

Birmingham Bloomfield Bancshares

Form 10-Q

November 09, 2012

[Table of Contents](#)

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

**FORM 10-Q**

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

**For the quarterly period ended September 30, 2012**

**Commission File Number 000-52584**

**BIRMINGHAM BLOOMFIELD BANCSHARES, INC.**

**(Exact name of registrant as specified in its charter)**

Edgar Filing: Birmingham Bloomfield Bancshares - Form 10-Q

**Michigan** **20-3993452**  
(State or other jurisdiction of **(I.R.S. Employer**  
incorporation or organization) **Identification No.)**  
**33583 Woodward Avenue, Birmingham, MI 48009**  
  
(Address of principal executive offices, including zip code)  
  
**(248) 723-7200**  
  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (i) 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 (ii) has been subject to such filing requirements for the past 90 days. Yes  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  Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) Yes  No

The number of shares outstanding of the issuer's Common Stock as of November 9, 2012, was 1,824,662 shares.

**Table of Contents**

**INDEX**

<b><u>PART I. FINANCIAL INFORMATION</u></b>	3
<b><u>ITEM 1. FINANCIAL STATEMENTS (Unaudited)</u></b>	3
<b><u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u></b>	24
<b><u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u></b>	35
<b><u>ITEM 4. CONTROLS AND PROCEDURES</u></b>	35
<b><u>PART II. OTHER INFORMATION</u></b>	37
<b><u>ITEM 1. LEGAL PROCEEDINGS</u></b>	37
<b><u>ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u></b>	37
<b><u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES</u></b>	37
<b><u>ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</u></b>	37
<b><u>ITEM 5. OTHER INFORMATION</u></b>	37
<b><u>ITEM 6. EXHIBITS</u></b>	38
EX-31.1	
EX-31.2	
EX-32.1	
EX-101	

**Table of Contents****PART 1 FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****CONSOLIDATED STATEMENTS OF CONDITION**

	(Unaudited) September 30, 2012	December 31, 2011
<b>Assets</b>		
Cash and cash equivalents		
Cash	\$ 20,841,410	\$ 4,693,585
Federal funds sold		
<b>Total cash and cash equivalents</b>	<b>20,841,410</b>	<b>4,693,585</b>
Securities, available for sale (Note 2)	3,837,942	4,594,761
Federal home loan bank stock	218,100	169,900
Loans held for sale		2,484,829
Loans (Note 3)		
Total portfolio loans	118,439,890	106,297,926
Less: allowance for loan losses	(1,974,350)	(1,574,350)
Net portfolio loans	116,465,540	104,723,576
Premises & equipment	1,326,624	1,395,187
Bank-owned Life Insurance	2,162,296	2,100,000
Interest receivable and other assets	3,644,739	4,235,623
<b>Total assets</b>	<b>\$ 148,496,651</b>	<b>\$ 124,397,461</b>
<b>Liabilities and Shareholders' Equity</b>		
Deposits (Note 4)		
Non-interest bearing	\$ 21,733,611	\$ 19,662,283
Interest bearing	109,413,057	88,015,546
<b>Total deposits</b>	<b>131,146,668</b>	<b>107,677,829</b>
Interest payable and other liabilities	667,532	755,090
<b>Total liabilities</b>	<b>\$ 131,814,200</b>	<b>\$ 108,432,919</b>
Shareholders' equity (Note 10)		
Senior non-cumulative perpetual preferred stock series D \$1,000 liquidation value per share, 1%		
Authorized, issued and outstanding 4,621 shares	4,621,000	4,621,000
Common stock, no par value		
Authorized 9,000,000 and 4,500,000 shares, respectively		
Issued and outstanding 1,824,662 and 1,812,662 shares, respectively	17,105,618	17,066,618
Additional paid in capital	493,154	493,154
Accumulated deficit	(5,628,990)	(6,311,398)
Accumulated other comprehensive income	91,669	95,168
<b>Total shareholders' equity</b>	<b>16,682,451</b>	<b>15,964,542</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 148,496,651</b>	<b>\$ 124,397,461</b>

# Edgar Filing: Birmingham Bloomfield Bancshares - Form 10-Q

See accompanying notes to consolidated financial statements

**Table of Contents****CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
<b>Interest Income</b>				
Interest and fees on loans	\$ 1,713,893	\$ 1,554,666	\$ 4,996,724	\$ 4,644,719
Interest on securities	24,301	22,472	75,249	75,194
Interest on fed funds and bank balances	7,317	4,940	13,907	15,304
<b>Total interest income</b>	<b>1,745,511</b>	<b>1,582,078</b>	<b>5,085,880</b>	<b>4,735,217</b>
<b>Interest Expense</b>				
Interest on deposits	238,608	301,195	689,555	929,127
Interest on fed funds and short-term borrowings			64	14,509
<b>Total interest expense</b>	<b>238,608</b>	<b>301,195</b>	<b>689,619</b>	<b>943,636</b>
<b>Net Interest Income</b>	<b>1,506,903</b>	<b>1,280,883</b>	<b>4,396,261</b>	<b>3,791,581</b>
<b>Provision for Loan Losses</b>	<b>330,000</b>	<b>105,000</b>	<b>400,000</b>	<b>159,000</b>
<b>Net Interest Income After Provision for Loan Losses</b>	<b>1,176,903</b>	<b>1,175,883</b>	<b>3,996,261</b>	<b>3,632,581</b>
<b>Non-interest Income</b>				
Service charges on deposit accounts	19,413	15,208	58,710	39,369
Mortgage banking activities	77,165	108,384	274,032	167,145
SBA loan sales	173,099	186,151	321,848	686,884
Other Income	30,031	8,808	240,733	30,426
<b>Total non-interest income</b>	<b>299,708</b>	<b>318,551</b>	<b>895,323</b>	<b>923,824</b>
<b>Non-interest Expense</b>				
Salaries and employee benefits	653,234	729,641	2,055,073	1,955,026
Occupancy expense	122,137	145,294	356,804	388,979
Equipment expense	49,950	55,722	150,229	133,310
Advertising and public relations	81,712	29,276	172,180	110,019
Data processing expense	63,178	57,379	180,219	166,952
Professional fees	102,328	105,963	378,629	363,403
Loan origination expense	48,091	37,223	155,147	86,273
Regulatory assessments	25,270	33,603	74,245	115,931
Other expenses	102,264	123,360	280,363	287,503
<b>Total non-interest expense</b>	<b>1,248,164</b>	<b>1,317,461</b>	<b>3,802,889</b>	<b>3,607,396</b>
<b>Net Income Before Federal Income Tax</b>	<b>228,447</b>	<b>176,973</b>	<b>1,088,695</b>	<b>949,009</b>
<b>Federal income tax expense</b>	<b>78,700</b>		<b>361,351</b>	
<b>Net Income</b>	<b>149,747</b>	<b>176,973</b>	<b>727,344</b>	<b>949,009</b>
Dividend on senior preferred stock	11,552	21,801	44,936	109,967
Accretion of discount on preferred stock		46,194		54,393
<b>Net Income Applicable to Common Shareholders</b>	<b>\$ 138,195</b>	<b>\$ 108,978</b>	<b>\$ 682,408</b>	<b>\$ 784,649</b>
<b>Basic and Diluted Income per Share</b>	<b>\$ 0.08</b>	<b>\$ 0.06</b>	<b>\$ 0.38</b>	<b>\$ 0.44</b>
<b>Average Shares Outstanding</b>	<b>1,824,662</b>	<b>1,801,652</b>	<b>1,817,874</b>	<b>1,800,557</b>

Edgar Filing: Birmingham Bloomfield Bancshares - Form 10-Q

See accompanying notes to consolidated financial statements.

**Table of Contents**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income applicable to common shareholders	\$ 138,195	\$ 108,978	\$ 682,408	\$ 784,649
Other comprehensive income (loss), net of applicable taxes				
Change in value of investments available for sale	(1,540)	12,034	(3,499)	39,101
Comprehensive income	\$ 136,655	\$ 121,012	\$ 678,909	\$ 823,750

See accompanying notes to consolidated financial statements.



**Table of Contents****CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY (Unaudited)**

	Nine Months Ended September 30,	
	2012	2011
<b><u>Total Shareholders Equity</u></b>		
Balance at beginning of period	\$ 15,964,542	\$ 10,985,525
Net income	727,344	949,009
Net change in unrealized gains on securities available for sale	(3,499)	39,101
Stock Awards	39,000	32,288
Preferred dividends	(44,936)	(109,967)
Redemption of Preferred Stock		(3,461,000)
Issuance of Preferred Stock		4,621,000
Balance at end of period	\$ 16,682,451	\$ 13,055,956

See accompanying notes to consolidated financial statements.

**Table of Contents****CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

	For the Nine Months Ended September 30,	
	2012	2011
<b>Cash flows from operating activities</b>		
Net income	\$ 727,344	\$ 949,009
Stock awards	39,000	32,288
Provision for loan losses	400,000	159,000
Gain on sale of loans	(274,032)	(167,145)
Proceeds for sales of loans originated for sale	11,954,511	4,044,977
Loans originated for sale	(9,195,650)	(4,787,553)
Amortization (accretion) of securities	3,662	(2,206)
Depreciation expense	165,446	167,657
Deferred income taxes	361,351	
Net decrease (increase) in other assets	169,039	(424,316)
Net decrease in other liabilities	(87,558)	(113,071)
<b>Net cash provided by operating activities</b>	<b>4,263,113</b>	<b>(141,360)</b>
<b>Cash flows from investing activities</b>		
Net change in portfolio loans	(12,141,965)	(2,308,873)
Purchase of securities	(1,549,200)	(2,275,437)
Proceeds from calls or maturities of securities	2,000,000	1,200,000
Principal payments on securities	248,856	124,785
Purchases of premises and equipment	(96,883)	(254,155)
<b>Net cash (used in) provided by investing activities</b>	<b>(11,539,192)</b>	<b>(3,513,680)</b>
<b>Cash flows from financing activities</b>		
Increase in deposits	23,468,840	13,920,246
Net change in short term borrowings		(1,469,095)
Net proceeds from senior preferred stock		1,160,000
Dividend on senior preferred stock	(44,936)	(109,967)
<b>Net cash provided by financing activities</b>	<b>23,423,904</b>	<b>13,501,184</b>
<b>Increase in cash and cash equivalents</b>	<b>16,147,825</b>	<b>9,846,144</b>
Cash and cash equivalents beginning of period	4,693,585	5,366,304
Cash and cash equivalents end of period	\$ 20,841,410	\$ 15,212,448
<b>Supplemental Information:</b>		
Interest paid	\$ 688,998	\$ 997,143
Income tax paid		
Loans transferred to other real estate		\$ 297,806

See accompanying notes to consolidated financial statements

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**Note 1 Summary of Significant Accounting Policies**

**Basis of Statement Presentation**

The accompanying unaudited consolidated interim financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ( U.S. GAAP ) 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 Birmingham Bloomfield Bancshares, Inc. (the Corporation ) and the notes thereto included in the Corporation s annual report on Form 10-K for the year ended December 31, 2011.

All adjustments, consisting 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 month periods ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ended December 31, 2012.

Certain amounts in the prior period financial statements have been reclassified to conform to the current period presentation.

**Principles of Consolidation**

The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiary the Bank of Birmingham (the Bank ). All significant intercompany balances and transactions have been eliminated in consolidation.

**Changes in Significant Accounting Policies**

Comprehensive Income - In June 2011, the FASB issued ASU 2011-05 Presentation of Comprehensive Income . This standard requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but continuous statements. This standard eliminates the option to present the components of other comprehensive income as part of the statement of equity. This standard is effective for fiscal years and interim periods with those years beginning after December 15, 2011. The implementation of this standard will only change the presentation of comprehensive income; it will not have an impact on the Company s financial position or results of operations. This guidance was adopted in the first quarter of 2012 with no impact to the financial statements.

**Table of Contents****Note 2 Securities**

The amortized cost and estimated fair value of securities, with gross unrealized gains and losses, follows (000s omitted):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>September 30, 2012</b>				
U. S. Government agency securities	\$ 1,845	\$ 12	\$	\$ 1,857
Municipal securities	703	19		722
Mortgage backed securities	901	92		993
Corporate bonds	250	16		266
Sub-Total Available for Sale	\$ 3,699	\$ 139	\$	\$ 3,838
FHLB Stock	218			218
Total Securities	\$ 3,917	\$ 139	\$	\$ 4,056
<b>December 31, 2011</b>				
U. S. Government agency securities	\$ 2,347	\$ 9	\$ (2)	\$ 2,354
Municipal securities	709	16	(4)	721
Mortgage backed securities	1,145	113		1,258
Corporate bonds	250	12		262
Sub-Total Available for Sale	\$ 4,451	\$ 150	\$ (6)	\$ 4,595
FHLB Stock	170			170
Total Securities	\$ 4,621	\$ 150	\$ (6)	\$ 4,765

As of September 30, 2012 and December 31, 2011, all securities are classified as available for sale excluding the FHLB stock. Unrealized gains and losses within the investment portfolio are determined to be temporary. The Bank has performed an analysis of the portfolio for other than temporary impairment and concluded no losses are required to be recognized. Management has no specific intent to sell any securities and it is not more likely than not the Bank will be required to sell any securities before recovery of the cost basis. Management expects to collect all amounts due according to the contractual terms of the security. The Corporation had no securities with unrealized losses at September 30, 2012 and a total of \$6,000 in gross unrealized losses related to three individual securities at December 31, 2011.

At September 30, 2012 and December 31, 2011, securities with a market value of \$2.9 million and \$3.6 million, respectively, were pledged to the Federal Home Loan Bank of Indianapolis as collateral to access funding.

Federal Home Loan Bank stock is restricted and can only be sold back to the Federal Home Loan Bank. The carrying value of the stock approximates its fair value.

The amortized cost and estimated fair value of all securities at September 30, 2012, by contractual maturity are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations without call or prepayment penalties. The contractual maturities of securities are as follows (000s omitted):

Edgar Filing: Birmingham Bloomfield Bancshares - Form 10-Q

	Amortized cost	Estimated fair value
Due in one year or less	\$ 1,751	\$ 1,758
Due in one year through five years	1,948	2,080
Due in five years through ten years		
Due after ten years		
Total	\$ 3,699	\$ 3,838

**Table of Contents****Note 3 Loans**

A summary of the portfolio loan balances as of September 30, 2012 and December 31, 2011 is as follows (000s omitted):

	September 30, 2012	December 31, 2011
Mortgage loans on real estate:		
Residential 1 to 4 family	\$ 8,492	\$ 4,005
Multifamily	15,710	14,508
Commercial	57,762	50,426
Construction	809	2,541
Second mortgage	129	112
Equity lines of credit	11,200	11,119
Total mortgage loans on real estate	94,102	82,711
Commercial loans	23,176	22,512
Consumer installment loans	1,216	1,141
Total loans	118,494	106,364
Less: Allowance for loan losses	(1,974)	(1,574)
Net deferred loan fees	(54)	(66)
Net loans	\$ 116,466	\$ 104,724

**Table of Contents****Note 3 Loans Continued**

An analysis of the allowance for loan losses for the three and nine month periods ended September 30, 2012 and 2011 (000s omitted):

**Three months ended September 30, 2012**

<b>Allowance for Loan Losses</b>	Commercial	Home Equity	Residential	Consumer	Total
Beginning balance	\$ 1,305	\$ 307	\$ 26	\$ 6	\$ 1,644
Charge-offs					
Recoveries					
Provision	327	(5)	7	1	330
Ending balance	\$ 1,632	\$ 302	\$ 33	\$ 7	\$ 1,974
Percent of principal balance	1.62%	3.20%	0.50%	0.51%	1.67%
Ending balance: individually evaluated for impairment	\$ 651	\$ 184	\$	\$	\$ 835
Ending balance: collectively evaluated for impairment	\$ 981	\$ 118	\$ 33	\$ 7	\$ 1,139

**Portfolio Loans**

Ending unpaid principal balance	\$ 101,018	\$ 9,436	\$ 6,664	\$ 1,376	\$ 118,494
Ending unpaid principal balance: individually evaluated for impairment	\$ 3,469	\$ 590	\$	\$	\$ 4,059
Ending unpaid principal balance: collectively evaluated for impairment	\$ 97,549	\$ 8,846	\$ 6,664	\$ 1,376	\$ 114,435

**Three months ended September 30, 2011**

<b>Allowance for Loan Losses</b>	Commercial	Home Equity	Residential	Consumer	Total
Beginning balance	\$ 1,131	\$ 349	\$ 9	\$ 13	\$ 1,502
Charge-offs		(128)			(128)
Recoveries	20				20
Provision	(86)	202	(4)	(7)	105
Ending balance	\$ 1,065	\$ 423	\$ 5	\$ 6	\$ 1,499
Percent of principal balance	1.17%	4.37%	0.53%	0.52%	1.46%
Ending balance: individually evaluated for impairment	\$ 56	\$ 212	\$	\$	\$ 268
Ending balance: collectively evaluated for impairment	\$ 1,009	\$ 211	\$ 5	\$ 6	\$ 1,231

**Portfolio Loans**

Ending unpaid principal balance	\$ 90,877	\$ 9,679	\$ 949	\$ 1,163	\$ 102,668
Ending unpaid principal balance: individually evaluated for impairment	\$ 699	\$ 590	\$	\$	\$ 1,289
Ending unpaid principal balance: collectively evaluated for impairment	\$ 90,178	\$ 9,089	\$ 949	\$ 1,163	\$ 101,379

**Table of Contents****Note 3 Loans Continued****Nine months ended September 30, 2012**

<b>Allowance for Loan Losses</b>	Commercial	Home Equity	Residential	Consumer	Total
Beginning balance	\$ 1,142	\$ 416	\$ 10	\$ 6	\$ 1,574
Charge-offs					
Recoveries					
Provision	490	(114)	23	1	400
Ending balance	\$ 1,632	\$ 302	\$ 33	\$ 7	\$ 1,974
Percent of principal balance	1.62%	3.20%	0.50%	0.51%	1.67%
Ending balance: individually evaluated for impairment	\$ 651	\$ 184	\$	\$	\$ 835
Ending balance: collectively evaluated for impairment	\$ 981	\$ 118	\$ 33	\$ 7	\$ 1,139
<b>Portfolio Loans</b>					
Ending unpaid principal balance	\$ 101,018	\$ 9,436	\$ 6,664	\$ 1,376	\$ 118,494
Ending unpaid principal balance: individually evaluated for impairment	\$ 3,469	\$ 590	\$	\$	\$ 4,059
Ending unpaid principal balance: collectively evaluated for impairment	\$ 97,549	\$ 8,846	\$ 6,664	\$ 1,376	\$ 114,435

**Nine months ended September 30, 2011**

<b>Allowance for Loan Losses</b>	Commercial	Home Equity	Residential	Consumer	Total
Beginning balance	\$ 1,070	\$ 352	\$ 14	\$ 12	\$ 1,448
Charge-offs		(128)			(128)
Recoveries	20				20
Provision	(25)	199	(9)	(6)	159
Ending balance	\$ 1,065	\$ 423	\$ 5	\$ 6	\$ 1,499
Percent of principal balance	1.17%	4.37%	0.53%	0.52%	1.46%
Ending balance: individually evaluated for impairment	\$ 56	\$ 212	\$	\$	\$ 268
Ending balance: collectively evaluated for impairment	\$ 1,009	\$ 211	\$ 5	\$ 6	\$ 1,231
<b>Portfolio Loans</b>					
Ending unpaid principal balance	\$ 90,877	\$ 9,679	\$ 949	\$ 1,163	\$ 102,668
Ending unpaid principal balance: individually evaluated for impairment	\$ 699	\$ 590	\$	\$	\$ 1,289
Ending unpaid principal balance: collectively evaluated for impairment	\$ 90,178	\$ 9,089	\$ 949	\$ 1,163	\$ 101,379



**Table of Contents**

**Note 3 Loans - continued**

Management uses a loan rating system to identify the inherent risk associated with portfolio loans. Loan ratings are based on a subjective definition that describes the conditions present at each level of risk and identifies the important aspect of each loan. The Bank currently uses a 1 to 8 grading scale for commercial loans. Each loan grade corresponds to a specific qualitative classification. All other consumer and mortgage loan types are not graded using the risk rating scale but are internally rated based on various credit quality characteristics using the same qualitative classification. The risk rating classifications included: pass, special mention, substandard, doubtful and loss.

Loans risk-rated as special mention are considered criticized loans, exhibiting some potential credit weakness that requires additional attention by management and are maintained on the internal watch list and monitored on a regular basis. Loans risk-rated as substandard or higher are considered classified loans exhibiting well-defined credit weakness and are recorded on the problem loan list and evaluated more frequently. The Bank's credit administration function is designed to provide increased information on all types of loans to identify adverse credit risk characteristics in a timely manner. Total criticized and classified loans increased to \$14,560,000 at September 30, 2012 from \$13,821,000 at December 31, 2011. The increase is isolated to commercial loans and is the result of deterioration in specific credits identified by Credit Administration. The general condition of the portfolio remains strong. The Bank has \$708,000 loans in non-accrual status at September 30, 2012 while there were no loans in non-accrual at December 31, 2011. There were no loans that were risk rated doubtful or loss at September 30, 2012 or December 31, 2011. Management closely monitors each loan adversely criticized or classified and institutes appropriate measures to eliminate the basis of criticism.

The primary risk elements considered by management regarding each consumer and residential real estate loan are lack of timely payment and loss of real estate values. Management has a reporting system that monitors past due loans and has adopted policies to pursue its creditor's rights in order to preserve the Bank's position. The primary risk elements concerning commercial and industrial loans and commercial real estate loans are the financial condition of the borrower, the sufficiency of collateral, and lack of timely payment. Management has a policy of requesting and reviewing periodic financial reporting from its commercial loan customers and verifies existence of collateral and its value.

An analysis of credit quality indicators at September 30, 2012 and December 31, 2011 follows (000s omitted):

**September 30, 2012**

**Commercial Loans**

Credit Quality	Commercial Real Estate	Commercial Term	Commercial LOC	Commercial Construction
1 pass	\$	\$	\$	\$ 93
2 pass		76		
3 pass	18,619	4,559	3,973	715
4 pass	44,960	11,725	2,680	
5 special mention	7,567	820	770	
6 substandard	689	2,832	940	
7 doubtful				
8 loss				
	\$ 71,835	\$ 20,012	\$ 8,363	\$ 808

**Consumer Loans**

Credit Quality	Home Equity LOC	Residential Mortgage	Home Equity Term	Consumer Installment	Consumer LOC
Pass	\$ 8,504	\$ 6,535	\$ 129	\$ 660	\$ 706
Special mention	342			10	
Substandard	590				

Edgar Filing: Birmingham Bloomfield Bancshares - Form 10-Q

Doubtful  
Loss

\$ 9,436	\$ 6,535	\$ 129	\$ 670	\$ 706
----------	----------	--------	--------	--------

13

**Table of Contents**

**Note 3 Loans - continued**

**December 31, 2011**

**Commercial Loans**

Credit Quality	Commercial Real Estate	Commercial Term	Commercial LOC	Commercial Construction
1 pass	\$	\$	\$	\$
2 pass	217	89		
3 pass	16,023	3,793	4,644	
4 pass	41,184	8,754	5,248	683
5 special mention	5,586	2,524	511	1,858
6 substandard	1,426	598	365	
7 - doubtful				
8 - loss				
	\$ 64,436	\$ 15,758	\$ 10,768	\$ 2,541

**Consumer Loans**

Credit Quality	Home Equity LOC	Residential Mortgage	Home Equity Term	Consumer Installment	Consumer LOC
Pass	\$ 8,686	\$ 1,828	\$ 111	\$ 583	\$ 700
Special mention	343			20	
Substandard	590				
Doubtful					
Loss					
	\$ 9,619	\$ 1,828	\$ 111	\$ 603	\$ 700

A loan is considered a troubled debt restructuring ( TDR ) if the Bank for economic or legal reasons related to the borrower s financial condition grants a concession to the debtor that the Bank would not otherwise consider. TDRs represent loans where the original terms of the agreement have been modified to provide relief to the borrower and are individually evaluated for impairment. All TDR loans continue to perform according to the modified contractual terms.

Information regarding modified loans as of September 30, 2012 and December 31, 2011 (000s omitted):

	Number of Contracts	Pre-Modification Investment	Post-Modification Investment
<b>September 30, 2012</b>			
<b>Troubled Debt Restructuring</b>			
Commercial Real Estate	1	\$ 699	\$ 699
Commercial Term	2	848	848
Commercial LOC	1	350	350
Construction			
Home Equity			
Residential Mortgage			
Consumer			

**December 31, 2011**

**Troubled Debt Restructuring**

Commercial Real Estate	1	\$	699	\$	699
Commercial Term					
Commercial LOC					
Construction					
Home Equity					
Residential Mortgage					
Consumer					

**Table of Contents****Note 3 Loans - continued**

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all principal and interest payments according to the contractual terms of the loan agreement. Characteristics considered by management in determining impairment include delinquency status, collateral value, and known factors adversely affecting the ability of the borrower to satisfy the terms of the agreement. When an individual loan is classified as impaired, the Corporation measures impairment using (1) the present value of expected cash flows discounted at the loans effective interest rate, (2) the loans observable market price, or (3) the fair value of the collateral. The method used is determined on a loan by loan basis, except for a collateral dependent loan. All collateral dependent loans are required to be measured using the fair value of collateral method. If the value of an impaired loan is less than the recorded investment in the loan an impairment reserve is recognized. All modified loans are considered impaired.

Large groups of homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer and residential loans for impairment disclosures, except if modified and considered to be a troubled debt restructuring.

Information regarding impaired loans at September 30, 2012; December 31, 2011; and September 30, 2011 (000s omitted):

	Recorded Investment	Unpaid Principal	Allowance	Average Investment	Year to Date Interest Recognized
<b>September 30, 2012</b>					
<b>Impaired loans</b>					
Loans with no related allowance recorded:					
Commercial Term	\$ 1,723	\$ 1,723	\$	\$ 1,723	\$ 88
Commercial Line of Credit	\$ 350	\$ 350	\$	\$ 350	\$ 18
Loans with allowance recorded:					
Commercial Real Estate	\$ 688	\$ 688	\$ 332	\$ 694	\$ 26
Commercial Term	\$ 708	\$ 708	\$ 319	\$ 708	\$ 44
Home Equity Line of Credit	\$ 590	\$ 590	\$ 184	\$ 590	\$ 22
Total loans:					
Commercial	\$ 3,469	\$ 3,469	\$ 651	\$ 3,475	\$ 176
Home Equity	\$ 590	\$ 590	\$ 184	\$ 590	\$ 22
<b>December 31, 2011</b>					
<b>Impaired loans</b>					
Loans with allowance recorded:					
Commercial Real Estate	\$ 699	\$ 699	\$ 115	\$ 699	\$ 35
Home Equity Line of Credit	\$ 590	\$ 590	\$ 212	\$ 590	\$ 29
Total loans:					
Commercial	\$ 699	\$ 699	\$ 115	\$ 699	\$ 35
Home Equity	\$ 590	\$ 590	\$ 212	\$ 590	\$ 29
<b>September 30, 2011</b>					
<b>Impaired loans</b>					
Loans with allowance recorded:					
Commercial Real Estate	\$ 699	\$ 699	\$ 56	\$ 699	\$ 27
Home Equity Line of Credit	\$ 590	\$ 590	\$ 212	\$ 590	\$ 22
Total loans:					
Commercial	\$ 699	\$ 699	\$ 56	\$ 699	\$ 27
Home Equity	\$ 590	\$ 590	\$ 212	\$ 590	\$ 22



**Table of Contents****Note 3 Loans - continued**

As of September 30, 2012 there were no loans more than 30 days past due while at December 31, 2011 loans representing \$4,000 were more than 30 days past due. Total non-performing loans, which represent non-accrual loans and loans past due 90 days or more and still accruing interest, were \$708,000 and \$0 at September 30, 2012 and December 31, 2011, respectively. Loans are placed in non-accrual status when, in the opinion of management, uncertainty exists as to the ultimate collection of principal and interest. Commercial loans are reported as being in non-accrual status if: (a) they are maintained on a cash basis because of deterioration in the financial position of the borrower, (b) payment in full of interest or principal is not expected, or (c) principal or interest has been in default for a period of 90 days or more. If it can be documented that the loan obligation is both well secured and in the process of collection, the loan may remain on accrual status. However, if the loan is not brought current before becoming 120 days past due, the loan is reported as non-accrual. A non-accrual asset may be restored to accrual status when none of its principal or interest is due and unpaid, when it otherwise becomes well secured, or is in the process of collection.

Information regarding past due loans at September 30, 2012 and December 31, 2011 follows (000s omitted):

	Loans past due				Total Past Due	Current	Total Loans	Non- Accrual	>90 days Accruing
	30	59	60 - 90	Over 90					
<b>September 30, 2012</b>									
Commercial real estate	\$	\$	\$	\$	\$ 71,835	\$ 71,835	\$	\$	
Commercial term					20,012	20,012	708		
Commercial LOC					8,363	8,363			
Construction					808	808			
Home equity LOC					9,436	9,436			
Residential mortgage					6,535	6,535			
Home equity term					129	129			
Consumer installment					670	670			
Consumer LOC					706	706			
	\$	\$	\$	\$	\$ 118,494	\$ 118,494	\$ 708	\$	

	Loans past due				Total Past Due	Current	Total Loans	Non- Accrual	>90 days Accruing
	30	59	60 - 90	Over 90					
<b>December 31, 2011</b>									
Commercial real estate	\$	\$	\$	\$	\$ 64,436	\$ 64,436	\$	\$	
Commercial term					15,758	15,758			
Commercial LOC					10,768	10,768			
Construction					2,541	2,541			
Home equity LOC					9,619	9,619			
Residential mortgage					1,828	1,828			
Home equity term					111	111			
Consumer installment	4				4	599	603		
Consumer LOC						700	700		
	\$ 4	\$	\$	\$	\$ 4	\$ 106,360	\$ 106,364	\$	

**Table of Contents****Note 4 Deposits**

Deposits are summarized as follows (000s omitted):

	September 30, 2012		December 31, 2011	
	Balance	Percentage	Balance	Percentage
Noninterest bearing demand	\$ 21,734	16.57%	\$ 19,662	18.26%
NOW accounts	9,411	7.18%	8,040	7.47%
Money market	11,544	8.80%	6,622	6.15%
Savings	19,277	14.70%	18,188	16.89%
Time deposits under \$100,000	9,981	7.61%	11,469	10.65%
Time deposits over \$100,000	47,970	36.58%	43,697	40.58%
Brokered deposits	11,230	8.56%		0.00%
Total deposits	\$ 131,147	100.0%	\$ 107,678	100.0%

At September 30, 2012, the scheduled maturities of time and brokered deposits are as follows (000s omitted):

	<\$100,000	>\$100,000	Total
2012	\$ 917	\$ 3,624	\$ 4,541
2013	3,336	24,663	27,999
2014	4,842	11,942	16,784
2015	170	8,820	8,990
2016	468	5,574	6,042
Thereafter	248	4,577	4,825
Total	\$ 9,981	\$ 59,200	\$ 69,181

**Note 5 Loan Servicing**

Loans serviced for others are not included in the accompanying consolidated financial statements. The unpaid principal balance of loans serviced for others was \$8,720,000 and \$6,388,000 at September 30, 2012 and December 31, 2011, respectively. Unamortized cost of loan servicing rights included in accrued interest receivable and other assets on the consolidated balance sheet, for the periods ended September 30, 2012 and December 31, 2011 are shown below:

	September 30, 2012	December 31, 2011
Balance, beginning of period	\$ 123,820	\$
Amount capitalized	63,350	129,783
Amount amortized	8,735	5,963
Balance, end of period	\$ 178,435	\$ 123,820



**Table of Contents****Note 6 Leases and Commitments**

The Corporation has entered into a lease agreement for its main office facility. Payments began in February 2005 and the initial term of the lease expires in October 2015. In October 2007, the Corporation exercised its first renewal option on the property which expires in October 2025. The main office lease has one additional ten year renewal option. In March 2011, a new one year lease was signed for additional office space in the building adjacent to the main office. During the first quarter of 2012, the Corporation renewed the lease for an additional three year period.

Rent expense was \$66,000 and \$73,000 for the three month period ended September 30, 2012 and 2011, respectively. Rent expense was \$200,000 and \$210,000 for the nine month period ended September 30, 2012 and 2011, respectively.

The following is a schedule of future minimum rental payments under operating leases on a calendar year basis:

2012	\$ 68,000
2013	273,000
2014	278,000
2015	257,000
2016	254,000
Thereafter	2,473,000
<b>Total</b>	<b>\$ 3,603,000</b>

**Note 7 Fair Value of Financial Instruments**

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 upon quoted market prices. However, in many instances, there are no quoted market prices for the Corporation'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 excludes certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Corporation.

The following methods and assumptions were used by the Corporation in estimating fair value disclosures for financial instruments:

**Cash and Cash Equivalents** - The carrying values of cash and cash equivalents approximate fair values.

**Securities** - Fair values of securities are based on quoted market prices. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities or other observable inputs.

**Loans Receivable** - For variable-rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other 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 of nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

**Deposit Liabilities** - The fair values disclosed for demand deposits 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.

**Accrued Interest** - The carrying value of accrued interest approximates fair value.



**Table of Contents****Note 7 Fair Value of Financial Instruments (continued)**

**Other Financial Instruments** - The fair value of other financial instruments, including loan commitments and unfunded letters of credit, based on discounted cash flow analyses, is not material.

The carrying values and estimated fair values of financial instruments at September 30, 2012 and December 31, 2011, are as follows (000s omitted):

**September 30, 2012**

	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
<b>Financial assets:</b>					
Cash and cash equivalents	\$ 20,841	\$ 20,841	\$ 20,841	\$	\$
Securities available for sale	4,056	4,056		4,056	
Net portfolio loans	116,466	117,503			117,503
Loans held for sale					
Accrued interest receivable	484	484		484	
<b>Financial liabilities:</b>					
Deposits	131,147	131,356		131,356	
Accrued interest payable	61	61		61	

**December 31, 2011**

	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3
<b>Financial assets:</b>					
Cash and cash equivalents	\$ 4,694	\$ 4,694	\$ 4,694	\$	\$
Securities available for sale	4,764	4,764		4,764	
Net portfolio loans	104,724	104,638			104,638
Loans held for sale	2,485	2,485		2,485	
Accrued interest receivable	450	450		450	
<b>Financial liabilities:</b>					
Deposits	107,678	107,987		107,987	
Accrued interest payable	61	61		61	

**Table of Contents**

**Note 8 Fair Value Accounting**

**Valuation Hierarchy**

Accounting standards establish a three-level valuation hierarchy for fair value measurements. The valuation hierarchy prioritizes valuation techniques based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date and are the primary method of valuation used by Birmingham Bloomfield Bancshares, Inc. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels are defined as follows.

Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets which the Corporation can participate.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement, and include inputs that are available in situations where there is little, if any, market activity for the related asset or liability.

Following is a description of the inputs and valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheets, as well as general classification of those instruments under the valuation hierarchy.

*Available-for-sale Securities*

Quoted market prices in an active market are used to value securities when such prices are available. Those securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, the fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows using reasonable inputs. Level 2 securities include U.S. Government agency securities, mortgage backed securities, obligations of states and municipalities, and certain corporate securities. Matrix pricing is a mathematical technique widely used in the banking industry to value investment securities without relying exclusively on quoted prices for specific investment securities, but rather relying on the investment securities' relationship to other benchmark quoted investment securities. In certain cases where Level 1 or Level 2 inputs are not available, securities would be classified within Level 3 of the hierarchy.

The following table presents the fair value measurements of assets recognized in the accompanying consolidated balance sheets measured at fair value on a recurring basis and the level within the valuation hierarchy in which the fair value measurements fall at September 30, 2012 and December 31, 2011 (000s omitted):

	Level 1	Level 2	Level 3	Fair Value
<b><u>September 30, 2012</u></b>				
U.S. government agency	\$	\$ 1,857	\$	\$ 1,857
Municipal securities		722		722
Mortgage backed securities		993		993
Corporate bonds		266		266
Securities available for sale	\$	\$ 3,838	\$	\$ 3,838
<b><u>December 31, 2011</u></b>				
U.S. government agency	\$	\$ 2,354	\$	\$ 2,354
Municipal securities		721		721
Mortgage backed securities		1,258		1,258

Edgar Filing: Birmingham Bloomfield Bancshares - Form 10-Q

Corporate bonds		262		262
Securities available for sale	\$	\$ 4,595	\$	\$ 4,595

**Table of Contents****Note 8 Fair Value Accounting continued**

Following is a description of the inputs and valuation methodologies used for instruments measured at fair value on a non-recurring basis and recognized in the accompanying consolidated balance sheets, as well as general classification of those instruments under the valuation hierarchy.

*Impaired Loans*

Loans for which it is probable the Corporation will not collect all principal and interest due according to the contractual terms are measured for impairment. The fair value of impaired loans is estimated using one of three methods; market value, collateral value, or discounted cash flow. Those impaired loans not requiring an allowance represent loans for which the fair value of collateral exceeds the recorded investment. When the fair value of the collateral is based on an observable market price or current appraised value, the impaired loan is classified within Level 2. When a market value is not available or management applies a discount factor to the appraised value, the Corporation records the impaired loan in Level 3.

*Other Real Estate Owned ( ORE )*

Loans on which the underlying collateral has been repossessed are adjusted to fair value less costs to sell upon transfer to repossessed assets. Subsequently, repossessed assets are carried at the lower of carrying value or fair value, less anticipated marketing and selling costs. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the repossessed asset as a nonrecurring Level 2 valuation. When a market value is not available or management applies a discount factor to the appraised value, the Corporation records the repossessed asset in Level 3.

The following table presents the fair value measurements of assets recognized in the accompanying consolidated balance sheets measured at fair value on a non-recurring basis and the level within the valuation hierarchy in which the fair value measurements fall at September 30, 2012 and December 31, 2011 (000s omitted):

	Balance	Level 1	Level 2	Level 3	Losses
<b><u>September 30, 2012</u></b>					
Impaired Loans	\$ 4,059	\$	\$	\$ 4,059	\$
ORE	\$	\$	\$	\$	\$
<b><u>December 31, 2011</u></b>					
Impaired Loans	\$ 1,289	\$	\$	\$ 1,289	\$
ORE	\$ 298	\$	\$	\$ 298	\$

**Table of Contents****Note 9 Minimum Regulatory Capital Requirements**

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The prompt corrective action regulations provide four classifications, well capitalized, adequately capitalized, undercapitalized and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and plans for capital restoration are required. The Bank was classified as well-capitalized as of September 30, 2012. For the period ended September 30, 2012, the Corporation qualifies for an exemption from regulatory capital requirements due to its asset size.

The Bank's actual capital amounts and ratios as of September 30, 2012 and December 31, 2011 are presented in the following table (000s omitted):

	Actual		For Capital Adequacy Purposes		To be Well-Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b><u>As of September 30, 2012</u></b>						
Total risk-based capital (to risk weighted assets)						
Bank of Birmingham	\$ 14,922	11.3%	\$ 10,546	8.0%	\$ 13,183	10.0%
Tier I capital (to risk weighted assets)						
Bank of Birmingham	\$ 13,270	10.1%	\$ 5,273	4.0%	\$ 7,910	6.0%
Tier I capital (to average assets)						
Bank of Birmingham	\$ 13,270	9.2%	\$ 5,769	4.0%	\$ 7,212	5.0%
<b><u>As of December 31, 2011</u></b>						
Total risk-based capital (to risk weighted assets)						
Bank of Birmingham	\$ 13,504	12.0%	\$ 9,026	8.0%	\$ 11,283	10.0%
Tier I capital (to risk weighted assets)						
Bank of Birmingham	\$ 12,091	10.7%	\$ 4,513	4.0%	\$ 6,770	6.0%
Tier I capital (to average assets)						
Bank of Birmingham	\$ 12,091	9.9%	\$ 4,866	4.0%	\$ 6,083	5.0%

**Table of Contents**

**Note 10 Shareholders Equity**

On July 28, 2011, the Corporation fully redeemed from the United States Treasury all of the Preferred Shares associated with the Capital Purchase Program for \$3,461,000. The redemption was funded by proceeds from the issuance of Preferred Shares to the U.S. Treasury under the Small Business Lending Fund totaling \$4,621,000. As a result of the transaction, the Corporation recorded \$46,000 in accelerated accretion on the remaining discount of the Capital Purchase Program Preferred stock during the third quarter of 2011, reducing the amount available to common shareholders. See Management's Discussion and Analysis of Financial Condition and Results of Operation for additional preferred stock discussion.



**Table of Contents**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

**Disclosure Regarding Forward Looking Statements**

This report contains forward-looking statements throughout that are based on management's beliefs, assumptions, current expectations, estimates and projections about the financial services industry, the economy, and about the Corporation and the Bank. Words such as anticipates, believes, estimates, expects, forecasts, intends, is likely, plans, projects, variations of such words and similar expressions are intended to identify such forward-looking statements. These forward-looking statements are intended to be covered by the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict with regard to timing, extent, likelihood and degree of occurrence. Actual results and outcomes may materially differ from what may be expressed or forecasted in the forward-looking statements. The Corporation undertakes no obligation to update, amend, or clarify forward looking statements, whether as a result of new information, future events (whether anticipated or unanticipated), or otherwise.

Future factors that could cause actual results to differ materially from the results anticipated or projected include, but are not limited to, the following: the credit risks of lending activities, including changes in the level and direction of loan delinquencies and write-offs and changes in estimates of the adequacy of the allowance for loan losses; competitive pressures among depository institutions; interest rate movements and their impact on customer behavior and net interest margin; the impact of re-pricing and competitor's pricing initiatives on loan and deposit products; the ability to adapt successfully to technological changes to meet customers' needs and development in the market place; our ability to access cost-effective funding; changes in financial markets; changes in economic conditions in general and particularly as related to the automotive and related industries in the Detroit metropolitan area; new legislation or regulatory changes, including but not limited to changes in federal and/or state tax laws or interpretations thereof by taxing authorities; changes in accounting principles, policies or guidelines; and our future acquisitions of other depository institutions or lines of business. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Further information concerning the Corporation and its business, including additional factors that could materially affect the Corporation's financial results, is included in its filings with the Securities and Exchange Commission.

## **Table of Contents**

### **Management's Discussion and Analysis of Financial Condition and Results of Operations**

#### **OVERVIEW**

The Corporation is a Michigan corporation that was incorporated in 2004 to serve as the holding company for a Michigan state bank, Bank of Birmingham (the Bank). The Bank is a full service commercial bank headquartered in Birmingham, Michigan. The Bank serves businesses and consumers across Oakland and Macomb counties with a full range of lending, deposit and internet banking services. The net income of the Corporation is derived primarily from net interest income. Net interest income is the difference between interest earned on the Bank's loan and investment portfolios and the interest paid on deposits and borrowings. The volume, mix and rate of interest-bearing assets and liabilities determine net interest income.

#### **OPERATIONS**

The Corporation's (and the Bank's) main office is located at 33583 Woodward Avenue, Birmingham, MI 48009. The building is a free-standing one story office building of approximately 8,300 square feet. The main office lease commenced in October 2005 and the Bank exercised its first renewal option resulting in the lease being extended until October 2025. The main office lease has an additional ten year renewal option. See Note 6 of the Notes to Consolidated Financial Statements regarding additional lease information.

The Bank will continue to focus on the lending, deposit and general banking needs in the community it serves. The profile of products available to customers continues to expand as the Bank offers more options for residential mortgage and commercial customers, including SBA and lease products. The Bank will investigate additional product and service offerings and will consider providing those that will be of benefit to our customers and the Bank.

#### **FINANCIAL CONDITION**

The Corporation reported net income applicable to common shareholders of \$138,000 or \$0.08 per common share for the three month period ended September 30, 2012 compared to net income of \$109,000 or \$0.06 per common share for the third quarter of 2011. For the nine months ended September 30, 2012 and 2011, net income applicable to common stock was \$682,000 or \$0.38 per share and \$785,000 or \$0.44 per share, respectively. The results for 2012 include the impact of recognizing tax expense not previously required. Excluding the effect of income tax expense of \$79,000 for the three month period ended September 30, 2012, pre-tax net income before preferred dividends was \$228,000, an increase of 29.1% from the third quarter of 2011. Pre-tax, pre-provision net income for the nine months ended September 30, 2012 was \$1,089,000, an increase of \$140,000 or 14.7%. The improved performance for the three and nine month period was the result of higher margins and earning asset growth. This generated a pre-tax, pre-provision return on average assets of 1.52% and 1.47%, respectively, for the three and nine month periods.

Total assets as of September 30, 2012 were \$148,497,000, an increase \$24,100,000 from December 31, 2011 and 19.4% from the third quarter of 2011. The growth was primarily the result of an increase in loan and deposit balances. The Company continues to focus on providing a broad range of product and services to generate core, organic growth.

#### **Cash and Cash Equivalents**

Cash and cash equivalents totaled \$20,841,000 at September 30, 2012. The increase was primarily the result of deposit growth and a strategic decision objective to maintain additional liquidity.

**Table of Contents****Investments**

Total investments decreased \$757,000 to \$3,838,000 during the nine month period ended September 30, 2012. The net reduction was the result of principal payments received on mortgage backed securities and the retirement of three U.S. Government agency securities totaling \$2.0 million. The Corporation used the proceeds from the called securities to purchase additional investments totaling \$1.5 million and fund new loan activity. The Corporation did not hold any held-to-maturity securities as of September 30, 2012 or December 31, 2011. The makeup of the Corporation's investment portfolio evolves with the changing price and risk structure, and liquidity needs of the Corporation.

Management believes that the unrealized gains and losses within the investment portfolio are temporary, since they are a result of market changes, rather than a reflection of credit quality. Management has no specific intent to sell any securities, although the entire investment portfolio is classified as available for sale. The following chart summarizes the portfolio by type at September 30, 2012 and December 31, 2011 (000s omitted):

	September 30, 2012		December 31, 2011		Change
U.S. Government agency securities	\$ 1,857	48.4%	\$ 2,354	51.2%	\$ (497)
Municipal securities	722	18.8%	721	15.7%	1
Mortgage backed securities	993	25.9%	1,258	27.4%	(265)
Corporate bonds	266	6.9%	262	5.7%	4
<b>Total securities</b>	<b>\$ 3,838</b>	<b>100.0%</b>	<b>\$ 4,595</b>	<b>100.0%</b>	<b>\$ (757)</b>

**Loans, Credit Quality and Allowance for Loan Losses**

The following table summarizes the mix of the Corporation's portfolio loans at September 30, 2012 and December 31, 2011 (000s omitted):

	September 30, 2012	December 31, 2011	Change
Real estate mortgage	\$ 93,293	\$ 80,170	\$ 13,123
Construction	809	2,541	(1,732)
Commercial and industrial	23,176	22,512	664
Consumer installment	1,216	1,141	75
Deferred loan fees and costs	(54)	(66)	12
<b>Total loans</b>	<b>\$ 118,440</b>	<b>\$ 106,298</b>	<b>\$ 12,142</b>

Total portfolio loans increased during the first nine months of 2012 to \$118,440,000. The growth during the quarter was concentrated in Real Estate Mortgage and Commercial and Industrial loans. The increase was due to focused business development efforts in generating new loan activity and expanding existing relationships. The only category experiencing a decline during the period was Construction loans. This loan type is generally temporary and the decrease was a result of converting the customer to permanent end financing after the construction phase was complete.

During the current quarter, the allowance for loan losses increased \$330,000 to \$1,974,000, representing 1.67% of total loans at September 30, 2012. The increase was a combined result of a net increase in specific reserves on impaired loans and portfolio growth. There were no charge-offs recorded for the three months ended September 30, 2012 while there was one charge-off totaling \$128,000 recorded for the three months ended September 30, 2011. There were no recoveries in the current quarter, while there were \$20,000 in recoveries for the same period in 2011.

The allowance for loan losses increased \$400,000 during the nine month period ended September 30, 2012 as a result of loan growth and additional reserves required on impaired loans. There were no charge-offs recorded for the nine months ended September 30, 2012 while there was one charge-off totaling \$128,000 recorded for the nine months ended September 30, 2011. For the nine months ended September 30, 2012,

## Edgar Filing: Birmingham Bloomfield Bancshares - Form 10-Q

there were no recoveries, while there were \$20,000 in recoveries for the same period in 2011.

Non-performing loans, which consist of non-accruing loans and loans past due 90 days or more and still accruing interest, at September 30, 2012 and December 31, 2011, were \$708,000 and \$0, respectively.

Management evaluates the condition of the loan portfolio on a quarterly basis or more frequently when warranted, to determine the adequacy of the allowance for loans losses. The allowance for loan losses is maintained at a level believed to be adequate to

**Table of Contents**

cover losses on individually evaluated loans that are determined to be impaired and on groups of loans with similar risk characteristics that are collectively evaluated for impairment. Estimated credits losses represent the current amount of the loan portfolio that is probable the institution will be unable to collect given the facts and circumstances as of the evaluation date. Management's evaluation of the allowance is based on consideration of actual loss experience, the present and prospective financial condition of borrowers, adequacy of collateral, industry concentrations within the portfolio, various environmental factors and general economic conditions. Loans individually evaluated for impairment are measured using one of the three standard methods and provided a specific allowance. Management believes that the present allowance is adequate given the size, complexity and risk profile of the current portfolio.

Although management believes that the allowance for credit losses is adequate to absorb losses as they arise, there can be no assurance that the Bank will not sustain losses in any given period that could be substantial in relation to the size of the allowance for credit losses. It must be understood that inherent risks and uncertainties related to the operation of a financial institution require management to depend on estimates, appraisals and evaluations of loans to prepare the Corporation's financial statements. Changes in economic conditions and the financial prospects of borrowers may result in changes to the estimates, appraisals and evaluations used. In addition, if circumstances and losses differ substantially from management's assumptions and estimates, the allowance for loan losses may not be sufficient to absorb all future losses and net income could be adversely impacted.

**Premises and Equipment**

Premises and equipment was \$1,327,000 as of September 30, 2012, a decrease of \$68,000 from December 31, 2011. The Corporation did not make any substantial purchases during the current year but will continue to support expects to support further growth of business lines with investments in operating facilities and technology.

**Deposits and Short-term Financing**

Total deposits reached \$131,147,000 as of September 30, 2012 an increase of 21.8% from December 31, 2011. All categories experienced an increase except Time Deposits less than \$100,000. The deposit growth was a result of attracting new customers with competitive products and expanding existing relationships. The Bank also began participating in the Brokered Deposit market during 2012. This new source of funding was used to replace maturing deposits and manage interest rate risk more effectively.

Deposits are summarized as follows (000s omitted):

	As of September 30, 2012		As of December 31, 2011	
	Balance	Percentage	Balance	Percentage
Non-interest bearing demand	\$ 21,734	16.57%	\$ 19,662	18.26%
NOW accounts	9,411	7.18%	8,040	7.47%
Money market	11,544	8.80%	6,622	6.15%
Savings	19,277	14.70%	18,188	16.89%
Time deposits < \$100,000	9,981	7.61%	11,469	10.65%
Time deposits > \$100,000	47,970	36.58%	43,697	40.58%
Brokered deposits	11,230	8.56%		0.00%
Total deposits	\$ 131,147	100.00%	\$ 107,678	100.00%

At September 30, 2012 and December 31, 2011, the Bank had no secured borrowings outstanding. The Bank did not utilize the FRB discount window in 2012. The Bank did utilize its line of credit from the FHLBI during the first nine months of 2012 for short term financing. However, there were no FHLBI borrowings outstanding at September 30, 2012, and the Bank did not utilize FHLB advances during the third quarter.

**Table of Contents****RESULTS OF OPERATIONS**

The Corporation reported net income applicable to common shareholders of \$138,000 for the third quarter of 2012 compared to \$109,000 for the same period of 2011. This is the first year the Corporation is required to record income tax expense, and recognized \$79,000 in taxes during the period. Excluding income tax expense, net income before preferred dividends was \$228,000, an increase of 28.8% from the third quarter of 2011. The increase in pre-tax earnings was the result of asset growth and improved margins. Net interest margin for the current period was 4.65% compared to 4.44% for the third quarter of 2011 and 4.91% for the most recent linked quarter. The increase relative to the prior year is a direct result of improving the asset mix of the balance sheet and reducing total funding costs. The margin compression experienced during the quarter is a function of the current competitive market. Total non-interest income for the three months period ended September 30, 2012 was \$300,000, a decrease of \$19,000 from the same period of 2011. The decrease was the result of a reduction in SBA loan income and mortgage banking activity. Provision total \$330,000 during the period, an increase of \$225,000 from the third quarter of 2011. The increase is a product of portfolio loan growth and additional specific reserves required on impaired loans. Total non-interest expense for the third quarter of 2012 was \$1,248,000, a decrease of 5.2% from the same period of 2011. The reduction in costs is the result of focused efforts by management to control operating expenses.

The following table present trends in selected financial data for the five most recent quarters (000s omitted except per share data):

	Quarter Ended				
	September 30, 2012	June 30, 2012	March 31, 2012	December 31, 2011	September 30, 2011
<b>Income Statement</b>					
Interest income	\$ 1,746	\$ 1,719	\$ 1,622	\$ 1,630	\$ 1,582
Interest expense	239	223	228	280	301
Net interest income	1,507	1,496	1,394	1,350	1,281
Provision for loan losses	330	50	20	75	105
Non-interest income	300	112	484	309	319
Non-interest expense	1,248	1,216	1,339	1,484	1,317
Income before income taxes	228	341	519	100	177
Income tax expense (benefit)	79	111	171	(2,885)	
Net income	150	230	348	2,985	177
Effective dividend on preferred stock	12	22	12	20	68
Net income applicable to common shareholders	138	208	336	2,965	109
Basic and diluted income per share	\$ 0.08	\$ 0.11	\$ 0.19	\$ 1.64	\$ 0.06
<b>Performance Measurements</b>					
Net interest margin (tax equivalent)	4.65%	4.91%	4.80%	4.61%	4.44%
Return on average assets (1)	0.41%	0.69%	1.11%	9.60%	0.58%
Return on average assets (2)	1.52%	1.17%	1.71%	0.56%	0.92%
Return on average common equity (1)	4.92%	7.84%	12.08%	132.13%	8.49%
Return on average common equity (2)	18.35%	13.34%	18.72%	7.77%	13.53%
Efficiency ratio	69.1%	75.7%	71.3%	89.4%	82.4%
Tier 1 Leverage Ratio (Bank only)	9.20%	9.82%	10.13%	9.94%	9.22%
Equity / Assets	11.23%	11.83%	12.67%	12.83%	10.47%
Total loans / Total deposits	90.3%	92.2%	95.4%	98.7%	92.3%
Book value per share	\$ 6.61	\$ 6.54	\$ 6.44	\$ 6.26	\$ 4.65
Income per share - basic & diluted	\$ 0.08	\$ 0.11	\$ 0.19	\$ 1.64	\$ 0.06
Shares outstanding	1,824,662	1,824,662	1,812,662	1,812,662	1,812,662

## Edgar Filing: Birmingham Bloomfield Bancshares - Form 10-Q

- (1) Amount is computed on net income before preferred dividends (annualized).
- (2) Amount is computed on pre-tax, pre-provision earnings before preferred dividends (annualized).

**Table of Contents****Net Interest Income**

Net interest income for the three month period ended September 30, 2012 totaled \$1,507,000, an increase of 17.6% compared to the same period of the prior year. The increase was a result of earning asset growth and a reduction in total funding costs. The earning asset growth was concentrated in loan volume, providing the largest benefit to interest income. Total average interest bearing liabilities increased \$14,211,000 in the third quarter of 2012 relative to the third quarter of 2011 but total related interest expenses decreased \$61,000. The lower cost of funds was achieved by changes in pricing strategy and improved mix of the portfolio.

The Corporation's net interest margin increased 21 basis points to 4.65% for the quarter ended September 30, 2012 compared to 4.44% for the same period in 2011. Net interest spread, the difference between the yield on earning assets and cost of funds, also increased relative to the third quarter of 2011. The increase in both spread and margin is the result of an improved mix and a reduction in deposit costs. Asset yields declined during the period due to a reduction in loan and investment rates but a more favorable mix mitigated the impact. Total cost of funds for the third quarter of 2012 was 0.89% compared to 1.31% for the same period of 2011. This was accomplished as a result of an effective pricing strategy implemented by management and access to other funding options.

The following table presents the Corporation's consolidated average balances of interest-earning assets, interest-bearing liabilities, and the amount of interest income or interest expense attributable to each category, the average yield or rate for each category, and the net interest margin for the periods ended September 30, 2012, and 2011 (000s omitted). Average loans are presented net of unearned income and the allowance for loan and lease losses. Interest on loans includes loan fees.

	Three Months Ended September 30,					
	2012			2011		
	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate
<b>Interest-earning assets:</b>						
Loans receivable	\$ 114,840	\$ 1,714	5.86%	\$ 101,577	\$ 1,555	6.00%
Securities available for sale	4,038	24	2.54%	2,729	22	3.30%
Federal funds sold			%			%
Interest-bearing balances with other financial institutions	10,131	7	0.28%	10,238	5	0.19%
<b>Total interest-earning assets</b>	<b>129,009</b>	<b>1,745</b>	<b>5.31%</b>	<b>114,544</b>	<b>1,582</b>	<b>5.41%</b>
<b>Noninterest-earning assets:</b>						
Cash and due from banks	11,589			5,640		
All other assets	5,459			1,342		
<b>Total Assets</b>	<b>\$ 146,057</b>			<b>\$ 121,526</b>		
<b>Interest-bearing liabilities:</b>						
NOW accounts	\$ 9,652	\$ 9	0.36%	\$ 7,835	\$ 8	0.38%
Money market	10,850	14	0.50%	10,495	11	0.43%
Savings	18,134	26	0.56%	18,493	26	0.56%
Time deposits	55,861	160	1.10%	54,694	256	1.86%
Brokered deposits	11,231	31	0.89%			%
Short-term borrowing			0.00%			%
<b>Total interest-bearing liabilities:</b>	<b>\$ 105,728</b>	<b>\$ 240</b>	<b>0.89%</b>	<b>\$ 91,517</b>	<b>\$ 301</b>	<b>1.31%</b>
<b>Non-interest bearing demand deposits</b>						
All other liabilities	22,895			16,997		
	706			492		
<b>Total liabilities</b>	<b>129,329</b>			<b>109,006</b>		
Shareholders' Equity	16,728			12,520		
<b>Total liabilities and shareholders' equity</b>	<b>\$ 146,057</b>			<b>\$ 121,526</b>		



Edgar Filing: Birmingham Bloomfield Bancshares - Form 10-Q

<b>Net Interest Income</b>	<b>\$ 1,505</b>	<b>\$ 1,281</b>
Net spread	4.42%	4.11%
Net Interest Margin(1)	4.65%	4.44%

(1) Net interest earnings divided by average interest-earning assets.

**Table of Contents****Net Interest Income**

Net interest income for the nine month period ended September 30, 2012 totaled \$4,395,000, an increase of 15.9% compared to the same period of the prior year. The increase was a result of earning asset growth and a reduction in total funding costs. The majority of the earning asset growth was concentrated in the loan portfolio. Total average interest bearing deposit accounts increased \$6,873,000 in the first nine months of 2012 relative to the first nine months of 2011 but total deposit related interest expenses decreased \$254,000. The lower cost of funds was achieved by changes in pricing strategy and improved mix of the portfolio.

The Corporation's net interest margin increased 30 basis points to 4.78% for the nine month period ended September 30, 2012 compared to 4.48% for the same period in 2011. Net interest spread, the difference between the yield on earning assets and cost of funds, also increased relative to the same period of 2011. The increase in both spread and margin is the result of an improved mix and a reduction in deposit costs. Asset yields declined during the period due to a reduction in loan and investment rates but a more favorable mix mitigated the impact. Total cost of funds for the first nine months of 2012 was 0.95% compared to 1.39% for the same period of 2011. This was a product of an effective pricing strategy implemented by management, access to other funding options and increased non-interest bearing deposits.

The following table presents the Corporation's consolidated average balances of interest-earning assets, interest-bearing liabilities, and the amount of interest income or interest expense attributable to each category, the average yield or rate for each category, and the net interest margin for the nine month periods ended September 30, 2012, and 2011 (000s omitted). Average loans are presented net of unearned income and the allowance for loan and lease losses. Interest on loans includes loan fees.

	Nine Months Ended September 30,					
	2012			2011		
	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate
<b>Interest-earning assets:</b>						
Loans receivable	\$ 110,669	\$ 4,997	5.94%	\$ 100,658	\$ 4,645	6.09%
Securities available for sale	4,309	75	2.45%	3,005	75	3.32%
Federal funds sold			%	13		0.13%
Interest-bearing balances with other financial institutions	7,965	13	0.23%	9,523	15	0.21%
<b>Total interest-earning assets</b>	<b>122,943</b>	<b>5,085</b>	<b>5.46%</b>	<b>113,199</b>	<b>4,735</b>	<b>5.52%</b>
<b>Noninterest-earning assets:</b>						
Cash and due from banks	7,250			3,698		
All other assets	5,489			1,115		
<b>Total Assets</b>	<b>\$ 135,682</b>			<b>\$ 118,012</b>		
<b>Interest-bearing liabilities:</b>						
NOW accounts	\$ 9,174	\$ 25	0.36%	\$ 7,989	\$ 20	0.35%
Money market	9,720	34	0.45%	9,252	34	0.49%
Savings	17,712	74	0.55%	18,215	89	0.65%
Time deposits	53,621	497	1.14%	54,596	786	1.92%
Brokered deposits	7,137	60	0.95%			%
Short-term borrowing	21		0.41%	460	15	4.22%
<b>Total interest-bearing liabilities:</b>	<b>\$ 97,385</b>	<b>\$ 690</b>	<b>0.95%</b>	<b>\$ 90,512</b>	<b>\$ 944</b>	<b>1.39%</b>
<b>Non-interest bearing demand deposits</b>						
All other liabilities	21,152			15,169		
	696			603		
<b>Total liabilities</b>	<b>119,233</b>			<b>106,284</b>		
Shareholders' Equity	16,449			11,728		
<b>Total liabilities and shareholders' equity</b>	<b>\$ 135,682</b>			<b>\$ 118,012</b>		

Edgar Filing: Birmingham Bloomfield Bancshares - Form 10-Q

<b>Net Interest Income</b>	<b>\$ 4,395</b>	<b>\$ 3,792</b>
Net spread	<b>4.51%</b>	<b>4.13%</b>
Net Interest Margin(1)	<b>4.78%</b>	<b>4.48%</b>

(1) Net interest earnings divided by average interest-earning assets.

**Table of Contents****Provision for Loans Losses**

The provision for loan losses was \$330,000 and \$105,000 for the three months ended September 30, 2012 and 2011, respectively. The increase from the previous comparable period was due to an increase in total specific reserves and loan growth. There were no charge-offs recorded for the three months ended September 30, 2012 while there was one charge-off totaling \$128,000 recorded for the three months ended September 30, 2011. There were no recoveries in the current quarter, while there were \$20,000 in recoveries for the same period in 2011.

The provision for loan losses was \$400,000 and \$159,000 for the nine months ended September 30, 2012 and 2011, respectively. The increase relative to the prior period was the result of an increase in specific reserves on impaired loans and new portfolio activity. There were no charge-offs recorded for the nine months ended September 30, 2012 while there was one charge-off totaling \$128,000 recorded for the nine months ended September 30, 2011. For the nine months ended September 30, 2012, there were no recoveries, while there were \$20,000 in recoveries for the same period in 2011.

**Non-Interest Income**

The Corporation reported non-interest income of \$300,000 and \$319,000 for the three months ended September 30, 2012 and 2011, respectively. Non-interest income decreased as a result of lower SBA loan sales and reduced volume with mortgage banking activities. Service charge income totaled \$19,000, an increase of \$4,000 relative to the third quarter of 2011 as a result of growth in deposit services and pricing changes. Other income increased \$21,000 to \$30,000 during the period as the Corporation recognized income from bank-owned life insurance purchased in December of 2011.

Non-interest income was \$895,000 and \$924,000 for the nine months ended September 30, 2012 and 2011, respectively. The decrease in non-interest income was primarily the result of lower SBA loan sales during 2012. The reduction in revenue was offset by additional income from residential mortgage activity and additional other income. Service charge income increased \$19,000 to \$59,000 as a result of pricing changes and additional deposit account activity. Mortgage banking activities income increased \$107,000 due to additional volume. Other income increased by \$210,000 as a result of the gain on sale of a foreclosed property and income from bank-owned life insurance

The following table presents the Corporation's non-interest income for the three and nine month periods ending September 30, 2012 and 2011:

	For the Three Months Ended			For the Nine Months Ended		
	September 30, 2012	September 30, 2011	Change	September 30, 2012	September 30, 2011	Change
<b>Non-interest income</b>						
Service charge income	\$ 19,413	\$ 15,208	\$ 4,205	\$ 58,710	\$ 39,369	\$ 19,341
Mortgage banking activities	77,165	108,384	(31,219)	274,032	167,145	106,887
SBA loan sales	173,099	186,151	(13,052)	321,848	686,884	(365,036)
Other income	30,031	8,808	21,223	240,733	30,426	210,307
Total non-interest income	\$ 299,708	\$ 318,551	\$ (18,843)	\$ 895,323	\$ 923,824	\$ (28,501)

**Non-Interest Expense**

Non-interest expense for the three month period ended September 30, 2012 was \$1,248,000, a decrease from the third quarter of 2011. The largest component of non-interest expense is Salaries and Benefits, totaling \$653,000 for the current period compared to \$730,000 for the three months ended September 30, 2011. The reduction in expense is a result of changes in staffing levels. Occupancy expense declined \$23,000, or 15.9%, as the Corporation no longer maintained mortgage lending production facilities. The Corporation continues to dedicate resources to business marketing efforts to improve franchise recognition; this is reflected in the increase in Advertising costs reported during the period relative to the prior year. Professional fees were relatively flat. Loan origination expenses increased \$11,000 during the period relative to the prior year as the Corporation experienced growth in portfolio loans and increased volume in residential mortgage activities. Regulatory assessments declined \$8,000 for the three month period ended September 30, 2012 due to a reduction in insurance rates and change in the assessment base. Other expenses totaled \$102,000 for the third quarter of 2012, a decrease of \$21,000 compared to the same period of 2011.

Non-interest expense for the nine month period ended September 30, 2012 was \$3,803,000, an increase of \$195,000 from the same period in 2011. This was the result of additional expenses associated with new employees, increased loan origination activity and growth of the

## Edgar Filing: Birmingham Bloomfield Bancshares - Form 10-Q

organization. Salaries and benefits represents the largest percentage of non-interest expense totaling \$2.1 million during the first nine months of 2012, an increase of \$100,000 from 2011. The increase is a result of additional

**Table of Contents**

staff and merit raises for employees. Occupancy expense declined \$32,000 as the Corporation eliminated mortgage lending production facilities. Equipment and Data Processing expenses increased relative to the same period of the prior year as the Company adds new products and services, and expands the existing infrastructure. Advertising expenses increased \$62,000 during the first nine months of 2012 as the Corporation continues to focus on developing brand awareness and supporting the local community. Loan origination expense was \$155,000 for the period, an increase of \$69,000. This additional cost is directly related to an increase in loan volume. Professional fees increased by 4.1% to \$379,000 as a result of additional legal fees and costs associated with engaging market professionals to assist the Corporation with strategic objectives. Regulatory assessments declined \$42,000 for the nine month period ended September 30, 2012 due to a reduction in insurance rates and change in the assessment base. Other expenses totaled \$280,000 for the third quarter of 2012, a decrease of \$7,000 compared to the same period of 2011.

The following table presents the Corporation's non-interest expense for the three and nine month periods ending September 30, 2012 and 2011:

	For the Three Months Ended			For the Nine Months Ended		
	September 30, 2012	September 30, 2011	Change	September 30, 2012	September 30, 2011	Change
<b>Non-interest expense</b>						
Salaries and employee benefits	\$ 653,234	\$ 729,641	\$ (76,407)	\$ 2,055,073	\$ 1,955,026	\$ 100,047
Occupancy expense	122,137	145,294	(23,157)	356,804	388,979	(32,175)
Equipment expense	49,950	55,722	(5,772)	150,229	133,310	16,919
Advertising	81,712	29,276	52,436	172,180	110,019	62,161
Data processing	63,178	57,379	5,799	180,219	166,952	13,267
Professional fees	102,328	105,963	(3,635)	378,629	363,403	15,226
Loan origination expenses	48,091	37,223	10,868	155,147	86,273	68,874
Regulatory assessments	25,270	33,603	(8,333)	74,245	115,931	(41,686)
Other expense	102,264	123,360	(21,096)	280,363	287,503	(7,140)
<b>Total non-interest expense</b>	<b>\$ 1,248,164</b>	<b>\$ 1,317,461</b>	<b>\$ (69,297)</b>	<b>\$ 3,802,889</b>	<b>\$ 3,607,396</b>	<b>\$ 195,493</b>

**Table of Contents**

**Income Taxes**

The Corporation recorded federal income tax expense of \$79,000 for the three month period ended September 30, 2012. A tax liability of \$63,000 was realized for the third quarter of 2011 with a corresponding reduction in the Deferred Tax Asset valuation reserve resulting in no income tax expense being reported for the third quarter of September 30, 2011.

The Corporation recorded federal income tax expense of \$361,000 for the nine month period ended September 30, 2012. A tax liability of \$344,000 was realized for the first nine months of 2011 with a corresponding reduction in the Deferred Tax Asset valuation reserve resulting in no income tax expense being reported for the first nine months of September 30, 2011.

The deferred tax asset (DTA) balance represents the aggregate tax effect of all deductible temporary differences and operating loss carry-forwards. DTAs are recorded when an event generating a tax benefit has been recognized in the financial statements and is measured using the applicable tax rate. When it is more likely than not a portion or all of the DTA will not be realized a valuation reserve is required. The objective of the reserve is to reduce the DTA balance to an amount that is likely to be recognized. The requirement for a valuation reserve on a DTA is based on an analysis of all existing evidence, both positive and negative.

Since inception, the Corporation established a reserve on the full amount of the outstanding DTA balance. The reserve was maintained based on the Corporation's cumulative losses and concern regarding the ability of the organization to realize the full benefit of the asset. In December 2011, as a result of improved earnings, positive performance trends and financial projections demonstrating sustainable profitability, management determined there was sufficient evidence the Corporation would be able to recognize the full benefit of the entire DTA balance and eliminated the valuation reserve of \$2,884,000. The Corporation's deferred tax asset (DTA) is included in other assets on the balance sheet. During the last quarter of 2011, management performed an evaluation of the ability of the Corporation to utilize the benefit of the DTA balance and determined no reserve was required. As of September 30, 2011, the Corporation had a valuation reserve for the entire balance of the DTA balance.

The Corporation has net operating loss carry-forwards of approximately \$4,132,000 that are available to reduce future taxable income. The carry-forwards begin to expire twenty years from date of origination.

**Table of Contents****LIQUIDITY AND CAPITAL RESOURCES; ASSET/LIABILITY MANAGEMENT**

The management team has responsibility for developing and recommending liquidity and risk management policies including but not limited to the determination of internal operating guidelines, contingency plans, change management and pricing to the Asset/Liability Committee (ALCO) of the Board of Directors. Management ensures that the liquidity of a bank allows it to provide funds to meet its cash flow needs, such as loan requests, outflows of deposits, other investment opportunities and general operating requirements, under multiple operating scenarios. While the current structure of the Corporation and the Bank are not complex, the objective in the management of liquidity and capital resources is to be able to take advantage of business opportunities that may arise. The major sources of liquidity for the Bank have been deposit growth, federal funds sold, and loans which mature within one year. The Bank is also a member of the Federal Home Loan Bank of Indianapolis and has access to funding from the discount window at the Federal Reserve Bank of Chicago. The ALCO committee has also approved alternate funding sources to add flexibility. Large deposit balances which might fluctuate in response to interest rate changes are closely monitored. These deposits consist mainly of certificates of deposit over \$100,000. We anticipate that we will have more than sufficient funds available to meet our future commitments. As of September 30, 2012, off balance sheet loan commitments totaled \$35,360,000. As a majority of the unused commitments represent commercial and equity lines of credit, the Bank expects, and experience has shown, that only a small portion of the unused commitments will normally be drawn upon.

The following table presents loan commitments by time period as of September 30, 2012 (000s omitted):

	Total	Amount of commitment expiration by period			
		Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Commitments to grant loans	\$ 14,195	\$ 14,195	\$	\$	\$
Unfunded commitments under lines of credit	20,587	3,374	13,080	894	3,239
Commercial and standby letters of credit	578	578			
Total commitments	\$ 35,360	\$ 18,147	\$ 13,080	\$ 894	\$ 3,239

Commitments to grant loans are governed by the Corporation's credit underwriting standards, as established in the Corporation's Loan Policy. As the above schedule illustrates, in general, it is the Corporation's practice to grant loan commitments for a finite period of time, usually lasting one year or less. The most significant departure from this practice involves home equity lines of credit (HELOCs). The Corporation's equity lines have a contractual draw period exceeding 5 years. The Corporation has the ability to suspend the draw privileges on a HELOC where a default situation or other impairment issue is identified.

The largest sources of cash and cash equivalents for the Corporation for the three months ended September 30, 2012, as noted in the Consolidated Statement of Cash Flows, were primarily loan sales and deposit origination.

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The prompt corrective action regulations provide five classifications, well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and plans for capital restoration are required. The Bank was well-capitalized as of September 30, 2012. Note 10 to the financial statements is hereby incorporated by reference. At September 30, 2012, the Corporation qualifies for an exemption from regulatory capital requirements due to its asset size.

On July 28, 2011, Birmingham Bloomfield Bancshares, Inc. entered into a Securities Purchase Agreement with the Secretary of the Treasury (the Treasury), pursuant to which the Company issued and sold to the Treasury 4,621 shares of its Senior Non-Cumulative Perpetual Preferred Stock, Series D (Series D Preferred Stock), having a liquidation preference of \$1,000 per share (the Liquidation Amount), for aggregate proceeds of \$4,621,000. In conjunction with the issuance of the Series D Preferred Stock, the Company has redeemed from the Treasury for \$3,461,000, all of the Series A Preferred Shares, Series B Preferred Shares, and Series C Preferred Shares which were issued to the Treasury in 2009 under the Treasury's Emergency Economic Stabilization Act of 2008 Capital Purchase Program.





---

## **Table of Contents**

The Series D Preferred Stock is entitled to receive non-cumulative dividends payable quarterly, on each January 1, April 1, July 1 and October 1, beginning October 1, 2011. The dividend rate, which is calculated on the aggregate Liquidation Amount, is based upon the current level of

Qualified Small Business Lending , or QSBL (as defined in the Securities Purchase Agreement) by the Company's wholly owned subsidiary Bank of Birmingham (the Bank ). The dividend rate for future dividend periods will be set based upon the Percentage Change in Qualified Lending (as defined in the Securities Purchase Agreement) between each dividend period and the Baseline QSBL level. Such dividend rate may vary from 1% per annum to 5% per annum for the second through tenth dividend periods, from 1% per annum to 7% per annum for the eleventh dividend period through year four and one-half. If the Series D Preferred Stock remains outstanding for more than four and one-half years, the dividend rate will be fixed at 9%. Prior to that time, in general, the dividend rate decreases as the level of the Bank's QSBL increases. Such dividends are not cumulative, but the Company may only declare and pay dividends on its common stock (or any other equity securities junior to the Series D Preferred Stock) if it has declared and paid dividends for the current dividend period on the Series D Preferred Stock, and will be subject to other restrictions on its ability to repurchase or redeem other securities.

Managing rates on earning assets and interest bearing liabilities focuses on maintaining stability in the net interest margin, an important factor in earnings growth and stability. Emphasis is placed on maintaining a controlled rate sensitivity position to avoid wide swings in margins and to manage risk due to changes in interest rates. Some of the major areas of focus of the Corporation's Asset Liability Committee (ALCO) incorporate the following overview functions: review the interest rate risk sensitivity of the Bank to measure the impact of changing interest rates on the Bank's net interest income, review the liquidity position through various measurements, review current and projected economic conditions and the corresponding impact on the Bank, ensure that capital and adequacy of the allowance for loan losses are maintained at proper levels to sustain growth, monitor the investment portfolio, recommend policies and strategies to the Board that incorporate a better balance of our interest rate risk, liquidity, balance sheet mix and yield management, and review the current balance sheet mix and proactively determine the future product mix.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Corporation's primary market risk exposure is interest rate risk and liquidity risk. All of the Corporation's transactions are denominated in U.S. dollars with no specific foreign exchange exposure. Any impacts that changes in foreign exchange rates would have on interest rates are assumed to be insignificant.

Interest rate risk (IRR) is the exposure of a banking organization's financial condition to adverse movements in interest rates. Accepting this risk can be an important source of profitability and shareholder value; however, excessive levels of IRR could pose a significant threat to our earnings and capital base. Accordingly, effective risk management that maintains IRR at prudent levels is essential to the Corporation's safety and soundness. The Board of Directors has instituted a policy setting limits on the amount of interest rate risk that may be assumed. Management provides information to the Board of Directors on a quarterly basis detailing interest rate risk estimates and activities to control such risk.

Evaluating a financial institution's exposure to changes in interest rates includes assessing both the adequacy of the management process used to control IRR and the organization's quantitative level of exposure. When assessing the IRR management process, the Corporation seeks to ensure that appropriate policies, procedures, management information systems and internal controls are in place to maintain IRR at prudent levels with consistency and continuity. Evaluating the quantitative level of IRR exposure requires the Corporation to assess the existing and potential future effects of changes in interest rates on its consolidated financial condition, including capital adequacy, earnings, liquidity, and, where appropriate, asset quality. This detailed analysis is performed on a quarterly basis, but is managed daily. The Bank continues to be in a liability sensitive position and management continues to work toward creating a more closely matched portfolio to minimize any potential impact that changing rates could have on earnings in the short term. The institution is well positioned to minimize the impact of rate changes, with the rate shock analysis showing that over the long term, rate changes pose only a minimal risk to our economic value of equity (EVE ratio).

The Corporation has not experienced a material change in its financial instruments that are sensitive to changes in interest rates since December 31, 2011, which information can be located in the Corporation's annual report on Form 10-K.

### **ITEM 4. CONTROLS AND PROCEDURES**

As of September 30, 2012, we conducted an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's chief executive officer and chief financial officer, of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures, as such term is defined under Exchange Act Rules 13a-15(e) and 15d-15(e).



**Table of Contents**

Based on this evaluation, the Corporation's chief executive officer and chief financial officer concluded that, as of September 30, 2012, such disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and accumulated and communicated to the Corporation's management, including the Corporation's chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

In designing and evaluating the disclosure controls and procedures, the Corporation's management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and in reaching a reasonable level of assurance. The Corporation's management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

There were no changes in the Corporation's internal controls over financial reporting during the period ended September 30, 2012 that materially affected, or are reasonably likely to materially affect, the Corporation's internal controls over financial reporting.

**Table of Contents**

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS.**

There are no known pending legal proceedings to which the Corporation or the Bank is a party or to which any of its properties are subject; nor are there material proceedings known to the Corporation, in which any director, officer or affiliate or any principal shareholder is a party or has an interest adverse to the Corporation or the Bank.

**ITEM 1A. RISK FACTORS.**

This item is not applicable.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

This item is not applicable.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES.**

This item is not applicable.

**ITEM 4. MINE SAFETY DISCLOSURES**

This item is not applicable.

**ITEM 5. OTHER INFORMATION.**

This item is not applicable.

**Table of Contents**

**ITEM 6. EXHIBITS.**

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
31.1	Rule 13a-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a) Certification of Chief Financial Officer.
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Interactive Data File.

**Table of Contents**

**SIGNATURES**

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

**BIRMINGHAM BLOOMFIELD BANCSHARES, INC.**

Date: November 9, 2012

By: /s/ Robert E. Farr  
Robert E. Farr  
Chief Executive Officer

Date: November 9, 2012

By: /s/ Thomas H. Dorr  
Thomas H. Dorr  
Chief Financial Officer

**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
<b>31.1</b>	<b>Certification pursuant to Rules 13a-15(f) and 15d-15(f) of the Securities Exchange Act</b>
<b>31.2</b>	<b>Certification pursuant to Rules 13a-15(f) and 15d-15(f) of the Securities Exchange Act</b>
<b>32.1</b>	<b>Certification pursuant to Rules 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act and 18 U.S.C. §1350</b>
<b>101</b>	<b>Interactive Data File.</b>