First Federal of Northern Michigan Bancorp, Inc.
Form 10-Q
November 09, 2011

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

FORM 10-Q

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

OR

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

For the transition period from to

Commission File Number 000-31957

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

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes x No¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

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

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

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

Common Stock, Par Value $0.01	Outstanding at November 9, 2011
(Title of Class)	2,884,049 shares

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

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

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

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

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

	September 30, 2011 (Unaudited)	December 31, 2010
ASSETS		
Cash and cash equivalents:		
Cash on hand and due from banks	$ 8,049,998	$ 1,889,999
Overnight deposits with FHLB	49,255	72,658
Total cash and cash equivalents	8,099,253	1,962,657
Securities AFS	50,088,379	35,301,238
Securities HTM	2,485,000	2,520,000
Loans held for sale	616,748	-
Loans receivable, net of allowance for loan losses of $1,654,364 and $2,831,332 as of September 30, 2011 and December 31, 2010, respectively	141,296,254	157,143,918
Foreclosed real estate and other repossessed assets	4,459,351	2,818,343
Federal Home Loan Bank stock, at cost	3,266,100	3,775,400
Premises and equipment	5,931,999	6,026,793
Accrued interest receivable	1,170,671	1,230,938
Intangible assets	407,968	627,306
Prepaid FDIC premiums	802,780	967,143
Deferred tax asset	330,386	659,194
Other assets	2,840,209	2,700,034
Total assets	$ 221,795,098	$ 215,732,964
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits	$ 152,814,940	$ 155,465,896
Advances from borrowers for taxes and insurance	221,753	130,030
Federal Home Loan Bank Advances	33,000,000	29,000,000
REPO Sweep Accounts	9,417,231	6,172,362
Accrued expenses and other liabilities	1,756,116	1,728,735
Total liabilities	197,210,040	192,497,023
Stockholders' equity:		
Common stock ($0.01 par value 20,000,000 shares authorized 3,191,799 shares issued)	31,918	31,918
Additional paid-in capital	23,852,021	23,822,152
Retained earnings	2,896,221	2,238,064
Treasury stock at cost (307,750 shares)	(2,963,918)	(2,963,918)
Unearned compensation	(556)	(38,382)
Accumulated other comprehensive income	769,372	146,107
Total stockholders' equity	24,585,058	23,235,941

Total liabilities and stockholders' equity	$ 221,795,098	$ 215,732,964

See accompanying notes to consolidated financial statements.

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

	For the Three Months Ended September 30, 2011	2010	For the Nine Months Ended September 30, 2011	2010
	(Unaudited)		(Unaudited)	
Interest income:				
Interest and fees on loans	$ 2,196,300	$ 2,590,033	$ 6,786,817	$ 7,683,432
Interest and dividends on investments				
Taxable	151,190	107,003	380,407	346,409
Tax-exempt	39,735	40,738	120,074	152,005
Interest on mortgage-backed securities	200,442	168,757	583,510	490,603
Total interest income	2,587,667	2,906,531	7,870,808	8,672,449
Interest expense:				
Interest on deposits	381,124	560,106	1,226,252	1,799,663
Interest on borrowings	183,030	291,228	523,785	908,467
Total interest expense	564,154	851,334	1,750,037	2,708,130
Net interest income	2,023,513	2,055,197	6,120,771	5,964,319
Provision for loan losses	(67,079)	352,711	(18,959)	958,639
Net interest income after provision for loan losses	2,090,592	1,702,486	6,139,730	5,005,680
Non-interest income:				
Service charges and other fees	197,267	206,024	542,986	609,538
Mortgage banking activities	218,671	447,319	637,116	1,010,634
Gain on sale of investments	-	-	-	496,817
Net gain (loss) on sale of premises and equipment,	(802)	-	(544)	9,423
Net gain (loss) on sale real estate owned and other repossessed assets	(7,680)	(1,147)	(54,368)	43,298
Other	61,846	65,267	186,447	391,603
Total non-interest income	469,302	717,463	1,311,637	2,561,312
Non-interest expense:				
Compensation and employee benefits	1,128,911	1,203,326	3,457,099	3,568,567
FDIC Insurance Premiums	54,061	88,820	176,448	277,368
Advertising	30,924	42,320	87,763	98,312
Occupancy	264,703	277,658	802,398	878,471
Amortization of intangible assets	73,113	73,113	219,338	219,338
Service bureau charges	69,383	71,230	224,881	236,926
Professional services	108,471	79,008	329,619	331,210
Other	595,593	512,725	1,495,664	1,363,511
Total non-interest expense	2,325,161	2,348,200	6,793,210	6,973,703
Income before income tax expense	234,733	71,750	658,157	593,289

Income tax expense		-		-		-		-
Net Income	$	234,733	$	71,750	$	658,157	$	593,289
Per share data:							$	-
Net income per share								
Basic	$	0.08	$	0.02	$	0.23	$	0.21
Diluted	$	0.08	$	0.02	$	0.23	$	0.21
Weighted average number of shares outstanding								
Basic and diluted		2,884,049		2,884,249		2,884,049		2,884,049
Dividends per common share	$	-	$	-	$	-	$	-

See accompanying notes to consolidated financial statements.

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

	Common Stock	Treasury Stock	Additional Paid-in Capital	Unearned Compensation	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance at December 31, 2010	$ 31,918	$ (2,963,918)	$ 23,822,152	$ (38,382)	$ 2,238,064	$ 146,107	$ 23,235,941
Treasury Stock at Cost	-	-	-	-	-	-	-
Stock-based compensation	-	-	29,869	37,826	-	-	67,695
Net income for the period	-	-	-	-	658,157	-	658,157
Change in unrealized gain: on available-for-sale securities (net of tax of $321,076)	-	-	-	-	-	623,265	623,265
Total comprehensive income	-	-	-	-	-	-	1,281,422
Balance at September 30, 2011	$ 31,918	$ (2,963,918)	$ 23,852,021	$ (556)	$ 2,896,221	$ 769,372	$ 24,585,058

See accompanying notes to the consolidated financial statements.

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

	For Nine Months Ended September 30, 2011	2010
	(Unaudited)	
Cash Flows from Operating Activities:		
Net income	$658,157	$593,289
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	525,446	608,538
Provision for loan loss	(18,959)	958,639
Amortization and accretion on securities	209,583	93,265
Gain on sale of investment securities	-	(496,817)
Stock-based compensation	67,695	166,055
Gain on sale of loans held for sale	(255,770)	(436,243)
Originations of loans held for sale	(18,479,727)	(30,128,868)
Proceeds from sale of loans held for sale	18,118,749	29,784,734
Loss (Gain) on sale of fixed assets	544	(9,423)
Loss (Gain) on sale of real estate owned and other repossessed assets	54,368	(43,298)
Net change in:		
Accrued interest receivable	60,267	17,156
Other assets	(461,249)	(1,108,485)
Prepaid FDIC insurance premiums	164,363	263,703
Deferred income tax expense	328,808	66,336
Accrued expenses and other liabilities	27,381	(384,078)
Net cash provided by (used in) operating activities	999,656	(55,497)
Cash Flows from Investing Activities:		
Net decrease in loans (loans originated, net of principal payments)	12,853,481	8,576,460
Proceeds from maturity and sale of available-for-sale securities	9,390,032	22,347,073
Proceeds from sale of property and equipment	1,780	30,874
Proceeds from sale of real estate and other repossessed assets	1,317,766	1,026,224
Purchase of securities	(23,407,417)	(21,553,359)
Purchase of premises and equipment	(213,638)	(12,160)
Proceeds from redemption of Federal Home Loan Bank Stock	509,300	-
Net cash provided by investing activities	451,304	10,415,112
Cash Flows from Financing Activities:		
Net decrease in deposits	(2,650,956)	(1,548,973)
Net increase in Repo Sweep accounts	3,244,869	979,108
Net increase in advances from borrowers	91,723	101,808
Advances from Federal Home Loan Bank and notes payable	8,350,000	12,925,000
Repayments of Federal Home Loan Bank advances and notes payable	(4,350,000)	(20,955,927)
Net cash provided by (used in) financing activities	4,685,636	(8,498,984)
Net increase in cash and cash equivalents	6,136,596	1,860,631
Cash and cash equivalents at beginning of period	1,962,657	3,099,058
Cash and cash equivalents at end of period	$8,099,253	$4,959,689

Supplemental disclosure of cash flow information:		
Cash paid during the period for		
Interest	$1,783,848	$2,796,474
Income taxes	-	-
Transfers of loans to foreclosed real estate and repossessed assets	3,013,142	1,257,767

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FIRST FEDERAL OF NORTHERN MICHIGAN BANCORP, INC.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1—BASIS OF FINANCIAL STATEMENT PRESENTATION

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

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

Note 2— PRINCIPLES OF CONSOLIDATION

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

Note 3—SECURITIES

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

	September 30, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
	(in thousands)			
Securities Available for Sale				
U.S. Government and agency obligations	$ 11,777	$ 139	$ -	11,916
Municipal obligations	6,935	413	-	7,348
Mortgage-backed securities	30,208	646	(31)	30,823
Equity securities	2	-	(1)	1

Total	$	48,922	$	1,198	$	(32	)	$	50,088
Securities Held to Maturity									
Municipal obligations	$	2,485	$	203	$	-		$	2,688

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

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

	September 30, 2011	
	Amortized Cost	Market Value
	(in thousands)	
Available For Sale:		
Due in one year or less	$ 1,972	$ 1,993
Due after one year through five years	9,806	10,013
Due in five year through ten years	6,531	6,770
Due after ten years	403	488
Subtotal	18,712	19,264
Equity securities	2	1
Mortgage-backed securities	30,208	30,823
Total	$ 48,922	$ 50,088
Held To Maturity:		
Due in one year or less	$ 90	$ 91
Due after one year through five years	395	425
Due in five year through ten years	645	707
Due after ten years	1,355	1,465
Total	$ 2,485	$ 2,688

At September 30, 2011 and December 31, 2010, securities with a carrying value and fair value of $33,126,000 and $34,336,000, respectively, were pledged to secure certain deposit accounts, FHLB advances and our line of credit at the Federal Reserve.

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

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

	September 30, 2011			
	Fair Value	Gross Unrealized Losses <12 months	Fair Value	Gross Unrealized Losses > 12 months
	(in thousands)			
Available For Sale:				
U.S. Government and agency obligations	$ -	$ -	$ -	$ -
Municipal obligations	-	-	-	-
Mortgage-backed securities	4,274	(31)	-	-
Equity securities	-	-	2	(1)
Total	$ 4,274	$ (31)	$ 2	$ (1)
Held to Maturity:				
Municipal obligations	$ -	$ -	$ -	$ -

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

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

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Note 4—LOANS

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

	At September 30, 2011	At December 31, 2010
	(in thousands)	
Real estate loans:		
Residential mortgage	$ 65,582	$ 71,697
Commercial loans:		
Secured by real estate	54,695	61,010
Other	7,380	8,848
Total commercial loans	62,075	69,858
Consumer loans:		
Secured by real estate	14,147	16,547
Other	1,410	2,118
Total consumer loans	15,557	18,665
Total gross loans	$ 143,214	$ 160,220
Less:		
Net deferred loan fees	(264)	(245)
Allowance for loan losses	(1,654)	(2,831)
Total loans, net	$ 141,296	$ 157,144

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

As of September 30, 2011

	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
Commercial Real Estate:							
Commercial Real Estate - construction	$ -	$ -	$ 173	$ 173	$ 88	$ 261	$ -
Commercial Real Estate - other	59	1	251	311	54,123	54,434	-
Commercial - non real estate	11	-	-	11	7,369	7,380	-

Consumer:							
Consumer - Real Estate	454	16	68	538	13,609	14,147	-
Consumer - Other	20	1	6	27	1,383	1,410	5
Residential:							
Residential	2,627	1,541	2,261	6,429	59,153	65,582	259
Total	$ 3,171	$ 1,559	$ 2,759	$7,489	$135,725	$ 143,214	$ 264

As of December 31, 2010

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

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

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

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

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

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

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

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

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

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

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

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

As of September 30, 2011

Loan Grade	Commercial Real Estate Construction	Commercial Real Estate Other	Commercial
1-2	$ -	$ -	$ 21
3	88	10,787	2,378
4	-	30,969	4,676
5	-	4,366	-
6	173	8,312	305
7	-	-	-
8	-	-	-
Total	$ 261	$ 54,434	$ 7,380

As of December 31, 2010

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

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

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

As of September 30, 2011	Residential	As of December 31, 2010	Residential
Grade		Grade	
Pass	$ 62,697	Pass	$ 68,301
Special Mention	-	Special Mention	-
Substandard	2,885	Substandard	3,396
Total	$ 65,582	Total	$ 71,697

As of September 30, 2011

	Consumer - Real Estate	Consumer - Other
Performing	$ 14,057	$ 1,400
Nonperforming	90	10
Total	$ 14,147	$ 1,410

As of December 31, 2010

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

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

	As of September 30, 2011
Commercial Real Estate:	
Commercial Real Estate - construction	$ 173
Commercial Real Estate - other	251
Commercial	-
Consumer:	
Consumer - real estate	90
Consumer - other	5
Residential:	
Residential	2,625
Total	$ 3,144

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

Residential:		
Residential		3,114
Total	$	6,240

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

The Bank has classified approximately $1,407,000 of its impaired loans as troubled debt restructurings as of September 30, 2011, as noted in the table below:

As of September 30, 2011

	Number of Contracts	Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Commercial Real Estate - Construction	-	-	-
Commercial Real Estate - Other	3	1,488	1,407
Commercial - non real estate	-	-	-
Residential	-	-	-

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

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

The Bank uses the following guidelines, as stated in policy, to determine when to realize a charge-off, whether a partial or full loan balance. A charge down in whole or in part is realized when unsecured consumer loans, credit card credits and ov