest income	$847	$253	$1,100

Provision for Loan Losses

The Bank's provision for loan losses was $106,000 and $224,000 for the three months and nine months ended September 30, 2010, respectively, as compared to a (credit to) provision for loan losses of $(137,000) and $1,943,000, respectively, for the same periods in 2009.

The increase in the provision for loan losses during the third quarter of 2010, as compared to a credit balance for the same period in the prior year, was primarily related to reductions that were made to the specific allowances for certain impaired loans during the three months ended September 30, 2009, resulting from payments received in excess of amounts previously estimated.

The significant decrease in the provision for loan losses during the nine months ended September 30, 2010, as compared to the same period in the prior year, was primarily related to specific allowances established for a group of ten impaired loans in 2009 that were severely impacted by prevailing economic conditions in 2009, discussed in more detail under "Allowance for Loan Losses."

Noninterest Income

Total noninterest income was $135,000 for the three months ended September 30, 2010 versus $139,000 for the same period in 2009. Service charges and fees decreased $13,000 due to changes in business practices of customers of the Bank during the third quarter of 2010. Other noninterest income increased to $35,000 for the three months ended September 30, 2010 from $26,000 in the same period in 2009 primarily due to increases in rental income.

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Total noninterest income was $473,000 for the nine months ended September 30, 2010 compared to $459,000 for the same period in 2009. Noninterest income for the nine months ended September 30, 2010 included a $29,000 gain on the sale of an available for sale security. Service charges and fees decreased $52,000 due to changes in business practices of customers of the Bank during 2010. Other noninterest income increased $37,000 to $109,000 for the nine months ended September 30, 2010 from $72,000 in the same period in 2009, due to a $17,000 increase in loan and SBA servicing related fees, an $18,000 increase in rental income and a $2,000 increase in other fees.

Noninterest Expense

Total noninterest expense was $1,434,000 for the three months ended September 30, 2010 versus $1,299,000 for the same period in 2009, an increase of $135,000 or 10.4%.

Salaries and benefits expense for the three months ended September 30, 2010 declined $8,000 to $743,000 compared to $751,000 for the same period in 2009.

FDIC insurance expense increased for the three months ended September 30, 2010 by $8,000 to $60,000 from $52,000 primarily due to increases in deposit balances during 2010.

Professional services for the three months ended September 30, 2010 increased by $34,000 to $156,000 from $122,000, primarily due to an increase in fees related to the proposed merger with Naugatuck Valley Financial Corporation, which was mutually terminated by the merger parties on November 12, 2010 due to an inability to obtain regulatory approval of the transaction.

Other operating expenses increased by $102,000 to $200,000 for the three months ended September 30, 2010 compared to the same period in 2009 primarily due to non-recurring telephone and communication expense and loan related legal fees refunded in the third quarter of 2009.

Total noninterest expense was $4,311,000 for the nine months ended September 30, 2010 compared to $4,100,000 for the same period in 2009, an increase of $211,000 or 5.1%.

Salaries and benefits expense for the nine months ended September 30, 2010 declined $32,000 to $2,262,000 compared to $2,294,000 for the same period in 2009.

FDIC insurance expense decreased for the nine months ended September 30, 2010 by $24,000 to $170,000 from $194,000 primarily due to a special one-time assessment accrued during the first nine months of 2009, partially offset by increases in deposit balances during 2010.

Professional services for the nine months ended September 30, 2010 increased by $169,000 from $395,000 to $564,000, primarily due to an increase in legal, accounting and advisory fees related to the proposed merger with Naugatuck Valley Financial Corporation, which was mutually terminated by the merger parties on November 12, 2010 due to an inability to obtain regulatory approval of the transaction.

In addition, other operating expenses increased by $115,000 to $514,000 for the nine months ended September 30, 2010 compared to the same period in 2009 primarily due to non-recurring telephone and communication expense savings realized in 2009.

Off-Balance Sheet Arrangements

See Note 9 to the Financial Statements for information regarding the Company’s off-balance sheet arrangements.

Liquidity

Management believes that the Company's short-term assets offer sufficient liquidity to cover potential fluctuations in deposit accounts and loan demand and to meet other anticipated operating cash requirements.

The Company's liquidity position as of September 30, 2010 and December 31, 2009 consisted of liquid assets totaling $23.0 million and $20.5 million, respectively. This represents 14.7% and 15.1% of total assets at September 30, 2010 and December 31, 2009, respectively. The liquidity ratio is defined as the percentage of liquid assets to total assets. The following categories of assets as described in the accompanying balance sheet are considered liquid assets: cash and due from banks, short-term investments, interest bearing certificates of deposit and securities available for sale. Liquidity is a measure of the Company's ability to generate adequate cash to meet financial obligations. The principal cash requirements of a financial institution are to cover downward fluctuations in deposits and increases in its loan portfolio.

In addition to the foregoing sources of liquidity, the Bank maintains a relationship with the Federal Home Loan Bank of Boston and has the ability to pledge certain of the Bank's assets as collateral for borrowings from that institution. In addition, the Bank maintains relationships with several brokers of certificates of deposits and could utilize the services of these brokers if the Bank desires additional liquidity to meet its needs.

Capital

The Company's and Bank's actual capital amounts and ratios at September 30, 2010 and December 31, 2009 were as follows:

The Company's actual capital amounts and ratios at September 30, 2010 and December 31, 2009 were
(dollars in thousands):

September 30, 2010	Actual			For Capital Adequacy Purposes			To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio		Amount	Ratio		Amount	Ratio
Total Capital to Risk-Weighted Assets	$17,458	12.60	%	$11,089	8.00	%	N/A	N/A
Tier 1 Capital to Risk-Weighted Assets	15,711	11.33	%	5,544	4.00	%	N/A	N/A
Tier 1 (Leverage) Capital to Average Assets	15,711	9.93	%	6,326	4.00	%	N/A	N/A

December 31, 2009	Actual			For Capital Adequacy Purposes			To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio		Amount	Ratio		Amount	Ratio
Total Capital to Risk-Weighted Assets	$17,290	13.25	%	$10,436	8.00	%	N/A	N/A
Tier 1 Capital to Risk-Weighted Assets	15,645	11.99	%	5,218	4.00	%	N/A	N/A
Tier 1 (Leverage) Capital to Average Assets	15,645	11.24	%	5,569	4.00	%	N/A	N/A

The Bank's actual capital amounts and ratios at September 30, 2010 and December 31, 2009 were (dollars in thousands):

September 30, 2010	Actual			For Capital Adequacy Purposes			To Be Well Capitalized Under Prompt Corrective Action Provisions		
	Amount	Ratio		Amount	Ratio		Amount	Ratio	
Total Capital to Risk-Weighted Assets	$16,382	11.90	%	$11,013	8.00	%	$12,620	10.00	%
Tier 1 Capital to Risk-Weighted Assets	14,647	10.64	%	5,507	4.00	%	7,570	6.00	%
Tier 1 (Leverage) Capital to Average Assets	14,647	9.32	%	6,287	4.00	%	6,732	5.00	%

December 31, 2009	Actual			For Capital Adequacy Purposes			To Be Well Capitalized Under Prompt Corrective Action Provisions		
	Amount	Ratio		Amount	Ratio		Amount	Ratio	
Total Capital to Risk-Weighted Assets	$16,014	12.39	%	$10,340	8.00	%	$12,924	10.00	%
Tier 1 Capital to Risk-Weighted Assets	14,384	11.13	%	5,170	4.00	%	7,755	6.00	%
Tier 1 (Leverage) Capital to Average Assets	14,384	10.44	%	5,512	4.00	%	6,889	5.00	%

Capital adequacy is one of the most important factors used to determine the safety and soundness of individual banks and the banking system. Based on the above ratios, the Company is considered to be “well capitalized” under applicable regulations specified by the Federal Reserve. The Bank is also considered to be “well capitalized” under other applicable regulations. To be considered “well capitalized”, an institution must generally have a leverage capital ratio of at least 5%, a Tier 1 risk-based capital ratio of at least 6% and a total risk-based capital ratio of at least 10%.

Market Risk

Market risk is defined as the sensitivity of income to fluctuations in interest rates, foreign exchange rates, equity prices, commodity prices and other market-driven rates or prices. Based upon the nature of the Company’s business, market risk is primarily limited to interest rate risk, defined as the impact of changing interest rates on current and future earnings.

The Company’s goal is to maximize long-term profitability, while minimizing its exposure to interest rate fluctuations. The first priority is to structure and price the Company’s assets and liabilities to maintain an acceptable interest rate spread, while reducing the net effect of changes in interest rates. In order to reach an acceptable interest rate spread, the Company must generate loans and seek acceptable investments to replace the lower yielding balances in Federal Funds sold and short-term investments. The focus also must be on maintaining a proper balance between the timing and volume of assets and liabilities re-pricing within the balance sheet. One method of achieving this balance is to originate variable rate loans for the portfolio to offset the short-term re-pricing of liabilities since a number of the interest bearing deposit products have no contractual maturity. Customers may withdraw funds from their accounts at any time and deposit balances may therefore run off unexpectedly due to changing market conditions.

The exposure to interest rate risk is monitored by senior management of the Bank and is reported quarterly to the Board of Directors of the Bank and the Company. Management reviews the interrelationships within the balance sheet to maximize net interest income within acceptable levels of risk.

Impact of Inflation and Changing Prices

The Company's financial statements have been prepared in terms of historical dollars, without considering changes in relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effect of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. Notwithstanding this fact, inflation can directly affect the value of loan collateral, in particular, real estate. Inflation, or disinflation, could significantly affect the Company's earnings in future periods.

Cautionary Statement Regarding Forward-Looking Statements

Some of the statements under "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this Report on Form 10-Q may include forward-looking statements which reflect management's current views with respect to future events and financial performance. Statements which include the words "expect," "intend," "plan," "believe," "project," "anticipate" and similar statements of a future or forward-looking n identify forward-looking statements for purposes of the federal securities laws or otherwise. All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in these statements or that could adversely affect the holders of the Company's common stock. These factors include, but are not limited to, (1) changes in prevailing interest rates which would affect the interest earned on the Company's interest earning assets and the interest paid on its interest bearing liabilities, (2) the timing of re-pricing of the Company's interest earning assets and interest bearing liabilities, (3) the effect of changes in governmental monetary policy, (4) the effect of changes in regulations applicable to the Company and the conduct of its business, (5) changes in competition among financial service companies, including possible further encroachment of non-banks on services traditionally provided by banks and the impact of recently enacted federal legislation, (6) the ability of competitors which are larger than the Company to provide products and services which are impractical for the Company to provide, (7) the volatility of quarterly earnings, due in part to the variation in the number, dollar volume and profit realized from SBA guaranteed loan participation sales in different quarters, (8) the effect of a loss of any executive officer, key personnel, or directors, (9) the effect of the Company's opening of branches and the receipt of regulatory approval to complete such actions, (10) the concentration of the Company's business in southern Connecticut, (11) the concentration of the Company's loan portfolio in commercial loans to small-to-medium sized businesses, which may be impacted more severely than larger businesses during periods of economic weakness, (12) the lack of seasoning in the Company's loan portfolio, which may increase the risk of future credit defaults, and (13) the effect of any decision by the Company to engage in any business that was not historically permitted for the Company. Other such factors may be described in other filings made by the Company with the Securities and Exchange Commission.

Although the Company believes that it offers the loan and deposit products and has the resources needed for success, future revenues and interest spreads and yields cannot be reliably predicted. These trends may cause the Company to adjust its operations in the future. Because of the foregoing and other factors, recent trends should not be considered reliable indicators of future financial results or stock prices.

Any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Not required.

Item 4T. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures.

Based upon an evaluation of the effectiveness of the Company's disclosure controls and procedures performed by the Company's management, with participation of the Company's President and Chief Operating Officer and its Chief Financial Officer as of the end of the period covered by this report, the Company's President and Chief Operating Officer and its Chief Financial Officer concluded that the Company's disclosure controls and procedures have been effective in ensuring that material information relating to the Company, including its subsidiaries, is made known to the certifying officers by others within the Company and the Bank during the period covered by this report.

As used herein, "disclosure controls and procedures" mean controls and other procedures of the Company that are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive and financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in Internal Control Over Financial reporting

There have not been any changes in the Company's internal control over financial reporting that occurred during the quarter ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II
Other Information

Item 1. Legal Proceedings

Periodically, there have been various claims and lawsuits against the Company, such as claims to enforce liens, condemnation proceedings on properties in which the Company holds security interests, claims involving the making and servicing of real property loans and other issues incident to our business. However, neither the Company nor any subsidiary is a party to any pending legal proceedings that management believes would have a material adverse effect on the Company's financial condition, results of operations or cash flows.

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Item 1A. Risk Factors

Not required.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. [Removed and Reserved]

Item 5. Other Information

Not applicable.

Item 6. Exhibits

No.	Description
2.1	Agreement and Plan of Merger, dated as of February 22, 2010, by and among Naugatuck Valley Financial Corporation, Newco (as defined therein) and Southern Connecticut Bancorp, Inc. (incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed on February 23, 2010)
2.2	First Amendment dated as of September 17, 2010 to the Agreement and Plan of Merger, dated as of February 22, 2010, by and among Naugatuck Valley Financial Corporation, Newco (as defined therein) and Southern Connecticut Bancorp, Inc. (incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed on September 20, 2010)
2.3	Mutual Termination Agreement, dated as of November 12, 2010, by and among Naugatuck Valley Financial Corporation, a federally chartered subsidiary holding company, Naugatuck Valley Financial Corporation, a Maryland corporation, and Southern Connecticut Bancorp, Inc. (incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed on November 12, 2010)
3(i)	Amended and Restated Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit 3(i) to the Registrant's Quarterly Report on Form 10-QSB filed on August 14, 2002)
3(ii)	By-Laws of the Registrant (incorporated by reference to Exhibit 3(ii) to the Registrant's Current Report on Form 8-K filed on March 6, 2007)
31.1	Rule 13a-14(a)/15d-14(a) Certification by President and Chief Operating Officer
31.2	Rule 13a-14(a)/15d-14(a) Certification by Senior Vice President and Chief Financial Officer
31.3	Rule 13a-14(a)/15d-14(a) Certification by Vice President and Chief Accounting Officer
32.1	Section 1350 Certification by President and Chief Operating Officer
32.2	Section 1350 Certification by Senior Vice President and Chief Financial Officer
32.3	Section 1350 Certification by Vice President and Chief Accounting Officer

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	SOUTHERN CONNECTICUT BANCORP, INC.
	By: /s/ John H. Howland Name: John H. Howland
Date: November 15, 2010	Title: President & Chief Operating Officer
	By: /s/ Stephen V. Ciancarelli Name: Stephen V. Ciancarelli
Date: November 15, 2010	Title: Senior Vice President & Chief Financial Officer
	By: /s/ Anthony M. Avellani Name: Anthony M. Avellani
Date: November 15, 2010	Title: Vice President & Chief Accounting Officer

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