



**2010  
ANNUAL  
REPORT**

**Shore  
Community  
Bank**

# Board of Directors



Philip Garfinkel  
Secretary



Zev Rosen  
Chairman



Robert T. English  
President & CEO



Earl F. Sutton  
President Emeritus



Jerry Boisseau, CFP



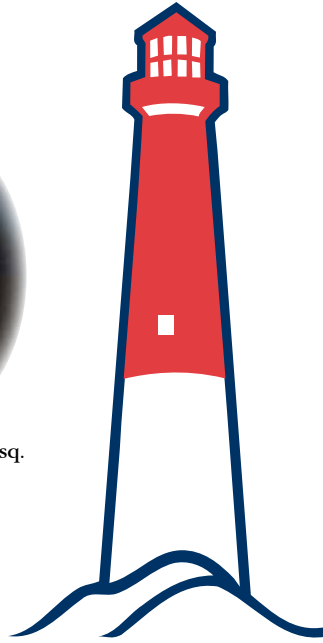
Howard Butensky, Esq.



Dennis Cirone, DC



Harry Disbrow, Sr.



Debra Abrahamovic Kay



Harry Jay Levin, Esq.



David Rosen



Leonard Silidker

## MISSION STATEMENT

Locally owned and operated, Shore Community Bank is committed to providing a broad range of financial services aimed at helping individuals, businesses, professionals and the public sector of the Ocean County communities we serve.

We are dedicated to exceeding your expectations with personalized services and to establishing life long relationships that will benefit our customers, associates and community.

*On the Cover:*

Photo of "Old Barney" © istockphoto|Andrew F Kazmierski

**BOARD OF DIRECTORS**

*Jerry Boisseau, CFP*  
Owner/President  
Amherst Financial Services, Inc.

*Robert T. English*  
President & CEO  
Shore Community Bank

*David Rosen*  
President  
Good Friend Electrical Supplies, Inc.

*Howard Butensky, Esq.*  
Practicing Attorney/Howard Butensky, PA

*Philip Garfinkel*  
President, Syndale Corporation

*Zev Rosen*  
Chairman of the Board  
Shore Community Bank  
Chairman of the Board  
Good Friend Electrical Supplies, Inc.

*Dennis Cirone, D.C.*  
President, Chiropractically Yours, P.A.

*Debra Abrahamovic Kay*  
President  
Captain's Inn Land Corporation  
Manager  
Captain's Inn Restaurant

*Leonard Silidker*  
Pharmacist /Instructor  
Toms River School System  
Founder & President  
NAIC/South Jersey

*Harry Disbrow, Sr.*  
Former President  
Bayshore Real Estate Agency, Inc.  
and Bayshore Building Co.

*Harry Jay Levin, Esq.*  
Managing Partner/Levin & Cyphers

*Earl F. Sutton*  
President Emeritus  
Shore Community Bank

**OFFICERS**

*Zev Rosen*  
Chairman of the Board

*James Feeney*  
Vice President  
Credit Administrator

*John Boekell*  
Assistant Vice President  
Branch Manager

*Gerri Blace-McPhee*  
Assistant Vice President  
Branch Manager

*Robert T. English*  
President  
Chief Executive Officer

*Ava Graber*  
Vice President  
Loan Operations

*Diana Doyle*  
Assistant Vice President  
Branch Manager

*Kelly Murt*  
Assistant Vice President  
Operations Officer

*Kenneth Greco*  
Senior Vice President  
Senior Loan Officer  
SBA Lending Officer  
Corporate Banking Division

*Dede Nissen*  
Vice President  
Residential Mortgage Division

*Tanya Enriquez*  
Assistant Vice President  
Chief Accounting Officer  
Funds Management Officer

*Philip S. Garfinkel*  
Corporate Secretary

*Oliva Mele*  
Senior Vice President  
Community Banking Division

*Dawn Tortoriello*  
Vice President  
Lending Officer

*Phyllis Martin*  
Assistant Vice President  
Branch Manager

*Barbara Cantamessa*  
Assistant Corporate Secretary

*Gayle Beckman*  
Assistant Vice President  
Branch Manager

*Allison Martinez*  
Assistant Vice President  
Credit Analyst

*Jean Triola*  
Assistant Treasurer  
Assistant Branch Manager

**Jackson  
Community Board**

William Allmann  
Anthony Bombacie  
Dennis Galvin, Esq.  
Clara Glory  
Charles Pinter  
Edwin Schuster

**ADVISORY BOARD**  
(Active)

Richard J. Banach  
James J. Caldwell  
Lee Childers  
Douglas Collier  
John DeVincens, Esq.  
Theodore Gooding  
Thomas Hourigan

Sidney Kassenoff  
Thomas Koerner  
Stephan R. Leone, Esq.  
Michael Mastronardy  
Robert Shea, Esq.  
Joseph Stack  
Robert Stone

**Manahawkin  
Community Board**

Earl Sutton  
Joseph Mancini  
Joseph Mezzina  
Angela Ominski  
David Wintrode Jr.

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## To our Shareholders, Clients and Friends:

We are pleased to report that many of the financial goals and objectives we established for the year 2010 were accomplished and for that we wish to extend our appreciation to our team of Officers and Associates for their dedication and hard work. Accomplishing our primary objective which is to significantly reduce non-performing assets has been stubbornly elusive due to the lingering effects of the December 2007 to June 2009 recession. In late 2010, the National Bureau of Economic Research declared that the recession ended in June 2009, however we have seen few signs of economic improvement in our local markets. High levels of unemployment and lower consumer spending, coupled with a stagnant housing market which continues to be weighed down by negative factors such as short sales, foreclosures and declining home prices have held any meaningful economic recovery in check. The 2007–2009 recession lasted 18 months, making it the longest recessionary period since the end of the Great Depression in 1933.

Recognizing that access to additional equity capital would be too expensive and essentially unavailable for a community bank of our asset size, we set a course that would preserve and grow our existing capital base through a combination of balance sheet management and improved earnings. As a result, our regulatory capital ratios have improved compared to 2009. At December 31, 2010, the Bank's Tier 1 leverage, Tier 1 risk based capital and total risk-based capital ratios were 8.80 percent, 15.15 percent and 16.42 percent, respectively, compared to 8.24 percent, 12.24 percent and 13.49 percent, respectively, in 2009.

Net income in 2010 increased to \$675 thousand from \$116 thousand in 2009. Net interest income grew by 8.91 percent, increasing \$569 thousand over 2009. We also benefited from a reduced level of provision for loan losses as we provided \$1.2 million in 2010 as compared to \$1.6 million in 2009. Other income

decreased by \$272 thousand, primarily as a result of gains of \$325 thousand recorded on sales of securities in 2009. We had no security gain income in 2010. Total operating expenses were reduced by \$145 thousand from 2009 levels.

Total assets, at December 31, 2010, decreased 2.89 percent and totaled \$207.9 million, compared to \$214.1 million at December 31, 2009. Total loans declined 15.01 percent and finished the year at \$117.9 million, as compared to \$138.7 million at December 31, 2009. Total deposits decreased 4.20 percent to \$170.7 million at December 31, 2010, as compared to \$178.1 million at December 31, 2009.

Net loan charge-offs were \$740 thousand in 2010 compared to net loan charge-offs of \$1.7 million in 2009. The allowance for loan losses as a percentage of period end loans was 2.12 percent at December 31, 2010 compared to 1.48 percent at December 31, 2009.

Non-performing assets, which includes other real estate owned, stood at \$9.2 million at December 31, 2010, compared to \$10.0 million at year end 2009.

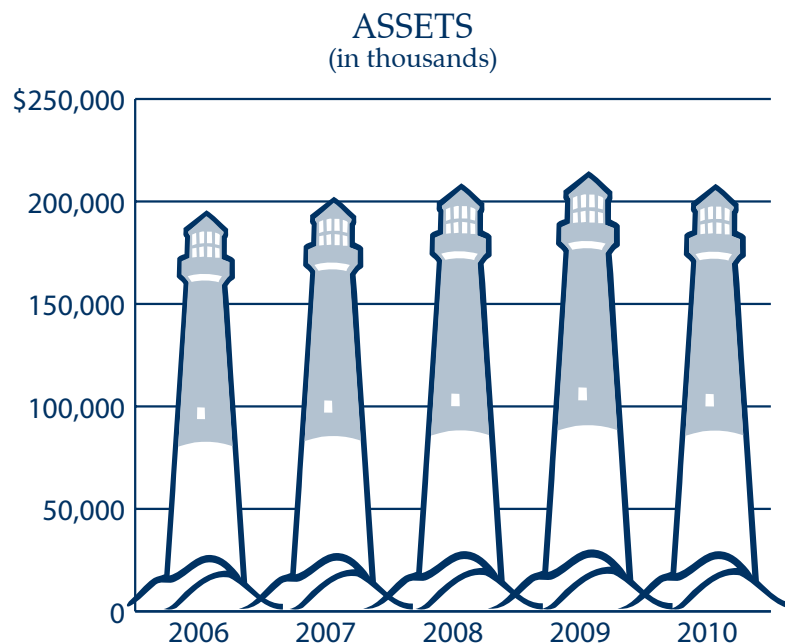
The Bank's capital ratios, net income and the allowance for loan losses as a percentage of total loans outstanding all improved in 2010. Our goal for 2011 is to build on these improvements while addressing the remaining challenges associated with reducing the level of non-performing assets. We thank you for the dedication and support you have shown over the years and, of course, for providing us with the opportunity to earn your business.

Zev Rosen  
Chairman of the Board

Robert T. English  
President & CEO

## SELECTED FINANCIAL DATA

(in thousands) (as of or for the year ending Dec. 31)						Percent Change			
	2010	2009	2008	2007	2006	'10 vs '09	'09 vs '08	'08 vs '07	'07 vs '06
Assets	\$207,868	\$214,062	\$208,130	\$201,605	\$195,021	(2.9%)	2.9%	3.2%	3.4%
Loans	115,415	136,651	154,507	155,150	143,552	(15.5)	(11.6)	(0.4)	8.1
Deposits	170,656	178,146	172,031	173,897	167,689	(4.2)	3.6	(1.1)	3.7
Shareholders' Equity	19,513	18,224	18,166	17,701	16,915	7.1	0.3	2.6	4.6
Net Income	675	116	16	430	1,143	481.9	625.0	(96.3)	(62.4)
Equity to Assets	9.4%	8.5%	8.7%	8.8%	8.7%				





**Balance Sheets**  
December 31, 2010 and 2009

	2010	2009
<b>Assets</b>		
Cash and due from banks	\$ 10,339,697	\$ 3,424,211
Federal funds sold	8,000,000	2,500,000
Cash and cash equivalents	18,339,697	5,924,211
Securities available for sale, at fair value	49,862,080	53,778,870
Securities held to maturity (fair value of \$15,348,367 at December 31, 2010 and \$8,235,207 at December 31, 2009)	15,425,308	8,031,601
Federal Home Loan Bank stock, at cost	644,500	635,700
Loans receivable, net of allowance for loan losses of \$2,496,440 at December 31, 2010 and \$2,056,164 at December 31, 2009	115,415,439	136,650,645
Premises and equipment, net	5,377,273	5,618,252
Accrued interest receivable	952,342	992,395
Prepaid expenses and other assets	766,777	1,200,072
Foreclosed assets	1,084,684	1,229,907
Total assets	\$ 207,868,100	\$ 214,061,653
<b>Liabilities and Stockholders' Equity</b>		
<b>Liabilities</b>		
Deposits:		
Non-interest bearing	\$ 24,855,897	\$ 21,584,557
Interest bearing	145,800,233	156,561,145
Total deposits	170,656,130	178,145,702
Securities sold under agreements to repurchase	9,100,000	9,100,000
Long-term debt	8,000,000	8,000,000
Accrued interest payable	316,100	348,011
Other liabilities	283,032	244,203
Total liabilities	188,355,262	195,837,916
<b>Stockholders' Equity</b>		
Common stock, par value \$5 per share; 4,000,000 shares authorized; 1,703,452 and 1,700,348 shares outstanding at 2010 and 2009, respectively	8,517,260	8,501,740
Surplus	9,354,274	9,340,752
Retained earnings	950,564	275,654
Accumulated other comprehensive income	690,740	105,591
Total stockholders' equity	19,512,838	18,223,737
Total liabilities and stockholders' equity	\$ 207,868,100	\$ 214,061,653

*See notes to financial statements.*



## Statements of Income

Years Ended December 31, 2010 and 2009

	2010	2009
<b>Interest Income</b>		
Loans receivable, including fees	\$ 7,813,573	\$ 9,111,768
Securities:		
Taxable	1,841,412	1,593,783
Tax-exempt	435,878	344,309
Federal funds sold and other	73,267	32,092
Total interest income	10,164,130	11,081,952
<b>Interest Expense</b>		
Deposits	2,472,683	3,959,705
Other	740,747	740,747
Total interest expense	3,213,430	4,700,452
Net interest income	6,950,700	6,381,500
<b>Provision for Loan Losses</b>	1,180,000	1,625,000
Net interest income after provision for loan losses	5,770,700	4,756,500
<b>Other Income</b>		
Service charges	310,440	298,162
Mortgage banking activities	144,343	176,837
Other	213,695	140,095
Net gains on sales of securities available for sale	-	325,263
Total other income	668,478	940,357
<b>Other Expenses</b>		
Salaries, wages and employee benefits	2,594,571	2,448,229
Occupancy	704,972	669,565
Equipment	197,057	202,980
Data processing	387,308	464,794
Advertising and promotion	34,436	35,153
Supplies, printing, and postage	130,491	120,518
Federal deposit insurance premium	404,113	483,141
Other	1,077,189	1,250,796
Total other expenses	5,530,137	5,675,176
Income before income tax expense	909,041	21,681
<b>Income Tax Expense (Benefit)</b>	234,131	(94,105)
Net income	\$ 674,910	\$ 115,786
<b>Earnings Per Share</b>		
Basic	\$ 0.40	\$ 0.07
Diluted	\$ 0.39	\$ 0.07

*See notes to financial statements.*



## Statements of Stockholders' Equity

Years Ended December 31, 2010 and 2009

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
<b>Balance, December 31, 2008</b>	\$ 8,501,740	\$ 9,320,696	\$ 159,868	\$ 184,251	<u>\$ 18,166,555</u>
Comprehensive income:					
Net income	-	-	115,786	-	115,786
Change in unrealized gains (losses) on securities available for sale, net of reclassification and taxes	-	-	-	(78,660)	<u>(78,660)</u>
Total comprehensive income					<u>37,126</u>
Stock compensation expense	<u>-</u>	<u>20,056</u>	<u>-</u>	<u>-</u>	<u>20,056</u>
<b>Balance, December 31, 2009</b>	8,501,740	9,340,752	275,654	105,591	<u>18,223,737</u>
Comprehensive income:					
Net income	-	-	674,910	-	674,910
Change in unrealized gains (losses) on securities available for sale, net of reclassification and taxes	-	-	-	585,149	<u>585,149</u>
Total comprehensive income					<u>1,260,059</u>
Exercise of stock options (3,104 shares)	15,520	(3,755)	-	-	11,765
Stock compensation expense	<u>-</u>	<u>17,277</u>	<u>-</u>	<u>-</u>	<u>17,277</u>
<b>Balance, December 31, 2010</b>	<u>\$ 8,517,260</u>	<u>\$ 9,354,274</u>	<u>\$ 950,564</u>	<u>\$ 690,740</u>	<u>\$ 19,512,838</u>

See notes to financial statements.



## Statements of Cash Flows

Years Ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
<b>Cash Flows from Operating Activities</b>		
Net income	\$ 674,910	\$ 115,786
Adjustments to reconcile change in net income to net cash provided by operating activities:		
Provision for loan losses	1,180,000	1,625,000
Provision for depreciation	330,508	328,937
Net amortization of investment premiums and discounts	480,382	236,731
Deferred income taxes	(54,008)	(191,492)
Stock compensation expense	17,277	20,056
Writedown of other real estate owned	15,000	-
Net realized gain on sale of securities	-	(325,263)
Net losses on foreclosed real estate	-	132,034
(Increase) decrease in assets:		
Accrued interest receivable	40,053	(25,725)
Prepaid expenses and other assets	97,203	40,901
Increase (decrease) in liabilities:		
Accrued interest payable	(31,911)	(313,070)
Other liabilities	38,829	72,320
	<u>2,788,243</u>	<u>1,716,215</u>
<b>Cash Flows from Investing Activities</b>		
Securities available for sale:		
Purchases	(15,030,000)	(68,152,125)
Maturities and principal repayments	19,448,939	22,265,568
Proceeds from sales	-	18,816,174
Securities held to maturity:		
Purchases	(7,701,699)	-
Maturities and principal repayments	300,710	382,613
Purchase of Federal Home Bank stock	(8,800)	(24,000)
Net decrease in loans	19,260,500	16,230,946
Purchases of bank premises and equipment	(89,529)	(130,309)
Proceeds from sales of foreclosed real estate	924,929	140,600
	<u>17,105,050</u>	<u>(10,470,533)</u>
<b>Cash Flows from Financing Activities</b>		
Net increase (decrease) in deposits	(7,489,572)	6,115,084
Proceeds from exercise of stock options	11,765	-
	<u>(7,477,807)</u>	<u>6,115,084</u>
Net increase (decrease) in cash and cash equivalents	12,415,486	(2,639,234)
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>5,924,211</u>	<u>8,563,445</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u>\$ 18,339,697</u>	<u>\$ 5,924,211</u>
<b>Supplementary Cash Flows Information</b>		
Interest paid	<u>\$ 3,245,341</u>	<u>\$ 5,013,522</u>
Income taxes paid	<u>\$ 179,957</u>	<u>\$ -</u>
<b>Supplementary Schedule of Noncash Investing Activities</b>		
Other real estate acquired in settlement of loans	<u>\$ 794,706</u>	<u>\$ -</u>

See notes to financial statements.

**1. Organization and Nature of Operations**

Shore Community Bank was incorporated March 20, 1996 under the laws of the State of New Jersey and is a New Jersey state chartered bank. The Bank commenced operations on February 24, 1997 and provides full banking services. As a state bank, the Bank is subject to regulation by the New Jersey Department of Banking and the Federal Deposit Insurance Corporation. The area served by the Bank is principally Ocean County, New Jersey.

**2. Summary of Accounting Policies**

**Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the determination of other-than-temporary impairment on securities and the valuation of deferred tax assets.

**Significant Group Concentrations of Credit Risk**

Most of the Bank's activities are with customers primarily located in Ocean County, New Jersey. Note 3 discusses the types of securities that the Bank invests in. The concentration of credit by type of loan is set forth in Note 4. Although the Bank has a diversified loan portfolio, its debtors' ability to honor their contracts is influenced by the region's economy. The Bank does not have any significant concentrations to any one industry or customer.

**Presentation of Cash Flows**

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks and federal funds sold, all of which mature within ninety days. Generally, federal funds are purchased and sold for one day periods.

**Securities**

Securities classified as available for sale are those securities that the Bank intends to hold for an indefinite period of time but not necessarily to maturity. Securities available for sale are carried at fair value. Any decision to sell a security classified as available for sale would be based on various factors, including significant movement in interest rates, changes in maturity mix of the Bank's assets and liabilities, liquidity needs, regulatory capital considerations and other similar factors. Unrealized gains or losses are reported as increases or decreases in other comprehensive income, net of the related deferred tax effect. Realized gains or losses, determined on the basis of the cost of the specific securities sold, are included in earnings. Premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

Securities classified as held to maturity are those securities the Bank has both the intent and ability to hold to maturity regardless of changes in market conditions, liquidity needs or changes in general economic conditions. These securities are carried at cost adjusted for the amortization of premium and accretion of discount, computed by the interest method over the terms of the securities.

Management determines the appropriate classification of debt securities at the time of purchase and re-evaluates such designation as of each balance sheet date.

## **2. Summary of Accounting Policies (Continued)**

Effective June 30, 2009, the Bank adopted accounting guidance related to recognition and presentation of other-than-temporary impairment. This accounting guidance specifies that (a) if a company does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. When an entity does not intend to sell the security, and it is more likely than not, the entity will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. For held to maturity debt securities, the amount of an other-than-temporary impairment recorded in other comprehensive income for the noncredit portion of a previous other-than-temporary impairment should be amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security.

The Bank has not recognized any other-than-temporary impairment losses in the years ended December 31, 2010 or 2009.

### **Loans Receivable**

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for loan losses and any deferred fees or costs. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield (interest income) of the related loans. The Bank is generally amortizing these amounts over the contractual life of the loan. Premiums and discounts on purchased loans are amortized as adjustments to interest income using the effective yield method.

The loans receivable portfolio is segmented into the following classes: commercial, residential mortgage and other consumer loans. Commercial loans consist of commercial and industrial, commercial real estate, commercial construction and SBA loans. Consumer loans consist of home equity and other consumer.

For all classes of loans receivable, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed. Interest received on nonaccrual loans, including impaired loans, generally is either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments.

## **2. Summary of Accounting Policies (Continued)**

### **Allowance for Loan Losses**

The allowance for credit losses consists of the allowance for loan losses and the reserve for unfunded lending commitments. The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The reserve for unfunded lending commitments represents management's estimate of losses inherent in its unfunded loan commitments. The allowance for credit losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Because all identified losses are immediately charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

The allowance for credit losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on the Bank's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class including loans not considered impaired. These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these categories of loans, adjusted for qualitative factors. These qualitative risk factors include:

1. Lending policies and procedures, including underwriting standards and collection, charge-off, and recovery practices.
2. National, regional, and local economic and business conditions as well as the condition of various market segments, including the value of underlying collateral for collateral dependent loans.
3. Nature and volume of the portfolio and terms of loans.
4. Experience, ability, and depth of lending management and staff.
5. Volume and severity of past due, classified and nonaccrual loans.
6. Quality of the Company's loan review system, and the degree of oversight by the Bank's Board of Directors.
7. Existence and effect of any concentrations of credit and changes in the level of such concentrations.

**2. Summary of Accounting Policies (Continued)**

Each factor is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss calculation.

A majority of the Bank's loan assets are loans to business owners of many types. The Bank makes commercial loans for real estate development and other business purposes required by the customer base.

The Bank's credit policies determine advance rates against the different forms of collateral that can be pledged against commercial loans. Typically, the majority of loans will be limited to a percentage of their underlying collateral values such as real estate values, equipment, eligible accounts receivable and inventory. Individual loan advance rates may be higher or lower depending upon the financial strength of the borrower and/or term of the loan. The assets financed through commercial loans are used within the business for its ongoing operation. Repayment of these kinds of loans generally comes from the cash flow of the business or the ongoing conversions of assets. Commercial real estate loans include long-term loans financing commercial properties. Repayment of this kind of loan is dependent upon either the ongoing cash flow of the borrowing entity or the resale of or lease of the subject property. Commercial real estate loans typically require a loan to value ratio of not greater than 75% and vary in terms.

Residential mortgages and home equity loans are secured by the borrower's residential real estate in either a first or second lien position. Residential mortgages and home equity loans have varying loan rates depending on the financial condition of the borrower and the loan to value ratio. Residential mortgages have amortizations up to 30 years and home equity loans have maturities up to 15 years.

Other consumer loans include installment loans, car loans, and overdraft lines of credit. The majority of these loans are unsecured.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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

An allowance for loan losses is established for an impaired loan if its carrying value exceeds its estimated fair value. The estimated fair values of substantially all of the Bank's impaired loans are measured based on the estimated fair value of the loan's collateral.

**2. Summary of Accounting Policies (Continued)**

For commercial loans secured by real estate, estimated fair values are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For commercial and industrial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable agings or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

Loans whose terms are modified are classified as troubled debt restructurings if the Bank grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate or an extension of a loan's stated maturity date. Non-accrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after modification. Loans classified as troubled debt restructurings are designated as impaired.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments, for commercial and consumer loans. Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful and loss. Loans criticized special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses. Loans not classified are rated pass.

In addition, Federal regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses and may require the Bank to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

**Bank Premises and Equipment**

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the related assets.

## **2. Summary of Accounting Policies (Continued)**

### **Share-Based Compensation**

The Bank has stock option plans in place for employees and directors. The Bank recognizes the cost of employee services received in exchange for an award of stock options based on the grant date fair value of the award. The cost is recognized over the vesting period. The Bank recognized \$17,277 and \$20,056 of stock option compensation expense in the years ended December 31, 2010 and 2009, respectively. There were no tax benefits recorded related to this stock option compensation expense.

### **Mortgage Banking Activities**

The Bank brokers mortgage loans in the Bank's market area to derive commission income. The mortgages are funded by a third party mortgage company. The Bank also originates mortgage loans for sale in the secondary market. The Bank does not service these mortgages after sale. Loans held for sale are carried at the lower of aggregate cost or fair value. Loans held for sale at December 31, 2010 totaled \$517,624 and are included in loans receivable, net on the balance sheet. The Bank had no loans held for sale at December 31, 2009.

### **Advertising**

The Bank follows the policy of charging the costs of advertising to expense as incurred.

### **Transfers of Financial Assets**

Transfers of financial assets, which include loan participation sales, are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

### **Income Taxes**

Deferred income taxes are provided on the liability method whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis and net operating loss carryforwards. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

The Bank follows accounting guidance related to accounting for uncertainty in income taxes, which sets out a consistent framework to determine the appropriate level of tax reserves to maintain for uncertain tax positions. A tax position is recognized as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with a tax examination presumed to occur. The amount recognized is the largest amount of tax benefit that has a more than 50 percent likelihood of being realized upon examination. For tax positions not meeting the more likely than not test, no tax benefit is recorded. The Bank had no material uncertain tax positions or accrued interest and penalties as of December 31, 2010 and 2009. The Bank's policy is to account for interest as a component of interest expense and penalties as component of other expense. The Bank is no longer subject to examination by taxing authorities for the years before January 1, 2007.

**2. Summary of Accounting Policies (Continued)**

**Off-Balance Sheet Financial Instruments**

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit and letters of credit. Such financial instruments are recorded in the balance sheet when they are funded.

**Earnings per Common Share**

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential 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 the Bank relate solely to outstanding stock options, and are determined using the treasury stock method.

**Foreclosed Assets**

Foreclosed assets are comprised of property acquired through a foreclosure proceeding or acceptance of a deed-in-lieu of foreclosure and loans classified as in-substance foreclosure. A loan is classified as in-substance foreclosure when the Bank has taken possession of the collateral regardless of whether formal foreclosure proceedings take place. Foreclosed assets initially are recorded at fair value, net of estimated selling costs, at the date of foreclosure, establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the assets are carried at the lower of cost or fair value minus estimated costs to sell. Revenues and expenses from operations and changes in the valuation allowance are included in other expenses.

**Subsequent Events**

The Bank has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2010 for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through March 4, 2011, the date these financial statements were available to be issued.

### 3. Securities

The amortized cost and fair value of securities as of December 31, 2010 and 2009 are summarized as follows:

	2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available for sale:				
U.S. Government agency securities	\$ 22,967,719	\$ 562,806	\$ (99,638)	\$ 23,430,887
U.S. Government sponsored enterprises – residential mortgage-backed securities	25,718,128	688,122	(57)	26,406,193
Other	25,000	-	-	25,000
	<u>\$ 48,710,847</u>	<u>\$ 1,250,928</u>	<u>\$ (99,695)</u>	<u>\$ 49,862,080</u>
Securities held to maturity:				
U.S. Government sponsored enterprises - residential mortgage-backed securities	\$ 202,185	\$ 18,605	\$ -	\$ 220,791
Obligations of state and political subdivisions	15,223,123	189,912	(285,458)	15,127,576
	<u>\$ 15,425,308</u>	<u>\$ 208,517</u>	<u>\$ (285,458)</u>	<u>\$ 15,348,367</u>
	2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities available for sale:				
U.S. Government agency securities	\$ 23,468,520	\$ 178,117	\$ (74,406)	\$ 23,572,231
U.S. Government sponsored enterprises - residential mortgage-backed securities	30,084,365	274,381	(202,107)	30,156,639
Other	50,000	-	-	50,000
	<u>\$ 53,602,885</u>	<u>\$ 452,498</u>	<u>\$ (276,513)</u>	<u>\$ 53,778,870</u>
Securities held to maturity:				
U.S. Government sponsored enterprises - residential mortgage-backed securities	\$ 249,966	\$ 15,022	\$ -	\$ 264,988
Obligations of state and political subdivisions	7,781,635	201,196	(12,512)	7,970,319
	<u>\$ 8,031,601</u>	<u>\$ 216,218</u>	<u>\$ (12,512)</u>	<u>\$ 8,235,307</u>

**3. Securities (Continued)**

The amortized cost and fair value of securities as of December 31, 2010, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because the borrowers may have the right to prepay obligations with or without any penalties.

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 92,714	\$ 95,409	\$ 1,286,747	\$ 1,289,879
Due after one year through five years	8,361,969	8,577,658	3,440,018	3,438,336
Due after five years through ten years	13,419,907	13,636,835	4,957,200	5,019,968
Due after ten years	1,093,130	1,120,985	5,539,158	5,379,393
	22,967,720	23,430,887	15,223,123	15,127,576
U.S. Government sponsored enterprises - residential mortgage-backed securities	25,718,127	26,406,193	202,185	220,791
Other	25,000	25,000	-	-
	<u>\$ 48,710,847</u>	<u>\$ 49,862,080</u>	<u>\$ 15,425,308</u>	<u>\$ 15,348,367</u>

The following tables show our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2010 and 2009:

	2010					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government agency securities	\$ 3,900,362	\$ (99,638)	\$ -	\$ -	\$ 3,900,362	\$ (99,638)
U.S. Government sponsored enterprises - residential mortgage-backed securities	60,629	(57)	-	-	60,629	(57)
Obligations of state and political subdivisions	7,117,216	(285,458)	-	-	7,117,216	(285,458)
Total temporarily impaired securities	<u>\$ 11,078,207</u>	<u>\$ (385,153)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 11,078,207</u>	<u>\$ (385,153)</u>

**3. Securities (Continued)**

	2009					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government agency securities	\$ 10,979,253	\$ (74,406)	\$ -	\$ -	\$ 10,979,253	\$ (74,406)
U.S. Government sponsored enterprises - residential mortgage-backed securities	13,512,043	(199,270)	412,810	(2,837)	13,924,853	(202,107)
Obligations of state and political subdivisions	396,390	(2,203)	360,353	(10,309)	756,743	(12,512)
Total temporarily impaired securities	<u>\$ 24,887,686</u>	<u>\$ (275,879)</u>	<u>\$ 773,163</u>	<u>\$ (13,146)</u>	<u>\$ 25,660,849</u>	<u>\$ (289,025)</u>

The Bank has 24 and 26 securities at December 31, 2010 and 2009, respectively, in an unrealized loss position. The decline in fair value is due only to interest rate fluctuations. The Bank does not intend to sell these securities prior to their recovery and it is more likely than not that the Bank will not have to sell the securities prior to recovery. No securities are deemed to be other-than-temporarily impaired. None of the individual unrealized losses are significant.

There were no sales of securities in 2010. Gross gains of \$325,263 and gross losses of \$-0- were realized on sales of available for sale securities in 2009.

Securities with a carrying value of \$25,555,867 and \$26,536,699 at December 31, 2010 and 2009, respectively, were pledged to secure securities sold under agreements to repurchase, public deposits and for other purposes required or permitted by law.

**4. Loans Receivable**

The composition of net loans receivable at December 31, 2010 and 2009 is as follows:

	<u>2010</u>	<u>2009</u>
Real estate:		
Commercial	\$ 68,888,483	\$ 83,224,773
Commercial construction	5,375,998	9,211,863
Residential	15,584,319	15,213,763
Residential construction	1,518,585	1,785,336
Home equity loans	4,301,143	5,379,995
	<u>95,668,528</u>	<u>114,815,730</u>
Commercial and industrial	18,799,783	21,370,972
Consumer loans	295,062	443,087
SBA loans	3,147,420	2,102,102
	<u>117,910,793</u>	<u>138,731,891</u>
Unearned net loan fees and origination costs	1,086	(25,082)
Allowance for loan losses	<u>(2,496,440)</u>	<u>(2,056,164)</u>
Net loans	<u>\$ 115,415,439</u>	<u>\$ 136,650,645</u>

**5. Allowance for Loan Losses**

The changes in the allowance for loan losses for the years ended December 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Balance, beginning	\$ 2,056,164	\$ 2,101,461
Provision for loan losses	1,180,000	1,625,000
Charge-offs	(896,667)	(1,696,257)
Recoveries	156,943	25,960
Balance, ending	<u>\$ 2,496,440</u>	<u>\$ 2,056,164</u>

**5. Allowance for Loan Losses (Continued)**

The following table presents the balance in the allowance for loan losses at December 31, 2010 disaggregated on the basis of the Bank's impairment method by class of loans receivable along with the balance of loans receivable by class disaggregated on the basis of the Bank's impairment methodology:

	2010					
	Allowance for Loan Losses			Loans Receivable		
	Balance	Balance Related to Loans Individually Evaluated for Impairment	Balance Related to Loans Collectively Evaluated for Impairment	Balance	Balance Individually Evaluated for Impairment	Balance Collectively Evaluated for Impairment
Commercial	\$ 1,977,501	\$ -	\$ 1,977,501	\$ 96,211,684	\$ 7,817,211	\$ 88,394,473
Residential mortgage	103,520	-	103,520	17,102,904	335,800	16,767,104
Home equity and consumer, other	23,904	-	23,904	4,596,205	-	4,596,205
Unallocated	391,515	-	391,515	-	-	-
	<u>\$ 2,496,440</u>	<u>\$ -</u>	<u>\$ 2,496,440</u>	<u>\$ 117,910,793</u>	<u>\$ 8,153,011</u>	<u>\$ 109,757,782</u>

The following table presents the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Bank's internal risk rating system as of December 31, 2010:

	2010				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	\$ 84,398,698	\$ 2,815,625	\$ 8,550,741	\$ 446,620	\$ 96,211,684
Residential mortgage	16,449,279	-	653,625	-	17,102,904
Home equity and consumer, other	4,592,552	-	3,653	-	4,596,205
	<u>\$ 105,440,529</u>	<u>\$ 2,815,625</u>	<u>\$ 9,208,019</u>	<u>\$ 446,620</u>	<u>\$ 117,910,793</u>

The following table summarizes information in regards to impaired loans by loan portfolio class as of December 31, 2010:

	2010				
	Recorded Investment after Charge- offs	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	\$ 7,817,211	\$ 9,929,392	\$ -	\$ 7,905,056	\$ -
Residential mortgage	335,800	361,301	-	341,100	-
With an allowance recorded:					
Commercial	-	-	-	-	-
Residential mortgage	-	-	-	-	-
Total:					
Commercial	7,817,211	9,929,392	-	7,905,056	-
Residential mortgage	335,800	361,301	-	341,100	-

**5. Allowance for Loan Losses (Continued)**

The following table presents nonaccrual loans by classes of the loan portfolio as of December 31, 2010:

	<u>2010</u>
Commercial	\$ 7,817,211
Residential mortgage	335,800
Home equity and consumer, other	-
	<u>\$ 8,153,011</u>

The performance and credit quality of the loan portfolio is also monitored by the analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the past due status as of December 31, 2010:

	<u>2010</u>						<u>Loans Receivable &gt;90 Days and Accruing</u>
	<u>30-59 Days Past Due</u>	<u>60-89 Days Past Due</u>	<u>Greater Than 90 Days</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans Receivables</u>	
Commercial	\$ 1,978,147	\$ 1,658,309	\$ 7,817,211	\$ 11,453,667	\$ 84,758,017	\$ 96,211,684	\$ -
Residential mortgage	340,758	118,352	335,800	794,910	16,307,994	17,102,904	-
Home equity and consumer, other	230,745	-	-	230,745	4,365,460	4,596,205	-
	<u>\$ 2,549,650</u>	<u>\$ 1,776,661</u>	<u>\$ 8,153,011</u>	<u>\$ 12,479,322</u>	<u>\$ 105,431,471</u>	<u>\$ 117,910,793</u>	<u>\$ -</u>

As of December 31, 2009, the Bank had impaired loans of \$8,763,903. Impaired loans requiring an allowance for loan losses totaled \$3,006,542 at December 31, 2009, with an allowance for loan losses of \$142,537. For the year ended December 31, 2009, the average recorded investment in impaired loans was \$8,250,681. No interest income was recognized for the time that the loans were impaired during 2009.

Loans on which the accrual of interest has been discontinued amounted to \$8,736,903 at December 31, 2009. There were no loan balances past due 90 days or more and still accruing interest at December 31, 2009.

**6. Bank Premises and Equipment**

The components of bank premises and equipment at December 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Building	\$ 4,193,783	\$ 4,172,917
Land and improvements	829,292	829,292
Leasehold improvements	314,000	298,927
Furniture, fixtures and equipment	1,420,910	1,375,991
Computer equipment and data processing software	389,989	368,702
Construction in progress	<u>63,981</u>	<u>86,218</u>
	7,211,955	7,132,047
Accumulated depreciation	<u>(1,834,682)</u>	<u>(1,513,795)</u>
	<u><u>\$ 5,377,273</u></u>	<u><u>\$ 5,618,252</u></u>

**7. Deposits**

The components of deposits at December 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Demand, non-interest bearing	\$ 24,855,897	\$ 21,584,557
Demand, interest bearing	26,891,507	28,344,254
Savings	21,903,147	18,060,890
Time, \$100,000 and over	45,912,984	52,236,808
Time, other	<u>51,092,595</u>	<u>57,919,193</u>
	<u><u>\$ 170,656,130</u></u>	<u><u>\$ 178,145,702</u></u>

At December 31, 2010, the scheduled maturities of time deposits are as follows:

2011	\$ 57,220,848
2012	12,668,839
2013	6,920,149
2014	13,810,898
2015	<u>6,384,845</u>
	<u><u>\$ 97,005,579</u></u>

**8. Borrowings**

Securities sold under agreements to repurchase at December 31, 2010 and 2009 consisted of a \$9,100,000 obligation at 4.60% maturing July 2012. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. Securities sold under these agreements are retained under the Bank's control at its safekeeping agent and had a fair value of \$9,802,256 at December 31, 2010. The Bank may be required to provide additional collateral based on the fair value of the underlying securities. Information concerning securities sold under agreements to repurchase for the years ended December 31, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Balance outstanding at December 31	\$ 9,100,000	\$ 9,100,000
Weighted average interest rate at the end of the year	4.60 %	4.60 %
Average daily balance during the year	\$ 9,100,000	\$ 9,100,000
Weighted average interest rate during the year	4.60 %	4.60 %
Maximum month-end balance during the year	\$ 9,100,000	\$ 9,100,000

Long-term debt at December 31, 2010 and 2009 consists of an \$8,000,000 advance from the Federal Home Loan Bank of New York (FHLB) due in June 2013 with interest at 3.9%. Advances from the FHLB are secured by certain qualifying investments of the Bank.

**9. Lease Commitments and Total Rental Expense**

The Bank leases the premises for three branch locations including a loan office under operating lease agreements expiring in various years through 2013. The Bank is responsible to pay all real estate taxes, insurance, utilities and maintenance and repairs on the buildings. The Bank also has two land leases for two branch locations under operating lease agreements expiring through 2026. The branch buildings for these locations are owned by the Bank.

Future minimum lease payments by year and in the aggregate, under the above lease agreements, are as follows:

2011	\$ 338,077
2012	345,740
2013	307,735
2014	254,947
2015	187,971
Thereafter	<u>1,259,473</u>
	<u>\$ 2,693,943</u>

Rent expense was \$335,077 and \$336,309 for the years ended December 31, 2010 and 2009, respectively.

**10. Employee Benefit Plan**

The Bank adopted a Savings Incentive Match Plan for Employees (SIMPLE) individual retirement plan as of January 1, 2004. Employees may contribute up to the maximum allowable each year and the Bank will match the elective deferral percentage of the employee's salary up to 3%. During 2010 and 2009, employer SIMPLE IRA matching contributions to the Plan charged to operations were \$32,590 and \$10,168, respectively.

### 11. Comprehensive Income

Accounting principles generally accepted in the United States of America require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

The components of other comprehensive income are as follows for the years ended December 31, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Unrealized holding gains on available for sale securities	\$ 975,248	\$ 194,162
Less: Reclassification adjustment for gains included in net income	-	(325,263)
Net unrealized gains (losses)	975,248	(131,101)
Tax effect	(390,099)	52,441
Net of tax amount	<u>\$ 585,149</u>	<u>\$ (78,660)</u>

### 12. Employment Agreement

The Bank has an employment agreement with its chief executive officer which includes minimum annual salary commitments and change of control provisions. Upon resignation after a change in the control of the Bank, as defined in the agreement, the individual will receive monetary compensation in the amount set forth in the agreement.

### 13. Stock Option Plans

Under the Bank's 1998 Non-Qualified Stock Option Plan for certain employees, officers and directors of the Bank, stock options are granted at the discretion of the Board of Directors. The exercise price of options granted to employees and officers cannot be less than 85% of the fair market value of the common shares at the date of grant. The exercise price of options granted to directors cannot be less than the fair market value of the common shares at the date of grant. A maximum of 46,594 shares of common stock are allotted to the Plan. Stock options granted under the Plan expire in ten years. As of December 31, 2010, shares available under the Plan totaled 14,334 shares.

The Bank also adopted the 2000 Non-Qualified Stock Option Plan for certain employees, officers and directors of the Bank and the 2000 Incentive Stock Option Plan for certain employees and officers of the Bank. Under the Plans, stock options are granted at the discretion of the Board of Directors. Each of the Plans is allotted 46,605 shares of the Bank's common stock. Under the 2000 Non-Qualified Stock Option Plan, the exercise price of options granted to employees and officers cannot be less than 85% of the fair market value of the common shares at the date of grant and options granted to directors cannot be less than the fair market value of the common shares. Under the 2000 Incentive Stock Option Plan, the exercise price of options granted to employees and officers cannot be less than the fair market value of the common shares at the date of grant. Stock options granted under the Plans expire in ten years. As of December 31, 2010, shares available under these Plans totaled 8,553.

**13. Stock Option Plans (Continued)**

Effective May 1, 2004, the Bank adopted the 2004 Non-Qualified Stock Option Plan for certain employees, officers and directors of the Bank and the 2004 Incentive Stock Option Plan for certain employees and officers of the Bank. Under the Plans, stock options are granted at the discretion of the Board of Directors. The 2004 Non-Qualified Stock Option Plan was allotted 33,720 shares and the 2004 Incentive Stock Option Plan was allotted 74,947 shares, respectively, of the Bank's common stock. Under the 2004 Non-Qualified Stock Option Plan, the exercise price of options granted to employees and officers cannot be less than 85% of the fair market value of the common shares at the date of grant and options granted to directors cannot be less than the fair market value of the common shares. Under the 2004 Incentive Stock Option Plan, the exercise price of options granted to employees and officers cannot be less than the fair market value of the common shares at the date of grant. Stock options granted under the Plans expire in ten years. As of December 31, 2010, shares available under the 2004 Non-Qualified Stock Option Plan and the 2004 Incentive Stock Option Plan totaled 3,162.

The following summarizes changes in stock options outstanding under the plans discussed above for the years ended December 31, 2010 and 2009. Stock option activity has been adjusted for the stock dividends issued in 2009.

	<u>Number of Options</u>	<u>Weighted Average Exercise Price</u>
Outstanding, December 31, 2008	119,236	\$ 9.63
Granted	50,000	3.23
Forfeited	<u>(46,692)</u>	<u>9.54</u>
Outstanding at December 31, 2009	122,544	7.05
Granted	7198	6.58
Exercised	(3,104)	3.79
Forfeited	<u>(7,198)</u>	<u>6.58</u>
Outstanding at December 31, 2010	<u>119,440</u>	<u>\$ 7.14</u>
Exercisable at December 31, 2010	<u>72,242</u>	<u>\$ 9.36</u>

The weighted-average remaining contractual life of the above options is approximately 5.3 years. Stock options outstanding at December 31, 2010 are exercisable at prices ranging from \$3.00 to \$16.25 per share. The total intrinsic value of options exercised during the year ended December 31, 2010 was \$-0-. At December 31, 2010, the aggregate intrinsic value of options outstanding and exercisable was \$181,000 and \$70,000, respectively.

The fair value of each option grant is estimated on the date of grant using the Black Scholes option-pricing model with the following weighted average assumption for grants in 2010; dividend yield of 0%, risk-free interest rate of 3.42%, expected life of 7 years, and expected volatility of 49.5%. The fair value of each option grant is estimated on the date of grant using the Black Scholes option-pricing model with the following weighted average assumption for grants in 2009: dividend yield of 0.00%, risk-free interest rate of 1.92%, expected life of 7 years, and expected volatility of 46.5%. The weighted average fair value of options granted in 2010 and 2009 was \$1.48 and \$1.49 per share, respectively.

**13. Stock Option Plans (Continued)**

Total stock based compensation cost for the years ended December 31, 2010 and 2009 related to stock options granted was \$17,277 and \$20,056, respectively. There were no tax benefits recognized in 2010 and 2009 related to the stock compensation expense.

As of December 31, 2010, there was \$53,000 of unrecognized compensation cost related to nonvested stock options granted. That cost is expected to be recognized over a weighted average period of 3 years.

**14. Earnings Per Share**

The following table sets forth the computations of basic and diluted earnings per share for the years ended December 31, 2010 and 2009, as adjusted for the stock dividend granted in 2009:

	<u>2010</u>	<u>2009</u>
Numerator, net income	<u>\$ 674,910</u>	<u>\$ 115,786</u>
Denominator:		
Denominator for basic earnings per share, weighted average shares	1,701,385	1,700,348
Effect of dilutive securities, stock options	<u>15,386</u>	<u>5,615</u>
Denominator for diluted earnings per share, weighted average shares and assumed conversions	<u>1,716,771</u>	<u>1,705,963</u>
Basic earnings per share	<u>\$ 0.40</u>	<u>\$ 0.07</u>
Diluted earnings per share	<u>\$ 0.39</u>	<u>\$ 0.07</u>

**15. Income Taxes**

The components of income tax expense (benefit) for the years ended December 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Federal:		
Current	\$ 190,060	\$ 51,395
Deferred	<u>(39,728)</u>	<u>(149,630)</u>
	150,332	(98,235)
State:		
Current	98,078	45,992
Deferred	<u>(14,279)</u>	<u>(41,862)</u>
	83,799	4,130
	<u>\$ 234,131</u>	<u>\$ (94,105)</u>

**15. Income Taxes (Continued)**

The components of the net deferred tax asset at December 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Deferred tax assets:		
Allowance for loan losses	\$ 997,079	\$ 821,232
OREO valuation reserve	17,409	70,049
Nonaccrual loan interest	75,543	93,105
Contribution carryforward	-	1,363
Other	-	9,784
	<u>1,090,031</u>	<u>995,533</u>
Deferred tax liabilities:		
Unrealized gain on securities available for sale	(460,493)	(70,394)
Premises and equipment	(125,611)	(90,645)
Prepaid expense deductions	(21,060)	(15,535)
	<u>(607,164)</u>	<u>(176,574)</u>
Net deferred tax asset	<u>\$ 482,867</u>	<u>\$ 818,959</u>

A reconciliation of the statutory income tax at a rate of 34% to the income tax expense included in the statements of income is as follows for the years ended December 31, 2010 and 2009:

	<u>2010</u>		<u>2009</u>	
	<u>Amount</u>	<u>% of Pre-Tax Income</u>	<u>Amount</u>	<u>% of Pre-Tax Income</u>
Federal income tax at statutory rate	\$ 309,074	34 %	\$ 7,372	34 %
Tax-exempt interest	(137,752)	(15)	(105,570)	(487)
State tax expense, net of federal benefit	55,307	6	2,725	13
Other	7,502	1	1,368	6
	<u>\$ 234,131</u>	<u>26 %</u>	<u>\$ (94,105)</u>	<u>(434) %</u>

**16. Transactions with Executive Officers, Directors and Principal Stockholders**

The Bank has had, and may be expected to have in the future, banking transactions in the ordinary course of business with its executive officers, directors, principal stockholders, their immediate families and affiliated companies (commonly referred to as related parties), on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. Loans to related parties at December 31, 2010 were \$5,122,572. Advances and repayments during 2010 totaled \$50,000 and \$694,620, respectively. Loans to related parties at December 31, 2009 were \$5,767,192.

**17. Financial Instruments with Off-Balance Sheet Risk**

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

A summary of the Bank's financial instrument commitments at December 31, 2010 and 2009 is as follows:

	<b>Contract Amount</b>	
	<b>2010</b>	<b>2009</b>
Commitments to grant loans	\$ 300,000	\$ 3,100,000
Unfunded commitments under lines of credit	8,437,000	12,137,218
Commercial and standby letters of credit	2,407,000	3,820,000
	<u>\$ 11,144,000</u>	<u>\$ 19,057,218</u>

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. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include personal or commercial real estate, accounts receivable, inventory and equipment.

Outstanding letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The majority of these standby letters of credit expire within the next twelve months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Bank requires collateral supporting these letters of credit as deemed necessary. The maximum undiscounted exposure related to these commitments at December 31, 2010 and 2009 was \$2,407,000 and \$3,820,000, respectively. The current amount of the liability as of December 31, 2010 and 2009 for guarantees under standby letters of credit issued is not material.

**18. Contingencies**

There are no material legal proceedings to which the Bank is party to except proceedings which arise in the normal course of business and, in the opinion of management, will not have any material effect on the consolidated financial position of the Bank.

**19. Regulatory Matters**

The Bank is required to maintain cash reserve balances in vault cash or with the Federal Reserve Bank. The total of these reserve balances at December 31, 2010 was approximately \$1,083,000.

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet the 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 Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. 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 Bank to maintain minimum amounts and ratios (set forth below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets and of Tier 1 capital to average assets. Management believes, as of December 31, 2010, that the Bank meets all capital adequacy requirements to which it is subject.

At December 31, 2010, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Bank's actual capital ratios at December 31, 2010 and 2009 and the minimum ratios required for capital adequacy purposes and to be well capitalized under the prompt corrective action provisions are as follows:

	2010					
	Actual		For Capital Adequacy Purposes		To be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollar Amounts in Thousands)					
Total capital (to risk-weighted assets)	\$ 20,392	16.42 %	\$ ≥ 9,938	≥ 8.0 %	\$ ≥ 12,422	≥ 10.0 %
Tier 1 capital (to risk-weighted assets)	18,822	15.15	≥ 4,969	≥ 4.0	≥ 7,453	≥ 6.0
Tier 1 capital (to average assets)	18,822	8.80	≥ 8,553	≥ 4.0	≥ 10,692	≥ 5.0
	2009					
Total capital (to risk-weighted assets)	\$ 19,972	13.49 %	\$ ≥ 11,844	≥ 8.0 %	\$ ≥ 14,805	≥ 10.0 %
Tier 1 capital (to risk-weighted assets)	18,119	12.24	≥ 5,922	≥ 4.0	≥ 8,883	≥ 6.0
Tier 1 capital (to average assets)	18,119	8.24	≥ 8,799	≥ 4.0	≥ 10,999	≥ 5.0

The Bank is subject to certain regulatory restrictions on the amount of dividends that it may declare without prior regulatory approval.

## 20. Fair Value Measurements and Disclosures

### Determination of Fair Value

The Bank uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of a financial instrument 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 many instances, there are no quoted market prices for the Bank's various financial instruments. 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 instrument.

Fair value guidance provides a consistent definition of fair value, which focuses on exit price 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. The fair value is determined at a reasonable point within the range that is most representative of fair value under current market conditions.

### Fair Value Hierarchy

In accordance with this guidance, the Bank groups its assets and liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

*Level 1* - Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

*Level 2* - Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

*Level 3* - Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.



**20. Fair Value Measurements and Disclosures (Continued)**

For non-financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2010 and 2009 are as follows:

	2010			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Other real estate owned	\$ 1,084,684	\$ -	\$ -	\$ 1,084,684
	2009			
Other real estate owned	\$ 1,229,907	\$ -	\$ -	\$ 1,229,907

Real estate properties acquired through, or in lieu of, foreclosure are to be sold and are carried at fair value less estimated cost to sell. Fair value is based upon independent market prices or appraised value of the property. These assets are included in Level 3 fair value based upon the lowest level of input that is significant to the fair value measurement.

Below is management's estimate of the fair value of all financial instruments, whether carried at cost or fair value on the Bank's balance sheet.

The following information should not be interpreted as an estimate of the fair value of the entire Bank since a fair value calculation is only provided for a limited portion of the Bank's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Bank's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair value of the Bank's financial instruments:

**Cash and Cash Equivalents (Carried at Cost)**

The carrying amounts reported in the balance sheet for cash and short-term instruments approximate those assets' fair values.

**Securities**

The fair value of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices.

**Loans Receivable (Carried at Cost)**

The fair values of loans are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair value of loans held for sale is based on secondary market prices.

**20. Fair Values of Financial Instruments (Continued)**

**Impaired Loans (Generally Carried at Fair Value)**

Impaired loans are those in which the Bank has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

**Federal Home Loan Bank Stock (Carried at Cost)**

The carrying amount of restricted investment in bank stock approximates fair value, and considers the limited marketability of such securities.

**Accrued Interest Receivable and Payable (Carried at Cost)**

The carrying amount of accrued interest receivable and accrued interest payable approximates its fair value.

**Deposit Liabilities (Carried at Cost)**

The fair values disclosed for demand deposits (e.g., interest and noninterest checking, passbook savings and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

**Securities Sold Under Agreements to Repurchase and Long-Term Debt (Carried at Cost)**

Fair values of these borrowings are estimated using discounted cash flow analysis, based on quoted prices for new advances with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

**Off-Balance Sheet Financial Instruments (Disclosed at Cost)**

Fair values for the Bank's off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties' credit standing. The fair value of these instruments was not material at December 31, 2010 and 2009.

**20. Fair Values of Financial Instruments (Continued)**

The estimated fair values of the Bank's financial instruments at December 31, 2010 and 2009 were as follows:

	2010		2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
(In Thousands)				
Financial assets:				
Cash and cash equivalents	\$ 18,340	\$ 18,340	\$ 5,924	\$ 5,924
Securities available for sale	49,862	49,862	53,779	53,779
Securities held to maturity	15,425	15,348	8,032	8,235
Federal Home Loan stock, at cost	645	645	636	636
Loans receivable, net	115,415	117,186	136,651	137,379
Accrued interest receivable	952	952	992	992
Financial liabilities:				
Deposits	170,656	172,210	178,146	178,498
Securities sold under agreements to repurchase	9,100	9,267	9,100	9,570
Long-term debt	8,000	8,243	8,000	8,333
Accrued interest payable	316	316	348	348
Off-balance sheet financial instruments:				
Commitments to extend credit	-	-	-	-
Standby letters of credit	-	-	-	-



## Independent Auditors' Report

Board of Directors  
Shore Community Bank  
Toms River, New Jersey

We have audited the accompanying balance sheets of Shore Community Bank as of December 31, 2010 and 2009, and the related statements of income, stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Shore Community Bank as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

*ParenteBeard LLC*

Allentown, Pennsylvania  
March 4, 2011



## Corporate Information

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### Headquarters

Shore Community Bank  
1012 Hooper Avenue  
Toms River, NJ 08753  
732-240-5800  
[www.shorecommunitybank.com](http://www.shorecommunitybank.com)

### Annual Stockholder's Meeting

The Annual Stockholder's Meeting will be held Wednesday, April 20, 2011 at 9:00 a.m. at the Toms River Country Club, 419 Washington Street, Toms River, NJ.

### Shareholder Information

Shareholders seeking information should contact Barbara Cantamessa, Assistant Corporate Secretary at 732-240-5800.

For assistance with stock records, please contact Registrar & Transfer Co. at 1-800-368-5948.

### Annual Report and Other Reports

Additional copies of the Annual Report and Annual Disclosure Statement are available without charge by written request or email: [bcantamessa@shorecommunitybank.com](mailto:bcantamessa@shorecommunitybank.com)

Shore Community Bank  
Barbara Cantamessa  
Assistant Corporate Secretary  
1012 Hooper Avenue  
Toms River, NJ 08753

### Market Information

Stock symbol: SHRC  
Shares of the Bank's common stock are listed on the Over the Counter Bulletin Board.

### Independent Auditors

ParenteBeard LLC  
One Windsor Plaza  
7535 Windsor Drive, Suite 300  
Allentown, PA 18195-1014  
610-336-8180

### Counsel

Gary L. Green, Esq.  
Archer & Greiner  
A Professional Corporation  
One Centennial Square  
P.O. Box 3000  
Haddonfield, NJ 08033  
856-795-2121

### Transfer and Dividend Paying Agent/Registrar

Registrar & Transfer Company  
10 Commerce Drive  
Cranford, New Jersey 07016-3572  
1-800-368-5948

### Market Makers

Knight Equity Markets, L.P.  
212-336-8672

Monroe Securities, Inc.  
800-766-5560



*Nobody knows the Shore like us.*

[www.shorecommunitybank.com](http://www.shorecommunitybank.com)

## Branch Locations:

1012 Hooper Avenue  
Toms River, New Jersey 08753  
732-240-5800 • Fax: 732-557-0669

1216 Route 37 East  
Toms River, New Jersey 08753  
732-573-1300 • Fax: 732-573-1313

201 Main Street  
Toms River, New Jersey 08753  
732-286-0811 • Fax: 732-286-0904

1801 Route 35 North  
Ortley, New Jersey 08751  
732-854-0600 • Fax: 732-854-1602

1130 East Veterans Hwy.  
Jackson, New Jersey 08527  
732-942-2970 • Fax: 732-942-8105

280 Route 72 East  
Manahawkin, New Jersey 08050  
609-978-9555 • Fax: 609-978-9557

## Commercial & SBA Loan Division:

1012 Hooper Avenue  
Toms River, New Jersey 08753  
732-240-5800 • Fax: 732-240-6047

## Residential Mortgage Division:

1216 Route 37 East  
Toms River, New Jersey 08753  
732-573-1136 • Fax: 732-573-1120

[www.shorecommunitybank.com](http://www.shorecommunitybank.com)

