First Federal of Northern Michigan Bancorp, Inc.
Form 10-Q
November 16, 2009

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, 2009

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 ¨ 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 16, 2009
(Title of Class)	2,884,249 shares

FIRST FEDERAL OF NORTHERN MICHIGAN BANCORP, INC.
FORM 10-Q
Quarter Ended September 30, 2009

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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, 2009 (Unaudited)	December 31, 2008
ASSETS		
Cash and cash equivalents:		
Cash on hand and due from banks	$ 2,212,553	$ 3,097,788
Overnight deposits with FHLB	64,036	372,523
Total cash and cash equivalents	2,276,589	3,470,311
Securities AFS	32,879,094	25,665,178
Securities HTM	3,980,434	4,022,235
Loans held for sale	50,000	107,000
Loans receivable, net of allowance for loan losses of $4,309,341 and $5,647,055 as of September 30, 2009 and December 31, 2008, respectively	178,737,529	192,270,714
Foreclosed real estate and other repossessed assets	3,535,684	1,637,923
Federal Home Loan Bank stock, at cost	4,196,900	4,196,900
Premises and equipment	6,779,358	7,089,746
Accrued interest receivable	1,368,598	1,469,176
Intangible assets	992,869	1,192,853
Other assets	4,613,876	4,939,523
Assets of discontinued operation	-	1,610,734
Total assets	$ 239,410,931	$ 247,672,293
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits	$ 156,358,009	$ 165,778,598
Advances from borrowers for taxes and insurance	188,965	104,475
Federal Home Loan Bank Advances	46,750,000	40,200,000
Note Payable	630,927	768,651
REPO sweep accounts	6,872,443	9,447,415
Accrued expenses and other liabilities	2,651,190	1,877,600
Liabilities of discontinued operations	-	76,792
Total liabilities	213,451,534	218,253,531
Stockholders' equity:		
Common stock ($0.01 par value 20,000,000 shares authorized 3,191,999 shares issued)	31,920	31,920
Additional paid-in capital	24,299,147	24,302,102
Retained earnings	5,087,238	8,762,412
Treasury stock at cost (307,750 shares)	(2,963,918)	(2,963,918)
Unallocated ESOP	(683,861)	(764,861)

Unearned compensation		(192,839)		(286,324)
Accumulated other comprehensive income		381,710		337,431
Total stockholders' equity		25,959,397		29,418,762
Total liabilities and stockholders' equity	$	239,410,931	$	247,672,293

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,		For the Nine Months Ended September 30,	
	2009	2008	2009	2008
	(Unaudited)		(Unaudited)	
Interest income:				
Interest and fees on loans	$ 2,762,789	$ 3,156,924	$ 8,570,404	$ 9,575,347
Interest and dividends on investments	211,720	248,386	584,788	764,630
Interest on mortgage-backed securities	136,177	119,501	430,928	265,793
Total interest income	3,110,686	3,524,810	9,586,120	10,605,770
Interest expense:				
Interest on deposits	795,356	1,275,690	2,736,532	3,811,954
Interest on borrowings	422,715	532,247	1,279,247	1,653,578
Total interest expense	1,218,071	1,807,937	4,015,779	5,465,532
Net interest income	1,892,615	1,716,873	5,570,341	5,140,238
Provision for loan losses	2,976,642	875,431	3,492,711	1,242,665
Net interest (expense) income after provision for loan losses	(1,084,027)	841,442	2,077,630	3,897,573
Non-interest income:				
Service charges and other fees	217,159	245,162	661,488	708,447
Mortgage banking activities	244,550	85,665	1,167,626	316,382
Gain on sale of available-for-sale investments	-	-	1,227	16,052
Net gain (loss) on sale of premises and equipment, real estate owned and other repossessed assets	(2,128)	5,403	25,350	28,497
Other	16,637	18,076	67,997	66,108
Insurance & brokerage commissions	15,157	45,000	129,797	135,000
Total non-interest income	491,375	399,307	2,053,486	1,270,486
Non-interest expenses:				
Compensation and employee benefits	1,095,509	1,203,733	3,414,767	3,654,827
FDIC insurance premiums	106,199	33,443	376,807	85,238
Advertising	31,784	40,118	93,655	98,914
Occupancy	294,567	299,616	897,054	950,952
Amortization of intangible assets	73,113	77,122	199,983	231,367
Service bureau charges	76,533	72,432	255,043	240,518
Professional services	93,588	112,057	359,711	309,231
Other	305,341	319,303	962,826	889,820
Total non-interest expenses	2,076,634	2,157,824	6,559,846	6,460,867
Loss from continuing operations before income tax benefit	(2,669,286)	(917,075)	(2,428,731)	(1,292,808)
Income tax expense (benefit) from continuing operations	1,148,845	(307,073)	1,200,585	(432,643)
Net loss from continuing operations	(3,818,131)	(610,002)	(3,629,316)	(860,165)
	-	(24,733)	(83,875)	(57,215)

Loss from discontinued operations, net of income tax benefit of $0, $12,741, $43,209, and $29,745, respectively				
Gain on sale of discontinued operations, net of income tax expense of $0, $0, $19,585 and $0, respectively	-	-	38,017	-
Net loss	$ (3,818,131)	$ (634,735)	$ (3,675,174)	$ (917,380)
Per share data:				
Loss per share from continuing operations				
Basic	$ (1.32)	$ (0.21)	$ (1.26)	$ (0.30)
Diluted	$ (1.32)	$ (0.21)	$ (1.26)	$ (0.30)
Income (loss) per share from discontinued operations				
Basic	$ -	$ (0.01)	$ (0.01)	$ (0.02)
Diluted	$ -	$ (0.01)	$ (0.01)	$ (0.02)
Net loss per share				
Basic	$ (1.32)	$ (0.22)	$ (1.27)	$ (0.32)
Diluted	$ (1.32)	$ (0.22)	$ (1.27)	$ (0.32)
Dividends per common share	$ -	$ 0.05	$ -	$ 0.15

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	Unallocated ESOP	Accumulated Other Comprehensive Income	Total
Balance at December 31, 2008	$ 31,920	$ (2,963,918)	$ 24,302,102	$ (286,324)	$ 8,762,412	$ (764,861)	$ 337,431	$ 29,418,762
Stock Options/Awards Expensed	-	-	64,924	93,485	-	-	-	158,409
ESOP common stock committed to be released	-	-	(67,879)	-	-	81,000	-	13,122
Net loss for the period	-	-	-	-	(3,675,174)	-	-	(3,675,174)
Changes in unrealized gain:								
on available-for-sale securities (net of tax of $22,810)	-	-	-	-	-	-	44,279	44,279
Total comprehensive loss	-	-	-	-	-	-	-	(3,630,895)
Balance at September 30, 2009	$ 31,920	$ (2,963,918)	$ 24,299,147	$ (192,839)	$ 5,087,238	$ (683,861)	$ 381,710	$ 25,959,397

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, 2009	2008
	(Unaudited)	
Cash Flows from Operating Activities:		
Net loss	$ (3,675,174)	$ (917,380)
Adjustments to reconcile net loss to net cash from operating activities:		
Depreciation and amortization	624,223	769,562
Provision for loan loss	3,492,711	1,242,665
Amortization and accretion on securities - net	50,224	46,831
Gain on sale of investment securities	(1,227)	(16,052)
ESOP contribution	13,122	49,668
Stock awards/options	158,409	172,611
Gain on sale of loans held for sale	(492,288)	(86,166)
Originations of loans held for sale	(42,604,156)	(8,800,236)
Proceeds from sale of loans held for sale	43,153,444	8,518,680
Gain on sale of fixed assets	(47,974)	(28,496)
Change in accrued interest receivable	100,578	113,612
Change in deferred tax assets	1,117,022	(612,860)
Change in other assets	(814,186)	(872,642)
Change in accrued expenses and other liabilities	773,590	(763,145)
Net cash provided by (used for) operating activities	1,848,318	(1,183,348)
Cash Flows from Investing Activities:		
Net decrease in loans	6,694,579	5,595,432
Proceeds from maturity and sale of available-for-sale securities	10,072,221	16,270,097
Proceeds from sale of property and equipment and repossessed assets	1,501,066	1,522,688
Net change in discontinued operations	1,533,942	294,537
Purchase of securities	(17,226,243)	(21,186,165)
Purchase of premises and equipment	(118,810)	(269,109)
Net cash provided by investing activities	2,456,755	2,227,480
Cash Flows from Financing Activities:		
Net (decrease) increase in deposits	(9,420,589)	7,734,741
Dividend paid on common stock	-	(432,637)
Net (decrease) increase in Repo Sweep accounts	(2,574,972)	4,145,540
Net increase in advances from borrowers	84,490	165,364
Advances from Federal Home Loan Bank	55,560,000	12,200,000
Repayments of Federal Home Loan Bank advances and notes payable	(49,147,724)	(18,915,144)
Net cash (used for) provided by financing activities	(5,498,795)	4,897,864
Net (decrease) increase in cash and cash equivalents	(1,193,722)	5,941,996
Cash and cash equivalents at beginning of period	3,470,311	5,340,857
Cash and cash equivalents at end of period	$ 2,276,589	$ 11,282,853
Supplemental disclosure of cash flow information:		

Cash paid during the period for income taxes	$	-	$	-
Cash paid during the period for interest	$	4,197,740	$	5,615,901

See accompanying notes to the consolidated financial statements.

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, 2008.

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, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009.

In accordance with FASB ASC 855, Subsequent Events, we have evaluated subsequent events though the date of this filing. We do not believe there are any material subsequent events which would require further disclosure.

Note 2— PRINCIPLES OF CONSOLIDATION AND DISCONTINUED OPERATIONS.

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 (as discussed further below). All significant intercompany balances and transactions have been eliminated in the consolidation.

On February 27, 2009 First Federal of Northern Michigan Bancorp, Inc. announced that it had sold the InsuranCenter of Alpena ("ICA") for $1,635,000. As a result, the financial position and results of operations of ICA are removed from the detail line items in the Company's condensed consolidated financial statements and presented separately as "discontinued operations." For further information, please refer to Note 15 of the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

As a result of the transaction, the Company reduced its full-time employees by 14 positions, or 13% of the Company's workforce. The Company expects the sale will reduce its non-interest expense by approximately $1.2 million in fiscal year 2009.

The Company recorded a gain of approximately $38,000, net of tax benefit, upon the closing of the sale. The Company retained the residual income stream associated with the April 2008 sale of its wholesale Blue Cross/Blue Shield override business to the Grotenhuis Group.

Note 3—LOANS.

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

	At September 30, 2009	At December 31, 2008
	(in thousands)	
Real estate loans:		
Residential mortgage	$ 83,135	$ 92,364
Commercial loans:		
Secured by real estate	60,206	49,787
Other	17,391	30,173
Total commercial loans	77,597	79,960
Consumer loans:		
Secured by real estate	19,778	22,303
Other	2,833	3,564
Total consumer loans	22,611	25,867
Total gross loans	$ 183,343	$ 198,191
Less:		
Net deferred loan fees	(296)	(274)
Allowance for loan losses	(4,309)	(5,647)
Total loans, net	$ 178,738	$ 192,270

Note 4—DIVIDENDS.

The Company suspended its quarterly dividend effective for the quarter ended December 31, 2008. The Company is dependent primarily upon the Bank for earnings and funds to pay dividends on common stock. Any reinstatement of dividends in the future will depend, in large part, on the Bank's earnings, capital requirements, financial condition and other factors considered by the Board of Directors of the Company. The payment of dividends also is subject to legal and regulatory restrictions. Any reinstatement of dividends, or stock repurchase, would require regulatory approval for a dividend from the Bank to the Company to fund the liquidity necessary to reinstate dividends or initiate a stock repurchase. We have made application for such a dividend but have been unsuccessful in getting regulatory approval due to a conservative regulatory posture regarding retaining capital at the Bank level in this economic environment.

Note 5 – 1996 STOCK OPTION PLAN AND 2006 STOCK-BASED INCENTIVE PLAN.

Effective January 1, 2006, the Company adopted FASB ASC 718-10, “Shareholder Based Payments”, which requires that the grant-date fair value of awarded stock options be expensed over the requisite service period. The Company’s 1996 Stock Option Plan (the “1996 Plan”), which was approved by shareholders, permits the grant of share options to its employees for up to 127,491 shares of common stock (retroactively adjusted for the exchange ratio applied in the Company’s 2005 stock offering and related second-step conversion). The Company’s 2006 Stock-Based Incentive Plan (the “2006 Plan”), which was approved by the shareholders , permits the award of up to 242,740 shares of common stock of which the maximum number to be granted as Stock Options is 173,386 and the maximum to be granted as Restricted Stock Awards is 69,354. Option awards are granted with an exercise price equal to the market price of the

Company's stock at the date of grant; those option awards generally vest based on five years of continual service and have ten year contractual terms. Certain options provide for accelerated vesting if there is a change in control (as defined in the Plans).

During the three and nine months ended September 30, 2009 the Company awarded no shares under the 2006 Stock-Based Incentive Plan. Shares issued under the 2006 Plan and exercised pursuant to the exercise of stock options may be either authorized but unissued shares or reacquired shares held by the Company as treasury stock.

Stock Options - A summary of option activity under the Plan during the nine months ended September 30, 2009 is presented below:

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2009	192,132	$ 9.48		
Granted	0	N/A		
Exercised	0	N/A		
Forfeited or expired	(3,850)	$ 9.57		
Oustanding at September 30, 2009	188,282	$ 9.47	6.51	$ 0
Options Exercisable at September 30, 2009	114,806	$ 9.44	6.67	$ 0

A summary of the status of the Company's nonvested options as of September 30, 2009, and changes during the nine months ended September 30, 2009, is presented below:

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2009	111,774	$ 2.11
Granted	0	N/A
Vested	(36,368)	$ 2.50
Forfeited	(1,930)	$ 2.10
Nonvested at September 30, 2009	73,476	$ 2.12

As of September 30, 2009 there was $140,000 of total unrecognized compensation cost, net of expected forfeitures, related to nonvested options under the Plans. That cost is expected to be recognized over a weighted-average period of 1.7 years. The total fair value of shares vested during the nine months ended September 30, 2009 was $60,334.

Restricted Stock Awards - As of September 30, 2009 there was $200,000 of unrecognized compensation cost related to nonvested restricted stock awards under the 2006 Plan. That cost is expected to be recognized over a weighted-average period of 1.7 years.

Note 6 – COMMITMENTS TO EXTEND CREDIT

The Company is a party to credit-related 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, standby letters of credit, and commercial lines of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated balance sheet. The Company’s exposure to credit loss is represented by the contracted amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance sheet instruments.

At September 30, 2009, the Company had outstanding commitments to originate loans of $29.4 million. These commitments included $9.1 million for permanent one-to-four family dwellings, $3.7 million for non-residential loans, $400,000 of undisbursed loan proceeds for construction of one-to-four family dwellings, $4.5 million of undisbursed lines of credit on home equity loans, $1.2 million of unused credit card lines, $8.7 million of unused commercial lines of credit, $770,000 of undisbursed commercial construction, $5,000 of unused letters of credit and $1.1 million in unused bounce protection.

Note 7 – SEGMENT REPORTING

The Company's principal activities include banking through its wholly owned subsidiary, First Federal of Northern Michigan, and the sale of insurance products through its indirect wholly owned subsidiary, ICA, purchased in 2003. The Bank provides financial products including retail and commercial loans as well as retail and commercial deposits. ICA receives commissions from the sale of various insurance products including health, life, and property. The segments were determined based on the nature of the products provided to customers.

The financial information for each operating segment is reported on the basis used internally to evaluate performance and allocate resources. The allocations have been consistently applied for all periods presented. Revenues and expenses between affiliates have been transacted at rates that unaffiliated parties would pay. The only transaction between the segments thus far relates to a deposit on behalf of ICA included in the Bank. The interest income and interest expense for this transaction has been eliminated. All other transactions are with external customers. The performance measurement of the operating segments is based on the management structure of the Company and is not necessarily comparable with similar information for any other financial institution. The information presented is also not necessarily indicative of the segment's financial condition and results of operations if they were independent entities.

As noted above, the majority of the assets of the Company's segment, ICA, were sold on February 27, 2009; therefore no segment information is reported for the three-month period ended September 30, 2009.

	For the Three Months Ended September 30, 2008 (Dollars in Thousands)			
	Bank	ICA	Eliminations	Total
Interest Income	$ 3,525	$ 9	$ (9)	$ 3,525
Interest Expense	1,817	-	(9)	1,808
Net Interest Income - Before provision for loan losses	1,708	9	-	1,717
Provision for Loan Losses	875	-	-	875
Net Interest Income - After provision for loan losses	833	9	-	842
Other Income	352	300	-	652
Operating Expenses	2,118	330	-	2,448
Loss - Before federal income tax benefit	(933)	(21)	-	(954)
Federal Income Tax expense (benefit)	(313)	(7)	-	(319)
Net loss	$ (620)	$ (14)	$ -	$ (635)
Depreciation and amortization	$ 186	$ 86	$ -	$ 272
Assets	$ 250,044	$ 5,350	$ (1,152)	$ 254,242
Expenditures related to long-lived assets:				
Goodwill	$ -	$ -	$ -	$ -
Intangible assets	-	-	-	-
Property and equipment	141	-	-	141
Total	$ 141	$ -	$ -	$ 141

	For the Nine Months Ended September 30, 2009 (Dollars in Thousands)			
	Bank	ICA	Eliminations	Total
Interest Income	$ 9,586	$ 4	$ (4)	$ 9,586
Interest Expense	4,016	4	(4)	4,016
Net Interest Income - Before provision for loan losses	5,570	-	-	5,570
Provision for Loan Losses	3,493	-	-	3,493
Net Interest Income - After provision for loan losses	2,078	-	-	2,078
Other Income	2,073	191	-	2,264
Operating Expenses	6,548	292	-	6,840
Loss - Before federal income tax benefit	(2,397)	(101)	-	(2,498)
Federal Income Tax expense (benefit)	1,212	(34)	-	1,178
Net loss	$ (3,609)	$ (67)	$ -	$ (3,676)
Depreciation and amortization	$ 577	$ 47	$ -	$ 624
Assets	$ 239,411	$ -	$ -	$ 239,411
Expenditures related to long-lived assets:				
Goodwill	$ -	$ -	$ -	$ -
Intangible assets	-	-	-	-
Property and equipment	119	-	-	119
Total	$ 119	$ -	$ -	$ 119

	For the Nine Months Ended September 30, 2008 (Dollars in Thousands)			
	Bank	ICA	Eliminations	Total
Interest Income	$ 10,606	$ 31	$ (31)	$ 10,606
Interest Expense	5,497	-	(31)	5,466
Net Interest Income - Before provision for loan losses	5,109	31	-	5,140
Provision for Loan Losses	1,242	-	-	1,242
Net Interest Income - After provision for loan losses	3,867	31	-	3,898
Other Income	1,131	1,321	-	2,452
Operating Expenses	6,335	1,394	-	7,729
Loss - Before federal income tax benefit	(1,337)	(42)	-	(1,379)
Federal Income Tax expense (benefit)	(448)	(14)	-	(462)
Net loss	$ (889)	$ (28)	$ -	$ (917)
Depreciation and amortization	$ 561	$ 186	$ -	$ 747
Assets	$ 250,044	$ 5,350	$ (1,152)	$ 254,242
Expenditures related to long-lived assets:				
Goodwill	$ -	$ -	$ -	$ -
Intangible assets	-	-	-	-

Property and equipment		268		-		-		268
Total	$	268	$	-	$	-	$	268

Note 8 - FAIR VALUE MEASUREMENTS.

FASB ASC 820-10 – Fair Value Measurements. The following tables present information about the Company's assets and liabilities measured at fair value on a recurring basis at September 30, 2009, and the valuation techniques used by the Company to determine those fair values.

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that the Company has the ability to access.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset or liability.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Company's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset or liability.

Disclosures concerning assets and liabilities measured at fair value are as follows:

Assets and Liabilities Measured at Fair Value on a Recurring Basis at September 30, 2009
(Dollars in thousands)

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at September 30, 2009
Assets:				
Investment securities- available-for-sale	$ -	$ 32,879	$ -	$ 32,879
Liabilities:				
None				

The Company also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. These assets include non-homogenous loans that are considered impaired and real estate owned. For impaired loans accounted for under FASB ASC 310-10, the Company has estimated the fair value using Level 3 inputs using discounted cash flow projections. Other Real Estate Owned consists of property received in full or partial satisfaction of a receivable. The Company utilizes independent appraisals or broker price opinions to estimate the fair value of these properties.

Assets Measured at Fair Value on a Nonrecurring Basis
(Dollars in thousands)

	Balance at September 30, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Change in fair value for the three-month period ended September 30, 2009	Change in fair value for the nine-month period ended September 30, 2009
Impaired loans accounted for under FASB ASC 310-10	$ 7,155	$ -	$ -	$ 7,155	$ 911	$ 2,610
Other real estate owned -residential mortgages	$ 512	$ -	$ -	$ 512	$ 22	$ 59
Other Real estate owned - commercial	$ 3,023	$ -	$ -	$ 3,023	$ 592	$ 622
Mortgage servicing rights	$ 703	$ -	$ -	$ 703	$ -	$ -
Mortgage loans held for sale	$ 50	$ -	$ 50	$ -	$ -	$ -

Mortgage Servicing Rights: Mortgage servicing rights represent the value associated with servicing residential mortgage loans. The value is determined through a discounted cash flow analysis which uses prepayment speed, interest rate, delinquency level and other assumptions as inputs. All of these assumptions require a significant degree of management judgment. Adjustments are only made when the discounted cash flows are less than the carrying value. As such, the Company classifies mortgage servicing rights as nonrecurring Level 3.

Mortgage Loans Held For Sale: Mortgage loans held for sale are recorded at the lower of carrying value or fair value. The fair value of mortgage loans held for sale is determined through forward commitments which the Company enters to sell these loans to secondary market counterparties. As such, the Company classifies mortgage loans held for sale as nonrecurring Level 2.

Impaired Loans: The Company does not record loans at fair value on a recurring basis. However, on occasion, a loan is considered impaired and an allowance for loan loss is established. A loan is considered impaired when it is probable that all of the principal and interest due under the original terms of the loan may not be collected. Once a loan is identified as individually impaired, management measures impairment in accordance with FASB ASC 310-10, Accounting by Creditors for Impairment of a Loan. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. In accordance with FASB ASC 820-10, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3.

Other Real Estate Owned: At the time of acquisition, other real estate owned is recorded at fair value, less estimated costs to sell, which becomes the property's new basis. Subsequent write-downs to reflect declines in value since the time of acquisition may occur from time to time and are recorded in other expense in the consolidated statements of operations. The fair value of the property used at and subsequent to the time of acquisition is typically determined by a third party appraisal of the property (nonrecurring Level 3).

Investment Securities Held to Maturity: The Company does not record investment securities held to maturity at fair value on a recurring basis. Therefore, when certain securities held to maturity were measured at fair value as discussed below, the Company’s municipal bonds classified as held to maturity are fair valued using a discount rate adjustment technique utilizing an imputed discount rate between current market interest rate spreads and market interest rate spreads at the approximate last date an active market existed for the these securities. Relevant inputs to the model include market spread data in consideration of credit characteristics, collateral type, credit rating and other relevant features. Where quoted prices are not available, fair values are measured using independent matrix pricing models, or other model-based valuation techniques such as the present value of future cash flows, requiring adjustments for factors such as prepayment speeds, liquidity risk, default rates, credit loss and the security’s credit rating. In instances where market action is inactive or inputs to the valuation are more opaque, securities are classified as nonrecurring Level 3 within the valuation hierarchy. Therefore, when management determines the fair value of an impaired held to maturity security through utilization of this type of model, the Company records the impaired security as nonrecurring Level 3

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based on quoted market prices. However, in many instances, there are no quoted market prices for the Company’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. FASB ASC 825-10 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.
The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

Cash and Cash Equivalents: The carrying amounts of cash and short-term instruments approximate fair values.

Securities: Fair values for securities, excluding Federal Home Loan Bank stock, are based on quoted market prices. The carrying value of Federal Home Loan Bank stock approximates fair value based on the redemption provisions of the Federal Home Loan Bank.

Loans Held for Sale: Fair values of mortgage loans held for sale are based on commitments on hand from investors or prevailing market prices.

Loans Receivable: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for certain mortgage loans (e.g., one- to four-family residential), credit card loans, and other consumer loans are based on quoted market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics. Fair values for other loans (e.g., commercial real estate and investment property mortgage loans, commercial, and industrial loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

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

REPO Sweep Accounts: The fair values disclosed for REPO Sweeps are equal to the amount payable on demand at the reporting date (i.e., their carrying amounts).

Long-term Borrowings: The fair values of the Company's long-term borrowings are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Accrued Interest: The carrying amounts of accrued interest approximate fair value.

The estimated fair values and related carrying or notional amounts of the Company's financial instruments are as follows:

	September 30, 2009		December 31, 2008	
	Carrying Amounts	Estimated Fair Value	Carrying Amounts	Estimated Fair Value
Financial assets:				