

FIRST RELIANCE BANCSHARES INC  
Form 10-Q  
August 13, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C.**

(Mark One) FORM 10-Q

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

For the Quarterly Period Ended June 30, 2012

OR

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

**For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_**

Commission File Number 000-49757

FIRST RELIANCE BANCSHARES, INC.

(Exact name of small business issuer as specified in its charter)

South Carolina                      80-0030931  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

2170 West Palmetto Street  
Florence, South Carolina 29501  
(Address of principal executive  
offices, including zip code)

(843) 656-5000

(Issuer's telephone number, including area code)

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State the number of shares outstanding of each of the issuer's classes of common equity as of the latest practicable date:

**4,096,774 shares of common stock, par value \$0.01 per share, as of July 31, 2012**

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  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  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   
(Do not check if a 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

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**FIRST RELIANCE BANCSHARES, INC****Condensed Consolidated Balance Sheets**

	June 30, 2012 (Unaudited)	December 31, 2011 (Audited)
Assets		
Cash and cash equivalents:		
Cash and due from banks	\$ 1,760,694	\$ 2,134,864
Interest-bearing deposits with other banks	38,457,523	41,885,966
Total cash and cash equivalents	40,218,217	44,020,830
Time deposits in other banks	100,702	100,373
Securities available-for-sale	82,759,656	84,534,318
Nonmarketable equity securities	1,619,900	2,431,800
Total investment securities	84,379,556	86,966,118
Mortgage loans held for sale	1,591,851	2,863,297
Loans receivable	285,982,883	303,398,403
Less allowance for loan losses	(5,241,995 )	(7,743,470 )
Loans, net	280,740,888	295,654,933
Premises, furniture and equipment, net	24,945,055	25,205,064
Accrued interest receivable	1,541,441	1,938,807
Other real estate owned	22,261,300	22,135,921
Cash surrender value life insurance	12,418,506	12,228,829
Other assets	3,083,679	3,852,250
Total assets	\$ 471,281,195	\$ 494,966,422
Liabilities and Shareholders' Equity		
Liabilities		
Deposits		
Noninterest-bearing transaction accounts	\$ 57,637,012	\$ 52,299,017
Interest-bearing transaction accounts	44,281,975	42,092,193
Savings	114,509,696	122,528,570
Time deposits \$100,000 and over	110,811,598	122,474,202
Other time deposits	71,980,673	88,422,515
Total deposits	399,220,954	427,816,497
Securities sold under agreement to repurchase	4,377,004	-
Advances from Federal Home Loan Bank	13,000,000	13,000,000
Junior subordinated debentures	10,310,000	10,310,000
Accrued interest payable	387,623	317,678

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Other liabilities	2,146,634	2,404,257
Total liabilities	429,442,215	453,848,432
Shareholders' Equity		
Preferred stock		
Series A cumulative perpetual preferred stock - 15,349 shares issued and outstanding	\$ 15,022,271	\$ 14,925,265
Series B cumulative perpetual preferred stock - 767 shares issued and outstanding	794,720	802,951
Series C cumulative mandatory convertible preferred stock - 2,293 shares issued and outstanding	2,293,000	2,293,000
Common stock, \$0.01 par value; 20,000,000 shares authorized, 4,096,774 and 4,084,400 shares issued and outstanding at June 30, 2012 and December 31, 2011, respectively	40,968	40,844
Capital surplus	28,001,244	27,992,485
Treasury stock, at cost, 19,289 and 13,245 shares at June 30, 2012 and December 31, 2011, respectively	(182,072 )	(173,650 )
Nonvested restricted stock	(215,236 )	(320,196 )
Retained deficit	(5,934,886 )	(6,304,429 )
Accumulated other comprehensive income	2,018,971	1,861,720
Total shareholders' equity	41,838,980	41,117,990
Total liabilities and shareholders' equity	\$471,281,195	\$494,966,422

See notes to condensed consolidated financial statements

**FIRST RELIANCE BANCSHARES, INC****Condensed Consolidated Statements of Operations****(Unaudited)**

	Three Months Ended		Six Months Ended	
	June 30,	2011	June 30,	2011
	2012		2012	2011
Interest income:				
Loans, including fees	\$4,103,473	\$5,019,414	\$8,503,300	\$10,089,688
Investment securities:				
Taxable	462,383	367,080	927,033	672,240
Nontaxable	181,098	483,120	378,089	1,017,577
Other interest income	30,114	30,545	57,994	54,608
Total	4,777,068	5,900,159	9,866,416	11,834,113
Interest expense:				
Time deposits	957,333	1,317,783	2,009,891	2,829,527
Other deposits	104,504	303,128	259,138	567,448
Other interest expense	128,374	(15,821 )	257,027	62,764
Total	1,190,211	1,605,090	2,526,056	3,459,739
Net interest income	3,586,857	4,295,069	7,340,360	8,374,374
Provision for loan losses	-	282,010	600,000	523,124
Net interest income after provision for loan losses	3,586,857	4,013,059	6,740,360	7,851,250
Noninterest income:				
Service charges on deposit accounts	445,903	447,228	850,518	892,790
Gain on sales of mortgage loans	342,583	178,603	552,738	301,648
Income from bank owned life insurance	95,130	100,176	189,677	200,638
Other charges, commissions and fees	257,536	207,190	469,009	399,243
Gain on sale of securities	347,010	535,581	507,787	580,856
Other non-interest income	263,486	121,086	436,360	221,382
Total	1,751,648	1,589,864	3,006,089	2,596,557
Noninterest expenses:				
Salaries and employee benefits	2,047,370	2,183,814	3,796,265	4,559,859
Occupancy expense	374,494	359,117	732,261	736,313
Furniture and equipment expense	393,277	312,952	752,936	627,622
Other operating expenses	2,443,534	2,451,228	4,006,669	4,407,217
Total	5,258,675	5,307,111	9,288,131	10,331,011
Income before income taxes	79,830	295,812	458,318	116,796

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Income tax benefit	-	(125,708 )	-	(419,394 )
Net income	79,830	421,520	458,318	536,190
Preferred stock dividends	249,247	249,247	498,495	498,495
Deemed dividends on preferred stock resulting from net accretion of discount and amortization of premium	44,388	44,388	88,776	88,288
Net income (loss) available to common shareholders	\$(213,805 )	\$127,885	\$(128,953 )	\$(50,593 )
Average common shares outstanding, basic	4,096,774	4,104,808	4,091,314	4,107,626
Average common shares outstanding, diluted	4,096,774	4,457,577	4,091,314	4,107,626
Basic income (loss) per share	\$(0.05 )	\$0.03	\$(0.03 )	\$(0.01 )
Diluted income (loss) per share	\$(0.05 )	\$0.03	\$(0.03 )	\$(0.01 )

See notes to condensed consolidated financial statements



**FIRST RELIANCE BANCSHARES, INC****Condensed Consolidated Statements of Comprehensive Income****(Unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net income from operations	\$79,830	\$421,520	\$458,318	\$536,190
Other Comprehensive income, net of tax:				
Unrealized holding gains on available-for-sale securities arising during period	469,994	1,547,065	492,390	1,734,878
Reclassification adjustment for gains realized in net income from operations	(229,026)	(353,483 )	(335,139)	(383,364 )
Other comprehensive income	240,968	1,193,582	157,251	1,351,514
Comprehensive income	\$320,798	\$1,615,102	\$615,569	\$1,887,704

See notes to condensed consolidated financial statements

**FIRST RELIANCE BANCSHARES, INC****Condensed Consolidated Statements of Shareholders' Equity****For the Six Months Ended June 30, 2012 and 2011****(Unaudited)**

	Preferred Stock	Common Stock	Capital Surplus	Treasury Stock	Nonvested Restricted Stock	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2010	\$17,843,176	\$41,159	\$28,140,094	\$(168,864)	\$(679,264)	\$4,002,469	\$(586,926 )	\$48,591,844
Net income						536,190		536,190
Other comprehensive gain, net of tax expense of \$696,234							1,351,514	1,351,514
Preferred Stock Dividend						(498,495 )		(498,495 )
Accretion of Series A Preferred stock discount	96,473					(96,473 )		-
Amortization of Series B Preferred stock premium	(8,185 )					8,185		-
Issuance Common Stock		3	999					1,002
Net Change in Restricted Stock		(218 )	(118,172 )		201,345			82,955
				(3,808 )				(3,808 )

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Purchase of  
treasury stock

Balance, June 30, 2011	\$ 17,931,464	\$ 40,944	\$ 28,022,921	\$(172,672)	\$(477,919)	\$ 3,951,876	\$ 764,588	\$ 50,061,202
Balance, December 31, 2011	\$ 18,021,216	\$ 40,844	\$ 27,992,485	\$(173,650)	\$(320,196)	\$(6,304,429)	\$ 1,861,720	\$ 41,117,990
Net income						458,318		458,318
Other comprehensive gain, net of tax expense of \$81,008							157,251	157,251
Accretion of Series A Preferred stock discount	97,006					(97,006 )		-
Amortization of Series B Preferred stock premium	(8,231 )					8,231		-
Issuance Common Stock		8	993					1,001
Net Change in Restricted Stock		116	7,766			104,960		112,842
Purchase of treasury stock						(8,422 )		(8,422 )
Balance, June 30, 2012	\$ 18,109,991	\$ 40,968	\$ 28,001,244	\$(182,072)	\$(215,236)	\$(5,934,886)	\$ 2,018,971	\$ 41,838,980

See notes to condensed consolidated financial statements

**FIRST RELIANCE BANCSHARES, INC****Condensed Consolidated Statements of Cash Flows****(Unaudited)**

	Six Months Ended	
	June 30,	
	2012	2011
Cash flows from operating activities:		
Net income	\$458,318	\$536,190
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	600,000	523,124
Depreciation and amortization expense	464,735	484,113
Gain on sale of available-for-sale securities	(507,787 )	(580,856 )
Loss on sale of other real estate owned	35,021	88,487
Write down of other real estate owned	882,189	718,255
Discount accretion and premium amortization	115,246	87,999
Disbursements for mortgage loans held-for-sale	(25,332,201)	(10,018,022)
Proceeds from sale of mortgage loans held-for-sale	26,603,647	10,482,500
Net decrease in valuation allowance for loans held-for-sale	-	(14,017 )
Decrease in interest receivable	397,366	329,560
Increase in cash surrender value of life insurance	(189,677 )	(200,638 )
Increase (decrease) in interest payable	69,945	(327,361 )
Amortization of deferred compensation on restricted stock	112,842	82,955
Decrease in other assets	629,303	629,732
Increase (decrease) in other liabilities	(257,623 )	391,826
Net cash provided by operating activities	4,081,324	3,213,847
Cash flows from investing activities:		
Net decrease in loans receivable	10,175,412	14,085,167
Purchases of securities available-for-sale	(13,220,603)	(44,587,976)
Proceeds on sales of securities available-for-sale	10,004,866	27,898,732
Maturities of securities available-for-sale	5,621,199	2,537,503
Net decrease of nonmarketable equity securities	811,900	893,500
Net increase in time deposits in other banks	(329 )	-
Proceeds from sales of other real estate owned	3,096,044	3,560,925
Purchases of premises and equipment	(146,466 )	(79,907 )
Net cash provided by investing activities	16,342,023	4,307,944
Cash flows from financing activities:		
Net increase (decrease) in demand deposits, interest-bearing transaction accounts and savings accounts	(491,097 )	17,400,276
Net decrease in certificates of deposit and other time deposits	(28,104,446)	(43,679,430)
Net increase (decrease) in securities sold under agreements to repurchase	4,377,004	(216,270 )
Increase in advances from the Federal Home Loan Bank	-	7,000,000

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Issuance of common stock to employees	1,001	1,002
Preferred stock dividends paid	-	(498,495 )
Purchase of treasury stock	(8,422 )	(3,808 )
Net cash used by financing activities	(24,225,960)	(19,996,725)
Net decrease in cash and cash equivalents	(3,802,613 )	(12,474,934)
Cash and cash equivalents, beginning of period	44,020,830	25,670,293
Cash and cash equivalents, end of period	\$40,218,217	\$13,195,359
Cash paid during the period for:		
Income taxes	\$-	\$-
Interest	\$2,456,111	\$3,732,552
Supplemental noncash investing and financing activities:		
Foreclosures on loans	\$4,138,633	\$9,372,119
Net change in valuation allowance – available-for-sale	\$157,252	\$1,351,514

See notes to condensed consolidated financial statements

## **Notes to Condensed Consolidated Financial Statements (Unaudited)**

### **Note 1 - Basis of Presentation**

The accompanying condensed consolidated financial statements have been prepared in accordance with the requirements for interim financial statements and, accordingly, they are condensed and omit certain disclosures that would appear in audited annual consolidated financial statements. The consolidated financial statements as of June 30, 2012 and for the interim periods ended June 30, 2012 and 2011 are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation. The consolidated financial information as of December 31, 2011 has been derived from the audited consolidated financial statements as of that date. For further information, refer to the consolidated financial statements and the notes included in First Reliance Bancshares, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2011.

### **Note 2 - Recently Issued Accounting Pronouncements**

The following is a summary of recent authoritative pronouncements:

In April 2011, the criteria used to determine effective control of transferred assets in the Transfers and Servicing topic of the Accounting Standards Codification ("ASC") was amended by Accounting Standards Update ("ASU") 2011-03. The requirement for the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms and the collateral maintenance implementation guidance related to that criterion were removed from the assessment of effective control. The other criteria to assess effective control were not changed. The amendments were effective for the Company on January 1, 2012 and had no effect on the financial statements.

ASU 2011-04 was issued in May 2011 to amend the Fair Value Measurement topic of the ASC by clarifying the application of existing fair value measurement and disclosure requirements and by changing particular principles or requirements for measuring fair value or for disclosing information about fair value measurements. The amendments were effective for the Company beginning January 1, 2012 and had no effect on the financial statements.

The Comprehensive Income topic of the ASC was amended in June 2011. The amendment eliminates the option to present other comprehensive income as a part of the statement of changes in stockholders' equity and requires consecutive presentation of the statement of net income and other comprehensive income. The amendments were

applicable to the Company on January 1, 2012 and have been applied retrospectively. In December 2011, the topic was further amended to defer the effective date of presenting reclassification adjustments from other comprehensive income to net income on the face of the financial statements. Companies should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect prior to the amendments while the Financial Accounting Standards Board ("FASB") redeliberates future requirements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

**Note 3 - Reclassifications**

Certain captions and amounts in the financial statements in the Company's Form 10-Q for the quarter ended June 30, 2011 were reclassified to conform to the June 30, 2012 presentation.

**Note 4 - Investment Securities**

The amortized cost and estimated fair values of securities available-for-sale were:

	Amortized Cost	Gross Unrealized Gains	Losses	Estimated Fair Value
June 30, 2012				
U.S. Government agencies	\$7,815,414	\$338,836	\$-	\$8,154,250
Mortgage-backed securities	57,466,979	1,838,919	36,314	59,269,584
Municipals	14,377,792	951,030	-	15,328,822
Other	100,000	-	93,000	7,000
Total	\$79,760,185	\$3,128,785	\$129,314	\$82,759,656

	Amortized Cost	Gross Unrealized Gains	Unrealized Losses	Estimated Fair Value
December 31, 2011				
U.S. Government agencies	\$2,839,706	\$185,239	\$-	\$3,024,945
Mortgage-backed securities	59,748,500	1,816,651	4,749	61,560,402
Municipals	19,084,899	853,072	-	19,937,971
Other	100,000	-	89,000	11,000
Total	\$81,773,105	\$2,854,962	\$93,749	\$84,534,318

The following is a summary of maturities of securities available-for-sale as of June 30, 2012. The amortized cost and estimated fair values are based on the contractual maturity dates. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalty.

	Securities Available-For-Sale	
	Amortized Cost	Estimated Fair Value
	Due within one year	\$1,415,889
Due after one year but within five years	1,985,806	2,054,920
Due after five years but within ten years	12,709,603	13,369,999
Due after ten years	6,081,908	6,614,629
	22,193,206	23,483,072
Mortgage-backed securities	57,466,979	59,269,584
Other	100,000	7,000
Total	\$79,760,185	\$82,759,656

The following table shows gross unrealized losses and fair value, aggregated by investment category, and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2012 and December 31, 2011.

	June 30, 2012		December 31, 2011	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Less Than 12 Months				
U.S. Government Agencies	\$-	\$-	\$5,085,963	\$4,749
Mortgage-backed securities	7,885,005	36,314	-	-
	7,885,005	36,314	5,085,963	4,749
12 Months or More				
Other	7,000	93,000	11,000	89,000
Total securities available-for-sale	\$7,892,005	\$129,314	\$5,096,963	\$93,749



At June 30, 2012, securities classified as available-for-sale were recorded at fair market value. Approximately 72% of the unrealized losses is the result of a single security in a continuous loss position for twelve months or more. The Company does not intend to sell this security in the near future and it is more likely than not that the Company will not be required to sell this security before recovery of its amortized cost. The Company believes, based on industry analyst reports and credit ratings, that the deterioration in value is not considered other-than-temporary.

During the first six months of 2012 and 2011, proceeds from the sale of available-for-sale securities were \$10,004,866 and \$27,898,732, respectively. Net gains on available-for-sale securities totaled \$507,787 and \$580,856 for the first six months of 2012 and 2011, respectively.

**Note 5 – Loans Receivable and Allowance for Loan Losses**

Major classifications of loans receivable are summarized as follows:

	June 30, 2012	December 31, 2011
Real estate loans:		
Construction	\$ 36,745,200	\$ 43,320,482
Residential:		
Residential 1-4 family	42,497,952	42,837,510
Multifamily	8,677,406	8,630,232
Second mortgages	4,432,261	4,503,752
Equity lines of credit	23,706,551	24,998,277
Total residential	79,314,170	80,969,771
Nonresidential	129,960,779	133,603,482
Total real estate loans	246,020,149	257,893,735
Commercial and industrial	31,369,008	36,465,095
Consumer	8,531,448	8,649,649
Other	62,278	389,924
Total loans	\$ 285,982,883	\$ 303,398,403

The Company has pledged certain loans as collateral to secure its borrowings from the Federal Home Loan Bank. The total of loans pledged was \$35,658,927 and \$35,976,783 at June 30, 2012 and December 31, 2011, respectively.

A summary of the allowance for loan losses for the six months ended June 30, 2012 and year ended December 31, 2011 is as follows:

	June 30, 2012	December 31, 2011
Beginning balance	\$ 7,743,470	\$ 6,271,045
Provision charged to operations	600,000	5,403,416
Recoveries on loans previously charged-off	592,482	639,211
Loans charged-off	(3,693,957)	(4,570,202 )
Ending balance	\$ 5,241,995	\$ 7,743,470

The following is an analysis of the allowance for loan losses by class of loans for the six months ended June 30, 2012 and the year ended December 31, 2011.

June 30, 2012

<i>(Dollars in Thousands)</i>	Total	Real Estate Loans			Non-Residential	Total Real Estate Loans	Commercial	Consumer and Other
		Construction	Residential	Residential				
Beginning balance	\$7,743	\$3,291	\$ 2,757	\$ 1,081	\$7,129	\$ 575	\$ 39	
Provisions	600	110	(678 )	535	(33 )	634	(1 )	
Recoveries	593	242	39	21	302	283	8	
Charge-offs	(3,694)	(2,003)	(289 )	(618 )	(2,910)	(780 )	(4 )	
Ending balance	\$5,242	\$1,640	\$ 1,829	\$ 1,019	\$4,488	\$ 712	\$ 42	

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**December 31, 2011**

<i>(Dollars in Thousands)</i>	Real Estate Loans				Total Real Estate Loans	Commercial	Consumer and Other
	Total	Construction	Residential	Non- Residential			
Beginning balance	\$6,271	\$2,548	\$ 1,730	\$ 947	\$5,225	\$ 998	\$ 48
Provisions	5,403	2,212	2,580	602	5,394	(9 )	18
Recoveries	639	356	88	70	514	113	12
Charge-offs	(4,570)	(1,825)	(1,641 )	(538 )	(4,004)	(527 )	(39 )
Ending balance	\$7,743	\$3,291	\$ 2,757	\$ 1,081	\$7,129	\$ 575	\$ 39

The following is a summary of loans evaluated for impairment individually and collectively, by class, for the six months ended June 30, 2012 and the year ended December 31, 2011.

**June 30, 2012**

<i>(Dollars in Thousands)</i>	Real Estate Loans				Total Real Estate Loans	Commercial	Consumer and Other
	Total	Construction	Residential	Non- Residential			
Allowance Evaluated for impairment Individually	\$662	\$6	\$ 145	\$ 397	\$548	\$ 101	\$ 13
Collectively	4,580	1,634	1,684	622	3,940	611	29
Allowance for loan losses	\$5,242	\$1,640	\$ 1,829	\$ 1,019	\$4,488	\$ 712	\$ 42
Total Loans Evaluated for impairment Individually	\$25,779	\$5,737	\$ 6,311	\$ 11,145	\$23,193	\$ 2,562	\$ 24
Collectively	260,204	31,008	73,003	118,816	222,827	28,807	8,570
Loans receivable	\$285,983	\$36,745	\$ 79,314	\$ 129,961	\$246,020	\$ 31,369	\$ 8,594

**December 31, 2011**

<i>(Dollars in Thousands)</i>	Real Estate Loans				Total Real Estate Loans	Commercial	Consumer and Other
	Total	Construction	Residential	Non- Residential			
Allowance Evaluated for impairment Individually	\$2,665	\$1,782	\$ 344	\$ 471	\$2,597	\$ 55	\$ 13
Collectively	5,078	1,509	2,413	670	4,532	520	26

Allowance for loan losses	\$7,743	\$3,291	\$ 2,757
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