BERKSHIRE BANCORP INC /DE/
Form 10-Q
November 14, 2012

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended **September 30, 2012**

or

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

For the transition period from ________________ to_________________

Commission file number: 0-13649

BERKSHIRE BANCORP INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**94-2563513**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
160 Broadway, New York, New York	**10038**
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone Number, Including Area Code: **(212) 791-5362**

N/A
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

As of November 12, 2012, there were 14,416,198 outstanding shares of the issuer's Common Stock, $.10 par value.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES

FORWARD-LOOKING STATEMENTS

Forward-Looking Statements. *Statements in this Quarterly Report on Form 10-Q that are not based on historical fact may be "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "believe", "may", "will", "expect", "estimate", "anticipate", "continue" or similar terms identify forward-looking statements. A wide variety of factors could cause the actual results and experiences of Berkshire Bancorp Inc. (the "Company") to differ materially from the results expressed or implied by the Company's forward-looking statements. Some of the risks and uncertainties that may affect operations, performance, results of the Company's business, the interest rate sensitivity of its assets and liabilities, and the adequacy of its loan loss allowance, include, but are not limited to: (i) deterioration in local, regional, national or global economic conditions which could result, among other things, in an increase in loan delinquencies, a decrease in property values, or a change in the housing turnover rate; (ii) changes in market interest rates or changes in the speed at which market interest rates change; (iii) changes in laws and regulations affecting the financial services industry; (iv) changes in competition; (v) changes in consumer preferences; (vi) changes in banking technology; (vii) ability to maintain key members of management; (viii) possible disruptions in the Company's operations at its banking facilities; (ix) cost of compliance with new corporate governance requirements, rules and regulations; (x) the potential impact on our operations and customers resulting from natural or man-made disasters, including the potential impact of Hurricane Sandy; and other factors referred to in this Quarterly Report and in Item 1A, "Risk Factors", of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2011.*

Certain information customarily disclosed by financial institutions, such as estimates of interest rate sensitivity and the adequacy of the loan loss allowance, are inherently forward-looking statements because, by their nature, they represent attempts to estimate what will occur in the future.

The Company cautions readers not to place undue reliance upon any forward-looking statement contained in this Quarterly Report. Forward-looking statements speak only as of the date they were made and the Company assumes no obligation to update or revise any such statements upon any change in applicable circumstances.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
QUARTERLY REPORT ON FORM 10-Q

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BERKSHIRE BANCORP INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands, Except Share Data)
(unaudited)

	September 30, 2012	December 31, 2011
ASSETS		
Cash and due from banks	$ 5,260	$ 12,105
Interest bearing deposits	100,019	88,931
Total cash and cash equivalents	105,279	101,036
Investment Securities:		
Available-for-sale	398,679	415,170
Held-to-maturity, fair value of $274 in 2012 and $293 in 2011	281	298
Total investment securities	398,960	415,468
Loans, net of unearned income	308,900	317,021
Less: allowance for loan losses	(13,525)	(17,720)
Net loans	295,375	299,301
Accrued interest receivable	3,414	3,224
Premises and equipment, net	7,241	7,474
Other assets	37,002	35,626
Total assets	$ 847,271	$ 862,129
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Non-interest bearing	$ 78,823	$ 74,073
Interest bearing	572,171	584,819
Total deposits	650,994	658,892
Securities sold under agreements to repurchase	50,000	50,000
Borrowings	2,672	6,139
Subordinated debt	7,217	22,681
Accrued interest payable	1,722	6,996
Other liabilities	2,259	1,893
Total liabilities	714,864	746,601
Stockholders' equity		
Preferred stock - $.01 Par value: 2,000,000 shares authorized - none issued		
Common stock - $.10 par value Authorized — 25,000,000 shares Issued — 14,416,198 shares Outstanding — September 30, 2012, 14,416,198 shares December 31, 2011, 14,443,183 shares	1,442	1,444
Additional paid-in capital	143,903	143,900
Accumulated Deficit	(10,636)	(19,299)
Accumulated other comprehensive loss, net	(2,302)	(10,517)
Total stockholders' equity	132,407	115,528
Total liabilities and stockholders' equity	$ 847,271	$ 862,129

The accompanying notes are an integral part of these statements

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BERKSHIRE BANCORP INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars In Thousands, Except Per Share Data)
(unaudited)

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2012	2011	2012	2011
INTEREST INCOME				
Loans, including related fees	$ 4,658	$ 5,229	$ 14,445	$ 16,406
Investment securities	2,406	3,240	7,143	9,901
Interest bearing deposits	59	65	243	199
Total interest income	7,123	8,534	21,831	26,506
INTEREST EXPENSE				
Deposits	1,144	1,503	3,544	4,612
Securities sold under agreements to repurchase	446	481	1,337	1,475
Interest expense on borrowings	69	240	410	752
Total interest expense	1,659	2,224	5,291	6,839
Net interest income	5,464	6,310	16,540	19,667
PROVISION FOR LOAN LOSSES	(4,193)	—	(4,193)	1,600
Net interest income after provision for loan losses	9,657	6,310	20,733	18,067
NON-INTEREST INCOME				
Service charges on deposit accounts	110	127	344	364
Investment securities gains	61	1,100	169	963
Other income	595	82	897	43,246
Total non-interest income	766	1,309	1,410	44,573
NON-INTEREST EXPENSE				
Salaries and employee benefits	2,263	2,243	7,123	7,077
Net occupancy expense	567	921	1,728	1,986
Equipment expense	86	76	252	236
FDIC assessment	300	300	900	952
Data processing expense	112	74	336	335
Other	652	728	1,984	2,475
Total non-interest expense	3,980	4,342	12,323	13,061
Income before provision for taxes	6,443	3,277	9,820	49,579
Provision for income taxes	3,260	281	1,157	2,374
Net income	$ 3,183	$ 2,996	$ 8,663	$ 47,205
Dividends on preferred stock	—	1,200	—	3,600
Income (loss) allocated to common stockholders	$ 3,183	$ 1,796	$ 8,663	$ 43,605
Net income (loss) per common share:				
Basic	$ .22	$ .25	$ .60	$ 6.18
Diluted	$ .22	$ .25	$ .60	$ 6.18

Number of shares used to compute net income (loss) per common share:

Basic	14,416	7,054	14,416	7,054
Diluted	14,416	7,054	14,416	7,054

The accompanying notes are an integral part of these statements.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)
(unaudited)

	For The Nine Months Ended September 30,	
	2012	2011
Net earnings	$ 8,663	$ 47,205
Other comprehensive income, net of tax:		
Unrealized gains (losses) on available- for-sale securities, net of taxes (benefits) of $5,409 and ($1,203), in 2012 and 2011, respectively	8,114	(1,805)
Reclassification adjustment for realized gains (losses) included in net earnings, net of taxes of $68 and $385, in 2012 and 2011, respectively	101	578
Comprehensive income	$ 16,878	$ 45,978

The accompanying notes are an integral part of these statements

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For The Nine Months Ended September 30, 2012 and 2011
(Dollars In Thousands, Except Share Data)
(Unaudited)

	Common Shares	**Preferred Shares**	**Common Stock Par Value**	**Preferred Stock Par Value**	**Additional paid-in capital**	**Accumulated other comprehensive (loss), net**	**Retained Earnings/ (Accumulated deficit)**	**Treasury stock**	**Comprehensive income (loss)**	**Total stockholders' equity**
Balance at December 31, 2010	7,698	60	$770	$1	$150,985	$(8,589)	$(65,123)	$(6,411)		$71,633
Net income							47,205		47,205	47,205
Other comprehensive loss netof taxes						(1,227)			(1,227)	(1,227)
Comprehensive income									$45,978	
Cash dividends - Preferred Stock							(3,600)			(3,600)
Balance at September 30, 2011	7,698	60	$770	$1	$150,985	$(9,816)	$(21,518)	$(6,411)		$114,011
Balance at December 31, 2011	14,443	—	$1,444	$—	$143,900	$(10,517)	$(19,299)	$—		$115,528
Net income							8,663		8,663	8,663
Other comprehensive income netof taxes						8,215			8,215	8,215
Comprehensive income									$16,878	
Adjustment	(27)		(2)		3					1
Balance at September 30, 2012	14,416	—	$1,442	$—	$143,903	$(2,302)	$(10,636)	$—		$132,407

The accompanying notes are an integral part of these statements.

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BERKSHIRE BANCORP INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	For The Nine Months Ended September 30,	
	2012	2011
Cash flows from operating activities:		
Net income	$ 8,663	$ 47,205
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Realized gains on investment securities	(169)	(963)
Net amortization of premiums of investment securities	1,833	838
Depreciation and amortization	373	352
Provision for loan losses	(4,193)	1,600
(Increase) decrease in accrued interest receivable	(190)	303
(Increase) decrease in other assets	(1,376)	11,857
(Decrease) increase in accrued interest payable and other liabilities	(4,908)	2
Net cash provided by operating activities	33	61,194
Cash flows from investing activities:		
Investment securities available for sale		
Purchases	(382,025)	(385,431)
Sales, maturities and calls	405,068	319,758
Investment securities held to maturity		
Maturities	17	15
Net decrease in loans	8,119	35,299
(Acquisition) sale of premises and equipment	(140)	216
Net cash provided by (used in) investing activities	31,039	(30,143)
Cash flows from financing activities:		
Net increase in non interest bearing deposits	4,750	4,648
Net decrease in interest bearing deposits	(12,648)	(24,547)
Repayment of borrowings	(18,931)	(3,372)
Net cash (used in) financing activities	(26,829)	(23,271)
Net increase in cash and cash equivalents	4,243	7,780
Cash and cash equivalents at beginning of period	101,036	79,117
Cash and cash equivalents at end of period	$ 105,279	$ 86,897
Supplemental disclosure of cash flow information:		
Cash used to pay interest	$ 10,565	$ 6,536
Cash used to pay income taxes, net of refunds	$ (2)	$ (2,810)
Schedule of non-cash financing activities:		
Dividends declared and not paid	$ —	$ 3,600

The accompanying notes are an integral part of these statements.

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BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
September 30, 2012 and 2011
(unaudited)

Note 1. General

Berkshire Bancorp Inc., a Delaware corporation, is a bank holding company registered under the Bank Holding Company Act of 1956. References herein to "Berkshire", the "Company" or "we" and similar pronouns, shall be deemed to refer to Berkshire Bancorp Inc. and its wholly-owned consolidated subsidiaries unless the context otherwise requires. Berkshire's principal activity is the ownership and management of its indirect wholly-owned subsidiary, The Berkshire Bank (the "Bank"), a New York State chartered commercial bank. The Bank is owned through Berkshire's wholly-owned subsidiary, Greater American Finance Group, Inc. ("GAFG").

The accompanying financial statements of Berkshire Bancorp Inc. and subsidiaries include the accounts of the parent company, Berkshire Bancorp Inc., and its wholly-owned subsidiaries: The Berkshire Bank, GAFG and East 39, LLC.

We have prepared the accompanying consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") for interim financial reporting. These consolidated financial statements, including the notes thereto, are unaudited and, in our opinion, include all adjustments, consisting of normal recurring adjustments and accruals, necessary for a fair presentation of our consolidated balance sheets, operating results, and cash flows for the periods presented. Operating results for the periods presented are not necessarily indicative of the results that may be expected for the remaining quarters of fiscal 2012 due to a variety of factors. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP") have been omitted in accordance with the rules and regulations of the SEC. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company's 2011 Annual Report on Form 10-K.

Subordinated Debt

In April 2012, we received a notice from the Federal Reserve Bank of New York stating that they do not object to the Company's request to redeem $15.5 million of Floating Rate Junior Subordinated Debt Securities Due 2034. On July 23, 2012, we redeemed said security, including accrued interest.

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BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 2. Earnings Per Share

Basic earnings per common share is calculated by dividing income available to common stockholders by the weighted average common stock outstanding, excluding stock options from the calculation. As of and for the nine-month periods ended September 30, 2012 and 2011, there were no potential dilutive shares. The following tables present the Company's calculation of income per common share:

	For The Three Months Ended					
	September 30, 2012			September 30, 2011		
	Income (numerator)	Shares (denominator)	Per share amount	Income (numerator)	Shares (denominator)	Per share amount
	(In thousands, except per share data)					
Basic earnings per common share						
Net income	$3,183			$2,996		
Dividends paid to preferred shareholders	—			(1,200)		
Net income available to common stockholders	$3,183	14,416	$ .22	$1,796	7,054	$ .25

	For The Nine Months Ended					
	September 30, 2012			September 30, 2011		
	Income (numerator)	Shares (denominator)	Per share amount	Income (numerator)	Shares (denominator)	Per share amount
	(In thousands, except per share data)					
Basic earnings (loss) per common share						
Net income (loss)	$8,663			$47,205		
Dividends paid to preferred shareholders	—			(3,600)		
Net income (loss) available to common stockholders	$8,663	14,416	$ .60	$43,605	7,054	$ 6.18

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BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 3. Income Taxes

The tax effect of the principal temporary differences at September 30, 2012 and December 31, 2011 are as follows:

	September 30, 2012	December 31, 2011
	(In thousands)	
Net deferred tax assets		
Loan loss provision	$ 6,089	$ 7,992
Depreciation	(823)	(303)
Non accrual interest	128	104
Net operating loss	7,324	9,483
Other	789	402
Other than temporary impairment	—	425
Valuation reserve	—	(3,912)
Unrealized loss on investment securities	5,477	6,445
Net deferred tax assets included in other assets	$ 18,984	$ 20,636

As of September 30, 2012 and December 31, 2011, the Company had $20.1 million and $24.4 million, respectively, of net operating losses ("NOL's") available to offset future taxable income for federal income tax purposes. The NOL's will begin to expire in 2029.

For the fiscal year ended December 31, 2011, the Company recorded a valuation reserve of $3.9 million relating primarily to NOL's. During the six months ended June 30, 2012, the valuation reserve was released due to additional current earnings and the expectation that we will recognize the remaining benefit of the NOL's within the next few years. Of the remaining deferred tax asset, management has determined that it is more likely than not that we will realize the net deferred tax asset based upon the nature and timing of the items referred to above. In order to fully realize the net deferred tax asset, the Company will need to generate future taxable income. Management has projected that the Company will generate sufficient taxable income to utilize the net deferred tax asset. However, there can be no assurance that such levels of taxable income will be generated.

In the normal course of business, the Company's Federal, New York State and New York City Corporation tax returns are subject to audit. The Company is currently open to audit by the Internal Revenue Service (the "IRS") under the statute of limitations for years after 2008. The Company is currently undergoing an examination by the IRS for the years 2008 and 2009. This examination has not yet been completed, however, no significant issues have been raised and we do not expect material adjustments.

The Company has performed an evaluation of its tax positions and has concluded that as of September 30, 2012 and December 31, 2011, there were no significant uncertain tax positions requiring additional recognition in its financial statements and does not believe that there will be any material changes in its unrecognized tax positions over the next twelve months.

The Company's policy is to recognize interest and penalties related to unrecognized tax benefits as a component of income tax expense. There were no accruals for interest or penalties during the nine months ended September 30, 2012 or the year ended December 31, 2011.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 4. Loan Portfolio

The following table sets forth information concerning the Company's loan portfolio by type of loan at the dates indicated:

	September 30, 2012		December 31, 2011	
	Amount	**% of Total**	Amount	**% of Total**
	(Dollars in thousands)			
Commercial and Industrial and Finance Leases	$15,967	5.2 %	$15,660	4.9 %
Secured by Real Estate				
Residential	98,347	31.8	104,854	33.0
Multi family	14,593	4.7	12,169	3.8
Commercial Real Estate and Construction	178,516	57.6	183,819	57.9
Consumer	2,073	0.7	1,240	0.4
Total loans	309,496	100.0%	317,742	100.0 %
Deferred loan fees	(596)		(721)	
Allowance for loan losses	(13,525)		(17,720)	
Loans, net	$295,375		$299,301	

The Bank had $511,000 and $647,000 of non-accrual loans as of September 30, 2012 and December 31, 2011, respectively, and no loans delinquent more than ninety days and still accruing interest at both September 30, 2012 and December 31, 2011. The Bank did not foreclose on any loans during both the nine months ended September 30, 2012 and the year ended December 31, 2011. The Bank classified the non-accrual loans as impaired loans at both September 30, 2012 and December 31, 2011. However, no specific reserves for impaired loans was made because the collateral underlying the impaired loans was deemed to be sufficient to cover any loss in the event of a default. Therefore, the allowance for loan loss is includable in the calculation of regulatory capital up to a maximum of 125% of risk-weighted assets or approximately $4.8 million and $5.2 million at September 30, 2012 and December 31, 2011, respectively.

Average impaired loans for the three and nine months ended September 30, 2012 and the three and nine months ended September 30, 2011 were approximately $31.9 million and $27.4 million, respectively, and $22.8 million and $16.9 million, respectively. Interest income that would have been recognized had these loans performed in accordance with their contractual terms was $8,000 and $25,000 for the three and nine months ended September 30, 2012, respectively, and $6,000 and $9,000 for the three and nine months ended September 30, 2011, respectively.

The following table sets forth information concerning activity in the Company's allowance for loan losses for the indicated periods.

	For The Three Months Ended		For The Nine Months Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
	(In thousands)			
Balance at beginning of period	$17,718	$ 17,730	$ 17,720	$ 16,105
Provision charged to operations	(4,193)	—	(4,193)	1,600
Loans charge-offs	—	—	(2)	(2)
Recoveries	—	—	—	27
Balance at end of period	$13,525	$ 17,730	$ 13,525	$ 17,730

Allowance for Credit Losses and Recorded Investment in Financing Receivables

The qualitative factors are determined based on the various risk characteristics of each loan class. Relevant risk characteristics are as follows:

Commercial and industrial loans - Loans in this class are made to businesses. Generally these loans are secured by assets of the business and repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer and/or business spending will have an effect on the credit quality in this loan class.

Commercial real estate - Loans in this class include income-producing investment properties and owner-occupied real estate used for business purposes. The underlying properties are generally located largely in our primary market area. The cash flows of the income producing investment properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates, which in turn, will have an effect on credit quality. In the case of owner-occupied real estate used for business purposes a weakened economy and resultant decreased consumer and/or business spending will have an adverse effect on credit quality.

Construction loans - Loans in this class primarily include land loans to local individuals, contractors and developers for developing the land for sale or for the purpose of making improvements thereon. Repayment is derived from sale of the lots/units including any pre-sold units. Credit risk is affected by market conditions, time to sell at an adequate price and cost overruns. To a lesser extent this class includes commercial development projects we finance which in most cases have an interest-only phase during construction and then convert to permanent financing. Credit risk is affected by cost overruns, market conditions and the availability of permanent financing, to the extent such permanent financing is not being provided by us.

Residential real estate - Loans in this class are made to and secured by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this loan class. The Company generally does not originate loans with a loan-to-value ratio greater than 80 percent and does not grant subprime loans.

Multi-Family real estate - Loans in this class are made to and secured by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this loan class. The Company generally does not originate loans with a loan-to-value ratio greater than 80 percent and does not grant subprime loans.

Consumer loans - Loans in this class may be either secured or unsecured and repayment is dependent on the credit quality of the individual borrower and, if applicable, sale of the collateral securing the loan (such as automobile or other secured assets). Therefore the overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this loan class.

Financing Leases - Loans in this class may be either secured or unsecured and repayment is dependent on the credit quality of the individual borrower and, if applicable, sale of the collateral securing the loan (such as equipment or other secured assets). Therefore the overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this loan class.

BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Allowance for Credit Losses and Recorded Investment in Loans
For the Nine Months Ended September 30, 2012
(In thousands)

	Commercial & Industrial	**Commercial Real Estate**	Construction	Multi Family	**Residential Real Estate**	Consumer	**Finance Leases**	Unallocated	Total
Allowance for credit losses:									
Beginning balance	$ 950	$ 7,857	$ 609	$ 411	$ 6,490	$ 53	$ 126	$ 1,224	$ 17,720
Charge-offs	(2)								(2)
Recoveries									
Provision	(297)	(1,433)	512	82	(1,779)	29	(83)	(1,224)	(4,193)
Ending balance	$ 651	$ 6,424	$ 1,121	$ 493	$ 4,711	$ 82	$ 43	$ 0	$ 13,525
Ending balance: individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Ending balance: collectively evaluated for impairment	$ 651	$ 6,424	$ 1,121	$ 493	$ 4,711	$ 82	$ 43	$ 0	$ 13,525
Financing Receivables:									
Ending balance	$ 14,242	$ 157,750	$ 20,766	$ 14,593	$ 98,347	$ 2,073	$ 1,725	$ 0	$ 309,496
Ending balance: individually evaluated for impairment	$ 0	$ 17,583	$ 9,730	$ 0	$ 7,897	$ 0	$ 0	$ 0	$ 35,210
Ending balance: collectively evaluated for impairment	$ 14,242	$ 140,167	$ 11,036	$ 14,593	$ 90,450	$ 2,073	$ 1,725	$ 0	$ 274,286

The Company believes the reversal of the unallocated amount in the allowance for credit losses is appropriate given the nature of the portfolio, the size of individual loans, historical loss experience and the current economy's impact on the real estate market. The Company will continue to closely monitor the environment and loan portfolio and make adjustments when appropriate.

Among the loans reviewed for impairment, $2.4 million of residential loans and $1.3 million of commercial real estate loans were identified as troubled debt restructurings ("TDRs"). TDRs are the result of an economic concession being granted to borrowers experiencing financial difficulties. Certain TDRs are classified as nonperforming at the time of restructuring and may only return to performing status after considering the borrower's sustained repayment performance under the revised payment terms for a reasonable period, generally six months. We evaluated all of the impaired loans by analyzing the collateral value and by evaluating the discounted cash flow. Based on the nature of the modifications no impairment was required.

Allowance for Credit Losses and Recorded Investment in Loans
For the Year Ended December 31, 2011
(In thousands)

	Commercial & Industrial	**Commercial Real Estate**	Construction	Multi Family	**Residential Real Estate**	Consumer	**Finance Leases**	Unallocated	Total
Allowance for credit losses:									
Beginning balance	$ 417	$ 8,610	$ 2,784	$ 147	$ 2,066	$ 25	$ 419	$ 1,637	$ 16,105
Charge-offs	(12)								(12)
Recoveries	27								27
Provision	518	(753)	(2,175)	264	4,424	28	(293)	(413)	1,600
Ending balance	$ 950	$ 7,857	$ 609	$ 411	$ 6,490	$ 53	$ 126	$ 1,224	$ 17,720
Ending balance: individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Ending balance: collectively evaluated for impairment	$ 950	$ 7,857	$ 609	$ 411	$ 6,490	$ 53	$ 126	$ 1,224	$ 17,720
Financing Receivables:									
Ending balance	$ 11,006	$ 169,015	$ 14,804	$ 12,169	$ 104,854	$ 1,240	$ 4,654	$ 0	$ 317,742
Ending balance: individually evaluated for impairment	$ 122	$ 23,343	$ 0	$ 0	$ 1,566	$ 0	$ 0	$ 0	$ 25,031
Ending balance: collectively evaluated for impairment	$ 10,884	$ 145,672	$ 14,804	$ 12,169	$ 103,288	$ 1,240	$ 4,654	$ 0	$ 292,711

The Company believes the unallocated amount included in the allowance for credit losses is appropriate given the nature of the portfolio with the size of individual loans and the current economy's impact on the real estate market. The Company will continue to closely monitor the environment and loan portfolio and make adjustments when appropriate.

Among the loans reviewed for impairment, $2.4 million of residential loans and $1.3 million of commercial real estate loans were identified as troubled debt restructurings ("TDRs"). TDRs are the result of an economic concession being granted to borrowers experiencing financial difficulties. Certain TDRs are classified as nonperforming at the time of restructuring and may only return to performing status after considering the borrower's sustained repayment performance under the revised payment terms for a reasonable period, generally six months. We evaluated all of the impaired loans by analyzing the collateral value and by evaluating the discounted cash flow. Based on the nature of the modifications no impairment was required.

Age Analysis of Past Due Loans
As of September 30, 2012
(In thousands)

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Loans > 90 Days and Accruing
Commercial & industrial	$ —	$ 2	$ —	$ 2	$ 14,240	$ 14,242	$ —
Construction	—	—	—	—	20,766	20,766	—
Commercial real estate	—	—	15	15	157,735	157,750	—
Consumer	—	—	—	—	1,882	1,882	—
Overdrafts	—	—	—	—	191	191	—
Residential - prime	909	—	496	1,405	96,942	98,347	—
Residential - multi family	—	—	—	—	14,593	14,593	—
Finance leases	—	—	—	—	1,725	1,725	—
Total	$ 909	$ 2	$ 511	$ 1,422	$ 308,074	$ 309,496	$ —

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Age Analysis of Past Due Loans
As of December 31, 2011
(In thousands)

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Loans > 90 Days and Accruing
Commercial & industrial	$ 11	$ —	$ 122	$ 133	$10,873	$11,006	$ —
Construction	—	—	—	—	14,804	14,804	—
Commercial real estate	21	—	—	21	168,994	169,015	—
Consumer	—	—	—	—	778	778	—
Overdrafts	—	—	—	—	462	462	—
Residential - prime	63	—	525	588	104,266	104,854	—
Residential - multi family	—	—	—	—	12,169	12,169	—
Finance leases	—	—	—	—	4,654	4,654	—
Total	$ 95	$ —	$ 647	$ 742	$317,000	$317,742	$ —

Impaired Loans
For the Nine Months Ended September 30, 2012
(In thousands)

	Recorded Loan	Unpaid Principal Balance	Related Allowance	Average Recorded Loan	Interest Income Recognized	Interest Income Foregone
With no related allowance recorded:						
Commercial & industrial	$ —	$ —	$ —	$ —	$ —	$ —
Construction	9,730	9,730	—	9,777	448	—
Commercial real estate	17,583	17,583	—	17,749	861	—
Consumer	14	14	—	15	—	—
Residential - prime	7,883	7,883	—	7,904	256	25
Residential - multi family	—	—	—	—	—	—
Finance leases	—	—	—	—	—	—
Total	$ 35,210	$ 35,210	$ —	$ 35,445	$ 1,565	$ 25
Commercial	27,313	27,313	—	27,526	1,309	—
Consumer	14	14	—	15	—	—
Residential	7,883	7,883	—	7,904	256	25
Finance leases	—	—	—	—	—	—

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Impaired Loans
For the Year Ended December 31, 2011
(In thousands)

	Recorded Loan	Unpaid Principal Balance	Related Allowance	Average Recorded Loan	Interest Income Recognized	Interest Income Foregone
With no related allowance recorded:						
Commercial & industrial	$ 122	$ 122	$ —	$ 31	$ —	$ 13
Construction	—	—	—	—	—	—
Commercial real estate	23,343	23,343	—	18,898	2,021	3
Consumer	—	—	—	—	—	—
Residential - prime	1,566	1,566	—	1,235	56	54
Residential - multi family	—	—	—	—	—	—
Finance leases	—	—	—	—	—	—
Total	$ 25,031	$ 25,031	$ —	$ 20,164	$ 2,077	$ 70
Commercial	23,465	23,465	—	18,929	2,021	16
Consumer	—	—	—	—	—	—
Residential	1,566	1,566	—	1,235	56	54
Finance leases	—	—	—	—	—	—

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BERKSHIRE BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (continued)
(unaudited)

Note 4. - (continued)

Loans on Nonaccrual Status
As of

	September 30, 2012	December 31, 2011
	(In thousands)	
Commercial & industrial	$ —	$ 122
Construction	—	—
Commercial real estate	15	—
Consumer	—	—
Residential	496	525
Residential - multi family	—	—
Finance leases	—	—
Total	$ 511	$ 647

Credit Exposure
Credit Risk Profile by Internally Assigned Grades
For the Nine Months Ended September 30, 2012
(In thousands)

	Commercial & Industrial	**Construction**	**Commercial Real Estate**
Grade:			
Pass	$ 14,089	$ 11,036	$ 122,373
Watch	—	—	8,290
Special Mention	—	—	10,267
Substandard	153	9,730	16,820
Total	$ 14,242	$ 20,766	$ 157,750

	Residential	Multi Family
Grade:		
Pass	$ 90,093	$ 14,593
Watch	719	—
Special Mention	1,466	—
Substandard	6,069	—
Total	$ 98,347	$ 14,593

	Consumer Overdrafts	**Consumer Other**	**Finance Leases**
Performing	$ 191	$ 1,882	$ 1,725
Nonperforming	—	—	—
Total	$ 191	$ 1,882	$ 1,725

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Credit Exposure
Credit Risk Profile by Internally Assigned Grades
For the Year Ended December 31, 2011
(In thousands)

	Commercial & Industrial	**Construction**	**Commercial Real Estate**
Grade:			
Pass	$ 10,840	$ 14,804	$ 114,508
Watch	—	—	8,650
Special Mention	—	—	19,489
Substandard	166	—	26,368
Total	$ 11,006	$ 14,804	$ 169,015

	Residential	Multi Family
Grade:		
Pass	$ 96,475	$ 12,169
Watch	731	—
Special Mention	1,561	—
Substandard	6,086	—
Total	$ 104,853	$ 12,169

	Consumer Overdrafts	**Consumer Other**	**Finance Leases**
Performing	$ 463	$ 778	$ 4,654
Nonperforming	—	—	—
Total	$ 463	$ 778	$ 4,654

The Company utilizes a grade risk rating system for commercial and industrial, commercial real estate and construction loans.

On a quarterly basis, or more often if needed, the Company formally reviews the ratings on all classified commercial and industrial, commercial real estate and construction loans. Semi-annually, the Company engages an independent third-party to review a significant portion of loans within these segments. Management uses the results of these reviews as part of its periodic review process.

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Loan Modifications
(Dollars in Thousands)

Troubled Debt Restructuring	As of September 30, 2012 Number of Loans	Pre-Modification Outstanding Recorded Loans	Post-Modification Outstanding Recorded Loans
Residential - prime	8	$ 2,351	$ 2,351
Commercial Real Estate	4	1,301	1,301
	12	$ 3,652	$ 3,652

Troubled Debt Restructuring	As of December 31, 2011 Number of Loans	Pre-Modification Outstanding Recorded Loans	Post-Modification Outstanding Recorded Loans
Residential	8	$ 2,388	$ 2,388
Commercial Real Estate	3	1,326	1,326
	11	$ 3,714	$ 3,714

The loans restructured during the nine months ended September 30, 2012 were restructured by extending maturity dates or reducing interest rates. No loans were restructured into two notes nor are there any commitments to extend additional funds on any TDRs. The commercial real estate loans are individually evaluated for impairment with any loss recognized in the allowance for loan losses.

In August 2012, the Bank sold a loan to K.F. Investors LLC, of which the Company and the Bank's Chairman of the Board and his immediate family members who serve as directors of the Bank are general partners, for approximately $6.8 million, which represented the Bank's carrying value.

Note 5. Investment Securities

The following is a summary of held to maturity investment securities as of the dates indicated:

	September 30, 2012 Amortized Cost	Gross unrealized gains (In thousands)	Gross unrealized losses	Fair value
Mortgage-backed securities	$ 281	$ —	$ (7)	$ 274

	December 31, 2011			
	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In thousands)			
U.S. Government Agencies	$298	$ 1	$ (6)	$293

The following is a summary of available-for-sale investment securities as of the dates indicated:

	September 30, 2012			
	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In thousands)			
U.S. Treasury Notes	$49,990	$33	$ —	$50,023
U.S. Government Agencies	148,637	764	(8)	149,393
Mortgage-backed securities	122,964	3,026	(373)	125,617
Corporate notes	10,097	142		10,239
Municipal securities	2,719	311	(366)	2,664
Auction rate securities	58,200	—	(7,717)	50,483
Marketable equity securities and other	1,145	4	(20)	1,129
Trading securities	9,218	—	(87)	9,131
Totals	$402,970	$4,280	$ (8,571)	$398,679

	December 31, 2011			
	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(In thousands)			
U.S. Treasury Notes	$80,072	$141	$ —	$80,213
U.S. Government Agencies	130,389	510	(33)	130,866
Mortgage-backed securities	140,049	2,750	(440)	142,359
Corporate notes	12,949	103	(49)	13,003
Municipal securities	2,682	—	(687)	1,995
Auction rate securities	65,700	—	(21,205)	44,495
Marketable equity securities and other	2,284	—	(45)	2,239
Totals	$434,125	$3,504	$ (22,459)	$415,170

Management uses a multi-factor approach to determine whether each investment security in an unrealized loss position is other-than-temporarily impaired ("OTTI"). An unrealized loss position exists when the current fair value of an investment is less than its amortized cost basis. The valuation factors utilized by management incorporate the ideas and concepts outlined in relevant accounting guidance. These include such factors as:

*The length of time and the extent to which the market value has been less than cost;

*The financial condition of the issuer of the security as well as the near and long-term prospect for the issuer;

*The rating of the security by a national rating agency;

*Historical volatility and movement in the fair market value of the security; and

*Adverse conditions relative to the security, issuer or industry.

The following table shows the outstanding auction rate securities aggregated by type of underlying collateral at September 30, 2012 and December 31, 2011:

	September 30, 2012		December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
		(In thousands)		
Preferred Shares of Money Center Banks	$ 58,200	$ 50,483	$ 63,700	$ 42,495
Public Utility Debt and Equity Securities	—	—	2,000	2,000
Totals	$ 58,200	$ 50,483	$ 65,700	$ 44,495

In accordance with ASC 320-10, Investment - Debt and Equity Securities, Management's impairment analysis for the corporate and auction rate securities that were in a loss position as of September 30, 2012 began with management's determination that it had the intent to hold these securities for sufficient time to recover the cost basis. Management also concluded that it was unlikely that it would be required to sell any of the securities before recovery of the cost basis.

At September 30, 2012 and December 31, 2011, the amortized cost of our auction rate securities was $58.2 million and $65.7 million, respectively. The fair value of the auction rate securities was $50.5 million and $44.5 million at September 30, 2012 and December 31, 2011, respectively.

The fair value of the auction rate securities is determined by management valuing the underlying security. The auction rate securities allow for conversion to the underlying preferred security after two failed auctions. As of September 30, 2012, there have been more than two failed auctions for all outstanding auction rate securities. It is our intention to continue to hold these securities and not convert to the underlying preferred securities. We also perform a discounted cash flow analysis, but we considered the market value of the underlying preferred shares to be more objective and relevant in pricing auction rate securities.

In determining whether there is OTTI, management considers the factors noted above. The financial performance indicators we review include, but are not limited to, net earnings, change in liquidity, and change in cash from operating activities, and, for money center banks, the regulatory capital ratios and the allowance for loan losses to the nonperforming loans. Through September 30, 2012, the auction rate securities have continued to pay interest at the highest rate as stipulated in the original prospectus. Currently, the interest rate paid approximates the rate paid on money market deposit accounts.

At September 30, 2012, we had 6 auction rate securities with an aggregate fair market value of $30.6 million which were below investment grade. At December 31, 2011, we had four auction rate securities with an aggregate fair market value of $15.3 million which were below investment grade.

Based upon our methodology for determining the fair value of the auction rate securities, we concluded that as of September 30, 2012, the unrealized loss for the auction rate securities is due to the market interest volatility, the continued illiquidity of the auction rate markets, and uncertainty in the financial markets as there has not been a deterioration in the credit quality of the issuer of the auction rate securities or a downgrade of additional auction rate securities from investment grade. It is not more likely than not that the Company would be required to sell the auction rate securities prior to recovery of the unrealized loss, nor does the Company intend to sell the security at the present time.

During the nine months ended September 30, 2012 and the year ended December 31, 2011, $2.0 million and zero auction rate securities, respectively, were redeemed.

There has been one credit rating down grade on our auction rate securities subsequent to December 31, 2011.

At September 30, 2012 and December 31, 2011, the Company owned preferred and common stock (collectively "equity securities"), with an amortized cost of $1.1 million and $2.3 million, respectively. The fair value of the equity securities was $1.1 million and $2.2 million at September 30, 2012 and December 31, 2011, respectively.

The Company has investments in certain debt securities that have unrealized losses or may be otherwise impaired, but an OTTI has not been recognized in the financial statements as management believes the decline is due to the credit markets coupled with the interest rate environment.

The following table indicates the length of time individual securities that we consider temporarily impaired have been in a continuous unrealized loss position at September 30, 2012 (in thousands):

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Description of Securities						
U.S. Treasury Notes	$ 9,131	$ 87	$ —	$ —	$9,131	$ 87
U.S. Government Agencies	16,963	7	26	1	16,989	8
Mortgage-backed securities	1,136	7	8,237	366	9,373	373
Auction rate securities	—	—	50,483	7,717	50,483	7,717
Municipal securities	—	—	858	366	858	366
Subtotal, debt securities	27,230	101	59,604	8,450	86,834	8,551
Marketable equity securities and other	—	—	41	20	41	20
Total temporarily impaired securities	$ 27,230	$ 101	$ 59,645	$ 8,470	$86,875	$ 8,571

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The Company had a total of 28 debt securities with a fair market value of $86.9 million which were temporarily impaired at September 30, 2012. The total unrealized loss on these securities was $8.6 million, which is attributable to the market interest volatility, the continued illiquidity of the debt markets, and uncertainty in the financial markets. We also had one equity security with a fair market value of $41,000 and an unrealized loss of $20,000. The unrealized loss on our debt securities is comprised of a loss of $7.7 million on nine auction rate securities which have declined in value due to auction failures beginning in February 2008 and a loss of $834,000 on other debt securities. It is not more likely than not that we would sell the auction rate securities before maturity, and we have the intent to hold all of these securities to maturity and will not be required to sell these securities, due to our ratio of cash and cash equivalents of approximately 12.4% of total assets at September 30, 2012. Therefore, the unrealized losses associated with these securities are not considered to be other than temporary.

The amortized cost and fair value of investment securities available for sale and held to maturity, by contractual maturity, at September 30, 2012 are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	September 30, 2012			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)			
Due in one year or less	$42,198	$42,223	$ —	$ —
Due after one through five years	26,260	26,558	—	—
Due after five through ten years	56,971	57,814	—	—
Due after ten years	208,978	211,341	281	274
Auction rate securities	58,200	50,483	—	—
Marketable equity securities and other	1,145	1,129	—	—
Trading securities	9,218	9,131	—	—
Totals	$402,970	$398,679	$ 281	$ 274

Gross gains realized on the sales of investment securities for the nine months ended September 30, 2012, and 2011 were approximately $1.3 million and $7.3 million, respectively. Gross losses realized for the nine months ended September 30, 2012 and 2011 were approximately $1.1 million and $6.3 million, respectively.

At both September 30, 2012 and December 31, 2011, securities sold under agreements to repurchase with a book value of $50.0 million were outstanding. The book value of the securities pledged for these repurchase agreements was $57.5 million and $55.6 million, respectively. As of September 30, 2012 and December 31, 2011, the Company did not own investment securities of any one issuer where the carrying value exceeded 10% of shareholders' equity.

Note 6. Deposits

The following table summarizes the composition of the average balances of major deposit categories:

	Nine Months Ended September 30, 2012		**Twelve Months Ended December 31, 2011**	
	Average Amount	Average Yield	Average Amount	Average Yield
	(Dollars in thousands)			
Demand deposits	$73,373	—	$ 76,900	—
NOW and money market	26,808	0.26 %	25,688	0.36 %
Savings deposits	202,510	0.18	191,316	0.40
Time deposits	363,464	1.18	379,860	1.34
Total deposits	$666,155	0.70 %	$ 673,764	0.87 %

Note 7. Comprehensive Income (Loss)

The Company follows the provisions of FASB ASC 220, Comprehensive Income, ("ASC 220") which includes net income as well as certain other items which result in a change to equity during the period. The following table presents the components of comprehensive income (loss):

	For The Nine Months Ended					
	September 30, 2012			September 30, 2011		
	Before tax amount	Tax (expense) benefit	Net of tax amount	Before tax amount	Tax (expense) benefit	Net of tax amount

	(In thousands)					
Unrealized gains (losses) on investment securities:						
Unrealized holding gains (losses) arising during period	$13,523	$ (5,409)	$ 8,114	$(3,008)	$ 1,203	$ (1,805)
Less reclassification adjustment for gains (losses) realized in net income	169	(68)	101	963	(385)	578
Unrealized gain (loss) on investment securities	13,692	(5,477)	8,215	(2,045)	818	(1,227)
Other comprehensive income (loss), net	$13,692	$ (5,477)	$ 8,215	$(2,045)	$ 818	$ (1,227)

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Note 8. Fair Value of Financial Instruments

FASB ASC 820, "Fair Value Measurements and Disclosure", ("ASC 820") defines fair value, establishes a framework for measuring fair value, and expands disclosure about fair value. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value. A financial instrument's level within the fair value hierarchy is based on the lowest level of input significant to the fair value measurement. There have been no material changes in valuation techniques as a result of the adoption of ASC 820.

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

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

Level 3 - Unobservable inputs that are supported by little or no market activity and significant to the fair value of the assets or liabilities that are developed using the reporting entities' estimates and assumptions, which reflect those that market participants would use.

The Company is required to disclose the estimated fair value of its assets and liabilities considered to be financial instruments. For the Company, as for most financial institutions, the majority of its assets and liabilities are considered financial instruments. However, many such instruments lack an available trading market, as characterized by a willing buyer and seller engaging in an exchange transaction. Also, it is the Company's general practice and intent to hold its financial instruments to maturity and not to engage in trading or sales activities, except for certain loans. Therefore, the Company had to use significant estimations and present value calculations to prepare this disclosure.

Changes in the assumptions or methodologies used to estimate fair values may materially affect the estimated amounts. Also, there may not be reasonable comparability between institutions due to the wide range of permitted assumptions and methodologies in the absence of active markets. This lack of uniformity gives rise to a high degree of subjectivity in estimating financial instrument fair values.

Estimated fair values have been determined by the Company using the best available data and an estimation methodology suitable for each category of financial instruments. The estimation methodologies used, the estimated fair values, and recorded book balances at September 30, 2012 and December 31, 2011 are outlined below.

	September 30, 2012		December 31, 2011	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
	(In thousands)			
Investment securities	$398,960	$398,953	$415,468	$415,463
Loans, net of unearned income	308,900	311,328	317,021	326,711
Time Deposits	348,052	349,297	369,259	371,266
Repurchase Agreements	50,000	51,443	50,000	52,432
Borrowings	2,672	2,696	6,139	6,256
Subordinated debt	7,217	7,217	22,681	22,681

For cash and cash equivalents, the recorded book values of $105.3 million and $101.0 million at September 30, 2012 and December 31, 2011, respectively, approximates fair value because of the relatively short term between the origination of the instrument and its expected realization. Therefore, the Company believes the measurement of fair value of cash and cash equivalents is derived from Level 1 inputs.

The estimated fair values of investment securities are based on quoted market prices (Level 1 inputs), if available. Estimated fair values are based on quoted market prices of comparable instruments if quoted market prices are not available (Level 2 inputs). Estimated fair values are also determined using unobservable inputs that are supported by little or no market values and significant assumptions and estimates (Level 3 inputs).

The net loan portfolio at September 30, 2012 and December 31, 2011 has been valued using a present value discounted cash flow where market prices were not available. The discount rate used in these calculations is the estimated current market rate adjusted for credit risk. The Company believes the fair value of portfolio loans is derived from Level 3 inputs.

The carrying value of interest receivable and payable approximates fair value and is derived from Level 1 inputs.

The estimated fair values of demand deposits (i.e. interest (checking) and non-interest bearing demand accounts, savings and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amounts). The fair value of such deposits is derived from Level 2 inputs. The fair value of time deposits have been valued using net present value discounted cash flow and is derived from Level 2 inputs.

The fair value of commitments to extend credit is estimated based upon the amount of unamortized deferred loan commitment fees. The fair value of letters of credit is based upon the amount of unearned fees plus the estimated cost to terminate letters of credit. Fair values of unrecognized financial instruments, including commitments to extend credit, and the fair value of letters of credit are considered immaterial. As such, no disclosures are made on the fair value of commitments.

The fair value of interest rate caps, included in borrowings, are based upon the estimated amount the Company would receive or pay to terminate the contracts or agreements, taking into account current interest rates and, when appropriate, the current creditworthiness of the counterparties. The aggregate fair value for the interest rate caps were zero at both September 30, 2012 and December 31, 2011.

The fair value of borrowings, repurchase agreements and subordinated debt approximates the carrying value due to the re-pricing of the debt. The Company measures the fair value of borrowings, repurchase agreements and subordinated debt using Level 2 inputs.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

A description of the valuation methodologies used for financial instruments measured at fair value on a recurring basis, as well as the classification of the instruments pursuant to the valuation hierarchy, are as follows:

Securities Available for Sale

When quoted market prices are available in an active market, securities are classified within Level 1 of the fair value hierarchy. If quoted market prices are not available or accessible, then fair values are estimated using pricing models, matrix pricing, or discounted cash flow models. The fair values of securities estimated using pricing models or matrix pricing are generally classified within Level 2 of the fair value hierarchy. When discounted cash flow models are used there is omitted activity or less transparency around inputs to the valuation and securities are classified within Level 3 of the fair value hierarchy.

Level 1 securities generally include equity securities valued based on quoted market prices in active markets. Level 2 instruments include U.S. government agency obligations, state and municipal bonds, mortgage-backed securities, collateralized mortgage obligations and corporate bonds. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Level 3 securities available for sale consist of instruments that are not readily marketable and may only be redeemed with the issuer at par such as Federal Home Loan Bank and Federal Reserve Bank stock. These securities are valued at par value.

Assets measured at fair value at September 30, 2012 and at December 31, 2011 are summarized below.

	At September 30, 2012 Fair Value Measurement Using			
	Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance September 30, 2012
	(Dollars in thousands)			
Assets				
Impaired Loans (1)	$—	$ —	$ 35,210	$ 35,210
Investment securities available for sale: (2)				
U.S. Treasury Notes	50,023	—	—	50,023
U.S. Government Agencies	—	149,393	—	149,393
Mortgage-backed securities	—	125,617	—	125,617
Corporate notes	10,239	—	—	10,239
Municipal securities	2,664	—	—	2,664
Auction rate securities	—	—	50,483	50,483
Trading securities	9,131	—	—	9,131
Marketable equity securities and other	65	1,064	—	1,129
Total Investment securities available for sale	72,122	276,074	50,483	398,679
Total assets	$72,122	$ 276,074	$ 85,693	$ 433,889

(1) Non-recurring basis - impaired loans represent carrying amount as no write-downs were taken to date.

(2) Recurring basis

The above table includes $8.6 million in net unrealized losses on the Company's available for sale securities. The Company has reviewed its investment portfolio at September 30, 2012, and determined that the unrealized losses are temporary.

The fair value of the derivative is zero and valued as a Level 3 input. Further disclosures are not included because they were not deemed material.

	At December, 31, 2011 Fair Value Measurement Using			
	Quoted Prices in	Significant Other	Significant Unobservable	Balance December 31,

	Active Markets for Identical Assets/Liabilities (Level 1)	Observable Inputs (Level 2)	Inputs (Level 3)	2011
	(Dollars in thousands)			
Assets				
Impaired Loans (1)	$—	$ —	$ 25,031	$ 25,031
Investment securities available for sale: (2)				
U.S. Treasury Notes	80,213	—	—	80,213
U.S. Government Agencies	—	130,866	—	130,866
Mortgage-backed securities	—	142,359	—	142,359
Corporate notes	13,003	—	—	13,003
Municipal securities	1,995	—	—	1,995
Auction rate securities	—	—	44,495	44,495
Marketable equity securities and other	803	1,436	—	2,239
Total Investment securities available for sale	96,014	274,661	44,495	415,170
Total assets	$96,014	$ 274,661	$ 69,526	$ 440,201

(1) Non-recurring basis - impaired loans represent carrying amount as no write-downs were taken to date.

(2) Recurring basis

The above table includes $19.0 million in net unrealized losses on the Company's available for sale securities. The Company has reviewed its investment portfolio at December 31, 2011, and determined that the unrealized losses are temporary.

The fair value of the derivative is zero and valued as a Level 3 input. Further disclosures are not included because they were not deemed material.

Assets and Liabilities Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3)

The following table presents a reconciliation for assets measured at fair value on a recurring basis for which the Company has utilized significant unobservable inputs (Level 3).

(Dollars in thousands)	Investment Securities Available for Sale
Balance, January 1, 2012	$ 44,495
Total gains/losses (realized/unrealized)	
Included in earnings	(187)
Included in other comprehensive income	13,488
Purchases	—
Sales	(7,313)
Issuances	—
Settlements	—
Redemptions	—
Interest	—
Other than temporary impairment expense	—
Capital deductions for operating expenses	—
Balance, September 30, 2012	$ 50,483
The amount of total gains (losses) for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at September 30, 2012	$ —

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Note 9. New Accounting Pronouncements

In April 2011, the FASB issued ASU No. 2011-03, which amends the accounting for repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The amendments remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. ASU No. 2011-03 is effective for the first interim or annual period beginning on or after December 15, 2011. Adoption of this update did not have a material effect on the Company's results of operations or financial condition.

In May 2011, the FASB issued ASU No. 2011-04, which results in common fair value measurement and disclosure requirements for US GAAP and International Financial Reporting Standards. ASU No. 2011-04 is effective for the first interim or annual period beginning after December 15, 2011. Adoption of this update did not have a material effect on the Company's results of operations or financial condition but resulted in additional disclosures.

In June 2011, the FASB issued ASU No. 2011-05 in order to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. This standard eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. This update requires all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. This update is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted because compliance with the amendments is already permitted. Adoption of this update did not have a material effect on the Company's results of operations or financial condition. See the Consolidated Statements of Comprehensive Income.

In December 2011, the FASB issued ASU No. 2011-11, which amends Topic 210, "Balance Sheet," to require an entity to disclose both gross and net information about financial instruments, such as sales and repurchase agreements and reverse sale and repurchase agreements and securities borrowing/lending arrangements, and derivative instruments that are eligible for offset in the statement of financial position and/or subject to a master netting arrangement or similar agreement. ASU 2011-11 is effective for annual and interim periods beginning on January 1, 2013, and is not expected to have a material effect on the Company's results of operations or financial condition.

Note 10. Subsequent Events

In late October 2012, Hurricane Sandy caused damage and business interruption to the Company’s cable systems, with the most significant impact in the New York metropolitan area. The Company is in the early stages of assessing the financial, operational and customer impacts of the storm, including impact on properties held by the Bank as collateral, and is, therefore, unable to estimate its full financial and operational impact. However, it is not expected to be significant to the Company’s overall fourth-quarter 2012 financial results.

We evaluated subsequent events under ASC Topic 855, Subsequent Events. We did not identify any items which would require disclosure in or adjustment to the interim financial statements, except as disclosed in Form 10-Q as of and for the period ended September 30, 2012.

Internal Control Over Financial Reporting

The objective of the Company's Internal Control Program is to allow the Bank and management to comply with Part 363 of the FDIC's regulations ("FDICIA") and to allow the Company to comply with Sections 302 and 404 of the Sarbanes-Oxley Act of 2002 ("SOX"). In November 2005, the FDIC amended Part 363 of its regulations by raising the asset-size threshold from $500 million to $1 billion for internal control assessments by management and external auditors. The final rule was effective December 28, 2005.

Section 302 of SOX requires the CEOs and CFOs of the Company to, among other matters, (i) certify that the annual and quarterly reports filed with the Securities and Exchange Commission are accurate and (ii) acknowledge that they are responsible for establishing, maintaining and periodically evaluating the effectiveness of the disclosure controls and procedures. Section 404 of SOX requires management to (i) report on internal control over financial reporting, (ii) assess the effectiveness of such internal controls, and (iii) obtain an external auditor's report on management's assessment of its internal control.

The Company is not an accelerated filer as defined in Rule 12b-2 of the Securities Exchange Act of 1934. On July 21, 2010, President Obama signed the Dodd-Frank Act into law. The Dodd-Frank Act includes a provision which permanently exempts non-accelerated filers, including the Company, from the requirement to obtain an external audit on the effectiveness of internal financial reporting controls provided in Section 404(b) of SOX. Disclosure of management's attestations on internal control over financial reporting under Section 404(a) of SOX is still required.

The Committee of Sponsoring Organizations (COSO) methodology may be used to document and test the internal controls pertaining to the accuracy of Company issued financial statements and related disclosures. COSO requires a review of the control environment (including anti-fraud and audit committee effectiveness), risk assessment, control activities, information and communication, and ongoing monitoring.

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

Executive Summary

We are a Delaware corporation organized in March 1979, and a bank holding company registered under the Bank Holding Company Act of 1956. We acquired The Berkshire Bank (the "Bank"), our indirect wholly-owned subsidiary in March 1999. The Bank was organized in 1987 as a New York State chartered commercial bank. Our principal activity is the ownership and management of the Bank. Our activities are primarily funded by cash on hand, rental income, income from our portfolio of investment securities and dividends, if any, received from the Bank. Our common stock is traded on the NASDAQ Stock Market under the symbol "BERK."

The Bank's principal business consists of gathering deposits from the general public and investing those deposits together with funds generated from ongoing operations and borrowings, primarily in residential and commercial loans, debt obligations issued by the U.S. Government and its agencies, debt obligations of business corporations, and mortgage-backed securities. The Bank operates from seven deposit-taking offices in New York City, four deposit-taking offices in Orange and Sullivan Counties, New York, and one deposit-taking office in Teaneck, New Jersey. The Bank's revenues are derived principally from interest on loans, and interest and dividends on investments in the securities portfolio. The Bank's primary regulator at the state level is the New York Superintendent of Banks and the New York Banking Board, while at the federal level its primary regulator is the Federal Deposit Insurance Corporation (the "FDIC"). Deposits are insured to the maximum allowable amount by the FDIC. The Bank is a member of the Federal Home Loan Bank system. The Company, as a bank holding company, is regulated by the Federal Reserve Board of New York.

Our results of operations depend primarily on net interest income, which is the difference between the income earned on our interest-earning assets and the cost of our interest-bearing liabilities. Net interest income is the result of our interest rate margin, which is the difference between the average yield earned on interest-earning assets and the average cost of interest-bearing liabilities, adjusted for the difference in the average balance of interest-earning assets as compared to the average balance of interest-bearing liabilities. We also generate non-interest income from loan fees, service charges on deposit accounts, mortgage servicing fees, and other fees, dividends on Federal Home Loan Bank of New York ("FHLB-NY") stock and net gains and losses on sales of securities and loans. Our operating expenses consist principally of employee compensation and benefits, occupancy and equipment costs, other general and administrative expenses and income tax expense. Our results of operations also can be significantly affected by our periodic provision for loan losses and specific provision for losses on loans.

On July 21, 2010 the Dodd-Frank Act was signed into law by President Obama. The Dodd-Frank Act represents a comprehensive overhaul of the financial services industry within the United States, establishes the Consumer Financial Protection Bureau (the “Bureau”), and will require the Bureau and other federal agencies to implement many new and significant rules and regulations. At this time it is difficult to predict the extent to which the Dodd-Frank Act or the resulting rules and regulations will impact our business. Compliance with these new laws and regulations will likely result in additional costs, and may adversely impact our results of operations, financial condition or liquidity.

Our investment policy, approved by the Board of Directors, is designed primarily to manage the interest rate sensitivity of our overall assets and liabilities, to generate a favorable return without incurring undue interest rate and credit risk, to complement our lending activities and to provide and maintain liquidity. In establishing our investment strategies, we consider our business and growth strategies, the economic environment, our interest rate risk exposure, our interest rate sensitivity "gap" position, the types of securities to be held, and other factors. We classify our investment securities as available for sale.

We decreased our provision for loan losses by $4.2 million during the nine months ended September 30, 2012 compared to an increase in the provision for loan losses of $1.6 million during the nine months ended September 30, 2011. The decrease in the provision for loan losses was deemed appropriate as a result of the regular quarterly analysis of the allowance for loan losses. The regular quarterly analysis is based on management's evaluation of the risk inherent in the various components of the loan portfolio and other factors, including historical loan loss experience (which is updated at least annually), changes in the composition and volume of the portfolio, collection policies and experience, trends in the volume of non-accrual loans and regional and national economic conditions. See "Provision for Loan Losses" below in this Item 2 for further discussion of the allowance for loan losses.

Net income, before the provision or benefit for income taxes, for the three and nine months ended September 30, 2012 was $6.4 million and $9.8 million, respectively, compared to net income, before dividends on our Series A Preferred Stock and before the provision for income taxes, for the three and nine months ended September 30, 2011 of $3.3 million and $49.6 million, respectively. Net income for the nine months ended September 30, 2012 includes the gain of $4.2 million due to the decrease in the provision for loan losses. No Series A Preferred Stock was outstanding during 2012. Net income for the three and nine months ended September 30, 2011 includes a one time gain of $42.5

million due to the settlement agreement discussed below.

Net income allocated to common stockholders, after the provision for income taxes, was $3.2 million and $8.7 million for the three and nine months ended September 30, 2012, respectively. Net income allocated to common stockholders, after dividends on our Series A Preferred Stock and provision for income taxes, was $1.8 million and $43.6 million for the three and nine months ended September 30, 2011, respectively.

In April 2012, we received a notice from the Federal Reserve Bank of New York stating that they do not object to the Company's request to redeem $15.5 million of Floating Rate Junior Subordinated Debt Securities Due 2034. On July 23, 2012, we redeemed said security, including accrued interest.

On May 16, 2011, we entered into a settlement agreement with the selling financial institution of the auction rate securities in the Bank's investment portfolio. Pursuant to the agreement, in settlement of all claims made by the Bank, the institution paid to the Bank the sum of $42.5 million, which is recorded in other income on the Statement of Operations.

Recent Developments

In late October 2012, Hurricane Sandy caused damage and business interruption to the Company’s cable systems, with the most significant impact in the New York metropolitan area. The Company is in the early stages of assessing the financial, operational and customer impacts of the storm, including impact on properties held by the Bank as collateral, and is, therefore, unable to estimate its full financial and operational impact. However, it is not expected to be significant to the Company’s overall fourth-quarter 2012 financial results.

The following discussion and analysis is intended to provide a better understanding of the consolidated financial condition and results of operations of Berkshire Bancorp Inc. and subsidiaries. All references to earnings per share, unless stated otherwise, refer to earnings per diluted share. References to Notes herein are references to the "Notes to Consolidated Financial Statements" of the Company located in Item 1 herein.

Critical Accounting Policies, Judgments and Estimates

The accounting and reporting policies of the Company conform with accounting principles generally accepted in the United States of America ("GAAP") and general practices within the financial services industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

The Company considers that the determination of the allowance for loan losses involves a higher degree of judgment and complexity than any of its other significant accounting policies. The allowance for loan losses is calculated with the objective of maintaining a reserve level believed by management to be sufficient to absorb estimated credit losses. Management's determination of the adequacy of the allowance is based on periodic evaluations of the loan portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires material estimates, including, among others, expected default probabilities, loss given default, the amounts and timing of expected future cash flows on impaired loans, mortgages, and general amounts for historical loss experience. The process also considers economic conditions, uncertainties in estimating losses and inherent risks in the loan portfolio. All of these factors may be susceptible to significant change. To the extent actual outcomes differ from management estimates, additional provisions for loan losses may be required that would adversely impact earnings in future periods. See

"Provision for Loan Losses" below in this Item 2 for further discussion of the allowance for loan losses.

The Company recognizes deferred tax assets and liabilities for the future tax effects of temporary differences, net operating loss carryforwards and tax credits. Deferred tax assets are subject to management's judgment based upon available evidence that future realization is more likely than not. If management determines that the Company may be unable to realize all or part of net deferred tax assets in the future, a direct charge to income tax expense may be required to reduce the recorded value of the net deferred tax asset to the expected realizable amount.

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The Company conducts a periodic review and evaluation of its securities portfolio, taking into account the severity and duration of each unrealized loss, as well as management's intent and ability to hold the security until the unrealized loss is substantially eliminated, in order to determine if a decline in market value of any security below its carrying value is either temporary or other than temporary. Unrealized losses on held-to-maturity securities that are deemed temporary are disclosed but not recognized. Unrealized losses on debt or equity securities available-for-sale that are deemed temporary are excluded from net income and reported net of deferred taxes as other comprehensive income or loss. All unrealized losses that are deemed other than temporary on either available-for-sale or held-to-maturity securities are recognized immediately as a reduction of the carrying amount of the security, with a charge recorded in the Company's consolidated statements of operations.

The following table presents the total dollar amount of interest income from average interest-earning assets and the resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed in both dollars and rates.

	For The Three Months Ended September 30, 2012			2011		
	Average Balance	Interest and Dividends	Average Yield/Rate	Average Balance	Interest and Dividends	Average Yield/Rate
			(Dollars in Thousands)			
INTEREST-EARNING ASSETS:						
Loans (1)	$312,192	$ 4,658	5.97%	$332,246	$ 5,229	6.30 %
Investment securities	405,846	2,406	2.37	418,746	3,240	3.09
Other (2)(5)	121,233	59	0.19	108,682	65	0.24
Total interest-earning assets	839,271	7,123	3.39	859,674	8,534	3.97
Noninterest-earning assets	28,505			29,937		
Total Assets	$867,776			$889,611		
INTEREST-BEARING LIABILITIES:						
Interest bearing deposits	238,740	118	0.20%	219,882	236	0.43 %
Time deposits	358,442	1,026	1.14	377,837	1,267	1.34
Other borrowings	60,358	515	3.41	80,437	721	3.59
Total interest-bearing liabilities	657,540	1,659	1.01	678,156	2,224	1.31
Demand deposits	75,733			78,270		
Noninterest-bearing liabilities	4,302			11,751		
Stockholders' equity (5)	130,201			121,434		
Total liabilities and stockholders' equity	$867,776			$889,611		
Net interest income		$ 5,464			$ 6,310	
Interest-rate spread (3)			2.38%			2.66 %

Net interest margin (4)		2.60%		2.94 %
Ratio of average interest-earning assets to average interest bearing liabilities	1.28		1.27	

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(1) Includes nonaccrual loans.
(2) Includes interest-bearing deposits, federal funds sold and securities purchased under agreements to resell.
(3) Interest-rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest bearing liabilities.
(4) Net interest margin is net interest income as a percentage of average interest-earning assets.
(5) Average balances are daily average balances except for the parent company which have been calculated on a monthly basis.

	For The Nine Months Ended September 30,							
	2012				2011			
	Average Balance	**Interest and Dividends**	**Average Yield/Rate**		**Average Balance**	**Interest and Dividends**	**Average Yield/Rate**	
			(Dollars in Thousands)					
INTEREST-EARNING ASSETS:								
Loans (1)	$317,757	$ 14,445	6.06	%	$ 343,668	$ 16,406	6.37	%
Investment securities	412,310	7,143	2.31		390,962	9,901	3.38	
Other (2)(5)	109,651	243	0.30		93,964	199	0.28	
Total interest-earning assets	839,718	21,831	3.47		828,594	26,506	4.27	
Noninterest-earning assets	28,432				30,799			
Total Assets	$868,150				$ 859,393			
INTEREST-BEARING LIABILITIES:								
Interest bearing deposits	229,318	325	0.19	%	213,552	754	0.47	%
Time deposits	363,464	3,219	1.18		383,221	3,858	1.34	
Other borrowings	71,820	1,747	3.24		81,567	2,227	3.64	
Total interest-bearing liabilities	664,602	5,291	1.06		678,340	6,839	1.34	
Demand deposits	73,373				78,306			
Noninterest-bearing liabilities	4,714				7,970			
Stockholders' equity (5)	125,461				94,777			
Total liabilities and stockholders' equity	$868,150				$ 859,393			
Net interest income		$ 16,540				$ 19,667		
Interest-rate spread (3)			2.41	%			2.93	%
Net interest margin (4)			2.63	%			3.16	%
Ratio of average interest-earning assets to average interest bearing liabilities	1.26				1.22			

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(1) Includes nonaccrual loans.

(2) Includes interest-bearing deposits, federal funds sold and securities purchased under agreements to resell.

(3) Interest-rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest bearing liabilities.

(4) Net interest margin is net interest income as a percentage of average interest-earning assets.

(5) Average balances are daily average balances except for the parent company which have been calculated on a monthly basis.

Results of Operations

Results of Operations for the Three and Nine Months Ended September 30, 2012 Compared to the Three and Nine Months Ended September 30, 2011.

Net Income Allocated to Common Stockholders. Net income allocated to common stockholders for the three and nine-month periods ended September 30, 2012 was $3.2 million and $8.7 million, respectively, or $.22 and $.60 per common share, respectively. Net income allocated to common stockholders for the three and nine-month periods ended September 30, 2011 was $1.8 million and $43.6 million, respectively, or $.25 and $6.18 per common share, respectively.

The net income allocated to common stockholders reported for the three months ended September 30, 2012 includes a provision for income taxes of $3.3 million, or $.23 per common share. The net income allocated to common stockholders reported for the nine months ended September 30, 2012 includes a provision for income taxes of $1.2 million, or $.08 per common share. The net income allocated to common stockholders reported for the three months ended September 30, 2011 includes (i) dividends accrued on our Series A Preferred Stock of $1.2 million, or $.17 per common share and (ii) provision for income taxes of $281,000, or $.04 per common share. The net income allocated to common stockholders reported for the nine months ended September 30, 2011 includes (i) dividends accrued on our Series A Preferred Stock of $3.6 million, or $.51 per common share, (ii) a provision for income taxes of $2.4 million, or $.34 per common share, and (iii) a one-time settlement payment of $42.5 million, or $6.02 per common share.

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The Company's net income is largely dependent on interest rate levels, the demand for the Company's loan and deposit products and the strategies employed to manage the interest rate and other risks inherent in the banking business.

Net Interest Income. The Company's primary source of revenue is net interest income, or the difference between interest income earned on interest-earning assets, such as loans and investment securities, and interest expense on interest-bearing liabilities such as deposits and borrowings. The amount of interest income is dependent upon many factors including: (i) the amount of interest-earning assets that the Company can maintain based upon its funding sources; (ii) the relative amounts of interest-earning assets versus interest-bearing liabilities; and (iii) the difference between the yields earned on those assets and the rates paid on those liabilities. Non-performing loans adversely affect net interest income because they must still be funded by interest-bearing liabilities, but they do not provide interest income. Furthermore, when we designate an asset as non-performing, all interest which has been accrued but not actually received is deducted from current period income, further reducing net interest income.

For the three and nine-month periods ended September 30, 2012, net interest income was $5.5 million and $16.5 million, respectively, compared to net interest income of $6.3 million and $19.7 million for the three and nine-month periods ended September 30, 2011. The decrease in net interest income during the 2012 periods compared to the 2011 periods was primarily due to the decrease in the average yields earned on the average amount of interest-earning assets, partially offset by the decrease in the average amount of interest-bearing liabilities and the decrease in the average rates paid on interest-bearing liabilities.

The average yields earned on interest-earning assets declined to 3.39% and 3.47% during the three and nine months ended September 30, 2012, respectively, from 3.97% and 4.27% during the three and nine months ended September 30, 2011, respectively. The average rates paid on interest-bearing liabilities declined to 1.01% and 1.06% during the three and nine months ended September 30, 2012, respectively, from 1.31% and 1.34% during the three and nine months ended September 30, 2011, respectively. The Company's interest-rate spread, the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities, declined to 2.38% and 2.41% during the three and nine months September 30, 2012, respectively, from 2.66% and 2.93% during the three and nine months ended September 30, 2011, respectively.

Net Interest Margin. Net interest margin, or annualized net interest income as a percentage of average interest-earning assets, was 2.60% and 2.63% for the three and nine months ended September 30, 2012, respectively, compared to 2.94% and 3.16% during the three and nine months ended September 30, 2011. We seek to secure and retain customer deposits with competitive products and rates, while making strategic use of the prevailing interest rate environment to borrow funds at what we believe to be attractive rates. We invest such deposits and borrowed funds in a prudent mix of fixed and adjustable rate loans, investment securities and short-term interest-earning assets. The decrease in net interest margin is primarily due to the decrease in the average amounts of higher yielding loans as a percentage of the total mix of interest-earning assets.

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Interest Income. Total interest income for the quarter ended September 30, 2012 decreased by $1.4 million to $7.1 million from $8.5 million for the quarter ended September 30, 2011. The decrease in total interest income was primarily due to the decrease in the average yield earned on the average amount of interest-earning assets to 3.39% during the 2012 quarter from 3.97% during the 2011 quarter, and the decrease in the average amount of higher yielding loans to $312.2 million during the 2012 quarter from $332.2 million during the 2011 quarter.

Total interest income for the nine-month period ended September 30, 2012 decreased by $4.7 million to $21.8 million from $26.5 million for the nine-month period ended September 30, 2011. The decrease in total interest income was due to the decrease in the average yield earned on the average amount of interest-earning assets to 3.47% during the nine-month period of 2012 from 4.27% during the nine-month period of 2011 and the decrease in the average amount of higher yielding loans to $317.8 million during the nine-month period of 2012 from $343.7 million during the nine-month period of 2011.

The following tables present the composition of interest income for the indicated periods:

	Three Months Ended September 30,			
	2012		2011	
	Interest Income	% of Total	Interest Income	% of Total
	(In thousands, except percentages)			
Loans	$4,658	65.39 %	$5,229	61.27 %
Investment Securities	2,406	33.78	3,240	37.97
Other	59	0.83	65	0.76
Total Interest Income	$7,123	100.00%	$8,534	100.00%

	Nine Months Ended September 30,			
	2012		2011	
	Interest Income	% of Total	Interest Income	% of Total
	(In thousands, except percentages)			
Loans	$14,445	66.17 %	$16,406	61.90 %
Investment Securities	7,143	32.72	9,901	37.35
Other	243	1.11	199	0.75
Total Interest Income	$21,831	100.00%	$26,506	100.00%

Loans, which are inherently risky and therefore command a higher return than our portfolio of investment securities and other interest-earning assets, decreased to 37.2% and 37.8% of total average interest-earning assets during the three and nine months ended September 30, 2012, respectively, from 38.6% and 41.5% of total interest-earning assets during the three and nine months ended September 30, 2011, respectively. The average amounts of investment securities was 48.4% and 49.1% of total average interest-earning assets during the three and nine months ended

September 30, 2012, respectively, compared to 48.7% and 47.2% of total interest-earning assets during the three and nine months ended September 30, 2011, respectively. While we actively seek to originate new loans with qualified borrowers who meet the Bank's underwriting standards, our strategy has been to maintain those standards, sacrificing some current income to avoid possible large future losses in the loan portfolio.

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At September 30, 2012 and 2011, total non-performing loan assets were $511,000 and $6.3 million, respectively, all of which were non-accrual loans. Depending upon the contractual interest rate of a loan, significant additions to non-performing loans, were such additions to occur, could have a material adverse effect on our results of operations. The effect of the decrease in non-accrual loans in 2012 from 2011 was negligible.

Federal Home Loan Bank Stock. The Bank owns stock of the Federal Home Loan Bank New York ("FHLB-NY") which is necessary for it to be a member of the FHLB-NY. Membership requires the purchase of stock equal to 1% of the Bank's residential mortgage loans or 5% of the outstanding borrowings, whichever is greater. The stock is redeemable at par. Therefore, its cost is equivalent to its redemption value. The Bank's ability to redeem FHLB-NY shares is dependent upon the redemption practices of the FHLB-NY. At September 30, 2012, the FHLB-NY neither placed restrictions on redemption of shares in excess of a member's required investment in stock, nor stated that it will cease paying dividends. The Bank did not consider this asset impaired at either September 30, 2012 or December 31, 2011.

Interest Expense. Total interest expense for the quarter ended September 30, 2012 decreased by $500,000 to $1.7 million from $2.2 million for the quarter ended September 30, 2011. The decrease in interest expense was due to the decrease in the average amounts of interest-bearing liabilities to $657.5 million from $678.2 million during the three months ended September 30, 2012 and 2011, respectively, and the decrease in the average rates paid on interest-bearing liabilities to 1.01% during the 2012 quarter from 1.31% during the 2011 quarter.

Total interest expense for the nine-month period ended September 30, 2012 decreased by $1.5 million to $5.3 million from $6.8 million for the nine-month period ended September 30, 2011. The decrease in interest expense was due to the decrease in the average amounts of interest-bearing liabilities to $664.6 million from $678.3 million during the nine-month periods ended September 30, 2012 and 2011, respectively, and the decrease in the average rates paid on such liabilities to 1.06% from 1.34% during the nine-month periods ended September 30, 2012 and 2011, respectively.

The following tables present the components of interest expense as of the dates indicated:

	Three Months Ended September 30,					
	2012			2011		
	Interest Expense	% of Total		Interest Expense	% of Total	
	(In thousands, except percentages)					
Interest-Bearing Deposits	$118	7.11	%	$236	10.61	%
Time Deposits	1,026	61.85		1,267	56.97	
Other Borrowings	515	31.04		721	32.42	
Total Interest Expense	$1,659	100.00	%	$2,224	100.00	%

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	Nine Months Ended September 30,			
	2012		2011	
	Interest Expense	% of Total	Interest Expense	% of Total
	(In thousands, except percentages)			
Interest-Bearing Deposits	$325	6.14 %	$754	11.03 %
Time Deposits	3,219	60.84	3,858	56.41
Other Borrowings	1,747	33.02	2,227	32.56
Total Interest Expense	$5,291	100.00%	$6,839	100.00%

Non-Interest Income. Non-interest income consists primarily of realized gains on sales of marketable securities and service fee income. Total non-interest income for the three and nine months ended September 30, 2012 was $766,000 and $1.4 million, respectively, compared to $1.3 million and $44.6 million for the three and nine months ended September 30, 2011. In May 2011, we entered into a settlement agreement with the selling financial institution of the auction rate securities in the Bank's investment portfolio. Pursuant to the agreement, the institution paid to the Bank the sum of $42.5 million. This amount has been included in other non-interest income for the nine months ended September 30, 2011. Excluding the settlement payment of $42.5 million, total non-interest income was $2.1 million for the nine months ended September 30, 2011.

Non-Interest Expense. Non-interest expense includes salaries and employee benefits, occupancy and equipment expenses, legal and professional fees and other operating expenses associated with the day-to-day operations of the Company. Total non-interest expense for the three and nine months ended September 30, 2012 was $4.0 million and $12.3 million, respectively, compared to $4.3 million and $13.1 million for the three and nine months ended September 30, 2011.

The following tables present the components of non-interest expense as of the dates indicated:

	Three Months Ended September 30,			
	2012		2011	
	Non-Interest Expense	% of Total	Non-Interest Expense	% of Total
	(In thousands, except percentages)			
Salaries and Employee Benefits	$2,263	56.86 %	$2,243	51.66 %
Net Occupancy Expense	567	14.25	921	21.21
Equipment Expense	86	2.16	76	1.75
FDIC Assessment	300	7.54	300	6.91
Data Processing Expense	112	2.81	74	1.70
Other	652	16.38	728	16.77
Total Non-Interest Expense	$3,980	100.00%	$4,342	100.00%