PATRIOT NATIONAL BANCORP INC
Form 10-Q
August 05, 2010

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

FORM 10-Q

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

For the Quarter Ended June 30, 2010 Commission file number 000-29599

PATRIOT NATIONAL BANCORP, INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Connecticut | 06-1559137 |
| (State of incorporation) | (I.R.S. Employer Identification Number) |

900 Bedford Street, Stamford, Connecticut 06901
(Address of principal executive offices)

(203) 324-7500
(Registrant's telephone number)

Check whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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 in Rule 12b-2 of the Exchange Act:

Large Accelerated Filer ____ Accelerated Filer __X__ Non-Accelerated Filer Smaller Reporting Company____

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

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

Common stock, $2.00 par value per share, 4,762,727 shares outstanding as of the close of business July 31, 2010.

Table of Contents

PART I - FINANCIAL INFORMATION

Item 1: Consolidated Financial Statements
PATRIOT NATIONAL BANCORP, INC.
CONSOLIDATED BALANCE SHEETS

| | June 30, 2010 (Unaudited) | December 31, 2009 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks: | | |
| Non-interest bearing deposits and cash | $ 9,359,050 | $ 19,465,521 |
| Interest-bearing deposits | 81,324,490 | 78,070,072 |
| Federal funds sold | 10,000,000 | 10,000,000 |
| Short-term investments | 357,939 | 263,839 |
| Cash and cash equivalents | 101,041,479 | 107,799,432 |
| | | |
| Available-for-sale securities (at fair value) | 61,089,895 | 48,829,981 |
| Federal Reserve Bank stock | 1,234,200 | 1,839,650 |
| Federal Home Loan Bank stock | 4,508,300 | 4,508,300 |
| Loans receivable (net of allowance for loan losses: 2010 $13,989,069; 2009 $15,794,118) | 603,964,630 | 645,205,943 |
| Accrued interest and dividends receivable | 2,968,306 | 3,236,252 |
| Premises and equipment, net | 5,923,808 | 6,595,727 |
| Cash surrender value of life insurance | 20,128,565 | 19,859,732 |
| Other real estate owned | 6,736,536 | 19,073,993 |
| Other assets | 8,874,717 | 9,467,911 |
| Total assets | $ 816,470,436 | $ 866,416,921 |
| | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Liabilities | | |
| Deposits: | | |
| Non-interest bearing deposits | $ 52,478,419 | $ 49,755,521 |
| Interest-bearing deposits | 662,764,530 | 711,578,771 |
| Total deposits | 715,242,949 | 761,334,292 |
| | | |
| Repurchase agreements | 7,000,000 | 7,000,000 |
| Federal Home Loan Bank borrowings | 50,000,000 | 50,000,000 |
| Junior subordinated debt owed to unconsolidated trust | 8,248,000 | 8,248,000 |
| Accrued expenses and other liabilities | 4,391,188 | 3,973,319 |
| Total liabilities | 784,882,137 | 830,555,611 |
| | | |
| Shareholders' equity | | |
| Preferred stock: no par value; 1,000,000 shares authorized; no shares issued | - | - |
| Common stock, $2 par value: 60,000,000 shares authorized; shares issued 4,774,432; shares outstanding 4,762,727. | 9,548,864 | 9,548,864 |
| Additional paid in capital | 49,651,534 | 49,651,534 |
| Accumulated deficit | (28,532,144) | (24,000,400) |
| Less: Treasury stock at cost: 11,705 shares | (160,025) | (160,025) |

| | | | | |
|---|---|---|---|---|
| Accumulated other comprehensive income - net unrealized | | | | |
| gain on available-for-sale securities, net of taxes | | 1,080,070 | | 821,337 |
| Total shareholders' equity | | 31,588,299 | | 35,861,310 |
| Total liabilities and shareholders' equity | $ | 816,470,436 | $ | 866,416,921 |

See accompanying notes to consolidated financial statements.

PATRIOT NATIONAL BANCORP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Interest and Dividend Income | | | | |
| Interest and fees on loans | $ 8,937,870 | $ 10,615,251 | $ 18,034,359 | $ 22,390,192 |
| Interest on investment securities | 377,286 | 265,313 | 866,848 | 793,948 |
| Dividends on investment securities | 66,421 | 84,778 | 135,706 | 127,223 |
| Interest on federal funds sold | 4,486 | 14,519 | 7,847 | 27,441 |
| Other interest income | 21,456 | 19,102 | 53,270 | 19,393 |
| Total interest and dividend income | 9,407,519 | 10,998,963 | 19,098,030 | 23,358,197 |
| | | | | |
| Interest Expense | | | | |
| Interest on deposits | 2,948,548 | 6,006,021 | 6,065,864 | 12,248,794 |
| Interest on Federal Home Loan Bank borrowings | 423,529 | 423,469 | 842,404 | 842,344 |
| Interest on subordinated debt | 71,031 | 89,038 | 140,364 | 182,259 |
| Interest on other borrowings | 76,927 | 76,927 | 153,008 | 153,008 |
| Total interest expense | 3,520,035 | 6,595,455 | 7,201,640 | 13,426,405 |
| | | | | |
| Net interest income | 5,887,484 | 4,403,508 | 11,896,390 | 9,931,792 |
| | | | | |
| Provision for Loan Losses | 512,000 | 5,956,000 | 1,239,000 | 7,556,000 |
| | | | | |
| Net interest income (loss) after provision for loan losses | 5,375,484 | (1,552,492) | 10,657,390 | 2,375,792 |
| | | | | |
| Noninterest Income | | | | |
| Mortgage brokerage referral fees | 26,790 | 79,687 | 53,674 | 82,182 |
| Loan origination & processing fees | 39,554 | 52,057 | 75,383 | 121,259 |
| Fees and service charges | 274,197 | 248,793 | 527,718 | 494,398 |
| Gain on sale of investment securities | - | - | - | 434,333 |
| Earnings on cash surrender value of life insurance | 138,722 | 191,006 | 268,833 | 380,019 |
| Other income | 81,363 | 95,054 | 173,486 | 177,060 |
| | 560,626 | 666,597 | 1,099,094 | 1,689,251 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Total noninterest income | | | | | | | | |
| Noninterest Expenses | | | | | | | | |
| Salaries and benefits | | 3,191,355 | | 2,926,005 | | 6,552,640 | | 5,917,185 |
| Occupancy and equipment expense, net | | 1,297,900 | | 1,406,889 | | 2,836,297 | | 2,812,112 |
| Data processing expenses | | 291,664 | | 262,256 | | 581,827 | | 495,339 |
| Professional and other outside services | | 702,994 | | 1,177,402 | | 1,875,171 | | 1,983,126 |
| Advertising and promotional expenses | | 71,045 | | 12,984 | | 154,678 | | 70,756 |
| Loan administration and processing expenses | | 71,188 | | 171,490 | | 176,216 | | 269,219 |
| Regulatory assessments | | 689,798 | | 922,354 | | 1,384,641 | | 1,201,727 |
| Insurance expenses | | 128,269 | | 138,008 | | 404,399 | | 172,773 |
| Other real estate operations | | 511,453 | | - | | 1,305,627 | | - |
| Other noninterest expenses | | 380,621 | | 429,574 | | 791,732 | | 830,624 |
| Total noninterest expenses | | 7,336,287 | | 7,446,962 | | 16,063,228 | | 13,752,861 |
| Loss before income taxes | | (1,400,177) | | (8,332,857) | | (4,306,744) | | (9,687,818) |
| Benefit (provision) for Income Taxes | | - | | 3,696,000 | | (225,000) | | 3,954,000 |
| Net loss | $ | (1,400,177) | $ | (4,636,857) | $ | (4,531,744) | $ | (5,733,818) |
| Basic and diluted loss per share | $ | (0.29) | $ | (0.98) | $ | (0.95) | $ | (1.21) |

See accompanying notes to consolidated financial statements.

4

PATRIOT NATIONAL BANCORP, INC
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(Unaudited)

| | Three Months Ended June 30, 2010 | Three Months Ended June 30, 2009 | Six Months Ended June 30, 2010 | Six Months Ended June 30, 2009 |
|---|---|---|---|---|
| Net loss | $ (1,400,177) | $ (4,636,857) | $ (4,531,744) | $ (5,733,818) |
| Unrealized holding (losses) gains on securities: | | | | |
| Unrealized holding (losses) gains arising during the period, net of taxes | (85,643) | 465,715 | 258,733 | 400,233 |
| Comprehensive loss | $ (1,485,820) | $ (4,171,142) | $ (4,273,011) | $ (5,333,585) |

See accompanying notes to consolidated financial statements.

PATRIOT NATIONAL BANCORP, INC
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Unaudited)

| | Number of Shares | Common Stock | Additional Paid-In Capital | Accumulated Deficit | Treasury Stock | Accumulated Other Comprehensive (Loss) Income |
|---|---|---|---|---|---|---|
| Six months ended June 30, 2009 | | | | | | |
| Balance at December 31, 2008 | 4,743,409 | $ 9,510,228 | $ 49,634,337 | $ (119,886) | $ (160,025) | $ (90,510) |
| Comprehensive loss | | | | | | |
| Net loss | - | - | - | (5,733,818) | - | - |
| Unrealized holding gain on available for sale securities, net of taxes | - | - | - | - | - | 400,233 |
| Total comprehensive loss | | | | | | |
| Issuance of common stock | | | | | | |
| Stock issued to directors | 19,318 | 38,636 | 17,197 | | | |
| Balance, June 30, 2009 | 4,762,727 | $ 9,548,864 | $ 49,651,534 | $ (5,853,704) | $ (160,025) | $ 309,723 |
| Six months ended June 30, 2010 | | | | | | |
| Balance at December 31, 2009 | 4,762,727 | $ 9,548,864 | $ 49,651,534 | $ (24,000,400) | $ (160,025) | $ 821,337 |
| Comprehensive loss | | | | | | |
| Net loss | - | - | - | (4,531,744) | - | - |

| | | | | | | |
|---|---|---|---|---|---|---|
| Unrealized holding gain on available for sale securities, net of taxes | - | - | - | - | - | 258,733 |
| Total comprehensive loss | | | | | | |
| | | | | | | |
| Balance, June 30, 2010 | 4,762,727 | $ 9,548,864 | $ 49,651,534 | $ (28,532,144) | $ (160,025) | $ 1,080,070 |

See accompanying notes to consolidated financial statements.

PATRIOT NATIONAL BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | Six Months Ended June 30, 2010 | Six Months Ended June 30, 2009 |
|---|---|---|
| Cash Flows from Operating Activities: | | |
| Net loss | $ (4,531,744) | $ (5,733,818) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Amortization and accretion of investment premiums and discounts, net | 220,040 | 52,608 |
| Provision for loan losses | 1,239,000 | 7,556,000 |
| Gain on sale of investment securities | - | (434,333) |
| Amortization of core deposit intangible | 7,950 | 8,394 |
| Earnings on cash surrender value of life insurance | (268,833) | (380,019) |
| Depreciation and amortization | 759,658 | 838,314 |
| Loss on disposal of bank premises and equipment | - | 111 |
| Payment of fees to directors in common stock | - | 55,833 |
| Loss on sale of other real estate owned | 173,289 | - |
| Impairment writedown on other real estate owned | 855,697 | - |
| Deferred income taxes | - | (3,679,142) |
| Changes in assets and liabilities: | | |
| Change in deferred loan costs (fees) | (251,312) | (381,531) |
| Decrease in accrued interest and dividends receivable | 267,946 | 1,050,962 |
| Decrease (increase) in other assets | 585,244 | (876,955) |
| Increase (decrease) in accrued expenses and other liabilities | 259,294 | (1,588,205) |
| Net cash used in operating activities | (683,771) | (3,511,781) |
| | | |
| Cash Flows from Investing Activities: | | |
| Purchases of available for sale securities | (15,162,500) | (9,345,528) |
| Proceeds from sales of available for sale securities | - | 19,852,541 |
| Principal repayments on available for sale securities | 3,099,854 | 3,100,244 |
| Proceeds from redemptions of available for sale securities | - | 6,000,000 |
| Redemptions of Federal Reserve Bank Stock | 605,450 | - |
| Purchases of Federal Reserve Bank Stock | - | (1,500) |
| Net decrease in loans | 40,253,625 | 63,039,420 |
| Proceeds from sale of other real estate owned | 11,423,342 | - |
| Capital improvements of other real estate owned | (114,871) | - |

| | | | | |
|---|---|---|---|---|
| Purchase of bank premises and equipment | | (87,739) | | (330,269) |
| Net cash provided by investing activities | | 40,017,161 | | 82,314,908 |
| | | | | |
| Cash Flows from Financing Activities: | | | | |
| Net (decrease) increase in demand, savings and money market deposits | | (10,002,369) | | 69,754,878 |
| Net (decrease) increase in time certificates of deposits | | (36,088,974) | | 4,801,098 |
| Dividends paid on common stock | | - | | (213,454) |
| Net cash (used in) provided by financing activities | | (46,091,343) | | 74,342,522 |
| | | | | |
| Net (decrease) increase in cash and cash equivalents | | (6,757,953) | | 153,145,650 |
| | | | | |
| Cash and Cash Equivalents: | | | | |
| Beginning | | 107,799,432 | | 24,602,751 |
| Ending | $ | 101,041,479 | $ | 177,748,401 |

7

PATRIOT NATIONAL BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS, Continued
(Unaudited)

| | Six Months Ended June 30, 2010 | 2009 |
|---|---|---|
| Supplemental Disclosures of Cash Flow Information | | |
| Cash paid for: | | |
| Interest | $ 7,111,982 | $ 13,459,875 |
| Income taxes | $ 2,080 | $ 1,379,080 |
| Supplemental disclosures of noncash investing and financing activities: | | |
| Unrealized holding gain on available for sale securities arising during the period | $ 417,308 | $ 645,536 |
| Transfer of loans to other real estate owned | $ - | $ 5,436,500 |

See accompanying notes to consolidated financial statements.

PATRIOT NATIONAL BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1: Basis of Financial Statement Presentation

The Consolidated Balance Sheet at December 31, 2009 has been derived from the audited financial statements of Patriot National Bancorp, Inc. (“Bancorp” or the "Company") at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

The accompanying unaudited financial statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. The accompanying consolidated financial statements and related notes should be read in conjunction with the audited financial statements of Bancorp and notes thereto for the year ended December 31, 2009.

The information furnished reflects, in the opinion of management, all normal recurring adjustments necessary for a fair presentation of the results for the interim periods presented. The results of operations for the six months ended June 30, 2010 are not necessarily indicative of the results of operations that may be expected for the remainder of 2010.

Certain 2009 amounts have been reclassified to conform to the 2010 presentation. Such reclassifications had no effect on net income.

Note 2: Investment Securities

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

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| June 30, 2010: | | | | |
| U. S. Government agency obligations | $ 15,038,797 | $ 63,183 | $ - | $ 15,101,980 |
| U. S. Government agency mortgage-backed securities | 42,409,331 | 823,971 | - | 43,233,302 |
| Money market preferred equity securities | 1,899,720 | 854,893 | - | 2,754,613 |
| Total Available-for-Sale Securities | $ 59,347,848 | $ 1,742,047 | $ - | $ 61,089,895 |
| December 31, 2009: | | | | |
| U. S. Government agency obligations | $ 5,176,712 | $ - | $ (68,212) | $ 5,108,500 |
| U. S. Government agency mortgage-backed securities | 40,428,810 | 241,520 | (166,872) | 40,503,458 |
| Money market preferred equity securities | 1,899,720 | 1,318,303 | - | 3,218,023 |
| Total Available-for-Sale Securities | $ 47,505,242 | $ 1,559,823 | $ (235,084) | $ 48,829,981 |

At June 30, 2010, there were no gross unrealized holding losses and gross unrealized holding gains on available-for-sale securities totaled approximately $1.7 million. At June 30, 2010, there were no securities that were in an unrealized loss position.

The following table presents the gross unrealized loss and fair value of Bancorp's available-for-sale securities, aggregated by the length of time the individual securities have been in a continuous loss position, at December 31, 2009:

| | Less Than 12 Months | | 12 Months or More | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| December 31, 2009: | | | | | | |
| U. S. Government agency obligations | $ 5,108,500 | $ (68,212) | $ - | $ - | $ 5,108,500 | $ (68,212) |
| U. S. Government agency mortgage-backed securities | 19,548,726 | (159,918) | 759,207 | (6,954) | 20,307,933 | (166,872) |
| Totals | $ 24,657,226 | $ (228,130) | $ 759,207 | $ (6,954) | $ 25,416,433 | $ (235,084) |

At December 31, 2009, six securities had unrealized losses with aggregate depreciation of 0.9% from the amortized cost. There were no securities with unrealized losses greater than 5% of amortized cost.

The amortized cost and fair value of available for sale debt securities at June 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 maturity summary:

| | Amortized Cost | Fair Value |
|---|---|---|
| June 30, 2010: | | |
| Maturity: | | |
| > 10 years | $ 15,038,797 | $ 15,101,980 |
| Mortgage-backed securities | 42,409,331 | 43,233,302 |
| Total | $ 57,448,128 | $ 58,335,282 |

Note 3: Loans Receivable and Allowance for Loan Losses

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

| | June 30, 2010 | December 31, 2009 |
|---|---|---|
| Real Estate | | |
| Commercial | $ 225,266,974 | $ 230,225,306 |
| Residential | 211,566,386 | 195,571,225 |
| Construction | 108,353,067 | 154,457,082 |
| Construction to permanent | 12,129,838 | 15,989,976 |
| Commercial | 16,288,888 | 19,298,505 |
| Consumer home equity | 42,657,141 | 44,309,265 |
| Consumer installment | 1,453,546 | 1,155,059 |
| Total Loans | 617,715,840 | 661,006,418 |
| Premiums on purchased loans | 124,897 | 131,993 |
| Net deferred loan costs (fees) | 112,962 | (138,350) |
| Allowance for loan losses | (13,989,069) | (15,794,118) |
| Loans receivable, net | $ 603,964,630 | $ 645,205,943 |

The changes in the allowance for loan losses for the periods shown are as follows:

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Balance at beginning of period | $ 15,061,796 | $ 16,630,905 | $ 15,794,118 | $ 16,247,070 |
| Provision for loan losses | 512,000 | 5,956,000 | 1,239,000 | 7,556,000 |
| Charge-offs | (1,594,136) | (6,095,148) | (3,177,383) | (7,311,433) |
| Recoveries | 9,409 | 72,911 | 133,334 | 73,031 |
| Balance at end of period | $ 13,989,069 | $ 16,564,668 | $ 13,989,069 | $ 16,564,668 |

At June 30, 2010 and December 31, 2009, the unpaid balances of loans delinquent 90 days or more and still accruing interest were $4.7 million and $3.6 million, respectively. All but two small loans aggregating $14,000 have matured and are either in the process of being renewed or awaiting payoff in full.

The unpaid principal balances of loans on nonaccrual status and considered impaired were $103.9 million at June 30, 2010 and $113.5 million at December 31, 2009. If non-accrual loans had been performing in accordance with their original terms, Bancorp would have recorded approximately $1.6 million of additional income during the quarter ended June 30, 2010 and $1.9 million during the quarter ended June 30, 2009. If non-accrual loans had been performing in accordance with their original terms, Bancorp would have recorded approximately $3.4 million of additional income for the six months ended June 30, 2010 and $3.1 million during the six months ended June 30, 2009.

The following information relates to impaired loans at June 30, 2010 and December 31, 2009:

| | June 30, 2010 | December 31, 2009 |
|---|---|---|
| Impaired loans receivable for which there is a related allowance for credit losses | $ 31,463,418 | $ 30,968,602 |
| Impaired loans receivable for which there is no related allowance for credit losses | $ 72,402,965 | $ 82,568,512 |
| Allowance for credit losses related to impaired loans | $ 3,727,621 | $ 3,942,012 |

For the three months ended June 30, 2010 and 2009, the interest collected and recognized as income on impaired loans was approximately $546,000 and $492,000, respectively. For the six months ended June 30, 2010 and 2009, the interest income collected and recognized on impaired loans was approximately $1,279,000 and $636,000, respectively.

At June 30, 2010, there were 17 loans totaling $30.7 million that were considered "troubled debt restructurings," all of which are included in non-accrual loans, as compared to December 31, 2009 when there were nine loans totaling $11.5 million, all of which were included in non-accrual loans.

Note 4: Deposits

The following table is a summary of Bancorp's deposits at the dates shown:

| | June 30, 2010 | December 31, 2009 |
|---|---|---|
| Non-interest bearing | $ 52,478,419 | $ 49,755,521 |
| | | |
| Interest bearing | | |
| NOW | 21,610,800 | 21,581,697 |
| Savings | 56,527,991 | 69,766,296 |
| Money market | 112,501,922 | 112,017,987 |
| Time certificates, less than $100,000 | 283,181,923 | 305,719,484 |
| Time certificates, $100,000 or more | 188,941,894 | 202,493,307 |
| Total interest bearing | 662,764,530 | 711,578,771 |
| Total Deposits | $ 715,242,949 | $ 761,334,292 |

Included in time certificates are certificates of deposit through the Certificate of Deposit Account Registry Service (CDARS) network of $3.3 million and $18.9 million at June 30, 2010 and December 31, 2009, respectively. These are considered brokered deposits. Pursuant to the Agreement discussed in Note 8, the level of deposits accepted from Bank customers, and the Bank's participation in the CDARS program as an issuer of deposits to customers of other banks in the CDARS program, may not exceed 10% of total deposits. With the Bank currently being adequately capitalized, it can no longer renew its wholesale or retail CDARS deposits, which is the reason for the decrease in these deposits.

Note 5: Income (loss) per share

Bancorp is required to present basic income (loss) per share and diluted income (loss) per share in its consolidated statements of operations. Basic income (loss) per share amounts are computed by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted income (loss) per share reflects additional common shares that would have been outstanding if potentially dilutive common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by Bancorp relate to outstanding stock options and are determined using the treasury stock method. Bancorp is also required to provide a reconciliation of the numerator and denominator used in the computation of both basic and diluted loss per share.

The following is information about the computation of loss per share for the three and six months ended June 30, 2010 and 2009.

Three months ended June 30, 2010

| | | Net Loss | Shares | | Amount |
|---|---|---|---|---|---|
| Basic and Diluted Loss Per Share | | | | | |
| Loss attributable to common shareholders | $ | (1,400,177) | 4,762,727 | $ | (0.29) |

Three months ended June 30, 2009

| | | Net Loss | Shares | | Amount |
|---|---|---|---|---|---|
| Basic and Diluted Loss Per Share | | | | | |
| Loss attributable to common shareholders | $ | (4,636,857) | 4,745,956 | $ | (0.98) |

Six months ended June 30, 2010

| | | Net Loss | Shares | | Amount |
|---|---|---|---|---|---|
| Basic and Diluted Loss Per Share | | | | | |
| Loss attributable to common shareholders | $ | (4,531,744) | 4,762,727 | $ | (0.95) |

Six months ended June 30, 2009

| | | Net Loss | Shares | | Amount |
|---|---|---|---|---|---|
| Basic and Diluted Loss Per Share | | | | | |
| Loss attributable to common shareholders | $ | (5,733,818) | 4,744,690 | $ | (1.21) |

Note 6: Other Comprehensive Income (Loss)

Other comprehensive income (loss), which is comprised solely of the change in unrealized gains and losses on available for sale securities, is as follows:

| | Three Months Ended June 30, 2010 | | | Six Months Ended June 30, 2010 | | |
|---|---|---|---|---|---|---|
| | Before Tax Amount | Tax Effect | Net of Tax Amount | Before Tax Amount | Tax Effect | Net of Tax Amount |
| Unrealized holding (losses) gains arising during the period | $ (138,135) | $ 52,492 | $ (85,643) | $ 417,308 | $ (158,575) | $ 258,733 |
| Reclassification adjustment for gains recognized in income | - | - | - | - | - | - |
| Unrealized holding (losses) gains on available for sale securities, net of taxes | $ (138,135) | $ 52,492 | $ (85,643) | $ 417,308 | $ (158,575) | $ 258,733 |

| | Three Months Ended June 30, 2009 | | | Six Months Ended June 30, 2009 | | |
|---|---|---|---|---|---|---|
| | Before Tax Amount | Tax Effect | Net of Tax Amount | Before Tax Amount | Tax Effect | Net of Tax Amount |
| Unrealized holding gains arising during the period | $ 751,160 | $ (285,445) | $ 465,715 | $ 1,079,869 | $ (410,350) | $ 669,519 |
| Reclassification adjustment for gains recognized in income | - | - | - | (434,333) | 165,047 | (269,286) |
| Unrealized holding gains on available for sale securities, net of taxes | $ 751,160 | $ (285,445) | $ 465,715 | $ 645,536 | $ (245,303) | $ 400,233 |

Note 7: Financial Instruments with Off-Balance Sheet Risk

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

The contractual amounts of commitments to extend credit and standby letters of credit represent the amounts of potential accounting loss should the contracts be fully drawn upon, the customers default and the values of any existing collateral become worthless. Bancorp 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. Management believes that Bancorp controls the credit risk of these financial instruments through credit approvals, credit limits, monitoring procedures and the receipt of collateral as deemed necessary.

Financial instruments whose contractual amounts represent credit risk are as follows at June 30, 2010:

| | | | |
|---|---|---|---|
| Commitments to extend credit: | | | |
| | Future loan commitments | $ | 9,466,000 |
| | Home equity line of credit | | 24,346,837 |
| | Unused lines of credit | | 10,837,425 |
| | Undisbursed construction loans | | 3,777,551 |
| Financial standby letters of credit | | | 172,000 |
| | | $ | 48,599,813 |

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 Bancorp upon extension of credit, is based on 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 Bancorp 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. Newly issued or modified guarantees that are not derivative contracts are recorded on Bancorp's consolidated balance sheet at the fair value at inception. No liability related to guarantees was required to be recorded at June 30, 2010.

Note 8: Regulatory and Operational Matters

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company's and the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). As of June 30, 2010, the Company and the Bank are categorized as "adequately capitalized" for these purposes. In addition, due to the Bank's asset profile and current economic conditions in its markets, the Bank's capital plan pursuant to the Agreement described below does target a minimum 9% Tier 1 leverage capital ratio.

The most recent notification from the Office of the Comptroller of the Currency categorized the Bank as adequately capitalized under the regulatory framework for prompt corrective action. To be categorized as adequately capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since then that management believes have changed the Bank's classification.

In February 2009 the Bank entered into a formal written agreement (the "Agreement") with the Office of the Comptroller of the Currency (the "OCC"). Under the terms of the Agreement, the Bank has appointed a Compliance Committee of outside directors and the Chairman of the Board. The Committee must report quarterly to the Board of Directors and to the OCC on the Bank's progress in complying with the Agreement. The Agreement requires the Bank to review, adopt and implement a number of policies and programs related to credit and operational issues. The Agreement further provides for certain asset growth restrictions for a limited period of time together with limitations on the acceptance of certain brokered deposits and the extension of credit to borrowers whose loans are criticized. The Bank may pay dividends during the term of the Agreement only with prior written permission from the OCC. The Agreement also requires that the Bank develop a three-year capital plan. The Bank has taken or put into process many of the steps required by the Agreement, and does not anticipate that the restrictions included within the Agreement will impair its current business plan.

The Company's subsidiary, Patriot National Bank (the "Bank"), which commenced operations in August 1994 was profitable each year from 1996 through 2007, inclusive. Since then, the Bank's financial performance was adversely impacted from the extraordinary effects of what may ultimately be the worst financial crisis since the Great Depression. The effects of the current economic environment have been and continue to be felt across many industries, with financial services and residential real estate being particularly hard hit.

During 2009, the net losses of the Company resulted in a shift in capital categories from classification as well-capitalized to classification as adequately capitalized as of September 30, 2009. The Bank remains adequately capitalized as of June 30, 2010. Should the Bank continue to incur losses of the same magnitude experienced in 2009 resulting in further erosion of capital, the Bank's regulatory capital classification could be downgraded.

Management has developed capital and strategic plans which take into consideration all available information in the development of future financial projections, which is at least, but not limited to, twelve months from the balance sheet date of December 31, 2009. The expected results of these plans, forecasts and strategic initiatives, which are based on multiple scenarios and stress tested cases, provide for as one of the primary goals the preservation of capital. Management's plan to preserve and enhance its capital levels depend on various factors, some of which are outside the control of management. These factors include improvement in the economy, the ability to raise capital, the ability to continue reducing the riskier and more speculative concentrations within the loan portfolio, and the ability to maintain the Company's liquidity.

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

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| June 30, 2010 | | | | | | |
| The Company: | | | | | | |
| Total Capital (to Risk Weighted Assets) | $ 45,457 | 8.70% | $ 41,800 | 8.00% | N/A | N/A |
| Tier 1 Capital (to Risk Weighted Assets) | 38,447 | 7.36% | 20,895 | 4.00% | N/A | N/A |
| Tier 1 Capital (to Average Assets) | 38,447 | 4.74% | 32,445 | 4.00% | N/A | N/A |
| The Bank: | | | | | | |
| Total Capital (to Risk Weighted Assets) | $ 45,596 | 8.73% | $ 41,783 | 8.00% | $ 52,229 | 10.00% |
| Tier 1 Capital (to Risk Weighted Assets) | 38,592 | 7.39% | 20,889 | 4.00% | 31,333 | 6.00% |
| Tier 1 Capital (to Average Assets) | 38,592 | 4.74% | 32,567 | 4.00% | 40,709 | 5.00% |
| December 31, 2009 | | | | | | |
| The Company: | | | | | | |
| Total Capital (to Risk Weighted Assets) | $ 51,072 | 8.58% | $ 47,894 | 8.00% | N/A | N/A |
| Tier 1 Capital (to Risk Weighted Assets) | 42,971 | 7.22% | 23,945 | 4.00% | N/A | N/A |
| Tier 1 Capital (to Average Assets) | 42,971 | 4.72% | 36,512 | 4.00% | N/A | N/A |
| The Bank: | | | | | | |
| Total Capital (to Risk Weighted Assets) | $ 51,056 | 8.58% | $ 47,821 | 8.00% | $ 59,506 | 10.00% |
| Tier 1 Capital (to Risk Weighted Assets) | 42,960 | 7.22% | 23,908 | 4.00% | 35,701 | 6.00% |
| Tier 1 Capital (to Average Assets) | 42,960 | 4.72% | 36,454 | 4.00% | 45,508 | 5.00% |

On December 16, 2009, Bancorp and the Bank entered into a Securities Purchase Agreement (the "SPA") with PNBK Holdings LLC, a newly formed Delaware entity created to be an investment vehicle for an investor group led by Michael A. Carrazza (collectively, "Carrazza"), pursuant to which Carrazza has the right to purchase 33,333,333 shares of Bancorp common stock for $50,000,000. The capital raised from the SPA should restore the Bank to the well capitalized regulatory classification. On May 3, 2010, Bancorp, the Bank and Carrazza entered into a First Amendment to Securities Purchase Agreement (the "Amendment") to extend the outside closing date of the SPA, primarily to accommodate the completion of all necessary regulatory applications and approvals required for Carrazza to consummate the transactions contemplated under the SPA. Pursuant to the terms of the Amendment, the parties have agreed to extend the outside closing date set forth under the SPA from May 31, 2010 to July 31, 2010 or later, provided certain conditions are met and further provided that the outside closing date shall not be extended later than August 31, 2010, unless mutually consented to in writing by the parties. The Amendment sets forth that the SPA shall automatically terminate as of certain dates, unless certain conditions are met or if extended by mutual consent of the parties in writing.  Management currently anticipates that, subject to certain conditions and contingencies, the Carrazza investment will be consummated in the third quarter of 2010.

However, even if the capital from the SPA is not raised during 2010, management believes that the expected continued reduction of nonperforming assets will result in improvements to the results of operations in 2010, and regulatory capital and the related ratios will remain at current levels. However, there can be no assurance that the economic conditions that caused the deterioration in loan quality, profits and capital will improve, and should the Bank’s capital and related ratios continue to deteriorate, the regulators could impose more severe directives on the Bank.

Restrictions on dividends, loans and advances

Bancorp shall not declare or pay any dividends without the prior written approval of the Reserve Bank and the Director of the Division of Banking Supervision and Regulation (the “Director”) of the Board of Governors.

Pursuant to the February 9, 2009 Agreement between the Bank and the Office of the Comptroller of the Currency, the Bank can pay dividends to the Company only pursuant to a dividend policy requiring compliance with the Bank's OCC-approved capital program, in compliance with applicable law and with the prior written determination of no supervisory objection by the Assistant Deputy Comptroller. In addition to the Agreement, certain other restrictions exist regarding the ability of the Bank to transfer funds to the Company in the form of cash dividends, loans or advances. The approval of the OCC is required to pay dividends in excess of the Bank’s earnings retained in the current year plus retained net earnings for the preceding two years. As of June 30, 2010, the Bank had an accumulated deficit; therefore, dividends may not be paid to the Company. The Bank is also prohibited from paying dividends that would reduce its capital ratios below minimum regulatory requirements.

Loans or advances to the Company from the Bank are limited to 10% of the Bank's capital stock and surplus on a secured basis.

Recent Legislative Developments

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Act”) was signed into law on July 21, 2010. The Act is a significant piece of legislation that will have major effects on the financial services industry, including the organization, financial condition and operations of banks and bank holding companies. Management is currently evaluating the impact of the Act; however, uncertainty remains as to its operational impact, which could have a material adverse impact on Bancorp’s business, results of operations and financial condition. Many of the provisions of the Act are aimed at financial institutions that are significantly larger than Bancorp and the Bank. Notwithstanding this, there are many other provisions that Bancorp and the Bank are subject to and will have to comply with, including any new rules applicable to Bancorp and the Bank promulgated by the Bureau of Consumer Financial Protection, a new regulatory body dedicated to consumer protection. As rules and regulations are promulgated by the agencies responsible for implementing and enforcing the Act, Bancorp and the Bank will have to address each to ensure compliance with applicable provisions of the Act and compliance costs are expected to increase.

Note 9: Income Taxes

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. A valuation allowance related to deferred tax assets is required when it is considered more likely than not that all or part of the benefit related to such assets will not be realized. Management has reviewed the deferred tax position of Bancorp at June 30, 2010. The deferred tax position has been affected by several significant matters in the past three years. These matters include increased levels of provision for loan losses, the increasing levels of non-accrual loans and other-than-temporary impairment write-offs of certain investments. As a result, Bancorp is in a cumulative net loss position at June 30, 2010, and under the applicable accounting guidance, has concluded that it is not more-likely-than-not that Bancorp will be able to realize the deferred tax assets and accordingly has established a full valuation allowance totaling $12.7 million against its net deferred tax asset at June 30, 2010. The valuation allowance is analyzed quarterly for changes affecting the deferred tax asset. If, in the future, Bancorp generates taxable income on a sustained basis, management's conclusion regarding the need for a deferred tax asset valuation allowance could change, resulting in the reversal of all or a portion of the deferred tax asset valuation allowance.

Note 10: Fair Value and Interest Rate Risk

Bancorp uses fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in certain instances, there are no quoted market prices for certain assets or liabilities. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the asset or liability.

Fair value measurements focus on exit prices in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment.

Bancorp's fair value measurements are classified into a fair value hierarchy based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. The three categories within the hierarchy are as follows:

- Level 1 Inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

- Level 2 Inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

- Level 3 Inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lower level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

A description of the valuation methodologies used for assets and liabilities recorded at fair value, and for estimating fair value for financial instruments only disclosed at fair value, is set forth below.

Cash and due from banks, federal funds sold, short-term investments and accrued interest receivable and payable: The carrying amount is a reasonable estimate of fair value. These financial instruments are not recorded at fair value on a recurring basis.

Available-for-Sale Securities: These financial instruments are recorded at fair value in the financial statements. 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 and sponsored agency bonds and mortgage-backed securities. Level 3 securities are instruments for which significant unobservable inputs are utilized.

FHLB Stock and Federal Reserve Bank Stock: The carrying value of the FHLB stock and Federal Reserve Bank stock approximates fair value based on the redemption provisions of the Federal Home Loan Bank and the Federal Reserve Bank. Bancorp does not record these assets at fair value on a recurring basis.

Loans: For variable rate loans, which 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 the period end rates, estimated by using local market data, 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. Bancorp does not record loans at fair value on a recurring basis. However, from time to time, nonrecurring fair value adjustments to collateral-dependent impaired loans are recorded to reflect partial write-downs based on the observable market price or current appraised value of collateral.

Other Real Estate Owned: The fair values of Bancorp's other real estate owned properties ("OREO") are based on the estimated current property valuations less estimated disposition costs. When the fair value is based on current observable appraised values, OREO is classified within Level 2. Bancorp classifies OREO within Level 3 when unobservable adjustments are made to appraised values. Bancorp does not record OREO at fair value on a recurring basis.

Deposits: The fair value of demand deposits, regular savings and certain money market deposits is the amount payable on demand at the reporting date. The fair value of certificates of deposit and other time deposits 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. Bancorp does not record deposits at fair value on a recurring basis.

Short-term borrowings: The carrying amounts of borrowings under short-term repurchase agreements and other short-term borrowings maturing within 90 days approximate their fair values. Bancorp does not record short-term borrowings at fair value on a recurring basis.

Junior Subordinated Debt: Junior subordinated debt reprices quarterly and as a result the carrying amount is considered a reasonable estimate of fair value. Bancorp does not record junior subordinated debt at fair value on a recurring basis.

Federal Home Loan Bank Borrowings: The fair value of the advances is estimated using a discounted cash flow calculation that applies current Federal Home Loan Bank interest rates for advances of similar maturity to a schedule of remaining maturities of such advances. Bancorp does not record these borrowings at fair value on a recurring basis.

Other Borrowings: The fair values of longer term borrowings and fixed rate repurchase agreements are estimated using a discounted cash flow calculation that applies current interest rates for transactions of similar maturity to a schedule of remaining maturities of such transactions. Bancorp does not record these borrowings at fair value on a recurring basis.

Off-balance sheet instruments: Fair values for Bancorp'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. Bancorp 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 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. The Company had no significant transfers into, or out of, levels 1 or 2 during the three months ended June 30, 2010.
- 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.
- 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 Bancorp beginning in 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 fiscal years. Bancorp adopted this guidance during the quarter ended March 31, 2010 and has included these disclosures in these financial statements.

The following tables summarize financial assets that are carried at fair value and measured at fair value on a recurring basis as of June 30, 2010 and December 31, 2009, and indicates the fair value hierarchy of the valuation techniques utilized by Bancorp to determine fair value:

| | Fair Value at Reporting Date Using | | | |
|---|---|---|---|---|
| June 30, 2010 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance as of June 30, 2010 |
| U.S. Government agency obligations | $ - | $ 15,101,980 | $ - | $ 15,101,980 |
| U.S. Government agency mortgage- | | | | |
| backed securities | - | 43,233,302 | - | 43,233,302 |
| Money market preferred equity securities | - | 2,754,613 | - | 2,754,613 |
| Securities available for sale | $ - | $ 61,089,895 | $ - | $ 61,089,895 |

| December 31, 2009 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance as of December 31, 2009 |
|---|---|---|---|---|
| U.S. Government agency obligations | $ - | $ 5,108,500 | $ - | $ 5,108,500 |
| U.S. Government agency mortgage- | | | | - |
| backed securities | - | 40,503,458 | - | 40,503,458 |
| Money market preferred equity securities | - | 3,218,023 | - | 3,218,023 |
| Securities available for sale | $ - | $ 48,829,981 | $ - | $ 48,829,981 |

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

The following tables reflect financial assets measured at fair value on a non-recurring basis as of June 30, 2010 and December 31, 2009, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

| June 30, 2010 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance as of June 30, 2010 |
|---|---|---|---|---|
| Impaired Loans (1) | $ - | $ - | $ 37,156,757 | $ 37,156,757 |

| December 31, 2009 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance as of December 31, 2009 |
|---|---|---|---|---|
| Impaired Loans (1) | $ - | $ - | $ 49,322,844 | $ 49,322,844 |

(1) Represents carrying value for which adjustments are based on the appraised value of the collateral.

The following tables summarize non-financial assets measured at fair value on a non-recurring basis as of June 30, 2010 and December 31, 2009, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

| June 30, 2010 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance as of June 30, 2010 |
|---|---|---|---|---|
| Other real estate owned | $ - | $ - | $ 6,736,536 | $ 6,736,536 |

| December 31, 2009 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance as of December 31, 2009 |
|---|---|---|---|---|
| Other real estate owned | $ - | $ - | $ 19,073,993 | $ 19,073,993 |

Bancorp 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 and, accordingly, the aggregate fair value amounts presented do not represent the underlying value of Bancorp.

The estimated fair value amounts have been measured as of June 30, 2010 and December 31, 2009 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 on those dates.

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

The following is a summary of the recorded book balances and estimated fair values of Bancorp's financial instruments at June 30, 2010 and December 31, 2009 (in thousands):

| | June 30, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| | Recorded Book Balance | Fair Value | Recorded Book Balance | Fair Value |
| Financial Assets: | | | | |
| Cash and noninterest bearing balances due from banks | 9,359 | 9,359 | 19,466 | 19,466 |
| Interest-bearing deposits due from banks | 81,324 | 81,324 | 78,070 | 78,070 |
| Federal funds sold | 10,000 | 10,000 | 10,000 | 10,000 |
| Short-term investments | 358 | 358 | 264 | 264 |
| Available-for-sale securities | 61,090 | 61,090 | 48,830 | 48,830 |
| Federal Reserve Bank stock | 1,234 | 1,234 | 1,840 | 1,840 |
| Federal Home Loan Bank stock | 4,508 | 4,508 | 4,508 | 4,508 |
| Loans receivable, net | 603,965 | 609,031 | 645,206 | 644,977 |
| Accrued interest receivable | 2,968 | 2,968 | 3,236 | 3,236 |
| | | | | |
| Financial Liabilities: | | | | |
| Demand deposits | 52,478 | 52,478 | 49,756 | 49,756 |
| Savings deposits | 56,528 | 56,528 | 69,766 | 69,766 |
| Money market deposits | 112,502 | 112,502 | 112,018 | 112,018 |
| Negotiable orders of withdrawal | 21,611 | 21,611 | 21,582 | 21,582 |
| Time deposits | 472,124 | 475,435 | 508,213 | 512,524 |
| FHLB Borrowings | 50,000 | 52,037 | 50,000 | 50,270 |
| Securities sold under repurchase agreements | 7,000 | 7,819 | 7,000 | 7,778 |
| Subordinated debentures | 8,248 | 8,248 | 8,248 | 8,248 |
| Accrued interest payable | 595 | 595 | 505 | 505 |

Bancorp assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of Bancorp's financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to Bancorp. 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 deposits and by investing in securities with terms that mitigate Bancorp's overall interest rate risk.

Off-balance sheet instruments

Loan commitments on which the committed interest rate is less than the current market rate were insignificant at June 30, 2010 and December 31, 2009. The estimated fair value of fee income on letters of credit at June 30, 2010 and December 31, 2009 was insignificant.

Note 11: Contingencies

On October 9, 2009, a complaint was filed against Bancorp and the Bank in the United States District Court, Southern District of New York ("Federal Litigation"). A complaint also was filed that same day with the State of Connecticut Superior Court – Stamford Judicial District (the "Connecticut Litigation"). Both cases were brought by PNBK Holdings LLC, a newly formed Delaware entity created to be an investment vehicle for an investor group led by Michael A. Carrazza (collectively, "Carrazza").

Both cases derive from Carrazza's expressed interest in acquiring a controlling interest in Bancorp. Carrazza commenced the Federal Litigation and the Connecticut Litigation in furtherance of this interest. On December 4, 2009, Carrazza and Bancorp entered into a Standstill Agreement pursuant to which the parties agreed to stop, temporarily and subject to the terms of the Standstill Agreement, the Connecticut Litigation so as to negotiate a Stock Purchase Agreement ("SPA"). On December 16, 2009, Bancorp and Carrazza executed the SPA. Pursuant to the Standstill Agreement the Company paid $400,000 (the "Escrowed Funds") into an escrow account. The Federal Litigation was withdrawn with prejudice and the Connecticut Litigation is being held in abeyance. The Escrowed Funds will be released to Carrazza upon certain defined circumstances. If the Connecticut Litigation were revived and Carrazza were to prevail in the revived action, Bancorp and/or the Bank could be required to pay additional damages; the Connecticut Litigation is unlikely to be revived should the transaction contemplated by the SPA be completed.

On May 3, 2010, Bancorp, the Bank and Carrazza entered into a First Amendment to Securities Purchase Agreement (the "Amendment") to extend the outside closing date of the SPA, primarily to accommodate the completion of all necessary regulatory applications and approvals required for Carrazza to consummate the transactions contemplated under the SPA. Pursuant to the terms of the Amendment, the parties have agreed to extend the outside closing date set forth under the SPA from May 31, 2010 to July 31, 2010 or later, provided certain conditions are met and further provided that the outside closing date shall not be extended later than August 31, 2010, unless mutually consented to in writing by the parties. The Amendment sets forth that the SPA shall automatically terminate as of certain dates, unless certain conditions are met or if extended by mutual consent of the parties in writing. Management currently anticipates that, subject to certain conditions and contingencies, the Carrazza investment will be consummated in the third quarter of 2010.

Note 12: Recent Accounting Pronouncements

The FASB issued Accounting Standards Update ("ASU") No. 2009-16, Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets in December 2009. Among other provisions, this ASU eliminates the concept of a "qualifying special-purpose entity" and removes the exception from applying certain accounting guidance to qualifying special-purpose entities. In addition, this ASU provides guidance as to when a portion of a transferred financial asset can be evaluated for sale accounting, provides additional guidance with regard to accounting for transfers of financial assets and requires additional disclosures. This ASU is effective at the beginning of a reporting entity's first fiscal year that begins after November 15, 2009. The Company adopted this guidance during the quarter ended March 31, 2010. The adoption of this guidance did not have an impact on the Company's results of operations or financial position.

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. The Company is currently evaluating the impact of the adoption of this guidance on its financial statements.

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

"SAFE HARBOR" STATEMENT UNDER PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Certain statements contained in Bancorp's public reports, including this report, and in particular in "Management's Discussion and Analysis of Financial Condition and Results of Operation," may be forward looking and subject to a variety of risks and uncertainties. These factors include, but are not limited to, (1) changes in prevailing interest rates which would affect the interest earned on Bancorp's interest earning assets and the interest paid on its interest bearing liabilities, (2) the timing of repricing of Bancorp'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 Bancorp and the Bank 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, (6) the ability of competitors that are larger than Bancorp to provide products and services which it is impracticable for Bancorp to provide, (7) the state of the economy and real estate values in Bancorp's market areas, and the consequent affect on the quality of Bancorp's loans, (8) recent governmental initiatives are expected to have a profound effect on the financial services industry and could dramatically change the competitive environment of Bancorp; (9) other legislative or regulatory changes, including those related to residential mortgages, changes in accounting standards, and Federal Deposit Insurance Corporation ("FDIC") premiums may adversely affect Bancorp; (10) the state of the economy in the greater New York metropolitan area and its particular effect on Bancorp's customers, vendors and communities and (11) Bancorp's ability to procure additional capital either through its December 16, 2009 Stock Purchase Agreement, as amended, with PNBK Holdings, LLC or, should that purchase not be consummated, through other means. Other such factors may be described in Bancorp's other filings with the SEC.

Although Bancorp believes that it offers the loan and deposit products and has the resources needed for continued success, future revenues and interest spreads and yields cannot be reliably predicted. These trends may cause Bancorp 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.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and to disclose contingent assets and liabilities. Actual results could differ from those estimates. Management has identified accounting for the allowance for loan losses, the analysis of other-than-temporary-impairment for its investment securities and valuation of deferred income tax assets, as Bancorp's most critical accounting policies and estimates in that they are important to the portrayal of Bancorp's financial condition and results. They require management's most subjective and complex judgment as a result of the need to make an estimate about the effect of matters that are inherently uncertain. These accounting policies, including the nature of the estimates and types of assumptions used, are described throughout this Management's Discussion and Analysis.

Summary

Bancorp incurred a net loss of $1.4 million ($0.29 basic and diluted loss per share) for the quarter ended June 30, 2010, as compared to a net loss of $4.6 million ($0.98 basic and diluted loss per share) for the quarter ended June 30, 2009. For the six-month period ended June 30, 2010, Bancorp incurred a net loss of $4.5 million ($0.95 basic and diluted loss per share) compared to net loss of $5.7 million ($1.21 basic and diluted loss per share) for the six months ended June 30, 2009. Bancorp incurred a pre-tax loss of $1.4 million for the quarter ended June 30, 2010, compared to a pre-tax loss of $8.3 million for the quarter ended June 30, 2009. For the six-month period ended June 30, 2010, Bancorp incurred a pre-tax loss of $4.3 million compared to a pre-tax loss of $9.7 million for the six months ended June 30, 2009. Bancorp's net interest margin for the quarter ended June 30, 2010 was 3.12% as compared to 1.91% for the quarter ended June 30, 2009. For the six-month period ended June 30, 2010 Bancorp's net interest margin was 3.11% as compared to 2.18% for the six months ended June 30, 2009. The increase in the net interest margin is a result of redeploying excess liquidity, a significant reduction in higher rate certificates of deposit and investment purchases. For the six months ended June 30, 2010, the impact of the collection of past due interest from non-accrual loans had a positive impact of 42 basis points on the net interest margin. Interest income and interest expense decreased by 14% and 47%, respectively, for the quarter ended June 30, 2010 compared to the quarter ended June 30, 2009. For the six months ended June 30, 2010, interest income and interest expense declined by 18% and 46%, respectively, compared to the six months ended June 30, 2009. The significant decline is primarily due to the cost of funds decreasing by 120 basis points for the six months ended June 30, 2010 as compared to the same period in 2009, due to substantial declines in interest rates paid on deposits.

Total assets decreased $49.9 million from $866.4 million at December 31, 2009 to $816.5 million at June 30, 2010. Cash and cash equivalents decreased $6.8 million from $107.8 million at December 31, 2009 to $101.0 million at June 30, 2010. The available for sale securities portfolio increased $12.3 million from $48.8 million at December 31, 2009 to $61.1 million at June 30, 2010 due to the purchase of $15.2 million in government agency bonds and mortgage-backed securities. The net loan portfolio decreased $41.2 million from $645.2 million at December 31, 2009 to $604.0 million at June 30, 2010. This is the result of continuing efforts to reduce concentration levels within the construction and commercial real estate loan portfolios and loan payoffs, including some on non-accrual status. Deposits decreased $46.1 million from $761.3 million at December 31, 2009 to $715.2 million at June 30, 2010, which is primarily reflective of the maturity of higher rate certificates of deposit. Borrowings remained unchanged as compared to December 31, 2009.

Financial Condition

Cash and Cash Equivalents

Cash and cash equivalents decreased $6.8 million, or 6%, to $101.0 million at June 30, 2010 compared to $107.8 million at December 31, 2009, due mainly to the decrease in cash and due from banks. Cash and due from banks decreased $6.8 million to $90.7 million at June 30, 2010 compared to $97.5 million at December 31, 2009. The decreased level of cash is reflective of the redeployment of excess funds into interest-earning investments and the decline in deposits, which has improved the overall net interest margin.

Investments

The following table is a summary of Bancorp's available for sale securities portfolio, at fair value, at the dates shown:

| | June 30, 2010 | December 31 2009 |
|---|---|---|
| U. S. Government Agency obligations | $ 15,101,980 | $ 5,108,500 |
| U. S. Government Agency mortgage-backed securities | 43,233,302 | 40,503,458 |
| Money market preferred equity securities | 2,754,613 | 3,218,023 |
| Total Available for Sale Securities | $ 61,089,895 | $ 48,829,981 |

Available for sale securities increased $12.3 million, or 25%, from $48.8 million at December 31, 2009 to $61.1 million at June 30, 2010. The increase is primarily due to the purchase of one government agency bond for $10.0 million and one government agency mortgage-backed security for $5.2 million during the first quarter of 2010. These purchases are part of management's plan to improve the yield and earnings on the Bank's liquid assets.

Bancorp performs a quarterly analysis of those securities that are in an unrealized loss position to determine if those losses qualify as other-than-temporary impairments. This analysis considers the following criteria in its determination: the ability of the issuer to meet its obligations, an impairment due to a deterioration in credit, management's plans and ability to maintain its investment in the security, the length of time and the amount by which the security has been in a loss position, the interest rate environment, the general economic environment and prospects or projections for improvement or deterioration.

Management has made the determination that none of the Bank's investment securities are other-than-temporarily impaired at June 30, 2010, as there are no available for sale securities that are in an unrealized loss position at June 30, 2010, and no impairment charges were recorded during the six-month period ended June 30, 2010.

Loans

The following table is a summary of Bancorp's loan portfolio at the dates shown:

| | June 30, 2010 | December 31, 2009 |
|---|---|---|
| Real Estate | | |
| Commercial | $ 225,266,974 | $ 230,225,306 |
| Residential | 211,566,386 | 195,571,225 |
| Construction | 108,353,067 | 154,457,082 |
| Construction to permanent | 12,129,838 | 15,989,976 |
| Commercial | 16,288,888 | 19,298,505 |
| Consumer home equity | 42,657,141 | 44,309,265 |
| Consumer installment | 1,453,546 | 1,155,059 |
| Total Loans | 617,715,840 | 661,006,418 |
| Premiums on purchased loans | 124,897 | 131,993 |
| Net deferred loan costs (fees) | 112,962 | (138,350) |
| Allowance for loan losses | (13,989,069) | (15,794,118) |
| Loans receivable, net | $ 603,964,630 | $ 645,205,943 |

Bancorp's net loan portfolio decreased $41.2 million, or 6.4%, from $645.2 million at December 31, 2009 to $604.0 million at June 30, 2010. The decrease is primarily a result of loan payoffs, including some that were impaired and on non-accrual status, resulting in decreases in construction loans of $46.1 million, construction-to-permanent loans of $3.9 million, commercial real estate loans of $5.0 million, commercial loans of $3.0 million and HELOCs of $1.7 million. These decreases were partially offset by an increase of $16.0 million in residential real estate loans. The decrease also reflects net charge-offs for the six months ended June 30, 2010 of $3.0 million. In an effort to reduce its concentration in construction and commercial real estate loans, Bancorp has continued its moratorium of originating new loans in the construction and commercial real estate portfolios.

At June 30, 2010, the net loan to deposit ratio was 84% and the net loan to total assets ratio was 74%. At December 31, 2009, these ratios were 85% and 74%, respectively.

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 uncollectability 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 for loan losses decreased by $1.8 million from December 31, 2009 to June 30, 2010 due to net charge-offs of $3.0 million after provisions of $1.2 million.

The allowance consists of allocated and general components. The allocated 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 Bank obtains current appraisals on all real estate and construction loans maturing in the subsequent four months, as well as for loans added to special mention. When a loan is placed on non-accrual status the loan is considered impaired. For collateral dependent loans, the appraised value is then reduced by estimated liquidation expenses and any senior liens and the result is compared to the principal loan balance to determine the impairment amount, if any. For loans that are not collateral dependent and for which a restructure is in place, the impairment is determined by using the discounted cash flow method which takes into account the difference between the original interest rate and the restructured rate.

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. In addition, a risk rating system is utilized to evaluate the general component of the allowance for loan losses. Management assigns risk ratings to commercial and industrial loans, construction loans and commercial real estate loans assigning ratings between one and nine, with a rating of one being the least risk, and a rating of nine reflecting the most risk or a complete loss. Risk ratings are assigned based upon the recommendations of the credit analyst and the originating loan officer and confirmed by the loan committee at the initiation of the transactions and are reviewed and changed, when necessary, during the life of the loan. Loans assigned a risk rating of six or above are monitored more closely by the credit administration officers and loan committee.

The allowance for loan losses reflects management's estimate of probable but unconfirmed losses inherent in the portfolio; such estimates are influenced by uncertainties in economic conditions, unfavorable information about a borrower's financial condition, delays in obtaining information, difficulty in identifying triggering events that correlate perfectly to subsequent loss rates, and risk factors that have not yet manifested themselves in loss allocation factors. Loan quality control is continually monitored by management, subject to oversight by the Board of Directors through its members who serve on the Loan Committee. Loan quality control is also reviewed by the full Board of Directors on a monthly basis. In 2008, the Bank created an internal loan review position in addition to the semi-annual loan reviews performed by an external independent firm. In 2009 the internal loan review function was expanded to a department of two employees. Loan Review reports on a quarterly basis to the Audit Committee.

The methodology for determining the adequacy of the allowance for loan losses has been consistently applied; however, in the future, revisions may be made to the methodology and assumptions based on historical information related to charge-off and recovery experience and management's evaluation of the current loan portfolio, and prevailing internal and external factors including but not limited to current economic conditions and local real estate markets.

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. Management considers all non-accrual loans and certain restructured loans to be impaired. All interest accrued but not collected for loans that are placed on nonaccrual status is reversed against interest income. The interest on these loans is accounted for on the cash-basis method until qualifying 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.

In most cases, loan payments that are past due less than 90 days, based on contractual terms, are considered collection delays and the related loans are not considered to be impaired. The Bank considers consumer installment loans to be pools of smaller balance homogeneous loans, which are collectively evaluated for impairment.

The changes in the allowance for loan losses for the periods shown are as follows:

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| (Thousands of dollars) | June 30, 2010 | June 30, 2009 | June 30, 2010 | June 30, 2009 |
| Balance at beginning of period | $ 15,062 | $ 16,631 | $ 15,794 | $ 16,247 |
| Charge-offs | (1,594) | (6,095) | (3,177) | (7,311) |
| Recoveries | 9 | 73 | 133 | 73 |
| Net Charge-offs | (1,585) | (6,022) | (3,044) | (7,238) |
| Provision charged to operations | 512 | 5,956 | 1,239 | 7,556 |
| Balance at end of period | $ 13,989 | $ 16,565 | $ 13,989 | $ 16,565 |
| | | | | |
| Ratio of net charge-offs during the period to average loans outstanding during the period | 0.25% | 0.78% | 0.47% | 0.91% |
| | | | | |
| Ratio of ALLL / Gross Loans | 2.26% | 2.27% | 2.26% | 2.27% |

Based upon the overall assessment and evaluation of the loan portfolio, management believes the allowance for loan losses of $14.0 million, at June 30, 2010, which represents 2.26% of gross loans outstanding, is adequate under prevailing economic conditions, to absorb existing losses in the loan portfolio. Bancorp has had three consecutive quarters of decreases in non-accrual loans and five consecutive quarters of decreases in additions to non-accrual loans. In addition, there has been lower levels of charge-offs.

Non-Accrual, Past Due and Restructured Loans

The following table presents non-accruing loans and loans past due 90 days or more and still accruing:

| (Thousands of dollars) | June 30, 2010 | December 31, 2009 |
|---|---|---|
| Loans past due over 90 days still accruing | $ 4,737 | $ 3,571 |
| Non accruing loans | 103,866 | 113,537 |
| Total | $ 108,603 | $ 117,108 |
| % of Total Loans | 17.57% | 17.72% |
| % of Total Assets | 13.30% | 13.52% |

All but two small loans aggregating $14,000 past due over 90 days and still accruing have matured and are either in the process of being renewed or awaiting payoff in full.  Non-accruing loans including troubled debt restructurings decreased by $6.2 million this quarter and by $9.7 million for the six months ended June 30, 2010. Non-accrual loans and troubled debt restructurings are attributable to the lingering effects of the downturn in the economy, which has severely impacted the real estate market and placed unprecedented stress on credit markets.  Residents of Fairfield County, Connecticut, many of whom are associated with the financial services industry, have been affected by the impact of the poor economy on employment and real estate values.

The $103.9 million of non-accrual loans at June 30, 2010 is comprised of exposure to 57 borrowers, for which a specific reserve of $3.7 million has been established.  Of the 103.9 million, loans totaling $101.7 million are collateral dependent and are secured by residential or commercial real estate located within the Bank's market area.  In all cases, the Bank has obtained current appraisal reports from independent licensed appraisal firms and discounted those values for estimated liquidation expenses to determine estimated impairment. Based on the Bank's analysis for loan impairment, specific reserves totaling $3.7 million are related to collateral dependent impaired loans.  Impairment related to a loan to one borrower totaling $2.2 million has been measured based on discounted cash flows resulting in no specific reserve.  That loan is also secured by real estate.  Of the $103.9 million of non-accrual loans at June 30, 2010, 25 notes with aggregate balances of $31.3 million continue to make loan payments and these loans are current within one month as to payments.

Independent real estate tracking reports indicate that the real estate market in Fairfield County, Connecticut, where the majority of the properties securing the Bank's loans are located, has improved in terms of higher average prices and significantly greater sales volume.  Management believes the local real estate market is beginning to show signs of stabilization and improvement.

Loans delinquent over 90 days and still accruing aggregating $4.7 million are comprised of nine loans, seven of which have matured aggregating approximately $4.7 million, continue to make payments and are either in the process of being renewed or awaiting payoff in full and two loans aggregating $14,000 which were delinquent and are in the process of collection.

Potential Problem Loans

In addition to the above, there are $69.4 million of substandard loans comprised of 38 borrowers and $67.3 million of special mention loans comprised of 40 borrowers for which management has a concern as to the ability of the borrowers to comply with the present repayment terms. The majority of the substandard accruing loans and special mention loans continue to make payments. All but two substandard accruing loans are current within 30 days at June 30, 2010 and all special mention loans are current within 30 days at June 30, 2010. Of the substandard accruing loans, one for $4.9 million is delinquent between 30-59 days and one for $2.5 million is delinquent between 60-89 days.

Other Real Estate Owned

The following table is a summary of Bancorp's other real estate owned at the dates shown:

| | June 30, 2010 | December 31, 2009 |
|---|---|---|
| Construction | $ 6,276,536 | $ 13,524,597 |
| Commercial | - | 4,934,896 |
| Land | 460,000 | 614,500 |
| Other real estate owned | $ 6,736,536 | $ 19,073,993 |

The balance of other real estate owned at June 30, 2010 is comprised of three properties that were obtained through loan foreclosure proceedings. During the six months ended June 30, 2010, no new other real estate owned properties were acquired, but six properties were sold for an aggregate loss of $173,000. During the six months ended June 30, 2010, there were write downs on four properties totaling $856,000 due to recently updated appraisals.

Deferred Taxes

The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. A valuation allowance related to deferred tax assets is required when it is considered more likely than not that all or part of the benefit related to such assets will not be realized. Management has reviewed the deferred tax position of Bancorp at June 30, 2010. The deferred tax position has been affected by several significant matters in the past three years. These matters include increased levels of provision for loan losses, the increasing levels of non-accrual loans and other-than-temporary impairment write-offs of certain investments. As a result, Bancorp is in a cumulative net loss position at June 30, 2010, and under the applicable accounting guidance, has concluded that it is not more-likely-than-not that the Company will be able to realize the deferred tax assets and accordingly has established a full valuation allowance totaling $12.7 million against its net deferred tax asset at June 30, 2010. The valuation allowance is analyzed quarterly for changes affecting the deferred tax asset. If, in the future, Bancorp generates taxable income on a sustained basis, management's conclusion regarding the need for a deferred tax asset valuation allowance could change, resulting in the reversal of all or a portion of the deferred tax asset valuation allowance.

Deposits

The following table is a summary of Bancorp's deposits at the dates shown:

| | June 30, 2010 | December 31, 2009 |
|---|---|---|
| Non-interest bearing | $ 52,478,419 | $ 49,755,521 |
| | | |
| Interest bearing | | |
| NOW | 21,610,800 | 21,581,697 |
| Savings | 56,527,991 | 69,766,296 |
| Money market | 112,501,922 | 112,017,987 |
| Time certificates, less than $100,000 | 283,181,923 | 305,719,484 |
| Time certificates, $100,000 or more | 188,941,894 | 202,493,307 |
| Total interest bearing | 662,764,530 | 711,578,771 |
| Total Deposits | $ 715,242,949 | $ 761,334,292 |

Total deposits decreased $46.1 million, or 6%, from $761.3 million at December 31, 2009 to $715.2 million at June 30, 2010. Demand deposits increased $2.7 million as a result of normal fluctuations in these accounts. Interest bearing accounts decreased $48.8 million, which is comprised of a decrease in certificates of deposit and savings accounts of $36.1 million and $12.7 million, respectively. The decrease in certificates of deposit is due to Bancorp intentionally allowing the higher rate CD's to runoff to help reduce the cost of funds and improve the interest spread. The decline in savings accounts is primarily reflective of the decrease in interest rates, which was done specifically to bring these rates in line with the other products. The FDIC has also permanently extended the increased level of insurance from $100,000 to $250,000.

Borrowings

At June 30, 2010, total borrowings were $65.2 million and are unchanged as compared to December 31, 2009. In addition to the outstanding borrowings disclosed in the consolidated balance sheet, Bancorp has the ability to borrow approximately $154 million in additional advances from the Federal Home Loan Bank of Boston, including a $2.0 million overnight line of credit. The Bank has also established a line of credit at the Federal Reserve Bank.

The subordinated debentures of $8,248,000 are unsecured obligations of the Company and are subordinate and junior in right of payment to all present and future senior indebtedness of the Company. The Company has entered into a guarantee, which together with its obligations under the subordinated debentures and the declaration of trust governing the Trust, including its obligations to pay costs, expenses, debts and liabilities, other than trust securities, provides a full and unconditional guarantee of amounts on the capital securities. The subordinated debentures, which bear interest at the three-month LIBOR plus 3.15% (3.68719% at June 30, 2010), mature on March 26, 2033. Beginning in the second quarter of 2009, the Company began deferring interest payments on the subordinated debentures as permitted under the terms of the debentures. The deferral in the second quarter of 2010 represented the fifth consecutive quarter of deferral. Interest is still being accrued and charged to operations. The Company may only defer the payment of interest until March, 2014, and all accrued interest must be paid prior to or at completion of the deferment period.

Capital

Capital decreased $4.3 million primarily as a result of the net loss for the six months ended June 30, 2010.

Off-Balance Sheet Arrangements

Bancorp's off-balance sheet arrangements, which primarily consist of commitments to lend, decreased by $8.1 million from $56.7 million at December 31, 2009 to $48.6 million at June 30, 2010, due to decreases of $13.9 million in undisbursed construction loans and $0.9 million in financial standby letters of credit offset by an increase of $6.1 million in future loan commitments. The decrease is due to Bancorp continuing its moratorium of originating new loans in the construction and commercial real estate portfolios.

RESULTS OF OPERATIONS

Interest and dividend income and expense

The following tables present average balance sheets (daily averages), interest income, interest expense and the corresponding yields earned and rates paid for major balance sheet components:

| | Three months ended June 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2010 | | | 2009 | | |
| | Average Balance | Interest Income/ Expense | Average Rate | Average Balance | Interest Income/ Expense | Average Rate |
| | (dollars in thousands) | | | | | |
| Interest earning assets: | | | | | | |
| Loans | $ 634,250 | $ 8,938 | 5.64% | $ 775,845 | $ 10,615 | 5.47% |
| Investments | 69,458 | 444 | 2.56% | 36,759 | 350 | 3.81% |
| Interest bearing deposits in banks | 41,761 | 21 | 0.20% | 59,418 | 19 | 0.13% |
| Federal funds sold | 10,000 | 4 | 0.16% | 49,670 | 15 | 0.12% |
| Total interest earning assets | 755,469 | 9,407 | 4.98% | 921,692 | 10,999 | 4.77% |
| | | | | | | |
| Cash and due from banks | 20,826 | | | 26,182 | | |
| Premises and equipment, net | 5,929 | | | 7,392 | | |
| Allowance for loan losses | (14,997) | | | (16,778) | | |
| Other assets | 46,492 | | | 37,407 | | |
| Total Assets | $ 813,719 | | | $ 975,895 | | |
| | | | | | | |
| Interest bearing liabilities: | | | | | | |
| Deposits | $ 662,308 | $ 2,949 | 1.78% | $ 802,738 | $ 6,006 | 2.99% |
| FHLB advances | 50,000 | 424 | 3.39% | 50,011 | 423 | 3.38% |
| Subordinated debt | 8,248 | 70 | 3.39% | 8,248 | 89 | 4.32% |
| Other borrowings | 7,000 | 77 | 4.40% | 7,000 | 77 | 4.40% |
| Total interest bearing liabilities | 727,556 | 3,520 | 1.94% | 867,997 | 6,595 | 3.04% |
| | | | | | | |
| Demand deposits | 48,640 | | | 47,062 | | |
| Accrued expenses and other liabilities | 4,858 | | | 3,822 | | |
| Shareholders' equity | 32,665 | | | 57,014 | | |
| Total liabilities and equity | $ 813,719 | | | $ 975,895 | | |
| | | | | | | |
| Net interest income | | $ 5,887 | | | $ 4,404 | |
| Interest margin | | | 3.12% | | | 1.91% |
| Interest spread | | | 3.04% | | | 1.73% |

| | Six months ended June 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2010 | | | 2009 | | |
| | Average Balance | Interest Income/ Expense | Average Rate | Average Balance | Interest Income/ Expense | Average Rate |
| | (dollars in thousands) | | | | | |
| Interest earning assets: | | | | | | |
| Loans | $ 644,093 | $ 18,034 | 5.60% | $ 792,495 | $ 22,390 | 5.65% |
| Investments | 68,077 | 1,003 | 2.95% | 46,073 | 922 | 4.00% |
| Interest bearing deposits in banks | 42,171 | 53 | 0.25% | 31,099 | 19 | 0.12% |
| Federal funds sold | 10,000 | 8 | 0.16% | 41,978 | 27 | 0.13% |
| Total interest earning assets | 764,341 | 19,098 | 5.00% | 911,645 | 23,358 | 5.12% |
| | | | | | | |
| Cash and due from banks | 21,088 | | | 21,425 | | |
| Premises and equipment, net | 6,086 | | | 7,510 | | |
| Allowance for loan losses | (15,456) | | | (16,715) | | |
| Other assets | 48,039 | | | 34,006 | | |
| Total Assets | $ 824,098 | | | $ 957,871 | | |
| | | | | | | |
| Interest bearing liabilities: | | | | | | |
| Deposits | $ 670,832 | $ 6,066 | 1.81% | $ 783,287 | $ 12,249 | 3.13% |
| FHLB advances | 50,000 | 843 | 3.37% | 50,005 | 842 | 3.37% |
| Subordinated debt | 8,248 | 140 | 3.39% | 8,248 | 182 | 4.41% |
| Other borrowings | 7,000 | 153 | 4.37% | 7,000 | 153 | 4.37% |
| Total interest bearing liabilities | 736,080 | 7,202 | 1.96% | 848,540 | 13,426 | 3.16% |
| | | | | | | |
| Demand deposits | 49,280 | | | 46,952 | | |
| Accrued expenses and other liabilities | 4,770 | | | 4,394 | | |
| Shareholders' equity | 33,968 | | | 57,985 | | |
| Total liabilities and equity | $ 824,098 | | | $ 957,871 | | |
| | | | | | | |
| Net interest income | | $ 11,896 | | | $ 9,932 | |
| Interest margin | | | 3.11% | | | 2.18% |
| Interest spread | | | 3.04% | | | 1.96% |

The following rate volume analysis reflects the impact that changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities had on net interest income during the periods indicated. Information is provided in each category with respect to changes attributable to changes in volume (changes in volume multiplied by prior rate), changes attributable to changes in rates (changes in rates multiplied by prior volume) and the total net change. The change resulting from the combined impact of volume and rate is allocated proportionately to the change due to volume and the change due to rate.

| | Three months ended June 30, 2010 vs 2009 Increase (decrease) in Interest Income/Expense Due to change in: | | | Six months ended June 30, 2010 vs 2009 Increase (decrease) in Interest Income/Expense Due to change in: | | |
|---|---|---|---|---|---|---|
| | Volume | Rate | Total | Volume | Rate | Total |
| | (dollars in thousands) | | | (dollars in thousands) | | |
| Interest earning assets: | | | | | | |
| Loans | $ (1,987) | $ 310 | $ (1,677) | $ (4,160) | $ (196) | $ (4,356) |
| Investments | 236 | (142) | 94 | 365 | (284) | 81 |
| Interest bearing deposits in banks | (5) | 7 | 2 | 9 | 25 | 34 |
| Federal funds sold | (15) | 4 | (11) | (24) | 5 | (19) |
| Total interest earning assets | (1,771) | 179 | (1,592) | (3,810) | (450) | (4,260) |
| | | | | | | |
| Interest bearing liabilities: | | | | | | |
| Deposits | $ (922) | $ (2,135) | $ (3,057) | $ (1,570) | $ (4,613) | $ (6,183) |
| FHLB advances | - | 1 | 1 | - | 1 | 1 |
| Subordinated debt | - | (19) | (19) | - | (42) | (42) |
| Other borrowings | - | - | - | - | - | - |
| Total interest bearing liabilities | (922) | (2,153) | (3,075) | (1,570) | (4,654) | (6,224) |
| | | | | | | |
| Net interest income | $ (849) | $ 2,332 | $ 1,483 | $ (2,240) | $ 4,204 | $ 1,964 |

For the quarter ended June 30, 2010, average interest earning assets decreased $166.2 million, or 18%, to $755.5 million for the quarter ended June 30, 2010 from $921.7 million for the quarter ended June 30, 2009, resulting in interest income for Bancorp of $9.4 million compared to $11.0 million for the same period in 2009. Interest and fees on loans decreased $1.7 million, or 16%, from $10.6 million for the quarter ended June 30, 2009 to $8.9 million for the quarter ended June 30, 2010. This decrease is primarily the result of a $141.6 million decrease in the average balance in the loan portfolio and the lingering impact of the high level of non-accrual loans, partially offset by the collection of $1.0 million of past due interest on non-accrual loans. When compared to the same period last year, interest income on investments increased by 27% due to an increase in the average balance of investments outstanding, but was partially offset by a decrease in the yield on the investment portfolio. The increase resulted from the purchase of $15.2 million in government agency bonds and mortgage-backed securities, which is in accordance with the ALCO Committee’s plan to redeploy excess liquidity into higher earning assets while maintaining favorable risk-based capital treatment. Income on interest-bearing deposits in banks increased 11% for the quarter ended June 30, 2010 compared to the quarter ended June 30, 2009. This increase is due to excess funds being placed in the account at the Federal Reserve Bank, which pays higher interest rates than overnight federal funds.

Total interest expense for the quarter ended June 30, 2010 of $3.5 million represents a decrease of $3.1 million, or 47%, as compared to interest expense of $6.6 million for the same period last year. This decrease in interest expense is the result of a decrease in both interest rates paid and in average balances of interest-bearing liabilities. Average balances of deposit accounts decreased $140.4 million, or 17%, which is comprised primarily of decreases in certificates of deposit and money market accounts of $138.9 million and $2.9 million, respectively, and partially offset by an increase in savings accounts of $1.3 million. In addition, significantly lower interest rates primarily contributed to the overall decrease of $3.1 million in interest expense on deposits. Average FHLB advances remained constant at $50 million resulting in $424,000 in interest expense on FHLB advances, which is consistent with the same period last year. The decrease in the index to which the junior subordinated debt interest rate is based resulted in a decline in interest expense of $19,000, or 21%.

As a result of the above, Bancorp's net interest income increased $1.5 million, or 34%, to $5.9 million for the three months ended June 30, 2010 as compared to $4.4 million for the same period last year. The net interest margin for the three months ended June 30, 2010 was 3.12% as compared to 1.91% for the three months ended June 30, 2009 as a result of the collection of $1.0 million of past due interest on non-accrual loans and a significant reduction in the cost of funds.

Interest and dividend income was $19.1 million for the six months ended June 30, 2010, which represents a decrease of $4.3 million, or 18%, as compared to interest and dividend income of $23.4 million for the same period last year. This decrease was due primarily to a $148.4 million decrease in the loan portfolio, as well as the high level impact of non-accrual loans. This was combined with a decrease in interest rates on investment securities, which was offset by an increase in average balances.

For the six months ended June 30, 2010, total interest expense decreased $6.2 million, or 46%, to $7.2 million from $13.4 million for the six months ended June 30, 2009. This decrease in interest expense was due to the above-mentioned reasons.

As a result of the above, net interest income increased $2.0 million, or 20%, for the six months ended June 30, 2010 to $11.9 million as compared to $9.9 million at June 30, 2009. The net interest margin for the six months ended June 30, 2010 was 3.11% as compared to 2.18% for the six months ended June 30, 2009.

Provision for Loan Losses

Based on management's most recent evaluation of the adequacy of the allowance for loan losses, the provision for loan losses charged to operations for the three months ended June 30, 2010 was $512,000 compared to $6.0 million for the three months ended June 30, 2009. The change in the provision for loan losses for the three months ended June 30, 2010 compared to the three months ended June 30, 2009 is due to a decrease in non-accruing loans in the second quarter of 2010 and is reflective of the reduction of the concentration of high-risk loans in the portfolio. For the six months ended June 30, 2010, non-accrual loans decreased $9.7 million compared to the six months ended June 30, 2009 during which non-accrual loans increased $39.7 million. At June 30, 2010 non-accrual loans were $103.9 million compared to $119.9 million at June 30, 2009, which represents a decrease of $16.0 million between these two periods. When comparing the allowance for loan losses to the loan portfolio, outstanding loans had decreased by 15.4% during the period from June 30, 2009 to June 30, 2010 and the ratio of ALLL to total loans decreased slightly from 2.27% to 2.26%. An analysis of the changes in the allowance for loan losses is presented under "Allowance for Loan Losses."

Noninterest income

Noninterest income decreased $106,000 from $667,000 for the quarter ended June 30, 2009 to $561,000 for the quarter ended June 30, 2010. This decrease is primarily due to a decrease in mortgage brokerage referral fees and earnings on Bank-owned life insurance of $53,000 and $52,000, respectively, and a $14,000 decrease in other income for the three months ended June 30, 2010 compared to the same period last year. These were partially offset by an increase in activity-based deposit fees and service charge income of $25,000.

For the six months ended June 30, 2010, non-interest income decreased $590,000, or 35%, to $1.1 million as compared to $1.7 million for the six months ended June 30, 2009. This decrease is primarily due to the gain on the sale of investment securities of $434,000 recorded in 2009; there were no such sales in 2010. Noninterest income also decreased due to the $111,000 decline in income earned on the Bank-owned life insurance, a $28,000 decrease in mortgage brokerage referral fees and $46,000 decline in loan origination and processing fees.

Noninterest expenses

Noninterest expenses decreased $111,000, or 1%, to $7.3 million for the quarter ended June 30, 2010 from $7.4 million for the quarter ended June 30, 2009. Other real estate operations expenses of $511,000 are due to Bancorp maintaining the properties acquired through loan foreclosure proceedings. This includes carrying costs of $237,000, an impairment write-down on one property of $154,000 and an aggregate loss of $120,000 on the sale of five properties during the quarter ended June 30, 2010. Bancorp had no such properties in the second quarter of 2009. Salaries and benefits expense increased $265,000 for the quarter ended June 30, 2010 from the same period last year due to an increase in headcount, as contract consultants previously in professional services were offered full-time positions, as well as increases in health insurance costs. Professional and other outside services, which are comprised primarily of audit and accounting fees, legal services and consulting fees, decreased $474,000 from $1.2 million for the quarter ended June 30, 2009, to $703,000 for the quarter ended June 30, 2010. The decrease is due to the contract consultants hired as permanent employees, lower audit and accounting fees during the current year, and consulting fees for strategic planning and capital raising that were included in 2009 results. Regulatory assessment fees decreased $233,000 to $690,000 for the quarter ended June 30, 2010 from $922,000 for the quarter ended June 30, 2009, which is due mainly to a FDIC special assessment of $453,000, paid in June 2009. Loan administration and processing expenses decreased $100,000 to $71,000 for the quarter ended June 30, 2010 due to a decrease in appraisal expenses pertaining to existing loans.

For the six months ended June 30, 2010, non-interest expenses increased $2.3 million, or 17%, to $16.1 million from $13.8 million for the same period in 2009. Bancorp incurred $1.3 million in other real estate operations expenses; there were no such expenses for the same period last year. Salaries and benefits increased $635,000 to $6.6 million; professional and other outside services decreased $108,000 to $1.9 million; and loan administration and processing expenses decreased $93,000 to $176,000 for the same period in 2009. The reasons for these variances are the same as those cited above. Insurance expenses increased $232,000 to $404,000 due to the increased level of non-performing assets needing forced placed insurance policies. Regulatory assessment fees increased $183,000 to $1.4 million from $1.2 million due to higher assessment rates charged.

Liquidity

Bancorp's liquidity ratio was 20% and 21% at June 30, 2010 and June 30, 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 consolidated balance sheets, are considered liquid assets: cash and due from banks, federal funds sold, short-term investments and available-for-sale securities. Liquidity is a measure of Bancorp's ability to generate adequate cash to meet financial obligations. The principal cash requirements of a financial institution are to cover downward fluctuations in deposit accounts and increases in its loan portfolio. Management believes Bancorp's short-term assets provide sufficient liquidity to cover loan demand, potential fluctuations in deposit accounts and to meet other anticipated cash operating requirements.

Capital

The following table illustrates Bancorp's regulatory capital ratios at June 30, 2010 and December 31, 2009 respectively:

| | June 30, 2010 | December 31, 2009 |
|---|---|---|
| Total Risk-based Capital | 8.70% | 8.58% |
| Tier 1 Risk-based Capital | 7.36% | 7.22% |
| Tier 1 Leverage Capital | 4.74% | 4.72% |

The following table illustrates the Bank's regulatory capital ratios at June 30, 2010 and December 31, 2009 respectively:

| | June 30, 2010 | December 31, 2009 |
|---|---|---|
| Total Risk-based Capital | 8.73% | 8.58% |
| Tier 1 Risk-based Capital | 7.39% | 7.22% |
| Tier 1 Leverage Capital | 4.74% | 4.72% |

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 Bank is considered to be "adequately capitalized" at June 30, 2010 under applicable regulations. To be considered "adequately capitalized," an institution must generally have a leverage capital ratio of at least 4%, a Tier 1 risk-based capital ratio of at least 4% and a total risk-based capital ratio of at least 8%.

Management continuously assesses the adequacy of the Bank's capital. As reported in Part II, Item 1 of this quarterly report, on December 16, 2009, Bancorp and the Bank entered into a Securities Purchase Agreement (the "SPA") with Carrazza pursuant to which Carrazza agreed to invest up to $50,000,000 to purchase up to 33,333,333 shares of Bancorp common stock (as adjusted) at a purchase price of $1.50 per share. On May 3, 2010, Bancorp, the Bank and Carrazza entered into a First Amendment to Securities Purchase Agreement (the "Amendment") to extend the outside closing date of the SPA, primarily to accommodate the completion of all necessary regulatory applications and approvals required for Carrazza to consummate the transactions contemplated under the SPA. Pursuant to the terms of the Amendment, the parties have agreed to extend the outside closing date set forth under the SPA from May 31, 2010 to July 31, 2010 or later, provided certain conditions are met and further provided that the outside closing date shall not be extended later than

August 31, 2010, unless mutually consented to in writing by the parties. The Amendment sets forth that the SPA shall automatically terminate as of certain dates, unless certain conditions are met or if extended by mutual consent of the parties in writing. Management currently anticipates that, subject to certain conditions and contingencies, the Carrazza investment will be consummated in the third quarter of 2010.

IMPACT OF INFLATION AND CHANGING PRICES

Bancorp's consolidated financial statements have been prepared in terms of historical dollars, without considering changes in the 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 general levels of inflation. Interest rates do not necessarily move in the same direction or with the same magnitude as the prices of goods and services. Notwithstanding this, inflation can directly affect the value of loan collateral, in particular, real estate. Inflation, or disinflation, could significantly affect Bancorp's earnings in future periods.

## Item 3: Quantitative and Qualitative Disclosures about 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 Bancorp's business, the primary source of market risk is interest rate risk, which is the impact that changing interest rates have on current and future earnings. In addition, Bancorp's loan portfolio is primarily secured by real estate in the company's market area. As a result, the changes in valuation of real estate could also impact Bancorp's earnings.

### Qualitative Aspects of Market Risk

Bancorp's goal is to maximize long term profitability while minimizing its exposure to interest rate fluctuations. The first priority is to structure and price Bancorp's assets and liabilities to maintain an acceptable interest rate spread while reducing the net effect of changes in interest rates. In order to accomplish this, the focus is 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 and purchase short-term investments to offset the increasing short term re-pricing of the liability side of the balance sheet. In fact, a number of the interest-bearing deposit products have no contractual maturity. Therefore, deposit balances may run off unexpectedly due to changing market conditions. Additionally, loans and investments with longer term rate adjustment frequencies are matched against longer term deposits and borrowings to lock in a desirable spread.

The exposure to interest rate risk is monitored by the Management Asset and Liability Committee consisting of senior management personnel. The Committee meets on a monthly basis, but may convene more frequently as conditions dictate. The Committee reviews the interrelationships within the balance sheet to maximize net interest income within acceptable levels of risk. This Committee reports to the Board of Directors on a monthly basis regarding its activities. In addition to the Management Asset and Liability Committee, there is a Board Asset and Liability Committee ("ALCO"), which meets quarterly. ALCO monitors the interest rate risk analyses, reviews investment transactions during the period and determines compliance with Bank policies.

### Quantitative Aspects of Market Risk

In order to manage the risk associated with interest rate movements, management analyzes Bancorp's interest rate sensitivity position through the use of interest income simulation and GAP analysis. The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are "interest sensitive." An asset or liability is said to be interest sensitive within a specific time period if it will mature or reprice within that time period.

Management's goal is to manage asset and liability positions to moderate the effects of interest rate fluctuations on net interest income. Interest income simulations are completed quarterly and presented to ALCO. The simulations provide an estimate of the impact of changes in interest rates on net interest income under a range of assumptions. Changes to these assumptions can significantly affect the results of the simulations. The simulation incorporates assumptions regarding the potential timing in the repricing of certain assets and liabilities when market rates change and the changes in spreads between different market rates.

Simulation analysis is only an estimate of Bancorp's interest rate risk exposure at a particular point in time. Management regularly reviews the potential effect changes in interest rates could have on the repayment of rate sensitive assets and funding requirements of rate sensitive liabilities.

Management has established interest rate risk guidelines measured by behavioral GAP analysis calculated at the one year cumulative GAP level and a net interest income and economic value of portfolio equity simulation model measured by a 200 basis point interest rate shock.

The table below sets forth an approximation of Bancorp's exposure to changing interest rates using management's behavioral GAP analysis and as a percentage of estimated net interest income and estimated net portfolio value using interest income simulation. The calculations use projected repricings of assets and liabilities at June 30, 2010 and December 31, 2009 on the basis of contractual maturities, anticipated repayments and scheduled rate adjustments.

| | Basis Points | Interest Rate Risk Guidelines | June 30, 2010 | December 31, 2009 |
|---|---|---|---|---|
| GAP percentage total | | +/- 10% | -6.62% | 3.98% |
| Net interest income | 200 | +/- 10% | -8.19% | 4.67% |
| | -200 | +/- 10% | 4.81% | 5.12% |
| Net portfolio value | 200 | +/- 20% | -4.57% | -8.93% |
| | -200 | +/- 20% | 7.81% | -7.42% |

The table below sets forth examples of changes in estimated net interest income and the estimated net portfolio value based on projected scenarios of interest rate increases and decreases. The analyses indicate the rate risk embedded in Bancorp's portfolio at the dates indicated should all interest rates instantaneously rise or fall. The results of these changes are added to or subtracted from the base case; however, there are certain limitations to these types of analyses. Rate changes are rarely instantaneous and these analyses may also overstate the impact of short-term repricings.

Net Interest Income and Economic Value
Summary Performance

June 30, 2010

| | Net Interest Income | | | Net Portfolio Value | | |
|---|---|---|---|---|---|---|
| Projected Interest Rate Scenario | Estimated Value | $ Change from Base | % Change from Base | Estimated Value | $ Change from Base | % Change from Base |
| + 200 | 23,320 | (2,079) | -8.19% | 34,790 | (1,665) | -4.57% |
| + 100 | 24,386 | (1,013) | -3.99% | 35,866 | (589) | -1.62% |
| BASE | 25,399 | | | 36,455 | | |
| - 100 | 27,129 | 1,730 | 6.81% | 36,931 | 476 | 1.31% |
| - 200 | 26,621 | 1,222 | 4.81% | 39,303 | 2,849 | 7.81% |

December 31, 2009

| | Net Interest Income | | | Net Portfolio Value | | |
|---|---|---|---|---|---|---|
| Projected Interest Rate Scenario | Estimated Value | $ Change from Base | % Change from Base | Estimated Value | $ Change from Base | % Change from Base |
| + 200 | 20,750 | 925 | 4.67% | 49,704 | (4,872) | -8.93% |
| + 100 | 20,113 | 288 | 1.45% | 51,762 | (2,814) | -5.16% |
| BASE | 19,825 | - | - | 54,576 | - | - |
| - 100 | 20,557 | 732 | 3.69% | 54,945 | 369 | 0.68% |
| - 200 | 20,841 | 1,016 | 5.12% | 50,525 | (4,051) | -7.42% |

Item 4: Controls and Procedures

Based on an evaluation of the effectiveness of Bancorp's disclosure controls and procedures performed by Bancorp's management, with the participation of Bancorp's Chief Executive Officer and its Chief Financial Officer as of the end of the period covered by this report, Bancorp's Chief Executive Officer and Chief Financial Officer concluded that Bancorp's disclosure controls and procedures have been effective.

As used herein, "disclosure controls and procedures" means controls and other procedures of Bancorp that are designed to ensure that information required to be disclosed by Bancorp in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the 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 Bancorp in the reports that it files or submits under the Securities Exchange Act is accumulated and communicated to Bancorp's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in Bancorp's internal control over financial reporting identified in connection with the evaluation described in the preceding paragraph that occurred during Bancorp's fiscal quarter ended June 30, 2010 that has materially affected, or is reasonably likely to materially affect, Bancorp's internal control over financial reporting.

PART II - OTHER INFORMATION.

Item 1: Legal Proceedings

Except as noted below, neither Bancorp nor the Bank has any pending legal proceedings, other than ordinary routine litigation incidental to its business, to which Bancorp or the Bank is a party or any of its property is subject.

On October 9, 2009, a complaint captioned PNBK Holdings LLC v. Patriot National Bancorp, Inc. and Patriot National Bank was filed in the United States District Court, Southern District of New York (the "Federal Litigation"). PNBK Holdings LLC is a newly formed Delaware entity created to be an investment vehicle for an investor group led by Michael A. Carrazza (collectively, "Carrazza"). Carrazza also filed a complaint with the State of Connecticut Superior Court – Stamford Judicial District on October 9, 2009 captioned PNBK Holdings LLC and Michael A. Carrazza v. Patriot National Bancorp, Inc. and Patriot National Bank (the "Connecticut Litigation").

Earlier in 2009, Carrazza expressed interest in acquiring a controlling interest in Bancorp. In late July 2009, Bancorp entered into a preliminary Letter of Intent with Carrazza which would result in additional capital of up to $50 million representing a substantial, controlling interest in Bancorp. The parties and Carrazza entered into extensive negotiations to memorialize the investment in the form of a definitive Securities Purchase Agreement ("SPA"). On the evening of September 30, 2009 and before executing a SPA with Carrazza, Bancorp received an unsolicited written offer from another investment group to acquire a controlling interest in Bancorp. This unsolicited offer was at a higher price than the Carrazza offer, again for up to $50 million of additional capital in return for a significant, controlling interest. The next day, October 1, 2009, the Board of Directors held a special meeting and consulted with its outside counsel and advisors to consider the unsolicited offer and to discuss the Carrazza proposal. The Board of Directors determined in its fiduciary capacity that it should further analyze and evaluate the unsolicited offer.

Following these events, Carrazza commenced the Federal Litigation and the Connecticut Litigation. Bancorp vigorously defended against these actions and through settlement discussions with Carrazza, Carrazza again expressed its interest in Bancorp. In late November 2009, Carrazza and Bancorp resumed negotiations. On December 4, 2009, Carrazza and Bancorp entered into a Standstill Agreement pursuant to which the parties agreed to stop, temporarily and subject to the terms of the Standstill Agreement, the Connecticut Litigation. On December 16, 2009, Bancorp, the Bank and Carrazza executed the SPA, as amended by a First Amendment to the SPA executed by Bancorp, the Bank and Carrazza on May 3, 2010. Pursuant to the Standstill Agreement, upon execution of the SPA, Bancorp agreed to wire $400,000 (the "Escrowed Funds") into an escrow account governed by the terms of a certain Escrow Agreement between Carrazza, Bancorp and Webster Bank, N.A. The Escrowed Funds will be released to Carrazza or Bancorp pursuant to the Escrow Agreement and the SPA, under which the Escrowed Funds will be released upon a non-appealable order or judgment from the Connecticut Superior Court, the Connecticut Appellate Court, or the Connecticut Supreme Court directing the release of the Escrowed Funds; the joint written agreement by Carrazza and Bancorp or in the case of termination of the SPA. As part of the execution of the SPA, the Federal Litigation was withdrawn with prejudice and the Connecticut Litigation is being held in abeyance.

The complaint filed by Carrazza in the Connecticut Litigation alleges, among other things, breach of the Letter of Intent, including a breach by Bancorp of the Letter of Intent's exclusivity provision. The Carrazza complaint seeks (a) compensatory damages; (b) the break-up fee payable under certain circumstances under the Letter of Intent (an amount equal to $100,000 plus certain out-of-pocket due diligence expenses of Carrazza (estimated by Carrazza as set forth in the Carrazza complaint to be in excess of $700,000)); (c) attorneys' fees and costs of the action brought by the Carrazza complaint; and (d) a pre-judgment attachment securing the eventual judgment in Carrazza's favor. In connection with this action, Carrazza has filed an application for a pre-judgment attachment order in the amount of at least $990,000 against Bancorp's property.

Item 1A: Risk Factors

During the three months ended June 30, 2010, there were no material changes to the risk factors relevant to Bancorp's operations, which are described in the Annual Report on Form 10-K for the year ended December 31, 2009.

Item 6: Exhibits

| No. | Description |
|---|---|
| 2 | Agreement and Plan of Reorganization dated as of June 28, 1999 between Bancorp and the Bank (incorporated by reference to Exhibit 2 to Bancorp's Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)). |
| 3(i) | Certificate of Incorporation of Bancorp, (incorporated by reference to Exhibit 3(i) to Bancorp's Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)). |
| 3(i)(A) | Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. dated July 16, 2004 (incorporated by reference to Exhibit 3(i)(A) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2004 (Commission File No. 000-29599)). |
| 3(i)(B) | Certificate of Amendment of Certificate of Incorporation of Patriot National Bancorp, Inc. dated June 15, 2006 (incorporated by reference to Exhibit 3(i)(B) to Bancorp's Quarterly Report of Form 10-Q for the quarter ended September 30, 2006 (commission File No. 000-29599)). |
| 3(ii) | Amended and Restated By-laws of Bancorp (incorporated by reference to Exhibit 3.2 to Bancorp's Current Report on Form 8 - K dated December 26, 2007 (Commission File No. 1-32007)). |

| No. | Description |
|---|---|
| 10(a)(1) | 2001 Stock Appreciation Rights Plan of Bancorp (incorporated by reference to Exhibit 10(a)(1) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2001 (Commission File No. 000-29599)). |
| 10(a)(3) | Employment Agreement, dated as of October 23, 2000, as amended by a First Amendment, dated as of March 21, 2001, among the Bank, Bancorp and Charles F. Howell (incorporated by reference to Exhibit 10(a)(4) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2000 (Commission File No. 000-29599)). |
| 10(a)(4) | Change of Control Agreement, dated as of January 1, 2007 among Angelo De Caro, and Patriot National Bank and Bancorp (incorporated by reference to Exhibit 10(a)(4) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2006 (Commission File No. 000-29599)). |
| 10(a)(5) | Employment Agreement dated as of January 1, 2008 among Patriot National Bank, Bancorp and Robert F. O'Connell (incorporated by reference to Exhibit 10(a)(5) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2007 (Commission File No. 000-29599)). |
| 10(a)(6) | Change of Control Agreement, dated as of January 1, 2007 among Robert F. O'Connell, Patriot National Bank and Bancorp (incorporated by reference to Exhibit 10(a)(6) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2006 (Commission File No. 000-29599)). |
| 10(a)(9) | License agreement dated July 1, 2003 between Patriot National Bank and L. Morris Glucksman (incorporated by reference to Exhibit 10(a)(9) to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 2003 (Commission File No. 000-29599)). |
| 10(a)(10) | Employment Agreement dated as of January 1, 2007 among Patriot National Bank, Bancorp and Charles F. Howell (incorporated by reference to Exhibit 10(a)(10) to Bancorp's Annual Report on Form 10-K for the year ended December 31, 2006 (Commission File No. 000-29599)). |

| No. | Description |
|---|---|
| 10(a)(11) | Change of Control Agreement, dated as of January 1, 2007 among Charles F. Howell, Patriot National Bank and Bancorp (incorporated by reference to Exhibit 10(a)(11) to Bancorp’s Annual Report on Form 10-K for the year ended December 31, 2006 (Commission File No. 000-29599)). |
| 10(a)(12) | 2005 Director Stock Award Plan (incorporated by reference to Exhibit 10(a)(12) to Bancorp’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 (Commission File No. 000 - 295999)). |
| 10(a)(13) | Change of Control Agreement, dated as of January 1, 2007 between Martin G. Noble and Patriot National Bank (incorporated by reference to Exhibit 10(a)(13) to Bancorp’s Annual Report on Form 10-K for the year ended December 31, 2006 (Commission File No. 000-29599)). |
| 10(a)(14) | Change of Control Agreement, dated as of January 1, 2007 among Philip W. Wolford, Patriot National Bank and Bancorp (incorporated by reference to Exhibit 10(a)(14) to Bancorp’s Annual Report on Form 10-K for the year ended December 31, 2006 (Commission File No. 000-29599)). |
| 10(a)(15) | Formal Written Agreement between Patriot National Bank and the Office of the Comptroller of the Currency (incorporated by reference to Exhibit 10(a)(15) to Bancorp’s Current Report on Form 8-K dated February 9, 2009 (Commission File No. 000-29599)). |
| 10(a)(16) | Securities Purchase Agreement by and among Patriot National Bancorp, Inc., Patriot National Bank and PNBK Holdings LLC dated as of December 16, 2009 (incorporated by reference to Exhibit 10.1 to Bancorp’s Current Report on Form 8-K dated December 17, 2009 (Commission File No. 000-29599)). |
| 10(a)(17) | First Amendment to Securities Purchase Agreement by and among Patriot National Bancorp, Inc., Patriot National Bank and PNBK Holdings LLC dated as of May 3, 2010 (incorporated by reference to Exhibit 10(a) to Bancorp's Current Report on Form 8-K dated May 3, 2010 (Commission File No. 000-29599)). |
| 10(c) | 1999 Stock Option Plan of the Bank (incorporated by reference to Exhibit 10(c) to Bancorp’s Current Report on Form 8-K dated December 1, 1999 (Commission File No. 000-29599)). |

| No. | Description |
|---|---|
| 14 | Code of Conduct for Senior Financial Officers (incorporated by reference to Exhibit 14 to Bancorp's Annual Report on Form 10 - KSB for the year ended December 31, 2004 (Commission File No. 000-29599). |
| 21 | Subsidiaries of Bancorp (incorporated by reference to Exhibit 21 to Bancorp's Annual Report on Form 10-KSB for the year ended December 31, 1999 (Commission File No. 000-29599)). |
| 31(1) | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer |
| 31(2) | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer |
| 32 | Section 1350 Certifications |

SIGNATURES

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

Patriot National Bancorp, inc.
(Registrant)

By: /s/ Robert F. O'Connell
Robert F. O'Connell,
Senior Executive Vice President
Chief Financial Officer

(On behalf of the registrant and as
chief financial officer)

August 5, 2010