PARKE BANCORP, INC.
Form 10-Q
August 14, 2012

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

FORM 10-Q

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

For the quarterly period ended: June 30, 2012.

or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____________ to ____________

Commission File No. 000-51338

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

New Jersey	65-1241959
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
601 Delsea Drive, Washington Township, New Jersey	08080
(Address of principal executive offices)	(Zip Code)

856-256-2500
(Registrant's telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer,

or a smaller reporting company. See the definitions of "large accelerated filer”, “accelerated filer", and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [X]

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

As of August 14, 2012, there were issued and outstanding 5,383,893 shares of the registrant's common stock.

PARKE BANCORP, INC.

FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2012

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

Parke Bancorp, Inc. and Subsidiaries
Consolidated Balance Sheets
(unaudited)

(in thousands except share and per share data)

	June 30, 2012	December 31, 2011
Assets		
Cash and due from financial institutions	$ 4,401	$ 3,733
Federal funds sold and cash equivalents	114,578	106,495
Total Cash and cash equivalents	118,979	110,228
Investment securities available for sale, at fair value	23,428	22,517
Investment securities held to maturity (fair value of $2,153 at June 30, 2012 and $2,080 at December 31, 2011)	2,049	2,032
Total investment securities	25,477	24,549
Loans held for sale	-	225
Loans, net of unearned income	604,877	625,117
Less: Allowance for loan losses	18,325	19,323
Net loans	586,552	605,794
Accrued interest receivable	2,969	3,039
Bank premises and equipment, net	4,130	4,122
Other real estate owned (OREO)	26,727	19,410
Restricted stock, at cost	2,227	3,565
Bank owned life insurance (BOLI)	5,632	5,541
Other assets	15,857	14,265
Total Assets	$ 788,550	$ 790,738
Liabilities and Equity		
Liabilities		
Deposits		
Noninterest-bearing deposits	$ 32,879	$ 31,146
Interest-bearing deposits	625,851	603,709
Total deposits	658,730	634,855
FHLB borrowings	20,529	50,607
Other borrowed funds	10,000	10,000
Subordinated debentures	13,403	13,403
Accrued interest payable	615	618
Other liabilities	5,192	3,982
Total liabilities	708,469	713,465
Equity		
Preferred stock, cumulative perpetual, $1,000 liquidation value; authorized 1,000,000 shares; Issued: 16,288 shares at June 30, 2012 and December 31, 2011	15,965	15,868

Common stock, $.10 par value; authorized 10,000,000 shares; Issued: 5,594,793 shares at June 30, 2012 and 5,097,078 shares December 31, 2011		560			510	
Additional paid-in capital		48,869			45,844	
Retained earnings		17,899			17,808	
Accumulated other comprehensive loss		(570	)		(626	)
Treasury stock, 210,900 shares at June 30, 2012 and December 31, 2011, at cost		(2,180	)		(2,180	)
Total shareholders' equity		80,543			77,224	
Noncontrolling (minority) interest in consolidated subsidiaries		(462	)		49	
Total equity		80,081			77,273	
Total liabilities and equity	$	788,550		$	790,738	

See accompanying notes to consolidated financial statements

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Parke Bancorp Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF INCOME
(unaudited)

(in thousands except share and per share data)

	For the six months ended June 30,		For the three months ended June 30,	
	2012	2011	2012	2011
Interest income:				
Interest and fees on loans	$18,871	$19,890	$9,358	$10,074
Interest and dividends on investments	540	704	252	330
Interest on federal funds sold and cash equivalents	119	44	66	27
Total interest income	19,530	20,638	9,676	10,431
Interest expense:				
Interest on deposits	3,459	4,005	1,687	1,950
Interest on borrowings	475	714	233	362
Total interest expense	3,934	4,719	1,920	2,312
Net interest income	15,596	15,919	7,756	8,119
Provision for loan losses	4,300	4,500	2,050	2,100
Net interest income after provision for loan losses	11,296	11,419	5,706	6,019
Noninterest income (loss):				
Loan fees	159	164	105	101
Net income from BOLI	91	88	46	44
Service fees on deposit accounts	104	108	54	53
Gain on sale of SBA loans	1,357	3,142	755	899
Other than temporary impairment losses	—	(57)	—	(37)
Portion of loss recognized in other comprehensive income (OCI) (before taxes)	—	—	—	—
Net impairment losses recognized in earnings	—	(57)	—	(37)
Gain (loss) on sale of real estate owned	(625)	52	(537)	—
Other	528	117	108	60
Total noninterest income	1,614	3,614	531	1,120
Noninterest expense:				
Compensation and benefits	2,852	2,822	1,410	1,408
Professional services	776	645	500	389
Occupancy and equipment	531	503	267	242
Data processing	203	224	109	114
FDIC insurance	546	685	276	343
OREO Expense	687	212	318	117
Other operating expense	1,902	1,366	1,110	649
Total noninterest expense	7,497	6,457	3,990	3,262
Income before income tax expense	5,413	8,576	2,247	3,877
Income tax expense	1,529	3,444	257	1,564
Net income attributable to Company and noncontrolling (minority) interest	3,884	5,132	1,990	2,313
Net income attributable to noncontrolling (minority) interest	(248)	(696)	(141)	(169)
Net income attributable to Company	3,636	4,436	1,849	2,144
Preferred stock dividend and discount accretion	504	499	253	250
Net income available to common shareholders	$3,132	$3,937	$1,596	1,894

Earnings per common share				
Basic	$0.58	$0.73	$0.30	$0.35
Diluted	$0.58	$0.71	$0.30	$0.35
Weighted average shares outstanding				
Basic	5,375,176	5,374,561	5,375,792	5,374,561
Diluted	5,379,758	5,513,923	5,381,121	5,451,221

See accompanying notes to consolidated financial statements

Parke Bancorp Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	For the six months ended June 30,	
	2012	2011
	(in thousands)	
Net income attributable to Company and other comprehensive income net of tax	$3,636	$4,436
Unrealized gains on securities:		
Non-credit unrealized gains on securities with OTTI	100	34
Net unrealized (losses) gains on securities without OTTI	(51)	70
Total unrealized gains on securities	49	104
Pension liability adjustments	7	20
Total other comprehensive income	56	124
Total comprehensive income	$3,692	$4,560

See accompanying notes to consolidated financial statements

Parke Bancorp Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	For the three months ended June 30,	
	2012	2011
	(in thousands)	
Net income attributable to Company and other comprehensive income net of tax	$1,849	$2,144
Unrealized gains on securities:		
Non-credit unrealized gains on securities with OTTI	100	30
Net unrealized (losses) gains on securities without OTTI	(23)	129
Total unrealized gains on securities	77	159
Pension liability adjustments	4	9
Total other comprehensive income	81	168
Total comprehensive income	$1,930	$2,312

See accompanying notes to consolidated financial statements

Parke Bancorp, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CHANGE IN TOTAL EQUITY
(unaudited)

	Preferred Stock	Shares of Common Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Shareholders Equity	Non-Controlling (Minority) Interest	Total Equity
	(in thousands except share data)									
Balance, December 31, 2011	$15,868	5,097,078	$510	$45,844	$17,808	$(626)	$(2,180)	$77,224	$49	$77,273
Capital withdrawals by noncontrolling (minority) interest									(759)	(759)
Stock options exercised		9,332	1	34				35		35
Treasury stock purchased (42,035 shares)										
10% common stock dividend		488,383	49	2,991	(3,041)			(1)		(1)
Comprehensive income:										
Net income					3,636			3,636	248	3,884
Non-credit unrealized gain on securities with OTTI, net of taxes						100		100		100
Net unrealized(loss) on securities without OTTI, net of taxes						(51)		(51)		(51)
Pension liability adjustments, net of taxes						7		7		7
Total comprehensive income								3,692	248	3,940
Dividend on preferred stock (5% annually)					(407)			(407)		(407)
Accretion of discount on	97				97)					

preferred stock										
Balance, June 30, 2012	$15,965	5,594,793	$560	$48,869	$17,899	$(570)	$(2,180)	$80,543	$(462)	$80,081

See accompanying notes to consolidated financial statements

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Parke Bancorp Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	For the six months ended June 30,	
	2012	2011
	(in thousands)	
Cash Flows from Operating Activities		
Net income	$ 3,884	$ 5,132
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	183	182
Provision for loan losses	4,300	4,500
Bank owned life insurance	(91)	(88)
Supplemental executive retirement plan expense	68	225
Gain on sale of SBA loans	(1,357)	(3,142)
SBA loans originated for sale	(12,784)	(14,629)
Proceeds from sale of SBA loans originated for sale	14,366	16,277
Loss (gain) on sale of other real estate owned	625	(52)
Other than temporary decline in value of investments	—	57
Net accretion of purchase premiums and discounts on securities	(11)	(39)
Deferred income tax benefit	602	—
Changes in operating assets and liabilities:		
Increase in accrued interest receivable and other assets	(2,031)	(670)
Increase (decrease) in accrued interest payable and other accrued liabilities	1,144	(1,056)
Net cash provided by operating activities	8,898	6,697
Cash Flows from Investing Activities		
Purchases of investment securities available for sale	(4,148)	—
Redemptions (purchases) of restricted stock	1,338	(79)
Proceeds from sale of securities available for sale	—	500
Proceeds from maturities, calls and principal payments on securities	3,189	2,192
Proceeds from sale of other real estate owned	1,246	2,483
Advances on other real estate owned	(207)	(3,730)
Net decrease (increase) in loans	5,961	(6,985)
Purchases of bank premises and equipment	(191)	(94)
Net cash provided by (used in) investing activities	7,188	(5,713)
Cash Flows from Financing Activities		
Payment of dividend on preferred stock	(407)	(408)
Cash payment of fractional shares on 10% stock dividend	(1)	(2)
Minority interest capital withdrawal, net	(759)	(599)
Net decrease in Federal Home Loan Bank and short term borrowings	(30,078)	—
Proceeds from exercise of stock options and warrants	35	—
Payments of Federal Home Loan Bank advances	—	(75)

Net increase in noninterest-bearing deposits		1,733			1,868	
Net increase (decrease) in interest-bearing deposits		22,142			(4,711	)
Net cash used in financing activities		(7,335	)		(3,927	)
Increase (decrease) in cash and cash equivalents		8,751			(2,943	)
Cash and Cash Equivalents, beginning of period		110,228			57,628	
Cash and Cash Equivalents, end of period	$	118,979		$	54,685	
Supplemental Disclosure of Cash Flow Information:						
Cash paid during the year for:						
Interest on deposits and borrowed funds	$	3,937		$	4,907	
Income taxes	$	2,365		$	3,444	
Supplemental Schedule of Noncash Activities:						
Real estate acquired in settlement of loans	$	8,981		$	682	

See accompanying notes to consolidated financial statements

Notes to Consolidated Financial Statements (Unaudited)

NOTE 1. ORGANIZATION

Parke Bancorp, Inc. ("Parke Bancorp” or the "Company") is a bank holding company incorporated under the laws of the State of New Jersey in January 2005 for the sole purpose of becoming the holding company of Parke Bank (the "Bank").

The Bank is a commercial bank which commenced operations on January 28, 1999. The Bank is chartered by the New Jersey Department of Banking and insured by the Federal Deposit Insurance Corporation ("FDIC"). Parke Bancorp and the Bank maintain their principal offices at 601 Delsea Drive, Washington Township, New Jersey. The Bank also conducts business through branches in Galloway Township, Northfield and Washington Township, New Jersey and Philadelphia, Pennsylvania.

The Bank competes with other banking and financial institutions in its primary market areas. Commercial banks, savings banks, savings and loan associations, credit unions and money market funds actively compete for savings and time certificates of deposit and all types of loans. Such institutions, as well as consumer financial and insurance companies, may be considered competitors of the Bank with respect to one or more of the services it renders.

The Bank is subject to the regulations of certain state and federal agencies, and accordingly, the Bank is periodically examined by such regulatory authorities. As a consequence of the regulation of commercial banking activities, the Bank’s business is particularly susceptible to future state and federal legislation and regulations.

The FDIC and the New Jersey Department of Banking and Insurance Consent Orders: On April 9, 2012, the Bank entered into Consent Orders with the FDIC and the New Jersey Department of Banking and Insurance (the “Department”). Under the Consent Orders, the terms of which are substantially identical, the Bank is required, among other things, subject to review and approval by the FDIC and the Department: (i) to adopt and implement a plan to reduce the Bank’s position in delinquent or classified assets; (ii) to adopt and implement a program providing for a periodic independent review of the Bank’s loan portfolio and the identification of problem credits; (iii) to review and revise the Bank’s loan policies and procedures to address identified lending deficiencies; and (iv) to adopt and implement a plan to reduce and manage each of the concentrations of credit identified by the FDIC and the Department.

The Consent Orders also require the Bank to obtain the prior approval of the FDIC and the New Jersey Department before declaring or paying any dividend or appointing or changing the title or responsibilities of any director or senior executive officer. Additional regulatory provisions require FDIC prior approval before the Bank enters into any employment agreement or other agreement or plan providing for the payment of a “golden parachute payment” or the making of any golden parachute payment.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Financial Statement Presentation: The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America (“GAAP”) and predominant practices within the banking industry.

The accompanying consolidated financial statements include the accounts of Parke Bancorp, Inc. and its wholly-owned subsidiaries Parke Bank, Parke Capital Markets, Farm Folly, Inc. and Taylors Glen LLC. Also included are the accounts of 44 Business Capital Partners LLC, a joint venture formed in 2009 to originate and service SBA loans. Parke Bank has a 51% ownership interest in the joint venture. Parke Capital Trust I,

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Parke Capital Trust II and Parke Capital Trust III are wholly-owned subsidiaries but are not consolidated because they do not meet the requirements for consolidation under applicable accounting guidance. All significant inter-company balances and transactions have been eliminated.

The accompanying interim financial statements should be read in conjunction with the annual financial statements and notes thereto included in Parke Bancorp Inc.'s Annual Report on Form 10-K for the year ended December 31, 2011 since they do not include all of the information and footnotes required by GAAP. The accompanying interim financial statements for the six months ended June 30, 2012 and 2011 are unaudited. The balance sheet as of December 31, 2011, was derived from the audited financial statements. In the opinion of management, these financial statements include all normal and recurring adjustments necessary for a fair statement of the results for such interim periods. Results of operations for the six months ended June 30, 2012 are not necessarily indicative of the results for the full year.

Use of Estimates: In preparing the interim financial statements, management makes estimates and assumptions based on available information that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the balance sheet and reported amounts of expenses and revenues. Actual results could differ from such estimates. The allowance for loan losses, deferred taxes, evaluation of investment securities for other-than-temporary impairment and fair values of financial instruments and other real estate owned ("OREO") are significant estimates and particularly subject to change.

Recently Issued Accounting Pronouncements:

In May 2011, FASB issued ASU 2011-04, Fair Value Measurement (Topic 820) - Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This ASU does not extend the use of fair value accounting, but provides guidance on how it should be applied where its use is already required or permitted. This guidance is to be applied prospectively and is effective during interim and annual periods beginning after December 15, 2011. Adoption of this guidance has not had a material impact on results of operations or financial condition.

In June 2011, the FASB issued guidance to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The amendments are effective for interim and annual periods beginning after December 15, 2011 with retrospective application. The Company adopted the accounting standard on January 1, 2012, as required, with no material impact on its results of operations or financial position.

NOTE 3. INVESTMENT SECURITIES

The following is a summary of the Company's investments in available for sale and held to maturity securities as of June 30, 2012 and December 31, 2011:

As of June 30, 2012		Amortized cost		Gross unrealized gains		Gross unrealized losses		Other-than-temporary impairments in OCI		Fair value
				(Amounts in thousands)						
Available for sale:										
U.S. Government sponsored entities	$	7	$	—	$	—	$	—	$	7
Corporate debt obligations		1,500		45		—		—		1,545
Residential mortgage-backed securities		15,911		737		—		—		16,648
Collateralized mortgage obligations		1,148		130		—		—		1,278
Collateralized debt obligations		5,556		—		1,114		492		3,950
Total available for sale	$	24,122	$	912	$	1,114	$	492	$	23,428
Held to maturity:										
States and political subdivisions	$	2,049	$	104	$	—	$	—	$	2,153

As of December 31, 2011		Amortized cost		Gross unrealized gains		Gross unrealized losses		Other-than-temporary impairments in OCI		Fair value
				(Amounts in thousands)						
Available for sale:										
U.S. Government sponsored entities	$	1,006	$	5	$	—	$	—	$	1,011
Corporate debt obligations		1,500		43		57		—		1,486
Residential mortgage-backed securities		13,697		764		—		—		14,461
Collateralized mortgage obligations		1,534		73		—		13		1,594
Collateralized debt obligations		5,556		—		1,080		511		3,965
Total available for sale	$	23,293	$	885	$	1,137	$	524	$	22,517
Held to maturity:										
States and political subdivisions	$	2,032	$	87	$	39	$	—	$	2,080

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The amortized cost and fair value of debt securities classified as available for sale and held to maturity, by contractual maturity as of June 30, 2012 are as follows:

	Amortized Cost	Fair Value
	(Amounts in thousands)	
Available for sale:		
Due within one year	$—	$—
Due after one year through five years	—	—
Due after five years through ten years	—	—
Due after ten years	7,062	5,512
Residential mortgage-backed securities and collateralized mortgage obligations	17,060	17,926
Total available for sale	$24,122	$23,438
Held to maturity:		
Due within one year	$—	$—
Due after one year through five years	—	—
Due after five years through ten years	—	—
Due after ten years	2,049	2,153
Total held to maturity	$2,049	$2,153

Expected maturities will differ from contractual maturities for mortgage related securities because the issuers of certain debt securities do have the right to call or prepay their obligations without any penalty.

As of June 30, 2012, securities with a carrying value of $11.0 million, and fair value of $11.9 million, were pledged as collateral for borrowed funds. In addition, securities with a carrying value of $5.0 million, and fair value of $5.4 million, were pledged to secure public deposits.

The following tables show the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2012 and December 31, 2011:

As of June 30, 2012	Less Than 12 Months		12 Months or Greater		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(Amounts in thousands)			
Available for sale:						
Collateralized debt obligations	—	—	3,636	1,114	3,636	1,114
Total available for sale	$—	$—	$3,636	$1,114	$3,636	$1,114
Held to maturity:						
States and political subdivisions	$—	$—	$—	$—	$—	$—

As of December 31, 2011	Less Than 12 Months		12 Months or Greater		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
			(Amounts in thousands)			
Available for sale:						
Corporate debt obligations	—	—	443	57	443	57
Collateralized debt obligations	—	—	3,670	1,080	3,670	1,080
Total available for sale	$—	$—	$4,113	$1,137	$4,113	$1,137
Held to maturity:						
States and political subdivisions	$758	$39	$—	$—	$758	$39

Collateralized Debt Obligations: The Company’s unrealized loss on investments in collateralized debt obligations (“CDOs”) relates to three securities issued by financial institutions, totaling $3.7 million. CDOs are pooled securities primarily secured by trust preferred securities (“TruPS”), subordinated debt and surplus notes issued by small and mid-sized banks and insurance companies. These securities are generally floating rate instruments with 30-year maturities, and are callable at par by the issuer after five years. The current economic downturn has had a significant adverse impact on the financial services industry; consequently, TruPS CDOs do not have an active trading market. With the assistance of competent third-party valuation specialists, the Company utilized the following methodology to determine the fair value:

Cash flows were developed based on the estimated speeds at which the trust preferred securities are expected to prepay (a range of 1% to 2%), the estimated rates at which the trust preferred securities are expected to defer payments, the estimated rates at which the trust preferred securities are expected to default (a range of 0.57% to 0.66%), and the severity of the losses on securities which default (95%). Trust preferred securities

generally allow for prepayment by the issuer without a prepayment penalty any time after five years. Due to the lack of new trust preferred issuances and the relatively poor conditions of the financial institution industry, a relatively modest rate of prepayment was assumed going forward. Estimates for conditional default rates ("CDR") are based on the payment characteristics of the trust preferred securities themselves (e.g. current, deferred, or defaulted) as well as the financial condition of the trust preferred issuers in the pool. Estimates for the near-term rates of deferral and CDR are based on key financial ratios relating to the financial institutions' capitalization, asset quality, profitability and liquidity. Finally, we consider whether or not the financial institution has received TARP funding, and if it has, the amount. Longer-term rates of deferral and defaults are based on historical averages. The fair value of each bond was assessed by discounting its projected cash flows by a discount rate. The discount rates were based on the yields of publicly traded TruPS and preferred stock issued by comparably rated banks (3 month LIBOR plus a spread of 400 to 959 basis points). The fair value for previous reporting periods was based on indicative market bids and resulted in much lower values due to the inactive trading market.

The underlying issuers have been analyzed, and projections have been made regarding the future performance, considering factors including defaults and interest deferrals. The analysis indicates that the Company should expect to receive all contractual cash flows. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, it does not consider these investments to be other-than-temporarily impaired at June 30, 2012.

Other-Than-Temporarily Impaired Debt Securities

We assess whether we intend to sell or it is more likely than not that we will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other-than-temporarily impaired ("OTTI") and that we do not intend to sell and will not be required to sell prior to recovery of our amortized cost basis, we separate the amount of the impairment into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and is recognized in other comprehensive income.

The present value of expected future cash flows is determined using the best estimate of cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best estimate cash flows vary depending on the type of security. The asset-backed securities cash flow estimates are based on bond specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds and structural support, including subordination and guarantees. The corporate bond cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or the disposition of assets using bond specific facts and circumstances including timing, security interests and loss severity.

We have a process in place to identify debt securities that could potentially have a credit impairment that is other than temporary. This process involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues. On a quarterly basis, we review all securities to determine whether an other-than-temporary decline in value exists and whether losses should be recognized. We consider relevant facts and circumstances in evaluating whether a credit or interest rate-related impairment of a security is other than temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events and (4) for fixed maturity securities, our intent to sell a security or whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity and for equity securities, our ability and intent to hold the security for a period of time that allows for the recovery in value.

The following table presents a roll-forward of the credit loss component of the amortized cost of debt securities that we have written down for OTTI and the credit component of the loss that is recognized in earnings. OTTI recognized in earnings for credit-impaired debt securities is presented as additions in two components based upon whether the current period is the first time the debt security was credit-impaired (initial credit impairment) or is not the first time the debt security was credit impaired (subsequent credit impairments). The credit loss component is reduced if we sell, intend to sell or believe we will be required to sell previously credit-impaired debt securities. Additionally, the credit loss component is reduced if we receive cash flows in excess of what we expected to receive over the remaining life of the credit-impaired debt security, the security matures or is fully written down. Changes in the credit loss component of credit-impaired debt securities were as follows for the periods ended June 30, 2012 and 2011.

	For the Six Months Ended June 30,	
	2012	2011
	(Amounts in thousands)	
Beginning balance	$1,950	$2,657
Initial credit impairment	—	—
Subsequent credit impairments	—	57
Reductions for amounts recognized in earnings due to intent or requirement to sell	—	—
Reductions for securities sold	—	—
Reductions for securities deemed worthless	(399)	316
Reductions for increases in cash flows expected to be collected	—	—
Ending balance	$1,551	$2,398

	For the Three Months Ended June 30,	
	2012	2011
	(Amounts in thousands)	
Beginning balance	$1,551	$2,596
Initial credit impairment	—	—
Subsequent credit impairments	—	37
Reductions for amounts recognized in earnings due to intent or requirement to sell	—	—
Reductions for securities sold	—	—
Reductions for securities deemed worthless	—	235
Reductions for increases in cash flows expected to be collected	—	—
Ending balance	$1,551	$2,398

A summary of investment gains and losses recognized in income during the six month and three month periods ended June 30, 2012 and 2011 are as follows:

	For the Six Months Ended June 30,	
	2012	2011
	(Amounts in thousands)	
Available for sale securities:		
Realized gains	$—	$—
Realized (losses)	—	—
Other than temporary impairment	—	(57)
Total available for sale securities	$—	$(57)
Held to maturity securities:		
Realized gains	$—	$—
Realized (losses)	—	—
Other than temporary impairment	—	—
Total held to maturity securities	$—	$—

	For the Three Months Ended June 30,	
	2012	2011
	(Amounts in thousands)	
Available for sale securities:		
Realized gains	$—	$—
Realized (losses)	—	—
Other than temporary impairment	—	(37)
Total available for sale securities	$—	$(37)
Held to maturity securities:		
Realized gains	$—	$—
Realized (losses)	—	—
Other than temporary impairment	—	—
Total held to maturity securities	$—	$—

NOTE 4. LOANS

The portfolio of loans outstanding consists of:

	June 30, 2012		December 31, 2011	
	Amount	Percentage of Total Loans	Amount	Percentage of Total Loans
	(Amounts in thousands)			
Commercial and Industrial	$ 22,541	3.7 %	$ 24,136	3.9 %
Real Estate Construction:				
Residential	11,325	1.9	21,287	3.4
Commercial	41,694	6.9	50,361	8.1
Real Estate Mortgage:				
Commercial – Owner Occupied	140,002	23.1	147,449	23.6
Commercial – Non-owner Occupied	210,569	34.9	204,216	32.6
Residential – 1 to 4 Family	139,105	23.0	138,768	22.2
Residential - Multifamily	20,777	3.4	20,126	3.2
Consumer	18,864	3.1	18,774	3.0
Total Loans	$ 604,877	100.0 %	$ 625,117	100.0 %

The Company maintains interest reserves for the purpose of making periodic and timely interest payments for borrowers that qualify for development and construction loans. Total development and construction loans with interest reserves were $7.4 million and $14.6 million at June 30, 2012 and December 31, 2011, respectively. The amount of interest capitalized from interest reserves and recognized as interest income for the six month periods ended June 30, 2012 and 2011 was $221,000 and $642,000, respectively. Interest reserves provide borrowers temporary sources of cash flow which can be used to make interest payments during the development or construction phases of a project. It is our expectation that equity in the project increases as the project moves towards completion and that cash flows will be positive once sales begin or stabilization occurs. Loans with interest reserves are monitored throughout the life of the project. Interest accrual may be suspended on interest reserve dependent loans that are not delinquent but are risk rated substandard or worse.

Loan Origination/Risk Management: In the normal course of business the Company is exposed to a variety of operational, reputational, legal, regulatory and credit risks that could adversely affect our financial performance. Most of our asset risk is primarily tied to credit (lending) risk. The Company has lending policies, guidelines and procedures in place that are designed to maximize loan income within an acceptable level of risk. The Board of Directors reviews and approves these policies, guidelines and procedures. When we originate a loan we make certain subjective judgments about the borrower’s ability to meet the loan’s terms and conditions. We also make objective and subjective value assessments on the assets we finance. The borrower’s ability to repay can be adversely affected by economic changes. Likewise, changes in market conditions and other external factors can affect asset valuations. The Company actively monitors the quality of its loan portfolio. A reporting system supplements the credit review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit risk, loan delinquencies, troubled debt restructures, nonperforming and potential problem loans. Diversification in the loan portfolio is another means of managing risk associated with fluctuations in economic conditions.

With respect to construction loans to developers and builders that are secured by non-owner occupied properties, the Company generally requires the borrower to have had an existing relationship with the Company and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analysis of the developers and property owners. Construction loans are generally underwritten based upon estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans, in addition to those of real estate loans. Commercial real estate loans may be riskier than loans for one-to-four family residences and are typically larger in dollar size. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. The repayment of these loans is generally largely dependent on the successful operation and management of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company’s commercial real estate portfolio are diverse in terms of type and geographic location within our market area. This diversity helps reduce the Company's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. The Company also monitors economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans. At June 30, 2012, approximately 39.9% of the outstanding principal balance of the Company’s commercial real estate loans were secured by owner-occupied properties.

Consumer loans may carry a higher degree of repayment risk than residential mortgage loans. Repayment is typically dependent upon the borrower’s financial stability which is more likely to be adversely affected by job loss, illness, or personal bankruptcy. To monitor and manage consumer loan risk, policies and procedures are developed and modified as needed. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans are heavily influenced by statutory requirements, which include, but are not limited to, a maximum loan-to-value percentage of 80%, collection remedies, the number of such loans a borrower can have at one time and documentation requirements. Historically the Company’s losses on consumer loans have been negligible.

The Company maintains an outsourced independent loan review program that reviews and validates the credit risk assessment program on a periodic basis. Results of these external independent reviews are presented to management. In 2011 the Company expanded its risk monitoring program by creating a standalone Credit Risk Management Department. The external independent loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit risk management personnel.

Nonaccrual and Past Due Loans: Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when a loan is 90 days past due, unless the loan is well secured and in the process of collection, as required by regulatory provision. Loans may be placed on non-accrual status regardless of

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whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

An age analysis of past due loans by class follows:

June 30, 2012	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days and Not Accruing	Total Past Due	Current	Total Loans	Loans > 90 Days and Accruing
	(Amounts in thousands)						
Commercial	$ —	—	308	308	22,233	22,541	—
Real Estate Construction:							
Residential	—	—	1,833	1,833	9,492	11,325	—
Commercial	—	1,698	8,056	9,754	31,940	41,694	—
Real Estate Mortgage:							
Residential	2,974	—	6,948	9,922	149,960	159,882	—
Commercial	—	1,227	25,538	26,765	323,806	350,571	—
Consumer	108	—	191	299	18,565	18,864	—
Total	$ 3,082	2,925	42,874	48,881	555,996	604,877	—

December 31, 2011	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days and Not Accruing	Total Past Due	Current	Total Loans	Loans > 90 Days and Accruing
	(Amounts in thousands)						
Commercial	$ 603	$ —	$ —	$ 603	$ 23,533	$24,136	$ —
Real Estate Construction:							
Residential	350	—	5,265	5,615	15,672	21,287	—
Commercial	—	—	7,703	7,703	42,658	50,361	—
Real Estate Mortgage:							
Residential	2,587	—	8,288	10,875	148,019	158,894	—
Commercial	2,932	—	22,929	25,861	325,804	351,665	—
Consumer	—	—	274	274	18,500	18,774	—
Total	$ 6,472	$ —	$ 44,459	$ 50,931	$574,186	$625,117	$ —

Impaired Loans: Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. In addition, any loan that is modified in a troubled debt restructuring is considered impaired.

All impaired loans have an independent third-party full appraisal to determine the net realizable value ("NRV") based on the fair value of the underlying collateral, less cost to sell (a range of 5% to 10%) and other costs, such as unpaid real estate taxes, that have been identified, or the present value of discounted cash flows in the case of certain impaired loans that are not collateral dependent. The appraisal will be based on an "as-is" valuation and will follow a reasonable valuation method that addresses the direct sales comparison,

income, and cost approaches to market value, reconciles those approaches, and explains the elimination of each approach not used. Appraisals are updated every 12 months or sooner if we have identified possible further deterioration in value. Prior to receiving the updated appraisal, we will establish a specific reserve for any estimated deterioration, based upon our assessment of market conditions, adjusted for estimated costs to sell and other identified costs. If the NRV is greater than the loan amount, then no impairment loss exists. If the NRV is less than the loan amount, the shortfall is recognized by a specific reserve. If the borrower fails to pledge additional collateral in the ninety day period, a charge-off equal to the difference between the loan carrying value and NRV will occur. In certain circumstances, however, a direct charge-off may be taken at the time that the NRV calculation reveals a shortfall. All impaired loans are evaluated based on the criteria stated above on a quarterly basis and any change in the reserve requirements are recorded in the period identified. All partially charged-off loans remain on nonaccrual status until they are brought current as to both principal and interest and have at least six months of payment history and future collectability of principal and interest is assured.

Impaired loans are set forth in the following tables.

June 30, 2012	Recorded Investment	Unpaid Principal Balance	Related Allowance
		(Amounts in thousands)	
With no related allowance recorded:			
Commercial	$ 808	$ 875	$ —
Residential Real Estate Construction	1,833	3,159	—
Commercial Real Estate Construction	6,457	6,457	—
Residential Real Estate Mortgage	10,516	10,710	—
Commercial Real Estate Mortgage	47,909	50,968	—
Consumer	191	227	—
	67,714	72,396	—
With an allowance recorded:			
Commercial	—	—	—
Residential Real Estate Construction	935	1,372	56
Commercial Real Estate Construction	1,599	2,057	16
Residential Real Estate Mortgage	4,232	4,268	682
Commercial Real Estate Mortgage	10,708	10,708	71
Consumer	—	—	—
	17,474	18,405	825
Total:			
Commercial	808	875	—
Residential Real Estate Construction	2,768	4,531	56
Commercial Real Estate Construction	8,056	8,514	16
Residential Real Estate Mortgage	14,748	14,978	682
Commercial Real Estate Mortgage	58,617	61,676	71
Consumer	191	227	—
	$ 85,188	$ 90,801	$ 825

Included in the above table are TDRs that are in compliance with their modified terms and accruing interest, totaling $41.7 million.

June 30, 2011	Recorded Investment		Unpaid Principal Balance (Amounts in thousands)		Related Allowance	
With no related allowance recorded:						
Commercial	$	594	$	594	$	—
Residential Real Estate Construction		4,756		4,947		—
Commercial Real Estate Construction		16,146		16,146		—
Residential Real Estate Mortgage		6,818		6,890		—
Commercial Real Estate Mortgage		30,210		30,209		—
Consumer		—		—		—
		58,524		58,786		—
With an allowance recorded:						
Commercial		—		—		—
Residential Real Estate Construction		6,427		7,628		1,449
Commercial Real Estate Construction		1,659		2,248		344
Residential Real Estate Mortgage		12,620		13,310		1,077
Commercial Real Estate Mortgage		18,127		18,247		246
Consumer		—		—		—
		38,833		41,433		3,116
Total:						
Commercial		594		594		—
Residential Real Estate Construction		11,183		12,575		1,449
Commercial Real Estate Construction		17,805		18,394		344
Residential Real Estate Mortgage		19,438		20,200		1,077
Commercial Real Estate Mortgage		48,337		48,456		246
Consumer		—		—		—
	$	97,357	$	100,219	$	3,116

Included in the above table are TDRs that are in compliance with their modified terms and accruing interest, totaling $41.1 million.

The following table presents by loan portfolio class, the average recorded investment and interest income recognized on impaired loans for the six months and three months ended June 30, 2012 and 2011:

	Six Months Ended June 30,			
	2012		2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Amounts in thousands)			
Commercial	$856	$11	$594	$10
Residential Real Estate Construction	3,658	45	12,211	188
Commercial Real Estate Construction	8,130	3	17,800	263
Residential Real Estate Mortgage	14,887	234	20,526	313
Commercial Real Estate Mortgage	60,372	1,143	51,617	1,342
Consumer	210	2	—	—
Total	$88,113	$1,438	$102,748	$2,116

	Three Months Ended June 30,			
	2012		2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(Amounts in thousands)			
Commercial	$730	$11	$594	$7
Residential Real Estate Construction	5,180	27	12,267	86
Commercial Real Estate Construction	12,296	—	19,332	96
Residential Real Estate Mortgage	14,938	122	20,771	162
Commercial Real Estate Mortgage	56,717	668	52,077	638
Consumer	190	1	—	—
Total	$90,051	$829	$105,041	$989

Troubled debt restructurings: Periodically management evaluates our loans for appropriate risk rating, interest accrual status and potential classification as a TDR, some of which are performing and accruing interest. A TDR is a loan on which we have granted a concession due to a borrower's financial difficulty. These are concessions that would not otherwise be considered. The terms of these modified loans may include extension of maturity, renewals, change in interest rate, additional collateral requirements or infusion of additional capital into the project by the borrower to reduce debt or to support future debt service. On construction and land development loans we may modify the loan as a result of delays or other project issues such as slower than anticipated sell-outs, insufficient leasing activity and/or a decline in the value of the underlying collateral securing the loan. Management believes that working with a borrower to restructure a loan provides us with a better likelihood of collecting our loan. It is our policy not to renegotiate the terms of a commercial loan simply because of a delinquency status. However, we will use our Troubled Debt Restructuring Program to work with delinquent borrowers when the delinquency is temporary. We consider all loans modified in a troubled debt restructuring to be impaired.

At the time a loan is modified in a troubled debt restructuring, we consider the following factors to determine whether the loan should accrue interest:

- Whether there is a period of current payment history under the current terms, typically 6 months;
- Whether the loan is current at the time of restructuring; and
- Whether we expect the loan to continue to perform under the restructured terms with a debt coverage ratio that complies with the Bank's credit underwriting policy of 1.25 times debt service.

We also review the financial performance of the borrower over the past year to be reasonably assured of repayment and performance according to the modified terms. This review consists of an analysis of the borrower's historical results; the borrower's projected results over the next four quarters; current financial information of the borrower and any guarantors. The projected repayment source needs to be reliable, verifiable, quantifiable and sustainable. In addition, all troubled debt restructurings are reviewed quarterly to determine the amount of any impairment.

At the time of restructuring, the amount of the loan principal for which we are not reasonably assured of repayment is charged-off, but not forgiven.

A borrower with a restructured loan must make a minimum of six consecutive monthly payments at the restructured level and be current as to both interest and principal to be on accrual status.

The following is an analysis of performing and nonperforming TDRs as of June 30, 2012 and December 31, 2011.

June 30, 2012	TDRs in compliance with their modified terms and accruing interest		TDRs that are not accruing interest		Total	
	Balance	Count	Balance	Count	Balance	Count
			(loan balances in thousands)			
Commercial	$500	1	$250	1	$750	2
Residential Real Estate Construction	935	2	497	1	1,432	3
Commercial Real Estate Construction	—	—	4,820	3	4,820	3
Commercial Real Estate Mortgage - Owner Occupied	5,916	6	2,064	4	7,980	10
Commercial Real Estate Mortgage - Non-owner Occupied	27,163	9	7,512	4	34,675	13
Residential Real Estate Mortgage -Multifamily	380	1	3,201	1	3,581	2
Residential Real Estate Mortgage - 1 to 4 family	6,787	6	2,536	5	9,323	11
Consumer	—	—	137	1	137	1
Total	$41,681	25	$21,017	20	$62,698	45

December 31, 2011	TDRs in compliance with their modified terms and accruing interest		TDRs that are not accruing interest		Total	
	Balance	Count	Balance	Count	Balance	Count
			(loan balances in thousands)			
Commercial	$603	1	$—	—	$603	1
Residential Real Estate Construction	2,195	2	2,832	3	5,027	5
Commercial Real Estate Construction	500	1	4,350	2	4,850	3
Commercial Real Estate Mortgage - Owner Occupied	2,740	5	4,450	6	7,190	11
Commercial Real Estate Mortgage - Non-owner Occupied	28,232	9	9,196	5	37,428	14
Residential Real Estate Mortgage -Multifamily	3,268	1	515	2	3,783	3
Residential Real Estate Mortgage - 1 to 4 family	3,605	7	4,340	6	7,945	13
Consumer	—	—	137	1	137	1
Total	$41,143	26	$25,820	25	$66,963	51

The following tables illustrate new TDRs and TDR default information for the six months and three months ended June 30, 2012 and 2011.

Troubled Debt Restructurings	For the six months ended June 30, 2012			For the six months ended June 30, 2011		
	Number of Contracts	Pre-Modification Recorded Investment	Post-Modification Recorded Investment	Number of Contracts	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
	(Dollars in Thousands)					
Commercial and Industrial	2	$ 750	$ 750	1	$ 594	$ 594
Construction:						
Residential	1	415	415	1	959	959
Commercial	—	—	—	—	—	—
Real Estate Mortgage:						
Commercial – Owner Occupied	1	3,220	3,220	1	315	315
Commercial – Non-owner Occupied	2	2,919	2,919	3	5,543	5,543
Residential – 1-4 Family	2	3,965	3,965	4	6,250	6,250
Residential – Multifamily	1	380	380	2	506	506
Consumer	—	—	—	—	—	—
Total	9	$ 11,649	$ 11,649	12	$ 14,167	$ 14,167

Troubled Debt Restructurings	For the three months ended June 30, 2012			For the three months ended June 30, 2011		
	Number of Contracts	Pre-Modification Recorded Investment	Post-Modification Recorded Investment	Number of Contracts	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
	(Dollars in Thousands)					
Commercial and Industrial	2	$ 750	$ 750	1	$ 594	$ 594
Construction:						
Residential	1	415	415	1	959	959
Commercial	—	—	—	—	—	—
Real Estate Mortgage:						
Commercial – Owner Occupied	1	3,220	3,220	1	315	315
Commercial – Non-owner Occupied	2	2,919	2,919	2	4,002	4,002
Residential – 1-4 Family	2	3,965	3,965	3	5,943	5,943
Residential – Multifamily	1	380	380	2	506	506
Consumer	—	—	—	—	—	—
Total	9	$ 11,649	$ 11,649	10	$ 12,319	$ 12,319

Troubled Debt Restructurings That Subsequently Defaulted	For the six months ended June 30, 2012		For the six months ended June, 30 2011	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(Dollars in Thousands)			
Commercial and Industrial	1	$ 603	—	$ —
Construction:				
Residential	1	1,004	—	—
Commercial	1	500	—	—
Real Estate Mortgage:				
Commercial – Owner Occupied	—	—	5	4,131
Commercial – Non-owner Occupied	2	3,623	1	121
Residential – 1-4 Family	3	776	1	929
Residential – Multifamily	1	3,267	—	—
Consumer	—	—	—	—
Total	9	$ 9,773	7	$ 5,181

Troubled Debt Restructurings That Subsequently Defaulted	For the three months ended June 30, 2012		For the three months ended June, 30 2011	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(Dollars in Thousands)			
Commercial and Industrial	—	$ —	—	$ —
Construction:				
Residential	—	—	—	—
Commercial	1	500	—	—
Real Estate Mortgage:				
Commercial – Owner Occupied	—	—	1	1,667
Commercial – Non-owner Occupied	—	—	—	—
Residential – 1-4 Family	2	566	—	—
Residential – Multifamily	—	—	—	—
Consumer	—	—	—	—
Total	3	$ 1,066	1	$ 1,667

Some loan modifications classified as TDRs may not ultimately result in the full collection of principal and interest, as modified, and result in potential incremental losses. These potential incremental losses have been factored into our overall allowance for loan losses estimate. The level of any re-defaults will likely be affected by future economic conditions. Once a loan becomes a TDR, it will continue to be reported as a TDR until it is repaid in full, foreclosed, sold or it meets the criteria to be removed from TDR status.

Credit Quality Indicators: As part of the on-going monitoring of the credit quality of the Company's loan portfolio, management tracks certain credit quality indicators including trends related to the risk grades of loans, the level of classified loans, net charge-offs, nonperforming loans (see details above) and the general economic conditions in the region.

The Company utilizes a risk grading matrix to assign a risk grade to each of its loans. Loans are graded on a scale of 1 to 7. Grades 1 through 4 are considered “Pass”. A description of the general characteristics of the seven risk grades is as follows:

1. Good: Borrower exhibits the strongest overall financial condition and represents the most creditworthy profile.
2. Satisfactory (A): Borrower reflects a well balanced financial condition, demonstrates a high level of creditworthiness and typically will have a strong banking relationship with Parke Bank.
3. Satisfactory (B): Borrower exhibits a balanced financial condition and does not expose the Bank to more than a normal or average overall amount of risk. Loans are considered fully collectable.
4. Watch List: Borrower reflects a fair financial condition, but there exists an overall greater than average risk. Risk is deemed acceptable by virtue of increased monitoring and control over borrowings. Probability of timely repayment is present.
5. Other Assets Especially Mentioned (OAEM): Financial condition is such that assets in this category have a potential weakness or pose unwarranted financial risk to the Bank even though the asset value is not currently impaired. The asset does not currently warrant adverse classification but if not corrected could weaken and could create future increased risk exposure. Includes loans which require an increased degree of monitoring or servicing as a result of internal or external changes.
6. Substandard: This classification represents more severe cases of #5 (OAEM) with characteristics that require increased monitoring. Assets are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Assets are inadequately protected by the current net worth and paying capacity of the borrower or of the collateral. Asset has a well-defined weakness or weaknesses that impairs the ability to repay debt and jeopardizes the timely liquidation or realization of the collateral at the asset’s net book value.
7. Doubtful: Assets which have all the weaknesses inherent in those assets classified #6 (Substandard) but the risks are more severe relative to financial deterioration in capital and/or asset value; accounting/evaluation techniques may be questionable and the overall possibility for collection in full is highly improbable. Borrowers in this category require constant monitoring, are considered work out loans and present the potential for future loss to the Bank.

An analysis of the credit risk profile by internally assigned grades is as follows:

At June 30, 2012	Pass	OAEM	Substandard	Doubtful	Total
		(Amounts in thousands)			
Commercial	$15,341	$6,892	$308	$—	$22,541
Residential Real Estate Construction	8,557	—	2,768	—	11,325
Commercial Real Estate Construction	18,215	—	23,479	—	41,694
Residential Real Estate Mortgage	143,057	6,742	10,083	—	159,882
Commercial Real Estate Mortgage	298,123	17,134	35,314	—	350,571
Consumer	18,673	—	191	—	18,864
Total	$501,966	$30,768	$72,143	$—	$604,877

At December 31, 2011	Pass	OAEM	Substandard	Doubtful	Total
		(Amounts in thousands)			
Commercial	$16,033	$7,500	$603	$—	$24,136
Residential Real Estate Construction	12,327	350	8,610	—	21,287
Commercial Real Estate Construction	23,898	—	26,463	—	50,361
Residential Real Estate Mortgage	136,919	7,628	14,347	—	158,894
Commercial Real Estate Mortgage	293,477	14,270	43,918	—	351,665
Consumer	18,500	—	274	—	18,774
Total	$501,154	$29,748	$94,215	$—	$625,117

NOTE 5. ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Company's allowance for loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, "Receivables" and allowance allocations calculated in accordance with ASC Topic 450, "Contingencies." Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Company's process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision for possible loan losses also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance for loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company’s control,

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including, among other things, the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Company's allowance for possible loan losses consists of three elements: (i) specific valuation allowances determined in accordance with ASC Topic 310 based on probable losses on specific loans; (ii) historical valuation allowances determined in accordance with ASC Topic 450 based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted, as necessary, to reflect the impact of current conditions; and (iii) general valuation allowances determined in accordance with ASC Topic 450 based on general economic conditions and other qualitative risk factors both internal and external to the Company.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor's ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship manager level for all commercial loans. When a loan has a grade of 6 or higher, the loan is analyzed to determine whether the loan is impaired and, if impaired, the need to specifically allocate a portion of the allowance for loan losses to the loan. Specific valuation allowances are determined by analyzing the borrower's ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower's industry, among other things.

Historical valuation allowances are calculated based on the historical loss experience of specific types of loans. The Company calculates historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical loss ratios are periodically updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical loss ratio and the total dollar amount of the loans in the pool. The Company's pools of similar loans include similarly risk-graded groups of commercial loans, commercial real estate loans, consumer real estate loans and consumer and other loans.

General valuation allowances are based on general economic conditions and other qualitative risk factors both internal and external to the Company. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the Bank's lending management and staff; (ii) the effectiveness of the Bank's loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the impact of competition on loan structuring and pricing; (vii) the effectiveness of the internal loan review function; (viii) the impact of environmental risks on portfolio risks; and (ix) the impact of rising interest rates on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. Each component is determined to have either a high, high-moderate, moderate, low-moderate or low degree of risk. The results are then input into a "general allocation matrix" to determine an appropriate general valuation allowance.

An analysis of the allowance for loan losses for the six month and three month periods ended June 30, 2012 and 2011 is as follows:

Allowance for Loan Losses:	For the six month period ended June 30, 2012				
	Beginning Balance	Charge-offs	Recoveries	Provisions	Ending Balance
	(Amounts in thousands)				
Commercial and Industrial	$451	$(66)	$—	$109	$494
Real Estate Construction:					
Residential	2,613	(1,289)	37	(71)	1,290
Commercial	1,971	(311)	—	(179)	1,481
Real Estate Mortgage:					
Commercial – Owner Occupied	2,714	(748)	—	1,555	3,521
Commercial – Non-owner Occupied	6,742	(2,938)	—	2,464	6,268
Residential – 1 to 4 Family	4,190	(350)	403	165	4,408
Residential – Multifamily	278	—	—	(10)	268
Consumer	148	(36)	—	66	178
Unallocated	216	—	—	201	417
Total	$19,323	$(5,738)	$440	$4,300	$18,325

Allowance for Loan Losses:	For the six month period ended June 30, 2011				
	Beginning Balance	Charge-offs	Recoveries	Provisions	Ending Balance
	(Amounts in thousands)				
Commercial and Industrial	$448	$(22)	$—	$70	$496
Real Estate Construction:					
Residential	2,980	(2,727)	—	2,241	2,494
Commercial	1,576	—	—	501	2,077
Real Estate Mortgage:					
Commercial – Owner Occupied	2,508	—	—	—	2,508
Commercial – Non-owner Occupied	3,792	—	—	660	4,452
Residential – 1 to 4 Family	2,848	—	—	846	3,694
Residential – Multifamily	372	—	—	—	372
Consumer	130	—	—	13	143
Unallocated	135	—	—	169	304
Total	$14,789	$(2,749)	$—	$4,500	$16,540

	For the three month period ended June 30, 2012				
	Beginning Balance	Charge-offs	Recoveries	Provisions	Ending Balance
	(Amounts in thousands)				
Commercial and Industrial	$441	$(66)	$—	$119	$494
Real Estate Construction:					
Residential	1,923	(437)	—	(196)	1,290
Commercial	1,513	(180)	—	148	1,481
Real Estate Mortgage:					
Commercial – Owner Occupied	2,833	(748)	—	1,436	3,521
Commercial – Non-owner Occupied	5,996	(139)	—	411	6,268
Residential – 1 to 4 Family	4,181	(78)	402	(97)	4,408
Residential – Multifamily	254	—	—	14	268
Consumer	182	(36)	—	32	178
Unallocated	234	—	—	185	417
Total	$17,557	$(1,684)	$402	$2,050	$18,325

	For the three month period ended June 30, 2011				
	Beginning Balance	Charge-offs	Recoveries	Provisions	Ending Balance
	(Amounts in thousands)				
Commercial and Industrial	$453	$—	$—	$43	$496
Real Estate Construction:					
Residential	2,315	(31)	—	210	2,494
Commercial	2,050	—	—	27	2,077
Real Estate Mortgage:					
Commercial – Owner Occupied	2,495	—	—	13	2,508
Commercial – Non-owner Occupied	3,827	—	—	625	4,452
Residential – 1 to 4 Family	3,055	(323)	—	962	3,694
Residential – Multifamily	332	—	—	40	372
Consumer	132	—	—	11	143
Unallocated	135	—	—	169	304
Total	$14,794	$(354)	$—	$2,100	$16,540

Allowance for Loan Losses, at June 30, 2012	Individually evaluated for impairment	Collectively evaluated for impairment	Total
	(Amounts in thousands)		
Commercial and Industrial	$—	$494	$494
Real Estate Construction:			
Residential	56	1,234	1,290
Commercial	16	1,465	1,481
Real Estate Mortgage:			
Commercial – Owner Occupied	58	3,463	3,521
Commercial – Non-owner Occupied	13	6,255	6,268
Residential – 1 to 4 Family	682	3,726	4,408
Residential – Multifamily	—	268	268
Consumer	—	178	178
Unallocated	—	417	417
Total	$825	$17,500	$18,325

Allowance for Loan Losses, at December 31, 2011	Individually evaluated for impairment	Collectively evaluated for impairment	Total
	(Amounts in thousands)		
Commercial and Industrial	$—	$451	$451
Real Estate Construction:			
Residential	1,297	1,316	2,613
Commercial	380	1,591	1,971
Real Estate Mortgage:			
Commercial – Owner Occupied	23	2,691	2,714
Commercial – Non-owner Occupied	2,526	4,216	6,742
Residential – 1 to 4 Family	600	3,590	4,190
Residential – Multifamily	33	245	278
Consumer	—	148	148
Unallocated	—	216	216
Total	$4,859	$14,464	$19,323

Loans, at June 30, 2012:	Individually evaluated for impairment	Collectively evaluated for impairment	Total
	(Amounts in thousands)		
Commercial and Industrial	$808	$21,733	$22,541
Real Estate Construction:			
Residential	2,768	8,557	11,325
Commercial	8,056	33,638	41,694
Real Estate Mortgage:			
Commercial – Owner Occupied	8,481	131,521	140,002
Commercial – Non-owner Occupied	50,136	160,433	210,569
Residential – 1 to 4 Family	11,167	127,938	139,105
Residential – Multifamily	3,581	17,196	20,777
Consumer	191	18,673	18,864
Total	$85,188	$519,689	$604,877

Loans, at December 31, 2011:	Individually evaluated for impairment	Collectively evaluated for impairment	Total
	(Amounts in thousands)		
Commercial and Industrial	$603	$23,533	$24,136
Real Estate Construction:			
Residential	8,610	12,677	21,287