

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

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

For the quarterly period ended September 30, 2011

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: **0-51296**

**COMMUNITY FINANCIAL SHARES, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**36-4387843**

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

**357 Roosevelt Road**

**Glen Ellyn, Illinois**

(Address of principal executive offices)

**60137**

(Zip Code)

**(630) 545-0900**

(Registrant's telephone number, including area code)

**None**

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

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

Yes [X] No [ ]

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

Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one)

Large Accelerated Filer [ ]

Accelerated Filer [ ]

Non-Accelerated Filer [ ]

Smaller Reporting Company [X]

(Do not check if a smaller reporting company)

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

Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

<u>Class</u>	<u>Outstanding at November 10, 2011</u>
Common Stock, no par value per share	1,245,267 shares

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Form 10-Q Quarterly Report

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**PART I. FINANCIAL INFORMATION**  
**ITEM 1. FINANCIAL STATEMENTS**

COMMUNITY FINANCIAL SHARES, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(In thousands, except share data)

	September 30, <u>2011</u> (Unaudited)	December 31, <u>2010</u>
<b>ASSETS</b>		
Cash and due from banks	\$ 5,614	\$ 4,553
Interest-bearing deposits	<u>23,308</u>	<u>27,934</u>
Cash and cash equivalents	28,922	32,487
Interest-bearing time deposits	3,633	4,827
Securities available for sale	41,791	43,175
Loans held for sale	1,456	1,770
Loans, less allowance for loan losses of \$6,773 and \$7,679 at September 30, 2011 and December 31, 2010, respectively	210,751	221,607
Foreclosed assets, net	2,327	3,008
Real estate held for investment	4,297	4,318
Prepaid FDIC assessment	759	1,506
Federal Home Loan Bank stock	5,398	5,398
Premises and equipment, net	15,249	15,535
Cash value of life insurance	6,120	5,938
Interest receivable and other assets	<u>7,373</u>	<u>7,527</u>
 Total assets	 <u>\$ 328,076</u>	 <u>\$ 347,096</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits	\$ 291,412	\$ 309,080
Federal Home Loan Bank advances	13,000	13,000
Other borrowings	1,300	1,500
Subordinated debentures	3,609	3,609
Interest payable and other liabilities	<u>2,470</u>	<u>2,152</u>
Total liabilities	311,791	329,341
 Commitments and contingent liabilities		
 Shareholders' equity		
Common stock - no par value, 5,000,000 shares authorized; 1,245,267 shares issued and outstanding	-	-
Preferred stock - \$1.00 par value, 1,000,000 shares authorized; 7,319 shares issued and outstanding	7	7
Paid-in capital	12,014	11,954
Retained earnings	3,570	6,046
Accumulated other comprehensive income (loss)	<u>694</u>	<u>(252)</u>
Total shareholders' equity	<u>16,285</u>	<u>17,755</u>
 Total liabilities and shareholders' equity	 <u>\$ 328,076</u>	 <u>\$ 347,096</u>

See Notes to Condensed Consolidated Financial Statements

COMMUNITY FINANCIAL SHARES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
Three and Nine Months Ended September 30, 2011 and 2010  
(In thousands, except share and per share data)  
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
<b>Interest and dividend income</b>				
Interest and fees on loans	\$2,930	\$3,057	\$8,855	\$9,111
Securities:				
Taxable	254	204	774	840
Exempt from federal income tax	110	136	332	416
Other interest income	<u>27</u>	<u>30</u>	<u>87</u>	<u>67</u>
Total interest and dividend income	3,321	3,427	10,048	10,434
<b>Interest expense</b>				
Deposits	487	678	1,560	2,261
Federal Home Loan Bank advances and other borrowed funds	101	109	301	363
Subordinated debentures	<u>17</u>	<u>20</u>	<u>53</u>	<u>54</u>
Total interest expense	<u>605</u>	<u>807</u>	<u>1,914</u>	<u>2,678</u>
<b>Net interest income</b>	2,716	2,620	8,134	7,756
<b>Provision for loan losses</b>	<u>173</u>	<u>110</u>	<u>2,867</u>	<u>4,775</u>
<b>Net interest income after provision for loan losses</b>	2,543	2,510	5,267	2,981
<b>Non-interest income</b>				
Service charges on deposit accounts	108	121	323	383
Gain on sale of loans	126	219	467	569
Gain on sale of securities	-	112	104	112
Write-down on other real estate owned	-	-	(255)	(185)
Gain (loss) on sale of foreclosed assets	(33)	46	(28)	50
Other non-interest income	<u>272</u>	<u>226</u>	<u>809</u>	<u>573</u>
Total non-interest income	<u>473</u>	<u>724</u>	<u>1,420</u>	<u>1,502</u>
<b>Non-interest expense</b>				
Salaries and employee benefits	1,402	1,456	4,264	4,177
Net occupancy and equipment expense	345	348	1,037	1,019
Data processing expense	300	275	889	820
Advertising and promotions	72	76	188	210
Professional fees	255	175	770	619
FDIC insurance premiums	296	185	829	555
Other real estate owned expenses	134	122	394	351
Other operating expenses	<u>325</u>	<u>337</u>	<u>939</u>	<u>928</u>
Total non-interest expense	<u>3,129</u>	<u>2,974</u>	<u>9,310</u>	<u>8,679</u>
<b>Income (loss) before income taxes</b>	(113)	260	(2,623)	(4,196)
Expense (benefit) for income taxes	<u>(112)</u>	<u>30</u>	<u>(482)</u>	<u>(1,852)</u>
<b>Net income (loss)</b>	<u>(1)</u>	<u>230</u>	<u>(2,141)</u>	<u>(2,344)</u>
Preferred stock dividend and accretion	<u>(113)</u>	<u>(112)</u>	<u>(335)</u>	<u>(332)</u>
<b>Net income (loss) available to common shareholders</b>	<u>\$(114)</u>	<u>\$ 118</u>	<u>\$(2,476)</u>	<u>\$(2,676)</u>
<b>Earnings (loss) per share</b>				
Basic	\$(0.09)	\$0.09	\$(1.99)	\$(2.15)
Diluted	\$(0.09)	\$0.09	\$(1.99)	\$(2.15)
Average shares outstanding basic	1,245,267	1,245,267	1,245,267	1,245,267
Average shares outstanding diluted	1,245,267	1,245,267	1,245,267	1,245,267
Dividends per share	\$0.00	\$0.00	\$0.00	\$0.00

See Notes to Condensed Consolidated Financial Statements

COMMUNITY FINANCIAL SHARES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
Nine Months Ended September 30, 2011 and 2010  
(In thousands, except share and per share data)  
(Unaudited)

	Number of Common Shares	Preferred Stock	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at January 1, 2011	1,245,267	\$ 7	\$11,954	\$6,046	\$(252)	\$17,755
Net loss	-	-	-	(2,141)	-	(2,141)
Change in unrealized net gain on securities available for sale, net of reclassification adjustment of \$104 and tax effects \$20	-	-	-	-	946	946
Total comprehensive loss				(285)	-	(1,195)
Preferred stock dividends (5%)	-	-	-	(50)	-	(285)
Discount on preferred stock	-	-	50	-	-	-
Stock option expense	-	-	10	-	-	10
Balance at September 30, 2011	<u>1,245,267</u>	<u>\$ 7</u>	<u>\$12,014</u>	<u>\$ 3,570</u>	<u>\$ 694</u>	<u>\$16,285</u>
Balance at January 1, 2010	1,245,267	\$ 7	\$11,877	\$11,064	\$(241)	\$22,707
Net loss	-	-	-	(2,344)	-	(2,344)
Change in unrealized net gain on securities available for sale, net of reclassification adjustment of \$112 and tax effects \$23	-	-	-	-	733	733
Total comprehensive loss				(285)	-	(1,611)
Preferred stock dividends (5%)	-	-	-	(47)	-	(285)
Discount on preferred stock	-	-	47	-	-	-
Stock option expense	-	-	12	-	-	12
Balance at September 30, 2010	<u>1,245,267</u>	<u>\$ 7</u>	<u>\$11,936</u>	<u>\$ 8,388</u>	<u>\$ 492</u>	<u>\$20,823</u>

See Notes to Condensed Consolidated Financial Statements

COMMUNITY FINANCIAL SHARES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
Nine Months Ended September 30, 2011 and 2010  
(In thousands)  
(Unaudited)

	Nine Months Ended September 30,	
	2011	2010
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss	\$ (2,141)	\$ (2,344)
Adjustments to reconcile net loss to net cash from (used in) operating activities		
Amortization on securities, net	107	100
Depreciation	487	492
Provision for loan losses	2,867	4,775
Gain on sale of securities	(104)	(112)
Write-down on other real estate owned	255	185
Loss/(Gain) on sale of foreclosed assets	28	(50)
Gain on sale of loans	(467)	(569)
Originations of loans for sale	(24,721)	(30,365)
Proceeds from sales of loans	25,188	30,935
Compensation cost of stock options	10	12
Change in cash value of life insurance	(182)	(179)
Change in interest receivable and other assets	1,004	(10,245)
Change in interest payable and other liabilities	318	566
Net cash from (used in) operating activities	2,649	(6,799)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Net change in interest-bearing time deposits	1,194	-
Purchases of securities available for sale	(13,029)	(24,633)
Proceeds from maturities and calls of securities available for sale	13,429	21,748
Proceeds from sales of securities available for sale	2,526	4,880
Proceeds from sale other real estate owned	7,889	2,136
Net change in loans	131	4,258
Property and equipment expenditures, net	(201)	(175)
Net cash from investing activities	11,939	8,214
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Change in:		
Non-interest bearing and interest bearing demand deposits and savings	(2,488)	(13,989)
Certificates and other time deposits	(15,180)	7,147
Proceeds of borrowings	2,000	11,000
Repayments of borrowings	(2,200)	(11,300)
Dividends paid on preferred stock	(285)	(285)
Net cash used in financing activities	(18,153)	(7,427)
Change in cash and cash equivalents	(3,565)	(6,012)
Cash and cash equivalents at beginning of period	32,487	25,848
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>\$ 28,922</b>	<b>\$ 19,836</b>
Supplemental disclosures		
Interest paid	\$ 1,932	\$ 2,865
Income taxes paid	-	-
Transfers from loans to foreclosed assets and real estate held for investment	4,053	5,625

See Notes to Condensed Consolidated Financial Statements

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COMMUNITY FINANCIAL SHARES, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Table dollars in thousands)  
September 30, 2011 and 2010

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**NOTE 1 – BASIS OF PRESENTATION**

The accounting policies followed in the preparation of the interim condensed consolidated financial statements included in this Quarterly Report on Form 10-Q are consistent with those used in the preparation of annual consolidated financial statements. The interim condensed consolidated financial statements reflect all normal and recurring adjustments, which are necessary, in the opinion of management of Community Financial Shares, Inc. (the “Company”), for a fair statement of results for the interim periods presented. Results for the three and nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011 or any other period.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for the interim financial period and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2010, which was filed with the U.S. Securities and Exchange Commission on March 31, 2011. The condensed consolidated balance sheet of the Company as of December 31, 2010 has been derived from the audited consolidated balance sheet as of that date.

**NOTE 2 – EARNINGS (LOSS) PER SHARE**

The number of shares used to compute basic and diluted loss per share were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
(in thousands)				
Net income (loss)	\$ (1)	\$230	\$(2,141)	\$(2,344)
Less: Accretion of discount on preferred stock	(17)	(16)	(50)	(47)
Dividends on preferred stock	<u>(96)</u>	<u>(96)</u>	<u>(285)</u>	<u>(285)</u>
Income (loss) available to common shareholders	<u>\$ (114)</u>	<u>\$118</u>	<u>\$(2,476)</u>	<u>\$(2,676)</u>
Weighted average shares outstanding	1,245,267	1,245,267	1,245,267	1,245,267
Effect of dilutive securities:				
Stock options	—	—	—	—
Shares used to compute diluted earnings (loss) per share	<u>1,245,267</u>	<u>1,245,267</u>	<u>1,245,267</u>	<u>1,245,267</u>
Earnings (loss) per share:				
Basic	\$(0.09)	\$0.09	\$(1.99)	\$(2.15)
Diluted	(0.09)	0.09	\$(1.99)	\$(2.15)

There were 31,830 and 32,630 anti-dilutive shares at September 30, 2011 and 2010, respectively.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Table dollars in thousands)

September 30, 2011 and 2010

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**NOTE 3 – CAPITAL ADEQUACY AND REGULATORY AND SUPERVISORY MATTERS**

At the dates indicated, the capital ratios of Community Bank-Wheaton/Glen Ellyn, the Company's wholly owned subsidiary (the "Bank"), were as follows:

	<u>September 30, 2011</u>		<u>December 31, 2010</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
Total capital (to risk-weighted assets)	\$18,796	7.9%	\$21,219	8.6%
Tier I capital (to risk-weighted assets)	15,762	6.6%	18,072	7.3%
Tier I capital (to average assets)	15,762	4.9%	18,072	5.4%

At September 30, 2011, regulatory approval is required for all dividend declarations by both the Bank and the Company.

On January 21, 2011, the Bank entered into a Stipulation and Consent to the Issuance of a Consent Order with the FDIC and IDFP, whereby the Bank consented to the issuance of a Consent Order (the "Order") by the FDIC and IDFP, without admitting or denying that grounds exist for the FDIC and IDFP to initiate an administrative proceeding against the Bank.

The Order requires the Bank to achieve Tier 1 capital at least equal to 8% of total assets and total capital at least equal to 12% of risk-weighted assets within 120 days. At September 30, 2011, these capital ratios were 4.9% and 7.9%, respectively. As a result, the Bank is currently deemed to be "undercapitalized" pursuant to the regulatory framework for prompt corrective action and is subject to the mandatory provisions of 12 U.S.C. § 1831o and 12 C.F.R. § 325 (subpart B). These provisions include, among other things, a requirement that the Bank submit a capital restoration plan to the FDIC and restrictions on the Bank's asset growth, acquisitions, new activities, new branches, payment of dividends, declaration of capital distributions and management fees.

The Order also requires the Bank to take the following actions: ensure that the Bank has competent management in place in all executive officer positions; increase the participation of the Bank's Board of Directors in the affairs of the Bank and in the approval of sound policies and objectives for the supervision of the Bank's activities; establish a compliance program to monitor the Bank's compliance with the Order; increase its allowance for loan losses to \$4,728,000 after application of the funds necessary to effect the charge-off of certain adversely classified loans identified in the related Report of Examination of the FDIC and IDFP (the "ROE"); implement a program for the maintenance of an adequate allowance for loan and lease losses; adopt a written profit plan and a realistic, comprehensive budget for all categories of income and expense for calendar year 2011; charge off from its books and records any loan classified as "loss" in the ROE; adopt a written plan to reduce the Bank's risk position in each asset in excess of \$500,000 which has been classified as "substandard" or "doubtful" in the ROE; cease extending additional credit to any borrower who is already obligated in any manner to the Bank on any extension of credit that has been charged off the books of the Bank or classified as "loss" in the ROE without the prior non-objection of the FDIC; not pay any dividends to the Company without prior regulatory approval; implement procedures for managing the Bank's sensitivity to interest rate risk; provide the Company with a copy of the Order; and submit quarterly progress reports to the FDIC and IDFP regarding the Bank's compliance with the Order.

The Order will remain in effect until modified or terminated by the FDIC and IDFP. Any material failure to comply with the provisions of the Order could result in enforcement actions by the FDIC and IDFP. While the Company intends to take such actions as may be necessary to enable the Bank to comply with the requirements of the Order, there can be no assurance that the Bank will be able to comply fully with the provisions of the Order, or to do so within the timeframes required, that compliance with the Order will not be more time consuming or more expensive than anticipated, or that compliance with the Order will enable the Company and the Bank to resume profitable operations, or that efforts to comply with the Order will not have adverse effects on the operations and financial condition of the Company and the Bank.

The Bank is actively working to comply with the requirements of the Order, which may require us to raise capital. However, the Bank's ability to raise any additional capital is contingent on the current capital markets and our financial performance, as well as on the mandatory provisions of 12 U.S.C. § 1831o and 12 C.F.R. § 325 (subpart B) to which the Bank is now subject.

#### NOTE 4 - SECURITIES AVAILABLE FOR SALE

The fair value of securities available for sale at September 30, 2011 and December 31, 2010 are as follows:

	<u>September 30, 2011</u>		
	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
U. S. government agencies	\$ 9,040	\$ 43	\$ -
State and political subdivisions	13,710	626	(25)
Mortgage-backed securities – Government sponsored entities (GSE) residential	18,719	462	(1)
Preferred stock	42	27	-
SBA guaranteed	<u>280</u>	<u>1</u>	<u>(1)</u>
	<u>\$41,791</u>	<u>\$1,159</u>	<u>\$(27)</u>

  

	<u>December 31, 2010</u>		
	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
U. S. government agencies	\$11,801	\$ 13	\$(216)
State and political subdivisions	12,868	173	(470)
Mortgage-backed securities – GSE residential	18,198	248	(154)
Preferred stock	11	-	(3)
SBA guaranteed	<u>297</u>	<u>-</u>	<u>(3)</u>
	<u>\$43,175</u>	<u>\$434</u>	<u>\$(846)</u>

Securities classified as U. S. government agencies include notes issued by government-sponsored enterprises such as the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Federal Home Loan Bank. The SBA-guaranteed securities are pools of loans guaranteed by the Small Business Administration.

The following tables show gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2011 and December 31, 2010:

Description of Securities	Less than 12 Months		<u>September 30, 2011</u> 12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Mortgage-backed securities – GSE residential	\$ 141	\$ (1)	\$ -	\$ -	\$ 141	\$ (1)
State and political subdivisions	-	-	1,886	(25)	1,886	(25)
SBA guaranteed	<u>-</u>	<u>-</u>	<u>234</u>	<u>(1)</u>	<u>234</u>	<u>(1)</u>
Total temporarily impaired securities	<u>\$141</u>	<u>\$(1)</u>	<u>\$2,120</u>	<u>\$(26)</u>	<u>\$2,261</u>	<u>\$(27)</u>

Description of Securities	Less than 12 Months		December 31, 2010 12 Months or More		Total	Unrealized Losses
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	
U.S. government agencies	\$ 7,788	\$(216)	\$ -	\$ -	\$ 7,788	\$(216)
State and political subdivisions	8,411	(365)	1,568	(105)	9,979	(470)
Mortgage-backed securities – GSE residential	9,002	(154)	-	-	9,002	(154)
Preferred stock	11	(3)	-	-	11	(3)
SBA guaranteed	<u>136</u>	<u>(1)</u>	<u>113</u>	<u>(2)</u>	<u>249</u>	<u>(3)</u>
Total temporarily impaired securities	<u>\$25,348</u>	<u>\$(739)</u>	<u>\$1,681</u>	<u>\$(107)</u>	<u>\$27,029</u>	<u>\$(846)</u>

### U.S. Government Agencies, State and Political Subdivisions, and Mortgage-backed securities

The unrealized losses on the Company's investments in direct obligations of U.S. government agencies, state and political subdivisions and mortgage-backed securities were caused by interest rate changes. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at September 30, 2011.

Unrealized gains and losses within the investment portfolio are determined to be temporary. The Company has performed an evaluation of its investments for other than temporary impairment and there was no impairment identified during the third quarter of 2011. The entire portfolio is classified as available for sale, however, management has no specific intent to sell any securities, and it is more likely than not that the company will not have to sell any security before recovery of its amortized cost basis.

The fair values of securities available for sale at September 30, 2011, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity are shown separately.

	Amortized Cost	Fair Value
Due in one year or less	\$ 67	\$ 68
Due after one year through five years	623	661
Due after five years through ten years	3,772	3,835
Due after ten years	17,643	18,186
Mortgage-backed securities	18,258	18,719
Preferred stock	15	42
SBA guaranteed	<u>280</u>	<u>280</u>
	<u>\$40,658</u>	<u>\$41,791</u>

Securities with a carrying value of approximately \$23.8 million at September 30, 2011 were pledged to secure public deposits, Federal Home Loan Bank advances and for other purposes as required or permitted by law.

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Sales activities for securities for the three and nine months ended September 30, 2011 and 2010 is shown in the following table:

	Three Months Ended		Nine Months Ended	
	<u>September 30,</u>		<u>September 30,</u>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
Sales proceeds	\$ -	\$4,880	\$2,526	\$4,880
Gross gains on sales	-	118	104	118
Gross losses on sales	-	6	-	6

## NOTE 5 – LOANS

Loans and Loan Income: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoffs are reported at their outstanding principal balances adjusted for unearned income, charge-offs, the allowance for loan losses, any unamortized deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans.

For loans amortized at cost, interest income is accrued based on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, as well as premiums and discounts, are deferred and amortized as a level yield adjustment over the respective term of the loan.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off are reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Discounts and premiums on purchased residential real estate loans are amortized to income using the interest method over the remaining period to contractual maturity, adjusted for anticipated prepayments. Discounts and premiums on purchased consumer loans are recognized over the expected lives of the loans using methods that approximate the interest method.

Allowance for Loan Losses: The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers nonclassified loans and is based on historical charge-off experience and expected loss given default derived from the Company's internal risk rating process. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent.

Groups of loans with similar risk characteristics are collectively evaluated for impairment based on the group's historical loss experience adjusted for changes in trends, conditions and other relevant factors that affect repayment of the loans. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment measurements, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

The Company has a geographic concentration of loan and deposit customers within the Chicago metropolitan area. Most of the loans are secured by specific items of collateral including commercial and residential real estate and other business and consumer assets. Commercial loans are expected to be repaid from cash flow from operations of businesses.

Loans consisted of the following at September 30, 2011 and December 31, 2010, respectively:

	September 30, <u>2011</u>	December 31, <u>2010</u>
Real estate		
Commercial	\$ 94,782	\$ 94,356
Construction	5,699	15,435
Residential	25,701	25,964
Home equity	<u>61,329</u>	<u>66,243</u>
Total real estate loans	187,511	201,998
Commercial	28,279	25,572
Consumer	<u>1,448</u>	<u>1,399</u>
Total loans	217,238	228,969
Deferred loan costs, net	286	317
Allowance for loan losses	<u>(6,773)</u>	<u>(7,679)</u>
Loans, net	<u>\$210,751</u>	<u>\$221,607</u>

**The risk characteristics of each loan portfolio segment are as follows:**

Commercial

Commercial loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial Real Estate

These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is

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generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's commercial real estate portfolio are diverse in terms of type and geographic location. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. As a general rule, the Company avoids financing single purpose projects unless other underwriting factors are present to help mitigate risk. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans.

### Construction

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

### Residential and Consumer

With respect to residential loans that are secured by one-to-four family residences and are generally owner occupied, the Company generally establishes a maximum loan-to-value ratio and may require private mortgage insurance if that ratio is exceeded. Home equity loans are typically secured by a subordinate interest in one-to-four family residences, and consumer loans are secured by consumer assets such as automobiles or recreational vehicles. Some consumer loans are unsecured such as small installment loans and certain lines of credit. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Repayment can also be impacted by changes in property values on residential properties. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

### **Policy for charging off loans:**

Management's general practice is to proactively charge down loans individually evaluated for impairment to the fair value of the underlying collateral.

Consistent with regulatory guidance, charge-offs on all loan segments are taken when specific loans, or portions thereof, are considered uncollectible. The Company's policy is to promptly charge these loans off in the period the uncollectible loss is reasonably determined.

For all loan portfolio segments except one-to-four family residential loans and consumer loans, the Company promptly charges-off loans, or portions thereof, when available information confirms that specific loans are uncollectible based on information that includes, but is not limited to, (1) the deteriorating financial condition of the borrower, (2) declining collateral values, and/or (3) legal action, including bankruptcy, that impairs the borrower's ability to adequately meet its obligations. For impaired loans that are considered to be solely collateral dependent, a partial charge-off is recorded when a loss has been confirmed by an updated appraisal or other appropriate valuation of the collateral.

The Company charges-off one-to-four family residential and consumer loans, or portions thereof, when the Company reasonably determines the amount of the loss. The Company adheres to timeframes established by applicable regulatory guidance which provides for the charge-down of one-to-four family first and junior lien mortgages to the net realizable value less costs to sell when the loan is 180 days past due, charge-off of unsecured open-end loans when the loan is 180 days past due, and charge down to the net realizable value when other secured loans are 120 days past due. Loans at these respective delinquency thresholds for which the Company can clearly document that the loan is both well-secured and in the process of collection, such that collection will occur regardless of delinquency status, need not be charged off.

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**Policy for determining delinquency:**

The entire balance of a loan is considered delinquent if the minimum payment contractually required to be made is not received by the specified due date.

**Period utilized for determining historical loss factors:**

The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company over the prior three years. Management believes the three year historical loss experience methodology is appropriate in the current economic environment, as it captures loss rates that are comparable to the current period being analyzed.

**Policy for recognizing interest income on impaired loans:**

Interest income on loans individually classified as impaired is recognized on a cash basis after all past due and current principal payments have been made.

**Policy for recognizing interest income on non-accrual loans:**

Subsequent payments on non-accrual loans are recorded as a reduction of principal, and interest income is recorded only after principal recovery is reasonably assured. Nonaccrual loans are returned to accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to the timely collection of interest or principal. The Company requires a period of satisfactory performance of not less than six months before returning a nonaccrual loan to accrual status.

The Bank has entered into transactions, including the making of direct and indirect loans, with certain directors and their affiliates (related parties). Such transactions were made in the ordinary course of business and were made on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons. Further, in management's opinion, these loans did not involve more than normal risk of collectibility or present other unfavorable features.

The aggregate amount of loans, as defined, to such related parties were as follows:

Balances, January 1, 2011	\$3,353
New loans including renewals	1
Payments, etc., including renewals	( 58)
Balances, September 30, 2011	<u>\$3,296</u>

The following table presents the balance in the allowance for loan losses and the recorded investment in loans based on portfolio segment and impairment method for the nine months ended September 30, 2011:

	Commercial								
	Commercial	Real Estate	Construction	Consumer	Residential	HELOC	Unallocated	Total	2010
Balance at beginning of period	\$ 791	\$1,200	\$3,877	\$ 19	\$ 661	\$ 838	\$ 293	\$7,679	\$4,812
Provision for loan losses	6	1,849	410	3	345	533	(279)	2,867	4,775
Charge-offs	(109)	(194)	(2,801)	(8)	(139)	(530)	-	(3,781)	(5,207)
Recoveries	<u>1</u>	<u>-</u>	<u>-</u>	<u>3</u>	<u>-</u>	<u>4</u>	<u>-</u>	<u>8</u>	<u>23</u>
Balance at end of period	<u>\$ 689</u>	<u>\$2,855</u>	<u>\$1,486</u>	<u>\$ 17</u>	<u>\$ 867</u>	<u>\$ 845</u>	<u>\$ 14</u>	<u>\$6,773</u>	<u>\$4,403</u>
Ending balance: individually evaluated for impairment	<u>\$ -</u>	<u>\$1,683</u>	<u>\$1,450</u>	<u>\$ -</u>	<u>\$ 566</u>	<u>\$ 447</u>	<u>\$ -</u>	<u>\$ 4,146</u>	
Ending balance: collectively evaluated for impairment	<u>\$ 689</u>	<u>\$1,172</u>	<u>\$ 36</u>	<u>\$ 17</u>	<u>\$ 301</u>	<u>\$ 398</u>	<u>\$ 14</u>	<u>\$ 2,627</u>	
<b>Total Loans:</b>									
Ending balance	<u>\$28,279</u>	<u>\$94,782</u>	<u>\$ 5,699</u>	<u>\$1,448</u>	<u>\$25,701</u>	<u>\$61,329</u>	<u>\$ -</u>	<u>\$217,238</u>	
Ending balance: individually evaluated for impairment	<u>\$ -</u>	<u>\$ 6,606</u>	<u>\$ 2,722</u>	<u>\$ -</u>	<u>\$ 7,946</u>	<u>\$ 1,796</u>	<u>\$ -</u>	<u>\$ 19,070</u>	
Ending balance: collectively evaluated for impairment	<u>\$28,279</u>	<u>\$88,176</u>	<u>\$ 2,977</u>	<u>\$1,448</u>	<u>\$17,755</u>	<u>\$59,533</u>	<u>\$ -</u>	<u>\$198,168</u>	

The following table presents the changes in the allowance for loan losses for the three months ended September 30, 2011:

	Commercial							Total	2010
	Commercial	Real Estate	Construction	Consumer	Residential	HELOC	Unallocated		
Balance at beginning of period	\$658	\$2,780	\$1,543	\$19	\$789	\$815	\$ -	\$6,604	\$4,374
Provision for loan losses	31	75	(57)	2	78	30	14	173	110
Charge-offs	-	-	-	(8)	-	-	-	(8)	(85)
Recoveries	-	-	-	4	-	-	-	4	4
Balance at end of period	<u>\$689</u>	<u>\$2,855</u>	<u>\$1,486</u>	<u>\$17</u>	<u>\$867</u>	<u>\$845</u>	<u>\$14</u>	<u>\$6,773</u>	<u>\$4,403</u>

The following table presents the balance in the allowance for loan losses and the recorded investment in loans based on portfolio segment and impairment method as of December 31, 2010:

	Commercial							Total
	Commercial	Real Estate	Construction	Consumer	Residential	HELOC	Unallocated	
Balance at beginning of period	\$ 762	\$2,245	\$ 619	\$ 24	\$ 770	\$ 390	\$ 2	\$4,812
Provision for loan losses	1,287	(589)	6,342	(7)	(2)	1,018	291	8,340
Charge-offs	(1,280)	(456)	(3,084)	(15)	(107)	(570)	-	(5,512)
Recoveries	22	-	-	17	-	-	-	39
Balance at end of period	<u>\$ 791</u>	<u>\$1,200</u>	<u>\$3,877</u>	<u>\$ 19</u>	<u>\$ 661</u>	<u>\$ 838</u>	<u>\$293</u>	<u>\$7,679</u>
Ending balance: individually evaluated for impairment	<u>\$ 109</u>	<u>\$ 315</u>	<u>\$3,647</u>	<u>\$ -</u>	<u>\$ 387</u>	<u>\$ 469</u>	<u>\$ -</u>	<u>\$4,927</u>
Ending balance: collectively evaluated for impairment	<u>\$ 682</u>	<u>\$ 885</u>	<u>\$ 230</u>	<u>\$19</u>	<u>\$ 274</u>	<u>\$ 369</u>	<u>\$293</u>	<u>\$2,752</u>
<b>Total Loans:</b>								
Ending balance	<u>\$25,572</u>	<u>\$94,356</u>	<u>\$15,435</u>	<u>\$1,399</u>	<u>\$25,964</u>	<u>\$66,243</u>	<u>\$ -</u>	<u>\$228,969</u>
Ending balance: individually evaluated for impairment	<u>\$ 351</u>	<u>\$ 5,707</u>	<u>\$11,189</u>	<u>\$ -</u>	<u>\$ 6,928</u>	<u>\$ 2,174</u>	<u>\$ -</u>	<u>\$ 26,349</u>
Ending balance: collectively evaluated for impairment	<u>\$25,221</u>	<u>\$88,649</u>	<u>\$ 4,246</u>	<u>\$1,399</u>	<u>\$19,036</u>	<u>\$64,069</u>	<u>\$ -</u>	<u>\$202,620</u>

The following table summarizes the Company's nonaccrual loans by class at September 30, 2011 and December 31, 2010.

	September 30, 2011	December 31, 2010
Commercial and industrial	\$ -	\$ 351
Real estate loans:		
Construction	2,722	9,789
Commercial and farm land	795	1,052
Residential mortgage	7,946	6,928
Home equity	<u>2,079</u>	<u>2,174</u>
Total	<u>\$13,542</u>	<u>\$20,294</u>

The following table presents impaired loans as of September 30, 2011:

	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Three Months Ended	Nine Months Ended	Interest Income Recognized	Interest Income Recognized
				Average Investment in Impaired Loans	Average Investment in Impaired Loans		
With no related allowance recorded:							
Commercial real estate	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 760	\$ -
Construction	572	1,323	-	572	-	572	-
Residential	2,356	2,355	-	2,358	-	2,360	-
HELOC	<u>524</u>	<u>524</u>	<u>-</u>	<u>525</u>	<u>-</u>	<u>523</u>	<u>1</u>
Subtotal	<u>\$3,452</u>	<u>\$4,202</u>	<u>\$ -</u>	<u>\$3,455</u>	<u>\$ -</u>	<u>\$4,215</u>	<u>\$ 1</u>
With an allowance recorded:							
Commercial real estate	\$ 6,606	\$ 6,606	\$1,683	\$ 6,607	\$36	\$ 5,534	\$199
Construction	2,150	2,150	1,450	2,150	-	2,150	-
Residential	5,591	5,603	566	5,596	13	5,609	47
HELOC	<u>1,271</u>	<u>1,271</u>	<u>447</u>	<u>1,261</u>	<u>3</u>	<u>1,258</u>	<u>7</u>
Subtotal	<u>\$15,618</u>	<u>\$15,630</u>	<u>\$4,146</u>	<u>\$15,614</u>	<u>\$ 52</u>	<u>\$14,551</u>	<u>\$253</u>
Total Impaired Loans	<u>\$19,070</u>	<u>\$19,832</u>	<u>\$4,146</u>	<u>\$19,069</u>	<u>\$ 52</u>	<u>\$18,766</u>	<u>\$254</u>

The following table presents impaired loans as of December 31, 2010:

	Recorded Balance	Unpaid Principal Balance	Specific Allowance
With no related allowance recorded:			
Commercial	\$ 109	\$ 109	\$ -
Commercial real estate	464	464	-
Construction	572	1,323	-
Residential	2,588	2,588	-
HELOC	<u>636</u>	<u>636</u>	<u>-</u>
Subtotal	<u>\$4,369</u>	<u>\$5,120</u>	<u>\$ -</u>
With an allowance recorded:			
Commercial	\$ 242	\$ 242	\$ 109
Commercial real estate	5,243	5,243	315
Construction	10,617	12,440	3,647
Residential	4,340	4,340	387
HELOC	<u>1,538</u>	<u>1,679</u>	<u>469</u>
Subtotal	<u>\$21,980</u>	<u>\$23,944</u>	<u>\$4,927</u>
Total Impaired Loans	<u>\$26,349</u>	<u>\$29,064</u>	<u>\$4,927</u>

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis is performed during the loan approval process and is updated as circumstances warrant. The Company uses the following definitions for risk ratings:

**Special Mention.** Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Bank's credit position at some future date.

**Substandard.** Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

The following tables summarize credit quality of the Company at September 30, 2011 and December 31, 2010:

	<b>September 30, 2011</b>						
	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>Doubtful</b>	<b>Loss</b>	<b>Total</b>	<b>Nonperforming</b>
Commercial and industrial	\$ 26,671	\$ 927	\$ 681	\$—	\$—	\$ 28,279	\$ —
Real estate loans:							
Construction	1,928	-	3,771	—	—	5,699	2,722
Commercial real estate	84,797	3,379	6,606	—	—	94,782	795
Residential mortgage	12,571	3,973	9,157	—	—	25,701	7,946
Home equity	57,415	530	3,384	—	—	61,329	2,079
Individuals loans for household and other personal expenditures	<u>1,448</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,448</u>	<u>—</u>
Total	<u>\$184,830</u>	<u>\$8,809</u>	<u>\$23,599</u>	<u>\$—</u>	<u>\$—</u>	<u>\$217,238</u>	<u>\$13,542</u>

	<b>December 31, 2010</b>						
	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>Doubtful</b>	<b>Loss</b>	<b>Total</b>	<b>Nonperforming</b>
Commercial and industrial	\$ 22,241	\$2,238	\$ 1,093	\$—	\$—	\$ 25,572	\$ 351
Real estate loans:							
Construction	2,077	773	12,585	—	—	15,435	9,789
Commercial real estate	85,412	3,203	5,741	—	—	94,356	1,052
Residential mortgage	14,685	1,285	9,994	—	—	25,964	6,928
Home equity	62,635	526	3,082	—	—	66,243	2,174
Individuals loans for household and other personal expenditures	<u>1,399</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,399</u>	<u>—</u>
Total	<u>\$188,449</u>	<u>\$8,025</u>	<u>\$32,495</u>	<u>\$—</u>	<u>\$—</u>	<u>\$228,969</u>	<u>\$20,294</u>

The following tables summarize past due aging of the Company's loan portfolio at September 30, 2011 and December 31, 2010:

	<b>September 30, 2011</b>						
	<b>30-59 Days Past Due</b>	<b>60-89 Days Past Due</b>	<b>Greater Than 90 Days</b>	<b>Total Past Due</b>	<b>Current</b>	<b>Total Loans</b>	<b>Loans &gt; 90 Days and Accruing</b>
Commercial and industrial	\$ —	\$ —	\$ —	\$ —	\$ 28,279	\$ 28,279	\$—
Real estate loans:							
Construction	—	—	2,722	2,722	2,977	5,699	—
Commercial real estate	1,874	—	795	2,669	92,113	94,782	—
Residential mortgage	223	546	7,946	8,715	16,986	25,701	—
Home equity	289	138	2,079	2,506	58,823	61,329	—
Individuals loans for household and other personal expenditures	<u>1</u>	<u>—</u>	<u>—</u>	<u>1</u>	<u>1,447</u>	<u>1,448</u>	<u>—</u>
Total	<u>\$2,387</u>	<u>\$684</u>	<u>\$13,542</u>	<u>\$16,613</u>	<u>\$200,625</u>	<u>\$217,238</u>	<u>\$—</u>

	<b>December 31, 2010</b>						
	<b>30-59 Days Past Due</b>	<b>60-89 Days Past Due</b>	<b>Greater Than 90 Days</b>	<b>Total Past Due</b>	<b>Current</b>	<b>Total Loans</b>	<b>Loans &gt; 90 Days and Accruing</b>
Commercial and industrial	\$ —	\$ —	\$ 351	\$ 351	\$ 25,221	\$ 25,572	\$—
Real estate loans:							
Construction	1,154	—	9,789	10,943	4,492	15,435	—
Commercial real estate	1,958	—	1,052	3,010	91,346	94,356	—
Residential mortgage	104	168	6,928	7,200	18,764	25,964	—
Home equity	687	298	2,174	3,159	63,084	66,243	—
Individuals loans for household and other personal expenditures	<u>12</u>	<u>—</u>	<u>—</u>	<u>12</u>	<u>1,387</u>	<u>1,399</u>	<u>—</u>
Total	<u>\$3,915</u>	<u>\$466</u>	<u>\$20,294</u>	<u>\$24,675</u>	<u>\$204,294</u>	<u>\$228,969</u>	<u>\$—</u>

The Company may grant a concession or modification for economic or legal reasons related to a borrower's financial condition that it would not otherwise consider resulting in a modified loan which is then identified as a troubled debt restructuring (TDR). The Company may modify loans through interest rate reductions, short-term extensions of maturity, interest only payments, or payment modifications to better match the timing of cash flows due under the modified terms with the cash flows from the borrowers' operations. Loan modifications are intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. TDRs are considered impaired loans for purposes of calculating the Company's allowance for loan losses.

The Company identifies loans for potential restructure primarily through direct communication with the borrower and evaluation of the borrower's financial statements, revenue projections, tax returns and credit reports. Even if the borrower is not presently in default, management will consider the likelihood that cash flow shortages, adverse economic conditions, and negative trends may result in a payment default in the near future.

For one-to-four family residential and home equity lines of credit, a restructure often occurs with past due loans and may be offered as an alternative to foreclosure. There are other situations where borrowers, who are not past due, experience a sudden job loss, become overextended with credit obligations, or other problems, have indicated that they will be unable to make the required monthly payment and request payment relief.

When considering a loan restructure, management will determine if: (i) the financial distress is short or long term; (ii) loan concessions are necessary; and (iii) the restructure is a viable solution.

When a loan is restructured, the new terms often require a reduced monthly debt service payment. No TDRs that were on non-accrual status at the time the concessions were granted have been returned to accrual status. For commercial loans, management completes an analysis of the operating entity's ability to repay the debt. If the operating entity is capable of servicing the new debt service requirements and the underlying collateral value is believed to be sufficient to repay the debt in the event of a default, the new loan is generally placed on accrual status.

For retail loans, an analysis of the individual's ability to service the new required payments is performed. If the borrower is capable of servicing the newly restructured debt and the underlying collateral value is believed to be sufficient to repay the debt in the event of a future default, the new loan is generally placed on accrual status. The reason for the TDR is also considered, such as paying past due real estate taxes or payments caused by a temporary job loss, when determining whether a retail TDR loan could be returned to accrual status. Retail TDRs remain on non-accrual status until sufficient payments have been made to bring the past due principal and interest current at which point the loan would be transferred to accrual status.

The following table summarizes the loans that have been restructured as TDRs during the three and nine months ended September 30, 2011:

	Three months ended September 30, 2011			Nine months ended September 30, 2011		
	Count	Balance Prior to TDR	Balance after TDR	Count	Balance Prior to TDR	Balance after TDR
Real estate loans:						
Commercial real estate	-	\$ -	\$ -	1	\$1,100	\$1,128
Construction	3	533	533	3	533	533
Residential mortgage	<u>1</u>	<u>371</u>	<u>371</u>	<u>1</u>	<u>371</u>	<u>371</u>
Total	<u>4</u>	<u>\$904</u>	<u>\$904</u>	<u>5</u>	<u>\$2,004</u>	<u>\$2,032</u>

The following table sets forth the Company's TDRs that had payment defaults during the three and nine months ended September 30, 2011. Default occurs when a TDR is 90 days or more past due, transferred to non-accrual status, or transferred to other real estate owned within twelve months of restructuring.

	Count	Default Balance
Real estate loans:		
Commercial real estate	1	\$ 588
Construction	<u>1</u>	<u>2,005</u>
Total	<u>2</u>	<u>\$2,093</u>

#### NOTE 6 – OTHER COMPREHENSIVE INCOME

Other comprehensive income components and related taxes for the nine months ended September 30, 2011 and 2010 were as follows:

	2011	2010
Net unrealized gains on securities available for sale	\$1,070	\$868
Less reclassification adjustment for realized gains included in income	(104)	(112)
Other comprehensive gain, before tax effect	966	756
Tax expense	<u>20</u>	<u>23</u>
Other comprehensive income	<u>\$946</u>	<u>\$733</u>

#### NOTE 7 – DISCLOSURES ABOUT FAIR VALUE OF ASSETS AND LIABILITIES

The Company measures fair value according to the Financial Accounting Standards Board Accounting Standards Codification (ASC) *Fair Value Measurements and Disclosures* (ASC 820-10). ASC 820-10 establishes a fair value hierarchy that prioritizes the inputs used in valuation techniques, but not the valuation techniques themselves. The fair value hierarchy is designed to indicate the relative reliability of the fair value measure. The highest priority given to quoted prices in active markets and the lowest to unobservable data such as the Company's internal information. ASC 820-10 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. There are three levels of inputs into the fair value hierarchy (Level 1 being the highest priority and Level 3 being the lowest priority):

- Level 1** Quoted prices in active markets for identical assets or liabilities.
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

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**Level 3** Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such instruments pursuant to the valuation hierarchy.

**Available-for-sale Securities**

If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 1 security includes preferred stock. Level 2 securities include certain collateralized mortgage and debt obligations, municipal securities, U.S. government agencies and SBA securities. Third party vendors compile prices from various sources and may apply such techniques as matrix pricing to determine the value of identical or similar investment securities (Level 2). Matrix pricing is a mathematical technique widely used in the banking industry to value investment securities without relying exclusively on quoted prices for specific investment securities but rather on the investment securities' relationship to other benchmark quoted investment securities. The following tables are as of September 30, 2011 and December 31, 2010, respectively:

	<u>At September 30, 2011</u>			
	<u>Fair Value Measurements Using</u>			
	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Available for sale securities:				
U.S. government agencies	\$ 9,040	\$ -	\$ 9,040	\$ -
State and political subdivisions	13,710	-	13,710	-
Mortgage-backed securities – GSE residential	18,719	-	18,719	-
Preferred stock	42	42	-	-
SBA guaranteed	<u>280</u>	<u>-</u>	<u>280</u>	<u>-</u>
Total available for sale securities	<u>\$41,791</u>	<u>\$42</u>	<u>\$41,749</u>	<u>\$ -</u>

	<u>At December 31, 2010</u>			
	<u>Fair Value Measurements Using</u>			
	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Available for sale securities:				
U.S. government agencies	\$11,801	\$ -	\$11,801	\$ -
State and political subdivisions	12,868	-	12,868	-
Mortgage-backed securities – GSE residential	18,198	-	18,198	-
Preferred stock	11	11	-	-
SBA guaranteed	<u>297</u>	<u>-</u>	<u>297</u>	<u>-</u>
Total available for sale securities	<u>\$43,175</u>	<u>\$11</u>	<u>\$43,164</u>	<u>\$ -</u>

The following is a description of the valuation methodologies used for instruments measured at fair value on a non-recurring basis and recognized in the accompanying September 30, 2011 and December 31, 2010 balance sheets, as well as the general classification of such instruments pursuant to the valuation hierarchy.

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**Impaired Loans (Collateral Dependent)**

Loans for which it is probable that the Bank will not collect all principal and interest due according to contractual terms are measured for impairment. Allowable methods for determining the amount of impairment include estimating fair value using the fair value of the collateral for collateral-dependent loans.

If the impaired loan is identified as collateral dependent, then the fair value method of measuring the amount of impairment is utilized. This method requires obtaining a current independent appraisal of the collateral and applying a discount factor to the value.

Impaired loans that are collateral dependent are classified within Level 3 of the fair value hierarchy when impairment is determined using the fair value method. The following tables are as of September 30, 2011 and December 31, 2010, respectively:

	<u>At September 30, 2011</u>			
	<u>Fair Value Measurements Using</u>			
	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Impaired loans	\$19,070	-	-	\$19,070

	<u>At December 31, 2010</u>			
	<u>Fair Value Measurements Using</u>			
	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Impaired loans	\$11,587	-	-	\$11,587

The carrying amount and estimated fair value of financial instruments at September 30, 2011 and December 31, 2010 are as follows:

	<u>September 30, 2011</u>		<u>December 31, 2010</u>	
	<u>Carrying Value</u>	<u>Fair Value</u>	<u>Carrying Value</u>	<u>Fair Value</u>
Financial assets				
Cash and cash equivalents	\$ 28,922	\$ 28,922	\$ 32,487	\$ 32,487
Interest-bearing time deposits	3,633	3,633	4,827	4,827
Securities available for sale	41,791	41,791	43,175	43,175
Loans held for sale	1,456	1,456	1,770	1,770
Loans receivable, net	210,751	213,251	221,607	224,054
Federal Home Loan Bank stock	5,398	5,398	5,398	5,398
Interest receivable	1,073	1,073	1,116	1,116
Financial liabilities				
Deposits	291,412	293,474	309,080	309,575
Federal Home Loan Bank advances	13,000	13,363	13,000	12,929
Other borrowings	1,300	1,300	1,500	1,500
Subordinated debentures	3,609	1,136	3,609	1,163
Interest payable	232	232	245	245

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The methods and assumptions used to estimate fair value are described as follows:

Carrying amount is the estimated fair value for cash and cash equivalents, interest-bearing time deposits, loans held for sale, Federal Home Loan Bank stock, interest receivable and payable, deposits due on demand, variable rate loans and other borrowings. For fixed rate loans and time deposits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. The fair value of fixed rate Federal Home Loan Bank advances and subordinated debentures are based on current rates for similar financing. The fair value of off-balance-sheet items, which is based on the current fees or cost that would be charged to enter into or terminate such arrangements, is immaterial.

While the above estimates are based on management's judgment of the most appropriate factors, there is no assurance that were the Company to have disposed of these items on the respective dates, the fair values would have been achieved, because the market value may differ depending on the circumstances. The estimated fair values at year end should not necessarily be considered to apply at subsequent dates.

Other assets and liabilities that are not financial instruments, such as premises and equipment, are not included in the above disclosures. Also, nonfinancial instruments typically not recognized on the balance sheet may have value but are not included in the above disclosures. These include, among other items, the estimated earnings power of core deposits, the trained workforce, customer goodwill, and similar items.

#### **NOTE 8 – TARP CAPITAL PURCHASE PROGRAM**

On May 15, 2009, the Company entered into a Letter Agreement and the related Securities Purchase Agreement, with the United States Department of the Treasury (the “Department of Treasury”) in accordance with the terms of the Department of Treasury’s TARP Capital Purchase Program. Pursuant to the Letter Agreement and Securities Purchase Agreement, the Company issued 6,970 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A, and a warrant for the purchase of 349 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series B, to the Department of Treasury for an aggregate purchase price of \$6,970,000 in cash.

The Series A preferred stock qualifies as Tier 1 capital and will pay cumulative dividends at a rate of 5% per annum until February 15, 2014. Beginning February 16, 2014, the dividend rate will increase to 9% per annum. The Series A preferred stock may be redeemed, in whole or in part, at any time from time to time, at the option of the Company, subject to consultation with the Company’s primary federal banking regulator, provided that any partial redemption must be for at least 25% of the issue price of the Series A preferred stock.

As part of the transaction, the Department of Treasury exercised the Warrant and received 349 shares of Series B preferred stock. The Series B preferred stock will pay cumulative dividends at a rate of 9% per annum. The Series B preferred stock may also be redeemed, in whole or in part, at any time from time to time, at the option of the Company, subject to consultation with the Company’s primary federal regulator, provided that any partial redemption must be for at least 25% of the liquidation value of the Series B preferred stock. The Series B preferred stock cannot be redeemed until all of the outstanding shares of Series A preferred stock have been redeemed.

The Securities Purchase Agreement also subjects the Company to certain of the executive compensation limitations included in the Emergency Economic Stabilization Act of 2008 (EESA), as modified by the American Recovery and Reinvestment Act of 2009. The Company will take all necessary action to ensure that its benefit plans with respect to senior executive officers continue to comply with Section 111(b) of the EESA and has agreed to not adopt any benefit plans with respect to, or which cover, its senior executive officers that do not comply with the EESA, and the applicable executives have consented to the foregoing.

On January 14, 2011, the Company was notified by the Federal Reserve Bank of Chicago (the “FRB”) that the overall condition of the Company and the Bank is less than satisfactory. As a result, the Company must now obtain prior written approval from the FRB prior to, among other things, the payment of any capital distribution, including stockholder dividends on the shares of Company preferred stock issued to the Department of Treasury pursuant to the TARP Capital Purchase Program. The Company has notified the Department of Treasury that, beginning with the February 15, 2011 dividend payment, the Company will defer all payments of dividends on its Series A preferred stock for an indefinite period of time.

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**NOTE 9 – RECENT ACCOUNTING PRONOUNCEMENTS**

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*. ASU 2010-20 requires that more information be disclosed about the credit quality of a company's loans and the allowance for loan losses held against those loans. A company will need to disaggregate new and existing disclosures based on how it develops its allowance for loan losses and how it manages credit exposures. The existing disclosures to be presented on a disaggregated basis include a rollforward of the allowance for loan losses, the related recorded investment in such loans, the nonaccrual status of loans, and impaired loans. Additional disclosure is also required about the credit quality indicators of loans by class at the end of the reporting period, the aging of past due loans, information about troubled debt restructurings, and significant purchases and sales of loans during the reporting period by class. For public companies, ASU 2010-20 requires certain disclosures as of the end of a reporting period effective for periods ending on or after December 15, 2010. Other required disclosures about activity that occurs during a reporting period are effective for periods beginning on or after December 15, 2010. The Company adopted this standard effective December 31, 2010. Since the adoption of this standard was disclosure related, it did not have a material effect on its financial position or results of operations.

In April 2011, the FASB issued ASU No. 2011-02, *Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*. ASU 2011-02 clarifies the guidance in ASC 310-40 *Receivables: Troubled Debt Restructurings by Creditors*. Creditors are required to identify a restructuring as a troubled debt restructuring if the restructuring constitutes a concession and the debtor is experiencing financial difficulties. ASU 2011-02 clarifies guidance on whether a creditor has granted a concession and clarifies the guidance on a creditor's evaluation of whether a debtor is experiencing financial difficulties. In addition, ASU 2011-02 also precludes the creditor from using the effective interest rate test in the debtor's guidance on restructuring of payables when evaluating whether a restructuring constitutes a troubled debt restructuring. The effective date of ASU 2011-2 for public entities is effective for the first interim or annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. If, as a result of adoption, an entity identifies newly impaired receivables, an entity should apply the amendments for purposes of measuring impairment prospectively for the first interim or annual period beginning on or after June 15, 2011. The Company adopted the methodologies prescribed by this ASU on July 1, 2011 with no material impact on its financial condition, results of operation, and cash flows or on the total TDRs identified by the Company.

*ASU No. 2011-05; Amendments to Topic 220, Comprehensive Income*. In June, 2011 FASB issued ASU No. 2011-05. Under the amendments in this ASU, an entity has the option to present the total comprehensive income, the components of net income, and the components of other comprehensive income either in a continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments in this ASU do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The amendments in this ASU should be applied retrospectively. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted, because compliance with the amendments is already permitted. The amendments do not require any transition disclosures. Due to the recency of this pronouncement, the Company is evaluating its timing of adoption of ASU 2011-05, but will adopt the ASU retrospectively by the due date.

**NOTE 10 – INCOME TAXES**

The provision for income taxes represents income tax expense (benefit) calculated using estimated annualized rates on taxable income or loss generated during the respective periods. During the nine months ended September 30, 2011, the Company incurred a net loss due to continued elevated provision expense as a result of declining collateral values. Due to these recent losses, the Company was unable to ascertain it would generate sufficient taxable income combined with available tax strategies to fully realize its deferred tax assets in the near

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term and therefore, established a deferred tax valuation allowance of \$767,000 during the nine months ended September 30, 2011.

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

The following discussion and analysis is intended as a review of significant factors affecting the financial condition and results of operations of the Company for the periods indicated. The discussion should be read in conjunction with the Condensed Consolidated Financial Statements and Notes included in this Form 10-Q. In addition to historical information, the following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. The Company's actual results could differ significantly from those anticipated in these forward-looking statements as a result of certain factors discussed elsewhere in this report.

### **Safe Harbor Statement**

This report (including information incorporated herein by reference) contains, and future oral and written statements of the Company and its management may contain, forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, with respect to the financial condition, results of operations, plans, objectives, future performance and business of the Company. Forward-looking statements, which may be based upon beliefs, expectations and assumptions of the Company's management and on information currently available to management, are generally identifiable by the use of words such as "believe," "expect," "anticipate," "plan," "intend," "estimate," "may," "will," "would," "could," "should" or other similar expressions. Additionally, all statements in this document, including forward-looking statements, speak only as of the date they are made, and the Company undertakes no obligation to update any statement in light of new information or future events.

The Company's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations and future prospects of the Company and its subsidiaries include, but are not limited to, the following:

- The strength of the United States economy in general and the strength of the local economies in which the Company conducts its operations which may be less favorable than expected and may result in, among other things, an escalation in problem assets and foreclosures, a deterioration in the credit quality and value of the Company's assets, especially real estate, which, in turn would likely reduce our customers' borrowing power and the value of assets and collateral associated with our existing loans;
- The potential impact of the Company's participation in the U.S. Department of Treasury's Troubled Asset Relief Program's Capital Purchase Program;
- The effects of, and changes in, federal, state and local laws, regulations and policies affecting banking, securities, insurance and monetary and financial matters;
- The failure of assumptions underlying the establishment of our allowance for loan losses, that may prove to be materially incorrect or may not be borne out by subsequent events;
- The success and timing of our business strategies and our ability to effectively carry out our business plan and capital restoration plan;
- An inability to meet our liquidity needs;
- The effect of changes in accounting policies and practices, as may be adopted from time-to-time by bank regulatory agencies, the Securities and Exchange Commission, the Public Company Accounting Oversight Board, the Financial Accounting Standards Board or other accounting standards setters;

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- The effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System, inflation, interest rate, market and monetary fluctuations;
  - The risks of changes in interest rates on the level and composition of deposits, loan demand and the values of loan collateral, securities and interest sensitive assets and liabilities;
  - Our ability to comply with the requirements of the Order and the mandatory provisions of 12 U.S.C. § 1831o and 12 C.F.R. § 325 (subpart B), as well as the effect of further changes to our regulatory ratings or capital levels under the regulatory framework for prompt corrective action or the imposition of additional enforcement action by regulatory authorities upon the Bank or the Company as a result of our inability to comply with applicable laws, regulations, regulatory orders and agreements;
  - Our ability to effectively manage market risk, credit risk and operational risk;
  - The ability of the Company to compete with other financial institutions as effectively as the Company currently intends due to increases in competitive pressures in the financial services sector;
  - The inability of the Company to obtain new customers and to retain existing customers;
  - The timely development and acceptance of products and services including services, products and services offered through alternative delivery channels such as the Internet;
  - Technological changes implemented by the Company and by other parties, including third party vendors, which may be more difficult or more expensive than anticipated or which may have unforeseen consequences to the Company and its customers;
  - The ability of the Company to develop and maintain secure and reliable electronic systems;
  - The ability of the Company to retain key executives and employees and the difficulty that the Company may experience in replacing key executives and employees in an effective manner;
  - Business combinations and the integration of acquired businesses which may be more difficult or expensive than expected;
  - The costs, effects and outcomes of existing or future litigation; and
  - The ability of the Company to manage the risks associated with the foregoing as well as anticipated.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Additional information concerning the Company and its business, including other factors that could materially affect the Company's financial results, is included in the Company's filings with the Securities and Exchange Commission.

## **Overview**

Community Financial Shares, Inc. (the "Company") is the holding company for Community Bank-Wheaton/Glen Ellyn (the "Bank"). The Company is headquartered in Glen Ellyn, Illinois and operates four offices in its primary market area, which is comprised of Glen Ellyn, Illinois and Wheaton, Illinois. One location is in Glen Ellyn and three are located in Wheaton.

The Company's principal business is conducted by the Bank and consists of offering a full range of community-based financial services, including commercial and retail banking services. The profitability of the Company's operations depends primarily on its net interest income, provision for loan losses, other income, and other expenses. Net interest income is the difference between the income the Company receives on its loan and

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securities portfolios and its cost of funds, which consists of interest paid on deposits and borrowings. The provision for loan losses reflects the cost of credit risk in the Company's loan portfolio. Other income consists of service charges on deposit accounts, gains on loan sales, securities gains (losses), and other income. Other expenses include salaries and employee benefits expenses, as well as occupancy and equipment expenses and other noninterest expenses.

Net interest income is dependent on the amounts and yields of interest-earning assets as compared to the amounts and rates of interest-bearing liabilities. Net interest income is sensitive to changes in market rates of interest and the Company's asset/liability management procedures in coping with such changes. The provision for loan losses is dependent upon management's assessment of the collectibility of the loan portfolio under current economic conditions.

### **Comparison of Financial Condition at September 30, 2011 and December 31, 2010**

Total assets at September 30, 2011 were \$328.1 million, which represented a decrease of \$19.0 million, or 5.5%, compared to \$347.1 million at December 31, 2010. The decrease in total assets was primarily due to decreases in loans receivable and cash and cash equivalents. Loans receivable decreased \$10.8 million, or 4.9%, to \$210.8 million at September 30, 2011 from \$221.6 million at December 31, 2010 and cash and cash equivalents decreased \$3.6 million, or 11.0%, to \$28.9 million at September 30, 2011 from \$32.5 million at December 31, 2010. Investment securities decreased \$1.4 million, or 3.2%, to \$41.8 million at September 30, 2011 from \$43.2 million at December 31, 2010. Interest-bearing time deposits decreased \$1.2 million to \$3.6 million at September 30, 2011 from \$4.8 million at December 31, 2010. Other real estate owned decreased \$680,000, or 22.6%, to \$2.3 million at September 30, 2011 from \$3.0 million at December 31, 2010. The decrease in loans during the nine months ended September 30, 2011 is partially due to the Bank taking possession of five properties totaling \$4.1 million through foreclosure and transferring them to other real estate owned. Included in other real estate owned at September 30, 2011 are three one-to-four family residences, a mixed-use commercial/residential property, one commercial property and one small parcel of land. In addition, the decrease in loans receivable was partially due to the write-off of \$3.8 million in balances during the first nine months of 2011. These write-downs were primarily due to the recognition of decreases in valuations on a portion of the Bank's nonperforming commercial real estate loans.

Total liabilities at September 30, 2011 were \$311.8 million, which represented a decrease of \$17.5 million, or 5.3%, compared to \$329.3 million at December 31, 2010. Deposits decreased \$17.7 million, or 5.7%, to \$291.4 million at September 30, 2011 from \$309.1 million at December 31, 2010. This decrease in deposits primarily consists of decreases in: (1) interest bearing demand deposit accounts of \$9.3 million, or 11.5%, to \$71.0 million at September 30, 2011 from \$80.3 million at December 31, 2010; (2) certificates of deposit of \$15.2 million, or 13.9%, to \$94.2 million at September 30, 2011 from \$109.4 million at December 31, 2010; and (3) noninterest-bearing deposit accounts of \$357,000, or 1.1%, to \$33.7 million at September 30, 2011 from \$34.0 million at December 31, 2010. The decrease in certificates of deposits is primarily due to the Bank's inability to renew certificates of deposit under the CDARS program as a result of the provisions of the Order. The decrease in interest-bearing demand deposits, certificates of deposit and noninterest-bearing deposits was partially offset by an increase in regular savings accounts of \$2.1 million, or 4.2%, to \$52.9 million at September 30, 2011 from \$50.8 million at December 31, 2010 and an increase in money market accounts of \$5.0 million, or 14.4%, to \$39.5 million at September from \$34.6 million at December 31, 2010. The percentage of regular savings accounts to total deposits increased to 18.2% at September 30, 2011 from 16.4% at December 31, 2010 and the percentage of certificates of deposit to total deposits decreased to 32.3% at September 30, 2011 from 35.4% at December 31, 2010. Borrowed money, consisting of Federal Home Loan Bank advances and other borrowings, decreased \$200,000, or 1.4%, to \$14.3 million at September 30, 2011 from \$14.5 million at December 31, 2010.

Stockholders' equity decreased \$1.5 million, or 8.3%, to \$16.3 million at September 30, 2011 from \$17.8 million at December 31, 2010. The decrease in stockholders' equity was primarily due to the Company's net loss for the nine months ended September 30, 2011 partially offset by an increase of \$946,000 in the Company's accumulated other comprehensive income relating to the change in fair value of its available-for-sale investment portfolio. As of September 30, 2011 there were 1,245,267 shares of Company common stock outstanding, resulting in a tangible book value of \$7.48 per share at that date.

Tangible book value provides a method to assess the level of tangible net assets on a per share basis. Tangible book value is determined by methods other than in accordance with Accounting Principles Generally Accepted in the United States (“GAAP”). The Company’s management uses this non-GAAP measure in its analysis of the Company’s performance. This measure should not be considered a substitute for book value per share value, a GAAP basis measure, nor should it be viewed as a substitute for operating results determined in accordance with GAAP. Management believes the presentation of tangible book value per share provides useful supplemental information that is essential to a proper understanding of the financial results of the Company. A reconciliation of tangible book value to GAAP book value can be found in the following table:

<b>Tangible book value per share:</b>	September 30, <u>2011</u>	December 31, <u>2010</u>
Total capital	\$ 16,285	\$ 17,755
Less: Preferred equity	<u>6,970</u>	<u>6,970</u>
Tangible common equity	<u>\$ 9,315</u>	<u>\$ 10,785</u>
Outstanding common shares	1,245,267	1,245,267
Tangible book value per share	\$ 7.48	\$ 8.66

### Comparison of Operating Results for the Three Months Ended September 30, 2011 and 2010

**General.** The Company’s net income decreased \$231,000 to a net loss of \$1,000 for the three months ended September 30, 2011, from net income of \$230,000 for the three months ended September 30, 2010. Due to the effect of preferred stock dividends, net loss available to common shareholders totaled \$114,000 for the three months ended September 30, 2011. This represents a basic and diluted loss per share of \$0.09 for the three months ended September 30, 2011 compared to basic and diluted earnings per share of \$0.09 for the three months ended September 30, 2010. The decrease in net income during the third quarter of 2011 is the result of the combined effect of a \$96,000 increase in net interest income, a \$251,000 decrease in noninterest income, a \$155,000 increase in noninterest expense and a \$63,000 increase in provision for loan losses.

**Net interest income.** The following table summarizes interest and dividend income and interest expense for the three months ended September 30, 2011 and 2010.

	<u>Three Months Ended September 30,</u>			
	<u>2011</u>	<u>2010</u>	<u>\$ Change</u>	<u>% Change</u>
	(Dollars in thousands)			
Interest and dividend income:				
Interest and fees on loans	\$2,930	\$3,057	\$(127)	(4.15%)
Securities:				
Taxable	254	204	50	24.51
Exempt from federal tax	110	136	(26)	(19.12)
Other interest income	<u>27</u>	<u>30</u>	<u>(3)</u>	(10.00)
Total interest and dividend income	<u>3,321</u>	<u>3,427</u>	<u>(106)</u>	(3.09)
Interest expense:				
Deposits	487	678	(191)	(28.17)
Federal Home Loan Bank advances and other borrowings	101	109	(8)	(7.34)
Subordinated debentures	<u>17</u>	<u>20</u>	<u>(3)</u>	(15.00)
Total interest expense	<u>605</u>	<u>807</u>	<u>(202)</u>	(25.03)
Net interest income	<u>\$2,716</u>	<u>\$2,620</u>	<u>\$ 96</u>	3.66

The following table summarizes average balances and annualized average yields or costs for the three months ended September 30, 2011 and 2010.

	<u>Three Months Ended September 30,</u>					
	<u>2011</u>			<u>2010</u>		
	Average <u>Balance</u>	<u>Interest</u>	Average Yield/ <u>Cost</u>	Average <u>Balance</u>	<u>Interest</u>	Average Yield/ <u>Cost</u>
	(Dollars in thousands)					
<b>Interest-earning assets:</b>						
Taxable securities	\$ 36,139	\$ 254	2.78%	\$ 24,994	\$ 204	3.23%
Tax-exempt securities	10,102	110	4.32	12,436	136	4.35
Loan receivables (1)	217,476	2,930	5.35	231,512	3,057	5.24
Interest-bearing deposits	22,672	26	0.47	25,390	30	0.47
FHLB stock	<u>5,398</u>	<u>1</u>	0.10	<u>5,398</u>	<u>-</u>	0.00
Total interest-earning assets	291,787	3,321	4.52	299,730	3,427	4.54
<b>Interest-bearing liabilities:</b>						
NOW accounts	71,897	66	0.36	74,834	109	0.58
Regular savings	53,065	52	0.39	48,315	69	0.57
Money market accounts	36,760	63	0.68	34,381	56	0.65
Certificates of deposit	95,164	306	1.28	108,209	444	1.63
FHLB advances and other	14,300	101	2.79	14,599	109	2.97
Subordinated debentures	<u>3,609</u>	<u>17</u>	1.91	<u>3,609</u>	<u>20</u>	2.15
Total interest-bearing liabilities	\$274,795	<u>605</u>	0.87	\$283,947	<u>807</u>	1.13
Net interest income		<u>\$2,716</u>			<u>\$2,620</u>	
Net interest spread			<u>3.65%</u>			<u>3.41%</u>
Net interest income to average interest-earning assets			<u>3.69%</u>			<u>3.47%</u>

(1)The average balance of loans receivable includes non-performing loans, interest on which is recognized on a cash basis.

**Interest Income.** Interest income decreased \$106,000 to \$3.3 million for the three months ended September 30, 2011 from \$3.4 million for the three months ended September 30, 2010. The average yield on interest-earning assets decreased 2 basis points to 4.52% for the three months ended September 30, 2011 from 4.54% for the comparable prior year period. In addition, there was a decrease of \$7.9 million in interest-earning assets to \$291.8 million for the three months ended September 30, 2011 from \$299.7 million for the prior year period.

Interest and fees on loans decreased \$127,000, or 4.2%, to \$2.9 million for the three months ended September 30, 2011, compared to \$3.1 million for the comparable prior year period. This decrease resulted from a decrease in the average balance of loans of \$14.0 million to \$217.5 million for the three months ended September 30, 2011 from \$231.5 million for the comparable prior year period. This decrease was partially offset by an increase in the average loan yield of 11 basis points to 5.35% for the three months ended September 30, 2011 from 5.24% for the comparable prior year period. Interest on taxable securities increased \$50,000 for the three months ended September 30, 2011 compared to the comparable prior year period. This increase is primarily due to an increase in the average balance of taxable securities of \$14.1 million to \$36.1 million for the three months ended September 30, 2011 from \$25.0 million for the three months ended September 30, 2010. This increase was partially offset by a decrease in the average yield on taxable securities of 45 basis points to 2.78% for the three months ended September 30, 2011 from 3.23% for the comparable prior year period.

**Interest Expense.** Interest expense decreased by \$202,000, or 25.0%, to \$605,000 for the three months ended September 30, 2011, from \$807,000 for the three months ended September 30, 2010. This decrease resulted from a decrease in the average rate paid on interest bearing liabilities of 26 basis points to 0.87% for the three months ended September 30, 2011 from 1.13% for the comparable prior year period. This decrease is primarily due to a decrease in overall market rates. In addition, the average balance of interest bearing liabilities decreased \$12.1

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million to \$274.8 million for the three months ended September 30, 2011 from \$283.9 million for the comparable prior year period. Interest expense resulting from Federal Home Loan Bank advances, subordinated debentures and other borrowings decreased \$11,000 during the three months ended September 30, 2011. The average balance on these borrowings decreased \$299,000 to \$17.9 million for the three months ended September 30, 2011 from \$18.2 million for the comparable prior year period. In addition, there was a decrease in the average cost on these borrowings of 20 basis points to 2.61% for the three months ended September 30, 2011 from 2.81% for the comparable period in 2010.

***Net Interest Income before Provision for Loan Losses.*** Net interest income before provision for loan losses increased \$96,000, or 3.6%, to \$2.7 million for the three months ended September 30, 2011 compared to \$2.6 million for the comparable period in 2010. The Company's net interest margin expressed as a percentage of average interest-earning assets increased to 3.69% for the three months ended September 30, 2011 as compared to 3.47% for the three months ended September 30, 2010. The yield on average interest-earning assets decreased 2 basis points to 4.52% for the three months ended September 30, 2011 from 4.54% for the comparable period ended September 30, 2010. The yield on average loans increased to 5.35% for the three months ended September 30, 2011 from 5.24% for the three months ended September 30, 2010. In addition, there was a 26 basis point decrease in the cost of average interest-bearing liabilities to 0.87% for the three months ended September 30, 2011 as compared to 1.13% for the comparable 2010 period.

***Provision for Loan Losses.*** The Bank's provision for loan losses increased to \$173,000 for the three months ended September 30, 2011 from \$110,000 for the comparable period in 2010. The \$63,000 increase in the provision was the result of management's quarterly analysis of the allowance for loan loss. At September 30, 2011, December 31, 2010 and September 30, 2010, nonperforming loans totaled \$13.5 million, \$20.3 million and \$20.8 million, respectively. At September 30, 2011, the ratio of the allowance for loan losses to nonperforming loans was 50.0% compared to 37.8% at December 31, 2010 and 21.1% at September 30, 2010. The ratio of the allowance to total loans was 3.12%, 3.35% and 1.93%, at September 30, 2011, December 31, 2010 and September 30, 2010, respectively.

Nonperforming loans decreased \$6.8 million, or 33.3%, to \$13.5 million at September 30, 2011 from \$20.3 million at December 31, 2010. The largest component of nonperforming loans is residential real estate loans, which increased \$1.0 million, or 14.7%, to \$7.9 million, or 58.7% of total nonperforming loans, at September 30, 2011, from \$6.9 million, or 34.1% of total nonperforming loans at December 31, 2010. Nonperforming real estate construction loans decreased \$7.1 million, or 72.2%, to \$2.7 million at September 30, 2011 from \$9.8 million at December 31, 2010. In addition, nonperforming commercial real estate loans decreased \$257,000, or 24.4%, to \$795,000 at September 30, 2011 from \$1.1 million at December 31, 2010. Charge-offs, net of recoveries, totaled \$4,000 for the three months ended September 30, 2011 compared to \$81,000 for the three months ended September 30, 2010. Nonperforming loans are loans that are ninety days past due and placed on nonaccrual status. Management continues to take aggressive actions in identifying and disposing of problem credits.

The amounts of the provision and allowance for loan losses are influenced by a number of factors, including current economic conditions, actual loss experience, industry trends and other factors, including real estate values in the Company's market area and management's assessment of current collection risks within the loan portfolio. Should the local economic climate continue to deteriorate, borrowers may experience increased difficulties paying off loans and the level of non-performing loans, charge-offs, and delinquencies could continue to rise, which would require us to further increase the provision. The allowance for loan losses represents management's estimate of probable incurred losses based on information available as of the date of the financial statements. The allowance for loan losses is based on management's evaluation of the collectibility of the loan portfolio, including past loan loss experience, known and inherent risks in the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, and economic conditions. Management believes that, based on information available at September 30, 2011, the Bank's allowance for loan losses was adequate to cover probable incurred losses inherent in its loan portfolio at that time. However, no assurances can be given that the Bank's level of allowance for loan losses will be sufficient to cover loan losses incurred by the Bank or that future adjustments to the allowance will not be necessary if economic or other conditions differ substantially from the economic and other conditions used by management to determine the current level of the allowance. In addition, the FDIC as an integral part of its examination processes, periodically reviews the Bank's allowance for loan losses and may require the Bank to make additional provisions for estimated loan

losses based upon judgments different from those of management. The FDIC examines the Bank periodically and, accordingly, as part of this examination the allowance is reviewed utilizing specific guidelines. Based upon its review, the FDIC may accordingly from time to time require reserves in addition to those previously provided.

### ***Noninterest Income***

	<u>Three Months Ended September 30,</u>			
	<u>2011</u>	<u>2010</u>	<u>\$ Change</u>	<u>% Change</u>
	(Dollars in thousands)			
Non-interest income:				
Service charges on deposit accounts	\$108	\$121	\$( 13)	(10.74%)
Gain on sale of loans	126	219	(93)	(42.47)
Gain on sale of securities	-	112	(112)	100.00
Gain (loss) on sale of foreclosed assets	(33)	46	(79)	(171.74)
Other non-interest income	<u>272</u>	<u>226</u>	<u>46</u>	20.35
Total non-interest income	<u>\$473</u>	<u>\$724</u>	<u>\$(251)</u>	(34.67)

Noninterest income totaled \$473,000 and \$724,000 for the three months ended September 30, 2011 and 2010, respectively. Gain on sale of loans decreased \$93,000 to \$126,000 for the three months ended September 30, 2011 from \$219,000 for the comparable prior year period. Gain on sale of securities decreased \$112,000 to zero for the three months ended September 30, 2011 from \$112,000 for the comparable prior year period. In addition, gain on sale of foreclosed assets decreased \$79,000 for the three months ended September 30, 2011 as compared to the prior year period. Other non-interest income increased \$46,000 to \$272,000 for the three months ended September 30, 2011 from \$226,000 for the three months ended September 30, 2010. This increase is primarily due to rents received on real estate held for investment and other foreclosed assets.

### ***Noninterest Expense***

	<u>Three Months Ended September 30,</u>			
	<u>2011</u>	<u>2010</u>	<u>\$ Change</u>	<u>% Change</u>
	(Dollars in thousands)			
Non-interest expenses:				
Salaries and employee benefits	\$1,402	\$1,456	\$(54)	(3.71%)
Net occupancy and equipment expense	345	348	(3)	(0.86)
Data processing expense	300	275	25	9.09
Advertising and promotions	72	76	(4)	(5.26)
Professional fees	255	175	80	45.71
FDIC insurance premiums	296	185	111	60.00
Other real estate owned expenses	134	122	12	9.84
Other operating expenses	<u>325</u>	<u>337</u>	<u>(12)</u>	(3.56)
Total non-interest expenses	<u>\$3,129</u>	<u>\$2,974</u>	<u>\$155</u>	5.21

Noninterest expense increased by \$155,000 to \$3.1 million for the three months ended September 30, 2011 from \$3.0 million for the comparable prior year period. Salaries and employee benefits expenses decreased by \$54,000, or 3.7%, to \$1.4 million for the three months ended September 30, 2011. Professional fees, including legal expenses, increased by \$80,000 to \$255,000 for the three months ended September 30, 2011. This increase is primarily due to loan collection costs. In addition, other real estate owned expenses increased to \$134,000 for the three months ended September 30, 2011 compared to \$122,000 for the prior year period. This increase is entirely due to expenses related to taking possession of foreclosed real estate. Other operating expenses, including occupancy, data processing, and marketing and advertising expenses, increased by a net \$18,000, or 2.6%, to \$717,000 for the three months ended September 30, 2011 from \$699,000 for the prior year period. Of this increase, \$25,000 is related to increases in data processing expense, which is primarily due to increased volume of clients utilizing the Bank's on-line banking product. This increase was partially offset by lower marketing and advertising expenses, which decreased \$4,000. Finally, FDIC insurance premiums increased by \$111,000, or 60.0%, to \$296,000 for the three months ended September 30, 2011 compared to \$185,000 for the prior year period. Management continues to emphasize the importance of expense management and control in order to continue to provide expanded banking services to a growing market base.

**Income Tax Benefit.** Income tax benefit totaled \$112,000 for the three months ended September 30, 2011 compared to an income tax expense of \$30,000 for the comparable prior year period.

### Comparison of Operating Results for the Nine Months Ended September 30, 2011 and 2010

**General.** The Company's net loss improved \$203,000 to \$2.1 million for the nine months ended September 30, 2011, from \$2.3 million for the nine months ended September 30, 2010. Due to the effect of preferred stock dividends, net loss available to common shareholders totaled \$2.5 million for the nine months ended September 30, 2011. This represents a basic and diluted loss per share of \$1.99 for the nine months ended September 30, 2011 compared to a basic and diluted loss per share of \$2.15 for the nine months ended September 30, 2010. The improvement in net loss during the nine months ended September 30, 2011 is the result of the combined effect of a \$378,000 increase in net interest income, an \$82,000 decrease in noninterest income, a \$631,000 increase in noninterest expense and a \$1.9 million decrease in provision for loan losses. In addition, during the nine months ended September 30, 2011 management determined that realization of a portion of the Company's deferred tax asset was more likely than not to occur. As a result, the Company incurred a non-cash income tax expense of \$767,000 related to a valuation allowance on deferred tax assets in the second quarter of 2011.

**Net interest income.** The following table summarizes interest and dividend income and interest expense for the nine months ended September 30, 2011 and 2010.

	<u>Nine Months Ended September 30,</u>			
	<u>2011</u>	<u>2010</u>	<u>\$ Change</u>	<u>% Change</u>
	(Dollars in thousands)			
Interest and dividend income:				
Interest and fees on loans	\$8,855	\$9,111	\$(256)	(2.81%)
Securities:				
Taxable	774	840	(66)	(7.86)
Exempt from federal tax	332	416	(84)	(20.19)
Other interest income	<u>87</u>	<u>67</u>	<u>20</u>	29.85
Total interest and dividend income	<u>10,048</u>	<u>10,434</u>	<u>(386)</u>	(3.70)
Interest expense:				
Deposits	1,560	2,261	(701)	(31.00)
Federal Home Loan Bank advances and other borrowings	301	363	(62)	(17.08)
Subordinated debentures	<u>53</u>	<u>54</u>	<u>(1)</u>	(1.85)
Total interest expense	<u>1,914</u>	<u>2,678</u>	<u>(764)</u>	(28.53)
Net interest income	<u>\$8,134</u>	<u>\$7,756</u>	<u>\$378</u>	4.87

The following table summarizes average balances and annualized average yields or costs for the nine months ended September 30, 2011 and 2010.

	<u>Nine Months Ended September 30,</u>					
	<u>2011</u>		<u>2010</u>			
	<u>Average Balance</u>	<u>Interest</u>	Average Yield/ <u>Cost</u>	<u>Average Balance</u>	<u>Interest</u>	Average Yield/ <u>Cost</u>
	(Dollars in thousands)					
<b>Interest-earning assets:</b>						
Taxable securities	\$ 36,956	\$ 774	2.80%	\$ 29,604	\$ 840	3.79%
Tax-exempt securities	10,106	332	4.39	12,723	416	4.37
Loan receivables (1)	219,686	8,855	5.39	233,743	9,111	5.21
Interest-bearing deposits	22,991	83	0.48	22,716	67	0.40
FHLB stock	<u>5,398</u>	<u>4</u>	0.10	<u>5,398</u>	<u>-</u>	0.00
Total interest-earning assets	295,137	10,048	4.55	304,184	10,434	4.59
<b>Interest-bearing liabilities:</b>						
NOW accounts	73,969	213	0.38	76,121	355	0.62
Regular savings	52,746	158	0.40	41,809	167	0.53
Money market accounts	35,548	177	0.66	36,782	178	0.65
Certificates of deposit	101,209	1,012	1.34	112,295	1,561	1.86
FHLB advances and other	14,343	301	2.81	14,698	363	3.31
Subordinated debentures	<u>3,609</u>	<u>53</u>	1.93	<u>3,609</u>	<u>54</u>	2.00
Total interest-bearing deposits	\$281,424	<u>1,914</u>	0.91	\$285,314	2,678	1.25
Net interest income		<u>\$8,134</u>			<u>\$7,756</u>	
Net interest spread			<u>3.64%</u>			<u>3.34%</u>
Net interest income to average interest-earning assets			<u>3.68%</u>			<u>3.41%</u>

(1)The average balance of loans receivable includes non-performing loans, interest on which is recognized on a cash basis.

**Interest Income.** Interest income decreased \$386,000, or 3.7%, to \$10.0 million for the nine months ended September 30, 2011, compared to \$10.4 million for the comparable prior year period. The average yield on interest-earning assets decreased 4 basis points to 4.55% for the nine months ended September 30, 2011 from 4.59% for the comparable prior year period. In addition, average interest-earning assets decreased \$9.0 million to \$295.1 million for the nine months ended September 30, 2011 compared to \$304.2 million for the nine months ended September 30, 2010.

Interest and fees on loans decreased \$256,000, or 2.8%, to \$8.9 million for the nine months ended September 30, 2011, compared to \$9.1 million for the comparable prior year period. This decrease resulted from a decrease in the average balance of loans of \$14.1 million to \$219.7 million for the nine months ended September 30, 2011 from \$233.7 million for the comparable prior year period. Partially offsetting this decrease was an increase in the average yield on loans of 18 basis points to 5.39% for the nine months ended September 30, 2011 from 5.21% for the comparable prior year period. Interest on taxable securities decreased \$66,000 for the nine months ended September 30, 2011 compared to the comparable prior year period. This decrease is primarily due to a decrease in the average yield on taxable securities of 99 basis points to 2.80% for the nine months ended September 30, 2011 from 3.79% for the comparable prior year period. This decrease was partially offset by an increase in the average balance of taxable securities of \$7.4 million to \$37.0 million for the nine months ended September 30, 2011 from \$29.6 million for the nine months ended September 30, 2010.

**Interest Expense.** Interest expense decreased by \$764,000, or 28.5%, to \$1.9 million for the nine months ended September 30, 2011, from \$2.7 million for the nine months ended September 30, 2010. This decrease resulted from a decrease in the average rate paid on interest bearing liabilities of 34 basis points to 0.91% for the nine months ended September 30, 2011 from 1.25% for the comparable prior year period. In addition, the average balance of interest-bearing liabilities decreased \$3.9 million to \$281.4 million for the nine months ended September

30, 2011 from \$285.3 million for the comparable prior year period. Interest expense resulting from Federal Home Loan Bank advances, subordinated debentures and other borrowings decreased \$63,000 during the nine months ended September 30, 2011. The average balance on these borrowings decreased \$355,000 to \$18.0 million for the nine months ended September 30, 2011 from \$18.3 million for the comparable prior year period. In addition, there was a decrease in the average cost on these borrowings of 42 basis points to 2.63% for the nine months ended September 30, 2011 from 3.05% for the comparable period in 2010.

**Net Interest Income before Provision for Loan Losses.** Net interest income before provision for loan losses increased \$378,000, or 4.9%, to \$8.1 million for the nine months ended September 30, 2011 compared to \$7.8 million for the comparable period in 2010. The Company's net interest margin expressed as a percentage of average interest-earning assets increased to 3.68% for the nine months ended September 30, 2011 as compared to 3.41% for the nine months ended September 30, 2010. The yield on average interest-earning assets decreased 4 basis points to 4.55% for the nine months ended September 30, 2011 from 4.59% for the comparable period ended September 30, 2010. The yield on average loans increased to 5.39% for the nine months ended September 30, 2011 from 5.21% for the nine months ended September 30, 2010. In addition, there was a 34 basis point decrease in the cost of average interest-bearing liabilities to 0.91% for the nine months ended September 30, 2011 as compared to 1.25% for the comparable 2010 period.

**Provision for Loan Losses.** The Bank's provision for loan losses decreased to \$2.9 million for the nine months ended September 30, 2011 from \$4.8 million for the comparable period in 2010. The decrease in the provision was the result of management's quarterly analysis of the allowance for loan loss. At September 30, 2011, December 31, 2010 and September 30, 2010, nonperforming loans totaled \$13.5 million, \$20.3 million and \$20.8 million, respectively. At September 30, 2011, the ratio of the allowance for loan losses to nonperforming loans was 50.0% compared to 37.8% at December 31, 2010 and 21.1% at September 30, 2010. The ratio of the allowance to total loans was 3.12%, 3.35% and 1.93%, at September 30, 2011, December 31, 2010 and September 30, 2010, respectively.

Nonperforming loans decreased \$6.8 million, or 33.3%, to \$13.5 million at September 30, 2011 from \$20.3 million at December 31, 2010. The largest component of nonperforming loans is residential real estate loans, which increased \$1.0 million, or 14.7%, to \$7.9 million, or 58.7% of total nonperforming loans, at September 30, 2011, from \$6.9 million, or 34.1% of total nonperforming loans at December 31, 2010. Nonperforming real estate construction loans decreased \$7.1 million, or 72.2%, to \$2.7 million at September 30, 2011 from \$9.8 million at December 31, 2010. In addition, nonperforming commercial real estate loans decreased \$257,000, or 24.4%, to \$795,000 at September 30, 2011 from \$1.1 million at December 31, 2010. Charge-offs, net of recoveries, totaled \$3.8 million for the nine months ended September 30, 2011 compared to \$5.2 million for the nine months ended September 30, 2010. Nonperforming loans are loans that are ninety days past due and placed on nonaccrual status. Management continues to take aggressive actions in identifying and disposing of problem credits.

#### **Noninterest Income**

	<u>Nine Months Ended September 30,</u>			
	<u>2011</u>	<u>2010</u>	<u>\$ Change</u>	<u>% Change</u>
	(Dollars in thousands)			
Non-interest income:				
Service charges on deposit accounts	\$323	\$383	\$(60)	(15.67%)
Gain on sale of loans	467	569	(102)	(17.93)
Gain on sale of securities	104	112	(8)	(7.14)
Write-down on other real estate owned	(255)	(185)	(70)	(37.84)
Gain on sale of foreclosed assets	(28)	50	(78)	(156.00)
Other non-interest income	<u>809</u>	<u>573</u>	<u>236</u>	41.19
Total non-interest income	<u>\$1,420</u>	<u>\$1,502</u>	<u>\$(82)</u>	(5.46)

Noninterest income totaled \$1.4 million and \$1.5 million for the nine months ended September 30, 2011 and 2010, respectively. Gain on sale of securities decreased \$8,000 to \$104,000 for the nine months ended September 30, 2011 compared to \$112,000 for the comparable prior year period. Gain on sale of loans decreased \$102,000 to \$467,000 for the nine months ended September 30, 2011 from \$569,000 for the comparable prior year period. Other non-interest income increased \$236,000 to \$809,000 for the nine months ended September 30, 2011 from \$573,000 for the nine months ended September 30, 2010. This increase is primarily due to rents received on

real estate held for investment and other foreclosed assets. In addition, write-downs on other real estate owned increased \$70,000 to \$255,000 for the nine months ended September 30, 2011 from \$185,000 for the comparable prior year period.

### ***Noninterest Expense***

	<u>Nine Months Ended September 30,</u>			
	<u>2011</u>	<u>2010</u>	<u>\$ Change</u>	<u>% Change</u>
	(Dollars in thousands)			
Non-interest expenses:				
Salaries and employee benefits	\$4,264	\$4,177	\$87	2.08%
Net occupancy and equipment expense	1,037	1,019	18	1.77
Data processing expense	889	820	69	8.42
Advertising and promotions	188	210	(22)	(10.48)
Professional fees	770	619	151	24.39
FDIC insurance premiums	829	555	274	49.37
Other real estate owned expenses	394	351	43	12.25
Other operating expenses	<u>939</u>	<u>928</u>	<u>11</u>	1.19
Total non-interest expenses	<u>\$9,310</u>	<u>\$8,679</u>	<u>\$631</u>	7.27

Noninterest expense increased by \$631,000 to \$9.3 million for the nine months ended September 30, 2011 from \$8.7 million for the comparable prior year period. Salaries and employee benefits expenses increased by \$87,000, or 2.1%, to \$4.3 million for the nine months ended September 30, 2011. This increase is partially the result of a \$33,000 increase in health insurance costs. Professional fees, including legal expenses, increased by \$151,000 to \$770,000 for the nine months ended September 30, 2011. This increase is primarily due to higher legal fees associated with foreclosure actions. In addition, other real estate owned expenses increased to \$394,000 for the nine months ended September 30, 2011 compared to \$351,000 for the prior year period. Other operating expenses, including occupancy, data processing, and marketing and advertising expenses, increased by a net \$65,000, or 3.2%, to \$2.1 million for the nine months ended September 30, 2011 from \$2.0 million for the prior year period. Of this increase, \$69,000 is related to increases in data processing expense, which is primarily due to increased volume of clients utilizing the Bank's on-line banking product. This increase was partially offset by lower marketing and advertising expenses, which decreased \$22,000. Finally, FDIC insurance premiums increased by \$274,000, or 49.4%, to \$829,000 for the nine months ended September 30, 2011 compared to \$555,000 for the prior year period. This increase is primarily due to a downgrade in the Bank's risk category as determined by the FDIC. Management continues to emphasize the importance of expense management and control in order to continue to provide expanded banking services to a growing market base.

***Income Tax Benefit.*** The Company recorded an income tax benefit of \$482,000 for the nine months ended September 30, 2011, despite a \$2.6 million pre-tax loss during that period due to the establishment of a valuation allowance against a portion of the Company's deferred tax assets. Under generally accepted accounting principles, income tax benefits and the related tax assets are only allowed to be recognized if they will more likely than not be fully utilized. In each future accounting period, the Company's management will consider both positive and negative evidence when considering the ability of the Company to utilize its net deferred tax asset. Any subsequent reduction in the valuation allowance would lower the amount of income tax expense recognized in the Company's consolidated statements of operations in future periods. However, if operating losses continue into the future, there can be no guarantee that an additional valuation allowance against the deferred tax assets will not be necessary. Income tax benefit totaled \$1.9 million for the nine months ended September 30, 2010.

### **Critical Accounting Policies**

The accounting and reporting policies of the Company are in accordance with accounting principles generally accepted in the United States and conform to general practices within the banking industry. The Company's significant accounting policies are described in detail in the notes to the consolidated financial statements included in the Company's Form 10-K for the year ended December 31, 2010, which was filed with the U.S. Securities and Exchange Commission on March 31, 2011. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. The financial position and results of operations can be affected by these estimates and assumptions and are integral to the understanding of reported results. Critical accounting policies are those policies that management believes are

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the most important to the portrayal of the Company's financial condition and results, and they require management to make estimates that are difficult, subjective, or complex.

***Allowance for Credit Losses.*** The allowance for credit losses provides coverage for probable losses inherent in the Company's loan portfolio. Management evaluates the adequacy of the allowance for credit losses each quarter based on changes, if any, in underwriting activities, the loan portfolio composition (including product mix and geographic, industry or customer-specific concentrations), trends in loan performance, regulatory guidance and economic factors. This evaluation is inherently subjective, as it requires the use of significant management estimates. Many factors can affect management's estimates of specific and expected losses, including volatility of default probabilities, rating migrations, loss severity and economic and political conditions. The allowance is increased through provisions charged to operating earnings and reduced by net charge-offs.

The Company determines the amount of the allowance based on relative risk characteristics of the loan portfolio. The allowance recorded for commercial loans is based on reviews of individual credit relationships and an analysis of the migration of commercial loans and actual loss experience. The allowance recorded for homogeneous consumer loans is based on an analysis of loan mix, risk characteristics of the portfolio, fraud loss and bankruptcy experiences, and historical losses, adjusted for current trends, for each homogeneous category or group of loans. The allowance for credit losses relating to impaired loans is based on the loan's observable market price, the collateral for certain collateral-dependent loans, or the discounted cash flows using the loan's effective interest rate.

Regardless of the extent of the Company's analysis of customer performance, portfolio trends or risk management processes, certain inherent but undetected losses are probable within the loan portfolio. This is due to several factors including inherent delays in obtaining information regarding a customer's financial condition or changes in their unique business conditions, the judgmental nature of individual loan evaluations, collateral assessments and the interpretation of economic trends. Volatility of economic or customer-specific conditions affecting the identification and estimation of losses for larger non-homogeneous credits and the sensitivity of assumptions utilized to establish allowances for homogenous groups of loans are among other factors. The Company estimates a range of inherent losses related to the existence of these exposures. The estimates are based upon the Company's evaluation of imprecision risk associated with the commercial and consumer allowance levels and the estimated impact of the current economic environment.

## **Liquidity and Capital Resources**

The Company's primary sources of funds are deposits, FHLB advances, and proceeds from principal and interest payments on loans and securities. While maturities, and scheduled amortization of loans and securities, and calls of securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions, and competition. The Company generally manages the pricing of its deposits to be competitive and to increase core deposit relationships.

Liquidity management is both a daily and long-term responsibility of management. The Company adjusts its investments in liquid assets based upon management's assessment of (i) expected loan demand, (ii) expected deposit flows, (iii) yields available on interest-earning deposits and securities, and (iv) the objectives of its asset/liability management program. Excess liquid assets are invested generally in interest-earning overnight deposits and short- and intermediate-term U.S. government and agency obligations.

The Company's most liquid assets are cash and short-term investments. The levels of these assets are dependent on the Company's operating, financing, lending, and investing activities during any given year. The Company has other sources of liquidity if a need for additional funds arises, including securities maturing within one year and the repayment of loans. The Company may also utilize the sale of securities available for sale, federal funds lines of credit from correspondent banks, and borrowings from the Federal Home Loan Bank of Chicago and M&I Bank.

The Company is a separate legal entity from the Bank and must provide for its own liquidity. In addition to its operating expenses, the Company is responsible for paying any dividends declared to its shareholders. The Company's primary source of funds is dividends received from the Bank. The amount of dividends that the Bank

may declare and pay to the Company is generally restricted under applicable law to net profits in the current year plus those for the previous two years. At September 30, 2011, the Company had liquid assets of \$961,000.

### Contractual Obligations

The following table discloses contractual obligations of the Company as of September 30, 2011:

(Dollars in Thousands)	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u> <u>and after</u>	<u>Total</u>
Federal Home Loan Bank advances	\$2,000	\$2,000	\$4,500	\$2,500	\$2,000	\$ -	\$13,000
Other borrowing	-	1,300	-	-	-	-	1,300
Subordinated debentures	-	-	-	-	-	3,609	3,609
Data Processing (1), (2)	<u>146</u>	<u>601</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>747</u>
Total	<u>\$2,146</u>	<u>\$3,901</u>	<u>\$4,500</u>	<u>\$2,500</u>	<u>\$2,000</u>	<u>\$3,609</u>	<u>\$18,656</u>

- (1) Estimated contract amount based on transaction volume. Actual expense was \$712,000 and \$590,000 in 2010 and 2009, respectively.  
(2) Contract expires September 30, 2013.

### Off-Balance-Sheet Arrangements

In the normal course of operations, we engage in a variety of financial transactions that, in accordance with U.S. generally accepted accounting principles, are not recorded in our financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments, letters of credit and lines of credit. For information about our loan commitments and unused lines of credit, see Note 16 of the notes to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2010, as filed with the SEC on March 31, 2011. We currently have no plans to engage in hedging activities in the future. For the year ended December 31, 2010 and for the nine months ended September 30, 2011, we engaged in no off-balance-sheet transactions reasonably likely to have a material effect on our financial condition, results of operations or cash flows.

### Impact of Inflation and Changing Prices

The financial statements and related data presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America, which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation. The primary impact of inflation on the operations of the Company is reflected in increased operating costs. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates, generally, have a more significant impact on a financial institution's performance than does inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

## ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### Interest Rate Risk

For a discussion of the potential impact of interest rate changes upon the market value of the Company's portfolio equity, see Item 7A in the Company's Annual Report on Form 10-K for the year ended December 31, 2010. Management, as part of its regular practices, performs periodic reviews of the impact of interest rate changes upon net interest income and the market value of the Company's portfolio equity. Based on, among other factors, such reviews, management believes that there have been no material changes in the market risk of the Company's asset and liability position since December 31, 2010.

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**ITEM 4: CONTROLS AND PROCEDURES**

The Company's management, including the Company's principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (the "SEC") (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. In addition, based on that evaluation, no change in the Company's internal control over financial reporting occurred during the nine months ended September 30, 2011 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II

### ITEM 1. LEGAL PROCEEDINGS

There are no material pending legal proceedings to which the Company or its subsidiaries are a party other than ordinary routine litigation incidental to their respective businesses.

### ITEM 1A. RISK FACTORS

There are no material changes to the risk factors disclosed in the Company's Form 10-K for the year ended December 31, 2010.

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

None

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

### ITEM 4. (REMOVED AND RESERVED)

### ITEM 5. OTHER INFORMATION

None

### ITEM 6. EXHIBITS

31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a)

31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a)

32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.0\* The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Shareholders' Equity; (iv) the Consolidated Statements of Cash Flows; and (v) the Notes to the Consolidated Financial Statements, tagged as blocks of text.

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\* Furnished, not filed.

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SIGNATURES

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

COMMUNITY FINANCIAL SHARES, INC.  
(Registrant)

/s/ Scott W. Hamer  
Scott W. Hamer  
Dated: November 14, 2011  
President and Chief Executive Officer  
(Principal Executive Officer)

/s/ Eric J. Wedeen  
Eric J. Wedeen  
Dated: November 14, 2011  
Chief Financial Officer  
(Principal Financial Officer)

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**EXHIBIT 31.1**

**CERTIFICATION OF CEO PURSUANT TO  
SECTION 302 OF THE SARBANES OXLEY ACT OF 2002**

I, Scott W. Hamer, Chief Executive Officer, certify that:

1. I have reviewed this Form 10-Q for the period ending September 30, 2011 of Community Financial Shares, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and in preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and

Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 14, 2011

By /s/Scott W. Hamer, CEO

(Signature and Title)

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**EXHIBIT 31.2**

**CERTIFICATION OF CFO PURSUANT TO  
SECTION 302 OF THE SARBANES OXLEY ACT OF 2002**

I, Eric J. Wedeen, Chief Financial Officer, certify that:

1. I have reviewed this Form 10-Q for the period ending September 30, 2011 of Community Financial Shares, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and in preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and

Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 14, 2011

By /s/Eric J. Wedeen, CFO

(Signature and Title)

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**EXHIBIT 32.1**

**CERTIFICATION OF CEO PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Community Financial Shares, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2011 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Scott W. Hamer, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Scott W. Hamer, CEO

Scott W. Hamer  
Chief Executive Officer  
November 14, 2011

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**EXHIBIT 32.2**

**CERTIFICATION OF CFO PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Community Financial Shares, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2011 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Eric J. Wedeen, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Eric J. Wedeen, CFO

Eric J. Wedeen  
Chief Financial Officer  
November 14, 2011