Cornerstone Financial Corp
Form 10-Q
May 13, 2011

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

FORM 10-Q

[X] Quarterly report pursuant to section 13 or 15 (d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2011

-OR-

[ ] Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from ___________ to _____________.

CORNERSTONE FINANCIAL CORPORATION
(Exact name of registrant, as specified in its charter)

NEW JERSEY	80-0282551
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

6000 MIDLANTIC DRIVE, SUITE 120 S, MOUNT LAUREL, NEW JERSEY	08054
(Address of principal executive offices)	Zip Code

Registrant's telephone number, including area code: (856) 439-0300

Securities registered pursuant to Section 12(b) of the Act:

NONE
(Title of Class)

Securities registered pursuant to Section 12(g) of the Act:

COMMON STOCK, NO PAR VALUE
(Title of Class)

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 past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES X NO ___.

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

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

Large accelerated filer [ ]   Accelerated filer [ ]

Non-accelerated filer [ ]   Smaller reporting company [X]
(Do not check if a smaller reporting company)

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) YES ___ NO X

As of May 12, 2011 there were 1,954,428 outstanding shares of the registrant's Common Stock.

CORNERSTONE FINANCIAL CORPORATION

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PART I. FINANCIAL INFORMATION

Item 1 -- Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(In thousands, except share data)		March 31, 2011		Decem
		(unaudited)		
Assets:				
Cash and due from banks	$	5,786	$	
Federal funds sold		10,000		
Cash and cash equivalents		15,786		
Investment securities:				
Held to maturity (fair value 2011 - $39,726; 2010 - $39,520)		40,158		
Available for sale (amortized cost 2011-$47,946; 2010- $47,945)		44,780		
Loans receivable		238,002		2
Less allowance for loan losses		2,962		
Loans receivable, net		235,040		2
Federal Home Loan Bank stock		1,435		
Premises and equipment, net		7,773		
Accrued interest receivable		1,930		
Bank owned life insurance		4,725		
Deferred taxes		2,149		
Other Real Estate Owned		830		
Other assets		1,589		
Total Assets	$	356,195	$	3
Liabilities:				
Non-interest bearing deposits	$	28,069	$	
Interest bearing deposits		169,106		1
Certificates of deposit		106,998		1
Total deposits		304,173		3
Advances from the Federal Home Loan Bank		25,000		
Line of Credit		4,929		
Subordinated debt		3,000		
Other liabilities		1,147		
Total Liabilities		338,249		3
Commitments and Contingencies (Note 4)				

Stockholders' Equity:			
Preferred stock:			
$0 par value; $1,000 per share stated value, authorized 1,000,000 shares; issued and outstanding 1,900 at March 31, 2011 and December 31, 2010 respectively		1,900	
Common stock:			
$0 par value: authorized 10,000,000 shares; issued and outstanding 1,954,428 at March 31, 2011 and 1,954,428 at December 31, 2010		-	
Additional paid-in capital		17,631	
Accumulated other comprehensive loss		(1,901)	
Retained earnings		316	
Total Shareholders' Equity		17,946	
Total Liabilities and Shareholders' Equity	$	356,195	$ 3

See accompanying notes to consolidated financial statements

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CORNERSTONE FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended			
(In thousands, except per share data)	March 31, 2011		March 31,2010	
Interest Income	(Unaudited)		(Unaudited)	
Interest and fees on loans	$	3,385	$	3,3
Interest on investment securities		886		5
Interest on federal funds		3		
Total interest income		4,274		3,9
Interest Expense				
Interest on deposits		905		9
Interest on borrowings		176		1
Total interest expense		1,081		1,1
Net interest income		3,193		2,8
Provision for loan losses		953		1
Net interest income after loan loss provision		2,240		2,6
Non-Interest Income				
Service charges on deposit accounts		43		
Bank owned life insurance income		40		
Gain on sale of loans		156		
Miscellaneous fee income		54		

Total non-interest income	293	1
Non-Interest Expense		
Salaries and employee benefits	1,377	1,2
Net occupancy	367	3
Data processing and other service costs	119	1
Professional services	158	1
Advertising and promotion	37	
Other real estate owned expense	29	
FDIC expense	133	1
Other operating expenses	148	1
Total non-interest expense	2,368	2,0
Income before income taxes	165	7
Income tax expense	56	3
Net income	109	4
Preferred stock dividends	33	
Net income available to common shareholders	$ 76	$ 4
Earnings per share		
Basic	$ 0.04	$ 0.
Diluted	$ 0.04	$ 0.
Weighted average shares outstanding		
Basic	1,954	1,9
Diluted	1,962	1,9

(1) All share and per share amounts have been restated to reflect the 8.0% common stock dividend payable on May 16, 2011 to common shareholders of record as of April 15, 2011.

See accompanying notes to consolidated financial statements

CORNERSTONE FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Unaudited)

(In thousands, except per share data)

	Comprehensive Income	Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Earnings
Balance at December 31, 2010		$ 1,900	$ -	$ 16,727	$ 1,109
Comprehensive income					
Net Income	$ 109	-	-	-	109

Unrealized gain on securities available for sale, net of tax	87				
Comprehensive income	$ 196				
Stock based compensation		-	-	35	-
Preferred Stock Dividend ($35 per share)		-	-	-	(33)
Declaration of 8% Common Stock Dividend		-	-	869	(869)
Balance at March 31, 2011		$ 1,900	$ -	$ 17,631	$ 316

See accompanying notes to consolidated financial statements.

CORNERSTONE FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	Three Months March 31, 2011 (Unaudited)	
Cash flows from operating activities:		
Net Income(loss)	$ 109	$
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	953	
Depreciation	108	
Amortization of premiums and discounts, net	9	
Stock option expense	35	
Gain on sale of loans	(156)	
Deferred tax expense (benefit)	394	
Income on Bank Owned Life Insurance	(40)	
Decrease (increase) in accrued interest receivable and other assets	11	
Increase (decrease) in other liabilities	25	
Net cash provided by operating activities	1,448	
Cash flows from investing activities:		
Purchases of investments held to maturity	-	
Purchases of securities available for sale	-	
Repayment of investments held to maturity	267	
Redemption (purchase) of FHLB Stock	-	
Net decrease in loans	3,193	
Purchases of premises and equipment	(75)	

Net cash provided (used in) investing activities		3,385	
Cash flows from financing activities:			
Net increase in deposits		1,903	
Proceeds from borrowings		52	
Principal payments on borrowings		-	
Cash dividend paid for preferred stock		(33)	
Net cash provided by financing activities		1,922	
Net increase in cash and cash equivalents		6,755	
Cash and cash equivalents at the beginning of the period		9,031	
Cash and cash equivalents at the end of the period		15,786	$
Supplemental disclosures of cash flow information:			
Cash paid during the period for interest	$	1,066	$
Cash paid during the period for income taxes		96	
Net change in unrealized gain on securities, net of tax		87	
Supplemental non-cash investing and financing activities:			
Unsettled AFS investment security	$	-	$

See accompanying notes to consolidated financial statements.

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CORNERSTONE FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Cornerstone Financial Corporation and its wholly owned subsidiary, Cornerstone Bank (together, the "Company"). These interim statements, which are unaudited, were prepared in accordance with instructions for Form 10-Q. In the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for fair presentation of the interim financial statements have been included.

Cornerstone Financial Corporation was formed in 2008 at the direction of the Board of Directors of Cornerstone Bank to serve as a holding company for the Bank. The holding company reorganization was completed in January 2009. The statement of financial condition as of December 31, 2010 has been derived from audited financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in Cornerstone Financial Corporation's Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the United States Securities and Exchange Commission.

NOTE 2 -- USE OF ESTIMATES

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the allowance for loan losses and the evaluation of deferred taxes.

NOTE 3 - CONTINGENCIES

The Company, from time to time, is a party to routine litigation that arises in the normal course of business. Management does not believe the resolution of this litigation, either any individual case or in the aggregate, would have a material adverse effect on the Company's financial condition or results of operations. However, the ultimate outcome of any such matter, as with litigation generally, is inherently uncertain and it is possible that some of these matters may be resolved materially adverse to the Company.

NOTE 4 - EARNINGS PER SHARE

Basic earnings per share is calculated on the basis of net income divided by the weighted average number of shares outstanding. Diluted earnings per share includes dilutive potential common shares as computed under the treasury stock method using average common stock prices.

All share and per share amounts have been restated to reflect the 8.0% common stock dividend, declared on March 17, 2011, and payable on May 16, 2011 to common shareholders of record as of April 15, 2011. This stock dividend resulted in the issuance of 144,772 additional shares and resulted in $869 thousand being transferred from retained earnings to additional paid in capital.

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NOTE 5 -- STOCK OPTIONS

The Company accounts for stock options in accordance with FASB Accounting Standards Codification (ASC) Topic 718 Stock Compensation. The Company recognizes the grant-date fair-value of stock options and other equity-based compensation issued to employees in the statement of operations. The Company had $229 thousand in unrecognized compensation costs relating to non-vested stock based compensation awards at March 31, 2011.

On July 16, 2009, options to purchase a total of 48,600 shares of common stock were granted with an exercise price of $4.63 per share. These options will expire ten years from the date of the grant and vest on a one-third per year basis beginning on July 16, 2010, with vesting accelerating in certain circumstances such as change in control of the Company. The exercise price of each option equals the market price of the common stock on the date of the grant.

On January 16, 2010, options to purchase a total of 119,880 shares of common stock were granted with an exercise price of $4.17 per share. These options will expire ten years from the date of the grant and vest on a one-third per year basis beginning on January 21, 2011, with vesting accelerating in certain circumstances such as change in control of the Company. The exercise price of each option equals the market price of the common stock on the date of the grant.

NOTE 6 - INVESTMENT SECURITIES

A comparison of amortized cost and approximate fair value of investment securities held to maturity at March 31, 2011 and December 31, 2010 is as follows (in thousands):

March 31, 2011

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Investments held to maturity:				
Government agency obligations	$ 32,707	$ 51	$ (1,056)	$ 31,702
Mortgage backed securities	7,451	123	-	7,574
Total	$ 40,158	$ 174	$ (1,056)	$ 39,276
Investments available for sale:				
Government agency obligations	$ 38,056	$ -	$ (2,201)	$ 35,855
US Treasury Securities	9,890	-	(965)	8,925
Total	$ 47,946	$ -	$ (3,166)	$ 44,780

	December 31, 2010			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Investments held to maturity:				
Government agency obligations	$ 32,706	$ 68	$ (1,131)	$ 31,643
Mortgage backed securities	7,729	148	-	7,877
Total	$ 40,435	$ 216	$ (1,131)	$ 39,520
Investments available for sale:				
Government agency obligations	$ 38,056	$ -	$ (2,496)	$ 35,560
US Treasury Securities	9,889	-	(814)	9,075
Total	$ 47,945	$ -	$ (3,310)	$ 44,635

The following table sets forth information regarding the fair value and unrealized losses on the Company's temporarily impaired investment securities at March 31, 2011 and December 31, 2010 for the time periods shown (in thousands):

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	March 31, 2011				
	Less than 12 months		12 months or longer		
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
Investments held to maturity:					
Government Agency Obligations	$ 27,407	$ (1,056)	$ -	$ -	$ 27,407
Investments available for sale:					
Government agency obligations	35,855	(2,201)	-	-	35,855
US Treasury Securities	8,925	(965)			8,925
Total temporarily impaired investment securities	$ 72,187	$ (4,222)	$ -	$ -	$ 72,187

	December 31, 2010					
	Less than 12 months		12 months or longer			
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	
Investments held to maturity:						
Government Agency Obligations	$ 27,132	$ 1,131	$ -	$ -	$ 27,132	
Mortgage Backed Securities	-	-	-	-	-	
Investments available for sale:						
Government agency obligations	$ 35,560	$ 2,496	$ -	$ -	$ 35,560	
US Treasury Securities	9,075	814	-	-	9,075	
Total temporarily impaired investment securities	$ 71,767	$ 4,441	$ -	$ -	$ 71,767	

Management has taken into consideration the following information in reaching the conclusion that the impairment of the securities listed in the table above is not other than temporary. The unrealized losses disclosed above are the result of fluctuations in market interest rates currently offered on like securities and do not reflect a deterioration or downgrade of the investment issuer's credit-worthiness or ability to meet its cash flow requirements. The Company believes that it is probable that it will receive all future contractual cash flows and does not intend to sell and will not be required to sell these investment securities until recovery or maturity. The U.S. Government agency sponsored securities which are listed have call provisions priced at par if called prior to their respective maturity dates.

Other Comprehensive Income (Loss)

The change in other comprehensive income (loss) components and related tax benefit are as follows for the three months ended March 31, 2011. The Company had no unrealized gains or losses on available for sale securities at March 31, 2010. (In thousands):

	March 31, 2011		
Unrealized gain on securities available for sale:	Before-Tax Amount	Tax Benefit	Net-of-T Amount
Unrealized holding gain arising during the year	$ 144	$ (57)	$
Other comprehensive income	$ 144	$ (57)	$

NOTE 7 -- LOANS RECEIVABLE

The Company monitors and asses the credit risk of its loan portfolio using the classes set forth below. These classes also represent the segments by which the company monitors the performance of its loan portfolio and estimates its allowance for loan losses.

Commercial loans include short and long-term business loans and commercial lines of credit for the purposes of providing working capital, supporting accounts receivable, purchasing inventory and acquiring fixed assets. The loans generally are secured by these types of assets as collateral and/or by personal guarantees provided by principals of the borrowers.

Commercial real estate loans are generally originated in amounts up to the lower of 75% of the appraised value or cost of the property and are secured by improved property such as multi-family dwelling units, office buildings, retail stores, warehouses, church buildings and other non-residential buildings, most of which are located in the Company's market area. Commercial real estate loans are generally made with fixed interest rates which mature or reprice in five to seven years with principal amortization of up to 25 years.

Residential real estate loans consist of loans secured by one- to four-family residences located in the Bank's market area. The Bank has originated one- to four-family residential mortgage loans in amounts up to 80% of the lesser of the appraised value or selling price of the mortgaged property without requiring mortgage insurance. A mortgage loan originated by the Bank, for owner occupied property, whether fixed rate or adjustable rate, can have a term of up to 30 years. Non-owner occupied property, whether fixed rate or adjustable rate, can have a term of up to 25 years. Adjustable rate loan terms limit the periodic interest rate adjustment and the minimum and maximum rates that may be charged over the term of the loan based on the type of loan.

Construction Loans will be made only if there is a permanent mortgage commitment in place. Interest rates on commercial construction loans are typically in line with normal commercial mortgage loan rates, while interest rates on residential construction loans are slightly higher than normal residential mortgage loan rates. These loans usually are adjustable rate loans and generally have terms of up to one year.

Consumer Loans includes installment loans and home equity loans, secured by first or second mortgages on homes owned or being purchased by the loan applicant. Home equity term loans and credit lines are credit accommodations secured by either a first or second mortgage on the borrower's residential property. Interest rates charged on home equity term loans are generally fixed; interest on credit lines is usually a floating rate related to the prime rate. The Bank generally requires a loan to value ratio of less than or equal to 80% of the appraised value, including any outstanding prior mortgage balance.

Loans receivable consist of the following (in thousands):

	March 31, 2011	December 31, 2
Commercial	$ 94,883	$ 95,441
Real estate -- commercial	109,211	112,217
Real estate -- residential	13,463	14,780
Construction	13,515	13,177
Consumer loans	7,143	7,450
Net deferred loan fees	(213)	(209)
	238,002	242,856
Allowance for loan losses	(2,962)	(3,826)
Loans receivable, net	$ 235,040	$ 239,030

Under New Jersey banking laws, the Bank is subject to a loans-to-one-borrower limitation of 15% of capital funds for most loans. At March 31, 2011, the loans-to-one-borrower limitation was approximately $4.6 million; this excludes an additional 10% of capital funds, or approximately $3.0 million which may be loaned if collateralized by readily marketable securities. At March 31, 2011, there were no loans outstanding or committed to any one borrower which individually or in the aggregate exceeded the Bank's loans-to-one-borrower limitation of 15% of capital funds.

A summary of the Company's credit quality indicators is as follow:

Pass - A credit which is assigned a rating of Pass shall exhibit some or all of

the following characteristics:

a. Loans that present an acceptable degree of risk associated with the financing being considered as measured against earnings and balance sheet trends, industry averages, etc. Actual and projected indicators and market conditions provide satisfactory evidence that the credit will perform as agreed.

b. Loans to borrowers that display acceptable financial conditions and operating results. Debt service capacity is demonstrated and future prospects are considered good.

c. Loans to borrowers where a comfort level is achieved by the strength of the cash flows from the business or project and the strength and quantity of the collateral or security position (i.e.: receivables, inventory and other readily marketable securities) as supported by a current valuation and/or the strong capabilities of a guarantor.

Special Mention - Loans on which the credit risk requires more than ordinary attention by the Loan Officer. This may be the result of some erosion in the borrower's financial condition, the economics of the industry, the capability of management, or changes in the original transaction. Loans which are currently sound yet exhibit potentially unacceptable credit risk or deteriorating long term prospects, will receive this classification. Loans which deviate from loan policy or regulations will not generally be classified in this category, but will be separately reported as an area of concern
Classified -- Classified loans include those considered by the Company to be substandard, doubtful or loss.

An asset is considered "substandard" if it involves more than an acceptable level of risk due to a deteriorating financial condition, unfavorable history of the borrower, inadequate payment capacity, insufficient security or other negative factors within the industry, market or management. Substandard loans have clearly defined weaknesses which can jeopardize the timely payment of the loan.

Assets classified as "doubtful" exhibit all of the weaknesses defined under the substandard category but with enough risk to present a high probability of some principal loss on the loan, although not yet fully ascertainable in amount.

Assets classified as "loss" are those considered uncollectible or of little value, even though a collection effort may continue after the classification and potential charge-off.

Non Performing Loans

Non-performing loans consist of non-accrual loans (loans on which the accrual of interest has ceased), loans over ninety days delinquent and still accruing interest, renegotiated loans and impaired loans. Loans are generally placed on non-accrual status if, in the opinion of management, collection is doubtful, or when principal or interest is past due 90 days or more, unless the collateral is considered sufficient to cover principal and interest and the loan is in the process of collection. At March 31, 2011 the Company had thirteen loan relationships totaling $10.1 million in non-accrual loans compared to twelve relationships totaling $9.8 million in non-accrual loans at December 31, 2010 The Company recognized no interest income on non-accrual loans during the three month period ended March 31, 2011 as compared to $17 thousand for the three month period ended March 31, 2010.

The following table represents loans by credit quality indicator at March 31, 2011.

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(In thousands)	Pass	Special Mention Loans	Classified Loans	Non Performing Loans	Total
Commercial	$ 89,837	$ 838	$ 3,013	$ 1,112	$ 94,800
Real Estate, Commercial	99,208	2,175	-	7,702	109,085
Real Estate, Residential	12,489	-	-	964	13,453
Construction	13,485	-	-	-	13,485
Consumer	6,598	243	50	288	7,179
Total Loans	$221,617	$ 3,256	$ 3,063	$10,066	$ 238,002

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The following table represents loans by credit quality indicator at December 31, 2010.

(In thousands)	Pass	Special Mention Loans	Classified Loans	Per
Commercial	$ 93,209	$ 845	$ -	$
Real Estate, Commercial	101,718	2,175	-	
Real Estate, Residential	13,596	-	1,170	
Construction	13,145	-	-	
Consumer	6,905	244	51	
Total Loans	$ 228,572	$ 3,264	$ 1,221	$

The following table represents past-due loans and leases as of March 31, 2011.

(In thousands)	30-89 Days Past Due	90 Days or more Past	Total Past Due and	Accruing

	and Still Accruing	Due and Still Accruing	Still Accruing	Current Balances	A Ba
Commercial	$ 1,179	$ 634	$ 1,813	$ 93,688	$
Real Estate, Commercial	-	-	-	101,383	
Real Estate, Residential	-	-	-	12,489	
Construction	556	-	556	13,485	
Consumer	-	243	243	6,891	
Total Loans and Leases	$ 1,735	$ 877	$ 2,612	$ 227,936	$
Percentage of Total loans	0.73%	0.37%	1.10%	95.77%	

The following table represents past-due loans and leases as of December 31, 2010.
(In thousands)

	30-89 Days Past Due and Still Accruing	90 Days or more Past Due and Still Accruing	Total Past Due and Still Accruing	Accruing Current Balances	B
Commercial	$ 209	$ 634	$ 843	$ 94,054	$
Real Estate, Commercial	-	-	-	103,893	
Real Estate, Residential	-	244	244	14,766	
Construction	-	-	-	13,145	
Consumer	-	-	-	7,200	
Total Loans	$ 209	$ 878	$ 1,087	$ 233,058	$
Percentage of Total loans	0.09%	0.36%	0.45%	95.97%	

Impaired loans are measured based on the present value of expected future discounted cash flows, the fair value of the loan or the fair value of the underlying collateral if the loan is collateral dependent. The recognition of interest income on impaired loans is the same as for non-accrual loans discussed above. At March 31, 2011, the Company

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had eighteen impaired loan relationships totaling $11.0 million (included within the non-accrual loans discussed above) in which $3.8 million in impaired loans had a related allowance for credit losses of $1.1 million and $7.2 million in impaired loans in which there is no related allowance for credit losses. The average balance of impaired loans totaled $11.4 million as of March 31, 2011, and interest income recorded on impaired loans during the three months ended March 31, 2011 totaled $13 thousand, as compared to $30 thousand for the three months ended March 31, 2010.

At March 31, 2011 the Company had two loan relationships totaling $877 thousand which were delinquent ninety days or more and still accruing interest. At December 31, 2010, the Company two loan relationships totaling $878 million which were delinquent ninety days or more and still accruing interest.

The following table represents data on impaired loans at March 31, 2011 and March 31, 2010.

(In thousands)	
Impaired loans for which a valuation allowance has been provided	$
Impaired loans for which no valuation allowance has been provided	
Total Loans determined to be impaired	
Allowance for loan losses related to impaired loans	
Average recorded investment in impaired loans	
Cash basis interest income recognized on impaired loans	$

The following table presents impaired loans by portfolio class at March 31, 2011

(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Valuation Allowance	Av A R In
Impaired loans with a valuation allowance:				
Commercial	$ 1,069	$ 1,069	$ 392	$
Real Estate, Commercial	1,551	1,551	520	
Real Estate, Residential	964	964	86	
Construction	-	-	-	
Consumer	197	197	98	
Subtotal	3,781	3,781	1,096	
Impaired loans with no valuation allowance:				
Commercial	676	676	-	
Real Estate, Commercial	6,151	6,151	-	
Real Estate, Residential	-	-	-	
Construction	-	-	-	
Consumer	385	385	-	
Subtotal	7,212	7,212	-	
Total Impaired loans:				
Commercial	1,745	1,745	392	
Real Estate, Commercial	7,702	7,702	520	
Real Estate, Residential	964	964	86	
Construction	-	-	-	
Consumer	582	582	98	
Total	$ 10,993	$ 10,993	$ 1,096	$

The following table presents impaired loans by portfolio class at December 31, 2010.

(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Valuation Allowance	Average Annual Recorded Investment
Impaired loans with a valuation allowance:				
Commercial	$ 1,198	$ 1,198	$ 962	$
Real Estate, Commercial	2,060	2,060	1,020	
Real Estate, Residential	-	-	-	
Construction	-	-	-	
Consumer	199	199	99	
Subtotal	3,457	3,457	2,081	
Impaired loans with no valuation allowance:				
Commercial	732	732	-	
Real Estate, Commercial	6,153	6,153	-	
Real Estate, Residential	-	-	-	
Construction	-	-	-	
Consumer	385	385	-	
Subtotal	7,271	7,271	-	
Total Impaired loans:				
Commercial	1,930	1,930	962	
Real Estate, Commercial	8,213	8,213	1,020	
Real Estate, Residential	-	-	-	
Construction	-	-	-	
Consumer	584	584	99	
Total	$ 10,728	$ 10,728	$ 2,081	$ 1

Included in the balance of the loans past due 90 days or more is a principal balance of $634 thousand dollars representing the Bank's participation interest in two loans originated by another New Jersey based institution. Although the borrowers have ceased making payments on these loans, we have received a legal opinion from our legal counsel that the Bank has valid claims against the lead/originating bank for violations of the participation agreements, and we have filed suit asserting these claims. In the event the lead bank is unable to collect from the borrowers, we believe, based on said legal opinion, that we may collect our principal and interest from the lead/originating bank. However, in that case our ability to collect on these loans will depend upon the outcome of our legal action against the lead/originating bank.

The following table provides information regarding risk elements in the loan portfolio as of March 31, 2011 and December 31, 2010

(In thousands)	March 31, 2011	December 31, 2010

Non-performing assets:		
Loans past due 90 days or more and accruing		
Commercial	$ 634	$
Consumer	243	
Total loans past due 90 days or more and accruing	877	
Non-accrual loans:		
Commercial	1,112	1,
Commercial real estate	7,702	8,
Residential Real Estate	964	
Consumer	288	
Total non-accrual loans	10,066	9,
Impaired loans	50	
Total non-performing loans	10,116	9,
Real estate owned	830	
Total non-performing assets	$ 11,823	11,
Non-performing loans as a percentage of loans	4.25%	4
Non-performing assets as a percentage of loans and real estate owned	4.97%	4
Non-performing assets as a percentage of total assets	3.32%	3

During the period ended March 31, 2011 the Company experienced a $268 thousand net increase in non-accrual loans. This change reflects the downgrading of four loan relationships to non-accrual status totaling $2.1 million partially offset by total charge offs of four loans relationships representing nine loans in the amount of $1.8 million during the three month period ended March 31, 2011. The downgraded loans consisted of two relationships representing residential mortgages loans totaling $964 thousand and two commercial relationships representing six loans totaling $1.1 million.

The following table sets forth with respect to the Bank's allowance for losses on loans:

(In thousands)	March 31, 2011	March 31, 2010
Balance at beginning of year	$ 3,826	$ 3,4
Provision:		
Commercial	943	1
Commercial real estate	(344)	
Residential real estate	323	
Consumer	31	
Total Provision	953	1
Charge-offs:		
Commercial	1,536	
Residential real estate	281	
Recoveries	-	
Total Net Charge-offs	1,817	
Balance at end of period	$ 2,962	$ 3,5

Period-end loans outstanding	$ 238,002	$ 237,4
Average loans outstanding	$ 239,449	$ 235,1
Allowance as a percentage of period-end loans	1.24%	1.
Net charge-offs as a percentage of average loans	0.76%	0.

Additional details for changes in the allowance for loan and leases by loan portfolio as of March 31, 2011 are as follows:

Allowance for Loan and Lease Losses	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	T
Beginning Balance, December 31, 2010	$ 1,743	$ 1,527	$ 417	$ 139	$
Charge-off	(1,536)	-	(281)	-	
Provision	943	(344)	323	31	
Ending Balance	$ 1,150	$ 1,183	$ 459	$ 170	$

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The Company prepares an allowance for loan loss model on a quarterly basis to determine the adequacy of the allowance. Management considers a variety of factors when establishing the allowance, such as the impact of current economic conditions, diversification of the loan portfolio, delinquency statistics, results of independent loan review and related classifications. The Bank's historic loss rates and the loss rates of peer financial institutions are also considered. In evaluating the Company's allowance for loan loss the Company maintains a Criticized Asset Committee ("CAC") consisting of senior management that monitors problem loans and formulates collection efforts and resolution plans for each borrower. On a monthly basis the CAC meets to review each problem loan and determines if there has been any change in collateral value due to changes in market conditions. Each quarter, when calculating the allowance for loan loss, the CAC reviews an updated loan impairment analysis on each problem loan to determine if a specific provision for loan loss is warranted. Management reviews the most recent appraisal on each loan adjusted for holding and selling costs. In the event there is not a recent appraisal on file, the Company will use the aged appraisal and apply a discount factor to the appraisal then adjust the holding and selling costs from the discounted appraisal value. At March 31, 2011, the Company maintained an allowance for loan loss ratio of 1.24% to period end loans outstanding. On a linked basis, our non-performing assets have increased by $266 thousand over their stated levels at December 31, 2010 representing a non-performing asset to total asset ratio of 3.32% at March 31, 2011 as compared to a non-performing asset to total asset ratio 3.26% at December 31, 2010.

The Company's charge-off policy states any asset classified loss shall be charged-off within thirty days of such classification unless the asset has already been eliminated from the books by collection or other appropriate entry. On a quarterly basis the Board Loan Committee ("BLC") will review past due, classified, non-performing and other loans, as it deems appropriate, to determine the collectability of such loans. If the BLC determines a loan to be uncollectible, the loan shall be charged to the allowance for loan loss. In addition, upon reviewing the collectability of a loan, the BLC may determine a portion of the loan to be uncollectible; in which case that portion of the loan deemed uncollectable will be partially charged-off against the allowance for loan loss.

For the three month period ending March 31, 2011 the Company experienced six charge offs relating to three loan relationships totaling $1.0 million and three partial charge-offs relating to two loan relationships totaling $782 thousand as compared to charge-offs of four loans representing one relationship totaling $382 thousand for the period ended December 31, 2010.

NOTE 8 -- Bank Owned Life Insurance

Bank Owned Life Insurance ("BOLI") is carried at its aggregate cash surrender value less surrender charges and totaled $4.7 million at March 31, 2011. Income of $40 thousand was recognized on BOLI during the three month period ended March 31, 2011 as compared to $41 thousand for the three month period ended March 31, 2010. The Bank is the sole owner and beneficiary of the BOLI.

NOTE 9 -- Deferred Compensation Plans

Effective January 1, 2006, the Bank adopted a Nonqualified Deferred Compensation Plan (The "Executive Plan") and the Directors' Fee Deferral and Death Benefit Plan (the "Directors' Plan"). Both plans provide for payments of deferred compensation to participants. The Company recorded $79 thousand in deferred compensation expense during the three month period ended March 31, 2011 as compared to $43 thousand for the three month period ended March 31, 2010.

NOTE 10 -- Income Taxes

The Company accounts for uncertainties in income taxes in accordance with Financial ASC Topic 740, Accounting for Uncertainty in Income Taxes. ASC Topic 740 prescribes a threshold and measurement process for recognizing in the financial statements a tax position taken or expected to be taken in a tax return. ASC Topic 740 also provides

guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company has determined that there are no significant uncertain tax positions requiring recognition in its financial statements.

Federal tax years 2007 through 2009 remain subject to examination as of March 31, 2011, while tax years 2006 through 2009 remain subject to examination by state taxing jurisdictions. In the event the Company is assessed for interest and/or penalties by taxing authorities, such assessed amounts will be classified in the financial statements as income tax expense.

The ability to realize deferred tax assets is dependent upon a variety of factors, including the generation of future taxable income, the existence of taxes paid and recoverable, the reversal of deferred tax liabilities, and tax planning strategies. Based upon these and other factors, the Company determined that it is more likely than not that its deferred tax asset will be realized. As such, no valuation allowance was established for the deferred tax asset as of March 31, 2011 or December 31, 2010. The Company will continue to reassess the realizability of the deferred tax asset in future periods. If, in the future, it is determined that the Company's deferred tax asset is not realizable, a valuation allowance may be established against the deferred tax asset, which may have a material impact on the Company's net income in the period in which it is recorded.

NOTE 11 -- Fair Value of Financial Instruments

ASC Topic 820 Fair Value Measurements and Disclosures establishes a framework for measuring fair value under U.S. generally accepted accounting principles, and expands disclosure requirements for fair value measurements. ASC Topic 820 does not require any new fair value measurements. The adoption of ASC Topic 820 did not have a material impact on the Company's consolidated financial statements.

ASC Topic 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels, as described below:

- o Level 1. Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities.

- o Level 2. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable, either directly or indirectly. Level 2 inputs include quoted prices for similar assets, quoted prices in markets that are not considered to be active, and observable inputs other than quoted prices such as interest rates.

- o Level 3. Level 3 inputs are unobservable inputs.

The fair value of securities available for sale are determined by obtaining quoted prices on a nationally recognized securites exchange (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities(Level 2 inputs).

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

ASSETS AND LIABILITIES MEASURED ON A RECURRING BASIS

Assets and liabilities measured at fair value on a recurring basis are summarized below:

	FAIR VALUE MEASUREMENTS AT MARCH 31, 2011			FAIR AT D
	QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT OTHER UNOBSERVABLE INPUTS (LEVEL 3)	QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)
		(IN THOUSANDS)		
Assets:				
Investment Securities				
US Government Obligations	$ --	$ 35,855	$ --	$ --

US Treasury Securities	$ 8,925	$ --	$ --	$9,075
Total assets on a recurring basis at fair value	$ 8,925	$ 35,855	$ --	$9,075

ASSETS AND LIABILITIES MEASURED ON A NON-RECURRING BASIS

Assets and liabilities measured at fair value on a non-recurring basis are summarized below:

	FAIR VALUE MEASUREMENTS AT MARCH 31, 2011			F AT D
	QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT OTHER UNOBSERVABLE INPUTS (LEVEL 3)	QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)
		(IN THOUSANDS)		
Assets:				
Impaired loans	$ --	$10,993	$ --	$ --
Other Real Estate Owned	--	830	--	--
Total assets measured on a non-recurring basis at fair value	$ --	$11,823	$ --	$ --

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach.

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The following required disclosure of the estimated fair value of financial instruments has been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

As required by ASC topic 825-10-65, the estimated fair value of financial instruments at March 31,2011 and December 31, 2010 was as follows:

	March 31, 2011	December 31, 20

(in thousands)	Carrying amount	Estimated fair value	Carrying amount	Esti fair
Financial assets:				
Cash and cash equivalents	$ 15,786	$ 15,786	$ 9,031	$
Investments held to maturity				
Federal Agency Securities	32,707	31,702	32,706	
Mortgage-backed Securities	7,451	7,574	7,729	
Investments available for sale				
US Treasury Securities	8,925	8,925	9,075	
Federal Agency Securities	35,855	35,855	35,560	
Loans receivable	238,002	265,571	242,856	2
FHLB stock	1,435	1,435	1,435	
Bank Owned Life Insurance	4,725	4,725	4,685	
Accrued interest receivable	1,930	1,930	2,152	
Total financial assets	$ 346,816	$ 373,503	$ 345,229	$ 3
Financial Liabilities:				
Checking Accounts	$ 45,744	$ 45,744	$ 59,625	$
Statement savings accounts	3,285	3,285	3,203	
Money market accounts	14,959	14,959	10,248	
Index Accounts	133,187	133,187	115,697	1
Certificates of deposit	106,998	105,702	113,497	1
FHLB advances	25,000	25,000	25,000	
Line of Credit	4,929	4,929	4,877	
Subordinated Debt	3,000	3,000	3,000	
Accrued interest payable	202	202	187	
Total financial liabilities	$ 337,304	$ 336,008	$ 335,334	$ 3
	Contract Value	Estimated Fair Value	Contract Value	Estim Fair
Off-balance sheet instruments:				
Commitments to extend credit	$ 54,153	$ -	$ 58,051	$

NOTE 12 -- Recent Accounting Pronouncements

Below is a discussion of recent accounting pronouncements. Recent pronouncements not discussed below were deemed to not be applicable to the Company.

In January 2011, the FASB issued (ASU) 2011-01 Receivables (Topic 310) Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20. This Update temporarily delays the effective date of the disclosures about troubled debt restructurings in Update 2010-20 for public entities. The amendments in this Update delay the effective date of the new disclosures about troubled debt restructurings for public entities and

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the coordination of the guidance for determining what constitutes a troubled debt restructuring until interim and annual periods ending after June 15, 2011. No significant impact to amounts reported in the consolidated financial position or results of operations are expected for the Company from the adoption of ASU 2011-01.

NOTE 13-- Private Placement Common Stock Offering and Preferred Stock Issuance

In June 2009, the Board of Directors of the Company approved a private placement common stock offering to accredited investors. In connection with this offering, the Board of Directors approved the issuance of common stock purchase warrants. As part of the offering, one warrant was issued for each share of Company common stock, no par, sold in the stock offering. Each warrant issued under the offering will allow the holder of the warrant to purchase one share of Company common stock, for a price of $9.00 per share through June 26, 2013. For the year ended December 31, 2009, the Company sold 153,889 shares under this offering and issued 153,889 common stock warrants. The $1.1 million proceeds received from the common stock offering were recorded as additional paid in capital.

In December 2009, the Company authorized the establishment of 2,000 shares of no par, $1,000 stated value, Perpetual Non-Cumulative Convertible Preferred Stock. The preferred stock is entitled to receive, as and when declared by the Company's Board of Directors, non-cumulative cash dividends at an annual rate of 7% of the stated value. In December 2009, the Company sold 1,900 preferred shares. The preferred stock is redeemable at the Company's option at any time after six months from the issue date at the stated value plus any dividends declared but unpaid. The preferred shares have priority of dividends such that no dividends or distributions shall be declared or paid to common shareholders unless full dividends on all outstanding preferred shares have been declared and paid for the most recently completed calendar quarter.

NOTE 14 -- Subsequent Events

The Company has evaluated subsequent events through the filing date of this report, and determined that there were no recognized or unrecognized subsequent events to report.

Item 2. Management's Discussion and Analysis

Forward-Looking Statements

Cornerstone Financial Corporation (the "Company") may from time to time make written or oral "forward-looking statements," including statements contained in the Company's filings with the Securities and Exchange Commission (including this Quarterly Report on Form 10-Q and the exhibits hereto), in its reports to shareholders and in other communications by the Company, which are made in good faith by the Company pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements involve risks and uncertainties, such as statements of the Company's plans, objectives, expectations, estimates and intentions that are subject to change based on various important factors (many of which are beyond the Company's control). Forward-looking statements may be identified by the use of words such as "expects," "subject," "believe," "will," "intends," "will be," or "would." The factors which could cause the Company's financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements include those items listed under "Item 1A-Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2010 and the following factors, among others: the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System ("Federal Reserve"); inflation; interest rates; market and monetary fluctuations; the timely development of new products and services by the Company and the perceived overall value of these products and services by users, including the features, pricing and quality compared to competitors' products and services; the success of the Company in gaining regulatory approval of its products, services, dividends and of new branches, when required; the impact of changes in financial services laws and

regulations (including laws concerning taxes, banking, securities and insurance); technological changes; acquisitions; the ability to continue to effectively manage costs, including the costs incurred in connection with the opening of new branches; changes in consumer spending and saving habits; the Company's ability to access the capital markets to maintain its regulatory capital standing and the success of the Company at managing the risks resulting from these factors.

The Company cautions that the above listed factors are not exclusive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company.

Overview

Cornerstone Financial Corporation

The Company was formed in 2008 at the direction of the Board of Directors of Cornerstone Bank (the "Bank") to serve as a holding company for the Bank. The Board believed that establishing a holding company would provide greater flexibility in raising capital and conducting the Bank's business. The holding company reorganization was completed in January 2009.

At March 31, 2011, we had total assets of $356.2 million, total loans, gross of $238.0 million, total investment securities of $84.9 million and total deposits of $304.2 million compared to total assets of $354.0 million, total loans, net of $242.3 million, total investment securities of $89.1 million and total deposits of $302.3 million at December 31, 2010. Our growth in assets and deposits reflects our commitment to provide outstanding customer service and a broad array of banking products driven by our customers' needs. We believe our strategy provides us with a competitive advantage over other financial institutions by developing lasting customer relationships that will enable us to continue to attract core deposits and loans within our market area.

Interest Rate Risk

Our primary objective in managing interest rate risk is to minimize the adverse impact of changes in interest rates on our net interest income while creating an asset/liability structure that maximizes earnings. Our Asset Liability Management Committee actively monitors and manages our interest rate exposure using gap analysis and interest rate simulation models.

Gap analysis measures the difference between volumes of rate-sensitive assets and liabilities and quantifies these repricing differences for various time intervals. Static gap analysis describes interest rate sensitivity at a point in time. However, gap analysis alone does not accurately measure the potential magnitude of changes in net interest income since changes in interest rates do not affect assets and liabilities at the same rate, to the same extent, or on the same basis. Furthermore, static gap analysis does not consider future growth or changes in the asset mix.

A positive gap (asset sensitive) indicates that more assets reprice during a given period compared to liabilities, while a negative gap (liability sensitive) indicates that more liabilities reprice during a given period compared to assets.

Generally, during a period of falling interest rates, a positive gap would tend to adversely affect net interest income, while a negative gap would tend to result in an increase in net interest income. During a period of rising interest rates, in general, a positive gap would tend to result in an increase in net interest income while a negative gap would tend to affect net interest income adversely. However, certain assets and liabilities may react differently to changes in interest rates even though they reprice or mature in the same or similar time periods. The interest rates on certain assets and liabilities may change at different times than changes in market interest rates, with some changing in advance of changes in market rates and some lagging behind changes in market rates. Also, certain assets (e.g., adjustable rate mortgages) often have provisions that may limit changes both each time the interest rate changes and on a cumulative basis over the life of the loan. Additionally, the actual prepayments and withdrawals in the event of a change in interest rates may differ significantly from those assumed in the calculations shown in the table below. Finally, the ability of borrowers to service their debt may decrease in the event of an interest rate increase.

Consequently, any model used to analyze interest rate sensitivity will be vulnerable to the assumptions made with respect to the foregoing factors.

We use a computer-based simulation model to assess the impact of changes in interest rates on net interest income. The model incorporates management's business plan assumptions and related asset and liability yields/costs, deposit sensitivity and the size, composition and maturity or repricing characteristics of our assets and liabilities. The assumptions are based on what management believes at that time to be the most likely interest rate environment. Actual results may differ from simulated results due to the various factors discussed above.

The following table sets forth the amount of our interest-earning assets and interest-bearing liabilities at March 31, 2011, which are expected to mature or reprice in each of the time periods shown:

(Dollars in thousands)	One Year or Less	One-Five Years	Over Five Years	Non-Rate Sensitive Assets/ Liabilitie
Interest-earning assets:				
Short term investments	$ 10,000	$ -	$ -	$
Investment securities held to maturity	-	5,000	35,158	
Investment securities available for sale			44,780	
Loans receivable	117,798	69,840	50,364	
Total interest-earning assets	127,798	74,840	130,302	
Non-rate sensitive assets:				
Other assets	-	-	-	23,255
Total assets	$ 127,798	$ 74,840	$ 130,302	$ 23,255

Interest-bearing liabilities:				
Interest-bearing demand	$ 17,675	$ -	$ -	$
Statement savings	3,285	-	-	
Money market	148,146	-	-	
Certificates of deposit	78,952	28,046	-	
Subordinated debt	-	3,000	-	
Borrowings	25,000	4,929	-	
Total interest-bearing liabilities	273,058	35,975	-	
Non-rate sensitive liabilities:				
Non-interest bearing deposits	-	-	-	28,069
Other liabilities	-	-	-	1,147
Capital	-	-	-	17,946
Total liabilities and capital	$ 273,058	$ 35,975	$ -	$ 47,162
Period GAP	$ (145,260)	$ 38,865	$ 130,302	$ (23,907
Cumulative interest-earning assets	$ 127,798	$ 202,638	$ 332,940	
Cumulative interest-bearing liabilities	$ 273,058	$ 309,033	$ 309,033	
Cumulative GAP	$ (145,260)	$ (106,395)	$ 23,907	
Cumulative RSA/RSL (1)	46.80%	65.57%	107.74%	

(1) Cumulative rate sensitive (interest-earning) assets divided by cumulative rate sensiti

At March 31, 2011, our interest rate sensitivity gap was within Board approved guidelines.

Gap analysis and interest rate simulation models require assumptions about certain categories of assets and deposits. For purposes of these analyses, assets and liabilities are stated at their contractual maturity, estimated likely call date, or earliest repricing opportunity. Interest-bearing demand deposits, statement savings and money market accounts do not have a stated maturity or repricing term and can be withdrawn or repriced at any time. This may impact our net interest income if more expensive alternative sources of deposits are required to fund loan growth or deposit runoff.

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Management projects the repricing characteristics of these accounts based on historical performance and assumptions that it believes reflect their rate sensitivity.

The following discussion focuses on the major components of our operations and presents an overview of the significant changes in our financial condition at March 31, 2011 as compared to December 31, 2010 and our results of operations for the three month periods ended March 31, 2011 as compared to the same period in 2010.

Comparison of Financial Condition at March 31, 2011 and December 31, 2010

Total assets at March 31, 2011 were $356.2 million, an increase of $2.2 million or 0.62% over December 31, 2010. This change was primarily due to increases in cash and cash equivalents of $6.8 million, bank owned life insurance of $40 thousand, investment securities available for sale of $145 thousand and other assets of $211 thousand, partially offset by decreases in investment securities held to maturity of $277 thousand, loans receivable, net, of $4.0 million, accrued interest receivable of $222 thousand, deferred taxes of $451 thousand, and premises and equipment of $33 thousand.

Gross loans receivable at March 31, 2011, totaled $238.0 million, a decrease of $4.9 million or 2.0% from December 31, 2010. This change was attributable to decreases of $558 thousand in commercial loans, $2.7 million in commercial real estate loans, $1.3 million in residential real estate loans and $307 thousand in consumer loans. The decline in gross loans represents significant payoffs received during the first quarter of 2011 coupled with recording $1.8 million in loan charge-offs. See Footnote 7 to our Consolidated Financial Statements for a breakdown of the components of our loan portfolio.

Non-performing assets consists of non-accrual loans (loans on which the accrual of interest has ceased) loans over ninety days delinquent and still accruing interest, renegotiated loans, impaired loans, and real estate owned. Loans are generally placed on non-accrual status if, in the opinion of management, collection is doubtful, or when principal or interest is past due 90 days or more unless the collateral is considered sufficient to cover principal and interest and the loan is in the process of collection. The Company recognized no interest income on non-accrual loans during the three month period ended March 31, 2011 as compared to $17 thousand for the three month period ended March 31, 2010.

Impaired loans are measured based on the present value of expected future discounted cash flows, the fair value of the loan or the fair value of the underlying collateral if the loan is collateral dependent. The recognition of interest income on impaired loans is the same as for non-accrual loans discussed above. At March 31, 2011 the Company had thirteen loan relationships totaling $10.1 million on non-accrual status compared to twelve relationships totaling $9.8 million on non-accrual status at December 31, 2010. At March 31, 2011, the Company had eighteen impaired loan relationships totaling $11.0 million (included within the non-accrual loans discussed above) in which $3.8 million in impaired loans had a related allowance for credit losses of $1.1 million and $7.2 million in impaired loans in which there is no related allowance for credit losses. The average balance of impaired loans totaled $11.4 million as of March 31, 2011, and interest income recorded on impaired loans during the three months ended March 31, 2011 totaled $13 thousand, as compared to $30 thousand for the three months ended March 31, 2010.

The balance in commercial loans 90-days past due and still accruing remained unchanged as of March 31, 2011 from the reported levels at December 31, 2010.

Included in the balance of the loans past due 90 days or more is a principal balance of $634 thousand dollars representing the Bank's participation interest in two loans originated by another New Jersey based institution. Although the borrowers have ceased making payments on these loans, we have received a legal opinion from our legal counsel that the Bank has valid claims against the lead/originating bank for violations of the participation agreements, and we have filed suit asserting these claims. In the event the lead bank is unable to collect from the borrowers, we believe, based on said legal opinion that we will collect our investment from the lead/originating bank. However, in that case our ability to collect on these loans will depend upon the outcome of our legal action against the lead/originating bank.

During the period ended March 31, 2011 the Company experienced a $268 thousand net increase in non-accrual loans. This change reflects the downgrading of four loan relationships to non-accrual status totaling $2.1 million partially offset by total charge offs of four loan relationships representing nine loans in the amount of $1.8 million during the three month period ended March 31, 2011. The downgraded loans consisted of two relationships representing residential mortgages loans totaling $964 thousand and two commercial relationships representing six loans totaling $1.1 million.

The Company prepares an allowance for loan loss model on a quarterly basis to determine the adequacy of the allowance. Management considers a variety of factors when establishing the allowance, such as the impact of current economic conditions, diversification of the loan portfolio, delinquency statistics, results of independent loan review and related classifications. The Bank's historic loss rates and the loss rates of peer financial institutions are also considered. In evaluating the Company's allowance for loan loss the Company maintains a Criticized Asset Committee ("CAC") consisting of senior management that monitors problem loans and formulates collection efforts and resolution plans for each borrower. On a monthly basis the CAC meets to review each problem loan and determines if there has been any change in collateral value due to changes in market conditions. Each quarter, when calculating the allowance for loan loss, the CAC reviews an updated loan impairment analysis on each problem credit to determine if a specific provision for loan loss is warranted. Management reviews the most recent appraisal on each loan, adjusted for holding and selling costs. In the event there is not a recent appraisal on file, the Company will use the aged appraisal and apply a discount factor to the appraisal then adjust the holding and selling costs from the discounted appraisal value. At March 31, 2011, the Company maintained an allowance for loan loss ratio of 1.24% to period end loans outstanding.

Any asset classified as loss is charged-off within thirty days of such classification unless the asset has already been eliminated from the books by collection or other appropriate entry. On a quarterly basis the BLC will review past due, classified, non-performing and other loans, as it deems appropriate, to determine the collectability of such loans. If the BLC determines a loan to be uncollectible, the loan is charged to the allowance for loan loss. In addition, upon reviewing the collectability of a loan, the BLC may determine a portion of the loan to be uncollectible; in which case that portion of the loan deemed uncollectable will be partially charged-off against the allowance for loan loss.

For the three month period ending March 31, 2011 the Company experienced six charge offs relating to three loan relationships totaling $1.0 million and three partial charge-offs relating to two loan relationships totaling $782 thousand as compared to charge-offs of four loans representing one relationship totaling $382 thousand for the period ended December 31, 2010.

Real estate acquired by foreclosure or by deed in lieu of foreclosure is classified as real estate owned until it is sold. At March 31, 2011 and December 31, 2010 the Company had $830 thousand in real estate owned.

Our investment securities are classified as either held to maturity or available for sale. Our investment portfolio decreased by $132 thousand or 0.37% to $84.9 million at March 31, 2011, from $85.1 million at December 31, 2010. The change in our investment portfolio is related to pay downs in our mortgage backed securities portfolio along with the associated premium and discount amortization associated with the portfolio. There were no security purchases, calls or maturities for the period ended March 31, 2011. See Footnote 6 to our Consolidated Financial statements for more information regarding our investment securities portfolio.

Our cash and cash equivalents increased by $6.8 million to $15.8 million at March 31, 2011 from $9.0 million at December 31, 2010. The increase reflects cash inflows from an increase in deposits, repayments of higher yielding investment securities in a lower rate environment and loan re- and prepayments exceeding current loan funding demands. The increase in deposits reflects, in part, the Bank benefiting from merger activity involving competing institutions and resulting customer dislocation. Management has elected to keep excess cash flow in short term, liquid assets to fund anticipated loan demand over the next several quarters.

Total liabilities at March 31, 2011 amounted to $338.2 million, an increase of $2.0 million or 0.59% from December 31, 2010. This change was primarily due to increases in total deposits of $1.9 million and line of credit borrowings from Atlantic Central Bankers Bank (ACBB) of $52 thousand, and other liabilities of $25 thousand.

Total deposits at March 31, 2011 were $304.2 million, an increase of $1.9 million or 0.63% from December 31, 2010. The increase in deposits was attributable to an increase of $20.8 million in interest bearing deposit accounts which was fueled by the migration of $12.4 million from non-interest bearing deposit accounts and the migration of $6.5 million from certificates of deposit. The change in deposits was primarily related to the competitive pricing of deposit products coupled with the continued development of relationships with local small businesses along with the high level of individualized service provided by our team of retail branch managers, which together fostered growth in deposits.

At March 31, 20101 and December 31, 2010 respectively, we had advances from the FHLB in the amount of $25.0 million. The weighted average interest rate on these borrowings from the FHLB was 1.49% at March 31, 2011 and 1.49% at December 31, 2010.

On February 17, 2009, the Company entered into a non-revolving line of credit loan agreement with Atlantic Central Bankers Bank in an amount up to $5.0 million. The term of the debt is for a three year period with a maturity date of February 17, 2012. The interest rate adjusts at a variable rate equal to prime plus 25 basis points with a floor of 4.25% . The Company has an outstanding balance on the line of credit of $4.9 million and has contributed $4.4 million as additional capital to the Bank.

On November 1, 2010, the Bank modified the terms of the hybrid capital instrument originally issued on October 31, 2008, in the aggregate amount of $3.0 million in the form of subordinated debt. This instrument qualifies as Tier II capital. The new term of the debt is for a ten year period with a maturity date of November 1, 2020. The interest rate is at a variable rate equal to the prime rate plus 100 basis points for the entire ten year term. The debt security is redeemable, at the Bank's option, at par on any January 31(st), April 30(th), July 31(st), or October 31(st) that the debt security remains outstanding however, the Bank shall not have the right to redeem the debt security prior to April 30, 2011.

Stockholders' equity at March 31, 2011 amounted to $17.9 million, an increase of $198 thousand or 1.1% over December 31, 2010. This increase reflects net income of $109 thousand, other comprehensive income of $87 thousand and stock based compensation expense of $35 thousand partially offset by $33 thousand in cash paid for the declaration of dividends on preferred stock for the three month period ended March 31, 2011.

Results of Operations

Net Income. We recorded net income for the three month period ended March 31, 2011 of $109 thousand or $0.04 per common and diluted share, respectively (after preferred stock dividend) as compared to net income of $475 thousand or $0.22 per common and diluted share, respectively for the same period in 2010. The change in net income for the three-month period compared to the prior period was attributable to increases of $393 thousand in net interest income and $139 thousand in non interest income due to a $156 thousand increase in gain on sale of loans, offset by an increase of $844 thousand in the provision for loan losses. Non- interest expenses increase by $298 thousand due to increased salary and benefit costs of $177 thousand, net occupancy costs of $46 thousand, data processing costs of $19 thousand, professional services of $20 thousand, other real estate owned expense of $20 thousand and FDIC insurance premium expenses of $24 thousand and advertising and promotion of $11 thousand, partially offset by a decrease of $19 thousand in other operating expenses. The net interest margin for the three-month period ended March 31, 2011 decreased by 7 basis points to 3.86% as compared to 3.93% for the same period in 2010.

Interest Income. Total interest income amounted to $4.3 million for the three-month period ended March 31, 2011, an increase of $352 thousand or 9.0% when compared to the same period in 2010. The increase in interest income was due to volume increases in our interest-bearing assets, partiallyoffset by a reduction in the average yield. The average

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yield on our interest-earning assets was 5.14% for the three month period ended March 31, 2011 compared to 5.45% during the same period in 2010. The reduction in yield in the quarterly period reflects generally reduced market rates of interest, as the Federal Reserve has maintained a low interest rate policy to help stimulate the U.S. economy.

Interest Expense. Total interest expense amounted to $1.1 million for the three-month period ended March 31, 2011, a decrease of $41 thousand or 3.7 % when compared to the same period in 2010. The decrease in interest expense resulted from lower rates paid on deposit and borrowing products when compared to the same period in 2010. The average cost of interest-bearing liabilities was 1.38% for the three-month period ended March 31, 2011 compared to 1.70% during the same period in 2010. The reduction in rate was partially offset by the increased volume of interest bearing liabilities.

The reduction in rates paid on deposit liabilities and borrowings reflects the same factors, discussed above, affecting the yield on our earning assets.

Allowance for Loan Losses. During the first quarter of 2011, we recorded a provision for loan losses of $953 thousand compared to a provision of $109 thousand for the same period in 2010. As a result of the $1.8 million in charge-offs recorded during the first quarter of 2011, the Company's historical loss rates within the respective portfolios have increased and have resulted in an increased provision for loan loss in the first quarter of 2011. At March 31, 2011, our allowance for loan losses represented 1.24% of total loans outstanding and 29.3% of non-performing loans.

Non-Interest Income. For the three-months ended March 31, 2011, non-interest income, which is comprised principally of service charges on deposit accounts, gain on sale of loans, origination fees on residential mortgage loans sold, bank owned life insurance income, ATM fees and other miscellaneous fee income totaled $293 thousand. This represents an increase of $139 thousand or 90.3% when compared to the same period in 2010. This increase resulted from increases of $156 thousand in gain on loans sold and miscellaneous fee income of $29 thousand, offset by decreases of $6 thousand on service charges on deposit accounts and a $1 thousand decrease in Bank owned life insurance.

Non-Interest Expense. Non-interest expense, which is comprised principally of salaries and employee benefits, net occupancy costs, FDIC insurance premium expense, advertising costs, data processing costs and professional services and other operating costs, totaled $2.4 million for the three months ended March 31, 2011. This represents an increase of $298 thousand or 14.4% when compared to the same period in 2010. The increase in non-interest expense was primarily the result of increased salary and benefit costs of $177 thousand, net occupancy costs of $46 thousand, data processing costs of $19 thousand, professional services costs of $20 thousand, FDIC expense of $ 24 thousand, other real estate owned expense of $20 thousand, and advertising and promotions of $11 thousand, partially offset by a decrease in other operating expenses of $19 thousand.

Income Taxes. We recorded a federal and state income tax expense of $56 thousand during the three month period ended March 31, 2011 compared to an income tax expense of $300 thousand for the same period in 2010. The effective tax rate for the three month period ended March 31, 2011 was 33.9% compared to 38.7% for the three month period ended March 31, 2010. The decrease in the effective tax rate for the three month period ended March 31, 2011 is due to tax exempt income comprising a larger portion of pretax income as compared to the three month period ended March 31, 2010.

Liquidity and Capital Resources

Liquidity. Liquidity represents our ability to meet our normal cash flow requirements for the funding of loans, repayment of deposits and payment of operating costs. Our primary sources of liquidity include growth in deposits, amortization and prepayment of loans, maturities of investment securities, and our borrowing capability. Management monitors liquidity daily, and on a monthly basis incorporates liquidity analysis into its asset/liability management program.

In addition to using growth in deposits, loan repayments and the investment portfolio as a source of liquidity, we also have access to unsecured, overnight lines of credit aggregating $58.7 million, consisting of $3.0 million, on an uncommitted basis, through ACBB and $55.7 million through the FHLB of New York. The arrangements with ACBB are for the sale of federal funds to the Bank, subject to the availability of such funds. Pursuant to a collateral agreement with the FHLB, advances under this line of credit are secured by a blanket lien on our residential mortgage loan portfolio. At March 31, 2011, we had no outstanding balance against the overnight line of credit at ACBB. In addition, the Company has a non revolving line of credit with ACBB for up to $5.0 million and as of March 31, 2011 there is an outstanding balance of $4.9 million. In addition, the Bank's membership in the FHLB provides the Bank with additional secured borrowing capacity of up to a maximum of 25% of the Bank's total assets, subject to certain conditions.

We had cash and cash equivalents of $15.8 million at March 31, 2011 in the form of cash and due from banks. At March 31, 2011, unused lines of credit available to our customers, committed undisbursed loan proceeds and standby letters of credit totaled $54.1 million. Certificates of deposit scheduled to mature in one year or less totaled $78.9 million at March 31, 2011. We anticipate that we will continue to have sufficient funds available to meet the needs of our customers for deposit repayments and loan fundings.

Our ability to generate deposits depends on the success of our branches. Our success is dependent on a number of factors, including our ability to establish branches in favorable locations, our ability to meet the needs of our customers through personalized services and a broad array of financial products, and the general economic conditions of the market area in which they are located. Unexpected changes in the national and local economy may also adversely affect our ability to attract or retain deposits and foster new loan relationships.

Capital Resources. Capital adequacy is the ability to support growth while protecting the interests of depositors and the deposit insurance fund. Bank regulatory agencies have developed certain capital ratio requirements, which are used to assist them in monitoring the safety and soundness of financial institutions. Management continually monitors these capital requirements.

The Bank is subject to risk-based capital guidelines promulgated by the FDIC that are designed to make regulatory capital requirements more sensitive to differences in risk profile among banks, to account for off-balance sheet exposure, and to minimize disincentives for holding liquid assets. Under the guidelines, assets and off-balance sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items. The minimum ratio of total capital to risk-weighted assets (including certain off-balance sheet activities, such as standby letters of credit) is 8%. At least 4% of total risk-weighted capital must consist of "Tier I Capital," consisting of common stockholders' equity and qualifying hybrid instruments, less certain goodwill items and other intangible assets. The remainder ("Tier II Capital") may consist of (a) the allowance for loan losses of up to 1.25% of risk-weighted assets, (b) excess of qualifying hybrid instruments, (c) perpetual debt (d) mandatory convertible securities, and (e) qualifying subordinated debt and intermediate-term preferred stock up to 50% of Tier I capital. Total capital is the sum of Tier I and Tier II capital less reciprocal holdings of other banking organizations, capital instruments, investments in unconsolidated subsidiaries and any other deductions as determined by the FDIC (determined on a case-by-case basis or as a matter of policy after formal rule-making).

In addition to the risk-based capital guidelines, the FDIC has adopted a minimum Tier I capital (leverage) ratio, under which banks must maintain a minimum level of Tier I capital to average total consolidated assets of at least 3% in the case of a bank that has the highest regulatory examination rating and is not contemplating significant growth or expansion. All other banks are expected to maintain a leverage ratio of at least 1% to 2% above the stated minimum.

The Bank was in compliance with all applicable minimum capital requirements for all periods presented. At March 31, 2011 the Bank maintained a Tier I leverage ratio of 6.92%, a Tier I risk-based capital ratio of 9.01% and a total risk-based capital ratio of 11.18% . The Bank's management believes that the Bank would be categorized as well capitalized under applicable FDIC capital adequacy regulations.

The Board of Governors of the Federal Reserve System has established similar capital requirements for bank holding companies, on a consolidated basis. However, these requirements only apply to bank holding companies with assets of $500 million or more. As such, the Company is not subject to these requirements.

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In June 2009, the Board of Directors of the Company approved a private placement common stock offering to accredited investors. In connection wit