

First Bancorp, Inc /ME/
Form 10-Q
November 08, 2010

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934
For the quarterly period ended September 30, 2010

Commission File Number 0-26589

THE FIRST BANCORP, INC.

(Exact name of Registrant as specified in its charter)

MAINE

(State or other jurisdiction of incorporation or
organization)

01-0404322

(I.R.S. Employer Identification No.)

MAIN STREET, DAMARISCOTTA, MAINE
(Address of principal executive offices)

04543
(Zip code)

(207) 563-3195

Registrant's telephone number, including area code

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of November 8, 2010

Common Stock: 9,770,860 shares

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Part I. Financial Information

Selected Financial Data (Unaudited)

The First Bancorp, Inc. and Subsidiary

In thousands of dollars except for per share amounts	For the nine months ended		For the quarters ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Summary of Operations				
Interest Income	\$42,918	\$48,093	\$14,570	\$15,224
Interest Expense	12,687	14,768	4,317	4,409
Net Interest Income	30,231	33,325	10,253	10,815
Provision for Loan Losses	6,300	7,660	1,800	3,060
Non-Interest Income	6,524	8,525	2,067	2,977
Non-Interest Expense	18,405	19,892	6,228	6,872
Net Income	9,039	10,380	3,195	2,890
Per Common Share Data				
Basic Earnings per Share	\$0.82	\$0.98	\$0.29	\$0.26
Diluted Earnings per Share	0.82	0.98	0.29	0.26
Cash Dividends Declared	0.585	0.585	0.195	0.195
Book Value per Common Share	13.06	12.65	13.06	12.65
Tangible Book Value per Common Share	10.23	9.80	10.23	9.80
Market Value	13.83	18.60	13.83	18.60
Financial Ratios				
Return on Average Equity ¹	9.55	% 11.40	% 9.88	% 9.28
Return on Average Tangible Equity ^{1,2}	12.23	% 14.76	% 12.60	% 11.96
Return on Average Assets ¹	0.90	% 1.02	% 0.93	% 0.85
Average Equity to Average Assets	11.22	% 10.69	% 11.18	% 11.01
Average Tangible Equity to Average Assets ²	9.17	% 8.66	% 9.16	% 8.95
Net Interest Margin Tax-Equivalent ^{1,2}	3.39	% 3.65	% 3.36	% 3.59
Dividend Payout Ratio	71.34	% 59.69	% 67.24	% 75.00
Allowance for Loan Losses/Total Loans	1.55	% 1.31	% 1.55	% 1.31
Non-Performing Loans to Total Loans	2.36	% 1.80	% 2.36	% 1.80
Non-Performing Assets to Total Assets	1.97	% 1.58	% 1.97	% 1.58
Efficiency Ratio ²	47.68	% 43.01	% 48.11	% 47.54
At Period End				
Total Assets	\$1,374,624	\$1,331,842	\$1,374,624	\$1,331,842
Total Loans	918,538	973,823	918,538	973,823
Total Investment Securities	368,859	265,052	368,859	265,052
Total Deposits	986,932	960,072	986,932	960,072
Total Shareholders' Equity	152,230	147,614	152,230	147,614

¹Annualized using a 365-day basis

²These ratios use non-GAAP financial measures. See Management's Discussion and Analysis of Financial Condition and Results of Operations for additional disclosures and information.

Item 1 – Financial Statements

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
The First Bancorp, Inc.

We have reviewed the accompanying interim consolidated financial information of The First Bancorp, Inc. and Subsidiary as of September 30, 2010 and 2009 and for the three-month and nine-month periods then ended. These financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit in accordance with standards of the Public Company Accounting Oversight Board (United States), the objective of which is to express an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

/s/ Berry, Dunn, McNeil & Parker

Portland, Maine
November 8, 2010

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Consolidated Balance Sheets (Unaudited)

The First Bancorp, Inc. and Subsidiary

In thousands of dollars	September 30, 2010	December 31, 2009	September 30, 2009
Assets			
Cash and due from banks	\$13,880	\$15,332	\$16,421
Overnight funds sold	-	-	7,500
Securities available for sale	232,075	81,838	38,575
Securities to be held to maturity (fair value of \$126,668 at September 30, 2010, \$192,838 at December 31, 2009 and \$216,921 at September 30, 2009)	121,341	190,537	211,784
Federal Reserve Bank stock, at cost	1,412	1,412	662
Federal Home Loan Bank stock, at cost	14,031	14,031	14,031
Loans held for sale	1,031	2,876	2,794
Loans	918,538	952,492	973,823
Less allowance for loan losses	14,245	13,637	12,800
Net loans	904,293	938,855	961,023
Accrued interest receivable	5,445	4,889	5,648
Premises and equipment	18,458	18,331	18,357
Other real estate owned	5,338	5,345	2,995
Goodwill	27,684	27,684	27,684
Other assets	29,636	30,264	24,368
Total assets	\$1,374,624	\$1,331,394	\$1,331,842
Liabilities			
Demand deposits	\$80,695	\$66,317	\$74,049
NOW deposits	123,899	114,955	112,087
Money market deposits	69,119	94,425	101,352
Savings deposits	102,911	90,873	93,363
Certificates of deposit	610,308	556,097	579,221
Total deposits	986,932	922,667	960,072
Borrowed funds – short term	92,500	149,601	82,882
Borrowed funds – long term	130,172	100,177	130,179
Other liabilities	12,790	11,011	11,095
Total Liabilities	1,222,394	1,183,456	1,184,228
Shareholders' equity			
Preferred stock	24,680	24,606	24,582
Common stock	98	97	97
Additional paid-in capital	45,385	45,121	45,003
Retained earnings	80,843	78,450	78,000
Net unrealized gain/(loss) on securities available-for-sale	1,421	(125)	189
Net unrealized loss on postretirement benefit costs	(197)	(211)	(257)
Total shareholders' equity	152,230	147,938	147,614
Total liabilities & shareholders' equity	\$1,374,624	\$1,331,394	\$1,331,842
Common Stock			
Number of shares authorized	18,000,000	18,000,000	18,000,000
Number of shares issued and outstanding	9,765,631	9,744,170	9,725,405
Book value per common share	\$13.06	\$12.66	\$12.65

See Report of Independent Registered Public Accounting Firm.

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Income (Unaudited)

The First Bancorp, Inc. and Subsidiary

In thousands of dollars	For the nine months ended		For the quarters ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Interest income				
Interest and fees on loans	\$33,342	\$37,704	\$11,136	\$12,171
Interest on deposits with other banks	5	1	3	1
Interest and dividends on investments	9,571	10,388	3,431	3,052
Total interest income	42,918	48,093	14,570	15,224
Interest expense				
Interest on deposits	7,699	9,403	2,648	2,709
Interest on borrowed funds	4,988	5,365	1,669	1,700
Total interest expense	12,687	14,768	4,317	4,409
Net interest income	30,231	33,325	10,253	10,815
Provision for loan losses	6,300	7,660	1,800	3,060
Net interest income after provision for loan losses	23,931	25,665	8,453	7,755
Non-interest income				
Investment management and fiduciary income	1,116	998	329	320
Service charges on deposit accounts	2,194	1,754	689	596
Net securities gains	2	-	-	1
Mortgage origination and servicing income	906	1,913	293	370
Other operating income	2,306	3,860	756	1,690
Total non-interest income	6,524	8,525	2,067	2,977
Non-interest expense				
Salaries and employee benefits	8,662	7,994	3,109	2,842
Occupancy expense	1,129	1,182	353	348
Furniture and equipment expense	1,671	1,700	550	562
FDIC insurance premiums	1,428	1,276	476	315
Net securities losses	-	147	-	-
Other than temporary impairment charge	-	916	-	-
Amortization of identified intangibles	213	213	71	71
Other operating expense	5,302	6,464	1,669	2,734
Total non-interest expense	18,405	19,892	6,228	6,872
Income before income taxes	12,050	14,298	4,292	3,860
Applicable income taxes	3,011	3,918	1,097	970
NET INCOME	\$9,039	\$10,380	\$3,195	\$2,890
Less dividends and amortization of premium on preferred stock	1,011	824	337	337
Net income available to common shareholders	\$8,028	\$9,556	\$2,858	\$2,553
Basic earnings per common share	\$0.82	\$0.98	\$0.29	\$0.26
Diluted earnings per common share	\$0.82	\$0.98	\$0.29	\$0.26
Weighted average number of shares outstanding	9,757,074	9,716,129	9,764,184	9,723,757
Incremental shares	4,707	26,808	4,062	52,629
Cash dividends declared per share	\$0.585	\$0.585	\$0.195	\$0.195

See Report of Independent Registered Public Accounting Firm.

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
The First Bancorp, Inc. and Subsidiary

In thousands of dollars except number of shares	Preferred stock	Common stock and additional paid-in capital Shares	Amount	Retained earnings	Accumulated other comprehensive income (loss)	Total shareholders' equity
Balance at December 31, 2008	\$-	9,696,397	44,214	74,057	(1,090)	117,181
Net income	-	-	-	10,380	-	10,380
Net unrealized gain on securities available for sale, net of taxes of \$543	-	-	-	-	1,008	1,008
Unrecognized transition obligation for postretirement benefits, net of taxes of \$7	-	-	-	-	14	14
Comprehensive income	-	-	-	10,380	1,022	11,402
Cash dividends declared	-	-	-	(6,437)	-	(6,437)
Equity compensation expense	-	-	28	-	-	28
Proceeds from sale of preferred stock	25,000	-	-	-	-	25,000
Premium on issuance of preferred stock	(493)	-	493	-	-	-
Amortization of premium for preferred stock issuance	75	-	(75)	-	-	-
Payment to repurchase common stock	-	(7,685)	(138)	-	-	(138)
Proceeds from sale of common stock	-	36,693	578	-	-	578
Balance at September 30, 2009	\$24,582	9,725,405	45,100	78,000	(68)	147,614
Balance at December 31, 2009	\$24,606	9,744,170	45,218	78,450	(336)	147,938
Net income	-	-	-	9,039	-	9,039
Net unrealized gain on securities available for sale, net of taxes of \$461	-	-	-	-	1,546	1,546
Unrecognized transition obligation for postretirement benefits, net of taxes of \$4	-	-	-	-	14	14
Comprehensive income	-	-	-	9,039	1,560	10,599
Cash dividends declared	-	-	-	(6,646)	-	(6,646)
Equity compensation expense	-	-	28	-	-	28
Amortization of premium for preferred stock issuance	74	-	(74)	-	-	-
Proceeds from sale of common stock	-	21,461	311	-	-	311
Balance at September 30, 2010	\$24,680	9,765,631	45,483	80,843	1,224	152,230

See Report of Independent Registered Public Accounting Firm.

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows (Unaudited)

The First Bancorp, Inc. and Subsidiary

In thousands of dollars	For the nine months ended	
	Sept 30, 2010	Sept 30, 2009
Cash flows from operating activities		
Net income	\$9,039	\$10,380
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	1,062	1,112
Change in deferred taxes	949	(565)
Provision for loan losses	6,300	7,660
Loans originated for resale	(39,369)	(98,868)
Proceeds from sales and transfers of loans	41,214	97,372
Net (gain) loss on sale or call of securities held-to-maturity	(2)	147
Write-down of securities available for sale	-	916
Net loss on sale of other real estate owned	31	-
Provision for losses on other real estate owned	310	412
Equity compensation expense	28	28
Net increase in other assets and accrued interest	(640)	(618)
Net increase (decrease) in other liabilities	287	(720)
Net accretion (amortization) of premiums on investments	181	(2,359)
Amortization of investment in limited partnership	225	-
Net acquisition amortization	173	126
Net loss on disposal of assets	-	3
Net cash provided by operating activities	19,788	15,026
Cash flows from investing activities		
Sale of overnight funds	-	(7,500)
Proceeds from maturities, payments and calls of securities available for sale	77,239	6,128
Proceeds from sales of securities available for sale	202	2,914
Proceeds from maturities, payments and calls of securities to be held to maturity	70,522	162,389
Proceeds from sales of other real estate owned	2,593	568
Purchases of securities available for sale	(226,805)	(32,917)
Purchases of securities to be held to maturity	-	(138,187)
Net increase in loans	25,334	243
Capital expenditures	(1,188)	(3,444)
Net cash used in investing activities	(52,103)	(9,806)
Cash flows from financing activities		
Net increase (decrease) in demand, savings, and money market accounts	10,054	(7,936)
Net increase in certificates of deposit	54,243	42,281
Advances on long-term borrowings	10,000	-
Repayment on long-term borrowings	-	(27,000)
Net decrease in short-term borrowings	(37,099)	(32,006)
Proceeds from issuance of preferred stock	-	25,000
Payments to repurchase common stock	-	(138)
Proceeds from sale of common stock	311	578
Dividends paid	(6,646)	(6,434)
Net cash provided (used) by financing activities	30,863	(5,655)
Net decrease in cash and cash equivalents	(1,452)	(435)
Cash and cash equivalents at beginning of year	15,332	16,856

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Cash and cash equivalents at end of period	\$13,880	\$16,421
Interest paid	\$12,856	\$15,195
Income taxes paid	\$2,130	\$4,634
Non-cash transactions		
Change in net unrealized gain on available for sale securities, net of tax	\$(1,546)	\$(1,008)
Net transfer from loans to other real estate owned	\$2,927	\$1,547

See Report of Independent Registered Public Accounting Firm.

The accompanying notes are an integral part of these consolidated financial statements.

Notes to Consolidated Financial Statements
The First Bancorp, Inc. and Subsidiary

Note 1 – Basis of Presentation

The First Bancorp, Inc. (the Company) is a financial holding company that owns all of the common stock of The First, N.A. (the Bank). The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of Management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. All significant intercompany transactions and balances are eliminated in consolidation. The income reported for the 2010 period is not necessarily indicative of the results that may be expected for the year ending December 31, 2010. For further information, refer to the consolidated financial statements and notes included in the Company's annual report on Form 10-K for the year ended December 31, 2009.

Subsequent Events

Events occurring subsequent to September 30, 2010, have been evaluated as to their potential impact to the Financial Statements.

Note 2 – Investment Securities

The following table summarizes the amortized cost and estimated fair value of investment securities at September 30, 2010:

In thousands of dollars	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale:				
U.S. Treasury and agency	\$ 18,892	\$ 1,422	\$-	\$ 20,314
Mortgage-backed securities	175,184	1,118	(1,505)	174,797
State and political subdivisions	34,327	1,405	-	35,732
Corporate securities	1,114	-	(267)	847
Other equity securities	371	19	(5)	385
	\$ 229,888	\$ 3,964	\$ (1,777)	\$ 232,075
Securities to be held to maturity:				
U.S. Treasury and agency	\$ 8,091	\$ 48	\$ (8)	\$ 8,131
Mortgage-backed securities	62,328	2,621	(109)	64,840
State and political subdivisions	50,772	2,960	(185)	53,547
Corporate securities	150	-	-	150
	\$ 121,341	\$ 5,629	\$ (302)	\$ 126,668
Non-marketable securities:				
Federal Home Loan Bank Stock	14,031	-	-	14,031
Federal Reserve Bank Stock	1,412	-	-	1,412
	\$ 15,443	\$-	\$-	\$ 15,443

The following table summarizes the amortized cost and estimated fair value at December 31, 2009:

In thousands of dollars	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value (Estimated)
Securities available for sale				
U.S. Treasury and agency	\$31,022	\$90	\$(153)	\$30,959
Mortgage-backed securities	31,254	133	(239)	31,148
State and political subdivisions	18,219	414	(119)	18,514
Corporate securities	1,120	-	(302)	818
Other equity securities	414	6	(21)	399
	\$82,029	\$643	\$(834)	\$81,838
Securities to be held to maturity				
U.S. Treasury and agency	\$39,099	\$142	\$(554)	\$38,687
Mortgage-backed securities	90,193	1,839	(363)	91,669
State and political subdivisions	61,095	1,603	(366)	62,332
Corporate securities	150	-	-	150
	\$190,537	\$3,584	\$(1,283)	\$192,838
Non-marketable securities:				
Federal Home Loan Bank Stock	14,031	-	-	14,031
Federal Reserve Bank Stock	1,412	-	-	1,412
Total	\$15,443	\$-	\$-	\$15,443

The following table summarizes the contractual maturities of investment securities at September 30, 2010:

In thousands of dollars	Securities available for sale		Securities to be held to maturity	
	Amortized Cost	Fair Value (Estimated)	Amortized Cost	Fair Value (Estimated)
Due in 1 year or less	\$-	\$-	\$1,197	\$1,210
Due in 1 to 5 years	2,948	3,140	5,838	6,189
Due in 5 to 10 years	2,387	2,440	15,161	16,184
Due after 10 years	224,182	226,110	99,145	103,085
Equity securities	371	385	-	-
	\$229,888	\$232,075	\$121,341	\$126,668

The following table summarizes the contractual maturities of investment securities at December 31, 2009:

In thousands of dollars	Securities available for sale		Securities to be held to maturity	
	Amortized Cost	Fair Value (Estimated)	Amortized Cost	Fair Value (Estimated)
Due in 1 year or less	\$-	\$-	\$330	\$335
Due in 1 to 5 years	18,144	18,381	7,934	8,245
Due in 5 to 10 years	3,671	3,783	15,020	15,591
Due after 10 years	59,800	59,275	167,253	168,667
Equity securities	414	399	-	-
	\$82,029	\$81,838	\$190,537	\$192,838

At September 30, 2010, securities with a fair value of \$124.7 million were pledged to secure public deposits, repurchase agreements, and for other purposes as required by law. This compares to securities with a fair value of \$154.0 million as of December 31, 2009 pledged for the same purpose.

Gains and losses on the sale of securities available for sale are computed by subtracting the amortized cost at the time of sale from the security's selling price, net of accrued interest to be received. The following table shows securities gains and losses for the nine months ended September 30, 2010 and 2009:

In thousands of dollars	For the nine	For the nine
	months ended September 30, 2010	months ended September 30, 2009
Proceeds from sales	\$202	\$2,914
Gross gains	\$2	\$9
Gross losses	-	(156)
Net gain/(loss)	\$2	\$(147)
Related income taxes	\$1	\$(55)

Management reviews securities with unrealized losses for other than temporary impairment. As of September 30, 2010, there were 47 securities with unrealized losses held in the Company's portfolio. These securities were temporarily impaired as a result of changes in interest rates reducing their fair market value, of which eight had been temporarily impaired for 12 months or more. At the present time, there have been no material changes in the credit quality of these securities resulting in other than temporary impairment, and in Management's opinion, no additional write-down for other-than-temporary impairment is warranted. Information regarding securities temporarily impaired as of September 30, 2010 is summarized below:

In thousands of dollars	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and agency	\$5,924	\$(8)	\$-	\$-	\$5,924	\$(8)
Mortgage-backed securities	136,212	(1,594)	1,028	(20)	137,240	(1,614)
State and political subdivisions	312	(3)	1,561	(182)	1,873	(185)
Corporate securities	-	-	848	(267)	848	(267)
Other equity securities	-	-	48	(5)	48	(5)
	\$142,448	\$(1,605)	\$3,485	\$(474)	\$145,933	\$(2,079)

During the first quarter of 2009, the Company took an after-tax charge of \$596,000 for other-than-temporary impairment related to one automotive company corporate security in the investment portfolio. As of December 31, 2009, there were 45 securities with unrealized losses held in the Company's portfolio. These securities were temporarily impaired as a result of changes in interest rates reducing their fair market value, of which eight had been temporarily impaired for 12 months or more. Information regarding securities temporarily impaired as of December 31, 2009 is summarized below:

In thousands of dollars	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and agency	\$19,999	\$(707)	\$-	\$-	\$19,999	\$(707)
Mortgage-backed securities	47,509	(602)	-	-	47,509	(602)
State and political subdivisions	9,396	(147)	1,350	(338)	10,746	(485)
Corporate securities	-	-	818	(302)	818	(302)
Other equity securities	-	-	44	(21)	44	(21)

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\$76,904 \$(1,456) \$2,212 \$(661) \$79,116 \$(2,117)

The Bank is a member of the Federal Home Loan Bank (“FHLB”) of Boston. The FHLB is a cooperatively owned wholesale bank for housing and finance in the six New England States. Its mission is to support the residential mortgage and community-development lending activities of its members, which include over 450 financial institutions across New England. As a requirement of membership in the FHLB, the Bank must own a minimum required amount

of FHLB stock, calculated periodically based primarily on its level of borrowings from the FHLB. The Bank uses the FHLB for much of its wholesale funding needs. As of September 30, 2010 and December 31, 2009, the Bank's investment in FHLB stock totaled \$14.0 million.

FHLB stock is a non-marketable equity security and therefore is reported at cost, which equals par value. Shares held in excess of the minimum required amount are generally redeemable at par value. However, in the first quarter of 2009 the FHLB announced a moratorium on such redemptions in order to preserve its capital in response to current market conditions and declining retained earnings. The minimum required shares are redeemable, subject to certain limitations, five years following termination of FHLB membership. The Bank has no intention of terminating its FHLB membership.

The FHLB has announced that dividend payments for 2010 are unlikely and the Company will likely have no dividend income on its FHLB stock in 2010. FHLB's net income for the third quarter of 2010 was \$41.3 million, a \$146.8 million increase from a net loss of \$105.4 million in the third quarter of 2009. The increase was primarily due to a \$168.3 million decrease in the credit-related other-than-temporary impairment charges on certain private-label mortgage-backed securities, partially offset by factors including a \$6.6 million decrease in net interest income after provision for credit losses, a \$10.3 million increase in REFCorp assessments, and a \$4.6 million increase in Affordable Housing Program contributions. Credit-related other-than-temporary impairment charges on certain private-label mortgage-backed securities were \$5.9 million for the third quarter of 2010, a \$168.3 million, or 96.6%, decrease from the \$174.2 million recorded in the third quarter of 2009. The \$5.9 million charge resulted from an increase in projected losses on the collateral underlying 37 private-label mortgage-backed securities with a combined par value of \$715.9 million. The reduction in credit losses attributable to other-than-temporary impairment, compared with the third quarter of 2009, primarily reflects the relative stabilization in projected factors, such as home prices and unemployment rates that affect the expected performance of the mortgage loans underlying FHLB's private-label mortgage-backed securities. FHLB's total regulatory capital-to-asset ratio was 6.4% at September 30, 2010, exceeding the regulatory minimum requirement by 2.4%. FHLB's permanent capital was \$4.0 billion.

The Bank periodically evaluates its investment in FHLB stock for impairment based on, among other things, the capital adequacy of the FHLB and its overall financial condition. No impairment losses have been recorded through September 30, 2010. The Bank will continue to monitor its investment in FHLB stock.

Note 3 – Loans

The following table shows the composition of the Company's loan portfolio as of September 30, 2010, December 31, 2009 and September 30, 2009:

In thousands of dollars	September 30, 2010			December 31, 2009			September 30, 2009		
Commercial									
Real estate	\$251,767	27.4	%	\$240,178	25.2	%	\$236,807	24.3	%
Construction	40,304	4.4	%	48,714	5.1	%	50,601	5.2	%
Other	106,993	11.6	%	114,486	12.0	%	118,151	12.1	%
Municipal	25,737	2.8	%	45,952	4.8	%	55,889	5.7	%
Residential									
Term	352,872	38.4	%	367,267	38.7	%	381,718	39.3	%
Construction	18,380	2.0	%	17,361	1.8	%	17,056	1.8	%
Home equity line of credit	104,434	11.4	%	94,324	9.9	%	88,830	9.1	%
Consumer	18,051	2.0	%	24,210	2.5	%	24,771	2.5	%
Total loans	\$918,538	100.0	%	\$952,492	100.0	%	\$973,823	100.0	%

Loan balances include net deferred loan costs of \$1.9 million as of September 30, 2010 and December 31, 2009, and deferred loan fees of \$560,000 and 548,000 for the same periods, respectively. Pursuant to collateral agreements,

qualifying first mortgage loans, which were valued at \$270.1 million at September 30, 2010 and \$295.1 million at December 31, 2009, were used to collateralize borrowings from the FHLB.

Transactions in the allowance for loan losses for the nine months ended September, 2010 and 2009 were as follows:

In thousands of dollars	September 30, 2010	September 30, 2009
Balance at beginning of year	\$13,637	\$8,800
Provision charged to operating expenses	6,300	7,660
	19,937	16,460
Loans charged off	(5,916)	(3,817)
Recoveries on loans	224	157
Net loans charged off	(5,692)	(3,660)
Balance at end of period	\$14,245	\$12,800

Loans on non-accrual status totaled \$21.7 million at September 30, 2010, \$18.6 million at December 31, 2009 and \$17.6 million at September 30, 2009. Loans past due greater than 90 days which are accruing interest totaled \$729,000 at September 30, 2010, \$1.2 million at December 31, 2009 and \$4.6 million at September 30, 2009. The Company continues to accrue interest on these loans because it believes collection of principal and interest is reasonably assured. Information regarding impaired loans is as follows:

In thousands of dollars	September 30, 2010	December 31, 2009	September 30, 2009
Balance of impaired loans	\$25,375	\$25,843	\$17,571
Less portion for which no allowance for loan losses is allocated	(16,174)	(13,682)	(8,081)
Portion of impaired loan balance for which an allowance for loan losses is allocated	9,201	12,161	9,490
Portion of allowance for loan losses allocated to the impaired loan balance	\$1,073	\$2,196	\$2,810

Note 4 – Stock Options and Stock-Based Compensation

At the 2010 Annual Meeting, shareholders approved the 2010 Equity Incentive Plan (the “2010 Plan”). This reserves 400,000 shares of Common Stock for issuance in connection with stock options, restricted stock awards and other equity based awards to attract and retain the best available personnel, provide additional incentive to officers, employees and non-employee Directors and promote the success of our business. Such grants and awards will be structured in a manner that does not encourage the recipients to expose the Company to undue or inappropriate risk. Options issued under the 2010 Plan will qualify for treatment as incentive stock options for purposes of Section 422 of the Internal Revenue Code. Other compensation under the 2010 Plan will qualify as performance-based for purposes of Section 162(m) of the Internal Revenue Code, and will satisfy NASDAQ guidelines relating to equity compensation. As of September 30, 2010, no awards had been granted under the 2010 Plan.

The Company established a shareholder-approved stock option plan in 1995 (the “1995 Plan”), under which the Company granted options to employees for 600,000 shares of common stock. Only incentive stock options were granted under the 1995 Plan. The option price of each option grant was determined by the Options Committee of the Board of Directors, and in no instance was less than the fair market value on the date of the grant. An option’s maximum term was ten years from the date of grant, with 50% of the options granted vesting two years from the date of grant and the remaining 50% vesting five years from date of grant. As of January 16, 2005, all options under the 1995 Plan had been granted.

The Company applies the fair value recognition provisions of the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 718 “Compensation – Stock Compensation”, to stock-based employee compensation. For the nine months ended September 30, 2010, \$28,000 in compensation cost was recognized for

options granted under the 1995 Plan, and the unrecognized compensation cost to be amortized over a weighted average remaining vesting period of three months is \$9,000, which is for 21,000 options granted in 2005. The weighted average fair market value per share was \$4.41 at the time of grant. The fair market value was estimated using the Black-Scholes option pricing model and the following assumptions: quarterly dividends of \$0.12, risk-free interest rate of 4.20%, volatility of 25.81%, and an expected life of ten years, the options' maximum term. Volatility is

based on the actual volatility of the Company's stock during the quarter in which the options were granted. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve at the time of the option grant.

The following table summarizes the non-vested options as of September 30, 2010:

	Number of Shares	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2009	21,000	\$4.41
Granted in 2010	-	-
Vested in 2010	(21,000)	4.41
Forfeited in 2010	-	-
Non-vested at September 30, 2010	-	\$-

During 2010, no options have been exercised. A summary of the status of the Stock Option Plan as of September 30, 2010 and changes during the nine-month period then ended, is presented below.

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Outstanding at December 31, 2009	55,500	\$ 15.89		
Granted in 2010	-	-		
Exercised in 2010	-	-		
Forfeited in 2010	-	-		
Outstanding at September 30, 2010	55,500	\$ 15.89	3.8	\$ 51
Exercisable at September 30, 2010	55,500	\$ 15.89	3.8	\$ 51

Note 5 – Preferred and Common Stock

Preferred Stock

On January 9, 2009, the Company received \$25 million from preferred stock issuance under the U.S. Treasury Capital Purchase Program (the "CPP Shares") at a purchase price of \$1,000 per share. The CPP Shares call for cumulative dividends at a rate of 5.0% per year for the first five years, and at a rate of 9.0% per year in following years, payable quarterly in arrears on February 15, May 15, August 15 and November 15 of each year. Incident to such issuance, the Company issued to the U.S. Treasury warrants (the "Warrants") to purchase up to 225,904 shares of the Company's common stock at a price per share of \$16.60 (subject to adjustment). The CPP Shares and the related Warrants (and any shares of common stock issuable pursuant to the Warrants) are freely transferable by Treasury to third parties and the Company has filed a registration statement with the Securities and Exchange Commission to allow for possible resale of such securities. The CPP Shares qualify as Tier 1 capital on the Company's books for regulatory purposes and rank senior to the Company's common stock and senior or at an equal level in the Company's capital structure to any other shares of preferred stock the Company may issue in the future.

The Company may redeem the CPP Shares at any time using any funds available to the Company, and any redemption would be subject to the prior approval of the Federal Reserve Bank of Boston. The minimum amount that may be

redeemed is 25% of the original CPP investment. The CPP Shares are “perpetual” preferred stock, which means that neither Treasury nor any subsequent holder would have a right to require that the Company redeem any of the shares. During the first three years following the Company’s sale of the CPP Shares, the Company is required to obtain Treasury’s consent to increase the dividend per share paid on the Company’s common stock unless the Company had redeemed the CPP Shares in full or Treasury had transferred all of the CPP Shares to other parties. Also during the first three years following the Company’s sale of the CPP Shares, the Company is required to obtain Treasury’s consent in order to repurchase any shares of its outstanding stock of any type (other than purchases of common stock or preferred

stock ranking junior to the CPP Shares in the ordinary course of the Company's business and consistent with the Company's past practices in connection with a benefit plan) unless the Company had redeemed the CPP Shares in full or Treasury had transferred all of the CPP Shares to other parties.

As a condition to Treasury's purchase of the CPP Shares, during the time that Treasury holds any equity or debt instrument the Company issued, the Company is required to comply with certain restrictions and other requirements relating to the compensation of the Company's chief executive officer, chief financial officer and three other most highly compensated executive officers. These restrictions include a prohibition on severance payments to those executive officers upon termination of their employment and a \$500,000 limit on the tax deductions the Company can take for compensation expense for each of those executive officers in a single year as well as a prohibition on bonus compensation to such officers other than limited amounts of long-term restricted stock.

In conjunction with the sale of the CPP Shares, the Company also issued warrants to Treasury giving it the right to purchase from the Company 225,904 shares of the Company's common stock at a price of \$16.60 per share. The Warrants have a term of ten years and could be exercised by Treasury or a subsequent holder at any time or from time to time during their term. To the extent they had not previously been exercised, the Warrants would expire after ten years. Treasury will not vote any shares of common stock it receives upon exercise of the Warrants, but that restriction would not apply to third parties to whom Treasury transferred the Warrants. The Warrants (and any common stock issued upon exercise of the Warrants) could be transferred to third parties separately from the CPP Shares. The proceeds from the sale of the CPP Shares were allocated between the CPP Shares and Warrants based on their relative fair values on the issue date. The fair value of the Warrants was determined using the Black-Scholes model which includes the following assumptions: common stock price of \$16.60 per share, dividend yield of 4.70%, stock price volatility of 24.43%, and a risk-free interest rate of 2.01%. The discount on the CPP Shares was based on the value that was allocated to the Warrants upon issuance, and is being accreted back to the value of the CPP Shares over a five-year period (the expected life of the shares upon issuance) on a straight-line basis.

Common Stock

As a consequence of the Company's issuance of securities under the U.S. Treasury's Capital Purchase Program ("the CPP"), its ability to repurchase stock while such securities remain outstanding is restricted to purchases from employee benefit plans. In the first nine months of 2010, the Company repurchased no common stock.

Note 6 – Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share (EPS) for the nine months ended September 30, 2010 and 2009:

In thousands, except number of shares and per share data	Income (Numerator)	Shares (Denominator)	Per-Share Amount
For the nine months ended September 30, 2010			
Net income as reported	\$ 9,039		
Less dividends and amortization of premium on preferred stock	1,011		
Basic EPS: Income available to common shareholders	8,028	9,757,074	\$0.82
Effect of dilutive securities: incentive stock options		4,707	
Diluted EPS: Income available to common shareholders plus assumed conversions	\$ 8,028	9,761,781	\$0.82
For the nine months ended September 30, 2009			
Net income as reported	\$ 10,380		
Less dividends and amortization of premium on preferred stock	824		
Basic EPS: Income available to common shareholders	9,556	9,716,129	\$0.98

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Effect of dilutive securities: incentive stock options and warrants		26,808	
Diluted EPS: Income available to common shareholders plus assumed conversions	\$ 9,556	9,742,937	\$0.98

The following table sets forth the computation of basic and diluted earnings per share (EPS) for the quarters ended September 30, 2010 and 2009:

In thousands, except number of shares and per share data	Income (Numerator)	Shares (Denominator)	Per-Share Amount
For the quarter ended September 30, 2010			
Net income as reported	\$ 3,195		
Less dividends and amortization of premium on preferred stock	337		
Basic EPS: Income available to common shareholders	2,858	9,764,184	\$0.29
Effect of dilutive securities: incentive stock options		4,062	
Diluted EPS: Income available to common shareholders plus assumed conversions	\$ 2,858	9,768,246	\$0.29
For the quarter ended September 30, 2009			
Net income as reported	\$ 2,890		
Less dividends and amortization of premium on preferred stock	337		
Basic EPS: Income available to common shareholders	2,553	9,723,757	\$0.26
Effect of dilutive securities: incentive stock options and warrants		52,629	
Diluted EPS: Income available to common shareholders plus assumed conversions	\$ 2,553	9,776,386	\$0.26

All earnings per share calculations have been made using the weighted average number of shares outstanding during the period. The potentially dilutive securities are incentive stock options granted to certain key members of Management and warrants granted to the U.S. Treasury under the CPP. The number of dilutive shares is calculated using the treasury method, assuming that all options and warrants were exercisable at the end of each period. Options and warrants that are out-of-the-money are not considered in the calculation of dilutive earnings per share as the effect would be anti-dilutive.

The following table presents the number of options and warrants outstanding as of September 30, 2010 and 2009 and the amount which are above or below the strike price:

	Outstanding	In-the-Money	Out-of-the-Money
As of September 30, 2010			
Incentive stock options	55,500	13,500	42,000
Warrants issued to U.S. Treasury	225,904	-	225,904
Total dilutive securities	281,404	13,500	267,904
As of September 30, 2009			
Incentive stock options	73,500	73,500	-
Warrants issued to U.S. Treasury	225,904	225,904	-
Total dilutive securities	299,404	299,404	-

Note 7 – Employee Benefit Plans

401(k) Plan

The Bank has a defined contribution plan available to substantially all employees who have completed nine months of service. Employees may contribute up to \$16,500 of their compensation if under age 50 and \$22,000 if age 50 or over, and the Bank may match employee contributions not to exceed 3.0% of compensation depending on contribution level. Subject to a vote of the Board of Directors, the Bank may also make a profit-sharing contribution to the Plan.

Such contribution equaled 2.0% of each eligible employee's compensation in 2009. The amount for 2010 has not been established. The expense related to the 401(k) plan was \$269,000 and \$254,000 for the nine month periods ended September 30, 2010 and 2009, respectively.

Supplemental Retirement Benefits

The Bank also provides unfunded, non-qualified supplemental retirement benefits for certain officers, payable in installments over 20 years upon retirement or death. The agreements consist of individual contracts with differing characteristics that, when taken together, do not constitute a postretirement plan. The costs for these benefits are recognized over the service periods of the participating officers in accordance with FASB ASC Topic 712 “Compensation – Nonretirement Postemployment Benefits”. The expense of these supplemental retirement benefits was \$174,000 and \$147,000 for the nine months ended September 30, 2010 and 2009, respectively. As of September 30, 2010, the associated accrued liability was \$1,555,000 compared to \$1,418,000 and \$1,370,000 at December 31, 2009 and September 30, 2009, respectively.

Post-Retirement Benefit Plans

The Bank sponsors two post-retirement benefit plans. One plan currently provides a subsidy for health insurance premiums to certain retired employees and a future subsidy for seven active employees who were age 50 and over in 1996. These subsidies are based on years of service and range between \$40 and \$1,200 per month per person. The other plan provides life insurance coverage to certain retired employees. The Bank also provides health insurance for retired directors. None of these plans are pre-funded. The Company utilizes FASB ASC Topic 712 “Compensation – Nonretirement Postemployment Benefits” to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its balance sheet and to recognize changes in the funded status in the year in which the changes occur through comprehensive income. The following table sets forth the accumulated postretirement benefit obligation and funded status:

In thousands of dollars	For the nine months ended	
	September 30, 2010	September 30, 2009
Change in benefit obligation		
Benefit obligation at beginning of year	\$1,962	\$1,990
Service cost	16	15
Interest cost	101	101
Benefits paid	(111)	(117)
Benefit obligation at end of period	1,968	1,989
Funded status		
Benefit obligation at end of period	(1,968)	(1,989)
Accrued benefit cost at end of period	\$(1,968)	\$(1,989)

The following table sets forth the net periodic pension cost:

In thousands of dollars	For nine months ended		For three months ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
Components of net periodic benefit cost				
Service cost	\$16	\$15	\$5	\$7
Interest cost	101	101	34	33
Amortization of unrecognized transition obligation	21	21	7	7
Amortization of prior service credit	(1)	(2)	-	-
Amortization of accumulated losses	18	15	6	5
Net periodic benefit cost	\$155	\$150	\$52	\$52

Amounts not yet reflected in net periodic benefit cost and included in accumulated other comprehensive income (loss) are as follows:

In thousands of dollars	September 30, 2010	December 31, 2009	September 30, 2009
Unamortized net actuarial loss	\$(233)	\$(233)	\$(295)
Unrecognized transition obligation	(70)	(92)	(100)
	(303)	(325)	(395)
Deferred tax benefit at 35%	106	114	138
Net unrecognized postretirement benefits included in accumulated other comprehensive income (loss)	\$(197)	\$(211)	\$(257)

A weighted average discount rate of 7.0% was used in determining the accumulated benefit obligation and the net periodic benefit cost. The assumed health care cost trend rate is 7.0%. The measurement date for benefit obligations was as of year-end for prior years presented. The expected benefit payments for the fourth quarter of 2010 are \$37,000 and the expected benefit payments for all of 2010 are \$148,000. There is no expected contribution for 2010. Plan expense for 2010 is estimated to be \$175,000. A 1% change in trend assumptions would create an approximate change in the same direction of approximately \$100,000 in the accumulated benefit obligation, \$7,000 in the interest cost and \$1,400 in the service cost.

Note 8 – Goodwill and Other Intangible Assets

As of December 31, 2009, in accordance FASB ASC Topic 350 “Intangibles – Goodwill and Other,” the Company completed its annual review of goodwill and determined there has been no impairment.

Note 9 – Mortgage Servicing Rights

FASB ASC Topic 940 “Financial Services – Mortgage Banking”, requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. The Company’s servicing assets and servicing liabilities are reported using the amortization method. In evaluating the carrying values of mortgage servicing rights, the Company obtains third party valuations based on loan level data including note rate, type and term of the underlying loans. The model utilizes several assumptions, the most significant of which is loan prepayments, calculated using a three-month moving average of weekly prepayment data published by the Public Securities Association (PSA) and modeled against the serviced loan portfolio, and the discount rate to discount future cash flows. As of September 30, 2010, the prepayment assumption using the PSA model was 259, which translates into an anticipated prepayment rate of 15.54%. The discount rate is the quarterly average ten-year U.S. Treasuries plus 5.0%. Other assumptions include delinquency rates, foreclosure rates, servicing cost inflation, and annual unit loan cost. All assumptions are adjusted periodically to reflect current circumstances. Amortization of mortgage servicing rights, as well as write-offs due to prepayments of the related mortgage loans, are recorded as a charge against mortgage servicing fee income.

For the nine months ended September 30, 2010 and 2009, servicing rights capitalized totaled \$385,000 and \$1,083,000, respectively. Servicing rights capitalized for the three-month periods ended September 30, 2010 and 2009, were \$149,000 and \$217,000 respectively. Servicing rights amortized for the nine-month periods ended September 30, 2010 and 2009, were \$313,000 and \$688,000, respectively. Servicing rights amortized for the three-month periods ended September 30, 2010 and 2009, were \$115,000 and \$121,000, respectively. The fair value of servicing rights was \$1,166,000, \$1,422,000 and \$1,300,000 at September 30, 2010, December 31, 2009 and September 30, 2009, respectively. At September 30, 2010 and 2009, the Bank serviced loans for others totaling \$242.3

million and \$213.8 million, respectively. Mortgage servicing rights are included in other assets and detailed in the following table:

In thousands of dollars	September 30, 2010	December 31, 2009	September 30, 2009
Mortgage servicing rights	\$5,467	\$5,086	\$4,911
Accumulated amortization	(4,128)	(3,814)	(3,715)
Impairment reserve	(216)	(73)	(71)
	\$1,123	\$1,199	\$1,125

Note 10 – Income Taxes

FASB ASC Topic 740 “Income Taxes” defines the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company’s financial statements. Topic 740 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. The Company is currently open to audit under the statute of limitations by the IRS for the years ended December 31, 2007 through 2009.

Note 11- Certificates of Deposit

The following table represents the breakdown of Certificates of Deposits at September 30, 2010 and 2009, and at December 31, 2009:

In thousands of dollars	September 30, 2010	December 31, 2009	September 30, 2009
Certificates of deposit < \$100,000	\$243,977	\$212,893	\$228,835
Certificates \$100,000 to \$250,000	326,515	287,051	284,143
Certificates \$250,000 and over	39,816	56,153	66,243
	\$610,308	\$556,097	\$579,221

Note 12 – Reclassifications

Certain items from the prior year were reclassified in the financial statements to conform with the current year presentation. These do not have a material impact on the balance sheet or statement of income presentations.

Note 13 – Fair Value Disclosures

Certain assets and liabilities are recorded at fair value to provide additional insight into the Company’s quality of earnings. Some of these assets and liabilities are measured on a recurring basis while others are measured on a nonrecurring basis, with the determination based upon applicable existing accounting pronouncements. For example, securities available for sale are recorded at fair value on a recurring basis. Other assets, such as, mortgage servicing rights, loans held for sale, and impaired loans, are recorded at fair value on a nonrecurring basis using the lower of cost or market methodology to determine impairment of individual assets. The Company groups assets and liabilities which are recorded at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. A financial instrument’s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement (with level 1 considered highest and level 3 considered lowest). A brief description of each level follows.

Level 1 – Valuation is based upon quoted prices for identical instruments in active markets.

Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 – Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates that market participants would use in pricing the asset or liability. Valuation includes use of discounted cash flow models and similar techniques.

The most significant instruments that the Company fair values include securities which fall into Level 2 in the fair value hierarchy. The securities in the available for sale portfolio are priced by independent providers. In obtaining such valuation information from third parties, the Company has evaluated their valuation methodologies used to develop the fair values in order to determine whether the valuations are representative of an exit price in the Company’s principal markets. The Company’s principal markets for its securities portfolios are the secondary

institutional markets, with an exit price that is predominantly reflective of bid level pricing in those markets.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

Securities Available for Sale. Investment securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices for similar assets, if available. If quoted prices are not available, fair values are measured using matrix pricing models, or other model-based valuation techniques requiring observable inputs other than quoted prices such as yield curves, prepayment speeds, and default rates. Recurring Level 1 securities would include U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets. Recurring Level 2 securities include federal agency securities, mortgage-backed securities, collateralized mortgage obligations, municipal bonds and corporate debt securities.

The following table presents the balances of assets and liabilities that were measured at fair value on a recurring basis as of September 30, 2010 and December 31, 2009.

In thousands of dollars	Level 1	At September 30, 2010		Total
		Level 2	Level 3	
Securities available for sale				
U.S. Treasury and agency	\$-	\$20,314	\$-	\$20,314
Mortgage-backed securities	-	174,797	-	174,797
State and political subdivisions	-	35,732	-	35,732
Corporate securities	-	847	-	847
Other equity securities	-	385	-	385
Total assets	\$-	\$232,075	\$-	\$232,075

In thousands of dollars	Level 1	At December 31, 2009		Total
		Level 2	Level 3	
Securities available for sale				
U.S. Treasury and agency	\$-	\$30,959	\$-	\$30,959
Mortgage-backed securities	-	31,148	-	31,148
State and political subdivisions	-	18,514	-	18,514
Corporate securities	-	818	-	818
Other equity securities	-	399	-	399
Total assets	\$-	\$81,838	\$-	\$81,838

Assets and Liabilities Recorded at Fair Value on a Non-Recurring Basis

Mortgage Servicing Rights. Mortgage servicing rights represent the value associated with servicing residential mortgage loans. Servicing assets and servicing liabilities are reported using the amortization method. In evaluating the carrying values of mortgage servicing rights, the Company obtains third party valuations based on loan level data including note rate, type and term of the underlying loans. As such, the Company classifies mortgage servicing rights as nonrecurring Level 2.

Loans Held for Sale. Mortgage loans held for sale are recorded at the lower of carrying value or market value. The fair value of mortgage loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, the Company classifies mortgage loans held for sale as nonrecurring Level 2.

Other Real Estate Owned. Real estate acquired through foreclosure is initially recorded at market value. The fair value of other real estate owned is based on property appraisals and an analysis of similar properties currently available. As such, the Company records other real estate owned as nonrecurring Level 2.

Impaired Loans. A loan is considered to be impaired when it is probable that all of the principal and interest due under the original underwriting terms of the loan may not be collected. Impairment is measured based on the fair value of the underlying collateral. As such, the Company records impaired loans as nonrecurring Level 2.

The following table includes assets measured at fair value on a nonrecurring basis that have had a fair value adjustment since their initial recognition. Other real estate owned is presented net of an allowance of \$670,000 at September 30, 2010 and \$583,000 at December 31, 2009. Impaired loans measured at fair value only include impaired loans with a related specific allowance for loan losses and are presented net of specific allowances of \$1.1 million at

September 30, 2010 and \$2.2 million at December 31, 2009.

In thousands of dollars	At September 30, 2010			Total
	Level 1	Level 2	Level 3	
Mortgage servicing rights	\$-	\$1,166	\$-	\$1,166
Loans held for sale	-	1,031	-	1,031
Other real estate owned	-	5,338	-	5,338
Impaired loans	-	8,128	-	8,128
Total assets	\$-	\$15,613	\$-	\$15,613

In thousands of dollars	At December 31, 2009			Total
	Level 1	Level 2	Level 3	
Mortgage servicing rights	\$-	\$1,422	\$-	\$1,422
Loans held for sale	-	2,876	-	2,876
Other real estate owned	-	5,345	-	5,345
Impaired loans	-	9,965	-	9,965
Total assets	\$-	\$19,608	\$-	\$19,608

FASB ASC Topic 825 “Financial Instruments”, requires disclosures of fair value information about financial instruments, whether or not recognized in the balance sheet, if the fair values can be reasonably determined. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company’s various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques using observable inputs when available. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Topic 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements.

Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

The estimated fair values for financial instruments as of September 30, 2010 and December 31, 2009 were as follows:

In thousands of dollars	September 30, 2010		December 31, 2009	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Financial assets				
Cash and cash equivalents	\$13,880	\$13,880	\$15,332	\$15,332
Securities available for sale	232,075	232,075	81,838	81,838
Securities to be held to maturity	121,341	126,668	190,537	192,838
Federal Home Loan Bank and Federal Reserve Bank stock	15,443	15,443	15,443	15,443
Loans held for sale	1,031	1,031	2,876	2,876
Loans (net of allowance for loan losses)	904,293	917,068	938,855	938,095
Accrued interest receivable	5,445	5,445	4,889	4,889
Financial liabilities				
Deposits	\$986,932	\$966,060	\$922,667	\$877,883
Borrowed funds	222,672	231,621	249,778	255,292
Accrued interest payable	911	911	1,078	1,078

The fair value estimates, methods, and assumptions for the Company’s financial instruments are set forth below.

Cash and Cash Equivalents

The carrying values of cash equivalents and due from banks approximate their relative fair values.

Investment Securities

The fair values of investment securities are estimated based on bid prices published in financial newspapers or bid quotations received from securities dealers. The fair value of certain state and municipal securities is not readily available through market sources other than dealer quotations, so fair value estimates are based on quoted market prices of similar instruments, adjusted for differences between the quoted instruments and the instruments being valued. Fair values are calculated based on the value of one unit without regard to any premium or discount that may result from concentrations of ownership of a financial instrument, possible tax ramifications, or estimated transaction costs. If these considerations had been incorporated into the fair value estimates, the aggregate fair value could have been changed. The carrying values of restricted equity securities approximate fair values.

Loans

Fair values are estimated for portfolios of loans with similar financial characteristics. The fair values of performing loans are calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest risk inherent in the loan. The estimates of maturity are based on the Company's historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of current economic and lending conditions, and the effects of estimated prepayments. Fair values for significant non-performing loans are based on estimated cash flows and are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows, and discount rates are judgmentally determined using available market information and specific borrower information. Management has made estimates of fair value using discount rates that it believes to be reasonable. However, because there is no market for many of these financial instruments, Management has no basis to determine whether the fair value presented above would be indicative of the value negotiated in an actual sale.

Accrued Interest Receivable

The fair value estimate of this financial instrument approximates the carrying value as this financial instrument has a short maturity. It is the Company's policy to stop accruing interest on loans for which it is probable that the interest is not collectible. Therefore, this financial instrument has been adjusted for estimated credit loss.

Deposits

The fair value of deposits is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposits compared to the cost of borrowing funds in the market. If that value were considered, the fair value of the Company's net assets could increase.

Borrowed Funds

The fair value of borrowed funds is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently available for borrowings of similar remaining maturities.

Accrued Interest Payable

The fair value estimate approximates the carrying amount as this financial instrument has a short maturity.

Off-Balance-Sheet Instruments

Off-balance-sheet instruments include loan commitments. Fair values for loan commitments have not been presented as the future revenue derived from such financial instruments is not significant.

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These values do not reflect any premium or discount that could result from offering for sale at

one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on Management's judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment

and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates. Fair value estimates are based on existing on- and off-balance-sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Other significant assets and liabilities that are not considered financial instruments include the deferred tax asset, premises and equipment, and other real estate owned. In addition, tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of the estimates.

Note 14 – Impact of Recently Issued Accounting Standards

In June 2009, the Financial Accounting Standards Board (“FASB”) issued guidance (incorporated in the FASB Accounting Standards Codification (“ASC”) via Accounting Standards Update (“ASU”) 2009-16, Transfers and Servicing: Accounting for Transfers of Financial Assets, in December 2009) which provides amended guidance relating to transfers of financial assets that eliminates the concept of a qualifying special-purpose entity. This guidance must be applied as of the beginning of each reporting entity’s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. This guidance must be applied to transfers occurring on or after its effective date. On and after the effective date, the concept of a qualifying special-purpose entity is no longer relevant for accounting purposes. Therefore, formerly qualifying special-purpose entities should be evaluated for consolidation by reporting entities on and after the effective date in accordance with the applicable consolidation guidance. The new guidance also changed the requirements which must be satisfied in order for an entity to treat a loan participation as a sale. The disclosure provisions were also amended and apply to transfers that occurred both before and after the effective date of this guidance. The adoption of this update did not have a significant impact on the Company’s consolidated financial statements.

In June 2009, the FASB issued guidance (incorporated in the FASB ASC via ASU 2009-17, Consolidations: Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities, in December 2009) which provides amended guidance for consolidation of a variable interest entity by replacing the quantitative-based risks and rewards calculation for determining which enterprise, if any, has a controlling financial interest in a variable interest entity. The amended guidance uses an approach that focuses on identifying which enterprise has the power to direct the activities of a variable interest entity that most significantly impact the entity’s economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. Additional disclosures about an enterprise’s involvement in variable interest entities are also required. This guidance is effective as of the beginning of each reporting entity’s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. The adoption of this update did not have a significant impact on the Company’s consolidated financial statements.

In January 2010, the FASB issued ASU 2010-06, Fair Value Measurements and Disclosures: Improving Disclosures about Fair Value Measurements, to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires new disclosures regarding transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a rollforward of activities, separately reporting purchases, sales, issuance, and settlements, for assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). The guidance is effective for annual reporting periods that begin after December 15, 2009, and for interim periods within those annual reporting periods except for the changes to the disclosure of rollforward activities for any Level 3 fair value measurements, which are effective for annual reporting periods that begin after December 15, 2010, and for interim periods within those annual reporting periods. Other than requiring additional disclosures, adoption of this new guidance did not have a material impact on the Company’s consolidated financial statements.

In February 2010, the FASB issued ASU 2010-09, Subsequent Events: Amendments to Certain Recognition and Disclosure Requirements, related to events that occur after the balance sheet date but before financial statements are issued. This guidance amends existing standards to address potential conflicts with Securities and Exchange Commission (“SEC”) guidance and refines the scope of the reissuance disclosure requirements to include revised financial statements only. Under this guidance, SEC filers are no longer required to disclose the date through which subsequent events have been evaluated. The adoption of this update did not have a material effect on the Company’s consolidated financial statements.

In July 2010, the FASB issued ASU No. 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. This ASU is intended to provide additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of its allowance for credit losses. The guidance is effective for interim and annual reporting periods ending after December 15, 2010. Other than requiring additional disclosures, adoption of this new guidance is not expected to have a material impact on the Company's consolidated financial statements.

Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations

The First Bancorp, Inc. and Subsidiary

Forward-Looking Statements

This report contains statements that are "forward-looking statements." We may also make written or oral forward-looking statements in other documents we file with the Securities and Exchange Commission ("SEC"), in our annual reports to shareholders, in press releases and other written materials, and in oral statements made by our officers, directors or employees. You can identify forward-looking statements by the use of the words "believe," "expect," "anticipate," "intend," "estimate," "assume," "outlook," "will," "should," and other expressions that predict or indicate future events and trends and which do not relate to historical matters. You should not rely on forward-looking statements, because they involve known and unknown risks, uncertainties and other factors, some of which are beyond the control of the Company. These risks, uncertainties and other factors may cause the actual results, performance or achievements of the Company to be materially different from the anticipated future results, performance or achievements expressed or implied by the forward-looking statements.

Some of the factors that might cause these differences include the following: changes in general national, regional or international economic conditions or conditions affecting the banking or financial services industries or financial capital markets, volatility and disruption in national and international financial markets, government intervention in the U.S. financial system, reductions in net interest income resulting from interest rate volatility as well as changes in the balance and mix of loans and deposits, reductions in the market value of wealth management assets under administration, changes in the value of securities and other assets, reductions in loan demand, changes in loan collectability, default and charge-off rates, changes in the size and nature of the Company's competition, changes in legislation or regulation and accounting principles, policies and guidelines, and changes in the assumptions used in making such forward-looking statements. In addition, the factors described under "Risk Factors" in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2009, as filed with the SEC, may result in these differences. You should carefully review all of these factors, and you should be aware that there may be other factors that could cause these differences. These forward-looking statements were based on information, plans and estimates at the date of this quarterly report, and we assume no obligation to update any forward-looking statements to reflect changes in underlying assumptions or factors, new information, future events or other changes.

Although The First Bancorp, Inc. believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from the results discussed in these forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to republish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Readers are also urged to carefully review and consider the various disclosures made by the Company, which attempt to advise interested parties of the facts that affect the Company's business.

Critical Accounting Policies

Management's discussion and analysis of the Company's financial condition is based on the consolidated financial statements which are prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of such financial statements requires Management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, Management evaluates its estimates, including those related to the allowance for loan losses, goodwill, the valuation of mortgage servicing rights, and other-than-temporary impairment on securities. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis in making judgments about the carrying values

of assets that are not readily apparent from other sources. Actual results could differ from the amount derived from Management's estimates and assumptions under different assumptions or conditions.

Allowance for Loan Losses. Management believes the allowance for loan losses requires the most significant estimates and assumptions used in the preparation of the consolidated financial statements. It is based on Management's evaluation of the level required in relation to estimated loss exposure in the loan portfolio. Management believes the allowance for loan losses is a significant estimate and regularly evaluates it for adequacy by taking into consideration factors such as prior loan loss experience, the character and size of the loan portfolio, business and economic conditions and Management's estimation of potential losses. The use of different estimates or assumptions could produce different provisions for loan losses.

Goodwill. Management utilizes numerous techniques to estimate the value of various assets held by the Company, including methods to determine the appropriate carrying value of goodwill as required under FASB ASC Topic 350 "Intangibles – Goodwill and Other." Goodwill from a purchase acquisition is subject to ongoing periodic impairment tests, which include an evaluation of the ongoing assets, liabilities and revenues from the acquisition and an estimation of the impact of business conditions.

Mortgage Servicing Rights. The valuation of mortgage servicing rights is a critical accounting policy which requires significant estimates and assumptions. The Bank often sells mortgage loans it originates and retains the ongoing servicing of such loans, receiving a fee for these services, generally 0.25% of the outstanding balance of the loan per annum. Mortgage servicing rights are recognized when they are acquired through the sale of loans, and are reported in other assets. They are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Management uses an independent firm which specializes in the valuation of mortgage servicing rights to determine the fair value. The most important assumption is the anticipated loan prepayment rate. The valuation includes an evaluation for impairment based upon the fair value of the rights, which can vary depending upon current interest rates and prepayment expectations, as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. The use of different assumptions could produce a different valuation. All of the assumptions are based on standards the Company believes would be utilized by market participants in valuing mortgage servicing rights and are consistently derived and/or benchmarked against independent public sources.

Other-Than-Temporary Impairment on Securities. One of the significant estimates related to investment securities is the evaluation of other-than-temporary impairments. The evaluation of other-than-temporary impairments is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in the fair value of investments should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuer's financial condition and/or future prospects, the effects of changes in interest rates or credit spreads and the expected recovery period of unrealized losses. Securities that are in an unrealized loss position are reviewed at least quarterly to determine if an other-than-temporary impairment is present based on certain quantitative and qualitative factors and measures. The primary factors considered in evaluating whether a decline in value of securities is other-than-temporary include: (a) the length of time and extent to which the fair value has been less than cost or amortized cost and the expected recovery period of the security, (b) the financial condition, credit rating and future prospects of the issuer, (c) whether the debtor is current on contractually obligated interest and principal payments, (d) the volatility of the securities market price, (e) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for recovery, which may be at maturity and (f) any other information and observable data considered relevant in determining whether other-than-temporary impairment has occurred, including the expectation of receipt of all principal and interest due.

Use of Non-GAAP Financial Measures

Certain information in Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Report contains financial information determined by methods other than in accordance with accounting principles generally accepted in the United States of America ("GAAP"). Management uses these

“non-GAAP” measures in its analysis of the Company’s performance and believes that these non-GAAP financial measures provide a greater understanding of ongoing operations and enhance comparability of results with prior periods as well as demonstrating the effects of significant gains and charges in the current period. The Company believes that a meaningful analysis of its financial performance requires an understanding of the factors underlying that performance. Management believes that investors may use these non-GAAP financial measures to analyze financial performance without the impact of unusual items that may obscure trends in the Company’s underlying performance. These disclosures should not be viewed as a substitute for operating results determined in accordance with GAAP, nor are

they necessarily comparable to non-GAAP performance measures that may be presented by other companies. In several places net interest income is presented on a fully taxable equivalent basis. Specifically included in interest income was tax-exempt interest income from certain investment securities and loans. An amount equal to the tax benefit derived from this tax exempt income has been added back to the interest income total, which adjustments increased net interest income accordingly. Management believes the disclosure of tax-equivalent net interest income information improves the clarity of financial analysis, and is particularly useful to investors in understanding and evaluating the changes and trends in the Company's results of operations. Other financial institutions commonly present net interest income on a tax-equivalent basis. This adjustment is considered helpful in the comparison of one financial institution's net interest income to that of another, as each will have a different proportion of tax-exempt interest from its earning assets. Moreover, net interest income is a component of a second financial measure commonly used by financial institutions, net interest margin, which is the ratio of net interest income to average earning assets. For purposes of this measure as well, other financial institutions generally use tax-equivalent net interest income to provide a better basis of comparison from institution to institution. The Company follows these practices. The following table provides a reconciliation of tax-equivalent financial information to the Company's consolidated financial statements prepared in accordance with GAAP. A 35.0% tax rate was used in both 2010 and 2009.

In thousands of dollars	For the nine months ended September 30,		For the quarters ended September 30,	
	2010	2009	2010	2009
Net interest income, as presented	\$30,231	\$33,325	\$10,253	\$10,815
Effect of tax-exempt income	1,704	1,787	577	617
Net interest income, tax equivalent	\$31,935	\$35,112	\$10,830	\$11,432

The Company presents its efficiency ratio using non-GAAP information. The GAAP-based efficiency ratio is noninterest expenses divided by net interest income plus noninterest income from the Consolidated Statements of Income. The non-GAAP efficiency ratio excludes securities losses and other-than-temporary impairment charges from noninterest expenses, excludes securities gains from noninterest income, and adds the tax-equivalent adjustment to net interest income. The following table provides a reconciliation between the GAAP and non-GAAP efficiency ratio:

Dollars in thousands	For the nine months ended September 30,		For the quarters ended September 30,	
	2010	2009	2010	2009
Non-interest expense, as presented	\$18,405	\$19,892	\$6,228	\$6,872
Net securities losses	-	(147)	-	-
Other than temporary impairment charge	-	(916)	-	-
Adjusted non-interest expense	18,405	18,829	6,228	6,872
Net interest income, as presented	30,231	33,325	10,253	10,815
Effect of tax-exempt income	1,704	1,787	577	617
Non-interest income, as presented	6,524	8,525	2,067	2,977
Effect of non-interest tax-exempt income	141	138	47	46
Net securities gains	2	-	-	1
Adjusted net interest income plus non-interest income	\$38,602	\$43,775	\$12,944	\$14,456
Non-GAAP efficiency ratio	47.68	% 43.01	% 48.11	% 47.54
GAAP efficiency ratio	50.07	% 47.53	% 50.55	% 49.83

The Company presents certain information based upon tangible average shareholders' equity instead of total average shareholders' equity. The difference between these measures is the Company's intangible assets, specifically goodwill

from prior acquisitions. Management, banking regulators and many stock analysts use the tangible common equity ratio and the tangible book value per common share in conjunction with more traditional bank capital ratios to compare the capital adequacy of banking organizations with significant amounts of goodwill or other intangible assets, typically stemming from the use of the purchase accounting method in accounting for mergers and acquisitions. The following table provides a reconciliation of tangible average shareholders' equity to the Company's consolidated

financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles:

In thousands of dollars	For the nine months ended		For the quarters ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Average shareholders' equity, as presented	\$ 151,132	\$ 145,990	\$ 152,951	\$ 148,094
Intangible assets	27,684	27,684	27,684	27,684
Tangible average shareholders' equity	\$ 123,448	\$ 118,306	\$ 125,267	\$ 120,410

Executive Summary

Net income for the first nine months of 2010 was \$9.0 million, down \$1.3 million or 12.9% from the \$10.4 million posted for the same period in 2009. Earnings per common share on a fully diluted basis were \$0.82 for the nine-months ended September 30, 2010, down \$0.16 or 16.3% from the \$0.98 posted for the same period in 2009. For the quarter ended September 30, 2010, net income was \$3.2 million, up \$0.3 million or 10.6% from the \$2.9 million posted for the same period in 2009. Earnings per common share on a fully diluted basis were \$0.29 for the quarter ended September 30, 2010, up \$0.03 or 11.5% from the \$0.26 posted for the same period in 2009. The Company saw a \$35,000 increase in earnings from the previous quarter, making net income posted for the quarter ended September 30, 2010, the highest posted in the past five quarters.

Net interest income on a tax-equivalent basis was down \$602,000 in the third quarter of 2010 compared to the same period in 2009, with the variance coming from the net interest margin dropping from 3.59% to 3.36%. Year-to-date, net interest income is down \$3.2 million from the same period in 2009, with the variance due primarily to our net interest margin declining from 3.65% to 3.39%. The margin decline year-to-date is the result of multiple factors: volume has been impacted by lower average earning assets in 2010 than in 2009 and rate compression is the result of some assets repricing downward and the extension of liabilities at a higher cost in order to reduce interest rate risk. For the third quarter, the decline in net interest margin was all attributable to rate compression.

While we continue to be in the longest and worst economic downturn since the Great Depression of the 1930's, the Company feels that the deteriorating trend in credit quality experienced during the past two years has somewhat stabilized in the past three quarters. Non-performing loans stood at 2.36% on September 30, 2010 compared to 2.53% of total loans on June 30, 2010 and 1.95% on December 31, 2009. This compares favorably to nonperforming loans at 3.51% for our peer group as of June 30, 2010, the latest data available from the Uniform Bank Performance Report ("UBPR peer group"). Net chargeoffs were \$5.7 million or 0.82% of average loans on an annualized basis for the first nine months of 2010. This compares to net chargeoffs of \$3.7 million or 0.49% of average loans on an annualized basis for the first nine months of 2009.

The slump in the housing market is continuing and the national unemployment rate is at 9.6%. Fortunately, the unemployment rate in Maine, at 7.7%, is somewhat better than the national average. Unemployment numbers, however, do not reflect the number of people experiencing reduced incomes from wage cutbacks and loss of overtime. In Maine, many people who are self-employed are also experiencing a decline in business revenues impacting their individual incomes as well. We provisioned \$6.3 million for loan losses in the first nine months of 2010, down \$1.4 million from the \$7.7 million provision made in the first nine months of 2009. As a result, the allowance for loan losses has increased \$608,000 or 4.5% year-to-date and now stands at 1.55% of outstanding loans compared to 1.43% at December 31, 2009 and 1.31% at September 30, 2009.

Total assets have increased \$43.2 million or 3.2% year-to-date. The loan portfolio is down \$34.0 million or 3.6%, with a drop due to refinancing of mortgages to very low fixed rates that have been sold to the secondary market. The investment portfolio is up \$81.0 million or 28.2% year-to-date. On the liability side of the balance sheet, low-cost deposits have increased \$28.0 million or 10% year-over-year, which is above our normal seasonal pattern. Local certificates of deposit are up \$4.6 million or 2.0%.

Remaining well capitalized remains a top priority for The First Bancorp. In the past year and a half, the Company's total risk-based capital has increased from 11.13% to 15.98%, well above the well-capitalized threshold of 10.0% set by the FDIC. In Management's view, participating in the U.S. Treasury Capital Purchase Program was the right decision for The First Bancorp. The Company obtained additional capital at a relatively low cost and it provides us with greater ability to ride out the current economic storm and allows us more flexibility to work with individuals and businesses as they too struggle through these adverse economic conditions.

The Company's operating ratios remain good, with a return on average tangible common equity of 12.60% for the quarter ended September 30, 2010 compared to 11.96% for the same period in 2009. Based upon June 30, 2010 data, our return on average equity was in the top 26% of all banks in the UBPR peer group, which had an average return of 2.88%. Our efficiency ratio continues to be an important component in our overall performance; it slipped to 48.11% for the third quarter compared to 47.54% for the same period in 2009. This was the result of lower revenues and not due to a significant increase in operating expenses. As of June 30, 2010, the average efficiency ratio for our UBPR peer group was 67.56%, which put us in the top 7% of all banks in the UBPR peer group.

Net Interest Income

Total interest income of \$42.9 million for the nine months ended September 30, 2010 is a 10.8% decrease from total interest income of \$48.1 million in the comparable period of 2009. Total interest expense of \$12.7 million for the first nine months of 2010 is a 14.1% decrease from total interest expense of \$14.8 million for the first nine months of 2009. As a result, net interest income decreased 9.3% or \$3.1 million to \$30.2 million for the nine months ended September 30, 2010, from the \$33.3 million reported for the same period in 2009. The Company's net interest margin on a tax-equivalent basis decreased from 3.65% in the first nine months of 2009 to 3.39% for the nine months ended September 30, 2010. This decrease was due to lower interest income as loans and investments continue to reprice downward, the previously noted decline in the mortgage loan portfolio, and extended maturities in wholesale funding. Tax-exempt interest income amounted to \$3.2 million and \$3.3 million for the nine months ended September 30, 2010 and 2009, respectively.

Total interest income of \$14.6 million for the quarter ended September 30, 2010 is a 4.3% decrease from total interest income of \$15.2 million in the same period in 2009. Total interest expense of \$4.3 million for the quarter ended September 30, 2010 is a 2.1% decrease from total interest expense of \$4.4 million in the comparable period of 2009. As a result, net interest income decreased 5.2% or \$0.6 million to \$10.2 million for the quarter ended September 30, 2010, from the \$10.8 million reported for the same period in 2009. The Company's net interest margin on a tax-equivalent basis decreased from 3.59% for the quarter end September 30, 2009 to 3.36% for the quarter ended September 30, 2010. Tax-exempt interest income amounted to \$1.1 million for the quarters ended September 30, 2010 and 2009.

The following tables present the amount of interest earned or paid, as well as the average yield or rate on an annualized basis, for each major category of assets or liabilities for the nine months and quarters ended September 30, 2010 and 2009. Tax-exempt income is calculated on a tax-equivalent basis, using a 35.0% tax rate in 2010 and 2009.

Dollars in thousands	For the nine months ended					
	September 30, 2010			September 30, 2009		
	Amount of interest	Average Yield/Rate		Amount of interest	Average Yield/Rate	
Interest on earning assets						
Interest-bearing deposits	\$5	6.08 %		\$1	4.95 %	
Investments	10,913	4.54 %		11,585	5.21 %	
Loans held for sale	125	4.72 %		45	4.83 %	
Loans	33,579	4.81 %		38,249	5.18 %	
Total interest-earning assets	44,622	4.74 %		49,880	5.19 %	
Interest-bearing liabilities						
Deposits	7,699	1.16 %		9,403	1.41 %	
Other borrowings	4,988	2.90 %		5,365	2.84 %	
Total interest-bearing liabilities	12,687	1.52 %		14,768	1.72 %	
Net interest income	\$31,935			\$35,112		
Interest rate spread		3.22 %			3.46 %	

Net interest margin	3.39	%	3.65	%
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Dollars in thousands	For the quarters ended					
	September 30, 2010			September 30, 2009		
	Amount of interest	Average Yield/Rate		Amount of interest	Average Yield/Rate	
Interest on earning assets						
Interest-bearing deposits	\$3	3.65	%	\$1	4.84	%
Investments	3,890	4.47	%	3,454	4.97	%
Loans held for sale	45	4.69	%	44	4.49	%
Loans	11,210	4.79	%	12,342	4.98	%
Total interest-earning assets	15,148	4.70	%	15,841	4.97	%
Interest-bearing liabilities						
Deposits	2,648	1.17	%	2,709	1.21	%
Other borrowings	1,669	2.88	%	1,700	2.95	%
Total interest-bearing liabilities	4,317	1.52	%	4,409	1.57	%
Net interest income	\$10,831			\$11,432		
Interest rate spread		3.19	%		3.41	%
Net interest margin		3.36	%		3.59	%

The following tables present changes in interest income and expense attributable to changes in interest rates and volume for interest-earning assets and interest-bearing liabilities for the nine months and quarters ended September 30, 2010 compared to 2009. Tax-exempt income is calculated on a tax-equivalent basis, using a 35.0% tax rate in 2010 and 2009.

For the nine months ended September 30, 2010 compared to 2009

In thousands of dollars	Volume	Rate	Rate/Volume ¹	Total
Interest on earning assets				
Interest-bearing deposits	\$3	\$-	\$ 1	\$4
Investment securities	934	(1,486)	(120)	(672)
Loans held for sale	38	(2)	(1)	35
Loans	(2,028)	(2,743)	146	(4,625)
Total interest income	(1,053)	(4,231)	26	(5,258)
Interest expense				
Deposits	(38)	(1,673)	7	(1,704)
Other borrowings ²	(481)	114	(10)	(377)
Total interest expense	(519)	(1,559)	(3)	(2,081)
Change in net interest income	\$(534)	\$(2,672)	\$ 29	\$(3,177)

For the quarters ended September 30, 2010 compared to 2009

In thousands of dollars	Volume	Rate	Rate/Volume ¹	Total
Interest on earning assets				
Interest-bearing deposits	\$3	\$-	\$ (1)	\$2
Investment securities	863	(342)	(85)	436
Loans held for sale	(1)	2	-	1
Loans	(693)	(465)	26	(1,132)
Total interest income	172	(805)	(60)	(693)
Interest expense				
Deposits	32	(92)	(1)	(61)
Other borrowings ²	9	(40)	-	(31)
Total interest expense	41	(132)	(1)	(92)
Change in net interest income	\$131	\$(673)	\$ (59)	\$(601)

¹ Represents the change attributable to a combination of change in rate and change in volume.

² Includes federal funds purchased.

Average Daily Balance Sheets

The following table shows the Company's average daily balance sheets for the nine-month periods and quarters ended September 30, 2010 and 2009.

	For the nine months ended		For the quarters ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
Assets				
Cash and due from banks	\$15,736	\$14,345	\$18,256	\$16,869
Overnight funds sold	110	27	326	82
Securities available for sale	153,762	22,707	203,694	35,288
Securities to be held to maturity	152,014	259,863	125,832	226,015
Federal Reserve Bank stock, at cost	1,412	662	1,412	662
Federal Home Loan Bank Stock, at cost	14,031	14,031	14,031	14,031
Loans held for sale (fair value approximates cost)	3,539	2,493	3,810	3,884
Loans	933,854	986,196	928,357	983,613
Allowance for loan losses	(14,453)	(10,617)	(14,392)	(12,325)
Net loans	919,401	975,579	913,965	971,288
Accrued interest receivable	5,596	6,368	5,442	6,002
Premises and equipment	18,395	17,906	18,659	18,531
Other real estate owned	5,425	2,538	5,003	2,533
Goodwill	27,684	27,684	27,684	27,684
Other assets	29,306	21,139	29,356	22,799
Total Assets	\$1,346,411	\$1,365,342	\$1,367,470	\$1,345,668
Liabilities & Shareholders' Equity				
Demand deposits	\$65,560	\$63,531	\$74,625	\$70,108
NOW deposits	116,457	105,323	119,547	107,684
Money market deposits	80,879	111,601	72,472	103,697
Savings deposits	95,806	86,514	100,000	90,916
Certificates of deposit	596,270	589,603	606,541	585,825
Total deposits	954,972	956,572	973,185	958,230
Borrowed funds – short term	10,163	6,688	40,148	12,394
Borrowed funds – long term	219,484	245,582	189,442	215,934
Dividends payable	987	932	988	1,015
Other liabilities	9,674	9,578	10,756	10,001
Total Liabilities	1,195,280	1,219,352	1,214,519	1,197,574
Shareholders' Equity:				
Preferred stock	24,606	24,267	24,656	24,558
Common stock	97	97	98	97
Additional paid-in capital	45,187	44,713	45,360	44,985
Retained earnings	80,873	77,631	81,505	79,013
Net unrealized gain (loss) on available-for-sale securities	573	(452)	1,531	(298)
Net unrealized loss on postretirement benefit costs	(205)	(266)	(199)	(261)
Total Shareholders' Equity	151,131	145,990	152,951	148,094
Total Liabilities & Shareholders' Equity	\$1,346,411	\$1,365,342	\$1,367,470	\$1,345,668

Non-Interest Income

Non-interest income was \$6.5 million for the nine months ended September 30, 2010, a decrease of 23.5% from the \$8.5 million reported for the first nine months of 2009. This decrease was attributable to mortgage origination and servicing income, which decreased \$1.0 million or 52.6% as a result of a lower volume of residential mortgages refinancing and these loans being sold to the secondary market. It was also impacted by the sale of the merchant credit card servicing portfolio in December of 2009. As a result of this sale, \$1.7 million in revenues which were recognized in the first nine months of 2009 were not repeated in 2010. Non-interest income was \$2.1 million for the quarter ended September 30, 2010, a decrease of 30.6% from the \$3.0 million reported for the quarter end September 30, 2009. This decrease was attributable to mortgage origination and merchant credit card income as mentioned above.

Non-Interest Expense

Non-interest expense of \$18.4 million for the nine months ended September 30, 2010 is a decrease of 7.5% compared to non-interest expense of \$19.9 million for the same period in 2009. This decrease was partly attributable to an other-than-temporary impairment charge of \$0.9 million recorded during the first quarter of 2009 that did not recur in 2010. It was also impacted by the sale of the merchant credit card servicing portfolio in December of 2009. As a result of this sale, \$1.6 million in expense that was recognized in the first nine months of 2009 were not repeated in 2010. Non-interest expense of \$6.2 million for the quarter ended September 30, 2010 is a decrease of 9.4% compared to non-interest expense of \$6.9 million for the same period in 2009. This decrease was attributable to a decrease in other operating expense for the quarter. The Company's efficiency ratio was 47.68% for the first nine months of 2010 compared to 43.01% for the first nine months of 2009. This decline was the result of the decrease in both net interest income and non-interest income previously discussed, despite a decrease in non-interest expense.

Income Taxes

Income taxes on operating earnings were \$3.0 million for the nine months ended September 30, 2010, down \$907,000 from the same period in 2009, and \$1.1 million for the quarter ended September 30, 2010, up \$0.1 million for the same period in 2009. This is in line with the decrease in the Company's level of income before taxes plus the purchase of additional New Markets Tax Credits in the second quarter of 2009.

FASB ASC Topic 740 "Income Taxes" defines the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. Topic 740 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken, in order for those tax positions to be recognized in the financial statements. The Company is currently open to audit under the statute of limitations by the IRS for the years ended December 31, 2007 through 2009.

Investments

The Company's investment portfolio increased by \$81.0 million or 28.2% between December 31, 2009, and September 30, 2010. The growth in the portfolio in the nine months of 2010 was primarily in GNMA mortgage-backed securities, which are fully backed by the U.S. Government and carry no credit risk. As of September 30, 2010, mortgage-backed securities had a carrying value of \$237.6 million and a fair value of \$239.7 million. Of this total, securities with a fair value of \$207.2 million or 86.4% of the mortgage-backed portfolio were issued by GNMA and securities with a fair value of \$32.5 million or 13.5% of the mortgage-backed portfolio were issued by FHLMC and FNMA. The Company had one private label mortgage-backed security at September 30, 2010 with a fair value of \$43,000.

The Company's investment securities are classified into two categories: securities available for sale and securities to be held to maturity. Securities available for sale consist primarily of debt securities which Management intends to hold for indefinite periods of time. They may be used as part of the Company's funds management strategy, and may be sold in response to changes in interest rates, prepayment risk and liquidity needs, to increase capital ratios, or for other similar reasons. Securities to be held to maturity consist primarily of debt securities that the Company has acquired

solely for long-term investment purposes, rather than for trading or future sale. For securities to be categorized as held to maturity Management must have the intent and the Company must have the ability to hold such investments until their respective maturity dates. The Company does not hold trading account securities. As securities matured or were called, we continued to lower liquidity risk as new securities were purchased by shifting the

investment portfolio to securities available for sale from held to maturity securities, which were 65.7% and 34.3%, respectively, at September 30, 2010, compared to 30.0% and 70.0%, respectively at December 31, 2009 and 15.4% and 84.6%, respectively, at September 30, 2009.

All investment securities are managed in accordance with a written investment policy adopted by the Board of Directors. It is the Company's general policy that investments for either portfolio be limited to government debt obligations, time deposits, and corporate bonds or commercial paper with one of the three highest ratings given by a nationally recognized rating agency. The portfolio is currently invested primarily in U.S. Government agency securities and tax-exempt obligations of states and political subdivisions. The individual securities have been selected to enhance the portfolio's overall yield while not materially adding to the Company's level of interest rate risk. The following table sets forth the Company's investment securities at their carrying amounts as of September 30, 2010 and 2009 and December 31, 2009.

In thousands of dollars	September 30, 2010	December 31, 2009	September 30, 2009
Securities available for sale			
U.S. Treasury and agency	\$20,314	\$30,959	\$10,404
Mortgage-backed securities	174,797	31,148	16,597
State and political subdivisions	35,732	18,514	10,124
Corporate securities	847	818	1,178
Other equity securities	385	399	272
	\$232,075	\$81,838	\$38,575
Securities to be held to maturity			
U.S. Treasury and agency	\$8,091	\$39,099	\$44,036
Mortgage-backed securities	62,328	90,193	105,259
State and political subdivisions	50,772	61,095	62,339
Corporate securities	150	150	150
	\$121,341	\$190,537	\$211,784
Non-marketable securities:			
Federal Home Loan Bank Stock	14,031	14,031	14,031
Federal Reserve Bank Stock	1,412	1,412	662
	15,443	15,443	14,693
Total securities	\$368,859	\$287,818	\$265,052

The following table sets forth yields and expected maturities of the Company's investment securities as of September 30, 2010. Yields on tax-exempt securities have been computed on a tax-equivalent basis using a tax rate of 35%.

Mortgage-backed securities are presented according to their final contractual maturity date, while the calculated yield takes into effect the intermediate cashflows from repayment of principal which results in a much shorter average life.

Dollars in thousands	Available For Sale		Held to Maturity	
	Fair Value	Yield to maturity	Amortized Cost	Yield to maturity
U.S. Treasury & Agency				
Due in 1 year or less	\$-	0.00 %	\$-	0.00 %
Due in 1 to 5 years	-	0.00 %	-	0.00 %
Due in 5 to 10 years	-	0.00 %	-	0.00 %
Due after 10 years	20,314	5.45 %	8,091	6.14 %
Total	20,314	5.45 %	8,091	6.14 %
Mortgage-Backed Securities				
Due in 1 year or less	-	0.00 %	2	6.04 %
Due in 1 to 5 years	44	5.71 %	1,118	4.16 %
Due in 5 to 10 years	76	8.50 %	1,033	5.93 %
Due after 10 years	174,677	4.12 %	60,175	4.02 %
Total	174,797	4.12 %	62,328	4.06 %
State & Political Subdivisions				
Due in 1 year or less	-	0.00 %	1,045	7.44 %
Due in 1 to 5 years	3,096	7.07 %	4,720	6.25 %
Due in 5 to 10 years	2,364	7.36 %	14,128	6.49 %
Due after 10 years	30,272	6.21 %	30,879	6.32 %
Total	35,732	6.36 %	50,772	6.38 %
Corporate Securities				
Due in 1 year or less	-	0.00 %	150	1.50 %
Due in 1 to 5 years	-	0.00 %	-	0.00 %
Due in 5 to 10 years	-	0.00 %	-	0.00 %
Due after 10 years	847	1.61 %	-	0.00 %
Total	847	1.61 %	150	1.50 %
Equity Securities	385	3.07 %	-	0.00 %
	\$232,075	4.57 %	\$121,341	5.17 %

Impaired Securities

The securities portfolio contains certain securities that the amortized cost of which exceeds fair value, which at September 30, 2010 amounted to \$2.1 million, or 0.6% of the amortized cost of the total securities portfolio. At December 31, 2009 this amount was \$2.1 million, or 0.8% of the total securities portfolio. As a part of the Company's ongoing security monitoring process, the Company identifies securities in an unrealized loss position that could potentially be other-than-temporarily impaired. If a decline in the fair value of a debt security is judged to be other-than-temporary, the decline related to credit loss is recorded in net realized securities losses while the decline attributable to other factors is recorded in other comprehensive income.

The Company's evaluation of securities for impairment is a quantitative and qualitative process intended to determine whether declines in the fair value of investment securities should be recognized in current period earnings. The primary factors considered in evaluating whether a decline in the fair value of securities is other-than-temporary include: (a) the length of time and extent to which the fair value has been less than cost or amortized cost and the expected recovery period of the security, (b) the financial condition, credit rating and future prospects of the issuer, (c) whether the debtor is current on contractually obligated interest and principal payments, (d) the volatility of the securities market price, (e) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for recovery, which may be at maturity, and (f) any other information and observable data

considered relevant in determining whether other-than-temporary impairment has occurred.

The Company's best estimate of cash flows uses severe economic recession assumptions due to market uncertainty. The Company's assumptions include but are not limited to delinquencies, foreclosure levels and constant default rates on the underlying collateral, loss severity ratios, and constant prepayment rates. If the Company does not expect to receive 100% of future contractual principal and interest, an other-than-temporary impairment charge is recognized. Estimating future cash flows is a quantitative and qualitative process that incorporates information received from third party sources along with certain internal assumptions and judgments regarding the future performance of the underlying collateral.

As of September 30, 2010, the Company had temporarily impaired securities with a fair value of \$145.9 million and unrealized losses of \$2.1 million, as identified in the table below. Securities in a continuous unrealized loss position more than twelve-months amounted to \$3.5 million as of September 30, 2010, compared with \$2.2 million at December 31, 2009. The Company has concluded that these securities were not other-than-temporarily impaired. This conclusion was based on the issuer's continued satisfaction of the securities obligations in accordance with their contractual terms and the expectation that the issuer will continue to do so, Management's intent and ability to hold these securities for a period of time sufficient to allow for any anticipated recovery in fair value which may be at maturity, the expectation that the Company will receive 100% of future contractual cash flows, as well as the evaluation of the fundamentals of the issuer's financial condition and other objective evidence. The following table summarizes temporarily impaired securities and their approximate fair values at September 30, 2010.

In thousands of dollars	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and agency	\$5,924	\$(8)	\$-	\$-	\$5,924	\$(8)
Mortgage-backed securities	136,212	(1,594)	1,028	(20)	137,240	(1,614)
State and political subdivisions	312	(3)	1,561	(182)	1,873	(185)
Corporate securities	-	-	848	(267)	848	(267)
Other equity securities	-	-	48	(5)	48	(5)
	\$142,448	\$(1,605)	\$3,485	\$(474)	\$145,933	\$(2,079)

The following information was considered in determining securities were not other-than-temporarily impaired:

Securities issued by the U.S. Treasury and U.S. Government-sponsored agencies and enterprises. As of September 30, 2010, the total unrealized losses on these securities amounted to \$8,000, compared with \$707,000 at December 31, 2009. All of these securities were credit rated "AAA" by the major credit rating agencies. Management believes that securities issued by the U.S. Treasury bear no credit risk because they are backed by the full faith and credit of the United States and that securities issued by U.S. Government-sponsored agencies and enterprises have minimal credit risk, as these agencies and enterprises play a vital role in the nation's financial markets. Management believes that the unrealized losses at September 30, 2010 were attributed to changes in current market yields and spreads since the date the underlying securities were purchased, and does not consider these securities to be other-than-temporarily impaired at September 30, 2010. The Company also has the ability and intent to hold these securities until a recovery of their amortized cost, which may be at maturity.

Mortgage-backed securities issued by U.S. Government agencies and U.S. Government-sponsored enterprises. As of September 30, 2010, the total unrealized losses on these securities amounted to \$1,614,000, compared with \$603,000 at December 31, 2009. All of these securities were credit rated "AAA" by the major credit rating agencies. Management believes that securities issued by U.S. Government agencies bear no credit risk because they are backed by the full faith and credit of the United States and that securities issued by U.S. Government-sponsored enterprises have minimal credit risk, as these agencies enterprises play a vital role in the nation's financial markets. Management believes that the unrealized losses at September 30, 2010 were attributable to changes in current market yields and

spreads since the date the underlying securities were purchased, and does not consider these securities to be other-than-temporarily impaired at September 30, 2010. The Company also has the ability and intent to hold these securities until a recovery of their amortized cost, which may be at maturity.

Obligations of state and political subdivisions. As of September 30, 2010, the total unrealized losses on municipal securities amounted to \$185,000, compared with \$484,000 at December 31, 2009. Municipal securities are supported

by the general taxing authority of the municipality and, in the cases of school districts, are supported by state aid. At September 30, 2010 all municipal bond issuers were current on contractually obligated interest and principal payments. The Company attributes the unrealized losses at September 30, 2010 to changes in prevailing market yields and pricing spreads since the date the underlying securities were purchased, combined with current market liquidity conditions and the disruption in the financial markets in general. Accordingly, the Company does not consider these municipal securities to be other-than-temporarily impaired at September 30, 2010. The Company also has the ability and intent to hold these securities until a recovery of their amortized cost, which may be at maturity.

Corporate securities. As of September 30, 2010, the total unrealized losses on corporate securities amounted to \$267,000, compared with \$302,000 at December 31, 2009. Corporate securities are dependent on the operating performance of the issuers. At September 30, 2010 all corporate bond issuers were current on contractually obligated interest and principal payments except for one General Motors holding. The Company attributes the unrealized losses at September 30, 2010 to changes in prevailing market yields and pricing spreads since the date the underlying securities were purchased, combined with current market liquidity conditions and the disruption in the financial markets in general. Accordingly, the Company does not consider these corporate securities to be other-than-temporarily impaired at September 30, 2010. The Company also has the ability and intent to hold these securities until a recovery of their amortized cost, which may be at maturity.

Federal Home Loan Bank Stock

The Bank is a member of the Federal Home Loan Bank (“FHLB”) of Boston. The FHLB is a cooperatively owned wholesale bank for housing and finance in the six New England States. Its mission is to support the residential mortgage and community-development lending activities of its members, which include over 450 financial institutions across New England. As a requirement of membership in the FHLB, the Bank must own a minimum required amount of FHLB stock, calculated periodically based primarily on its level of borrowings from the FHLB. The Bank uses the FHLB for much of its wholesale funding needs. As of September 30, 2010 and December 31, 2009, the Bank’s investment in FHLB stock totaled \$14.0 million. FHLB stock is a non-marketable equity security and therefore is reported at cost, which equals par value. Shares held in excess of the minimum required amount are generally redeemable at par value. However, in the first quarter of 2009 the FHLB announced a moratorium on such redemptions in order to preserve its capital in response to current market conditions and declining retained earnings. The minimum required shares are redeemable, subject to certain limitations, five years following termination of FHLB membership. The Bank has no intention of terminating its FHLB membership.

The FHLB has announced that dividend payments for 2010 are unlikely and the Company will likely have no dividend income on its FHLB stock in 2010. FHLB’s net income for the third quarter of 2010 was \$41.3 million, a \$146.8 million increase from a net loss of \$105.4 million in the third quarter of 2009. The increase was primarily due to a \$168.3 million decrease in the credit-related other-than-temporary impairment charges on certain private-label mortgage-backed securities, partially offset by factors including a \$6.6 million decrease in net interest income after provision for credit losses, a \$10.3 million increase in REFCorp assessments, and a \$4.6 million increase in Affordable Housing Program contributions. Credit-related other-than-temporary impairment charges on certain private-label mortgage-backed securities were \$5.9 million for the third quarter of 2010, a \$168.3 million, or 96.6%, decrease from the \$174.2 million recorded in the third quarter of 2009. The \$5.9 million charge resulted from an increase in projected losses on the collateral underlying 37 private-label mortgage-backed securities with a combined par value of \$715.9 million. The reduction in credit losses attributable to other-than-temporary impairment, compared with the third quarter of 2009, primarily reflects the relative stabilization in projected factors, such as home prices and unemployment rates that affect the expected performance of the mortgage loans underlying FHLB’s private-label mortgage-backed securities. FHLB’s total regulatory capital-to-asset ratio was 6.4% at September 30, 2010, exceeding the regulatory minimum requirement by 2.4%. FHLB’s permanent capital was \$4.0 billion.

The Bank periodically evaluates its investment in FHLB stock for impairment based on, among other things, the capital adequacy of the FHLB and its overall financial condition. No impairment losses have been recorded through September 30, 2010. The Bank will continue to monitor its investment in FHLB stock.

Loans Held for Sale

Loans held for sale are carried at the lower of cost or market value, with a balance of \$1.0 million at September 30, 2010 compared with \$2.9 million at December 31, 2009 and \$2.8 million at September 30, 2009. No recourse obligations have been incurred in connection with the sale of loans.

Loans

The loan portfolio declined in the first nine months of 2010, with total loans at \$918.5 million at September 30, 2010, down \$34.0 million or 3.6% from total loans of \$952.5 million at December 31, 2009. Commercial loans decreased \$4.3 million or 1.1% between December 31, 2009 and September 30, 2010, municipal loans decreased by \$20.2 million or 44.0%. Residential term loans decreased \$14.4 million or 3.9% during the same period as a result of borrowers refinancing home mortgage loans which were sold to the secondary market.

Commercial loans are comprised of three major categories, commercial real estate loans, commercial construction loans and other commercial loans. Commercial real estate is primarily comprised of loans to small businesses collateralized by owner-occupied real estate, while other commercial is primarily comprised of loans to small businesses collateralized by plant and equipment, commercial fishing vessels and gear, and limited inventory-based lending. Commercial real estate loans typically have a maximum loan-to-value of 75% based upon current appraisal information at the time the loan is made. Land and land development loans typically have a maximum loan-to-value of 65% to 75% based upon current appraisal information at the time the loan is made. Construction loans comprise a very small portion of the portfolio, and at 44.6% of capital are well under the regulatory guidance of 100.0% of capital. Construction and non-owner-occupied commercial real estate loans are at 98.5% of total capital, well under the regulatory guidance of 300.0% of capital. Municipal loans are comprised of loans to municipalities in the State of Maine for capitalized expenditures, construction projects or tax-anticipation notes. All municipal loans are considered general obligations of the municipality and as such are collateralized by the taxing ability of the municipality for repayment of debt.

Residential loans are also comprised of two categories, term loans, which include traditional amortizing home mortgages, home equity loans and lines of credit, and construction loans, which include loans for owner-occupied residential construction. Residential loans typically have a 75% to 80% loan to value based upon current appraisal information at the time the loan is made. Consumer loans are primarily amortizing loans to individuals collateralized by automobiles, pleasure craft and recreation vehicles, with a maximum loan to value of 80%-90% of the purchase price of the collateral. Consumer loans also include a small amount of unsecured short-term time notes to individuals. The following table summarizes the loan portfolio at September 30, 2010 and 2009 and December 31, 2009.

Dollars in thousands	September 30, 2010			December 31, 2009			September 30, 2009		
Commercial									
Real estate	\$251,767	27.4	%	\$240,178	25.2	%	\$236,807	24.3	%
Construction	40,304	4.4	%	48,714	5.1	%	50,601	5.2	%
Other	106,993	11.6	%	114,486	12.0	%	118,151	12.1	%
Municipal	25,737	2.8	%	45,952	4.8	%	55,889	5.7	%
Residential									
Term	352,872	38.4	%	367,267	38.7	%	381,718	39.3	%
Construction	18,380	2.0	%	17,361	1.8	%	17,056	1.8	%
Home equity line of credit	104,434	11.4	%	94,324	9.9	%	88,830	9.1	%
Consumer	18,051	2.0	%	24,210	2.5	%	24,771	2.5	%
Total loans	\$918,538	100.0	%	\$952,492	100.0	%	\$973,823	100.0	%

The following table sets forth certain information regarding the contractual maturities of the Bank's loan portfolio as of September 30, 2010:

In thousands of dollars	< 1 Year	1 - 5 Years	5 - 10 Years	> 10 Years	Total
Commercial					
Real estate	\$12,161	\$13,653	\$20,280	\$205,673	\$251,767
Construction	12,634	5,766	276	21,628	40,304
Other	17,398	24,235	31,105	34,255	106,993
Municipal	8,004	2,996	7,905	6,832	25,737
Residential					
Term	7,331	13,919	28,134	303,488	352,872
Construction	9,011	874	301	8,194	18,380
Home equity line of credit	1,380	363	1,050	101,641	104,434
Consumer	6,919	7,679	1,147	2,306	18,051
Total loans	\$74,838	\$69,485	\$90,198	\$684,017	\$918,538

The following table provides a listing of loans by category, excluding loans held for sale, between variable and fixed rates as of September 30, 2010.

Dollars in thousands	Fixed-Rate		Adjustable-Rate		Total	
	Amount	% of total	Amount	% of total	Amount	% of total
Commercial						
Real estate	\$49,875	5.4 %	\$201,892	22.0 %	\$251,767	27.4 %
Construction	6,857	0.7 %	33,447	3.6 %	40,304	4.4 %
Other	49,319	5.4 %	57,674	6.3 %	106,993	11.6 %
Municipal	22,093	2.4 %	3,644	0.4 %	25,737	2.8 %
Residential						
Term	127,447	13.9 %	225,425	24.5 %	352,872	38.4 %
Construction	5,124	0.6 %	13,256	1.4 %	18,380	2.0 %
Home equity line of credit	2,309	0.3 %	102,125	11.1 %	104,434	11.4 %
Consumer	14,934	1.6 %	3,117	0.3 %	18,051	2.0 %
Total loans	\$277,958	30.3 %	\$640,580	69.7 %	\$918,538	100.0 %

Loan Concentrations

As of September 30, 2010, the Bank did not have any concentration of loans in one particular industry that exceeded 10% of its total loan portfolio.

Credit Risk Management and Allowance for Loan Losses

Credit risk is the risk of loss arising from the inability of a borrower to meet its obligations. We manage credit risk by evaluating the risk profile of the borrower, repayment sources, the nature of the underlying collateral, and other support given current events, conditions, and expectations. We attempt to manage the risk characteristics of our loan portfolio through various control processes, such as credit evaluation of borrowers, establishment of lending limits, and application of lending procedures, including the holding of adequate collateral and the maintenance of compensating balances. However, we seek to rely primarily on the cash flow of our borrowers as the principal source of repayment. Although credit policies and evaluation processes are designed to minimize our risk, Management

recognizes that loan losses will occur and the amount of these losses will fluctuate depending on the risk characteristics of our loan portfolio, as well as general and regional economic conditions. We provide for loan losses through the establishment of an allowance for loan losses which represents an

estimated reserve for existing losses in the loan portfolio. We deploy a systematic methodology for determining our allowance that includes a quarterly review process, risk rating, and adjustment to our allowance. We classify our portfolios as either consumer or commercial and monitor credit risk separately as discussed below. We evaluate the adequacy of our allowance continually based on a review of all significant loans, with a particular emphasis on nonaccruing, past due, and other loans that we believe require special attention.

The allowance consists of three elements: (1) specific reserves and valuation allowances for individual credits; (2) general reserves for types or portfolios of loans based on historical loan loss experience, judgmentally adjusted for current conditions and credit risk concentrations; and (3) unallocated reserves. Combined specific reserves and general reserves by loan type are considered allocated reserves. All outstanding loans are considered in evaluating the adequacy of the allowance.

Adequacy of the allowance for loan losses is determined using a consistent, systematic methodology, which analyzes the risk inherent in the loan portfolio. In addition to evaluating the collectability of specific loans when determining the adequacy of the allowance for loan losses, Management also takes into consideration other factors such as changes in the mix and size of the loan portfolio, historic loss experience, the amount of delinquencies and loans adversely classified, economic trends, changes in credit policies, and experience, ability and depth of lending management. The adequacy of the allowance for loan losses is assessed by an allocation process whereby specific loss allocations are made against certain adversely classified loans, and general loss allocations are made against segments of the loan portfolio which have similar attributes. The Company's historical loss experience, industry trends, and the impact of the local and regional economy on the Company's borrowers, are considered by Management in determining the adequacy of the allowance for loan losses.

The allowance for loan losses is increased by provisions charged against current earnings. Loan losses are charged against the allowance when Management believes that the collectability of the loan principal is unlikely. Recoveries on loans previously charged off are credited to the allowance. While Management uses available information to assess possible losses on loans, future additions to the allowance may be necessary based on increases in non-performing loans, changes in economic conditions, growth in loan portfolios, or for other reasons. Any future additions to the allowance would be recognized in the period in which they were determined to be necessary. In addition, various regulatory agencies periodically review the Company's allowance for loan losses as an integral part of their examination process. Such agencies may require the Company to record additions to the allowance based on judgments different from those of Management.

Commercial

Our commercial portfolio includes all secured and unsecured loans to borrowers for commercial purposes, including commercial lines of credit and commercial real estate. Our process for evaluating commercial loans includes performing updates on loans that we have rated for risk. Our non-performing commercial loans are generally reviewed individually to determine impairment, accrual status, and the need for specific reserves. Our methodology incorporates a variety of risk considerations, both qualitative and quantitative. Quantitative factors include our historical loss experience by loan type, collateral values, financial condition of borrowers, and other factors. Qualitative factors include judgments concerning general economic conditions that may affect credit quality, credit concentrations, the pace of portfolio growth, and delinquency levels; these qualitative factors are also considered in connection with our unallocated portion of our allowance for loan losses.

The process of establishing the allowance with respect to our commercial loan portfolio begins when a loan officer initially assigns each loan a risk rating, using established credit criteria. Approximately 50% of our outstanding loans and commitments are subject to review and validation annually by an independent consulting firm, as well as periodically by our internal credit review function. Our methodology employs Management's judgment as to the level of losses on existing loans based on our internal review of the loan portfolio, including an analysis of the borrowers' current financial position, and the consideration of current and anticipated economic conditions and their potential effects on specific borrowers and or lines of business. In determining our ability to collect certain loans, we also consider the fair value of any underlying collateral. We also evaluate credit risk concentrations, including trends in

large dollar exposures to related borrowers, industry and geographic concentrations, and economic and environmental factors.

Residential and Consumer

Consumer and residential mortgage loans are generally segregated into homogeneous pools with similar risk characteristics. Trends and current conditions in consumer and residential mortgage pools are analyzed and historical loss experience is adjusted accordingly. Quantitative and qualitative adjustment factors for the consumer and

residential mortgage portfolios are consistent with those for the commercial portfolios. Certain loans in the consumer and residential portfolios identified as having the potential for further deterioration are analyzed individually to confirm the appropriate risk rating and accrual status, and to determine the need for a specific reserve. Consumer loans that are greater than 120 days past due are generally charged off. Residential loans that are greater than 90 days past due are evaluated for collateral adequacy and if deficient are placed on non-accrual status..

Unallocated

The unallocated portion of the allowance is intended to provide for losses that are not identified when establishing the specific and general portions of the allowance and is based upon Management's evaluation of various conditions that are not directly measured in the determination of the portfolio and loan specific allowances. Such conditions include general economic and business conditions affecting our lending area, credit quality trends (including trends in delinquencies and nonperforming loans expected to result from existing conditions), loan volumes and concentrations, specific industry conditions within portfolio categories, recent loss experience in particular loan categories, duration of the current business cycle, bank regulatory examination results, findings of external loan review examiners, and Management's judgment with respect to various other conditions including loan administration and management and the quality of risk identification systems. Management reviews these conditions quarterly. We have risk management practices designed to ensure timely identification of changes in loan risk profiles; however, undetected losses may exist inherently within the loan portfolio. The judgmental aspects involved in applying the risk grading criteria, analyzing the quality of individual loans, and assessing collateral values can also contribute to undetected, but probable, losses.

The allowance for loan losses includes reserve amounts to assigned individual loans on the basis of loan impairment. Certain loans are evaluated individually and are judged to be impaired when Management believes it is probable that the Company will not collect all of the contractual interest and principal payments as scheduled in the loan agreement. Under this method, loans are selected for evaluation based on internal risk ratings or non-accrual status. A specific reserve is allocated to an individual loan when that loan has been deemed impaired and when the amount of a probable loss is estimable on the basis of its collateral value, the present value of anticipated future cash flows, or its net realizable value. At September 30, 2010, impaired loans with specific reserves totaled \$9.2 and the amount of such reserves was \$1.1 million. This compares to impaired loans with specific reserves of \$12.2 million at December 31, 2009 and the amount of such reserves was \$2.2 million.

All of these analyses are reviewed and discussed by the Directors' Loan Committee, and recommendations from these processes provide Management and the Board of Directors with independent information on loan portfolio condition. Our total allowance at September 30, 2010 is considered by Management to be adequate to address the credit losses inherent in the loan portfolio at that date. Management views the level of the allowance for loan losses as adequate. However, our determination of the appropriate allowance level is based upon a number of assumptions we make about future events, which we believe are reasonable, but which may or may not prove valid. Thus, there can be no assurance that our charge-offs in future periods will not exceed our allowance for loan losses or that we will not need to make additional increases in our allowance for loan losses.

The allowance for loan losses totaled \$14.2 million at September 30, 2010, compared to \$13.6 million and \$12.8 million as of December 31, 2009 and September 30, 2009, respectively. Management's ongoing application of methodologies to establish the allowance include an evaluation of non-accrual loans for specific reserves. These specific reserves decreased \$1.1 million in the first nine months of 2010 from \$2.2 million at December 31, 2009 to \$1.1 million at September 30, 2010. The specific loans that make up those categories change from period to period. Impairment on those loans, which would be reflected in the allowance for loan losses, might or might not exist, depending on the specific circumstances of each loan. The portion of the reserve based upon homogeneous pools of loans increased by \$493,000 in the first nine months of 2010. This was attributable to higher losses in the past two years, which results in higher reserve loss factors applied to these pools. The portion of the reserve based on qualitative factors decreased by \$601,000 during 2010 as a result of slight improvements in the national and local

economies. Despite the shifts in specific, pooled and qualitative reserves, Management feels that market trends and other internal factors justified the \$1.9 million increase in unallocated reserves in the first nine months of 2010 from \$1.9 million on December 31, 2009 to \$3.7 million on September 30, 2010.

The following table summarizes our allocation of allowance by loan type as of September 30, 2010 and 2009 and December 31, 2009. The percentages are the portion of each loan type to total loans.

Dollars in thousands	September 30, 2010			December 31, 2009			September 30, 2009		
Commercial									
Real estate	\$4,992	27.4	%	\$5,297	25.2	%	\$4,822	24.3	%
Construction	780	4.4	%	896	5.1	%	752	5.2	%
Other	2,330	11.6	%	3,095	12.0	%	2,950	12.1	%
Municipal	20	2.8	%	23	4.8	%	22	5.7	%
Residential									
Term	1,221	38.4	%	1,197	38.7	%	1,100	39.3	%
Construction	47	2.0	%	43	1.8	%	40	1.8	%
Home equity line of credit	506	11.4	%	515	9.9	%	534	9.1	%
Consumer	638	2.0	%	716	2.5	%	646	2.5	%
Unallocated	3,711	0.0	%	1,855	0.0	%	1,934	0.0	%
Total	\$14,245	100.0	%	\$13,637	100.0	%	\$12,800	100.0	%

Based upon Management's evaluation, provisions are made to maintain the allowance as a best estimate of inherent losses within the portfolio. The provision for loan losses to maintain the allowance was \$6.3 million for the first nine months of 2010 as compared to \$7.7 million for the first nine months of 2009. Net chargeoffs were \$5.7 million in the first nine months of 2010 compared to net chargeoffs of \$3.7 million in the first nine months of 2009. Our allowance as a percentage of outstanding loans has increased from 1.43% as of December 31, 2009 to 1.55% as of September 30, 2010, reflecting the changes in our loss estimates and the increases resulting from the application of our loss estimate methodology.

The following table summarizes the activities in our allowance for loan losses:

Dollars in thousands	September 30, 2010	December 31, 2009	September 30, 2009	
Balance at beginning of year	\$ 13,637	\$ 8,800	\$ 8,800	
Loans charged off:				
Commercial				
Real estate	3,351	2,430	1,405	
Construction	175	-	-	
Other	1,028	2,329	1,058	
Municipal	-	-	-	
Residential				
Term	315	1,767	696	
Construction	402	47	47	
Home equity line of credit	8	177	117	
Consumer	637	826	494	
Total	5,916	7,576	3,817	
Recoveries on loans previously charged off				
Commercial				
Real estate	3	-	-	
Construction	-	-	-	
Other	38	79	72	
Municipal	-	-	-	
Residential				
Term	3	59	3	
Construction	-	-	-	
Home equity line of credit	-	1	-	
Consumer	180	114	82	
Total	224	253	157	
Net loans charged off	5,692	7,323	3,660	
Provision for loan losses	6,300	12,160	7,660	
Balance at end of period	\$ 14,245	\$ 13,637	\$ 12,800	
Ratio of net loans charged off to average loans outstanding	0.82	% 0.75	% 0.49	%
Ratio of allowance for loan losses to total loans outstanding	1.55	% 1.43	% 1.31	%

Management believes the allowance for loan losses is adequate as of September 30, 2010. In Management's opinion, the level of the provision for loan losses and the corresponding increase in the allowance for loan losses is directionally consistent with the overall credit quality of our loan portfolio and corresponding levels of nonperforming loans and unallocated reserves, as well as with the performance of the national and local economies, higher levels of unemployment and the outlook for the recession continuing for some time to come.

Nonperforming Loans

Nonperforming loans are comprised of loans placed on non-accrual status when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. When a loan becomes 90 days past due, it is evaluated for collateral dependency based upon the most recent appraisal. If the collateral value is lower than the outstanding loan balance plus accrued interest and estimated

selling costs, the loan is placed on non-accrual status, all accrued interest is reversed from interest income, and a specific reserve is established for the difference between the loan balance and the collateral value less selling costs. At the same time, a new independent, third-party appraisal may be ordered, based on the currency of the most recent

appraisal and the size of the loan, and upon receipt of the revised appraisal – typically 30 days for residential loans and 60-90 days for commercial loans – the loan may have an additional specific reserve or write down based upon the new appraisal information.

On an ongoing basis, if a non-performing loan is collateral dependent as its source of repayment, we may have an independent appraisal done periodically, based on the currency of the most recent appraisal and the size of the loan, and an additional specific reserve or write down based upon the new appraisal information will be made if needed. Once a loan is placed on nonaccrual, it remains in nonaccrual status until the loan is current as to payment of both principal and interest and the borrower demonstrates the ability to pay and remain current. All payments made on nonaccrual loans are applied to the principal balance of the loan. Nonperforming loans, expressed as a percentage of total loans, totaled 2.36% at September 30, 2010 compared to 1.95% at December 31, 2009 and 1.80% at September 30, 2009. The following table shows the distribution of nonperforming loans as of September 30, 2010 and 2009 and December 31, 2009:

In thousands of dollars	September 30, 2010	December 31, 2009	September 30, 2009
Commercial			
Real estate	\$6,946	\$6,198	\$6,706
Construction	438	458	485
Other	2,424	2,638	2,954
Municipal	-	-	-
Residential			
Term	9,772	5,868	5,567
Construction	1,738	3,182	1,701
Home equity line of credit	280	143	88
Consumer	107	75	71
Total nonperforming loans	\$21,705	\$18,562	\$17,572

Total nonperforming loans does not includes loans 90 or more days past due and still accruing interest. These are loans in which we expect to collect all amounts due, including past-due interest. As of September 30, 2010, loans 90 or more days past due and still accruing interest totaled \$0.7 million, compared to \$1.2 million and \$4.6 million at December 31, 2009 and September 30, 2009, respectively.

Troubled Debt Restructured

A restructuring of debt constitutes a troubled debt restructured (“TDR”) if the Bank, for economic or legal reasons related to the borrower’s financial difficulties, grants a concession to the borrower that it would not otherwise consider. To determine whether or not a loan should be classified as a TDR, Management evaluates a loan based upon the following criteria:

- The borrower demonstrates financial difficulty; common indicators include past due status with bank obligations, substandard credit bureau reports, an inability to refinance with another lender, and
- The Bank has granted a concession; common concession types include maturity date extension, interest rate adjustments to below market pricing, and deferment of payments.

As of September, 2010 we had 32 loans with a value of \$5.1 million that have been restructured. This compares to 52 loans with a value of \$8.4 million classified as TDRs as of December 31, 2009 and 37 loans with a balance of \$5.6 million classified as TDRs as of September 30, 2009. As of September 30, 2010, seven of the loans classified as TDRs with a total balance of \$0.8 million were greater than 30 days past due. As of that date, there was one loan with a balance of \$38,000 in the current TDRs in which the borrower had filed for bankruptcy.

Impaired Loans

Impaired loans include non-accrual loans and troubled debt restructured. Impaired loans totaled \$25.4 million at September 30, 2010, and have decreased \$468,000 from December 31, 2009. The number of loans increased by two loans from 183 to 185 during the same period. Impaired commercial loans increased \$514,000 from December 31, 2009 to September 30, 2010. The specific allowance for impaired commercial loans decreased from \$1.9 million at

December 31, 2009 to \$633,000 as of September 30, 2010, which represented the fair value deficiencies for those loans for which the net fair value of the collateral was estimated at less than our carrying amount of the loan. From December 31, 2009 to September 30, 2010, impaired residential loans decreased \$1.2 million, impaired home equity lines of credit increased \$137,000, and impaired consumer loans increased \$32,000.

Past Due Loans

The Bank's overall loan delinquency ratio was 2.50% at September 30, 2010, versus 3.14% at December 31, 2009 and 2.89% at September 30, 2009. Loans 90 days delinquent and accruing decreased from \$1.2 million at December 31, 2009 to \$0.7 million as of September 30, 2010. This total is made up of 6 loans, with the largest loan totaling \$307,000. We expect to collect all amounts due on these loans, including interest. The following table sets forth loan delinquencies as of September 30, 2010 and 2009 and December 31, 2009:

Dollars in thousands	September 30, 2010	December 31, 2009	September 30, 2009	
Commercial				
Real estate	\$6,337	\$9,443	\$9,732	
Construction	234	458	574	
Other	2,135	3,607	4,309	
Municipal	-	-	-	
Residential				
Term	11,762	11,747	11,034	
Construction	423	3,182	1,818	
Home equity line of credit	1,800	682	357	
Consumer	339	775	298	
Total	\$23,030	\$29,894	\$28,122	
Loans 30-89 days past due to total loans	0.86	% 1.26	% 0.98	%
Loans 90+ days past due and accruing to total loans	0.08	% 0.12	% 0.47	%
Loans 90+ days past due on non-accrual to total loans	1.56	% 1.76	% 1.44	%
Total past due loans to total loans	2.50	% 3.14	% 2.89	%

Potential Problem Loans and Loans in Process of Foreclosure

Potential problem loans consist of classified accruing commercial and commercial real estate loans that were between 30 and 89 days past due. Such loans are characterized by weaknesses in the financial condition of borrowers or collateral deficiencies. Based on historical experience, the credit quality of some of these loans may improve due to changes in collateral values or the financial condition of the borrowers, while the credit quality of other loans may deteriorate, resulting in some amount of loss. These loans are not included in the analysis of non-accrual loans above. At September 30, 2010, there were 25 potential problem loans with a balance of \$1.6 million or 0.17% of total loans. This compares to 28 loans with a balance of \$8.7 million or 0.9% of total loans at December 31, 2009.

As of September 30, 2010, there were 37 loans in the process of foreclosure with a total balance of \$10.5 million. The Bank's foreclosure process begins when a loan becomes 45 days past due at which time a preliminary foreclosure letter is sent to the borrower. If the loan becomes 80 days past due, copies of the promissory note and mortgage deed are forwarded to the Bank's attorney for review and an affidavit for a Motion for Summary Judgment is then prepared. An authorized Bank officer signs the affidavit certifying the validity of the documents and verification of the past due amount which is then forwarded to the court. Once a Motion for Summary Judgment is granted, a Period of Redemption (POR) begins which gives the customer 90 days to cure the default. A foreclosure auction date is then set

30 days from the POR expiration date if the default is not cured.

In October 2010, the Bank conducted a self-audit of its loans in foreclosure and its foreclosure process and found there were no deficiencies or areas to improve. For loans sold to the secondary market on which servicing is retained, the Bank follows Freddie Mac's and Fannie Mae's published guidelines and regularly reviews these guidelines for updates and changes to process. All secondary market loans have been sold without recourse in a non-securitized, one-on-one basis. As a result, the Bank has no liability for these loans in the event of a foreclosure.

Other Real Estate Owned

Other real estate owned and repossessed assets (“OREO”) are comprised of properties or other assets acquired through a foreclosure proceeding, or acceptance of a deed or title in lieu of foreclosure. Real estate acquired through foreclosure is carried at the lower of fair value less estimated cost to sell or the cost of the asset and is not included as part of the allowance for loan loss totals. At September 30, 2010, there were 18 properties owned with a net OREO balance of \$5.3 million, net of an allowance for losses of \$0.7 million, compared to December 31, 2009 when there were 18 properties owned with a net OREO balance of \$5.3 million, net of an allowance for losses of \$0.6 million and September 30, 2009 when there were ten properties owned with a net OREO balance of \$3.0 million, net of an allowance for losses of \$0.7 million.

The following table presents the composition of other real estate owned:

In thousands of dollars	September 30, 2010	December 31, 2009	September 30, 2009
Carrying Value			
Commercial			
Real estate	\$-	\$-	\$-
Construction	1,420	1,182	1,152
Other	1,056	1,920	1,528
Municipal	-	-	-
Residential			
Term	3,532	2,826	990
Construction	-	-	-
Home equity line of credit	-	-	-
Consumer	-	-	-
Total	\$6,008	\$5,928	