

SUSSEX BANCORP
Form 10-Q
May 16, 2011

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2011

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

For the transition period from _____ to _____

Commission File Number 0-29030

SUSSEX BANCORP
(Exact name of registrant as specified in its charter)

New Jersey
State or other jurisdiction of incorporation or organization)

22-3475473
(I.R.S. Employer Identification No.)

200 Munsonhurst Rd., Franklin, NJ
(Address of principal executive offices)

07416
(Zip Code)

(973) 827-2914
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities and 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 SD-T 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 the 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 company
(Do not check if a smaller reporting company)

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

As of May 6, 2011 there were 3,367,775 shares of common stock, no par value, issued.

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FORWARD-LOOKING STATEMENTS

We may, from time to time, make written or oral “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, including statements contained in our filings with the Securities and Exchange Commission (the “SEC”), our reports to shareholders and in other communications by us. This Report on Form 10-Q contains “forward-looking statements” which may be identified by the use of such words as “believe,” “expect,” “anticipate,” “should,” “planned,” “estimated” and “potential.” Examples of forward-looking statements include, but are not limited to, estimates with respect to our financial condition, results of operation and business that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include, but are not limited to:

§ changes to interest rates, the ability to control costs and expenses;

§ our ability to integrate new technology into our operations;

§ general economic conditions;

§ the success of our efforts to diversify its revenue base by developing additional sources of non-interest income while continuing to manage its existing fee based business;

§ the impact on us of the changing statutory and regulatory requirements; and

§ the risks inherent in commencing operations in new markets.

Any or all of our forward-looking statements in this Report on Form 10-Q, and in any other public statements we make may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Consequently, no forward-looking statements can be guaranteed. We disclaim any obligation to subsequently revise any forward-looking statements to reflect events or circumstances after the date of such statements, or to reflect the occurrence of anticipated or unanticipated events.

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PART I – FINANCIAL INFORMATION

Item 1 – Financial Statements

SUSSEX BANCORP
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(Dollars in thousands)

March 31, 2011 December 31, 2010

ASSETS

Cash and due from banks	\$ 6,401	\$ 4,672
Interest-bearing deposits with other banks	9,120	10,077
Federal funds sold	3,000	3,000
Cash and cash equivalents	18,521	17,749
Interest bearing time deposits with other banks	600	600
Securities available for sale, at estimated fair value	80,385	89,380
Securities held to maturity, at cost (estimated fair value of \$1,334 at March 31, 2011 and \$1,007 at December 31, 2010)	1,333	1,000
Federal Home Loan Bank Stock, at cost	1,785	2,235
Loans receivable, net of unearned income	343,474	338,234
Less: allowance for loan losses	7,226	6,397
Net loans receivable	336,248	331,837
Foreclosed real estate	2,080	2,397
Premises and equipment, net	6,629	6,749
Accrued interest receivable	1,836	1,916
Goodwill	2,820	2,820
Bank owned life insurance	10,277	10,173
Other assets	6,378	7,168
Total Assets	\$ 468,892	\$ 474,024

LIABILITIES AND STOCKHOLDERS' EQUITY

Liabilities:

Deposits:

Non-interest bearing	\$ 38,893	\$ 35,362
Interest bearing	351,338	350,605
Total deposits	390,231	385,967
Short term borrowings	-	10,000
Long term borrowings	26,000	26,000
Accrued interest payable and other liabilities	2,263	2,504
Junior subordinated debentures	12,887	12,887
Total Liabilities	431,381	437,358

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Stockholders' Equity:		
Preferred stock, no par value, 1,000,000 shares authorized; none issued	-	-
Common stock, no par value, 10,000,000 shares authorized;		
issued shares 3,363,155 in 2011 and 3,352,346 in 2010;		
outstanding shares 3,362,375 in 2011 and 3,351,566 in 2010	27,891	27,870
Treasury stock, at cost; 780 shares in 2011 and in 2010	(4)	(4)
Retained earnings	9,447	8,753
Accumulated other comprehensive income	177	47
Total Stockholders' Equity	37,511	36,666
Total Liabilities and Stockholders' Equity	\$ 468,892	\$ 474,024

See Notes to Unaudited Consolidated Financial Statements

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SUSSEX BANCORP
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(Dollars in thousands, except per share data)	Three Months Ended March 31,	
	2011	2010
INTEREST INCOME		
Loans receivable, including fees	\$ 4,784	\$ 4,680
Securities:		
Taxable	365	514
Tax-exempt	292	263
Federal funds sold	1	7
Interest bearing deposits	3	2
Total Interest Income	5,445	5,466
INTEREST EXPENSE		
Deposits	769	1,104
Borrowings	265	352
Junior subordinated debentures	54	53
Total Interest Expense	1,088	1,509
Net Interest Income	4,357	3,957
PROVISION FOR LOAN LOSSES	839	737
Net Interest Income after Provision for Loan Losses	3,518	3,220
OTHER INCOME		
Service fees on deposit accounts	316	334
ATM and debit card fees	122	115
Bank owned life insurance	104	36
Insurance commissions and fees	615	547
Investment brokerage fees	31	60
Realized holding gains on trading securities	-	11
Gain (loss) on sale of foreclosed real estate	(11)	4
Other	68	69
Total Other Income	1,245	1,176
OTHER EXPENSES		
Salaries and employee benefits	2,007	1,841
Occupancy, net	381	344
Furniture, equipment and data processing	300	299
Advertising and promotion	43	51
Professional fees	127	133
Director Fees	67	58
FDIC assessment	256	224
Insurance	56	56
Stationary and supplies	43	44
Loan collection costs	115	77
Write-down on foreclosed real estate	145	29

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Expenses related to foreclosed real estate	24	28
Amortization of intangible assets	3	4
Other	293	343
Total Other Expenses	3,860	3,531
Income before Income Taxes	903	865
PROVISION FOR INCOME TAXES	209	222
Net Income	\$ 694	\$ 643
EARNINGS PER SHARE		
Basic	\$ 0.21	\$ 0.20
Diluted	\$ 0.21	\$ 0.20

See Notes to Unaudited Consolidated Financial Statements

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SUSSEX BANCORP
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Three Months Ended March 31, 2011 and 2010
(Unaudited)

(Dollars in thousands, except per share data)	Number of Shares Outstanding	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
Balance at December 31, 2009	3,259,786	\$27,805	\$6,577	\$ 145	\$-	\$ 34,527
Comprehensive income:						
Net income	-	-	643	-	-	643
Change in unrealized gains on securities available for sale, net of tax						
	-	-	-	134	-	134
Total Comprehensive Income						777
Restricted stock granted	57,762	-	-	-	-	-
Compensation expense related to stock option and restricted stock grants						
	-	16	-	-	-	16
Balance at March 31, 2010	3,317,548	\$27,821	\$7,220	\$ 279	\$-	\$ 35,320
Balance at December 31, 2010	3,351,566	\$27,870	\$8,753	\$ 47	\$(4)	\$ 36,666
Comprehensive income:						
Net income	-	-	694	-	-	694
Change in unrealized gains on securities available for sale, net of tax						
	-	-	-	130	-	130
Total Comprehensive Income						824
Restricted stock granted	11,850	-	-	-	-	-
Restricted stock forfeited	(1,041)	-	-	-	-	-
Compensation expense related to stock option and restricted stock grants						
	-	21	-	-	-	21
Balance at March 31, 2011	3,362,375	\$27,891	\$9,447	\$ 177	\$(4)	\$ 37,511

See Notes to Unaudited Consolidated Financial Statements

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SUSSEX BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)	Three Months Ended March 31,	
	2011	2010
Cash Flows from Operating Activities		
Net income	\$ 694	\$ 643
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	839	737
Provision for depreciation and amortization	153	166
Net change in trading securities	-	382
Net amortization of securities premiums and discounts	222	31
Net realized (gain) loss on sale of foreclosed real estate	11	(4)
Provision for foreclosed real estate	145	29
Earnings on bank owned life insurance	(104)	(36)
Compensation expense for stock options and stock awards	21	16
Decrease in assets:		
Accrued interest receivable	80	86
Other assets	701	402
Increase (decrease) in accrued interest payable and other liabilities	(241)	146
Net Cash Provided by Operating Activities	2,521	2,598
Cash Flows from Investing Activities		
Securities available for sale:		
Purchases	(3)	(10,002)
Maturities, calls and principal repayments	8,992	7,749
Securities held to maturity:		
Purchases	(333)	-
Net (increase) decrease in loans	(5,250)	2,492
Purchases of interest bearing time deposits	-	(500)
Proceeds from the sale of foreclosed real estate	161	166
Purchases of bank premises and equipment	(30)	(164)
Decrease in FHLB stock	450	-
Net Cash (Used in) Provided by Investing Activities	3,987	(259)
Cash Flows from Financing Activities		
Net increase in deposits	4,264	15,996
Repayments of borrowings	(10,000)	(15)
Net Cash (Used in) Provided by Financing Activities	(5,736)	15,981
Net Increase in Cash and Cash Equivalents	772	18,320
Cash and Cash Equivalents - Beginning	17,749	23,079
Cash and Cash Equivalents - Ending	\$ 18,521	\$ 41,399
Supplementary Cash Flows Information		

Interest paid	\$ 1,107	\$ 1,549
Income taxes paid	\$ 7	\$ 25
Supplementary Schedule of Noncash Investing and Financing Activities		
Foreclosed real estate acquired in settlement of loans	\$ -	\$ 677

See Notes to Unaudited Consolidated Financial Statements

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Note 1 - Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of Sussex Bancorp (“we,” “us” or “our”) and its wholly-owned subsidiary Sussex Bank (the “Bank”). The Bank’s wholly-owned subsidiaries are SCB Investment Company, Inc., SCBNY Company, Inc., ClassicLake Enterprises, LLC, Wheatsworth Properties Corp., and Tri-State Insurance Agency, Inc. (“Tri-State”), a full service insurance agency located in Sussex County, New Jersey. Tri-State’s operations are considered a separate segment for financial disclosure purposes. All inter-company transactions and balances have been eliminated in consolidation. The Bank operates ten banking offices, eight located in Sussex County, New Jersey and two in Orange County, New York.

The Company is subject to the supervision and regulation of the Board of Governors of the Federal Reserve System (the “FRB”). The Bank’s deposits are insured by the Deposit Insurance Fund (“DIF”) of the Federal Deposit Insurance Corporation (“FDIC”) up to applicable limits. The operations of the Company and the Bank are subject to the supervision and regulation of the FRB, FDIC and the New Jersey Department of Banking and Insurance (the “Department”) and the operations of Tri-State are subject to supervision and regulation by the Department.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by the accounting principles generally accepted in the United States of America (“U.S. GAAP”) for full year financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal, recurring nature. Operating results for the three month period ended March 31, 2011, are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto that are included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of March 31, 2011 for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through the date these financial statements were issued.

Reclassifications

Certain amounts in the prior period financial statements have been reclassified to conform to the current year presentation. These reclassifications had no effect on previously reported net income.

New Accounting Standards

In July 2010, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. This issuance will help investors assess the credit risk of a company’s receivables portfolio and the adequacy of its allowance for credit losses held against the portfolios by expanding credit risk disclosures. ASU requires more information about the credit quality of financing receivables in the disclosures to financial statements, such as aging information and credit quality indicators. Both new and existing disclosures must be disaggregated by portfolio segment or class. The disaggregation of information is based on how a company develops its allowance for credit losses and how it manages its credit exposure. The amendments in ASU 2010-20 apply to all public and nonpublic entities with financing receivables. Financing receivables include loans and trade accounts receivable. However, short-term trade accounts receivable, receivables measured at fair value or lower of cost or fair value, and debt securities are exempt from these disclosure amendments. 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 and have been added to Note 3. The disclosures about activity that occurs during a reporting period are effective for interim and

annual reporting periods ending on or after December 15, 2010 and have been added to Note 3.

In April 2011, FASB issued ASU 2011-02, A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring. This issuance clarifies guidance on a creditor's evaluation of whether or not a concession has been granted, with an emphasis on evaluating all aspects of the modification rather than a focus on specific criteria, such as the effective interest rate test, to determine a concession. The ASU goes on to provide guidance on specific types of modifications such as changes in the interest rate of the borrowing, and insignificant delays in payments, as well as guidance on the creditor's evaluation of whether or not a debtor is experiencing financial difficulties. For public entities, the amendments in ASU 2011-02 are effective for the first interim or annual periods beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. The entity should also

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disclose information required by ASU 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, which had previously been deferred by ASU 2011-01, Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in ASU 2010-20, for interim and annual periods beginning on or after June 15, 2011. The Company has not completed evaluating the impact of ASU 2011-02 on its consolidated financial statements.

Note 2 – Securities

The amortized cost and approximate fair value of securities available for sale and held to maturity as of March 31, 2011 and December 31, 2010 are summarized as follows:

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2011				
Available for sale securities:				
U.S. government agencies	\$15,358	\$59	\$(30)	\$15,387
State and political subdivisions	28,965	170	(517)	28,618
Mortgage-backed securities:				
U.S. government-sponsored enterprises	29,938	749	(39)	30,648
Private mortgage-backed securities	4,188	219	-	4,407
Equity securities-financial services industry and other	1,641	9	(325)	1,325
	80,090	1,206	(911)	80,385
Held to maturity securities:				
State and political subdivisions	1,333	3	(2)	1,334
Total securities	\$81,423	\$1,209	\$(913)	\$81,719
December 31, 2010				
Available for sale securities:				
U.S. government agencies	\$21,158	\$78	\$(47)	\$21,189
State and political subdivisions	29,353	97	(715)	28,735
Mortgage-backed securities:				
U.S. government-sponsored enterprises	32,560	747	(21)	33,286
Private mortgage-backed securities	4,592	215	-	4,807
Equity securities-financial services industry and other	1,638	9	(284)	1,363
	89,301	1,146	(1,067)	89,380
Held to maturity securities:				
State and political subdivisions	1,000	7	-	1,007
Total securities	\$90,301	\$1,153	\$(1,067)	\$90,387

The amortized cost and fair value of securities at March 31, 2011 are shown below by contractual maturity. Actual maturities may differ from contractual maturities as issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value

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Due in one year or less	\$6,435	\$6,456	\$333	\$334
Due after one year through five years	10,288	10,262	-	-
Due after five years through ten years	197	200	-	-
Due after ten years	27,403	27,087	1,000	1,000
Total bonds and obligations	44,323	44,005	1,333	1,334
Mortgage-backed securities:				
US government-sponsored enterprises	29,938	30,648	-	-
Private mortgage-backed securities	4,188	4,407	-	-
Equity securities-financial services industry and other	1,641	1,325	-	-
Total securities	\$80,090	\$80,385	\$1,333	\$1,334

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Temporarily Impaired Securities and Other-Than-Temporary Impairment

The following table shows the gross unrealized losses and fair value for securities in our portfolio that are not deemed to be other than temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at March 31, 2011 and December 31, 2010.

(Dollars in thousands)	Less Than Twelve Months		Twelve Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
March 31, 2011						
Available for sale securities:						
U.S. government agencies	\$2,970	\$(30)	-	-	\$2,970	\$(30)
State and political subdivisions	12,014	(354)	\$1,044	\$(163)	13,058	(517)
Mortgage-backed securities:						
U.S. government-sponsored enterprises	7,307	(39)	-	-	7,307	(39)
Private mortgage-backed securities	-	-	-	-	-	-
Equity securities-financial services industry and other	794	(66)	422	(259)	1,216	(325)
	23,085	(489)	1,466	(422)	24,551	(911)
Held to maturity securities:						
State and political subdivisions	498	(2)	-	-	498	(2)
Total temporarily impaired securities	\$23,583	\$(491)	\$1,466	\$(422)	\$25,049	\$(913)
December 31, 2010						
Available for sale securities:						
U.S. government agencies	\$6,962	\$(47)	-	-	\$6,962	\$(47)
State and political subdivisions	18,006	(578)	\$1,071	\$(137)	19,077	(715)
Mortgage-backed securities:						
U.S. government-sponsored enterprises	4,536	(21)	-	-	4,536	(21)
Private mortgage-backed securities	-	-	-	-	-	-
Equity securities-financial services industry and other	820	(50)	445	(234)	1,265	(284)
	30,324	(696)	1,516	(371)	31,840	(1,067)
Held to maturity securities:						
State and political subdivisions	-	-	-	-	-	-
Total temporarily impaired securities	\$30,324	\$(696)	\$1,516	\$(371)	\$31,840	\$(1,067)

Available for sale securities

As of March 31, 2011, we reviewed our investment portfolio for indications of impairment. This review included analyzing the length of time and the extent to which the fair value has been lower than the cost, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer and the intent and likelihood of selling the security. The intent and likelihood of sale of debt and equity securities is evaluated based upon our investment strategy for the particular type of security and our cash flow needs, liquidity position, capital adequacy and interest rate risk position. For each security (including but not limited to those whose fair value is less than their amortized cost basis), an extensive, regular review is conducted to determine if an other-than-temporary impairment has occurred.

At March 31, 2011, the decline in market value and the unrealized losses for the our state and political subdivisions investment portfolio were caused by changes in interest rates and spreads and were not the result of credit quality. At March 31, 2011, there were thirty securities that had an unrealized loss. These securities typically have maturity dates greater than ten years and the fair values are more sensitive to changes in market interest rates. As of March 31, 2011, we did not intend to sell and it was not more-likely-than-not that we would be required to sell any of these securities before recovery of their amortized cost basis. Therefore none of our state and political subdivision securities at March 31, 2011 were deemed to be other than temporarily impaired.

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At March 31, 2011, the decline in market value and the unrealized losses for our mortgaged-backed securities that are backed by U.S. government-sponsored enterprises were caused by changes in interest rates and spreads and were not the result of credit quality. At March 31, 2011, there were three securities that had an unrealized loss. The decline in market value and the unrealized losses were primarily due to changes in spreads and market conditions and not credit quality. As of March 31, 2011, we did not intend to sell and it was not more-likely-than-not that we would be required to sell any of these securities before recovery of their amortized cost basis. Therefore none of our mortgaged-backed securities at March 31, 2011 were deemed to be other than temporarily impaired.

Our investments in marketable equity securities consist primarily of a mutual fund, one equity portfolio fund and common stock of entities in the financial services and insurance industries. These securities, other than the mutual fund, which had a fair value of \$784 thousand at March 31, 2011, have been adversely impacted by the effects of the current economic environment on the financial services and insurance industries. We evaluated each of the underlying banks for credit impairment based on its financial condition and performance. Based on our evaluation and our ability and intent to hold those investments for a reasonable period of time sufficient for a forecasted recovery of amortized cost, we do not consider these investments to be other-than-temporarily impaired at March 31, 2011. At March 31, 2011, there were eight securities that had an unrealized loss. We continue to closely monitor the performance of the securities we own as well as the impact from any further deterioration in the economy or in the banking industry that may adversely affect these securities. We will continue to evaluate them for other-than-temporary impairment, which could result in a future non-cash charge to earnings.

During the second quarter of 2010, we recognized \$171 thousand pre-tax (\$113 thousand after-tax, or \$0.03 per share) non-cash other-than-temporarily impaired charge related to an equity portfolio fund that had an amortized cost of \$250 thousand and a termination date of October 2010. The impairment was recognized because the market value of this security was below our amortized cost for an extended period of time along with credit deterioration in some of the underlying collateral and it was not believed the market value of this security would recover to our amortized cost before its termination date. The fund was comprised of common stocks of bank holding companies. During the third quarter of 2010, management decided to execute a redemption in kind provision for this investment prior to the termination date of October 22, 2010. We received its pro-rata share of the underlying bank securities. We received seventeen different equity securities totaling \$76 thousand. In October of 2010 the securities which then were recorded at market value resulted in an additional \$3 thousand pre-tax charge related to the exchange. As of March 31, 2011, the current market value of these equities securities was \$81 thousand and three remain in an unrealized loss position.

Held to maturity securities

At March 31, 2011, the decline in market value and the unrealized losses for the our state and political subdivisions investment portfolio were caused by changes in interest rates and spreads and were not the result of credit quality. At March 31, 2011, there was one security that had an unrealized loss. These securities typically have maturity dates greater than ten years and the fair values are more sensitive to changes in market interest rates. As of March 31, 2011, we did not intend to sell and it was not more-likely-than-not that we would be required to sell any of these securities before recovery of their amortized cost basis. Therefore none of our state and political subdivision securities at March 31, 2011 were deemed to be other than temporarily impaired.

Note 3 – Loans

The composition of net loans receivable at March 31, 2011 and December 31, 2010:

(Dollars in thousands)	March 31, 2011	December 31, 2010
Commercial and industrial loans	\$ 15,203	\$ 15,045

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Construction	20,745	20,862
Commercial real estate	207,747	204,407
Residential real estate	98,615	96,659
Consumer and other	1,305	1,395
	343,615	338,368
Unearned net loan origination fees	(141)	(134)
Allowance for loan losses	(7,226)	(6,397)
Net loans receivable	\$ 336,248	\$ 331,837

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The following table presents changes in the allowance for loan losses for the three months ended March 31, 2011 and 2010:

(Dollars in thousands)	Commercial and Industrial	Construction	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
March 31, 2011							
Beginning balance	\$ 436	\$ 1,183	\$ 3,760	\$ 798	\$ 56	\$ 164	\$ 6,397
Charge-offs	-	-	(1)	(12)	(12)	-	(25)
Recoveries	1	-	7	-	7	-	15
Provision	11	164	187	46	3	428	839
Ending balance	\$ 448	\$ 1,347	\$ 3,953	\$ 832	\$ 54	\$ 592	\$ 7,226
March 31, 2010							
Beginning balance	\$ 379	\$ 1,387	\$ 3,283	\$ 323	\$ 76	\$ 48	\$ 5,496
Charge-offs	(9)	-	-	-	(19)	-	(28)
Recoveries	13	-	1	-	6	-	20
Provision	5	327	411	40	-	(46)	737
Ending balance	\$ 388	\$ 1,714	\$ 3,395	\$ 363	\$ 63	\$ 2	\$ 6,225

An age analysis of loans receivable which are past due as of March 31, 2011 and December 31, 2010 is as follows:

(Dollars in thousands)	30-59 Days Past Due	60-89 days Past Due	Greater Than 90 Days (a)	Total Past Due	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
March 31, 2011							
Commercial and industrial	\$ 210	\$ 21	\$ 103	\$ 334	\$ 14,869	\$ 15,203	\$ 25
Construction	-	-	6,503	6,503	14,242	20,745	-
Commercial real estate	1,645	3,312	17,333	22,290	185,457	207,747	77
Residential real estate	1,866	631	1,283	3,780	94,835	98,615	34
Consumer and other	1	25	-	26	1,279	1,305	-
Total	\$ 3,722	\$ 3,989	\$ 25,222	\$ 32,933	\$ 310,682	\$ 343,615	\$ 136
December 31, 2010							
Commercial and industrial	\$ 182	\$ 229	\$ 98	\$ 509	\$ 14,536	\$ 15,045	\$ 20
Construction	-	-	6,430	6,430	14,432	20,862	-
Commercial real estate	2,316	3,946	14,959	21,221	183,186	204,407	29
Residential real estate	3,029	-	1,244	4,273	92,386	96,659	-
Consumer and other	3	16	-	19	1,376	1,395	-
Total	\$ 5,530	\$ 4,191	\$ 22,731	\$ 32,452	\$ 305,916	\$ 338,368	\$ 49

(a) Includes loans greater than 90 days past due and still accruing.

Loans which the accrual of interest has been discontinued at March 31, 2011 and December 31, 2010 were:

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(Dollars in thousands)

March 31, 2011 December 31, 2010

Commercial and industrial	\$ 78	\$ 78
Construction	6,503	6,430
Commercial real estate	17,256	14,930
Residential real estate	1,249	1,244
Consumer and other	-	-
Total	\$ 25,086	\$ 22,682

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The following table presents the balance in the allowance of loan losses at March 31, 2011 and December 31, 2010 disaggregated on the basis of the Company's impairment method by class of loans receivable along with the balance of loans receivable by class disaggregated on the basis of the Company's impairment methodology:

	Allowance for Loan Losses			Loans Receivable		
		Balance Related to Loans Individually Evaluated for Impairment	Balance Related to Loans Collectively Evaluated for Impairment		Individually Evaluated for Impairment	Collectively Evaluated for Impairment
(Dollars in thousands)	Balance	Impairment	Impairment	Balance	Impairment	Impairment
March 31, 2011						
Commercial and industrial	\$448	\$ 54	\$ 394	\$15,203	\$ 78	\$ 15,125
Construction	1,347	760	587	20,745	6,503	14,242
Commercial real estate	3,953	1,003	2,950	207,747	18,571	189,176
Residential real estate	832	216	616	98,615	1,249	97,366
Consumer and other loans	54	1	53	1,305	1	1,304
Unallocated	592	-	-	-	-	-
Total	\$7,226	\$ 2,034	\$ 4,600	\$343,615	\$ 26,402	\$ 317,213
December 31, 2010						
Commercial and industrial	\$436	\$ 54	\$ 382	\$15,045	\$ 78	\$ 14,967
Construction	1,183	610	573	20,862	6,636	14,226
Commercial real estate	3,760	493	3,267	204,407	15,514	188,893
Residential real estate	798	233	565	96,659	1,244	95,415
Consumer and other loans	56	-	56	1,395	-	1,395
Unallocated	164	-	-	-	-	-
Total	\$6,397	\$ 1,390	\$ 4,843	\$338,368	\$ 23,472	\$ 314,896

In determining the adequacy of the allowance for loan losses, we estimate losses based on the identification of specific problem loans through its credit review process and also estimates losses inherent in other loans on an aggregate basis by loan type. The credit review process includes the independent evaluation of the loan officer assigned risk ratings by the Chief Credit Officer and a third party loan review company. Such risk ratings are assigned loss component factors that reflect our loss estimate for each group of loans. It is management's and the Board of Directors' responsibility to oversee the lending process to ensure that all credit risks are properly identified, monitored, and controlled, and that loan pricing, terms, and other safeguards against non-performance and default are commensurate with the level of risk undertaken and is rated as such based on a risk-rating system. Factors considered in assigning risk ratings and loss component factors include: borrower specific information related to expected future cash flows and operating results, collateral values, financial condition, payment status and other information; levels of and trends in portfolio charge-offs and recoveries; levels in portfolio delinquencies; effects of changes in loan concentrations and observed trends in the economy and other qualitative measurements.

Our risk-rating system as defined below is consistent with the system used by regulatory agencies and consistent with industry practices. Loans rated Substandard, Doubtful or Loss is consistent with the regulatory definitions of classified assets.

Pass: This category represents loans performing to contractual terms and conditions and the primary source of repayment is adequate to meet the obligation. We have five categories within the Pass classification depending on

strength of repayment sources, collateral values and financial condition of the borrower.

Special Mention: This category represents loans performing to contractual terms and conditions; however the primary source of repayment or the borrower is exhibiting some deterioration or weaknesses in financial condition that could potentially threaten the borrowers' future ability to repay our loan principal and interest or fees due.

Substandard: This category represents loans where the primary source of repayment has significantly deteriorated or weakened which has or could threaten the borrowers' ability to make scheduled payments. The weaknesses require close supervision by our management and there is a distinct possibility that we could

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sustain some loss if the deficiencies are not corrected. Such weaknesses could jeopardize the timely and ultimate collection of our loan principal and interest or fees due. Loss may not be expected or evident, however, loan repayment is inadequately supported by current financial information or pledged collateral.

Doubtful: Loans so classified have all the inherent weaknesses of a substandard loan with the added provision that collection or liquidation in full is highly questionable and not reasonably assured. The probability of at least partial loss is high, but extraneous factors might strengthen the asset to prevent loss. The validity of the extraneous factors is continuously monitored. Once these factors are questionable the loan will be considered for a downgrade and a full or partial charge-off.

Loss: Loans so classified are considered uncollectible, and of such little value that their continuance as active assets is not warranted. Such loans are fully charged off.

The following tables illustrate our credit risk profile by creditworthiness category as of March 31, 2011 and December 31, 2010:

(Dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
March 31, 2011					
Commercial and industrial	\$13,899	\$1,226	\$55	\$23	\$15,203
Construction	10,734	2,498	7,513	-	20,745
Commercial real estate	165,342	18,946	23,459	-	207,747
Residential real estate	94,799	2,121	1,695	-	98,615
Consumer and other	1,294	-	11	-	1,305
	\$286,068	\$24,791	\$32,733	\$23	\$343,615
December 31, 2010					
Commercial and industrial	\$14,268	\$679	\$75	\$23	\$15,045
Construction	10,669	2,753	7,440	-	20,862
Commercial real estate	162,147	19,880	21,920	460	204,407
Residential real estate	93,884	1,083	1,681	11	96,659
Consumer and other	1,382	-	13	-	1,395
	\$282,350	\$24,395	\$31,129	\$494	\$338,368

A loan is considered impaired, in accordance with the impairment accounting guidance (FASB ASC 310-10-35-16), when based on current information and events, it is probable that we will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, postponement or forgiveness of principal, forbearance or other actions intended to maximize collection. The average recorded investment in impaired loans is calculated using the average of impaired loans over the past five quarter-end periods. We recognize income on impaired loans under the cash basis when the collateral on the loan is sufficient to cover the outstanding obligation to the Company. If these factors do not exist, we will record all payments as a reduction of principal on such loans.

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The following table reflects our impaired loans as of March 31, 2011 and December 31, 2010:

(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
March 31, 2011					
With no related allowance recorded:					
Commercial and industrial	-	-	-	\$20	-
Construction	\$3,435	\$5,779	-	3,367	\$1
Commercial real estate	6,670	7,074	-	8,792	36
Residential real estate	733	583	-	719	5
Consumer and other	-	-	-	16	-
With an allowance recorded:					
Commercial and industrial	78	78	\$54	74	-
Construction	3,068	3,103	760	2,411	-
Commercial real estate	11,901	12,734	1,003	9,874	43
Residential real estate	516	668	216	530	-
Consumer and other	1	1	1	-	-
Total:					
Commercial and industrial	78	78	54	94	-
Construction	6,503	8,882	760	5,778	1
Commercial real estate	18,571	19,808	1,003	18,666	79
Residential real estate	1,249	1,251	216	1,249	5
Consumer and other	1	1	1	16	-
	\$26,402	\$30,020	\$2,034	\$25,803	\$85
December 31, 2010					
With no related allowance recorded:					
Commercial and industrial	-	-	-	\$188	-
Construction	\$3,230	\$3,535	-	2,885	\$38
Commercial real estate	4,863	5,284	-	8,122	118
Residential real estate	560	560	-	849	7
Consumer and other	-	-	-	9	-
With an allowance recorded:					
Commercial and industrial	78	78	\$54	71	-
Construction	3,406	5,481	610	2,568	-
Commercial real estate	10,651	11,453	493	10,379	299
Residential real estate	684	684	233	449	1
Consumer and other	-	-	-	-	-
Total:					
Commercial and industrial	78	78	54	259	-
Construction	6,636	9,016	610	5,453	38
Commercial real estate	15,514	16,737	493	18,501	417
Residential real estate	1,244	1,244	233	1,298	8

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Consumer and other	-	-	-	9	-
	\$23,472	\$27,075	\$1,390	\$25,519	\$463

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Note 4 – Earnings per Share

Basic earnings per share are calculated by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares (nonvested restricted stock grants and stock options) had been issued, as well as any adjustment to income that would result from the assumed issuance of potential common shares that may be issued by us. Potential common shares related to stock options are determined using the treasury stock method.

(In thousands, except per share data)	Three Months Ended March 31, 2011			Three Months Ended March 31, 2010		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic earnings per share:						
Net income	\$694	3,254	\$0.21	\$643	3,248	\$0.20
Effect of dilutive securities:						
Stock options	-	64		-	42	
Diluted earnings per share:						
Net income and assumed conversions	\$694	3,318	\$0.21	\$643	3,290	\$0.20

Note 5 – Comprehensive Income

The components of other comprehensive income and related tax effects are as follows:

(Dollars in thousands)	Three Months Ended March 31,	
	2011	2010
Unrealized holding gain on available for sale securities	\$ 217	\$ 223
Reclassification adjustments for net gains (losses) included in net income	-	-
Net unrealized gain	217	223
Tax effect	(87)	(89)
Other comprehensive income, net of tax	\$ 130	\$ 134

Note 6 – Segment Information

Our insurance agency operations are managed separately from the traditional banking and related financial services that we also offer. The insurance agency operation provides commercial, individual, and group benefit plans and personal coverage.

(Dollars in thousands)	Three Months Ended March 31, 2011			Three Months Ended March 31, 2010		
	Banking and Financial Services	Insurance Services	Total	Banking and Financial Services	Insurance Services	Total
Net interest income from external sources	\$4,357	\$-	\$4,357	\$3,957	\$-	\$3,957
Other income from external sources	630	615	1,245	629	547	1,176
Depreciation and amortization	150	3	153	163	3	166
Income before income taxes	793	110	903	850	15	865

Income tax expense (1)	165	44	209	216	6	222
Total assets	466,029	2,863	468,892	468,757	3,004	471,761

(1) Insurance services calculated at statutory tax rate of 40%

Note 7 - Stock-Based Compensation

We currently have stock-based compensation plans in place for our directors, officers, employees, consultants and advisors. Under the terms of these plans the Company may grant restricted shares and stock options for the purchase of our common stock. The stock-based compensation is granted under terms determined by the Compensation Committee of the Board of Directors. Our standard stock option grants have a maximum term of ten years, generally vest over periods ranging between one and four years, and are granted with an exercise price equal to the fair market value of the common stock on the date the options are granted. Restricted stock is valued at the market value of the common stock on the date of grant and generally vests between two and seven years. All dividends paid on restricted stock, whether vested or unvested, are granted to the stockholder.

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Information regarding our stock option plans as of March 31, 2011 was as follows:

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Contractual Term	Aggregate Intrinsic Intrinsic Value
Options outstanding, beginning of year	116,075	\$ 12.33		
Options exercised	-	-		
Options forfeited	-	-		
Options outstanding, end of quarter	116,075	\$ 12.33	2.79	\$ -
Options exercisable, end of quarter	116,075	\$ 12.33	2.79	\$ -
Option price range at end of quarter	\$ 8.86 to \$16.45			
Option price range for exercisable shares	\$ 8.86 to \$16.45			

During the first three months of 2011 and 2010, we expensed \$47 thousand and \$42 thousand, respectively, in stock-based compensation under restricted stock awards. Information regarding our restricted stock activity as of March 31, 2011 is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Restricted stock, beginning of year	101,991	\$ 4.71
Granted	11,850	6.25
Forfeited	(1,041)	4.80
Vested	(4,875)	6.88
Restricted stock, end of quarter	107,925	\$ 4.90

At March 31, 2011, unrecognized compensation expense for non-vested restricted stock was \$469 thousand, which is expected to be recognized over an average period of 4.9 years.

Note 8 - Guarantees

We do not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit are conditional commitments issued by us to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. We, generally, hold collateral and/or personal guarantees supporting these commitments. We had \$2.2 million of undrawn standby letters of credit outstanding as of March 31, 2011. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The amount of the liability as of March 31, 2011 for guarantees under standby letters of credit issued is not material.

Note 9 - Fair Value of Financial Instruments

Management uses its best judgment in estimating the fair value of our consolidated financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts we could have realized in a sale transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective period ends, and have

not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each period end.

Under FASB ASC 820, Fair Value Measurement and Disclosures, there is a hierarchal disclosure framework associated with the level of pricing observability utilized in measuring assets and liabilities at fair value. The three broad levels defined by the FASB ASC 820 hierarchy are as follows:

Level I - Quoted prices are available in active markets for identical assets or liabilities as of the reported date.

Level II - Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly

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observable as of the reported date. The nature of these asset and liabilities include items for which quoted prices are available but traded less frequently, and items that are fair valued using other financial instruments, the parameters of which can be directly observed.

Level III - Assets and liabilities that have little to no pricing observability as of the reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

The following table summarizes the valuation of our financial assets measured on a recurring basis by the above FASB ASC 820 pricing observability levels:

(Dollars in thousands)	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level I)	Significant Other Observable Inputs (Level II)	Significant Unobservable Inputs (Level III)
March 31, 2011:				
U.S. government agencies	\$ 15,387	-	\$ 15,387	-
State and political subdivisions	28,618	-	28,618	-
Mortgage-backed securities				
U.S. government-sponsored enterprises	30,648	-	30,648	-
Private mortgage-backed securities	4,407	-	4,407	-
Equity securities-financial services industry and other	1,325	\$ 1,177	148	-
December 31, 2010:				
U.S. government agencies	\$ 21,189	-	\$ 21,189	-
State and political subdivisions	28,735	-	28,735	-
Mortgage-backed securities				
U.S. government-sponsored enterprises	33,286	-	33,286	-
Private mortgage-backed securities	4,807	-	4,807	-
Equity securities-financial services industry and other	1,363	\$ 1,213	150	-

On June 1, 2010, we transferred all trading securities, which amounted to \$2.2 million, to available for sale at fair value. All trading securities at March 31, 2010 were mortgage-backed securities. Our trading securities and available for sale securities portfolios contain investments which were all rated within our investment policy guidelines at time of purchase and upon review of the entire portfolio all securities are marketable and have observable pricing inputs. There were no trading securities held during 2011. There were holding gains on trading securities recorded on the income statement of \$11 thousand for the three months ended March 31, 2010.

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For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level are as follows:

(Dollars in thousands)	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level I)	Significant Other Observable Inputs (Level II)	Significant Unobservable Inputs (Level III)
March 31, 2011:				
Impaired loans	\$ 13,688	-	-	\$ 13,688
Foreclosed real estate	1,691	-	-	1,691
December 31, 2010:				
Impaired loans	\$ 13,430	-	-	\$ 13,430
Foreclosed real estate	2,007	-	-	2,007

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of our assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between our disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair value of our financial instruments at March 31, 2011 and December 31, 2010:

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Cash and Cash Equivalents (Carried at Cost): The carrying amounts reported in the balance sheet for cash and cash equivalents approximate those assets' fair value.

Time Deposits with Other Banks (Carried at Cost): Fair value for fixed-rate time certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits. We generally purchase amounts below the insured limit, limiting the amount of credit risk on these time deposits.

Securities: The fair value of securities, available for sale (carried at fair value) is determined by obtaining quoted market prices on nationally recognized securities exchanges (Level I), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level 3). In the absence of such evidence, management's best estimate is used. Management's best estimate consists of both internal and external support on certain Level 3 investments. Internal cash flow models using a present value formula that includes assumptions market participants would use along with indicative exit pricing obtained from broker/dealers (where available) were used to support fair values of certain Level 3 investments.

Loans Receivable (Carried at Cost): The fair values of loans are estimated using discounted cash flow analyses, using the market rates on the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates and projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

Impaired Loans (Generally Carried at Fair Value): Impaired loans are those that are accounted for under FASB ASC 310, Accounting by Creditors for Impairment of a Loan, in which we have measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included in Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

Federal Home Loan Bank Stock (Carried at Cost): The carrying amount of restricted investment in bank stock approximates fair value and considers the limited marketability of such securities.

Deposit Liabilities (Carried at Cost): The fair values disclosed for demand, savings and club accounts are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Borrowings (Carried at Cost): Fair values of FHLB advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

Junior Subordinated Debentures (Carried at Cost): Fair values of junior subordinated debt are estimated using discounted cash flow analysis, based on market rates currently offered on such debt with similar credit risk characteristics, terms and remaining maturity.

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Accrued Interest Receivable and Accrued Interest Payable (Carried at Cost): The carrying amounts of accrued interest receivable and payable approximate their fair values.

Off-Balance Sheet Instruments (Disclosed at Cost): Fair values for our off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

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The following information is an estimate of the fair value of a limited portion of our assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between our disclosures and those of other companies may not be meaningful.

The estimated fair values of our financial instruments at March 31, 2011 and December 31, 2010 were as follows:

(Dollars in thousands)	March 31, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	\$ 18,521	\$ 18,521	\$ 17,749	\$ 17,749
Time deposits with other banks				