

FORM 10-Q
UNITED STATES
FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON, D.C. 20329-9900

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2008

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

FDIC Certificate No.: 58072

USA Bank

(Exact name of registrant as specified in its charter)

New York

(State or other jurisdiction of incorporation
or organization)

20-0646362

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

601 North Main Street, Port Chester, New York 10573

(Address of principal executive offices)
(Zip Code)

(914) 939-3700

(Registrant's telephone number, including area code)

N/A

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

As of November 13, 2008, 5,750,000 shares of the Issuer's common stock, \$2.00 par value, were outstanding.

Table of Contents

Part I Financial Information

<u>Item 1. Consolidated Financial Statements</u>	Page
Consolidated Balance Sheets as of September 30, 2008, and December 31, 2007 (unaudited)	1
Consolidated Statements of Operations for the three and nine months ended September 30, 2008 and 2007 (unaudited)	2
Consolidated Statements of Changes in Shareholders' Equity for the nine months ended September 30, 2008 and 2007 (unaudited)	3
Consolidated Statements of Cash Flows for the nine months ended September 30, 2008 and 2007 (unaudited)	4
Notes to Consolidated Financial Statements (unaudited)	6
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	20
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	41
<u>Item 4. Controls and Procedures</u>	41
<u>Item 4T. Controls and Procedures</u>	41
<h3>Part II Other Information</h3>	
<u>Item 1. Legal Proceedings</u>	42
<u>Item 1A. Risk Factors</u>	42
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	42
<u>Item 3. Defaults Upon Senior Securities</u>	42
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	42
<u>Item 5. Other Information</u>	42
<u>Item 6. Exhibits</u>	42
<u>Signatures</u>	43

PART I
Financial Information

Item 1. Consolidated Financial Statements

USA BANK
CONSOLIDATED BALANCE SHEETS
September 30, 2008, and December 31, 2007 (unaudited)

	September 30, 2008	December 31, 2007
ASSETS		
Cash and due from banks	\$ 940,478	\$ 2,746,304
Federal funds sold and overnight investments	1,984,883	8,209,367
Cash and cash equivalents	2,925,361	10,955,671
Interest-bearing deposits	-	4,835,943
Held to maturity securities, at amortized cost (fair value \$1,212,734 in 2008 and \$1,424,183 in 2007)	1,187,182	1,395,835
Available for sale securities, at fair value	34,405,947	37,520,245
Total investment securities	35,593,129	38,916,080
Loans held for sale	4,516,905	6,786,211
Loans, net of the allowance for loan losses of \$1,862,000 in 2008 and \$1,421,000 in 2007	147,555,291	105,493,540
Leasehold improvements and equipment, net	728,049	846,337
Other real estate owned	2,370,250	-
Accrued interest receivable	1,444,769	993,008
Other assets	571,643	646,827
Total assets	\$ 195,705,397	\$ 169,473,617
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits		
Noninterest-bearing deposits	\$ 9,560,701	\$ 5,490,964
Interest-bearing deposits	142,295,437	117,350,203
Total deposits	151,856,138	122,841,167
Securities sold under repurchase agreements	23,000,000	23,000,000
Accrued expenses and other liabilities	916,339	1,323,236
Total liabilities	175,772,477	147,164,403
Commitments and Contingencies		
Shareholders' Equity		
Common stock, par value \$2; 5,750,000 shares authorized, issued and outstanding at September 30, 2008, and December 31, 2007	11,500,000	11,500,000
Additional paid-in capital	21,116,774	21,116,774
Accumulated deficit	(11,581,351)	(10,334,178)
Accumulated other comprehensive income – net unrealized (loss) gain on available for sale securities – net of taxes (2007)	(1,102,503)	26,618
Total shareholders' equity	19,932,920	22,309,214
Total liabilities and shareholders' equity	\$ 195,705,397	\$ 169,473,617

See Accompanying Notes to Consolidated Financial Statements

USA BANK
CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three and Nine Months Ended September 30, 2008 and 2007 (unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Interest Income				
Interest on Federal funds sold and overnight investments	\$ 40,685	\$ 251,557	\$ 178,647	\$ 915,939
Interest on interest-bearing deposits	108	48,463	114,415	48,463
Interest and fees on loans	2,700,140	1,754,601	7,538,544	4,516,177
Interest on investments	495,431	604,468	1,623,936	970,065
Interest on loans held for sale	62,077	103,804	298,751	178,723
Total interest income	<u>3,298,441</u>	<u>2,762,893</u>	<u>9,754,293</u>	<u>6,629,367</u>
Interest Expense				
Interest expense on deposits	1,494,108	1,331,939	4,639,835	3,456,477
Interest expense on securities sold under repurchase agreements	265,650	233,992	791,396	252,370
Interest expense on advances	-	-	68	-
Total interest expense	<u>1,759,758</u>	<u>1,565,931</u>	<u>5,431,299</u>	<u>3,708,847</u>
Net interest income	1,538,683	1,196,962	4,322,994	2,920,520
Provision for loan losses	185,030	212,000	724,386	275,000
Net interest income after provision for loan losses	<u>1,353,653</u>	<u>984,962</u>	<u>3,598,608</u>	<u>2,645,520</u>
Noninterest Income				
Gains on sales of securities	85,565	-	401,258	-
Gains on sales of loans	8,070	105,396	89,909	448,606
Broker fee income	4,172	74,298	68,213	99,598
Service charges	15,806	21,815	51,456	48,098
Other	13,539	11,265	27,058	24,557
Total noninterest income	<u>127,152</u>	<u>212,774</u>	<u>637,894</u>	<u>620,859</u>
Noninterest Expense				
Salaries and employee benefits	591,273	796,037	2,035,938	2,704,990
Occupancy and equipment	192,035	171,541	603,632	496,008
Professional fees	208,388	264,550	652,345	688,141
Legal	110,720	206,911	507,077	497,768
Commissions	60,420	270,640	252,937	480,485
Contract services	39,196	59,557	148,753	223,046
Printing, stationery and supplies	14,844	20,230	46,246	74,891
Advertising	44,527	63,276	111,055	255,163
Data and item processing	93,603	92,439	268,150	273,237
FDIC Insurance	88,835	21,000	327,185	61,597
OREO Expense	42,087	-	111,345	-
Other	113,361	74,981	419,012	349,434
Total noninterest expense	<u>1,599,289</u>	<u>2,041,162</u>	<u>5,483,675</u>	<u>6,104,760</u>
Net loss	<u>\$ (118,484)</u>	<u>\$ (843,426)</u>	<u>\$ (1,247,173)</u>	<u>\$ (2,838,381)</u>
Basic and diluted loss per share	<u>\$ (0.02)</u>	<u>\$ (0.15)</u>	<u>\$ (0.22)</u>	<u>\$ (0.49)</u>

See Accompanying Notes to Consolidated Financial Statements

USA BANK
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the Nine Months Ended September 30, 2008 and 2007 (unaudited)

	Number of Shares	Common Stock	Additional Paid in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2006	5,750,000	\$11,500,000	\$ 21,116,774	\$ (6,017,998)	\$ (32,234)	\$ 26,566,542
Comprehensive loss:						
Net loss	-	-	-	(2,838,381)	-	(2,838,381)
Unrealized holding gains on available for sale securities	-	-	-	-	161,007	161,007
Total comprehensive loss						<u>(2,677,374)</u>
Balance, September 30, 2007	<u>5,750,000</u>	<u>\$11,500,000</u>	<u>\$ 21,116,774</u>	<u>\$ (8,856,379)</u>	<u>\$ 128,773</u>	<u>\$ 23,889,168</u>
Balance, December 31, 2007	5,750,000	\$11,500,000	\$ 21,116,774	\$ (10,334,178)	\$ 26,618	\$ 22,309,214
Comprehensive loss:						
Net loss	-	-	-	(1,247,173)	-	(1,247,173)
Unrealized holding losses on available for sale securities	-	-	-	-	(1,129,121)	(1,129,121)
Total comprehensive loss						<u>(2,376,294)</u>
Balance, September 30, 2008	<u>5,750,000</u>	<u>\$11,500,000</u>	<u>\$ 21,116,774</u>	<u>\$ (11,581,351)</u>	<u>\$ (1,102,503)</u>	<u>\$ 19,932,920</u>

See Accompanying Notes to Consolidated Financial Statements

USA BANK
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2008 and 2007 (unaudited)

	Nine Months Ended September 30,	
	2008	2007
Cash Flows from Operations		
Net loss	\$ (1,247,173)	\$ (2,838,381)
Adjustments to reconcile net loss to net cash provided by operating activities		
Amortization and accretion of premiums and discounts on investments, net	(37,116)	(9,361)
Provision for loan losses	724,386	275,000
Gain on sale of available for sale securities	(401,258)	-
Loans originated for sale, net of principal payments received	(4,360,057)	(27,985,030)
Proceeds from sales of loans	6,240,259	38,607,173
Net gains on sales of loans	(89,909)	(448,606)
Depreciation and amortization	164,244	159,917
Changes in assets and liabilities:		
Increase in deferred loan fees	88,485	301,376
Increase in accrued interest receivable	(451,761)	(535,364)
Decrease in other assets	75,184	39,653
(Decrease) increase in accrued expenses and other liabilities	(406,897)	451,977
Net cash provided by operating activities	298,387	8,018,354
Cash Flows from Investing Activities		
Increase in interest-bearing deposits	-	(4,845,108)
Proceeds from maturity of interest-bearing deposits	4,835,943	-
Purchase of available for sale securities	(23,796,959)	(33,502,226)
Proceeds from sale of available for sale securities	23,312,065	-
Principal repayments on available for sale securities	2,903,920	1,536,763
Principal repayments of held to maturity securities	213,178	264,603
Net increase in loans receivable	(44,765,859)	(36,185,752)
Purchase of leasehold improvements and equipment	(45,956)	(267,067)
Net cash used in investing activities	(37,343,668)	(72,998,787)
Cash Flows from Financing Activities		
Net increase in time deposits	18,801,141	41,171,686
Net increase in other deposits	10,213,830	(3,720,376)
Net increase in repurchase agreements	-	23,000,000
Net cash provided by financing activities	29,014,971	60,451,310
Net decrease in cash and cash equivalents	(8,030,310)	(4,529,123)
Cash and cash equivalents		
Beginning	10,955,671	25,103,881
Ending	\$ 2,925,361	\$ 20,574,758

See Accompanying Notes to Consolidated Financial Statements

USA BANK
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
For the Nine Months Ended September 30, 2008 and 2007 (unaudited)

	Nine Months Ended September 30,	
	2008	2007
Supplemental Disclosure of Cash Flow Information		
Cash paid for:		
Interest	<u>\$ 5,648,900</u>	<u>\$ 4,802,934</u>
Supplemental disclosure of noncash investing activities:		
Unrealized holding (losses) gains on available for sale securities arising during the period	<u>\$ (1,129,121)</u>	<u>\$ 161,007</u>
Transfer of loans held for sale to loans receivable	<u>\$ 479,013</u>	<u>\$ 18,256,394</u>
Transfer of loans to other real estate owned	<u>\$ 2,370,250</u>	<u>\$ -</u>

See Accompanying Notes to Consolidated Financial Statements

USA Bank
Notes to Consolidated Financial Statements
September 30, 2008 and 2007 (Unaudited)

Note 1. Nature of Operations

USA Bank (the “Bank”) is a State of New York chartered commercial bank whose deposits are insured by the Federal Deposit Insurance Corporation. The Bank offers traditional commercial banking services to customers through its main office in Port Chester, NY.

Note 2. Basis of Consolidated Financial Statement Presentation

Principles of Consolidation

The Consolidated Balance Sheet at December 31, 2007 has been derived from the audited financial statements of the Bank at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. The interim consolidated financial statements and notes thereto include the accounts of the Bank and its wholly-owned subsidiary, USA MBA, Inc., a Connecticut-based mortgage brokerage company, which is inactive. All significant intercompany balances and transactions have been eliminated in consolidation. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and general practices within the banking industry and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities as of the dates of the balance sheet and the reported amounts of income and expenses for the reporting periods. Amounts in prior period financial statements are reclassified whenever necessary to conform to current period presentations. The information furnished reflects, in the opinion of management, all normal recurring adjustments necessary for a fair presentation of the results for the interim periods presented. The results of operations for the three months and nine months ended September 30, 2008, are not necessarily indicative of the results which may be expected for the year as a whole. The accompanying consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements of the Bank and notes thereto as of December 31, 2007, filed with the FDIC on Form 10-KSB on March 31, 2008.

Other Real Estate Owned

Other real estate owned consists of properties acquired through, or in lieu of, loan foreclosure or other proceedings and is initially recorded at the lower of the related loan balances less any specific allowance for loss, or fair value at the date of foreclosure, which establishes a new cost basis. Subsequent to foreclosure, the properties are held for sale and are carried at the lower of cost or fair value less estimated costs of disposal. Any write-down to fair value at the time of acquisition is charged to the allowance for loan losses. Properties are evaluated regularly to ensure the recorded amounts are supported by current fair values, and a charge to operations is recorded as necessary to reduce the carrying amount to fair value less estimated costs to dispose.

Revenue and expense from the operations of other real estate owned and the provision to establish and adjust valuation allowances are included in operations. Costs relating to the development and improvement of the property are capitalized, subject to the limit of fair value of the collateral. Gains or losses from the sale of other real estate owned are included in operations upon disposal.

Note 3. Investments

The amortized cost, gross unrealized gains, gross unrealized losses and approximate fair values of available for sale and held to maturity securities at September 30, 2008, and December 31, 2007, are as follows:

September 30, 2008

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale securities				
U.S. Government Sponsored Agencies	\$ 4,900,000	\$ 2,457	\$ (6,550)	\$ 4,895,907
Mortgage-backed securities	30,608,450	46,319	(1,144,729)	29,510,040
Total available for sale	\$ 35,508,450	\$ 48,776	\$ (1,151,279)	\$ 34,405,947
Held to maturity securities				
Mortgage-backed securities	\$ 1,187,182	\$ 25,552	\$ -	\$ 1,212,734

December 31, 2007

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale securities				
U.S. Government Sponsored Agencies	\$ 10,997,408	\$ 52,352	\$ -	\$ 11,049,760
Mortgage-backed securities	26,478,839	489,127	(497,481)	26,470,485
Total available for sale	\$ 37,476,247	\$ 541,479	\$ (497,481)	\$ 37,520,245
Held to maturity securities				
Mortgage-backed securities	\$ 1,395,835	\$ 28,348	\$ -	\$ 1,424,183

At September 30, 2008, gross unrealized holding losses on nine available for sale securities totaled \$1,151,279, an aggregate depreciation of 4.15% from the Bank's amortized cost. Unrealized losses on two of these securities aggregated \$650,608 or 11.28% depreciation from the Bank's amortized cost, and have been in an unrealized loss position for twelve months or longer. Management does not believe that any of these unrealized losses as of September 30, 2008 are other than temporary, as all of these securities have AAA ratings, except one which was downgraded to BB subsequent to September 30, 2008 – see Note 16, Subsequent Event, or Agency implied AAA credit ratings (meaning that the agency, such as Fannie Mae, backing the securities is AAA rated) and are currently performing as expected (minimal delinquencies and cumulative losses within the pools of mortgages supporting these securities). The Bank has the ability and intent to hold these securities until fair value recovery or to maturity, if necessary, and expects to receive all contractual principal and interest related to these investments. As a result, management believes that these unrealized losses will not have a negative impact on future earnings or a permanent effect on capital.

At December 31, 2007, gross unrealized holding losses on four available for sale securities totaled \$497,481, an aggregate depreciation of 6.14% from the Bank's amortized cost.

None of the unrealized losses on available for sale securities as of December 31, 2007, existed for a period of twelve months or longer.

At September 30, 2008, \$24.8 million of the available for sale securities and the \$1.2 million of held to maturity securities have been pledged as collateral for municipal deposits and securities sold under agreements to repurchase. There were sales of \$4.3 million and \$22.9 million of investment securities during the three months and nine months ended September 30, 2008, respectively, which resulted in gains of \$86,000 and \$401,000, respectively. There were no sales of investment securities during the three months and nine months ended September 30, 2007.

One private label whole loan CMO investment with a book value of \$4,747,000 at September 30, 2008 was downgraded by Standard & Poor's from AAA to BB on October 28, 2008. The fair value and unrealized loss on this security at September 30, 2008 were \$4,270,000 and \$477,000, respectively. This security has credit support coverage and any losses to date or in the future have currently been and are anticipated to be absorbed by subordinate classes within the pool of mortgages. The downgrade was based upon projected cumulative losses within the pool, which is essentially equivalent to the credit support available on the Bank's tranche of this security. Management does not consider this investment to be other-than-temporarily impaired and the Bank has the ability and intent to hold this security to full recovery of the cost basis.

To the extent that continued changes in interest rates, credit movements and other factors that influence the fair value of investments occur, the Bank may be required to record impairment charges for other-than-temporary impairment in future periods.

Subsequent to quarter-end, the credit and liquidity crisis in the United States and throughout the global financial system has resulted in substantial volatility in financial markets and the banking system. These and other economic events have had a significant adverse impact on investment portfolios. As a result, the Bank's investments have likely incurred a significant decline in fair value since September 30, 2008.

Note 4. Loans and Allowance for Loan Losses

A summary of the Bank's loan portfolio as of September 30, 2008, and December 31, 2007, is as follows:

	<u>September 30, 2008</u>	<u>% of Total Portfolio</u>	<u>December 31, 2007</u>	<u>% of Total Portfolio</u>
Real estate loans				
Residential mortgages	\$ 11,700,838	7.82%	\$ 9,854,486	9.21%
Commercial real estate	33,978,267	22.72%	34,540,293	32.28%
Construction	72,017,316	48.14%	45,309,980	42.34%
Home equity	9,962,561	6.66%	8,730,086	8.16%
Total real estate loans	<u>127,658,982</u>	<u>85.34%</u>	<u>98,434,845</u>	<u>91.99%</u>
Commercial and industrial loans	<u>19,719,906</u>	<u>13.18%</u>	<u>5,811,828</u>	<u>5.43%</u>
Consumer loans	<u>2,214,869</u>	<u>1.48%</u>	<u>2,755,848</u>	<u>2.58%</u>
Total gross loans	<u>149,593,757</u>	<u>100.00%</u>	<u>107,002,521</u>	<u>100.00%</u>
Deferred loan fees, net	(176,466)		(87,981)	
Allowance for loan losses	<u>(1,862,000)</u>		<u>(1,421,000)</u>	
Loans receivable, net	<u>\$ 147,555,291</u>		<u>\$ 105,493,540</u>	

In the normal course of business, the Bank may grant loans to executive officers, directors and members of their immediate families, as defined, and to entities in which these individuals have more than a 10% equity ownership. Such loans are transacted at terms including interest rates, substantially the same as those available to unrelated customers.

Allowance for Loan Losses

The following represents the activity in the allowance for loan losses for the nine months ended September 30, 2008, and September 30, 2007:

	<u>September 30, 2008</u>	<u>September 30, 2007</u>
Balance at beginning of period	\$ 1,421,000	\$ 703,000
Provision for loan losses	724,386	275,000
Charge-offs	<u>(283,386)</u>	<u>(33,000)</u>
Balance at end of period	<u>\$ 1,862,000</u>	<u>\$ 945,000</u>

Non-Accrual, Past Due and Restructured Loans

The following is a summary of non-accrual and past due loans:

	<u>September 30, 2008</u>	<u>December 31, 2007</u>
Loans delinquent over 90 days and still accruing	\$ 320,000	\$ -
Non-accrual loans	<u>3,914,726</u>	<u>3,626,285</u>
Total nonperforming loans	<u>\$ 4,234,726</u>	<u>\$ 3,626,285</u>
% of Total Loans	2.83%	3.39%
% of Total Assets	2.17%	2.14%
Ratio of allowance for loan losses to nonperforming loans	43.97%	39.19%

Note: One non-accrual loan of \$479,013 has a specific reserve of \$139,000.

The Bank had two loans considered “troubled debt restructurings” as of or during the nine months ended September 30, 2008. There were no restructured loans during the year ended December 31, 2007. On July 16, 2008, the Bank entered into a forbearance agreement with a borrower relating to two loans totaling \$1.9 million with one borrower. The agreement covers the period from August 1, 2008 through June 1, 2010. These two loans are included in non-accrual loans as of September 30, 2008. Under the terms of the agreement, the borrower agreed to pay to the Bank an increased interest rate on the principal balance outstanding and assigned rental payments of \$6,800 per month from one of the collateral properties through the term of the agreement. The borrower also agreed that the due date for final payment will be the earlier of the date of sale or refinancing of the premises or June 30, 2010. Based on appraisals dated August 20, 2008, the Bank established a specific reserve of \$139,000 during the third quarter of 2008 within the allowance for loan losses while the other has a net realizable value sufficient to enable the Bank to collect balance due.

Potential Problem Loans

Other than loans that have been identified as non-accrual at September 30, 2008, and December 31, 2007, the Bank had no material loans as to which management has significant doubts as to the ability of the borrower to comply with the present repayment terms. At September 30, 2008, four of the six non-accrual loans totaling \$2.0 million are in the process of foreclosure; however, management’s analyses of the loans’ net realizable values show no anticipated additional losses. Also, the other two non-accrual loans totaling \$1.9 million have been restructured.

Loans Held for Sale

As of September 30, 2008, and December 31, 2007, the Bank had \$4.5 million and \$6.8 million, respectively, invested in loans held for sale. Loans held for sale are comprised of fully collateralized mortgages and HELOC lines of credit.

Note 5. Other Real Estate Owned

Other real estate owned represents the estimated net realizable value of real estate received in satisfaction of a non-performing loan through foreclosure proceedings in June 2008.

Note 6. Deposits

At September 30, 2008, and December 31, 2007, deposits consisted of the following:

	<u>September 30, 2008</u>	<u>December 31, 2007</u>
Noninterest-bearing checking	\$ 4,926,192	\$ 5,490,964
Noninterest-bearing money market	4,634,509	-
Total noninterest-bearing deposits	<u>\$ 9,560,701</u>	<u>\$ 5,490,964</u>
Interest-bearing deposits		
Interest-bearing checking	6,582,573	1,496,125
NOW and money market	5,965,343	8,083,554
Savings	11,387,180	8,211,324
Checking, NOW, money market and savings	<u>23,935,096</u>	<u>17,791,003</u>
Time Certificates under \$100,000	55,326,595	52,330,858
Time Certificates over \$100,000	63,033,746	47,228,342
Time deposits	<u>118,360,341</u>	<u>99,559,200</u>
Total interest-bearing deposits	<u>142,295,437</u>	<u>117,350,203</u>
Total deposits	<u>\$ 151,856,138</u>	<u>\$ 122,841,167</u>

Included in time deposits at September 30, 2008, and December 31, 2007, were brokered deposits totaling \$27,978,821 and \$27,966,987, respectively. Brokered deposits at September 30, 2008, and at December 31, 2007, have original maturities of four weeks to five years, respectively.

Note 7. Securities Sold Under Agreements to Repurchase

The following table summarizes the securities sold under agreements to repurchase:

<u>Maturity Date</u>	<u>September 30, 2008</u>	<u>December 31, 2007</u>
May 2017	\$ 4,000,000	\$ 4,000,000
July 2017	7,000,000	7,000,000
July 2017	4,000,000	4,000,000
July 2017	4,000,000	4,000,000
July 2017	4,000,000	4,000,000
Total securities sold under agreements to repurchase	<u>\$ 23,000,000</u>	<u>\$ 23,000,000</u>

Securities sold under agreements to repurchase were collateralized by mortgage-backed securities. The weighted average cost of funds on the repurchase agreements was 4.59% at both September 30, 2008 and December 31, 2007. The amounts outstanding as of September 30, 2008 and December 31, 2007 have original maturities of ten years and are structured to be callable on scheduled dates from six to eighteen months from inception or on a quarterly basis thereafter at the option of the counterparty. The average outstanding balance was \$23.0 million for both the three-month and nine-month periods ended September 30, 2008 and the average outstanding balances were \$20,462,366 and \$7,394,265 for the three-month and nine-month periods ended September 30, 2007, respectively.

Note 8. Available Borrowings

The Bank has established a secured line of credit facility with M&T Bank. The Bank has the ability to borrow up to \$5 million on an overnight basis from M&T Bank using investments as collateral equal to 125% of the borrowed amount. The Bank also has an arrangement with the Federal Reserve Bank for secured borrowings of up to \$1 million. The only borrowing with the Federal Reserve Bank was on June 30, 2008 for \$900,000 which was repaid in full on July 1, 2008. There were no borrowings outstanding on the M&T Bank line of credit as of or during the three-month or nine-month periods ended September 30, 2008, or as of or during the year ended December 31, 2007.

Note 9. Income Taxes

Since the Bank is in a net operating loss position, the Bank has recorded a full valuation allowance to reduce its net deferred tax asset to zero at September 30, 2008.

Note 10 Loss per Share

The Bank's loss per share for each of the three-month and nine-month periods ended September 30, 2008 and 2007 was calculated by dividing the net loss for the respective periods by the weighted average shares outstanding. The calculation of the loss per share for the three months and nine months ended September 30, 2008 and 2007 appears below:

	<u>Three Months Ended September 30, 2008</u>	<u>Three Months Ended September 30, 2007</u>
Net Loss	\$ (118,484)	\$ (843,426)
Weighted Average Shares	5,750,000	5,750,000
Basic and diluted loss per share	\$ (0.02)	\$ (0.15)
	<u>Nine Months Ended September 30, 2008</u>	<u>Nine Months Ended September 30, 2007</u>
Net Loss	\$ (1,247,173)	\$ (2,838,381)
Weighted Average Shares	5,750,000	5,750,000
Basic and diluted loss per share	\$ (0.22)	\$ (0.49)

Note 11. Related Party Transactions

The aggregate dollar amount of loans to related parties was approximately \$2,035,000 and \$562,000 at September 30, 2008, and December 31, 2007, respectively.

Related party deposits aggregated approximately \$480,000 and \$1,365,000 as of September 30, 2008, and December 31, 2007, respectively. The Bank paid \$39,800 during the nine months ended September 30, 2008, for information technology-related services to an IT consulting company, the principal of which is a director of the Bank. The Bank also paid rent for

its main branch facility at 601 North Main Street, Port Chester, New York, of approximately \$84,191 during the nine months ended September 30, 2008, to a company partially owned by certain directors.

Note 12. Fair Value

The Bank uses fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Bank may be required to record at fair value other assets on a nonrecurring basis such as loans held for sale, collateral-dependent impaired loans and other real estate owned. These nonrecurring fair value adjustments typically involve application of the lower of cost or market accounting or write-downs of individual assets.

Fair Value Hierarchy

Under SFAS No. 157, the Bank groups assets at fair value in three levels, based on the markets in which the assets are traded and the reliability of the assumptions used to determine fair value. These levels are:

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

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

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

Following is a description of valuation methodologies used for assets recorded at fair value.

Investment Securities Available-for-Sale

Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets, and money market funds. Level 2 securities include mortgage-backed securities issued by government-sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans

The Bank does not record loans at fair value on a recurring basis. However, from time to time, nonrecurring fair value adjustments to collateral-dependent loans are recorded to reflect partial write-downs based on the observable market price or current appraised value of collateral.

The following table reflects financial assets measured at fair value on a recurring basis as of September 30, 2008, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	<u>Balance as of September 30, 2008</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Financial assets held at fair value				
Securities available for sale	<u>\$ 34,405,947</u>	<u>\$ -</u>	<u>\$ 34,405,947</u>	<u>\$ -</u>

The following table reflects financial assets measured at fair value on a non-recurring basis as of September 30, 2008, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	<u>Balance as of September 30, 2008</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Financial assets held at fair value				
Impaired Loans (1)	<u>\$ 4,095,726</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,095,726</u>

(1) Represents carrying value and related write-downs for which adjustments are based on the appraised value of the collateral.

The Bank will apply the fair value measurement and disclosure provisions of SFAS No. 157 effective January 1, 2009 to nonfinancial assets and liabilities measured on a nonrecurring basis. The Bank measures the fair value of the following on a nonrecurring basis: (1) long-lived assets; (2) other real estate owned; and (3) indefinite-lived assets.

Note 13. Financial Instruments with Off-Balance-Sheet Risk

In the normal course of business the Bank is a party to financial instruments with off-balance-sheet risk to meet the financing needs of its customers. These financial instruments include commitments to extend credit and involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized in the consolidated financial statements. The contractual amounts of these instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The contractual amounts of commitments to extend credit represents the amounts of potential accounting loss should the contract be fully drawn upon, the customer default, and the value of any existing collateral become worthless. The Bank uses the same credit policies and procedures in making commitments and conditional obligations as it does for on-balance-sheet

instruments and evaluates each customer's creditworthiness on a case-by-case basis. Management believes that the Bank controls the credit risk of these financial instruments through credit approvals, credit limits, monitoring procedures and the receipt of collateral as deemed necessary.

Financial instruments whose contract amounts represent credit risk are as follows at September 30, 2008 (unaudited), and December 31, 2007:

	<u>September 30, 2008</u>	<u>December 31, 2007</u>
Commitments to extend credit:		
Future loan commitments	\$ 14,534,000	\$ 29,502,849
Unused lines of credit	10,623,362	17,478,512
Undisbursed construction loans	20,042,698	24,743,688
Financial standby letters of credit	489,744	320,994
	<u>\$ 45,689,804</u>	<u>\$ 72,046,043</u>

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments to extend credit generally have fixed expiration dates or other termination clauses and may require payment of a fee by the borrower. Since these commitments could expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of the collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include residential and commercial property, deposits and securities.

Standby letters of credit are written commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. All guarantees issued or modified that are not derivative contracts have been recorded on the Bank's balance sheet at their fair value at inception. The liabilities related to guarantees recorded at September 30, 2008, and December 31, 2007, were not significant.

Note 14. Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the Federal banking agencies. Failure to meet minimum capital requirements can result in certain mandatory – and possibly additional discretionary – actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. The Bank meets the quantitative measures to be considered well capitalized.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total and Tier 1 capital (as defined in the

regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes that as of September 30, 2008, and December 31, 2007, the Bank meets all capital adequacy requirements to which it is subject.

The FDIC categorizes banks based on certain capital ratios under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios, which the Bank continues to exceed.

The Authorization Certificate issued by the NY Banking Department requires the Bank to maintain a risk-based ratio of Tier 1 capital to assets of not less than eight percent (8%) for a period of three years.

Supervisory Action

On October 22, 2007, the NY Banking Department and the FDIC issued, with the consent of the Bank, parallel Orders to Cease and Desist applicable to the Bank. The Orders, which were substantially identical, were issued as a result of findings made during the regulators' Safety and Soundness Examination conducted as of the close of business on September 30, 2006, and Compliance Examinations conducted as of the close of business on February 20, 2007. None of the findings or the terms of the Orders affect or address the Bank's ability to meet its financial obligations, including the timely payment of customer deposits or the funding of loan commitments, nor do the Orders affect the FDIC level of insurance of the Bank's deposits.

The Orders require the Bank to refrain from certain practices and to take affirmative action to correct identified deficiencies and weaknesses in its operations. The full text of the Orders can be viewed on the FDIC website and the NY Banking Department website at www.fdic.gov and <http://www.banking.state.ny.us>, respectively.

A summary of the terms and conditions of the Orders follows:

The Orders prohibit the Bank from operating with inadequate management supervision and Board of Directors oversight, inadequately trained and supervised staff and inadequate audit, compliance and information technology and security policies, processes and procedures, and without a current, comprehensive business and strategic plan and budget. They also prohibit violations of the Bank Secrecy Act and various consumer protection statutes.

The Orders require the Bank to adopt a number of policies and procedures designed to strengthen and improve its operations, and to assess and report to the regulators within specified time frames, regarding several aspects of its operations. The Orders require the Bank to engage qualified professionals acceptable to the regulators to prepare or assist with the preparation of some of the required reports. The Orders direct the Bank to prepare and submit the following reports and other materials:

- A Management Report assessing the Bank's management and staffing needs, performance, competence and responsibilities, and recommending staff training and Board of Directors and senior management recruitment and retention plans and a plan to respond to the recommendations contained in the Management Plan;

- A Corporate Governance Review and report by an independent third party assessing the Bank's corporate governance process, including compliance with the corporate governance provisions of the Sarbanes–Oxley Act of 2002;
- An Expense Report detailing and assessing the propriety of fees and expenses paid to the Bank's insiders and a plan for the Bank to seek reimbursement of payments to insiders determined to have been inappropriate;
- A Strategic Plan for at least the next three years, including detailed financial and market assumptions, goals, strategies and policies, and a mission statement;
- A Profit Plan, including plans to improve the Bank's operating performance, as gauged by specific metrics, and a comprehensive budget;
- An effective Corporate Information Security Policy;
- A Disaster Recovery / Business Continuity Plan and a test of such Plan;
- A Compliance Management System, including consumer protection compliance monitoring, testing and training procedures, a Compliance Training Program and appointment of a qualified compliance officer;
- An Audit Program providing for implementation, monitoring and testing of internal audit controls and procedures, consumer protection compliance, information security and anti-money laundering compliance; and
- Quarterly Progress Reports on compliance with the Orders.

The Orders further require the Bank to take the following affirmative actions:

(i) increased, informed Board of Directors participation and oversight, including the adoption of good corporate record-keeping and reporting practices; (ii) correction of legal and regulatory violations; (iii) implementation of recommended Bank Secrecy Act policies and procedures; (iv) implementation of an effective information security policy and a disaster recovery/business continuity plan; and (v) establishment of a Compliance Committee of the Board of Directors.

Actions that have been taken by the Bank since September 30, 2006 (the date as of which the examination was conducted) include the following: (i) the election of Ronald J. Gentile, whose experience includes 19 years with the FDIC and service as chief executive officer of a bank facing similar issues, as President and Chief Executive Officer and a Director; (ii) the hiring of a Chief Compliance Officer with more than five years of experience, (iii) the election of six additional independent directors, resulting in seven of the nine current directors' being independent; and (iv) the retention of independent consultants to prepare or assist in the preparation of a revised strategic plan and budget, a review of expenses paid to the Bank's insiders and a review of the Bank's loan function.

In the third quarter of 2007, the Board of Directors established a Compliance Committee to supervise the implementation of the Orders. This Committee meets monthly and is currently

composed of the President and Chief Executive Officer, four other directors, each of whom is independent, the Bank's Compliance Officer and an independent consultant. The Compliance Committee reports regularly to the Board of Directors.

The Bank has also taken affirmative actions to implement and test its revised Disaster Recovery / Business Continuity Plan, its Information Technology structure and other processes and procedures.

Note 15. Commitments and Contingencies

Representations and Warranties Reserves

In the normal course of business, the Bank is subject to potential recourse obligations resulting from standard representations and warranties customary in mortgage loan sales activities. Violations of these representations and warranties may require the Bank to repurchase loans previously sold. For the nine months ended September 30, 2008, and the year ended December 31, 2007, the Bank sold \$6.2 million and \$48.3 million of loans, respectively. The Bank is contingently liable under representations and warranties made in the contracts relating to these sales, in certain instances for the life of the loans. The Bank has established a reserve for representations and warranties related to these sales which totaled \$2,800 at September 30, 2008, and \$26,000 at December 31, 2007. On an ongoing basis, the Bank monitors the adequacy of the representations and warranties reserve liability, which is established upon the initial sale of the loans, and is included in accrued expenses and other liabilities in the balance sheet. The Bank has not been required to repurchase any loans under such representations and warranties obligations.

Legal Proceedings

On May 7, 2007, two actions were begun in the Supreme Court of the State of New York. One naming the Bank as the defendant was brought by Salvatore Pane, Lisa Vitale and Perry Winter, and the other naming Fred DeCaro, Jr., and the Bank as defendants was brought by Salvatore Pane and First Lincoln Mortgage Corp. (formerly USA Mortgage Bankers of America, Inc.). The first suit, which purports to be brought by the plaintiffs as shareholders and as representatives of a class of shareholders, alleges that the offering materials used by the Bank in connection with its offerings of stock in 2005 and 2006 contained various representations that were untrue, that various payments were made to related parties and that various loans were improperly made. While the plaintiffs seek monetary judgments and other relief from Mr. DeCaro, the only judgment demanded against the Bank is "such other relief as to the Court may seem just and proper."

The suit against the Bank only alleges that the Bank had entered into an agreement to acquire USA Mortgage Bankers of America, Inc., and that the Bank "abandoned" the plan and breached the agreement. The plaintiffs seek damages in an unspecified amount.

The Bank believes that the claims are without merit and intends to defend itself vigorously. The Bank has filed motions to dismiss these suits, which motions have been denied. While the Bank recognizes that these suits may constitute loss contingencies within the meaning of SFAS No. 5, an estimate of the amount thereof cannot be made. A motion by counsel to the

plaintiffs to withdraw as counsel in these suits has been filed. While the Bank has not opposed the granting of this motion, the court has not yet ruled on the matter.

In addition, on August 21, 2007, a suit was instituted by Ralph G. Meyer, Jr., and Anthony J. Gioia in the Supreme Court of the State of New York, County of Nassau, naming the Bank and Fred DeCaro, Jr., as defendants. The plaintiffs, both former employees of the Bank, claim that misrepresentations and other actions by the defendants induced them to terminate their prior employment and to accept employment with the Bank. Effective August 5, 2008, the Bank entered into settlement agreements with each of the plaintiffs. Of the aggregate amount of payments to Mr. Meyer and Mr. Gioia under the Settlement Agreements, the Bank is responsible for an aggregate of \$25,000 plus certain payroll taxes. The balance of the payment and legal fees will be paid under the Bank's Employment Practices Liability Insurance.

Note 16. Subsequent Events

Investment Downgrade

One private label whole loan CMO investment with a book value of \$4,747,000 at September 30, 2008 was downgraded by Standard & Poor's from AAA to BB on October 28, 2008. The fair value and unrealized loss on this security at September 30, 2008 were \$4,270,000 and \$477,000, respectively. This security has credit support coverage and any losses to date or in the future have currently been and are anticipated to be absorbed by subordinate classes within the pool of mortgages. The downgrade was based upon projected cumulative losses within the pool, which is essentially equivalent to the credit support available on the Bank's tranche of this security. Management does not consider this investment to be other-than-temporarily impaired and the Bank has the ability and intent to hold this security to full recovery of the cost basis.

To the extent that continued changes in interest rates, credit movements and other factors that influence the fair value of investments occur, the Bank may be required to record impairment charges for other-than-temporary impairment in future periods.

Lease Buyout

On October 15, 2008, the Bank entered into a lease buy-out agreement with the landlord of its administrative office facility at 800 Westchester Avenue. The agreement called for a payment of \$600,000 to release the Bank from the remaining 29-month term of its lease obligation after January 31, 2008.

The current staff at 800 Westchester Avenue will be relocated to both the main bank branch at 601 North Main Street, Port Chester, NY, and its existing facility that is used for administrative purposes only at Sherwood Place, Greenwich, CT.

The lease buy-out is a fourth quarter event and the \$600,000 buy-out amount therefore will be reflected in noninterest expense during the fourth quarter. The savings generated from this transaction, which will commence in February 2009 in the form of a reduction of approximately \$30,000 per month in rental expense, is anticipated to be approximately \$870,000 in excess of what would have been paid over the remaining term of the lease commitment.

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

The following discussion and analysis is intended to assist in understanding the financial condition and results of operations of the Bank. This discussion should be read in conjunction with the accompanying unaudited financial statements as of and for the three months and nine months ended September 30, 2008 and 2007, along with the audited financial statements as of and for the year ended December 31, 2007, included in the Bank's Annual Report on Form 10-KSB filed with the FDIC on March 31, 2008.

Summary

As of September 30, 2008, the Bank had total assets of \$195.7 million, which is an increase of \$26.2 million (15.5%) from the \$169.5 million at December 31, 2007. Total assets at September 30, 2008 primarily consisted of \$147.6 million in loans, net of the allowance for loan losses, and \$35.6 million in investment securities. Funding for these assets was primarily derived from deposits of \$151.9 million, repurchase agreements of \$23.0 million, and shareholders' equity of \$19.0 million. Total equity capital at September 30, 2008, was \$19.9 million, representing a Tier 1 Leverage Capital Ratio of 10.8%. This compares to total equity capital at December 31, 2007, which was \$22.3 million, representing a Tier 1 Leverage Capital Ratio of 13.21%.

Earning assets, comprised of federal funds sold, overnight investments, interest-bearing deposits, investment securities, loans held for sale and total gross loans, net of non-accrual loans increased \$25.4 million (15.6%) from \$162.4 million at December 31, 2007, to \$187.8 million at September 30, 2008. The earning asset growth was primarily in total gross loans, net of non-accrual loans, which increased \$42.3 million (40.9%). This loan growth was partially funded by decreases in federal funds sold and overnight investments, interest-bearing deposits, investment securities and loans held for sale of \$6.2 million (75.8%), \$4.8 million (100.0%), \$3.3 million (8.5%), and \$2.3 million (33.4%), respectively. Additional funding to support the loan growth during the first nine months of 2008 was from deposit growth, which increased \$29.0 million (23.6%) from \$122.8 million at December 31, 2007, to \$151.9 million at September 30, 2008. The major portion of the overall deposit increase was in time deposits, which increased \$18.8 million (18.9%). The remaining deposit growth was in savings deposits, noninterest-bearing deposits and interest-bearing checking, which increased \$3.2 million (38.7%), \$4.1 million (74.1%) and \$5.1 million (340.0%), respectively.

The Bank had a net loss of \$118,000 (or basic and diluted loss per share of \$0.02) and \$1,247,000 (or basic and diluted loss per share of \$0.22) for the three months and nine months ended September 30, 2008, respectively, compared to a net loss of \$843,000 (or basic and diluted loss per share of \$0.15) and \$2.8 million (or basic and diluted loss per share of \$0.49) for the three months and nine months ended September 30, 2007, respectively. The \$725,000 reduction in net loss in the third quarter of 2008, compared to the third quarter of 2007, is primarily due to the \$342,000 increase in net interest income and the \$442,000 reduction in operating expenses. The increased net interest income is due to the growth in interest earning assets with a larger proportion in higher-yielding loans. The \$442,000 reduction in operating expenses in the three months ended September 30, 2008, compared to the three months ended September 30, 2007, was primarily the result of reductions in salaries and benefits of \$205,000, reflecting reductions

in staff, reductions in commission expense of \$210,000, reflecting the Bank's focus on more traditional commercial banking, and the \$96,000 reduction in legal expenses. Partially offsetting the favorable impact of the above was the \$86,000 reduction in noninterest income, caused by a reduction in gains on loan sales of \$97,000 and a \$70,000 lower level of fees from the brokering of loans, both of which were partially offset by the \$86,000 increase in gains recognized on the sales of investments versus no such gains recognized in the three months ended September 30, 2007. There was also a \$27,000 increase in the provision for loan losses due to a combination of increased loan volume in the three months ended September 30, 2008, as compared to the three months ended September 30, 2007, and increased loan charge-offs. Net interest margin for the three months and nine months ended September 30, 2008, was 3.21% and 3.06%, respectively, as compared to 3.14% for both the three months and nine months ended September 30, 2007. The increase in net interest margin for the three months ended September 30, 2008, compared to the three months ended September 30, 2007, reflects the increased proportion of higher-yielding loans in the interest-earning assets mix. The decrease in interest margin for the nine months ended September 30, 2008, as compared to the nine months ended September 30, 2007, is largely attributable to the decline in the prevailing interest rates partially offset by the change in the mix of earning assets to higher-yielding earning assets, specifically loans.

The results for the three months and nine months ended September 30, 2008, as compared to the three months and nine months ended September 30, 2007, reflect management's continued focus on leveraging the Bank's capital with quality commercial loan growth, an emphasis on revenue enhancement and cost reduction strategies and the continuous use of asset liability strategies to manage the Bank's interest rate sensitivity.

Goals of the Board of Directors and management of the Bank in future periods include achieving profitability with the goal of improving the Bank's capital ratios, reducing the Bank's concentration of commercial and construction loans with the goal of improving the Bank's asset quality, and continuing to refine and implement policies and practices to monitor asset quality and to improve the loan underwriting and credit administration functions.

Critical Accounting Policy

In the ordinary course of business, the Bank has made a number of estimates and assumptions relating to reporting results of operations and financial condition in preparing its consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ significantly from those estimates under different assumptions and conditions. The Bank's management believes the following discussion addresses the Bank's only critical accounting policy, which is the policy that is most important to the portrayal of the Bank's financial condition and results of operations and requires management's most difficult, subjective and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. The Bank's management has reviewed this critical accounting policy and the resulting estimates with its loan committee. Refer to the discussion below under "Allowance for Loan Losses."

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 operations. Loans 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. During the nine months ended September 30, 2008, there were charge-offs of \$283,386, including \$229,369 relating to one construction loan for which the collateral property was obtained in satisfaction of the loan balance through foreclosure proceedings and is presented as other real estate owned at September 30, 2008. There were no recoveries of previously charged-off loans during the nine months ended September 30, 2008 and 2007, and there was a partial charge-off of \$33,000 on one residential loan for the nine months ended September 30, 2007.

The Bank had seven loans totaling \$4.2 million considered to be impaired loans, of which six loans totaling \$3.9 million were on non-accrual at September 30, 2008, and one loan is delinquent over 90 days and still accruing as of September 30, 2008, for which there is interest past due but for which no loss is anticipated. Four of the six non-accrual loans totaling \$2.0 million are in the process of foreclosure; however, management's analyses of the loans' net realizable values show no anticipated additional losses. Also, the other two non-accrual loans totaling \$1.9 million have been restructured, as discussed further in the next paragraph.

On July 16, 2008, the Bank entered into a forbearance agreement with a borrower relating to two loans of the seven loans considered impaired at September 30, 2008. The two loans, which were considered "troubled debt restructurings," were to one borrower and totaled \$1.9 million. Under the terms of the agreement, the borrower agreed to pay the Bank an increased interest rate on the principal balance outstanding and assigned rental payments of \$6,800 per month from one of the collateral properties through the term of the agreement. The borrower also agreed that the due date for final payment will be the earlier of the date of sale or refinancing of the premises or June 30, 2010. Appraisals were done on the collateral for each of these loans as of August 20, 2008. As a result of the appraisals, one of these loans required a specific reserve of \$139,000 to be established during the third quarter of 2008 within the allowance for loan losses, while the other has a net realizable value sufficient to enable the Bank to collect the balance due.

The Bank's ongoing allowance for loan losses analysis results in an allowance for loan losses that consists of specific and general components. The specific component relates to allowances established for individual impaired loans. The general component relates to pools of loans segregated by loan type, and is based on historical loss experience adjusted by certain qualitative factors as determined by management and the board of directors.

The accrual of interest income on loans is discontinued whenever reasonable doubt exists as to its collectibility and generally is discontinued when loans are past due 90 days as to either principal or interest, or are otherwise considered impaired. When the accrual of interest income is discontinued, all previously accrued and uncollected interest is reversed against interest income. The accrual of interest on loans past due 90 days or more may be continued if the loan is well secured, and it is believed all principal and accrued interest income due on the loan will be realized, and the loan is in the process of collection. A non-accrual loan is restored to accrual status when it is no longer delinquent and collectibility of interest and principal is no longer in doubt.

The allowance for loan losses is evaluated on a regular basis by management and is based on 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.

Based upon this evaluation, management believes the allowance for loan losses of \$1,862,000 or 1.24% of total gross loans at September 30, 2008, to be adequate, under prevailing economic conditions, to absorb losses on existing loans. At December 31, 2007, the allowance was \$1,421,000 or 1.33% of total gross loans outstanding. The decrease in the allowance for loans losses to total gross loans as of September 30, 2008, as compared to December 31, 2007, primarily reflects the reduction in the allowance relating to the charge-off of \$229,369 on one loan, resulting from the write-down to estimated fair value of the loan's underlying collateral which was obtained in satisfaction of the loan balance through foreclosure proceedings.

Management considers all non-accrual loans, other loans past due 90 days or more based on contractual terms, and restructured loans to be impaired. In most cases, loan payments that are past due less than 90 days and the related loans are not considered to be impaired. The Bank considers consumer installment loans to be pools of smaller balance homogeneous loans, which are collectively evaluated for impairment.

Recent Accounting Changes

In September 2006, the FASB issued SFAS No. 157, "*Fair Value Measurements*." This statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. It clarifies that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity operates. This statement does not require any new fair value measurements, but rather, it provides enhanced guidance to other pronouncements that require or permit assets or liabilities to be measured at fair value. This statement is effective for fiscal years beginning after November 15, 2007, with earlier adoption permitted. The FASB has approved a one-year deferral for the implementation of the statement for non-financial assets and non-financial liabilities that are recognized or disclosed at fair value in the consolidated financial statements on a nonrecurring basis. Effective January 1, 2008, the Bank adopted SFAS No. 157. The impact of the adoption of this statement was not material.

In October 2008, the FASB issued FASB Staff Position No. FAS 157-3, "*Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*" ("FSP 157-3"), which was effective upon issuance including prior periods for which financial statements have not been issued.

FSP 157-3 applies to financial assets within the scope of accounting pronouncements that require or permit fair value measurements in accordance with SFAS No. 157, clarifies the application of SFAS No. 157 in a market that is not active, and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The Bank adopted this FSP for its September 30, 2008 financial statements. The impact of adoption on the Bank's financial statements was not material.

In February 2007, the FASB issued SFAS No. 159, “*The Fair Value Option for Financial Assets and Financial Liabilities.*” This statement permits companies to elect to follow fair value accounting for certain financial assets and liabilities in an effort to mitigate volatility in earnings without having to apply complex hedge accounting provisions. The statement also establishes presentation and disclosure requirements designed to facilitate comparison between entities that chose different measurement attributes for similar types of assets and liabilities. This statement is effective for fiscal years beginning after November 15, 2007. The Bank did not elect the fair value option for any financial assets or financial liabilities as of January 1, 2008, the effective date of the standard.

Comparison of Financial Condition as of September 30, 2008, versus December 31, 2007

General

The Bank’s total assets were \$195.7 million at September 30, 2008, an increase of \$26.2 million (15.5%) from \$169.5 million at December 31, 2007. Earning assets, net of non-accrual loans, were \$187.8 million as of September 30, 2008, an increase of \$25.4 million (15.6%) from \$162.4 million at December 31, 2007.

The earning asset growth for the first three quarters of 2008 was primarily due to the \$42.3 million (40.9%) increase in total gross loans, net of non-accrual loans, which was partially funded by reductions in all other earning asset categories, which decreased in total \$17.6 million (29.9%). This overall reduction was made up of reduced balances in federal funds sold and overnight investments, interest-bearing deposits, investment securities and loans held for sale of \$6.2 million (75.8%), \$4.8 million (100.0%), \$3.3 million (8.5%) and \$2.3 million (33.4%), respectively. Additional funding for the earning asset growth was primarily provided by the \$29.0 million (23.6%) growth in total deposits.

Federal funds sold and overnight investments

The balance in federal funds sold and overnight investments totaled \$2.0 million at September 30, 2008, which is a decrease of \$6.2 million (75.8%) compared to \$8.2 million at December 31, 2007. The yield on federal funds sold declined precipitously since mid-September 2007 to the September 30, 2008 2.00% level as a result of the Federal Reserve’s reduction of interest rates. These funds provide a source of liquidity to fund portfolio loan growth and loans held for sale, and are used to cover fluctuations in deposits as they mature in keeping with the guidelines established by the Bank’s Asset and Liability Management Committee. See “Liquidity” for additional discussion related to funding sources, including available lines of credit.

Interest-Bearing Deposits in Banks

Interest-bearing deposits in banks mature within one year and are carried at cost. The balance in interest-bearing deposits at December 31, 2007, was \$4.8 million, which consisted of a fixed-rate deposit which matured in July 2008; therefore, the balance as of September 30, 2008 was \$-0-.

Loans

Total gross loans reached \$149.6 million at September 30, 2008. The loan portfolio consisted of commercial real estate loans of \$34.0 million, construction loans of \$72.0 million,

residential mortgages of \$11.7 million, home equity lines of credit of \$10.0 million, commercial and industrial loans of \$19.7 million and consumer loans of \$2.2 million. The ratio of total gross loans to total deposits as of September 30, 2008, was 98.5%, up from the December 31, 2007 ratio of 87.1% and higher than the Bank's targeted ratio of 80% to 90%. Approximately \$6.0 million of loans were paid-off in early October 2008, which then lowered the total gross loan to total deposits ratio closer to the targeted ratio.

As of September 30, 2008, the Bank had \$72.0 million in construction loans, which represents 48% of the Bank's total loan portfolio and 378% of the Bank's total capital position. The Bank's policy states that all construction loans over \$2 million will require an additional appraisal by a Bank-approved appraiser to provide further support of value. The Bank utilizes the lower of the two appraisals in determining the loan-to-value ratio to be assigned. Before any disbursement on a construction loan is made, the Bank reviews current engineering construction reports with photographs showing the current status of the construction, updated title reports, the percentage of loan disbursements to total cost and maturity date.

Every month a detailed report on the Bank's construction loans is presented to the Board of Directors at its regularly scheduled board meeting. The report reflects the total loan commitment, outstanding balance, loan type, county where collateral property is located, the percentage of loan balance to project costs and loan-to-value ratio, maturity date, interest reserve, compensating balance required and actual compensating balance on deposit. Concentration reports are prepared and submitted to the Board of Directors quarterly.

Additionally, the Bank's Loan Committee has taken further safeguards within the past few months, to monitor and limit the risks inherent in construction loans, such as:

- 1.) Reducing loan-to-value ("*LTV*") ratios below the current policy levels of 60% land development, 65% commercial real estate / multi-family by 5-10% or more, in some recently approved construction loans. The Bank's policy currently allows for a 50% *LTV* on raw land, but the Bank has generally refrained from granting any such loans in the current environment;
- 2.) The Bank restricts construction loans to a single borrower (including guarantors) to no more than two. Once one of the two projects has been completed and successfully sold, the Bank will consider making a construction loan for an additional project.

Allowance for Loan Losses and Non-Accrual, Past Due and Restructured Loans

The allowance for loan losses consists of the balance at the beginning of the period plus the current year provision of \$724,386, less loan charge-offs of \$283,386, and totaled \$1.9 million at September 30, 2008. As of September 30, 2008, there were 13 loans thirty days or more past due totaling \$7.7 million, six of which totaling \$3.9 million are ninety days or more past due and have been put on non-accrual status in accordance with the Bank's policy.

The following represents the activity in the allowance for loan losses for the nine months ended September 30, 2008 and 2007.

	For the Nine Months Ended September 30	
	2008	2007
Balance at beginning of period	\$ 1,421,000	\$ 703,000
Provision for loan losses	724,386	275,000
Charge-offs	(283,386)	(33,000)
Balance at end of period	<u>\$ 1,862,000</u>	<u>\$ 945,000</u>

Non-Accrual, Past Due and Restructured Loans

The following is a summary of non-accrual and past due loans:

	September 30, 2008	December 31, 2007
Loans delinquent over 90 days and still accruing	\$ 320,000	\$ -
Non-accrual loans	<u>3,914,726</u>	<u>3,626,285</u>
Total nonperforming loans	<u>\$ 4,234,726</u>	<u>\$ 3,626,285</u>
% of Total Loans	2.83%	3.39%
% of Total Assets	2.17%	2.14%
Ratio of allowance for loan losses to nonperforming loans	43.97%	39.19%

Note: One non-accrual loan of \$479,013 has a specific reserve of \$139,000.

The Bank had two loans considered “troubled debt restructurings” as of or during the nine months ended September 30, 2008. There were no restructured loans during the year ended December 31, 2007. On July 16, 2008, the Bank entered into a forbearance agreement, which restructured two loans totaling \$1.9 million with one borrower. The agreement covered the period from August 1, 2008, through June 1, 2010. These loans are included in non-accrual loans as of September 30, 2008. Under the terms of the agreement, the borrower agreed to pay to the Bank an increased interest rate on the principal balance outstanding and assigned rental payments of \$6,800 per month from one of the collateral properties through the term of the agreement. The borrower also agreed that the due date for final payment will be the earlier of the date of sale or refinancing of the premises or June 30, 2010. Based on appraisals dated August 20, 2008, the Bank established a specific reserve of \$139,000 during the third quarter of 2008 within the allowance for loan losses while the other has a net realizable value sufficient to enable the Bank to collect the balance due.

Potential Problem Loans

Other than loans that have been identified as non-accrual at September 30, 2008, and December 31, 2007, the Bank had no material loans as to which management has significant doubts as to the ability of the borrower to comply with the present repayment terms. At September 30, 2008, four of the six non-accrual loans totaling \$2.0 million are in the process of foreclosure; however, management’s analyses of the loans’ net realizable values show no anticipated additional losses. Also, the other two non-accrual loans totaling \$1.9 million have been restructured.

Other Real Estate Owned

Other real estate owned represents the estimated net realizable value of real estate received in satisfaction of a non-performing loan through foreclosure proceedings in June 2008.

Deposits

Deposits were \$151.9 million at September 30, 2008, an increase of \$29.0 million (23.6%) from the \$122.8 million in deposits at December 31, 2007. Noninterest-bearing deposits increased \$4.1 million (74.1%), reaching \$9.6 million at September 30, 2008, from \$5.5 million at December 31, 2007. Interest-bearing deposits increased \$24.9 million (21.3%), reaching \$142.3 million at September 30, 2008, from \$117.3 million at December 31, 2007.

The deposit growth is primarily due to the increased balances of demand deposits, money market and NOW accounts, savings and time deposits (including brokered deposits), which increased \$4.5 million (64.7%), \$2.5 million (31.1%), \$3.2 million (38.7%) and \$18.8 million (18.9%), respectively. The growth in interest-bearing demand deposits is due to one large deposit made in June 2008, resulting in the related deposit account having a balance of \$4.9 million at September 30, 2008.

Core deposits, which include demand, money market and NOW, savings and time deposits less than \$100,000, totaled \$82.7 million at September 30, 2008, an increase of \$17.8 million (27.4%) from the \$64.9 million at December 31, 2007. This reflects the Bank's efforts to attract these types of deposits by aggressively marketing its remote deposit capture product and being very competitive in the interest rates offered for these products.

Brokered time deposits remained level at \$28.0 million as of both September 30, 2008 and December 31, 2007 and declined as a percent of total deposits from 22.8% at December 31, 2007, to 18.4% at September 30, 2008. Therefore, none of the growth in interest-earning assets for the nine months ended September 30, 2008, was funded by brokered deposits.

Repurchase Agreements

The Bank entered into repurchase agreements in 2007 and has maintained the balance of \$23.0 million at September 30, 2008 and December 31, 2007. The weighted average cost of funds on the repurchase agreements was 4.59% at both September 30, 2008 and December 31, 2007.

Accrued expenses and other liabilities

Accrued expenses and other liabilities decreased \$407,000 to \$916,000 at September 30, 2008, from \$1,323,000 at December 31, 2007. This decrease was the result of a \$217,600 decrease in accrued interest payable, primarily due to the timing of semi-annual payments on certain brokered deposits in August and February each year and the reduction in interest rates by the Federal Reserve Bank from year end 2007 to September 30, 2008. It also reflects reductions in the accrual for severance of \$50,000 for planned staff reductions at December 31, 2007, as opposed to no such accrual being required as of September 30, 2008. It also reflects lower accruals for commissions of \$28,923 and legal expenses of \$38,319. In addition, the 401k employees' contributions of \$64,656 were included in accrued expenses at December 31, 2007 because this amount was not paid to the Bank's Plan until January 8, 2008. There were no 401k employees' contributions in accrued expenses at September 30, 2008.

Results of Operations – Comparison of the Results of Operations for the Three Months and Nine Months Ended September 30, 2008 and 2007

General

The Bank had a net loss of \$118,000 (or \$0.02 loss per share), for the three months ended September 30, 2008, compared to a net loss of \$843,000 (or \$0.15 loss per share) for the three months ended September 30, 2007, an 86% reduction from 2007. For the nine months ended September 30, 2008, the Bank had a net loss of \$1,247,000 (or \$0.22 loss per share), compared to a net loss of \$2,838,000 (or \$0.49 loss per share), a 56% reduction from 2007. The improved results for the three and nine months ended September 30, 2008 reflect increased net interest income from loan growth, the recognition of gains on the sale of securities versus no such gains being recognized in 2007, and reduced noninterest expenses, reflecting management's expense reduction efforts. Partially offsetting the favorable impact on earnings of the items noted above were lower gains on the sales of loans due to both the volatile mortgage market and the Bank's focus primarily on traditional commercial banking in 2008, and an increase in the provision for loan losses due to increased loan volume in 2008 and the \$139,000 specific reserve for one non-accrual loan.

Net interest income

The Bank's net interest income is dependent primarily upon the difference or spread between the average yield earned on federal funds sold and overnight investments, interest-bearing deposits, loans, investment securities, and other earning assets and the average rate paid on deposits and borrowings, as well as the relative amounts of such interest-earning assets and interest-bearing liabilities. The Bank, like other banking institutions, is subject to interest rate risk to the degree that its interest-bearing liabilities re-price at different times than its interest-earning assets. The Bank's Asset and Liability Management Committee monitors the interest rate risk and takes steps to reduce the impact on net interest income due to changes in interest rates.

For the three months ended September 30, 2008, net interest income was \$1.5 million versus \$1.2 million for the three months ended September 30, 2007, a \$342,000 (28.5%) increase. The increase in net interest income is primarily the result of the \$39.5 million (25.9%) increase in average interest-earning assets, which reached \$191.7 million for the three months ended September 30, 2008, as compared to average interest-earning assets of \$152.3 million for the three months ended September 30, 2007.

For the nine months ended September 30, 2008, net interest income was \$4.3 million versus \$2.9 million for the nine months ended September 30, 2007, a \$1.4 million (48.0%) increase of which \$1.6 million was attributed to increase in volume and \$0.2 million was attributed to a decrease in rates. This volume increase was the result of the \$63.9 million (51.5%) increase in average interest-earning assets, which reached \$188.1 million for the nine months ended September 30, 2008, as compared to average interest-earning assets of \$124.2 million for the nine months ended September 30, 2007. This growth in average earning assets reflects the Bank's continued effort to leverage upon the Bank's capital with quality loan growth.

The net interest spread increased from 2.23% for the three months ended September 30, 2007, to 2.58% for the three months ended September 30, 2008. The yield on interest-earning assets was 6.88% for the three months ended September 30, 2008, as compared to 7.26% for the three months ended September 30, 2007. The 38 basis point decline in the yield on interest-earning assets reflects the impact of the 3.25% of interest rate cuts made by the Federal Reserve Bank since June 30, 2007, which was partially offset by the growth in the average loan volume, the Bank's highest-yielding asset, and the reduction in the average volume of Federal funds sold and overnight investments, currently the lowest-yielding earning asset. The drop in the yield on earning assets was also mitigated by the high percentage of fixed-rate loans in the Bank's loan portfolio, which were not impacted by the interest rate cuts.

The Bank's average loan portfolio increased \$60.4 million (72.6%) to an average balance of \$143.6 million (74.9% of average interest-earning assets) during the three months ended September 30, 2008, with an average yield of 7.52%, as compared to an average balance of \$83.2 million (54.6% of average interest-earning assets) with an average yield of 8.44% for the three months ended September 30, 2007. The average volume of Federal funds sold decreased \$11.6 million (60.1%) from \$19.2 million (12.6% of average interest-earning assets) with an average yield of 5.23% for the three months ended September 30, 2007 to \$7.7 million (4.0% of average interest-earning assets) with an average yield of 2.12% for the three months ended September 30, 2008.

The Bank's average balance of investment securities decreased by \$3.9 million (9.6%) for the three months ended September 30, 2008, as compared to the three months ended September 30, 2007. The liquidity provided by the reduction in the investment portfolio was utilized to fund higher yielding loans and the decrease was partially due to the sale of certain investments.

For the nine months ended September 30, 2008, the net interest spread increased to 2.32% from 2.06% for the nine months ended September 30, 2007. The yield on earning assets declined to 6.91% for the nine months ended September 30, 2008, as compared to 7.12% for the nine months ended September 30, 2007. The 21 basis point decrease in the yield on interest-earning assets reflects the impact of the 3.25% interest rate cuts made by the Federal Reserve Bank since June 30, 2007, which was partially offset by the growth in the average loan volume, the Bank's highest-yielding asset, and the reduction in the average volume of Federal funds sold, currently the lowest-yielding earning asset. The drop in the yield on earning assets was also mitigated by the high percentage of fixed rate loans in the Bank's loan portfolio, which were not impacted by the interest rate cuts.

The Bank's average loan portfolio increased \$57.8 million (77.6%) to an average balance of \$132.2 million (70.3% of average interest-earning assets) for the nine months ended September 30, 2008, with an average yield of 7.60%, as compared to an average balance of \$74.4 million (59.9% of average interest-earning assets) with an average yield of 8.09% for the nine months ended September 30, 2007. The average volume of Federal funds sold and overnight investments decreased \$13.9 million (60.1%) from \$23.1 million (18.6% of average interest-earning assets) with an average yield of 5.28% for the nine months ended September 30, 2007 to \$9.2 million (4.9% of average interest-earning assets) with an average yield of 2.58% for the nine months ended September 30, 2008.

The Bank's average balance of investment securities increased by \$16.1 million (73.5%) for the nine months ended September 30, 2008, as compared to the nine months ended September 30, 2007, primarily as a result of the Bank's asset liability management growth strategy. This growth strategy involved utilizing investment securities to collateralize \$23.0 million of repurchase agreements, while locking in a 1.65% spread at the time of their investment.

For the three months ended September 30, 2008, the Bank's cost of interest-bearing liabilities was 4.30%, a 73 basis point reduction from the 5.03% cost of interest-bearing liabilities for the three months ended September 30, 2007. This reflects the impact of the interest rate cuts made by the Federal Reserve and the change in the mix of interest-bearing liabilities. The Bank's cost of funds, which includes both the cost of interest-bearing liabilities adjusted for the average balance of non-interest-bearing deposits, was 4.05% for the three months ended September 30, 2008, a 75 basis point reduction from the cost of funds of 4.80% for the three months ended September 30, 2007. This decrease reflects not only the impact of the interest rate cuts and the change in the mix of interest-bearing liabilities, but also the \$4.0 million (74.1%) increase in the Bank's non-interest-bearing deposits, primarily non-interest-bearing money market accounts.

The primary funding source for the \$60.4 million (72.6%) increase in the Bank's average loan balance for the three months ended September 30, 2008, as compared to the three months ended September 30, 2007, was the \$39.0 million (53.4%) increase in the average balance of time certificates of deposit for these three-month periods. The other source of funding for the increase in the average loan balance was the decrease in the average balance of overnight investments, interest-bearing deposits and investment securities of \$11.6 million, \$3.9 million and \$3.9 million, respectively. The average balance of time certificates of deposit reached \$112.0 million (68.5% of average interest-bearing liabilities) for the three months ended September 30, 2008, as compared to an average balance of time certificates of deposits of \$73.0 million (58.7% of average interest-bearing liabilities) for the three months ended September 30, 2007. The cost of these funds decreased 95 basis points, going from 5.46% for the three months ended September 30, 2007 to 4.51% for the three months ended September 30, 2008.

For the nine months ended September 30, 2008, the Bank's cost of interest-bearing liabilities was 4.59%, a 47 basis point reduction from the 5.06% cost of interest-bearing liabilities for the nine months ended September 30, 2007. This reflects the impact of the interest rate cuts made by the Federal Reserve and the change in the mix of interest-bearing liabilities. The Bank's cost of funds, which includes the cost of interest-bearing liabilities adjusted for the average balance of non-interest-bearing deposits, was 4.30% for the nine months ended September 30, 2008, a 51 basis point reduction from the cost of funds of 4.81% for the nine months ended September 30, 2007. This decrease reflects not only the impact of the interest rate cuts by the Federal Reserve and the change in the mix of interest-bearing liabilities, but also the \$5.4 million (108.8%) increase in the Bank's non-interest-bearing deposits, primarily non-interest-bearing money market accounts.

The primary funding source for the \$57.8 million (77.6%) increase in the Bank's average loan balance for the nine months ended September 30, 2008, as compared to the nine months

ended September 30, 2007, was the \$51.8 million (85.2%) increase in the average balance of time certificates of deposit for the nine-month periods. The average balance of time certificates of deposit reached \$112.6 million (71.4% of average interest-bearing liabilities) for the nine months ended September 30, 2008, as compared to an average volume of time certificates of deposits of \$60.8 million (62.2% of average interest-bearing liabilities) for the nine months ended September 30, 2007. The cost of these funds decreased 62 basis points, going from 5.44% for the nine months ended September 30, 2007 to 4.82% for the nine months ended September 30, 2008.

Average Balances, Yields and Rates

The following table presents average balance sheets (daily averages), interest income, interest expense, and the corresponding annualized rates on earning assets and rates paid on interest-bearing liabilities for the three months ended September 30, 2008 and 2007.

Distribution of Assets, Liabilities and Shareholders' Equity: Interest Rates and Interest Differential

	Three months ended September 30, 2008			Three months ended September 30, 2007			Fluctuations in Interest Income/ Expense Total
	Average Balance	Interest Income/ Expense	Average Rate	Average Balance	Interest Income/ Expense	Average Rate	
Interest-earning assets:							
Loans (1)	\$143,584,552	\$ 2,700,140	7.52%	\$ 83,200,680	\$ 1,754,601	8.44%	\$ 945,539
Interest-bearing deposits	8,710	108	4.96%	3,871,369	48,463	5.01%	(48,355)
Loans held for sale	4,287,637	62,077	5.79%	5,925,801	103,804	7.01%	(41,727)
Investments	36,176,483	495,431	5.48%	40,031,194	604,468	6.04%	(109,037)
Federal funds sold and overnight investments	7,670,010	40,685	2.12%	19,228,721	251,557	5.23%	(210,872)
Total interest-earning assets	191,727,392	3,298,441	6.88%	152,257,765	2,762,893	7.26%	535,548
Cash and due from banks	1,171,847			2,075,817			
Premise and equipment, net	757,894			832,825			
Allowance for loan losses	(1,713,689)			(873,262)			
Other	3,331,614			1,584,953			
Total Assets	<u>\$195,275,058</u>			<u>\$155,878,098</u>			
Interest-bearing liabilities							
Time deposits	\$112,041,442	\$ 1,262,688	4.51%	\$ 73,038,498	\$ 996,741	5.46%	\$ 265,947
Saving deposits	13,191,770	113,731	3.45%	12,173,087	126,979	4.17%	(13,248)
Money market and NOW	15,371,455	117,689	3.06%	18,862,392	208,219	4.42%	(90,530)
Repurchase agreements	23,000,000	265,650	4.62%	20,462,366	233,992	4.57%	31,658
Total interest-bearing liabilities	163,604,667	1,759,758	4.30%	124,536,343	1,565,931	5.03%	193,827
Noninterest-bearing deposits	10,082,725			6,054,345			
Accrued expenses and other liabilities	1,171,093			1,116,891			
Shareholders' equity	20,416,573			24,170,519			
Total liabilities and equity	<u>\$195,275,058</u>			<u>\$155,878,098</u>			
Net interest income		<u>\$ 1,538,683</u>			<u>\$ 1,196,962</u>		<u>\$ 341,721</u>
Interest spread			<u>2.58%</u>			<u>2.23%</u>	
Interest margin			<u>3.21%</u>			<u>3.14%</u>	

(1) Includes non-accruing loans

Changes in Assets and Liabilities and Fluctuations in Interest Rates

The following table summarizes the variance between interest income and interest expense for the three months ended September 30, 2008 and 2007, resulting from changes in the volume of average assets and liabilities and fluctuations in interest rates earned and paid. The changes in interest attributable to both rate and volume have been allocated to both rate and volume on a pro-rata basis.

	Three months ended September 30, 2008 versus 2007		
	Increase (Decrease)	Due to Change in Average	
		Volume	Rate
Interest-earning assets			
Loans	\$945,539	\$ 1,153,434	\$ (207,895)
Interest-bearing deposits	(48,355)	(48,054)	(301)
Loans held for sale	(41,727)	(25,637)	(16,090)
Investments	(109,037)	(55,451)	(53,586)
Federal funds sold and overnight investments	(210,872)	(106,016)	(104,856)
Total interest-earning assets	<u>535,548</u>	<u>918,276</u>	<u>(382,728)</u>
Interest-bearing liabilities			
Time deposits	265,947	462,358	(196,411)
Savings deposits	(13,248)	10,026	(23,274)
Money market and NOW	(90,530)	(34,090)	(56,440)
Repurchase agreements	31,658	29,288	2,370
Total interest-bearing liabilities	<u>193,827</u>	<u>467,582</u>	<u>(273,755)</u>
Net interest income	<u>\$341,721</u>	<u>\$ 450,694</u>	<u>\$ (108,973)</u>

Average Balances, Yields and Rates

The following table presents average balance sheets (daily averages), interest income, interest expense, and the corresponding annualized rates on earning assets and rates paid on interest-bearing liabilities for the nine months ended September 30, 2008 and 2007.

Distribution of Assets, Liabilities and Shareholders' Equity: Interest Rates and Interest Differential

	Nine months ended September 30, 2008			Nine months ended September 30, 2007			Fluctuations in Interest Income/ Expense Total
	Average Balance	Interest Income/ Expense	Average Rate	Average Balance	Interest Income/ Expense	Average Rate	
Interest-earning assets							
Loans (1)	\$132,216,954	\$ 7,538,544	7.60%	\$ 74,436,940	\$ 4,516,177	8.09%	\$ 3,022,367
Interest-bearing deposits	3,128,493	114,415	4.88%	1,292,347	48,463	5.00%	65,952
Loans held for sale	5,562,064	298,751	7.16%	3,446,892	178,723	6.91%	120,028
Investments	37,957,717	1,623,936	5.70%	21,878,809	970,065	5.91%	653,871
Federal funds sold and overnight investments	<u>9,238,364</u>	<u>178,647</u>	2.58%	<u>23,139,684</u>	<u>915,939</u>	5.28%	<u>(737,292)</u>
Total interest-earning assets	<u>188,103,592</u>	<u>9,754,293</u>	6.91%	<u>124,194,672</u>	<u>6,629,367</u>	7.12%	<u>3,124,926</u>
Cash and due from banks	1,537,867			2,804,399			
Premise and equipment, net	791,847			776,421			
Allowance for loan losses	(1,645,869)			(792,424)			
Other	<u>1,949,191</u>			<u>1,838,328</u>			
Total Assets	<u>\$190,736,628</u>			<u>\$128,821,396</u>			
Interest-bearing liabilities							
Time deposits	\$112,618,338	\$ 4,071,872	4.82%	\$ 60,799,391	\$ 2,481,542	5.44%	\$ 1,590,330
Saving deposits	12,048,060	335,018	3.71%	15,424,472	503,875	4.36%	(168,857)
Money market and NOW	10,169,451	232,945	3.05%	14,170,571	471,060	4.43%	(238,115)
Repurchase agreements	23,000,000	791,396	4.59%	7,394,265	252,370	4.55%	539,026
Line of Credit	<u>3,285</u>	<u>68</u>	2.76%	<u>-</u>	<u>-</u>	0.00%	<u>68</u>
Total interest-bearing liabilities	<u>157,839,134</u>	<u>5,431,299</u>	4.59%	<u>97,788,699</u>	<u>3,708,847</u>	5.06%	<u>1,722,452</u>
Noninterest-bearing deposits	10,378,887			4,971,172			
Accrued expenses and other liabilities	1,213,629			973,107			
Shareholders' equity	<u>21,304,978</u>			<u>25,088,418</u>			
Total liabilities and equity	<u>\$190,736,628</u>			<u>\$128,821,396</u>			
Net interest income		<u>\$ 4,322,994</u>			<u>\$ 2,920,520</u>		<u>\$ 1,402,474</u>
Interest spread			<u>2.32%</u>			<u>2.06%</u>	
Interest margin			<u>3.06%</u>			<u>3.14%</u>	

(1) Includes non-accruing loans

Changes in Assets and Liabilities and Fluctuations in Interest Rates

The following table summarizes the variance between interest income and interest expense for the nine months ended September 30, 2008, and September 30, 2007, resulting from changes in the volume of average assets and liabilities and fluctuations in interest rates earned and paid. The changes in interest attributable to both rate and volume have been allocated to both rate and volume on a pro-rata basis.

	Nine months ended September 30, 2008, versus 2007		
	Increase (Decrease)	Due to Change in Average	
		Volume	Rate
Interest-earning assets			
Loans	\$ 3,022,367	\$ 3,309,620	\$ (287,253)
Interest-bearing deposits	65,952	67,181	(1,229)
Loans held for sale	120,028	113,393	6,635
Investments	653,871	689,039	(35,168)
Federal funds sold and overnight investments	(737,292)	(398,240)	(339,052)
Total interest-earning assets	<u>3,124,926</u>	<u>3,780,993</u>	<u>(656,067)</u>
Interest-bearing liabilities			
Time deposits	1,590,330	1,902,099	(311,769)
Savings deposits	(168,857)	(100,528)	(68,329)
Money market and NOW	(238,115)	(113,324)	(124,791)
Repurchase agreements	539,026	536,954	2,072
Line of Credit	68	68	-
Total interest-bearing liabilities	<u>1,722,452</u>	<u>2,225,269</u>	<u>(502,817)</u>
Net interest income	<u>\$ 1,402,474</u>	<u>\$ 1,555,724</u>	<u>\$ (153,250)</u>

Provision for Loan Losses

The provision for loan losses for the three months ended September 30, 2008 was \$185,030 compared to \$212,000 for the three months ended September 30, 2007. The provision for loan losses for the nine months ended September 30, 2008 was \$724,386 compared to \$275,000 for the nine months ended September 30, 2007. The provision for the three- and nine-month periods ended September 30, 2008 primarily reflects the loan growth experienced for those periods and the \$139,000 of specific reserve for one non-accrual loan. The amount charged to the provision represents the amount considered necessary by management to maintain an adequate allowance for loan losses based on management's analysis of loan risk ratings and other factors.

The allowance for loan losses totaled \$1,862,000 or 1.24% of total gross loans as of September 30, 2008, and \$1,421,000 or 1.33% of total gross loans as of December 31, 2007. The decrease in the percentage of the allowance for loans losses to total gross loans from December 31, 2007 to September 30, 2008, primarily reflects the impact of the charge-off in the amount of \$229,000 on one loan, resulting from the write-down to estimated fair value of the loan's underlying collateral which was obtained in satisfaction of the loan balance through foreclosure proceedings in June 2008.

Noninterest income

Noninterest income was \$127,000 and \$213,000 for the three months ended September 30, 2008 and 2007, respectively. This \$86,000 decrease in noninterest income primarily reflects a \$97,000 reduction in gains on sales of loans, which was partially offset by \$86,000 of gains recognized on the sales of investments during the three months ended September 30, 2008, as compared to no such gains being recognized on the sales of investments during the three months ended September 30, 2007. For the three months ended September 30, 2008, gains on sales of loans were \$8,000 compared to \$105,000 for the three months ended September 30, 2007. The reduction in gains on sales of loans reflects a combination of the changes in the mortgage market in general over the last several months, and the Bank's new focus on traditional commercial banking.

For the nine months ended September 30, 2008 and 2007, noninterest income was \$638,000 and \$621,000, respectively. The primary cause of the \$17,000 increase in noninterest income in comparing the nine-month periods was the recognition of \$401,000 of gains on the sales of investments as compared to no such gains recognized in 2007. Partially offsetting the gains on the sales of investments were reduced gains on sales of loans and lower fee income from the brokering of loans of \$359,000 and \$31,000, respectively. The decrease in gains on loan sales and the lower level of fee income from the brokering of loans reflects a combination of the changes in the mortgage market in general over the last several months, and the Bank's new focus on traditional commercial banking.

Noninterest expense

Total noninterest expense was \$1,599,000 for the three months ended September 30, 2008, versus \$2,041,000 for the same period of 2007, a decrease of \$442,000 (21.7%). The primary contributors to the overall expense reduction were decreases in salaries and benefits, commissions, legal and professional fees of \$205,000, \$210,000, \$96,000 and \$56,000, respectively.

Salaries and employee benefits expense was \$591,000 for the three months ended September 30, 2008, compared to the \$796,000 incurred during the three months ended September 30, 2007. The \$205,000 (25.7%) decrease in salaries and employee benefits expense primarily reflects the decrease in full-time-equivalent employees from 43 as of September 30, 2007 to 35 (26 salaried employees and 9 non-salaried loan officers) as of September 30, 2008.

Commissions earned by loan representatives for loan closings decreased \$210,000 to \$61,000 for the three months ended September 30, 2008, as compared to \$271,000 for the three months ended September 30, 2007. The decrease in commissions expense primarily resulted from management's continuing efforts to reduce costs by focusing on more traditional commercial banking. Legal expense was \$96,000 (46.5%) less for the three months ended September 30, 2008, as compared to the same period in 2007, as a result of a lower level of legal expense related to regulatory issues in 2008, as compared to 2007. Professional fees were also \$56,000 (21.2%) lower during the three months ended September 30, 2008, as compared to the three months ended September 30, 2007, principally due to the expenses in 2007 related to the implementation of Sarbanes – Oxley.

Partially offsetting the reductions noted were increases in occupancy and equipment expense, FDIC insurance, occupancy and other real estate owned (“*OREO*”) expense of \$20,000, \$68,000 and \$42,000, respectively. FDIC insurance increased \$68,000 (323.0%), from \$21,000 for the three months ended September 30, 2007 to \$89,000 for the three months ended September 30, 2008, which was attributable to both increased levels of deposits and higher insurance rates. Occupancy and equipment expense increased \$20,000 (11.9%) from \$172,000 during the three months ended September 30, 2007 to \$192,000 during the three months ended September 30, 2008. The primary causes of the overall increase in occupancy and equipment expense were increased rent and property taxes related to the branch facility located at 601 North Main Street, Port Chester, NY. The expense increase of \$42,000 in other real estate owned expense relates to one property taken by foreclosure in 2008 compared to no such properties and related expense occurring in 2007.

Total noninterest expense was \$5,484,000 for the nine months ended September 30, 2008, versus \$6,105,000 for the same period of 2007, a decrease of \$621,000 (10.2%). This decrease reflects management’s continuing efforts to reduce costs by focusing on more traditional commercial banking as evidenced by the reductions of \$669,000 in salaries and employee benefits, \$228,000 in commissions, \$144,000 in advertising, and \$74,000 in contract services. Partially offsetting the reductions noted were increases in occupancy expense, FDIC insurance and *OREO* expense of \$108,000, \$266,000 and \$111,000, respectively.

Salaries and benefit expense was \$2,036,000 for the nine months ended September 30, 2008, compared to \$2,705,000 for the nine months ended September 30, 2007. The \$669,000 (24.7%) decrease in salaries and benefits expense primarily reflects a \$438,000 (20.1%) reduction in salaries, which represents the decrease in full-time-equivalent employees from 43 as of September 30, 2007 to 35 as of September 30, 2008. These staff reductions reflect management’s efforts to reduce expenses as outlined in the Bank’s strategic plan. The Bank also reduced sign-on bonuses paid to loan representatives. Such bonuses have almost been eliminated in 2008, which reflects the Bank’s effort to focus on traditional commercial banking. Such bonuses were \$7,000 during the nine months ended September 30, 2008, down \$196,000 (96.6%) from \$203,000 which was incurred during the nine months ended September 30, 2007.

The other significant expense reductions when comparing the nine months ended September 30, 2008 to the nine months ended September 30, 2007 were decreases in commissions expense, advertising and contract services of \$227,000, \$144,000 and \$74,000, respectively. The \$227,000 (47.4%) reduction in commissions from \$480,000 to \$253,000 reflects the Bank’s focus on traditional commercial banking and its move away from the origination and sale of loans. The \$144,000 (56.5%) reduction in advertising expense from \$255,000 to \$111,000 reflects a shift to print and radio media in 2008, versus print and cable television media which was used in 2007 for the generation of loans and deposits, when the Bank was initially introducing itself to the local market. The \$74,000 reduction in contract services from \$223,000 to \$149,000 was primarily due to reduced costs related to the origination and sale of loans, including a payment of \$40,000 for a finder’s fee in 2007, with no comparable expenditure in 2008.

Partially offsetting the reduction in expenses noted were increases in occupancy, FDIC insurance and expenses related to other real estate owned of \$108,000, \$266,000 and \$111,000,

respectively. Occupancy and equipment expense was \$604,000 for the nine months ended September 30, 2008, an increase of \$108,000 (21.7%) compared to the \$496,000 incurred for the nine months ended September 30, 2007. The primary cause of the increase in occupancy and equipment expense for the nine-month periods was the increase in rent expense and real estate taxes as a result of the relocation of the Bank's main branch facility to 601 North Main Street, Port Chester, NY, from the previous location at 211 Irving Avenue, Port Chester, NY. The increase also reflects the annual common area maintenance assessment for the Bank's administrative offices at 800 Westchester Avenue, Rye Brook, NY. The \$266,000 (431.2%) increase in FDIC insurance from \$61,000 for the nine months ended September 30, 2007 to \$327,000 for the nine months ended September 30, 2008, attributable to increased deposits and insurance rates. The \$111,000 increase in other real estate owned expenses, mainly property real estate taxes of \$84,365, legal fees of \$8,035, and insurance of \$5,951, relates to one property which was taken by foreclosure in 2008 compared to no such expenses in 2007, since there were no foreclosures during the nine months ended September 30, 2007.

Loss on Average Equity and Average Assets

The loss on average equity for the three months and nine months ended September 30, 2008, was (2.32)% and (7.81%), respectively. The loss on average equity for the three months and nine months ended September 30, 2007, was (14.0)% and (15.1%), respectively. The loss on average assets for the three months and nine months ended September 30, 2008, was (0.24)% and (0.87%), respectively. The loss on average assets for the three months and nine months ended September 30, 2007, was (2.2)% and (2.9)%, respectively.

Liquidity

The liquidity ratio is defined as the percentage of liquid assets to total assets. The following categories of assets in the accompanying balance sheet are considered liquid assets: cash and due from banks; federal funds sold and overnight investments; interest-bearing deposits; available for sale securities (which have not been pledged to secure municipal deposits or repurchase agreements); and loans held for sale. Liquidity is a measure of the Bank's ability to generate adequate cash to meet financial obligations. The principal cash requirements of a financial institution are to cover downward fluctuations in deposits and increases in its loan portfolio. Additional liquidity is also provided by the Bank's lines of credit. The Bank has in place two secured lines of credit with correspondent banks. One is a \$5.0 million overnight secured line of credit with a correspondent bank and the other is a \$1.0 million secured line of credit with the Federal Reserve Bank of New York to meet daily needs. On June 30, 2008, the Bank borrowed \$900,000 on the line of credit with the Federal Reserve Bank and it was repaid on July 1, 2008.

Management believes that the Bank's short-term assets provide excess liquidity with liquid assets of approximately \$17.0 million (8.7% of total assets) at September 30, 2008, and \$28.3 million (16.7% of total assets) at December 31, 2007. The existing excess liquidity at September 30, 2008, will be used to fund new loans for both portfolio and sale, as well as to meet potential fluctuations in deposits. The Bank has been funding loans at higher rates than liquid assets. Therefore the liquidity ratio has been reduced to below the targeted level of approximately 10% of total assets at September 30, 2008.

Capital

As of December 31, 2007, the most recent notification from the FDIC and the NY Banking Department categorized the Bank as “well capitalized” under the regulatory framework for prompt corrective action. To be categorized as “well capitalized,” the Bank must maintain total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events that have occurred since then that management believes have changed the Bank’s categorization. The Bank currently has no plans to raise additional capital.

The following table illustrates the Bank’s regulatory capital ratios as of the dates indicated:

	<u>September 30, 2008</u>		<u>December 31, 2007</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
	(Dollars in thousands)			
Total Capital to Risk-Weighted Assets	\$22,897	13.92%	\$ 23,704	18.21%
Tier 1 Capital to Risk-Weighted Assets	\$21,035	12.78%	\$ 22,283	17.12%
Tier 1 (Leverage) Capital to Average Assets	\$21,035	10.77%	\$ 22,283	13.21%

Capital adequacy is one of the most important factors used to determine the safety and soundness of individual banks. Based on the above ratios, the Bank meets the quantitative guidelines to be considered “well capitalized” under applicable regulations. To be considered “well capitalized,” an institution must generally have a leverage capital ratio of at least 5%, a Tier 1 risk-based capital ratio of at least 6%, and a total risk-based ratio of at least 10%.

Market Risk

Market risk is defined as the sensitivity of income to fluctuations in interest rates, foreign exchange rates, equity prices, commodity prices and other market-driven rates or prices. Based on the nature of the Bank’s business, market risk is primarily limited to interest rate risk, defined as the impact of changing interest rates on current and future earnings.

The Bank’s goal is to maximize long-term profitability while minimizing its exposure to interest rate fluctuations. The first priority is to structure and price the Bank’s assets and liabilities to maintain an acceptable interest rate spread, while reducing the net effect of changes in interest rates. In order to reach an acceptable interest rate spread, the Bank must generate loans and seek acceptable long-term investments to replace lower-yielding balances in Federal funds sold. The focus also must be on maintaining a proper balance between the timing and volume of assets and liabilities re-pricing within the balance sheet. One method of achieving this balance is to originate variable rate loans for the portfolio to offset the short-term re-pricing of the liabilities. In fact, a number of interest-bearing deposit products have no contractual maturity. Customers may withdraw funds from their accounts at any time; deposit balances may therefore run off unexpectedly due to changing market conditions.

The exposure to interest rate risk is monitored by the Bank’s Senior Management and is reported to the Bank’s Asset and Liability Management Committee on a quarterly basis. Management reviews the interrelationships within the balance sheet to maximize net interest income within acceptable levels of risk.

Impact of Inflation and Changing Prices

The Bank's consolidated financial statements have been prepared in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation. Unlike most individual companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effect of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. Notwithstanding this fact, inflation can directly affect the value of loan collateral, in particular, real estate. Inflation, or disinflation, could significantly affect the Bank's earnings in future periods.

“Safe Harbor” Statement Under Private Securities Litigation Reform Act of 1995

Some of the statements under “Management's Discussion and Analysis of Financial Condition and Results of Operations” and elsewhere in this Report on Form 10-Q may include forward-looking statements which reflect our current views with respect to future events and financial performance. Statements which include the words “expect,” “intend,” “plan,” “believe,” “project,” “anticipate” and similar statements of future or forward-looking nature identify forward-looking statements for purposes of the federal securities laws or otherwise. All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in these statements or that could adversely affect the holders of our common stock. These factors include, but are not limited to, (1) changes in prevailing interest rates that would affect the interest earned on the Bank's interest-earning assets and interest paid on its interest-bearing liabilities, (2) the timing of re-pricing of the Bank's interest-earning assets and interest-bearing liabilities, (3) the effect of changes in governmental monetary policy, (4) the effect of changes in regulations applicable to the Bank and the conduct of its business, (5) changes in competition among financial service companies, including possible further encroachment of non-banks on services traditionally provided by banks and the impact of recently enacted federal legislation, (6) the ability of competitors which are larger than the Bank to provide products and services that are impractical for the Bank to provide, (7) the volatility of quarterly earnings, due in part to the variation in number, dollar volume, and profit realized from the brokering and sale of loans held for sale in different quarters, (8) the effect of the loss of any executive officer, key personnel, or director, (9) the effect of the Bank's opening branches and the receipt of regulatory approval to complete such actions, (10) the concentration of the Bank's business in its market area, (11) the concentration of the Bank's loan portfolio in commercial loans to small- and medium-sized businesses, which may be affected more severely than larger businesses during periods of economic weaknesses, and (12) the lack of seasoning in the Bank's loan portfolio, which may increase risk for future credit defaults. Other such factors may be described in other filings made by the Bank with the FDIC.

Although the Bank believes that it both offers the loan and deposit products and has the resources needed for success, future revenues and interest spreads and yields cannot be reliably predicted. These trends may cause the Bank to adjust its operations in the future. Because of the foregoing and other factors, recent results should not be considered reliable indicators of future financial results.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Bank is a “smaller reporting company” and, accordingly, is not required to provide the information required by this Item.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Based on an evaluation of the Bank’s disclosure controls and procedures performed by its Chief Executive Officer and its Chief Financial Officer as of the end of the period covered by this report, the Bank’s Chief Executive Officer and its Chief Financial Officer concluded that the Bank’s disclosure controls and procedures have been effective during the period covered by this report.

As used herein, “disclosure controls and procedures” means controls and other procedures of the Bank that are designed to ensure that information required to be disclosed by the Bank in the reports it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the applicable rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Bank in the reports it files or submits under the Securities Exchange Act is accumulated and communicated to the Bank’s management, including its principal executive officer or officers and its principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in Internal Control over Financial Reporting

There have not been any material changes in the Bank’s internal controls over financial reporting or in other factors that occurred during the quarter ended September 30, 2008, that have materially affected or are reasonably likely to materially affect the Bank’s internal control over financial reporting.

Item 4T. Controls and Procedures

Not applicable.

**PART II
OTHER INFORMATION**

Item 1. Legal Proceedings

The information contained in Note 15 to the financial statements under “Legal Proceedings” included herein is hereby incorporated in response to this Item 1.

Item 1A. Risk Factors

Not applicable.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the quarter ended September 30, 2008, the Bank had no unregistered sales of securities nor did it repurchase any of its Common Stock.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

Exhibit No.	Description
31.1	Certification by Chief Executive Officer Pursuant to Rule 13a-14.
31.2	Certification by Chief Financial Officer Pursuant to Rule 13a-14.
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.

SIGNATURES

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

USA Bank

Date: November 13, 2008

/s/ Ronald J. Gentile

Name: Ronald J. Gentile
President and Chief Executive Officer

Date: November 13, 2008

/s/ Paul V. Erwin

Name: Paul V. Erwin
Senior Vice President, Chief Financial Officer
and Secretary

**CERTIFICATION
BY PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO RULE 13a-14**

I, Ronald J. Gentile, certify that:

1. I have reviewed this quarterly report on Form 10-Q of USA Bank;
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 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 reliability of financial reporting and the preparation of consolidated 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 (the registrant's fourth fiscal quarter in the case of an annual report) 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 the registrant's board of directors (or persons performing the equivalent functions):
- (a) 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
 - (b) 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.

/s/ Ronald J. Gentile

Name: Ronald J. Gentile
President and Chief Executive Officer
(Principal executive officer)

Date: November 13, 2008

**CERTIFICATION
BY PRINCIPAL FINANCIAL OFFICER
PURSUANT TO RULE 13a-14**

I, Paul V. Erwin, certify that:

1. I have reviewed this quarterly report on Form 10-Q of USA Bank;
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 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 reliability of financial reporting and the preparation of consolidated 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 (the registrant's fourth fiscal quarter in the case of an annual report) 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 the registrant's board of directors (or persons performing the equivalent functions):
- (a) 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
 - (b) 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.

/s/ Paul V. Erwin

Name: Paul V. Erwin
Senior Vice President, Chief Financial Officer,
and Secretary
(Principal financial officer)

Date: November 13, 2008

CERTIFICATION 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 USA BANK (the “*Bank*”) on Form 10-Q for the period ended September 30, 2008, as transmitted for filing with the Federal Deposit Insurance Corporation on the date hereof (the “*Report*”), I, Ronald J. Gentile, the Chief Executive Officer of the Bank, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 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; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Bank.

Date: November 13, 2008

/s/ Ronald J. Gentile

Name: Ronald J. Gentile

President and Chief Executive Officer

CERTIFICATION 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 USA BANK (the “*Bank*”) on Form 10-Q for the period ended September 30, 2008, as transmitted for filing with the Federal Deposit Insurance Corporation on the date hereof (the “*Report*”), I, Paul V. Erwin, the Chief Financial Officer of the Bank, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 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; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Bank.

Date: November 13, 2008

/s/ Paul V. Erwin

Name: Paul V. Erwin
Senior Vice President, Chief Financial Officer
and Secretary