

FIDELITY SOUTHERN CORP

Form 10-Q

November 08, 2010

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

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

For the quarterly period ended September 30, 2010

Commission File Number: 0-22374

Fidelity Southern Corporation

(Exact name of registrant as specified in its charter)

Georgia

58-1416811

(State or other jurisdiction of incorporation or organization)

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

3490 Piedmont Road, Suite 1550, Atlanta GA

30305

(Address of principal executive offices)

(Zip Code)

(404) 639-6500

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting

(Do not check if a

Company

Smaller Reporting

Company)

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

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

Class

Shares Outstanding at October 31, 2010

Common Stock, no par value

10,660,024

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PART I FINANCIAL INFORMATION
Item 1. Financial Statements
FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	(Unaudited) September 30, 2010	December 31, 2009
	<i>(Dollars in Thousands)</i>	
Assets		
Cash and due from banks	\$ 65,717	\$ 168,766
Interest-bearing deposits with banks	1,644	1,926
Federal funds sold	642	428
Cash and cash equivalents	68,003	171,120
Investment securities available-for-sale (amortized cost of \$150,067 and \$137,020 at September 30, 2010, and December 31, 2009, respectively)	152,572	136,917
Investment securities held-to-maturity (approximate fair value of \$16,613 and \$19,942 at September 30, 2010, and December 31, 2009, respectively)	15,689	19,326
Investment in FHLB stock	6,542	6,767
Loans held-for-sale (loans at fair value: \$138,150 at September 30, 2010; \$80,869 at December 31, 2009)	186,494	131,231
Loans	1,355,248	1,289,859
Allowance for loan losses	(28,293)	(30,072)
Loans, net of allowance for loan losses	1,326,955	1,259,787
Premises and equipment, net	19,229	18,092
Other real estate, net	21,252	21,780
Accrued interest receivable	8,148	7,832
Bank owned life insurance	29,967	29,058
Other assets	44,367	49,610
Total Assets	\$ 1,879,218	\$ 1,851,520
Liabilities		
Deposits:		
Noninterest-bearing demand deposits	\$ 186,112	\$ 157,511
Interest-bearing deposits:		
Demand and money market	429,133	252,493
Savings	367,402	440,596
Time deposits, \$100,000 and over	208,853	257,450
Other time deposits	369,674	442,675
Total deposits	1,561,174	1,550,725
Other short-term borrowings	22,715	41,870
Subordinated debt	67,527	67,527

Other long-term debt	75,000	50,000
Accrued interest payable	2,671	4,504
Other liabilities	11,116	7,209
 Total liabilities	 1,740,203	 1,721,835
 Shareholders' Equity		
Preferred stock, no par value. Authorized 10,000,000; 48,200 shares issued and outstanding.	45,358	44,696
Common stock, no par value. Authorized 50,000,000; issued and outstanding 10,658,913 and 10,169,347 at September 30, 2010, and December 31, 2009.	56,541	53,342
Accumulated other comprehensive income (loss), net of taxes	1,553	(64)
Retained earnings	35,563	31,711
 Total shareholders' equity	 139,015	 129,685
 Total liabilities and shareholders' equity	 \$ 1,879,218	 \$ 1,851,520

See accompanying notes to consolidated financial statements.

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FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2010	2009	2010	2009
	<i>(Dollars in Thousands, except per share data)</i>			
Interest income				
Loans, including fees	\$ 64,886	\$ 65,112	\$ 22,068	\$ 22,208
Investment securities	6,350	7,896	1,602	2,824
Federal funds sold and bank deposits	149	106	43	44
Total interest income	71,385	73,114	23,713	25,076
Interest expense				
Deposits	18,732	30,648	5,507	9,478
Short-term borrowings	898	422	185	44
Subordinated debt	3,378	3,527	1,138	1,143
Other long-term debt	1,135	1,672	446	610
Total interest expense	24,143	36,269	7,276	11,275
Net interest income	47,242	36,845	16,437	13,801
Provision for loan losses	10,150	21,300	5,025	4,500
Net interest income after provision for loan losses	37,092	15,545	11,412	9,301
Noninterest income				
Service charges on deposit accounts	3,291	3,264	1,072	1,138
Other fees and charges	1,596	1,486	553	509
Mortgage banking activities	14,842	11,338	7,042	3,081
Indirect lending activities	3,397	3,237	1,200	1,042
SBA lending activities	1,797	584	951	147
Securities gains	2,291	519		519
Bank owned life insurance	980	948	324	321
Other	1,122	412	419	461
Total noninterest income	29,316	21,788	11,561	7,218
Noninterest expense				
Salaries and employee benefits	30,634	24,969	11,729	8,127
Furniture and equipment	2,002	2,055	684	709
Net occupancy	3,374	3,296	1,159	1,114
Communication	1,390	1,195	471	430
Professional and other services	3,391	3,628	1,279	1,292

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Cost of operation of other real estate	5,939	4,829	1,412	562
FDIC insurance premiums	2,657	2,756	890	877
Other	6,409	5,263	2,355	3,356
Total noninterest expense	55,796	47,991	19,979	16,467
Income (loss) before income tax benefit	10,612	(10,658)	2,994	52
Income tax expense (benefit)	3,467	(4,875)	913	(346)
Net income (loss)	7,145	(5,783)	2,081	398
Preferred stock dividends	(2,469)	(2,469)	(823)	(823)
Net income (loss) available to common equity	4,676	\$ (8,252)	\$ 1,258	\$ (425)
Earnings (loss) per share:				
Basic earnings (loss) per share	\$.44	\$ (.81)	\$.12	\$ (.04)
Diluted earnings (loss) per share	\$.39	\$ (.81)	\$.10	\$ (.04)
Weighted average common shares outstanding-basic	10,579,438	10,132,761	10,708,885	10,195,342
Weighted average common shares outstanding-fully diluted	11,878,586	10,132,761	12,073,391	10,195,342

See accompanying notes to consolidated financial statements.

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FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended	
	September 30,	
	2010	2009
	<i>(In Thousands)</i>	
Operating Activities		
Net income (loss)	\$ 7,145	\$ (5,783)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Provision for loan losses	10,150	21,300
Depreciation and amortization of premises and equipment	1,344	1,445
Other amortization	1,372	617
Reserve for impairment of other real estate	3,588	3,138
Share-based compensation	82	181
Proceeds from sales of loans	829,134	640,887
Proceeds from sales of other real estate	10,118	12,624
Loans originated for resale	(874,641)	(704,106)
Gain on loan sales	(9,756)	(5,986)
Gain on sales of investment securities	(2,291)	(519)
(Gain) loss on sales of other real estate	(541)	50
Increase in cash value of bank owned life insurance	(909)	(877)
Net (increase) decrease in deferred income taxes	(2,097)	1,609
Changes in assets and liabilities which provided (used) cash:		
Accrued interest receivable	(316)	39
Other assets	5,759	(6,045)
Accrued interest payable	(1,833)	(2,719)
Other liabilities	3,907	1,771
 Net cash used in operating activities	 (19,785)	 (42,374)
Investing Activities		
Purchases of investment securities available-for-sale	(230,141)	(149,236)
Purchases of investment in FHLB stock	(90)	(1,485)
Proceeds from sale of investment securities held-for-sale	94,676	26,069
Maturities and calls of investment securities held-to-maturity	3,643	4,350
Maturities and calls of investment securities available-for-sale	123,921	32,048
Redemption of investment in FHLB stock	315	
Net (increase) decrease in loans	(89,605)	33,102
Capital improvements to other real estate	(350)	(398)
Purchases of premises and equipment	(2,481)	(497)
 Net cash used in investing activities	 (100,112)	 (56,047)
Financing Activities		
Net increase in transactional accounts	132,047	275,448
Net decrease in time deposits	(121,598)	(111,609)

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Proceeds of issuance of other long-term debt	25,000	30,000
Repayment of other long-term debt		(2,500)
Net decrease in short-term borrowings	(19,155)	(36,756)
Dividends paid	(6)	(2)
Proceeds from the issuance of common stock	2,299	478
Preferred stock dividends paid	(1,807)	(1,580)
Net cash provided by financing activities	16,780	153,479
Net (decrease) increase in cash and cash equivalents	(103,117)	55,058
Cash and cash equivalents, beginning of period	171,120	92,025
Cash and cash equivalents, end of period	\$ 68,003	\$ 147,083
Supplemental disclosures of cash flow information:		
Cash paid (refunded) during the period for:		
Interest	\$ 25,976	\$ 38,988
Income taxes	\$ 2,278	\$ (3,316)
Non-cash transfers to other real estate	\$ 12,287	\$ 21,590
Stock dividend	\$ 818	\$ 265
Accrued but unpaid dividend on preferred stock	\$ 308	\$ 308
Accretion on U.S. Treasury preferred stock	\$ 662	\$ 662
Loans transferred from held-for-sale	\$ 3,884	\$

See accompanying notes to consolidated financial statements.

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**FIDELITY SOUTHERN CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
SEPTEMBER 30, 2010**

1. Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of Fidelity Southern Corporation and its wholly owned subsidiaries (Fidelity). Fidelity Southern Corporation (FSC) owns 100% of Fidelity Bank (the Bank), and LionMark Insurance Company, an insurance agency offering consumer credit related insurance products. FSC also owns five subsidiaries established to issue trust preferred securities, which entities are not consolidated for financial reporting purposes in accordance with Accounting Standards Codification (ASC) 942-810-55, as FSC is not the primary beneficiary. The Company , as used herein, includes FSC and its subsidiaries, unless the context otherwise requires.

These unaudited consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles followed within the financial services industry for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required for complete financial statements.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the periods covered by the statements of operations. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of mortgage loans held-for-sale, the calculations of and the amortization of capitalized servicing rights, the valuation of net deferred income taxes and the valuation of real estate or other assets acquired in connection with foreclosures or in satisfaction of loans. In addition, the actual lives of certain amortizable assets and income items are estimates subject to change. The Company principally operates in one business segment, which is community banking.

In the opinion of management, all adjustments considered necessary for a fair presentation of the financial position and results of operations for the interim periods have been included. All such adjustments are normal recurring accruals. Certain previously reported amounts have been reclassified to conform to current presentation. These reclassifications had no impact on previously reported net income, or shareholders' equity or cash flows. The Company's significant accounting policies are described in Note 1 of the Notes to Consolidated Financial Statements included in our 2009 Annual Report on Form 10-K filed with the Securities and Exchange Commission. There were no new accounting policies or changes to existing policies adopted in the first nine months of 2010, which had a significant effect on the results of operations or statement of financial condition. For interim reporting purposes, the Company follows the same basic accounting policies and considers each interim period as an integral part of an annual period.

Operating results for the nine month period ended September 30, 2010, are not necessarily indicative of the results that may be expected for the year ended December 31, 2010. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K and Annual Report to Shareholders for the year ended December 31, 2009.

2. Shareholders' Equity

The Board of Governors of the Federal Reserve System (the FRB) is the primary regulator of FSC, a bank holding company. The Bank is a state chartered commercial bank subject to Federal and state statutes applicable to banks chartered under the banking laws of the State of Georgia and to banks whose deposits are insured by the Federal Deposit Insurance Corporation (the FDIC), the Bank's primary Federal regulator. The Bank is a wholly owned subsidiary of the Company. The Bank's state regulator is the Georgia Department of Banking and Finance (the GDBF). The FDIC and the GDBF examine and evaluate the financial condition, operations, and policies and procedures of state chartered commercial banks, such as the Bank, as part of their legally prescribed oversight responsibilities. The FRB, FDIC, and GDBF have established capital adequacy requirements as a function of their oversight of bank holding companies and state chartered banks. Each bank holding company and each bank must maintain certain

minimum capital ratios. At September 30, 2010, and December 31, 2009, the Company exceeded all capital ratios required by the FRB, FDIC, and GDBF to be considered well capitalized. In addition, the Bank's Tier 1 leverage ratio of 9.75% exceeded the 8% minimum required by memoranda of understanding executed in 2009 between FSC, the Bank, the FDIC, the FRB, and the GDBF.

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Earnings per share were calculated as follows:

	For the Quarter Ended September 30,	
	2010	2009
	<i>(Dollars in Thousands, except per share data)</i>	
Net income	\$ 2,081	\$ 398
Less dividends on preferred stock and accretion of discount	(823)	(823)
Net income (loss) available to common equity	\$ 1,258	\$ (425)
Average common shares outstanding	10,550	9,895
Effect of stock dividends	159	300
Average common shares outstanding basic	10,709	10,195
Dilutive stock options and warrants	1,364	
Average common shares outstanding dilutive	12,073	10,195
Earnings (loss) per share basic	\$.12	\$ (.04)
Earnings (loss) per share dilutive	\$.10	\$ (.04)
	For the Nine Months Ended September 30,	
	2010	2009
	<i>(Dollars in Thousands, except per share data)</i>	
Net income (loss)	\$ 7,145	\$ (5,783)
Less dividends on preferred stock and accretion of discount	(2,469)	(2,469)
Net income (loss) available to common equity	\$ 4,676	\$ (8,252)
Average common shares outstanding	10,422	9,785
Effect of stock dividends	157	348
Average common shares outstanding basic	10,579	10,133
Dilutive stock options and warrants	1,300	
Average common shares outstanding dilutive	11,879	10,133
Earnings (loss) per share basic	\$.44	\$ (.81)

Earnings (loss) per share dilutive \$.39 \$ (.81)
 Average number of shares for 2010 includes participating securities related to unvested restricted stock awards.

3. Contingencies

Due to the nature of their activities, the Company and its subsidiaries are at times engaged in various legal proceedings that arise in the course of normal business, some of which were outstanding as of September 30, 2010. While it is difficult to predict or determine the outcome of these proceedings, it is the opinion of management, after consultation with its legal counsel, that the ultimate liabilities, if any, will not have a material adverse impact on the Company's consolidated results of operations, financial position, or cash flows.

4. Comprehensive Income (Loss)

Comprehensive income (loss) includes net income (loss) and other comprehensive income (loss), related to unrealized gains and losses on investment securities classified as available-for-sale. All other comprehensive income (loss) items are tax effected at a rate of 38% for each period.

During the third quarter and first nine months of 2010, other comprehensive income net of tax was \$292,000 and \$1.6 million, respectively. Other comprehensive income, net of tax, was \$2.4 million for the comparable periods in 2009. Comprehensive income for the third quarter and first nine months of 2010 was \$2.4 million and \$8.8 million compared to comprehensive income (loss) of \$2.8 million and \$(3.4) million for the same period in 2009.

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The Company's 1997 Stock Option Plan authorized the grant of options to management personnel for up to 500,000 shares of the Company's common stock. All options granted have three year to eight year terms and vest and become fully exercisable at the end of three years to five years of continued employment. No options may be or were granted after June 30, 2007, under this plan.

The Fidelity Southern Corporation Equity Incentive Plan (the 2006 Incentive Plan), permits the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, and other incentive awards (Incentive Awards). The maximum number of shares of the Company's common stock that may be issued under the 2006 Incentive Plan is 750,000 shares, all of which may be stock options. Generally, no award shall be exercisable or become vested or payable more than 10 years after the date of grant. Options granted under the 2006 Incentive Plan have four year terms and become fully exercisable at the end of three years of continued employment. Incentive awards available under the 2006 Incentive Plan totaled 153,327 shares at September 30, 2010.

In the first quarter of 2010, FSC granted 154,078 restricted shares of common stock under the 2006 Equity Incentive Plan to certain employees. The stock was granted at \$4.50 per share, vests 40% over two years and then 20% per year through five years and will be fully vested after January 22, 2015. The restricted stock is subject to section 111 of the Emergency Economic Stabilization Act of 2008, as amended by the American Recovery and Reinvestment Act of 2009 and regulations issued by the Department of the Treasury. At September 30, 2010, there was \$589,000 in remaining unrecognized compensation cost related to the restricted stock.

A summary of option activity as of September 30, 2010, and changes during the nine month period then ended is presented below:

	Number of share options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Terms	Aggregate Intrinsic Value
Outstanding at January 1, 2010	494,405	\$ 8.59		
Granted				
Exercised				
Forfeited	1,666	4.60		
Outstanding at September 30, 2010	492,739	\$ 8.60	2.16 years	\$
Exercisable at September 30, 2010	376,072	\$ 9.84	1.95 years	\$

Share-based compensation expense was not significant for the three month and nine month periods ended September 30, 2010.

6. Fair Value Election and Measurement

Effective January 1, 2008, the Company adopted the provisions of SFAS No. 157, Fair Value Measurements, now codified in FASB ASC 820-10-35, for financial assets and financial liabilities. SFAS No. 157 establishes a common definition of fair value and framework for measuring fair value under U.S. GAAP. Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. FASB ASC 820-10-35 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820-10-35 are described below:

Level 1 Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 Quoted prices in markets that are not active, or inputs that are observable, either directly, for substantially the full term of the asset or liability;

Level 3 Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

A financial instrument's level within the hierarchy is based on the lowest level of input that is significant to the fair value measurement.

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In certain circumstances, fair value enables a company to more accurately align its financial performance with the economic value of hedged assets. Fair value enables a company to mitigate the non-economic earnings volatility caused from financial assets and financial liabilities being carried at different bases of accounting, as well as to more accurately portray the active and dynamic management of a company's balance sheet.

In accordance with SFAS No. 159 "The Fair Value Option for Financial Assets and Financial Liabilities" which is now codified in ASC 825-10-25, the Company has elected to record newly originated mortgage loans held-for-sale at fair value. The following is a description of mortgage loans held-for-sale as of September 30, 2010, for which fair value has been elected, including the specific reasons for electing fair value and the strategies for managing these assets on a fair value basis.

Mortgage Loans Held-for-Sale

The Company records mortgage loans held-for-sale at fair value. The Company chose to record these mortgage loans held-for-sale at fair value in order to eliminate the complexities and inherent difficulties of achieving hedge accounting and to better align reported results with the underlying economic changes in value of the loans and related hedge instruments. This election impacts the timing and recognition of origination fees and costs, as well as servicing value. Specifically, origination fees and costs, which had been appropriately deferred under SFAS No. 91 "Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases" now codified in ASC 310-20-25 and previously recognized as part of the gain/loss on sale of the loans, are now recognized in earnings at the time of origination. Interest income on mortgage loans held-for-sale is recorded on an accrual basis in the consolidated statement of operations under the heading "Interest income - loans, including fees". The servicing value is included in the fair value of the Interest Rate Lock Commitments (IRLCs) with borrowers. The mark to market adjustments related to loans held-for-sale and the associated economic hedges are captured in mortgage banking activities.

Valuation Methodologies and Fair Value Hierarchy

The primary financial instruments that the Company carries at fair value include investment securities, IRLCs, derivative instruments, and loans held-for-sale. Classification in the fair value hierarchy of financial instruments is based on the criteria set forth in SFAS No. 157, now codified in FASB ASC 820-10-35.

Debt securities issued by U.S. Government corporations and agencies, debt securities issued by states and political subdivisions, and agency residential mortgage backed securities classified as available-for-sale are reported at fair value utilizing Level 2 inputs. 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. The investments in the Company's portfolio are generally not quoted on an exchange but are actively traded in the secondary institutional markets.

The fair value of mortgage loans held-for-sale is based on what secondary markets are currently offering for portfolios with similar characteristics. The fair value measurements consider observable data that may include market trade pricing from brokers and the mortgage-backed security markets. As such, the Company classifies these loans as Level 2.

The Company classifies IRLCs on residential mortgage loans held-for-sale, which are derivatives under SFAS No. 133 now codified in ASC 815-10-15, on a gross basis within other liabilities or other assets. The fair value of these commitments, while based on interest rates observable in the market, is highly dependent on the ultimate closing of the loans. These "pull-through" rates are based on both the Company's historical data and the current interest rate environment and reflect the Company's best estimate of the likelihood that a commitment will ultimately result in a closed loan. As a result of the adoption of Staff Accounting Bulletin No. 109 ("SAB No. 109"), the loan servicing value is also included in the fair value of IRLCs. Because these inputs are not transparent in market trades, IRLCs are considered to be Level 3 assets.

Derivative instruments are primarily transacted in the secondary mortgage and institutional dealer markets and priced with observable market assumptions at a mid-market valuation point, with appropriate valuation adjustments for liquidity and credit risk. For purposes of valuation adjustments to its derivative positions under FASB ASC 820-10-35, the Company has evaluated liquidity premiums that may be demanded by market participants, as well as

the credit risk of its counterparties and its own credit if applicable. To date, no material losses due to a counterparty's inability to pay any net uncollateralized position has been incurred.

The credit risk associated with the underlying cash flows of an instrument carried at fair value was a consideration in estimating the fair value of certain financial instruments. Credit risk was considered in the valuation through a variety of inputs, as applicable, including, the actual default and loss severity of the collateral, and level of subordination. The assumptions used to estimate credit risk applied relevant information that a market participant would likely use in valuing an instrument. Because mortgage loans held-for-sale are sold within a few weeks of origination, it is unlikely to demonstrate any of the credit weaknesses discussed above and as a result, there were no credit related adjustments to fair value at September 30, 2010.

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The following tables present financial assets measured at fair value at September 30, 2010, and December 31, 2009 on a recurring basis and the change in fair value for those specific financial instruments in which fair value has been elected at September 30, 2010 and 2009. The changes in the fair value of economic hedges were also recorded in mortgage banking activities and are designed to partially offset the change in fair value of the mortgage loans held-for-sale and interest rate lock commitments referenced in the tables below.

	Assets Measured at Fair Value September 30, 2010	Fair Value Measurements at September 30, 2010		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Debt securities issued by U.S. Government corporations and agencies	\$ 31,671	\$	\$ 31,671	\$
Debt securities issued by states and political subdivisions	11,794		11,795	
Residential mortgage-backed securities Agency	109,107		109,106	
Mortgage loans held-for-sale	138,150		138,150	
Other Assets ⁽¹⁾	2,768			2,768
Other Liabilities ⁽¹⁾	714			714

(1) This amount includes mortgage related interest rate lock commitments and derivative financial instruments to hedge interest rate risk. Interest rate lock commitments were recorded on a gross basis.

Assets	Fair Value Measurements at December 31, 2009	Significant
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	Measured at Fair Value December 31, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1) <i>(In Thousands)</i>	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Debt securities issued by U.S. Government corporations and agencies	\$ 63,119	\$	\$ 63,119	\$
Debt securities issued by states and political subdivisions	11,407		11,407	
Residential mortgage-backed securities Agency	62,391		62,391	
Mortgage loans held-for-sale	80,869		80,869	
Other Assets ⁽¹⁾	1,778			1,778
Other Liabilities ⁽¹⁾	55			55

(1) This amount includes mortgage related interest rate lock commitments and derivative financial instruments to hedge interest rate risk. Interest rate lock commitments were recorded on a gross basis.

	For Items Measured at Fair Value Pursuant to Election of the Fair Value Option: Fair Value Gain (Loss) related to Mortgage Banking Activities for the Three Months Ended September 30, 2010		September 30, 2009	
	<i>(In Thousands)</i>			
Mortgage loans held-for-sale	\$	(1,262)	\$	2,522

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**For Items Measured at Fair Value
Pursuant to
Election of the Fair Value Option: Fair
Value Gain
(Loss) related to Mortgage Banking
Activities for
the Nine Months Ended
September 30, September 30,
2010 2009
(In Thousands)**

Mortgage loans held-for-sale	\$	2,365	\$	1,609
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The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (level 3) during the three and nine months ended September 30, 2010 and 2009.

		Other Assets⁽¹⁾		Other Liabilities⁽¹⁾
<i>(In Thousands)</i>				
Beginning Balance July 1, 2010	\$	2,447	\$	(2,714)
Total gains (losses) included in earnings: ⁽²⁾				
Issuances		2,768		(714)
Settlements and closed loans		(1,864)		2
Expirations		(583)		2,712
Total gains (losses) included in other comprehensive income				
Ending Balance September 30, 2010 ⁽³⁾	\$	2,768	\$	(714)

(1) Includes mortgage related interest rate lock commitments and derivative financial instruments entered into to hedge interest rate risk.

(2) Amounts included in earnings are recorded in

mortgage
banking
activities.

- (3) Represents the amount included in earnings attributable to the changes in unrealized gains/losses relating to IRLCs and derivatives still held at period end.

	Other Assets⁽¹⁾	Other Liabilities⁽¹⁾
	<i>(In Thousands)</i>	
Beginning Balance January 1, 2010	\$ 1,778	\$ (55)
Total gains (losses) included in earnings: ⁽²⁾		
Issuances	6,503	(3,465)
Settlements and closed loans	(2,524)	48
Expirations	(2,989)	2,758
Total gains (losses) included in other comprehensive income		
Ending Balance September 30, 2010 ⁽³⁾	\$ 2,768	\$ (714)

- (1) Includes mortgage related interest rate lock commitments and derivative financial instruments entered into to hedge interest rate risk.

- (2) Amounts included in earnings are recorded in mortgage

banking
activities.

- (3) Represents the amount included in earnings attributable to the changes in unrealized gains/losses relating to IRLCs and derivatives still held at period end.

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	Other Assets⁽¹⁾	Other Liabilities⁽¹⁾
	<i>(In Thousands)</i>	
Beginning Balance July 1, 2009	\$ 2,220	\$ (33)
Total gains (losses) included in earnings: ⁽²⁾		
Issuances	855	(1,186)
Settlements and closed loans	(300)	3
Expirations	(1,920)	30
Total gains (losses) included in other comprehensive income		
Ending Balance September 30, 2009 ⁽³⁾	\$ 855	\$ (1,186)

(1) Includes mortgage related interest rate lock commitments and derivative financial instruments entered into to hedge interest rate risk.

(2) Amounts included in earnings are recorded in mortgage banking activities.

(3) Represents the amount included in earnings attributable to the changes in unrealized gains/losses relating to IRLCs and derivatives still held at period

end.

	Other Assets⁽¹⁾	Other Liabilities⁽¹⁾
	<i>(In Thousands)</i>	
Beginning Balance January 1, 2009	\$	\$
Total gains (losses) included in earnings: ⁽²⁾		
Issuances	4,343	(1,686)
Settlements and closed loans	(1,090)	3
Expirations	(2,398)	497
Total gains (losses) included in other comprehensive income		
Ending Balance September 30, 2009 ⁽³⁾	\$ 855	\$ (1,186)

(1) Includes mortgage related interest rate lock commitments and derivative financial instruments entered into to hedge interest rate risk.

(2) Amounts included in earnings are recorded in mortgage banking activities.

(3) Represents the amount included in earnings attributable to the changes in unrealized gains/losses relating to IRLCs and derivatives still held at period end.

The following tables present the assets that are measured at fair value on a non-recurring basis by level within the fair value hierarchy as reported on the consolidated statements of financial position at September 30, 2010 and December 31, 2009.

	Fair Value Measurements at September 30, 2010				
	Total	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Valuation Allowance
			<i>(In Thousands)</i>		
Impaired loans	\$ 38,507	\$	\$	\$ 38,507	\$ (3,299)
ORE	21,252			21,252	(3,588)
Mortgage servicing rights	2,832			2,832	(222)
SBA Servicing rights	2,686			2,686	(183)

	Fair Value Measurements at December 31, 2009				
	Total	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Valuation Allowance
			<i>(In Thousands)</i>		
SBA loans held-for-sale	\$ 4,807	\$	\$	\$ 4,807	\$ (87)
Impaired loans	75,971			75,971	(6,038)
ORE	21,780			21,780	(3,975)
Mortgage servicing rights	875			875	(83)

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SBA loans held-for-sale are measured at the lower of cost or fair value. Fair value is based on recent trades for similar loan pools as well as offering prices for similar assets provided by buyers in the SBA secondary market. If the cost of a loan is determined to be greater than the fair value of similar loans, the impairment is recorded by the establishment of a reserve to reduce the value of the loan. There were no impaired SBA loans held-for-sale at September 30, 2010. Impaired loans are evaluated and valued at the time the loan is identified as impaired, at the lower of cost or fair value. Fair value is measured based on the value of the collateral securing these loans and is classified as a Level 3 in the fair value hierarchy. Collateral may include real estate or business assets, including equipment, inventory and accounts receivable. The value of real estate collateral is determined based on an appraisal by qualified licensed appraisers hired by the Company. If significant, the value of business equipment is based on an appraisal by qualified licensed appraisers hired by the Company otherwise, the equipment's net book value on the business' financial statements is the basis for the value of business equipment. Inventory and accounts receivable collateral are valued based on independent field examiner review or aging reports. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business. Impaired loans are evaluated on at least a quarterly basis for additional impairment and adjusted accordingly.

Mortgage servicing rights are initially recorded at fair value when mortgage loans are sold service retained. These assets are then amortized in proportion to and over the period of estimated net servicing income. On a monthly basis these servicing assets are assessed for impairment based on fair value. Management determines fair value by stratifying the servicing portfolio into homogeneous subsets with unique behavior characteristics, converting those characteristics into income and expense streams, adjusting those streams for prepayments, present valuing the adjusted streams, and combining the present values into a total. If the cost basis of any loan stratification tranche is higher than the present value of the tranche, an impairment is recorded.

SBA servicing rights are initially recorded at fair value when loans are sold service retained. These assets are then amortized in proportion to and over the period of estimated net servicing income. On a monthly basis these servicing assets are assessed for impairment based on fair value. Management determines fair value by stratifying the servicing portfolio into homogeneous subsets with unique behavior characteristics, converting those characteristics into income and expense streams, adjusting those streams for prepayments, present valuing the adjusted streams, and combining the present values into a total. If the cost basis of any loan stratification tranche is higher than the present value of the tranche, an impairment is recorded.

Foreclosed assets in Other Real Estate are adjusted to fair value upon transfer of the loans to foreclosed assets. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value less estimated selling costs. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset as nonrecurring Level 3. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business.

The following tables present the difference between the aggregate fair value and the aggregate unpaid principal balance of loans held-for-sale for which the fair value option has been elected as of September 30, 2010 and December 31, 2009. The tables also include the difference between aggregate fair value and the aggregate unpaid principal balance of loans that are 90 days or more past due, as well as loans in nonaccrual status.

Aggregate Fair Value September 30, 2010	Aggregate Unpaid Principal Balance Under FVO September 30, 2010	Fair Value Over Unpaid Principal
	<i>(In Thousands)</i>	

Loans held-for-sale	\$ 138,150	\$	135,545	\$	2,605
Past due loans of 90+ days					
Nonaccrual loans					

	Aggregate Fair Value December 31, 2009		Aggregate Unpaid Principal Balance Under FVO December 31, 2009 <i>(In Thousands)</i>		Fair Value Over/(Under) Unpaid Principal
Loans held-for-sale	\$ 80,869	\$	80,629	\$	240
Past due loans of 90+ days					
Nonaccrual loans					

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SFAS No. 107, Disclosures about Fair Value of Financial Instruments, (SFAS No. 107) as amended by FASB Staff Position No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments now codified in ASC 825-10-50 requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on settlements using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets, and, in many cases, could not be realized in immediate settlement of the instrument. ASC 825-10-50 excludes certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

	September 30, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	<i>(In Thousands)</i>			
Financial Instruments (Assets):				
Cash and due from banks	\$ 67,361	\$ 67,361	\$ 170,692	\$ 170,692
Federal funds sold	642	642	428	428
Investment securities available-for-sale	152,572	152,572	136,917	136,917
Investment securities held-to-maturity	15,689	16,613	19,326	19,942
Investment in FHLB stock	6,542	6,542	6,767	6,767
Total loans	1,513,449	1,400,064	1,391,018	1,283,330
Total financial instruments (assets)	1,756,255	\$ 1,643,794	1,725,148	\$ 1,618,076
Non-financial instruments (assets)	122,963		126,372	
Total assets	\$ 1,879,218		\$ 1,851,520	
Financial Instruments (Liabilities):				
Noninterest-bearing demand deposits	\$ 186,112	\$ 186,112	\$ 157,511	\$ 157,511
Interest-bearing deposits	1,375,062	1,381,241	1,393,214	1,402,637
Total deposits	1,561,174	1,567,353	1,550,725	1,560,148
Short-term borrowings	22,715	22,715	41,870	41,143
Subordinated debt	67,527	59,985	67,527	60,573
Other long-term debt	75,000	75,443	50,000	51,017
Total financial instruments (liabilities)	1,726,416	\$ 1,725,496	1,710,122	\$ 1,712,881
Non-financial instruments (liabilities and shareholders equity)	152,802		141,398	
Total liabilities and shareholders equity	\$ 1,879,218		\$ 1,851,520	

The carrying amounts reported in the consolidated balance sheets for cash, due from banks, and Federal funds sold approximate the fair values of those assets. For investment securities, fair value equals quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar

securities or dealer quotes.

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type. The fair value of performing loans is calculated by discounting scheduled cash flows through the remaining maturities using estimated market discount rates that reflect the credit and interest rate risk inherent in the loans along with a market risk premium and liquidity discount.

Fair value for significant nonperforming loans is estimated taking into consideration recent external appraisals of the underlying collateral for loans that are collateral dependent. If appraisals are not available or if the loan is not collateral dependent, estimated cash flows are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows, and discount rates are judgmentally determined using available market information and specific borrower information.

The fair value of deposits with no stated maturities, such as noninterest-bearing demand deposits, savings, interest-bearing demand, and money market accounts, is equal to the amount payable on demand. The fair value of time deposits is based on the discounted value of contractual cash flows based on the discounted rates currently offered for deposits of similar remaining maturities.

The carrying amounts reported in the consolidated balance sheets for short-term debt generally approximate those liabilities fair values with the exception of FHLB advances which are estimated based on the current rates offered to us for debt of the same remaining maturity.

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The fair value of the Company's long-term debt is estimated based on the quoted market prices for the same or similar issues or on the current rates offered to us for debt of the same remaining maturities.

For off-balance sheet instruments, fair values are based on rates currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing for loan commitments and letters of credit. Fees related to these instruments were immaterial at September 30, 2010, and December 31, 2009, and the carrying amounts represent a reasonable approximation of their fair values. Loan commitments, letters and lines of credit, and similar obligations typically have variable interest rates and clauses that deny funding if the customer's credit quality deteriorates. Therefore, the fair values of these items are not significant and are not included in the foregoing schedule.

This presentation excludes certain nonfinancial instruments. The disclosures also do not include certain intangible assets, such as customer relationships, and deposit base intangibles. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

7. Derivative Financial Instruments

The Company maintains a risk management program to manage interest rate risk and pricing risk associated with its mortgage lending activities. The risk management program includes the use of forward contracts and other derivatives that are recorded in the financial statements at fair value and are used to offset changes in value of the mortgage inventory due to changes in market interest rates. As a normal part of its operations, the Company enters into derivative contracts to economically hedge risks associated with overall price risk related to IRLCs and mortgage loans held-for-sale carried at fair value under ASC 825-10-25. Fair value changes occur as a result of interest rate movements as well as changes in the value of the associated servicing. Derivative instruments used include forward sale commitments and IRLCs. All derivatives are carried at fair value in the Consolidated Balance Sheets in other assets or other liabilities. A gross gain of \$990,000 and a gross loss of \$659,000 for the first nine months of 2010 associated with the forward sales commitments and IRLCs are recorded in the Consolidated Statements of Operations in mortgage banking activities.

The Company's risk management derivatives are based on underlying risks primarily related to interest rates and forward sales commitments. Forwards are contracts for the delayed delivery or net settlement of an underlying instrument, such as a mortgage loan, in which the seller agrees to deliver on a specified future date, either a specified instrument at a specified price or yield or the net cash equivalent of an underlying instrument. These hedges are used to preserve the Company's position relative to future sales of loans to third parties in an effort to minimize the volatility of the expected gain on sale from changes in interest rate and the associated pricing changes.

Credit and Market Risk Associated with Derivatives

Derivatives expose the Company to credit risk. If the counterparty fails to perform, the credit risk at that time would be equal to the net derivative asset position, if any, for that counterparty. The Company minimizes the credit or repayment risk in derivative instruments by entering into transactions with high quality counterparties that are reviewed periodically by the Company's Risk Management area.

The Company's derivative positions as of September 30, 2010, were as follows:

	Contract or Notional Amount
	<i>(In Thousands)</i>
Forward rate commitments	\$ 270,519
Interest rate lock commitments	140,008
Total derivatives contracts	\$ 410,527

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Investment securities at September 30, 2010, and December 31, 2009, are summarized as follows:

	September 30, 2010		December 31, 2009	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	<i>(In Thousands)</i>			
Available-for-Sale:				
Obligations of U.S. Government corporations and agencies:				
Due in less than one year	\$ 15,000	\$ 15,083	\$ 28,674	\$ 28,351
Due after one year through five years	16,135	16,588	35,000	34,768
Municipal securities:				
Due after one year through five years	5,592	5,708	3,816	3,765
Due five years through ten years	6,113	6,086	6,144	6,090
Due after ten years			1,746	1,552
Residential mortgage-backed securities-agency:				
Due after one year through five years	105,660	107,524	32,452	33,247
Due five years through ten years	1,567	1,583	29,188	29,144
	\$ 150,067	\$ 152,572	\$ 137,020	\$ 136,917
Held-to-Maturity:				
Residential mortgage-backed securities-agency:				
Due in less than one year	\$ 2,012	\$ 2,044	\$	\$
Due after one year through five years	13,677	14,569	19,326	19,942
	\$ 15,689	\$ 16,613	\$ 19,326	\$ 19,942

The Bank sold 16 securities held-for-sale totaling \$98.3 million during the nine months ended September 30, 2010. Proceeds received were \$100.6 million for a gross gain of \$2.3 million. Four securities held-for-sale totaling \$15.5 million were sold during the nine months ended September 30, 2009. Proceeds received were \$16.1 million for a gross gain of \$519,000. The Bank had 14 securities for a total of \$110.7 million called during the nine months ended September 30, 2010. There were no securities called for the nine months ended September 30, 2009. There were no investments held in trading accounts during 2010 and 2009.

	September 30, 2010				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Other than Temporary Impairment	Fair Value
	<i>(In Thousands)</i>				
Available-for-Sale:					
Obligations of U.S. Government corporations and agencies					
	\$ 31,135	\$ 536	\$	\$	\$ 31,671

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Municipal securities	11,705	249	(160)	11,794
Residential mortgage-backed securities agency	107,227	1,880		109,107
	\$ 150,067	\$ 2,665	\$ (160)	\$ 152,572
Held-to-Maturity:				
Residential mortgage-backed securities agency	\$ 15,689	\$ 924	\$	\$ 16,613
	\$ 15,689	\$ 924	\$	\$ 16,613

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	December 31, 2009				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Other than Temporary Impairment	Fair Value
	<i>(In Thousands)</i>				
Available-for-Sale:					
Obligations of U.S. Government corporations and agencies	\$ 63,674	\$	\$ (555)	\$	\$ 63,119
Municipal securities	11,706	20	(319)		11,407
Residential mortgage-backed securities agency	61,640	923	(172)		62,391
	\$ 137,020	\$ 943	\$ (1,046)	\$	\$ 136,917
Held-to-Maturity:					
Residential mortgage-backed securities agency	\$ 19,326	\$ 616	\$	\$	\$ 19,942
	\$ 19,326	\$ 616	\$	\$	\$ 19,942

The following table reflects the gross unrealized losses and fair values of investment securities with unrealized losses at September 30, 2010, and December 31, 2009, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss and temporarily impaired position:

	12 Months or Less		More Than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	<i>(In Thousands)</i>			
Available-for-Sale September 30, 2010:				
U.S. Government corporations and agencies	\$	\$	\$	\$
Municipal securities	884	160		
Residential mortgage-backed securities agency				
	\$ 884	\$ 160	\$	\$
Held-to-Maturity September 30, 2010:				
Residential mortgage-backed securities agency	\$	\$	\$	\$

	12 Months or Less		More Than 12 Months	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	<i>(In Thousands)</i>			

Available-for-Sale December 31, 2009:

U.S. Government corporations and agencies	\$ 53,119	\$ 555	\$	\$
Municipal securities	5,690	70	2,363	249
Residential mortgage-backed securities agency	22,445	172		
	\$ 81,254	\$ 797	\$ 2,363	\$ 249

Held-to-Maturity December 31, 2009:

Residential mortgage-backed securities agency	\$	\$	\$	\$
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If fair value of a debt security is less than its amortized cost basis at the balance sheet date, management must determine if the security has an other than temporary impairment (OTTI). If management does not expect to recover the entire amortized cost basis of a security, an OTTI has occurred. If management's intention is to sell the security, an OTTI has occurred. If it is more likely than not that management will be required to sell a security before the recovery of the amortized cost basis, an OTTI has occurred. The Company will recognize the full OTTI in earnings if it intends to sell a security or will more likely than not be required to sell the security. Otherwise, an OTTI will be separated into the amount representing a credit loss and the amount related to all other factors. The amount of an OTTI related to credit losses will be recognized in earnings. The amount related to other factors will be recognized in other comprehensive income, net of taxes.

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There were no individual investment securities in a continuous unrealized loss position at September 30, 2010, for more than 12 months. Four individual investment securities were in a continuous unrealized loss position at December 31, 2009, for up to 22 months. In determining other-than-temporary impairment losses on securities, management primarily considers the credit rating of the municipality itself as the primary source of repayment and secondarily the financial viability of the insurer of the obligation.

9. Certain Transfers of Financial Assets

The Company has transferred certain residential mortgage loans, SBA loans, and indirect automobile loans in which the Company has continuing involvement to third parties. The Company has not engaged in securitization activities with respect to such loans. The Company's continuing involvement in such transfers has been limited to certain servicing responsibilities. The Company is not required to provide additional financial support to any of these entities, nor has the Company provided any support it was not obligated to provide. Servicing rights may give rise to servicing assets, which are initially recognized at fair value, subsequently amortized, and tested for impairment. Gains or losses upon sale, in addition to servicing fees and collateral management fees, are recorded in noninterest income.

The majority of the indirect automobile loan pools and certain SBA and residential mortgage loans are sold with servicing retained. When the contractually specific servicing fees on loans sold servicing retained are expected to be more than adequate compensation to a servicer for performing the servicing, a capitalized servicing asset is recognized based on fair value. When the expected costs to a servicer for performing loan servicing are not expected to adequately compensate a servicer, a capitalized servicing liability is recognized based on fair value. Servicing assets and servicing liabilities are amortized over the expected lives of the serviced loans utilizing the interest method. Management makes certain estimates and assumptions related to costs to service varying types of loans and pools of loans, prepayment speeds, the projected lives of loans and pools of loans sold servicing retained, and discount factors used in calculating the present values of servicing fees projected to be received.

No less frequently than quarterly, management reviews the status of all loans and pools of servicing assets to determine if there is any impairment to those assets due to such factors as earlier than estimated repayments or significant prepayments. Any impairment identified in these assets will result in reductions in their carrying values through a valuation allowance and a corresponding increase in operating expenses.

Residential Mortgage Loans

The Company typically sells first lien residential mortgage loans to third party investors including Fannie Mae. Certain of these loans are exchanged for cash and servicing rights, which generate servicing assets for the Company. The servicing assets are recorded initially at fair value. All such transfers have been accounted for as sales by the Company. Sales treatment results in a gain or loss, which is recorded in Mortgage Banking Activities in the Consolidated Statement of Operations. As seller, the Company has made certain standard representations and warranties with respect to the originally transferred loans. The Company estimates its reserves under such arrangements predominantly based on prior experience. To date, the Company's buy-backs have been de minimus. The Company classifies interest rate lock commitments on residential mortgage loans held-for-sale, which are derivatives under SFAS No. 133 now codified in ASC 815-10-15, on a gross basis within other liabilities or other assets. The fair value of these commitments, while based on interest rates observable in the market, is highly dependent on the ultimate closing of the loans. These pull-through rates are based on both the Company's historical data and the current interest rate environment and reflect the Company's best estimate of the likelihood that a commitment will ultimately result in a closed loan. As a result of the adoption of SAB No. 109, the loan servicing value is also included in the fair value of interest rate lock commitments (IRLCs).

SBA Loans

Transfers of SBA loans were executed with third parties. These SBA loans, which are typically partially guaranteed or otherwise credit enhanced, are generally secured by business property such as inventory, equipment, and accounts receivable. As seller, the Company had made certain representations and warranties with respect to the originally transferred loans and the Company has not incurred any material losses with respect to such representations and warranties. Consistent with the updated guidance on accounting for transfers of financial assets, because the Company warrants the borrower will make all scheduled payments for the first 90 days following the sale of certain SBA loans, all sales in the third quarter of 2010 were accounted for as secured borrowings which results in an increase in Cash for

the proceeds of the borrowing and an increase in Other Short-Term Borrowings on the Consolidated Balance Sheet. No gain or loss is recognized for the proceeds of secured borrowings. When the 90 day warranty period expires, the secured borrowing is reduced, loans are reduced, and a gain or loss on sale is recorded in SBA Lending Activities in the Consolidated Statement of Operations.

Indirect Automobile Loans

The Bank purchases, on a nonrecourse basis, consumer installment contracts secured by new and used vehicles purchased by consumers from franchised motor vehicle dealers and selected independent dealers located throughout the Southeast. A portion of the indirect automobile loans the Bank originates is sold with servicing retained. Certain of these loans are exchanged for cash and servicing rights, which generate servicing assets for the Company. The servicing assets are recorded initially at fair value. As seller, the Company has made certain standard representations and warranties with respect to the originally transferred loans. The amount of loans repurchased has been de minimus.

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At September 30, 2010 and 2009, the total fair value of servicing all loans sold, was approximately \$5.4 million and \$3.5 million, respectively. To estimate the fair values of these servicing assets, consideration was given to dealer indications of market value, where applicable, as well as the results of discounted cash flow models using key assumptions and inputs for prepayment rates, credit losses, and discount rates.

10. Recent Accounting Pronouncements

In June 2009, the FASB issued SFAS No. 166, Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140 now codified by Accounting Standards Update No. 2009-16 (ASU No. 2009-16). This update improves the relevance, representational faithfulness, and comparability of the information provided about a transfer of financial assets; the effects of a transfer on financial position, financial performance and cash flows; and a transferor's continuing involvement in the transferred financial assets. ASU No. 2009-16 was effective for annual reporting periods beginning after November 15, 2009. The Company adopted this guidance on January 1, 2010. There was no material impact on its financial condition and statement of operations as a result of the adoption of this guidance.

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R) now codified by ASU No. 2009-17 to improve financial reporting by companies with variable interest entities. ASU No. 2009-17 addresses the effects on certain provisions of FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities, as a result of the elimination of the qualifying special-purpose entity (QSPE) in FASB Statement No. 166, Accounting for Transfers of Financial Assets, and the application of certain key provisions of Interpretation 46(R). ASU No. 2009-17 was effective for annual reporting periods beginning after November 15, 2009. The Company adopted this guidance on January 1, 2010. There was no material impact on its financial condition and statement of operations as a result of the adoption of this guidance.

In January 2010, the FASB issued ASU 2010-06, an update to ASC 820-10, Fair Value Measurements . This update adds a new requirement to disclose transfers in and out of level 1 and level 2, along with the reasons for the transfers, and requires a gross presentation of purchases and sales of level 3 activities. Additionally, the update clarifies that entities provide fair value measurement disclosures for each class of assets and liabilities and that entities provide enhanced disclosures around level 2 valuation techniques and inputs. The Company adopted the disclosure requirements for level 1 and level 2 transfers and the expanded fair value measurement and valuation disclosures effective January 1, 2010. The disclosure requirements for level 3 activities are effective on January 1, 2011. The adoption of the disclosure requirements for level 1 and level 2 transfers and the expanded qualitative disclosures, had no impact on the Company's financial position and statement of operations. The Company does not expect the adoption of the level 3 disclosure requirements to have an impact on its financial position and statement of operations.

In February 2010, the FASB issued ASU No. 2010-09 an update to Subsequent Events (Topic 855) to clarify that an SEC filer must evaluate subsequent events through the date the financial statements are issued. The update removes the requirement for SEC filers to disclose the date through which subsequent events were evaluated. ASU No. 2010-09 was effective upon issuance and was adopted by the Company immediately. This ASU did not have a material impact on the Company's financial condition and statements of operations.

In April 2010, the FASB issued ASU No. 2010-18 Effect of a Loan Modification When the Loan is Part of a Pool That is Accounted for as a Single Asset which clarifies that modifications of loans that are accounted for within a pool under Subtopic 310-30, which provides guidance on accounting for acquired loans that have evidence of credit deterioration upon acquisition, do not result in the removal of those loans from the pool even if the modification would otherwise be considered a troubled debt restructuring. This ASU is effective for modifications of loans accounted for within pools occurring in the first interim period ending after July 15, 2010. The Company does not expect the adoption of this ASU to have a material impact on its financial position and statement of operations.

In July 2010, the FASB issued ASU No. 2010-20 Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses which amends Topic 310 to improve the disclosures that an entity provides about the credit quality of its financing receivables and the related allowance for credit losses. As a result of these amendments, an entity is required to disaggregate by portfolio segment or class certain existing disclosures and provide certain new disclosures about its financing receivables and related allowance for credit losses. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after

December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The Company does not expect the adoption of this ASU to have a material impact on its financial position and statement of operations and will include the required disclosures in its annual report.

11. Subsequent Event

In October 2010, the Company approved the distribution of a stock dividend on November 12, 2010 of one share for every 200 shares owned on the record date of November 2, 2010. The stock dividend has been given retroactive effect in the accompanying consolidated financial statements. Subsequent events have been evaluated through the date the financial statements were filed.

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

The following analysis reviews important factors affecting our financial condition at September 30, 2010, compared to December 31, 2009, and compares the results of operations for the third quarters ended September 30, 2010, and 2009. These comments should be read in conjunction with our consolidated financial statements and accompanying notes appearing in this report and the Risk Factors set forth in our Annual Report on Form 10-K for the year ended December 31, 2009. All percentage and dollar variances noted in the following analysis are calculated from the balances presented in the accompanying consolidated financial statements.

Forward-Looking Statements

This report on Form 10-Q may include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that reflect our current expectations relating to present or future trends or factors generally affecting the banking industry and specifically affecting our operations, markets and products. Without limiting the foregoing, the words believes, expects, anticipates, estimates, projects, intends, and similar expressions are intended to identify forward-looking statements. These forward-looking statements are based upon assumptions we believe are reasonable and may relate to, among other things, the deteriorating economy and its impact on operating results and credit quality, the adequacy of the allowance for loan losses, changes in interest rates, and litigation results. These forward-looking statements are subject to risks and uncertainties. Actual results could differ materially from those projected for many reasons, including without limitation, changing events and trends that have influenced our assumptions. These trends and events include (1) the impact of current governmental economic and regulatory measures, including the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act, and the uncertainty of future governmental economic and regulatory measures; (2) the continued uncertainty in general business and economic conditions, both nationally and in our local market, as the impact such economic uncertainty has on real estate values in our lending market and the overall credit quality in our loan portfolio; (3) the restrictions imposed on our operations by the MOU and the terms of the U.S. Treasury Department's (the Treasury) equity investment in us, and the resulting limitations on executive compensation imposed through our participation in the TARP Capital Purchase Program; (4) difficulties in maintaining quality loan growth, particularly in light of the difficulties in the national and local housing market in general and residential construction and new home sales in particular; (5) unique risks associated with our construction and land development loans; (6) our ability to maintain and service relationships with automobile dealers and indirect automobile loan purchasers and our ability to profitably manage changes in our indirect automobile lending operations; (7) the accuracy and completeness of information from customers and our counterparties; (8) greater loan losses than historic levels and an insufficient allowance for loan losses; (9) our liquidity and sources of liquidity; (10) changes in the interest rate environment and their impact on our net interest margin; (11) our ability to raise capital; (12) the volatility and limited trading of our common stock; (13) the impact of dilution on our common stock; (14) the effectiveness of our controls and procedures; (15) our ability to attract and retain skilled people; (16) greater competitive pressures among financial institutions in our market; (17) changes in political, legislative and economic conditions, including inflation or deflation; and (18) failure to achieve the revenue increases expected to result from our investments in our growth strategies, including our branch additions and in our transaction deposit and lending businesses.

This list is intended to identify some of the principal factors that could cause actual results to differ materially from those described in the forward-looking statements included herein and are not intended to represent a complete list of all risks and uncertainties in our business. Investors are encouraged to read the related section in our 2009 Annual Report on Form 10-K, including the Risk Factors set forth therein. Additional information and other factors that could affect future financial results are included in our filings with the Securities and Exchange Commission.

Critical Accounting Policies

Our accounting and reporting policies are in accordance with U.S. generally accepted accounting principles and conform to general practices within the financial services industry. Our financial position and results of operations are affected by management's application of accounting policies, including estimates, assumptions and judgments made to arrive at the carrying value of assets and liabilities and amounts reported for revenues, expenses and related

disclosures. Different assumptions in the application of these policies, or conditions significantly different from certain assumptions, could result in material changes in our consolidated financial position or consolidated results of operations. Critical accounting and reporting policies include those related to the allowance for loan losses, fair value of mortgage loans held-for-sale, the capitalization of servicing assets and liabilities and the related amortization, loan related revenue recognition, and income taxes. Our accounting policies are fundamental to understanding our consolidated financial position and consolidated results of operations. Significant accounting policies have been periodically discussed and reviewed with and approved by the Board of Directors.

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Our critical accounting policies that are highly dependent on estimates, assumptions, and judgment are substantially unchanged from the descriptions included in the notes to consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2009.

Results of Operations**Earnings**

For the third quarter of 2010, the Company recorded net income of \$2.1 million compared to net income of \$398,000 for the third quarter of 2009. Net income (loss) available to common equity was \$1.3 million and \$(425,000) for the quarters ended September 30, 2010 and 2009, respectively. Basic and diluted earnings per share for the three months ended September 30, 2010 were \$.12 and \$.10, respectively, compared to a loss per share (basic and diluted) of \$.04 for the three months ended September 30, 2009. The increase in net income for the third quarter of 2010 when compared to the same period in 2009 was due to a \$4.3 million increase in noninterest income, and an increase in net interest income of \$2.6 million, net of a \$3.5 million increase in noninterest expense. Net income (loss) for the nine months ended September 30, 2010 was \$7.1 million compared to \$(5.8) million for the same period in 2009. Net income (loss) available to common equity was \$4.7 million and \$(8.3) million for the nine month period ended September 30, 2010 and 2009, respectively. Basic and diluted earnings per share for the first nine months of 2010 were \$.44 and \$.39, respectively, compared to a loss per share (basic and diluted) of \$.81 for the nine months ended September 30, 2009. The increase in net income for the nine months ended September 30, 2010 compared to the same period in 2009 was due to the decrease in provision for loan losses which decreased \$11.2 million due to continued decreases in the amount of charge-offs for both consumer and construction loans, and an increase in net interest income of \$10.4 million. Net interest income increased as the cost of funds decreased more quickly than the yield on earning assets resulting in improved net interest margin.

Net Interest Income

Net interest income for the third quarter of 2010 increased \$2.6 million or 19.1% to \$16.4 million when compared to the same period in 2009 due primarily to a decrease of \$4.0 million in interest expense. The yield on interest-earning assets for the third quarter of 2010 was 5.33%, a decrease of 28 basis points when compared to the yield on interest-earning assets for the same period in 2009. The average balance of loans outstanding for the third quarter of 2010 increased \$49.5 million or 3.4% to \$1.510 billion when compared to the same period in 2009. The yield on average loans outstanding for the period decreased 24 basis points to 5.81% when compared to the same period in 2009 primarily due to a decrease in yield on indirect automobile loans in response to competitive pressures as management took steps to grow the loan portfolio. Somewhat offsetting this decrease in rate was a decrease in the level of nonperforming assets from \$83.5 million at September 30, 2009 to \$60.7 million at September 30, 2010. The average balance of interest-bearing liabilities decreased \$62.7 million or 3.9% to \$1.547 billion for the third quarter of 2010 while the rate on this average balance decreased 91 basis points to 1.87% when compared to the same period in 2009. The 91 basis point decrease in the cost of interest-bearing liabilities was higher than the 28 basis point decrease in the yield on interest earning assets, resulting in a 63 basis point increase in net interest spread. Net interest margin increased 60 basis points to 3.70% for the third quarter of 2010 compared to 3.10% for the same period in 2009. Net interest income for the first nine months of 2010 increased \$10.4 million to \$47.2 million when compared to the same period in 2009. The yield on interest-earning assets for the first nine months of 2010 was 5.41%, a decrease of 17 basis points when compared to the yield on interest-earning assets for the same period in 2009. The yield on average loans outstanding for the period increased three basis points to 5.99% when compared to the same period in 2009 due to reduced nonperforming assets. The yield on total interest earning assets decreased 17 basis points to 5.41% primarily due to a decrease in the yield on investments as the Bank repositioned the portfolio as part of interest rate, cash flow, and capital risk weighting strategies. The average balance of interest-bearing liabilities decreased \$9.8 million or .6% to \$1.558 billion for the first nine months of 2010 while the rate on this average balance decreased 101 basis points to 2.07% when compared to the same period in 2009. The 101 basis point decrease in the cost of interest-bearing liabilities was higher than the 17 basis point decrease in the yield on interest earning assets, resulting in an 84 basis point increase in net interest spread. Net interest margin increased 77 basis points to 3.59% for the nine months ended September 30, 2010 compared to 2.82% for the same period in 2009.

The Bank manages its net interest spread and net interest margin based primarily on its loan and deposit pricing. As part of management's concerted effort to reduce the cost of funds on deposits, there was a shift in the mix of deposits from higher cost certificate of deposits to lower cost savings and money market accounts. Management will continue to review its deposit pricing in 2010 and forecasts a continued decrease to cost of funds as higher priced certificates of deposit and brokered deposits mature and reset to lower interest rates.

Table of Contents**Provision for Loan Losses**

The allowance for loan losses is established and maintained through provisions charged to operations. Such provisions are based on management's evaluation of the loan portfolio including loan portfolio concentrations, current economic conditions, past loan loss experience, adequacy of underlying collateral, and such other factors which, in management's judgment, require consideration in estimating loan losses. Loans are charged off or charged down when, in the opinion of management, such loans are deemed to be uncollectible or not fully collectible. Subsequent recoveries are added to the allowance.

For all loan categories, historical loan loss experience, adjusted for changes in the risk characteristics of each loan category, current trends, and other factors, is used to determine the level of allowance required. Additional amounts are allocated based on the probable losses of individual impaired loans and the effect of economic conditions on both individual loans and loan categories. Since the allocation is based on estimates and subjective judgment, it is not necessarily indicative of the specific amounts of losses that may ultimately occur.

The allowance for loan losses for homogenous pools is allocated to loan types based on historical net charge-off rates adjusted for any current trends or other factors. The specific allowance for individually reviewed nonperforming loans and loans having greater than normal risk characteristics is based on a specific loan impairment analysis.

In determining the appropriate level for the allowance, management ensures that the overall allowance appropriately reflects a margin for the imprecision inherent in most estimates of the range of probable credit losses. This additional amount, if any, is reflected in the overall allowance. Management believes the allowance for loan losses is adequate to provide for losses inherent in the loan portfolio at September 30, 2010 (see Asset Quality).

The provision for loan losses for the third quarter and the first nine months of 2010 was \$5.0 million and \$10.2 million, respectively, compared to \$4.5 million and \$21.3 million for the same periods in 2009. The allowance for loan losses as a percentage of loans at September 30, 2010, was 2.09% compared to 2.33% at December 31, 2009, and to 2.71% at September 30, 2009. The decrease in the allowance as a percentage of loans at September 30, 2010, was due to decreased charge-offs in both the residential construction and consumer loan portfolios for the nine months ended September 30, 2010, compared to the same period in 2009 as well as management's assessment of the recent stabilization in real estate values and the overall improved economy. The ratio of net charge-offs to average loans on an annualized basis for the first nine months of 2010 decreased to 1.22% compared to 1.95% for the same period in 2009. The ratio of net charge-offs to average loans for the year ended December 31, 2009, was 2.44%. From January 1, 2008 to September 30, 2010, net charge-offs were \$63.8 million and the Company recorded an aggregate provision for loan losses of \$75.5 million. For every dollar of net charge-offs realized, the Company recorded \$1.18 in provision during this period. The following schedule summarizes changes in the allowance for loan losses for the periods indicated:

	Nine Months Ended		Year Ended
	September 30,		December
	2010	2009	31,
	2009		
	<i>(Dollars in Thousands)</i>		
Balance at beginning of period	\$ 30,072	\$ 33,691	\$ 33,691
Charge-offs:			
Commercial, financial and agricultural	144	301	315
SBA	322	660	730
Real estate-construction	6,529	9,867	20,217
Real estate-mortgage	266	293	416
Consumer installment	5,463	9,013	11,622
Total charge-offs	12,724	20,134	33,300

Recoveries:			
Commercial, financial and agricultural	23	8	8
SBA		29	31
Real estate-construction	206	35	77
Real estate-mortgage	4	15	20
Consumer installment	562	604	745
Total recoveries	795	691	881
Net charge-offs	11,929	19,443	32,419
Provision for loan losses	10,150	21,300	28,800
Balance at end of period	\$ 28,293	\$ 35,548	\$ 30,072
Annualized ratio of net charge-offs to average loans	1.22%	1.95%	2.44%
Allowance for loan losses as a percentage of loans at end of period	2.09%	2.71%	2.33%

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Substantially all of the consumer installment loan net charge-offs in the first nine months of 2010 and 2009 were from the indirect automobile loan portfolio. Consumer installment loan net charge-offs decreased \$2.7 million to \$4.9 million for the nine months ended September 30, 2010, compared to the same period in 2009. On a quarterly basis, the charge-off trend also shows improvement with net charge-offs of \$2.2 million, \$2.5 million, \$2.1 million, \$1.4 million, and \$1.4 million for the third and fourth quarters of 2009, and the first, second and third quarters of 2010, respectively. The annualized ratio of net charge-offs to average consumer loans outstanding was 1.06% and 1.25% during the first nine months of 2010 and 2009, respectively.

Construction loan net charge-offs were \$6.3 million in the first nine months of 2010 compared to \$9.8 million in the same period of 2009. The residential construction markets, while lagging the improvement in the consumer market, are showing some signs of stabilizing. The Bank's construction nonaccrual loans have shown a positive trend over the past five quarters with a total of \$73.9 million, \$56.3 million, \$44.3 million, \$43.9 million and \$41.2 million for the quarters ended September 2009 through September 2010, respectively. Management will continue to monitor closely and aggressively address credit quality and trends in the residential construction loan portfolio.

Noninterest Income

Noninterest income for the third quarter of 2010 was \$11.6 million compared to \$7.2 million for the same period in 2009, an increase of \$4.3 million for the three month period. The increase was a result of higher income from mortgage banking activities, and higher income from SBA lending activities offset somewhat by lower securities gains.

For the third quarter of 2010 compared to the same period in 2009, income from mortgage banking activities increased \$4.0 million compared to the same period in 2009 due to a \$3.3 million increase in the gain on loans sold, and a \$649,000 increase in origination fee income. Mortgage loans sold totaled \$357 million for the third quarter of 2010 compared to \$242 million sold in the third quarter of 2009. Originations totaled \$386 million in the third quarter of 2010 compared to \$217 million for the same period in 2009. Historically low interest rates and an increase in origination staff contributed to the increase in the volume of loans originated.

For the third quarter of 2010 compared to the same period in 2009, income from SBA lending activities increased \$804,000 due to an increase in the gain on loans sold. SBA loans sold totaled \$9.8 million for the third quarter of 2010 compared to \$1.3 million sold in the third quarter 2009. With the improvement in credit markets, demand for loan sales and therefore the market price and profit on loan sales have improved in 2010.

Securities gains decreased \$519,000 for the quarter ended September 30, 2010 compared to the same period in 2009 because there were no securities sales in 2010.

Noninterest income for nine months ended September 30, 2010 was \$29.3 million compared to \$21.8 million for the same period in 2009, an increase of \$7.5 million or 34.6%. The increase was a result of higher income from mortgage banking activities, higher securities gains, higher income from SBA lending activities and increased other operating income.

For the nine months ended September 30, 2010 compared to the same period in 2009, income from mortgage banking activities increased \$3.5 million compared to the same period in 2009 due primarily to a \$3.8 million increase in the gain on loans sold. Mortgage loans sold totaled \$749 million for 2010 compared to \$571 million sold for the same period in 2009.

Securities gains increased \$1.8 million for the first nine months ended September 30, 2010 compared to the same period in 2009 because of the sale of \$98 million in GNMA, FHLMC and FNMA mortgage backed securities during 2010 for a gain of \$2.3 million, compared to \$16 million in 2009 for a gain of \$519,000, as management repositioned the investment portfolio as part of the interest rate, cash flow, and capital risk rating strategies.

Income from SBA lending activities increased \$1.2 million or 207.71% due to an increase in the gain on loans sold. SBA loans sold totaled \$16.3 million in 2010 compared to \$10.2 sold for the same period in 2009.

Other operating income increased \$710,000 to \$1.1 million for the nine months ended September 30, 2010 compared to the same period in 2009. The increase is primarily the result of higher gains on sale of ORE which increased from a loss of \$50,000 in 2009 to a gain of \$541,000 in 2010. The increase is a result of comparatively more stable real estate values particularly in the housing market.

Noninterest Expense

Noninterest expense was \$20.0 million for the third quarter of 2010, compared to \$16.5 million for the same period in 2009, an increase of \$3.5 million or 21.3%. The increase was a result of higher salaries and benefits expense which increased \$3.6 million or 44.3% as a result of the expansion of the mortgage division and an increase in lenders in the SBA, Commercial, Private Banking and Indirect Auto Lending divisions. Other operating expense increased \$577,000 or 32.5% due to higher underwriting loan growth in the mortgage division, advertising expenses from an outdoor advertising campaign in 2010, credit reporting expenses, appraisal fees, and miscellaneous operating expenses related primarily to the increased mortgage originations. The cost of operation of other real estate decreased \$728,000 or 34.0% to \$1.4 million due primarily to smaller write-downs related to ORE and lower foreclosure expenses. The average ORE balance decreased to \$21.6 million for the third quarter of 2010 compared to \$23.5 million for the same period in 2009.

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Noninterest expense was \$55.8 million for the first nine months of 2010, compared to \$48.0 million for the same period in 2009, an increase of \$7.8 million or 16.3%. The increase was a result of higher salaries and benefits expense which increased \$5.7 million or 22.7% as a result of growth as discussed above. Other operating expense increased \$1.1 million or 21.8% due primarily to higher underwriting and insurance expense. The cost of operation of other real estate increased \$1.1 million or 23.0% to \$5.9 million due primarily to higher write-downs related to ORE which increased \$543,000, higher foreclosure expenses which increased \$306,000 and increased ORE related taxes and maintenance.

	Nine Months Ended September 30, 2010		2009		Year Ended December 31, 2009		2008	
	\$	%	\$	%	\$	%	\$	%
	<i>(Dollars in Thousands)</i>							
Writedown of ORE	\$ 3,681	62.0%	\$ 3,138	65.0%	\$ 3,869	56.4%	\$ 2,353	69.2%
ORE real property taxes	546	9.2	378	7.8	631	9.2	365	10.7
Foreclosure expense	1,116	18.8	810	16.8	1,617	23.6	113	3.3
ORE misc. expense	596	10.0	503	10.4	742	10.8	568	16.8
Cost of operation of ORE	\$ 5,939	100.0%	\$ 4,829	100.0%	\$ 6,859	100.0%	\$ 3,399	100.0%

Provision for Income Taxes

The provision for income taxes for both the third quarter and first nine months of 2010 was an expense of \$913,000 and \$3.5 million, respectively, compared to a benefit of \$346,000 and \$4.9 million for the same periods in 2009. The increased income tax expense in 2010 was primarily the result of an increase in income before taxes.

Taxes are accounted for in accordance with ASC 740-10-05. Under the liability method, deferred tax assets and liabilities (net DTA) are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. A charge to establish a valuation allowance is recognized if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) some portion or all of the deferred tax assets will not be realized. All available evidence, both positive and negative, is used in the consideration to determine whether, based on the weight of that evidence will be commensurate with the extent to which it can be objectively verified.

Four sources of taxable income are considered in determining whether a valuation allowance is required, included as set forth within ASC 740: taxable income in prior years, future reversals of existing taxable temporary differences, tax planning strategies and future taxable income. Management has concluded that it will more likely than not realize the benefit of its net DTA as of September 30, 2010 based to a large extent on its reliance on projections of future taxable income. Management believes that sufficient taxable income will be present in near term future periods to fully realize these DTAs.

Management also recognizes that the actual results could not only be impacted by the operational decisions it makes and strategies it pursues, but also by factors beyond its control and that can be difficult to predict such as macro and/or regional economic trends. Management continues to see improvement in certain key drivers of the Company's operational performance such as credit, pricing, and expenses. However, the general economic conditions, while showing continued signs of improvement, remain adverse with elevated unemployment and uncertainty related to the future interest rate environment and real estate values in its primary markets. As a result, the Company's net DTA of \$14.2 million as of September 30, 2010 could require a partial or full valuation allowance in future periods to the extent future taxable income does not occur at levels sufficient to support the amounts projected to be needed to realize the net DTA and Projections of future taxable income are required to be revised. The deferred tax asset balance was \$13.1 million at December 31, 2009 and \$11.7 million at September 30, 2009.

Financial Condition

Total assets were \$1.879 billion at September 30, 2010, compared to \$1.852 billion at December 31, 2009, an increase of \$27.7 million, or 1.50%. This increase was due to a \$65.4 million increase in loans and a \$55.3 million increase in loans held-for-sale, somewhat offset by a \$103.1 million decrease in cash and cash equivalents.

Cash and cash equivalents decreased \$103.1 million or 60.3% to \$68.0 million at September 30, 2010, compared to December 31, 2009. This balance varies with the Bank's liquidity needs and is influenced by scheduled loan closings, investment purchases, timing of customer deposits, and loan sales.

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Total unrealized gains on investment securities available-for-sale, net of unrealized losses of \$160,000, were \$2.5 million at September 30, 2010. Total unrealized losses on investment securities available-for-sale, net of unrealized gains of \$943,000, were \$103,000 at December 31, 2009. Net unrealized gains on investment securities available-for-sale increased \$2.6 million during the first nine months of 2010.

If fair value of a debt security is less than its amortized cost basis at the balance sheet date, management must determine if the security has an other than temporary impairment (OTTI). If management does not expect to recover the entire amortized cost basis of a security, an OTTI has occurred. If management's intention is to sell the security, an OTTI has occurred. If it is more likely than not that management will be required to sell a security before the recovery of the amortized cost basis, an OTTI has occurred. The Company will recognize the full OTTI in earnings if it intends to sell a security or will more likely than not be required to sell the security. Otherwise, an OTTI will be separated into the amount representing a credit loss and the amount related to all other factors. The amount of an OTTI related to credit losses will be recognized in earnings. The amount related to other factors will be recognized in other comprehensive income, net of taxes. There were no investment securities in a continuous unrealized loss position in excess of 12 months at September 30, 2010.

Loans held-for-sale increased \$55.3 million or 42.1% to \$186.5 million at September 30, 2010, compared to December 31, 2009. The increase was due to an increase in mortgage loans held-for-sale as a result of a historic decrease in mortgage interest rates during the third quarter of 2010 and a 42.6% increase in the number of originators at September 30, 2010 compared to December 31, 2009.

Loans increased \$65.4 million or 5.1% to \$1.355 billion at September 30, 2010, compared to \$1.290 billion at December 31, 2009. The increase in loans was primarily the result of an increase in commercial loans of \$29.5 million or 7.3% to \$435.8 million, an increase in consumer installment loans of \$24.7 million or 9.4% to \$654.0 million and an increase in mortgage loans of \$9.4 million or 3.8% to \$136.0 million. Commercial loan balances increased as management targeted the lending needs of small businesses and added loan officers. Consumer installment loans increased as the Bank grew its indirect automobile loan portfolio by expanding its lending area and competitive loan pricing. Somewhat offsetting these increases was a decrease in real estate construction loans of \$25.3 million or 16.3% to \$129.5 million. As the recession continued during the first nine months of 2010, demand for construction loans continued to be limited and the portfolio balance continued to decrease including \$21.6 million in loans that were transferred to other real estate.

The following schedule summarizes our total loans at September 30, 2010, and December 31, 2009:

	September 30, 2010	December 31, 2009
	<i>(In Thousands)</i>	
Loans:		
Commercial, financial and agricultural	\$ 94,221	\$ 113,604
Tax exempt commercial	5,202	5,350
Real estate mortgage commercial	336,395	287,354
Total commercial	435,818	406,308
Real estate construction	129,486	154,785
Real estate mortgage residential	135,977	130,984
Consumer installment	653,967	597,782
Loans	1,355,248	1,289,859
Allowance for loan losses	(28,293)	(30,072)
Loans, net of allowance	\$ 1,326,955	\$ 1,259,787

Total Loans:		
Loans	\$ 1,355,248	\$ 1,289,859
Loans Held-for-Sale:		
Residential mortgage	138,151	80,869
Consumer installment	30,000	30,000
SBA	18,343	20,362
Total loans held-for-sale	186,494	131,231
Total loans	\$ 1,541,742	\$ 1,421,090

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The following schedule summarizes our asset quality at September 30, 2010, and December 31, 2009:

	September 30, 2010	December 31, 2009
	<i>(Dollars in Thousands)</i>	
Nonperforming assets:		
Nonaccrual loans	\$ 60,695	\$ 69,743
Repossessions	882	1,393
Other real estate	21,252	21,780
Total nonperforming assets	\$ 82,829	\$ 92,916
 Includes SBA guaranteed loans of approximately	 \$ 6,200	 \$ 4,500
 Loans 90 days past due and still accruing	 \$	 \$
 Allowance for loan losses	 \$ 28,293	 \$ 30,072
 Ratio of loans past due and still accruing to loans	 %	 %
 Ratio of nonperforming assets to total loans, ORE, and repossessions	 5.30%	 6.43%
 Allowance to period-end loans	 2.09%	 2.33%
 Allowance to nonaccrual loans and repossessions (coverage ratio)	 .46x	 .42x

The \$60.7 million in nonaccrual loans at September 30, 2010, included \$41.2 million in residential construction related loans, \$14.8 million in commercial and SBA loans and \$4.7 million in retail and consumer loans. Of the \$41.2 million in residential construction related loans on nonaccrual, \$20.0 million was related to 93 single family construction loans with completed homes and homes in various stages of completion, \$18.6 million was related to 373 single family developed lots, and \$2.6 million related to other loans.

The \$21.3 million in other real estate at September 30, 2010, was made up of six commercial properties with a balance of \$5.4 million and the remainder were residential construction related balances which consisted of \$5.7 million in 50 residential single family homes completed or substantially completed, \$9.5 million in 328 single family developed lots, and \$601,000 in one parcel of undeveloped land.

The Bank makes standard representations and warranties in the normal course of selling mortgage loans in the secondary market. We have not experienced any material repurchase requests as a result of these obligations related to the representations and warranties. The Bank does not securitize the mortgages it originates.

Deposits

	September 30, 2010		December 31, 2009		September 30, 2009	
	\$	%	\$	%	\$	%
	<i>(Dollars in Millions)</i>					
Core deposits ⁽¹⁾	\$ 1,270.0	81.3%	\$ 1,194.3	77.0%	\$ 1,203.8	74.9%
Time deposits greater than \$100,000	208.9	13.4	257.4	16.6	294.7	18.3
Brokered deposits	82.4	5.3	99.0	6.4	109.0	6.8
Total deposits	\$ 1,561.3	100.0%	\$ 1,550.7	100.0%	\$ 1,607.5	100.0%

(1) Core deposits include noninterest-bearing demand, money market and interest-bearing demand, savings deposits, and time deposits less than \$100,000.

Total deposits at September 30, 2010, were \$1.561 billion compared to \$1.551 billion at December 31, 2009, a \$10.4 million or .7% increase. Along with the increase in total deposits, the designed change to the deposit mix and interest rate paid on deposits demonstrates the Company's commitment to improved net interest margin and liquidity. Interest-bearing demand and money market accounts increased \$176.6 million or 70.0% to \$429.1 million. Noninterest-bearing demand deposits increased \$28.6 million or 18.2% to \$186.1 million. Savings deposits decreased \$73.2 million or 16.6% to \$367.4 million. Other time deposits decreased \$73.0 million or 16.5% to \$369.7 million. Time deposits greater than \$100,000 decreased \$48.6 million or 18.9% to \$208.9 million. Savings accounts decreased due in part to transfers between saving accounts and interest-bearing demand accounts as customers sought higher yields while still maintaining liquidity. Noninterest-bearing demand accounts increased primarily due to higher business account balances in response to unlimited protection from the FDIC under the Temporary Liquidity Guarantee Program. Interest-bearing demand and money market account balances increased as a result of an advertising campaign for our promotional rate money market accounts. Time deposits greater than \$100,000 and other time deposits decreased as management allowed higher cost maturities to go unreplaced as a result of improved liquidity from higher transactional deposits.

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Other long-term debt increased \$25.0 million or 50.0% to \$75.0 million at September 30, 2010 compared to \$50.0 million at December 31, 2009. The increase is a result of the reclassification from short-term borrowings of a FHLB advance that was restructured to take advantage of historically low interest rates. A \$25.0 million 4.06% FHLB advance maturing November 5, 2010 was modified by extending the maturity date to July 16, 2013 and reducing the interest rate to 1.76%.

	September 30, 2010	December 31, 2009
	<i>(In Thousands)</i>	
Long-Term Debt		
FHLB four year Fixed Rate Advance with interest at 3.2875% maturing March 12, 2012	\$ 5,000	\$ 5,000
FHLB five year European Convertible Advance with interest at 2.395% maturing March 12, 2013, with a one-time FHLB conversion option to reprice to a three-month LIBOR-based floating rate at the end of two years	5,000	5,000
FHLB five year European Convertible Advance with interest at 2.79% maturing March 12, 2013, with a one-time FHLB conversion option to reprice to a three-month LIBOR-based floating rate at the end of three years	5,000	5,000
FHLB four year Fixed Rate Credit Advance with interest at 3.24% maturing April 2, 2012	2,500	2,500
FHLB five year European Convertible Advance with interest at 2.40% maturing April 3, 2013, with a one-time FHLB conversion option to reprice to a three-month LIBOR-based floating rate at the end of two years	2,500	2,500
FHLB four year Fixed Rate Credit Advance with interest at 2.90% maturing March 11, 2013	15,000	15,000
FHLB three year Fixed Rate Credit Advance with interest at 2.56% maturing April 13, 2012	15,000	15,000
FHLB three year Fixed Rate Credit Advance with interest at 1.76% maturing July 16, 2013	25,000	
Total long-term debt	\$ 75,000	\$ 50,000

Subordinated Debt

The Company has five unconsolidated business trust (trust preferred) subsidiaries that are variable interest entities. The Company's subordinated debt consists of the outstanding obligations of the five trust preferred issues and the amounts to fund the investments in the common stock of those entities.

The following schedule summarizes our subordinated debt at September 30, 2010:

Type	Issued ⁽¹⁾	Subordinated Debt <i>(Dollars in Thousands)</i>	Interest Rate
Trust Preferred	March 8, 2000	\$ 10,825	Fixed @ 10.875%
Trust Preferred	July 19, 2000	10,309	Fixed @ 11.045%
Trust Preferred	June 26, 2003	15,464	Variable @ 3.39% ⁽²⁾
Trust Preferred	March 17, 2005	10,310	Variable @ 2.18% ⁽³⁾
Trust Preferred	August 20, 2007	20,619	Fixed @ 6.620% ⁽⁴⁾
		\$ 67,527	

(1) Each trust preferred security has a final maturity thirty years from the date of issuance.

(2) Reprices quarterly at a rate 310 basis points over three month LIBOR and is subject to refinancing or repayment at par with regulatory approval.

(3) Reprices quarterly at a rate 189 basis points over three month LIBOR.

(4) Five year fixed rate, and then reprices

quarterly at a
rate 140 basis
points over
three month
LIBOR.

Liquidity and Capital Resources

Market and public confidence in our financial strength and that of financial institutions in general will largely determine the access to appropriate levels of liquidity. This confidence is significantly dependent on our ability to maintain sound credit quality and the ability to maintain appropriate levels of capital resources.

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Liquidity is defined as the ability to meet anticipated customer demands for funds under credit commitments and deposit withdrawals at a reasonable cost and on a timely basis. Management measures the liquidity position by giving consideration to both on-balance sheet and off-balance sheet sources of and demands for funds on a daily and weekly basis. In addition, because FSC is a separate entity and apart from the Bank, it must provide for its own liquidity. FSC is responsible for the payment of dividends declared for its common and preferred shareholders, and interest and principal on any outstanding debt or trust preferred securities.

Sources of the Bank's liquidity include cash and cash equivalents, net of Federal requirements to maintain reserves against deposit liabilities; investment securities eligible for sale or pledging to secure borrowings from dealers and customers pursuant to securities sold under agreements to repurchase (repurchase agreements); loan repayments; loan sales; deposits and certain interest-sensitive deposits; brokered deposits; a collateralized line of credit at the Federal Reserve Bank of Atlanta (FRB) Discount Window; a collateralized line of credit from the Federal Home Loan Bank of Atlanta (FHLB); and borrowings under unsecured overnight Federal funds lines available from correspondent banks. Substantially all of FSC's liquidity is obtained from subsidiary service fees and dividends from the Bank, which is limited by applicable law. The principal demands for liquidity are new loans, anticipated fundings under credit commitments to customers and deposit withdrawals.

Management seeks to maintain a stable net liquidity position while optimizing operating results, as reflected in net interest income, the net yield on interest-earning assets and the cost of interest-bearing liabilities in particular. Our Asset/Liability Management Committee (ALCO) meets regularly to review the current and projected net liquidity positions and to review actions taken by management to achieve this liquidity objective. Managing the levels of total liquidity, short-term liquidity, and short-term liquidity sources continues to be an important exercise because of the coordination of the projected mortgage, SBA and indirect automobile loan production and sales, loans held-for-sale balances, and individual loans and pools of loans sold anticipated to increase from time to time during the year. In addition to the ability to increase brokered deposits and retail deposits, as of September 30, 2010, we had the following sources of available unused liquidity:

	September 30, 2010
	<i>(In Thousands)</i>
Unpledged securities	\$ 44,000
FHLB advances	19,000
FRB lines	185,000
Unsecured Federal funds lines	47,000
Additional FRB line based on eligible but unpledged collateral	200,000
Total sources of available unused liquidity	\$ 495,000

The Company's net liquid asset ratio, defined as federal funds sold, investments maturing within 30 days, unpledged securities, available unsecured federal funds lines of credit, FHLB borrowing capacity and available brokered certificates of deposit divided by total assets was 21.9% at September 30, 2009, 18.8% at December 31, 2009 and 15.3% at September 30, 2010.

Shareholders' Equity

Shareholders' equity was \$139.0 million at September 30, 2010, and \$129.7 million at December 31, 2009.

Shareholders' equity as a percent of total assets was 7.40% at September 30, 2010, compared to 7.00% at December 31, 2009. The increase in shareholders' equity in the first nine months of 2010 was primarily the result of net income and the issuance of common stock.

At September 30, 2010, and December 31, 2009, the Company exceeded all minimum capital ratios required by the FRB, as reflected in the following schedule:

Capital Ratios:	FRB Minimum Capital Ratio	September 30, 2010	December 31, 2009
Leverage	4.00%	9.69%	9.03%
Risk-Based Capital			
Tier I	4.00	11.52	11.25
Total	8.00	14.02	13.98

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The following table sets forth the capital requirements for the Bank under FDIC regulations and the Bank's capital ratios at September 30, 2010, and December 31, 2009, respectively:

Capital Ratios:	FDIC Regulations Well Capitalized	September 30, 2010	December 31, 2009
Leverage	5.00% ⁽¹⁾	9.75%	9.27%
Risk-Based Capital			
Tier I	6.00	11.58	11.55
Total	10.00	13.47	13.48

(1) 8% required by memoranda of understanding.

In 2010, FSC and Fidelity Bank operated under a memoranda of understanding (MOU) with the FRB, the GDBF and the FDIC. The MOU, which relate primarily to the Bank's asset quality and loan loss reserves, require that FSC and the Bank submit plans and report to its regulators regarding its loan portfolio and profit plans, that the Bank maintain its Tier 1 Leverage Capital ratio at not less than 8% and an overall well-capitalized position as defined in applicable FDIC rules and regulations during the life of the MOU. Additionally, the MOU require that, prior to declaring or paying any cash dividends, FSC and the Bank must obtain the written consent of their respective regulators.

On October 14, 2008, the U.S. Treasury announced the Troubled Asset Relief Program (TARP) Capital Purchase Program (the Program). The Program was instituted by the Treasury pursuant to the Emergency Economic Stabilization Act of 2008 (EESA), which provides up to \$700 billion to the Treasury to take equity positions in financial institutions. On December 19, 2008, as part of the Program, Fidelity entered into a Letter Agreement (Letter Agreement) and a Securities Purchase Agreement Standard Terms with the Treasury, pursuant to which Fidelity agreed to issue and sell, and the Treasury agreed to purchase (1) 48,200 shares of Fidelity's Fixed Rate Cumulative Perpetual Preferred Stock, Series A, having a liquidation preference of \$1,000 per share, and (2) a ten-year warrant to purchase up to 2,266,458 shares of the Company's common stock at an exercise price of \$3.19 per share, for an aggregate purchase price of \$48.2 million in cash. Pursuant to the terms of the Letter Agreement, the ability of Fidelity to declare or pay dividends or distributions of its common stock is subject to restrictions, including a restriction against increasing dividends from the last quarterly cash dividend per share (\$.01) declared on the common stock prior to December 19, 2008, as adjusted for subsequent stock dividends and other similar actions. In addition, as long as the preferred shares are outstanding, dividends payments are prohibited until all accrued and unpaid dividends are paid on such preferred stock, subject to certain limited exceptions. This restriction will terminate on the third anniversary of the date of issuance of the preferred shares or, if earlier, the date on which the preferred shares have been redeemed in whole or the Treasury has transferred all of the preferred shares to third parties.

During the first nine months of 2010 and 2009, we did not pay any cash dividends on our common stock. In October 2010, the Company approved the distribution of a stock dividend on November 12, 2010 of one share for every 200 shares owned on the record date. Dividends for the remainder of 2010 will be reviewed quarterly, with the declared and paid dividend consistent with current earnings, capital requirements and forecasts of future earnings.

Market Risk

Our primary market risk exposures are credit risk and interest rate risk and, to a lesser extent, liquidity risk. We have little or no risk related to trading accounts, commodities, or foreign exchange.

Interest rate risk is the exposure of a banking organization's financial condition and earnings ability to withstand adverse movements in interest rates. Accepting this risk can be an important source of profitability and shareholder value; however, excessive levels of interest rate risk can pose a significant threat to assets, earnings, and capital.

Accordingly, effective risk management that maintains interest rate risk at prudent levels is essential to our success. ALCO, which includes senior management representatives, monitors and considers methods of managing the rate and sensitivity repricing characteristics of the balance sheet components consistent with maintaining acceptable levels of changes in portfolio values and net interest income with changes in interest rates. The primary purposes of ALCO are to manage interest rate risk consistent with earnings and liquidity, to effectively invest our capital, and to preserve the value created by our core business operations. Our exposure to interest rate risk compared to established tolerances is reviewed on at least a quarterly basis by our Board of Directors.

Evaluating a financial institution's exposure to changes in interest rates includes assessing both the adequacy of the management process used to control interest rate risk and the organization's quantitative levels of exposure. When assessing the interest rate risk management process, we seek to ensure that appropriate policies, procedures, management information systems, and internal controls are in place to maintain interest rate risk at prudent levels with consistency and continuity. Evaluating the quantitative level of interest rate risk exposure requires us to assess the existing and potential future effects of changes in interest rates on our consolidated financial condition, including capital adequacy, earnings, liquidity, and, where appropriate, asset quality.

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Interest rate sensitivity analysis, referred to as equity at risk, is used to measure our interest rate risk by computing estimated changes in earnings and the net present value of our cash flows from assets, liabilities, and off-balance sheet items in the event of a range of assumed changes in market interest rates. Net present value represents the market value of portfolio equity and is equal to the market value of assets minus the market value of liabilities, with adjustments made for off-balance sheet items. This analysis assesses the risk of loss in the market risk sensitive instruments in the event of a sudden and sustained 200, 300 and 400 basis point increase or decrease in market interest rates.

Our policy states that a negative change in net present value (equity at risk) as a result of an immediate and sustained 200 basis point increase or decrease in interest rates should not exceed the lesser of 2% of total assets or 15% of total regulatory capital. It also states that a similar increase or decrease in interest rates should not negatively impact net interest income or net income by more than 5% or 15%, respectively.

The most recent rate shock analysis indicated that the effects of an immediate and sustained increase or decrease of 200 basis points in market rates of interest would fall within policy parameters and approved tolerances for equity at risk, net interest income, and net income.

We have historically been cumulatively asset sensitive to six months; however, we have been liability sensitive from six months to one year, largely mitigating the potential negative impact on net interest income and net income over a full year from a sudden and sustained decrease in interest rates. Likewise, historically the potential positive impact on net interest income and net income of a sudden and sustained increase in interest rates is reduced over a one-year period as a result of our liability sensitivity in the six month to one year time frame.

Rate shock analysis provides only a limited, point in time view of interest rate sensitivity. The gap analysis also does not reflect factors such as the magnitude (versus the timing) of future interest rate changes and asset prepayments. The actual impact of interest rate changes upon earnings and net present value may differ from that implied by any static rate shock or gap measurement. In addition, net interest income and net present value under various future interest rate scenarios are affected by multiple other factors not embodied in a static rate shock or gap analysis, including competition, changes in the shape of the Treasury yield curve, divergent movement among various interest rate indices, and the speed with which interest rates change.

Interest Rate Sensitivity

The major elements used to manage interest rate risk include the mix of fixed and variable rate assets and liabilities and the maturity and repricing patterns of these assets and liabilities. We perform a quarterly review of assets and liabilities that reprice and the time bands within which the repricing occurs. Balances generally are reported in the time band that corresponds to the instrument's next repricing date or contractual maturity, whichever occurs first. However, fixed rate indirect automobile loans, mortgage-backed securities, and residential mortgage loans are primarily included based on scheduled payments with a prepayment factor incorporated. Through such analyses, we monitor and manage our interest sensitivity gap to minimize the negative effects of changing interest rates.

The interest rate sensitivity structure within our balance sheet at September 30, 2010, indicated a cumulative net interest sensitivity asset gap of 16.69% when projecting out six months. When projecting forward one year, there was a cumulative net interest sensitivity asset gap of 13.78%. This information represents a general indication of repricing characteristics over time; however, the sensitivity of certain deposit products may vary during extreme swings in the interest rate cycle. Since all interest rates and yields do not adjust at the same velocity, the interest rate sensitivity gap is only a general indicator of the potential effects of interest rate changes on net interest income. Our policy states that the cumulative gap at six months and one year should generally not exceed 15% and 10%, respectively. The primary reason the Bank exceeded the policy for six months and one year is the temporary growth of the mortgage loans held-for-sale portfolio. The policy exception has been reviewed and approved by the Asset Liability Committee after reviewing the current and projected interest rate environment.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

See Item 2 Market Risk and Interest Rate Sensitivity for quantitative and qualitative discussion about our market risk.

Item 4. Controls and Procedures**Evaluation of Disclosure Controls and Procedures**

Pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, Fidelity's management supervised and participated in an evaluation, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures (as defined under Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based on, or as of the date of, that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

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Changes in Internal Control over Financial Reporting

There has been no change in the Company's internal control over financial reporting during the nine months ended September 30, 2010, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. *Legal Proceedings*

We are a party to claims and lawsuits arising in the course of normal business activities. Although the ultimate outcome of all claims and lawsuits outstanding as of September 30, 2010, cannot be ascertained at this time, it is the opinion of management that these matters, when resolved, will not have a material adverse effect on our results of operations or financial condition.

Item 1A. *Risk Factors*

While the Company attempts to identify, manage, and mitigate risks and uncertainties associated with its business to the extent practical under the circumstances, some level of risk and uncertainty will always be present. Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2009, describes some of the risks and uncertainties associated with our business. These risks and uncertainties have the potential to materially affect our cash flows, results of operations, and financial condition. We do not believe that there have been any material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2009.

Item 6. *Exhibits*

(a) Exhibits. The following exhibits are filed as part of this Report.

- 3(a) Amended and Restated Articles of Incorporation of Fidelity Southern Corporation, as amended effective December 16, 2008 (incorporated by reference from Exhibit 3(a) to Fidelity Southern Corporation's Annual Report on Form 10-K for the year ended December 31, 2009)
- 3(b) By-Laws of Fidelity Southern Corporation, as amended (incorporated by reference from Exhibit 3(b) to Fidelity Southern Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007)
- 31.1 Certification of Principal Executive Officer pursuant to Securities Exchange Act Rules 13a-14 and 15d-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Principal Financial Officer pursuant to Securities Exchange Act Rules 13a-14 and 15d-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURES

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

FIDELITY SOUTHERN CORPORATION
(Registrant)

Date: November 5, 2010

BY: /s/ James B. Miller, Jr.
James B. Miller, Jr.
Chief Executive Officer

Date: November 5, 2010

BY: /s/ Stephen H. Brolly
Stephen H. Brolly
Chief Financial Officer