

CHICOPEE BANCORP, INC.  
Form 10-Q  
November 04, 2010

**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 September 30, 2010

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-51996

**CHICOPEE BANCORP, INC.**

(Exact name of registrant as specified in its charter)

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<b>Massachusetts</b> (State or other jurisdiction of incorporation or organization)	<b>20-4840562</b> (I.R.S. Employer Identification No.)
<b>70 Center Street, Chicopee, Massachusetts</b> (Address of principal executive offices)	<b>01013</b> (Zip Code)
<b>(413) 594-6692</b>	

(Registrant's telephone number, including area code)

**Not Applicable**

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer <input type="checkbox"/>	Accelerated Filer <input checked="" type="checkbox"/>
Non-Accelerated Filer <input type="checkbox"/>	Smaller Reporting Company <input type="checkbox"/>

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

As of November 3, 2010, there were 6,150,623 shares of the Registrant's Common Stock outstanding.

CHICOPEE BANCORP, INC.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## CHICOPEE BANCORP, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(Dollars In Thousands)

	September 30, 2010 (Unaudited)	December 31, 2009
<b>Assets</b>		
Cash and due from banks	\$ 7,545	\$ 9,757
Short-term investments		16
Federal funds sold	31,119	10,302
<b>Total cash and cash equivalents</b>	<b>38,664</b>	<b>20,075</b>
Securities available-for-sale, at fair value	498	503
Securities held-to-maturity, at cost (fair value \$61,269 and \$63,130 at September 30, 2010 and December 31, 2009, respectively)	61,065	62,983
Federal Home Loan Bank stock, at cost	4,489	4,306
Loans, net of allowance for loan losses (\$4,267 at September 30, 2010 and \$4,077 at December 31, 2009)	432,240	424,655
Loans held for sale	1,172	534
Other real estate owned	285	80
Mortgage servicing rights	297	297
Bank owned life insurance	12,928	12,610
Premises and equipment, net	10,309	10,652
Accrued interest and dividends receivable	1,668	1,629
Deferred income tax asset	2,109	2,112
FDIC prepaid insurance	1,472	1,900
Other assets	2,113	1,814
<b>Total assets</b>	<b>\$ 569,309</b>	<b>\$ 544,150</b>
<b>Liabilities and Stockholders Equity</b>		
<b>Deposits</b>		
Non-interest-bearing	\$ 46,647	\$ 42,629
Interest-bearing	335,499	322,869
<b>Total deposits</b>	<b>382,146</b>	<b>365,498</b>
Securities sold under agreements to repurchase	18,064	20,422
Federal Home Loan Bank of Boston advances	74,779	63,675
Accrued expenses and other liabilities	435	383
<b>Total liabilities</b>	<b>475,424</b>	<b>449,978</b>
<b>Stockholders equity</b>	<b>72,479</b>	<b>72,479</b>

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Common stock (no par value, 20,000,000 shares authorized, 7,439,368 shares issued at September 30, 2010 and December 31, 2009)

Treasury stock, at cost (1,215,545 shares at September 30, 2010 and 1,060,338 shares at December 31, 2009)	(15,714)	(13,951)
Additional paid-in-capital	2,126	1,765
Unearned compensation (restricted stock awards)	(1,642)	(2,269)
Unearned compensation (Employee Stock Ownership Plan)	(4,538)	(4,761)
Retained earnings	41,103	40,843
Accumulated other comprehensive income	71	66
<b>Total stockholders' equity</b>	<b>93,885</b>	<b>94,172</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 569,309</b>	<b>\$ 544,150</b>

See accompanying notes to unaudited consolidated financial statements.

## CHICOPEE BANCORP, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

(In Thousands, Except for Number of Shares and Per Share Amounts)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Interest and dividend income:				
Loans, including fees	\$ 5,862	\$ 5,897	\$ 17,714	\$ 17,717
Interest and dividends on securities	337	172	941	578
Other interest-earning assets	10	14	21	22
<b>Total interest and dividend income</b>	<b>6,209</b>	<b>6,083</b>	<b>18,676</b>	<b>18,317</b>
Interest expense:				
Deposits	1,516	1,875	4,467	5,577
Securities sold under agreements to repurchase	10	46	55	160
Other borrowed funds	500	414	1,543	1,220
<b>Total interest expense</b>	<b>2,026</b>	<b>2,335</b>	<b>6,065</b>	<b>6,957</b>
<b>Net interest income</b>	<b>4,183</b>	<b>3,748</b>	<b>12,611</b>	<b>11,360</b>
Provision for loan losses	376	385	761	550
<b>Net interest income after provision for loan losses</b>	<b>3,807</b>	<b>3,363</b>	<b>11,850</b>	<b>10,810</b>
Non-interest income (loss):				
Service charges, fees and commissions	426	387	1,282	1,074
Loan sales and servicing, net	86	108	237	544
Net gain on sales of securities available-for-sale		154		181
Loss on sales of other than temporarily impaired securities		(179)		(179)
Loss on sale of other real estate owned	(15)	(6)	(23)	(6)
Other than temporary impairment charge		(1,297)	(13)	(1,403)
Income from bank owned life insurance	106	118	318	350
<b>Total non-interest income (loss)</b>	<b>603</b>	<b>(715)</b>	<b>1,801</b>	<b>561</b>
Non-interest expenses:				
Salaries and employee benefits	2,484	2,647	7,728	7,585
Occupancy expenses	362	370	1,189	1,228
Furniture and equipment	209	269	764	860
FDIC insurance assessment	105	122	418	430
Data processing	338	276	903	811
Professional fees	158	119	416	384
Advertising	131	143	384	370
Stationery, supplies and postage	79	89	234	294
Other non-interest expense	460	506	1,445	1,511
<b>Total non-interest expense</b>	<b>4,326</b>	<b>4,541</b>	<b>13,481</b>	<b>13,473</b>

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Income (loss) before income taxes	84	(1,893)	170	(2,102)
Income tax benefit	(99)	(492)	(90)	(641)
Net income (loss)	\$ 183	\$ (1,401)	\$ 260	\$ (1,461)
Earnings (loss) per share: (1)				
Basic	\$ 0.03	\$ (0.25)	\$ 0.05	\$ (0.26)
Diluted	\$ 0.03	\$ (0.25)	\$ 0.05	\$ (0.26)
Adjusted weighted average shares outstanding:				
Basic	5,685,598	5,703,089	5,710,883	5,719,807
Diluted	5,685,598	5,703,089	5,718,995	5,719,807

- (1) Common stock equivalents are excluded from the computation of diluted net loss per share for the three and nine months ended September 30, 2009, since the inclusion of such equivalents would be anti-dilutive.

See accompanying notes to unaudited consolidated financial statements.

## CHICOPEE BANCORP, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Nine Months Ended September 30, 2010 and 2009

(Dollars In Thousands)

(Unaudited)

	Common Stock	Treasury Stock	Additional Paid-in Capital	Unearned Compensation (restricted stock awards)	Unearned Compensation (Employee Stock Ownership Plan)	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2009	\$ 72,479	\$ (13,951)	\$ 1,765	\$ (2,269)	\$ (4,761)	\$ 40,843	\$ 66	\$ 94,172
Comprehensive income:								
Net income						260		260
Change in net unrealized gain on securities available-for-sale (net of deferred income taxes of \$3)							5	5
Total comprehensive income								265
Treasury stock purchased (155,207 shares)								
		(1,763)						(1,763)
Change in unearned compensation:								
Stock option expense			316					316
Restricted stock award expense				627				627
Common stock held by ESOP committed to be released			45		223			268
Balance at September 30, 2010	\$ 72,479	\$ (15,714)	\$ 2,126	\$ (1,642)	\$ (4,538)	\$ 41,103	\$ 71	\$ 93,885
Balance at December 31, 2008	\$ 72,479	\$ (12,483)	\$ 1,168	\$ (3,107)	\$ (5,059)	\$ 42,439	\$ (1,420)	\$ 94,017
Comprehensive loss:								
Net loss						(1,461)		(1,461)
Change in net unrealized gain on securities available-for-sale (net of deferred income taxes of \$465)							1,414	1,414
Total comprehensive loss								(47)
Treasury stock purchased (107,503 shares)								
		(1,335)						(1,335)
Change in unearned compensation:								
Stock option expense			392					392
Restricted stock award expense				626				626
Common stock held by ESOP committed to be released			52		223			275



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Balance at September 30, 2009	\$ 72,479	\$ (13,818)	\$ 1,612	\$ (2,481)	\$ (4,836)	\$ 40,978	\$ (6)	\$ 93,928
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See accompanying notes to unaudited consolidated financial statements.

**CHICOPEE BANCORP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

	Nine Months Ended September 30,	
	2010	2009
	(In thousands)	
Cash flows from operating activities:		
Net income (loss)	\$ 260	\$ (1,461)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	752	857
Provision for loan losses	761	550
Decrease in deferred income taxes		100
Increase in cash surrender value of life insurance	(318)	(350)
Realized gain on investment securities, net		(181)
Realized loss on other than temporarily impaired securities		179
Realized gains on sales of mortgage loans	(118)	(317)
Increase in other assets	(266)	(550)
(Increase) decrease in accrued interest and dividends receivable	(39)	21
Decrease in FDIC prepaid insurance	428	
Net change in loans originated for resale	(638)	185
Net loss on sales of other real estate owned	23	6
Increase in other liabilities	52	56
Other than temporary impairment charge	13	1,403
Change in unearned compensation	1,211	1,293
<b>Net cash provided by operating activities</b>	<b>2,121</b>	<b>1,791</b>
Cash flows from investing activities:		
Additions to premises and equipment	(336)	(735)
Loan originations and principal collections, net	(8,767)	(458)
Proceeds from sale or paydown of other real estate owned	193	263
Proceeds from sales of securities available-for-sale		2,144
Purchases of securities available-for-sale		(1,416)
Purchases of securities held-to-maturity	(73,925)	(79,085)
Maturities of securities held-to-maturity	74,590	85,400
Proceeds from principal paydowns of securities held-to-maturity	1,265	510
Purchase of FHLB stock	(183)	
<b>Net cash (used) provided by investing activities</b>	<b>(7,163)</b>	<b>6,623</b>
Cash flows from financing activities:		
Net increase in deposits	16,648	49,773
Net decrease in securities sold under agreements to repurchase	(2,358)	(60)
Proceeds from long-term FHLB advances	24,500	10,554
Payments on long-term FHLB advances	(13,396)	(29,836)
Net decrease in other short-term borrowings		(10,000)
Stock purchased for treasury	(1,763)	(1,335)
<b>Net cash provided by financing activities</b>	<b>23,631</b>	<b>19,096</b>
<b>Net increase in cash and cash equivalents</b>	<b>18,589</b>	<b>27,510</b>

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Cash and cash equivalents at beginning of period		20,075		23,100
Cash and cash equivalents at end of period	\$	38,664	\$	50,610
Supplemental cash flow information:				
Interest paid on deposits	\$	4,467	\$	5,577
Interest paid on borrowings		1,616		1,385
Income taxes paid		212		63
Transfers from loans to other real estate owned		421		277
	See accompanying notes to unaudited consolidated financial statements.			

## CHICOPEE BANCORP, INC. AND SUBSIDIARIES

## Notes to Unaudited Consolidated Financial Statements

At and for the Three and Nine Months Ended September 30, 2010 and 2009

**1. Basis of Presentation**

Chicopee Bancorp, Inc. (the Corporation) has no significant assets other than all of the outstanding shares of its wholly-owned subsidiaries, Chicopee Savings Bank (the Bank) and Chicopee Funding Corporation (collectively, the Company). The Corporation was formed on March 14, 2006 and became the holding company for the Bank upon completion of the Bank's conversion from a mutual savings bank to a stock savings bank. The conversion of the Bank was completed on July 19, 2006. The accounts of the Bank include three of its wholly-owned subsidiaries and a 99% owned subsidiary. The consolidated financial statements of the Company as of September 30, 2010 and for the periods ended September 30, 2010 and 2009 included herein are unaudited. In the opinion of management, all adjustments, consisting only of normal recurring adjustments necessary for a fair presentation of the financial condition, results of operations, changes in stockholders' equity and cash flows, as of and for the periods covered herein, have been made. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2009 included in the Company's Annual Report on Form 10-K.

The results for the three and nine month interim periods ended September 30, 2010 are not necessarily indicative of the operating results for a full year.

**2. Earnings Per Share**

Basic earnings per share represents income available to common stockholders divided by the adjusted weighted-average number of common shares outstanding during the period. The adjusted outstanding common shares equals the gross number of common shares issued less average treasury shares, unallocated shares of the Chicopee Savings Bank Employee Stock Ownership Plan (ESOP), and average dilutive restricted stock awards under the 2007 Equity Incentive Plan. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company relate to outstanding stock options and certain stock awards and are determined using the treasury stock method.

Earnings (loss) per share is computed as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net income (loss) (in thousands)	\$ 183	\$ (1,401)	\$ 260	\$ (1,461)
Weighted average number of common shares issued	7,439,368	7,439,368	7,439,368	7,439,368
Less: average number of treasury shares	(1,144,317)	(1,038,383)	(1,090,696)	(993,330)
Less: average number of unallocated ESOP shares	(476,120)	(505,878)	(476,120)	(505,878)
Less: average number of dilutive restricted stock awards	(133,333)	(192,018)	(161,669)	(220,353)
Adjusted weighted average number of common shares outstanding	5,685,598	5,703,089	5,710,883	5,719,807
Plus: dilutive outstanding restricted stock awards			8,112	
Plus: dilutive outstanding stock options				
Weighted average number of diluted shares outstanding	5,685,598	5,703,089	5,718,995	5,719,807
Earnings (loss) per share:				
Basic- common stock	\$ 0.03	\$ (0.25)	\$ 0.05	(\$ 0.26)
Basic- unvested share-based payment awards	\$ 0.03	\$ (0.25)	\$ 0.05	(\$ 0.26)
Diluted- common stock	\$ 0.03	\$ (0.25)	\$ 0.05	(\$ 0.26)
Diluted- unvested share-based payment awards	\$ 0.03	\$ (0.25)	\$ 0.05	(\$ 0.26)



## CHICOPEE BANCORP, INC. AND SUBSIDIARIES

## Notes to Unaudited Consolidated Financial Statements (Continued)

## At and for the Three and Nine Months Ended September 30, 2010 and 2009

There were 598,834 and 671,667 stock options that were not included in the calculation of diluted earnings per share for the three and nine months ended September 30, 2010 and 2009, respectively, because their effect was anti-dilutive.

### 3. Equity Incentive Plan

#### Stock Options

Under the Company's 2007 Equity Incentive Plan (the Plan), the Company may grant options to directors, officers and employees for up to 743,936 shares of common stock. Both incentive stock options and non-qualified stock options may be granted under the Plan. The exercise price for each option is equal to the market price of the Company's stock on the date of grant and the maximum term of each option is ten years. The stock options vest over five years in five equal installments on each anniversary of the date of grant.

The Company recognizes compensation expense over the vesting period, based on the grant-date fair value of the options granted. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions for options granted during the years ended December 31, 2009 and 2008:

	Years Ended December 31,	
	2009	2008
Expected dividend yield	2.00%	2.00%
Expected term	6.5 years	6.5 years
Expected volatility	25.89%	24.52%
Risk-free interest rate	2.95%	1.99%

No options were granted during 2010. Expected volatility is based on the historical volatility of the Company's stock and other factors. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. The Company uses historical data, such as option exercise and employee termination rates, to calculate the expected option life.

A summary of options under the Plan as of September 30, 2010, and changes during the nine months then ended, is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (000 s)
Outstanding at December 31, 2009	688,167	\$ 14.22	7.50	
Granted				
Exercised				
Forfeited or expired	89,333	14.29		
Outstanding at September 30, 2010	598,834	\$ 14.21	6.66	\$ 8,510
Exercisable at September 30, 2010	350,398	\$ 14.28	6.52	\$ 5,004

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Exercisable at September 30, 2009	266,665	\$	14.29	7.68	\$ 3,811
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The weighted-average grant-date fair value of options granted during 2009 and 2008 was \$3.07 and \$2.37, respectively. The weighted average grant-date fair value of the options outstanding and exercisable at September 30, 2010 is \$3.88 and \$3.92, respectively. For the nine months ended September 30, 2010 and 2009, share based compensation expense applicable to the Plan was \$316,000 and \$392,000 and the related tax benefit was \$64,000 and \$78,000 for both periods, respectively. No options have been exercised as of September 30, 2010 and no options were granted prior to July 1, 2007. As of September 30, 2010, unrecognized stock-based compensation expense related to non-vested options amounted to \$863,000. This amount is expected to be recognized over a period of 1.95 years.

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**CHICOPEE BANCORP, INC. AND SUBSIDIARIES**
**Notes to Unaudited Consolidated Financial Statements (Continued)****At and for the Three and Nine Months Ended September 30, 2010 and 2009****Stock Awards**

Under the Company's 2007 Equity Incentive Plan, the Company may grant stock awards to its directors, officers and employees for up to 297,574 shares of common stock. The stock awards vest 20% per year beginning on the first anniversary of the date of grant. The fair market value of the stock awards, based on the market price at the date of grant, is recorded as unearned compensation. Unearned compensation is amortized over the applicable vesting period. The weighted-average grant-date fair value of stock awards as of September 30, 2010 is \$14.29. The Company recorded compensation cost related to stock awards of approximately \$627,000 and \$213,000 of related tax benefit in the nine months ended September 30, 2010 and 2009. Stock awards with a fair value of \$651,000, \$777,000 and \$765,000 have vested during the nine months ended September 30, 2010, 2009 and 2008, respectively. No stock awards were granted prior to July 1, 2007. As of September 30, 2010, unrecognized stock-based compensation expense related to non-vested restricted stock awards amounted to \$1.5 million. This amount is expected to be recognized over a period of 1.82 years.

A summary of the status of the Company's stock awards as of September 30, 2010, and changes during the nine months ended September 30, 2010, is as follows:

	Number of Shares	Weighted Average Grant-Date Fair Value
<b>Nonvested Shares</b>		
Balance at December 31, 2009	176,070	\$ 14.29
Granted		
Vested	58,684	14.29
Forfeited		
Balance at September 30, 2010	117,386	\$ 14.29

**4. Recent Accounting Pronouncements (Applicable to the Company)**

In September 2009, the Financial Accounting Standards Board ( FASB ) issued guidance (incorporated in the FASB Accounting Standards Codification ( ASC ) via Accounting Standards Update ( ASU ) 2009-16, *Transfers and Servicing: Accounting for Transfers of Financial Assets*, in December 2009) which provides amended guidance relating to transfers of financial assets that eliminates the concept of a qualifying special-purpose entity. This guidance must be applied as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. This guidance must be applied to transfers occurring on or after its effective date. On and after the effective date, the concept of a qualifying special-purpose entity is no longer relevant for accounting purposes. Therefore, formerly qualifying special-purpose entities should be evaluated for consolidation by reporting entities on and after the effective date in accordance with the applicable consolidation guidance. The new guidance also changed the requirements which must be satisfied in order for an entity to treat a loan participation as a sale. The disclosure provisions were also amended and apply to transfers that occurred both before and after the effective date of this guidance. The adoption of this update did not have a significant impact on the Company's consolidated financial statements.

In September 2009, the FASB issued guidance (incorporated in the FASB ASC via ASU 2009-17, *Consolidations: Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities*, in December 2009) which provides amended guidance for consolidation of a variable interest entity by replacing the quantitative-based risks and rewards calculation for determining which enterprise, if any, has a controlling financial interest in a variable interest entity. The amended guidance uses an approach that focuses on identifying which enterprise has the power to direct the activities of a variable





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**CHICOPEE BANCORP, INC. AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements (Continued)**

**At and for the Three and Nine Months Ended September 30, 2010 and 2009**

interest entity that most significantly impact the entity's economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. Additional disclosures about an enterprise's involvement in variable interest entities are also required. This guidance is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. The adoption of this update did not have a significant impact on the Company's consolidated financial statements.

In January 2010, the FASB issued ASU 2010-06, *Fair Value Measurements and Disclosures: Improving Disclosures about Fair Value Measurements*, to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires new disclosures regarding transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a rollforward of activities, separately reporting purchases, sales, issuance, and settlements, for assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). The guidance is effective for annual reporting periods that begin after December 15, 2009, and for interim periods within those annual reporting periods except for the changes to the disclosure of rollforward activities for any Level 3 fair value measurements, which are effective for annual reporting periods that begin after December 15, 2010, and for interim periods within those annual reporting periods. Other than requiring additional disclosures, adoption of this new guidance did not have a material impact on the Company's consolidated financial statements.

In February 2010, the FASB issued ASU 2010-09, *Subsequent Events: Amendments to Certain Recognition and Disclosure Requirements*, related to events that occur after the statement of condition date but before financial statements are issued. This guidance amends existing standards to address potential conflicts with Securities and Exchange Commission (SEC) guidance and refines the scope of the reissuance disclosure requirements to include revised financial statements only. Under this guidance, SEC filers are no longer required to disclose the date through which subsequent events have been evaluated. The adoption of this update did not have a material effect on the Company's consolidated financial statements.

In July 2010, the FASB issued ASU No. 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. This ASU is intended to provide additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of its allowance for credit losses. The guidance is effective for interim and annual reporting periods ending after December 15, 2010. Other than requiring additional disclosures, adoption of this new guidance is not expected to have a material impact on the Company's consolidated financial statements.

***Reclassification***

Certain amounts in the 2009 financial statements have been reclassified to conform to the current period's presentation. These reclassifications had no effect on the net income previously reported.

## CHICOPEE BANCORP, INC. AND SUBSIDIARIES

## Notes to Unaudited Consolidated Financial Statements (Continued)

At and for the Three and Nine Months Ended September 30, 2010 and 2009

## 5. Comprehensive Income or Loss

Accounting principles generally require recognized revenue, expenses, gains, and losses to be included in net income or loss. Certain changes in assets and liabilities, such as the after-tax effect of unrealized gains and losses on securities available-for-sale, are not reflected in the statement of operations, but the cumulative effect of such items from period-to-period is reflected as a separate component of the equity section of the statement of financial condition (accumulated other comprehensive income or loss). Other comprehensive income or loss, along with net income or loss, comprises the Company's total comprehensive income or loss.

Comprehensive income (loss) is comprised of the following:

	<b>Three Months Ended September 30, 2010      2009 (In Thousands)</b>	
Net income (loss)	\$ 183	\$ (1,401)
Other comprehensive income, net of tax:		
Unrealized holding gains on available-for-sale securities arising during the period	11	537
Other than temporary impairment charge, included in net loss		1,297
Reclassification adjustment for loss on sale of available-for-sale securities included in net loss		25
Tax effect	(4)	(458)
Other comprehensive income, net of tax	7	1,401
Total comprehensive income	\$ 190	\$

	<b>Nine Months Ended September 30, 2010      2009 (In Thousands)</b>	
Net income (loss)	\$ 260	\$ (1,461)
Other comprehensive income (loss), net of tax:		
Unrealized holding (loss) gain on available-for-sale securities arising during the period	(5)	478
Other than temporary impairment charge, included in net loss	13	1,403
Reclassification adjustment for gain on sale of available-for-sale securities included in net loss		(2)
Tax effect	(3)	(465)
Other comprehensive income, net of tax	5	1,414
Total comprehensive income (loss)	\$ 265	\$ (47)



## CHICOPEE BANCORP, INC. AND SUBSIDIARIES

## Notes to Unaudited Consolidated Financial Statements (Continued)

At and for the Three and Nine Months Ended September 30, 2010 and 2009

**6. Investment Securities**

While the Company prefers lending as the primary use of its excess cash flows, the Company maintains an investment portfolio for managing interest-rate risk and liquidity while generating an acceptable level of revenue. The securities portfolio is managed in accordance with regulatory guidelines and established internal corporate investment policies. Adverse changes in the factors used in management's assessment of other-than-temporary impairment could lead to additional impairment charges.

At September 30, 2010 and December 31, 2009, the Company's investment securities portfolio amounted to \$61.6 million and \$63.5 million, or 10.8% and 11.7% of total assets, respectively. The following table sets forth, at the dates indicated, information regarding the amortized cost and fair values, with gross unrealized gains and losses of the Company's investment securities:

	Amortized Cost	September 30, 2010		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
(In Thousands)				
<u>Securities available-for-sale</u>				
Marketable equity securities <sup>1</sup>	\$ 389	\$ 129	\$ (20)	\$ 498
<b>Total securities available-for-sale</b>	<b>\$ 389</b>	<b>\$ 129</b>	<b>\$ (20)</b>	<b>\$ 498</b>
<u>Securities held-to-maturity</u>				
U.S. Treasury securities	\$ 34,468	\$	\$ (1)	\$ 34,467
Corporate and industrial revenue bonds	22,001			22,001
Collateralized mortgage obligations	4,596	205		4,801
<b>Total securities held-to-maturity</b>	<b>\$ 61,065</b>	<b>\$ 205</b>	<b>\$ (1)</b>	<b>\$ 61,269</b>
	Amortized Cost	December 31, 2009		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
(In Thousands)				
<u>Securities available-for-sale</u>				
Marketable equity securities <sup>1</sup>	\$ 402	\$ 116	\$ (15)	\$ 503
<b>Total securities available-for-sale</b>	<b>\$ 402</b>	<b>\$ 116</b>	<b>\$ (15)</b>	<b>\$ 503</b>
<u>Securities held-to-maturity</u>				
Debt securities of U.S. Government sponsored enterprises	\$ 1,999	\$	\$	\$ 1,999
U.S. Treasury securities	43,118	3	(4)	43,117
Corporate and industrial revenue bonds	12,109			12,109
Collateralized mortgage obligations	5,757	153	(5)	5,905
<b>Total securities held-to-maturity</b>	<b>\$ 62,983</b>	<b>\$ 156</b>	<b>\$ (9)</b>	<b>\$ 63,130</b>

- <sup>1</sup> Does not include investments in FHLB-Boston stock of \$4.5 million and \$4.3 million, and Banker's Bank stock of \$183,000 and \$183,000, respectively, at September 30, 2010 and December 31, 2009.

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**CHICOPEE BANCORP, INC. AND SUBSIDIARIES**
**Notes to Unaudited Consolidated Financial Statements (Continued)****At and for the Three and Nine Months Ended September 30, 2010 and 2009**

The fair value of securities available-for-sale decreased \$5,000, or 1.0%, to \$498,000 at September 30, 2010 from December 31, 2009, primarily due to changes in the market values of each equity security. The decrease in amortized cost of securities available-for-sale of \$13,000 is the result of writing down a security to fair value due to an other-than-temporary impairment charge. Available-for-sale securities are fully comprised of equity securities: 5 individual issues of highly traded stocks, representing 3 companies in the financial industry. The amortized cost of held-to-maturity securities decreased \$1.9 million, or 3.0%, to \$61.1 million due to maturities of U.S. Treasury securities of \$72.6 million and a maturity of the debt security of U.S. Government sponsored enterprises of \$2.0 million, and pay downs and maturities of collateralized mortgage obligations and bonds of \$1.3 million, partially offset by purchases of \$63.9 million in U.S. Treasury securities and a purchase of a \$10.0 million bond.

At September 30, 2010 and December 31, 2009, securities with a carrying value of \$18.3 million and \$30.4 million, respectively, were pledged as collateral to support securities sold under agreements to repurchase.

The amortized cost and estimated fair value of debt securities by contractual maturity at September 30, 2010 are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without prepayment penalties. The collateralized mortgage obligations are allocated to maturity categories according to final maturity date.

	<b>Held-to-Maturity</b>	
	<b>Amortized Cost</b>	<b>Fair Value</b>
	<b>(In Thousands)</b>	
Within 1 year	\$ 34,469	\$ 34,468
From 1 to 5 years	3,796	3,796
From 5 to 10 years	12,896	13,101
Over 10 years	9,904	9,904
	<b>\$ 61,065</b>	<b>\$ 61,269</b>

***Unrealized Losses on Investment Securities***

Management conducts, at least on a monthly basis, a review of its investment portfolio including available-for-sale ( AFS ) and held-to-maturity ( HTM ) securities to determine if the value of any security has declined below its cost or amortized cost and whether such security is other-than-temporarily impaired ( OTTI ). Securities are evaluated individually based on guidelines established by the FASB and include but are not limited to: (1) intent and ability of the Company to retain the investment for a period of time sufficient to allow for the anticipated recovery in market value; (2) percentage and length of time which an issue is below book value; (3) financial condition and near-term prospects of the issuer; (4) whether the debtor is current on contractually obligated interest and principal payments; (5) the volatility of the market price of the security; and (6) any other information and observable data considered relevant in determining whether other-than-temporary impairment has occurred, including the expectation of receipt of all principal and interest due. The Company's OTTI policy provides for the following: once a security is identified as impaired, the Company will test for OTTI; if the security fails the OTTI test, the security will be written down to the fair value as of the balance sheet date; an impaired security that passes the OTTI test will be reviewed by Management, to determine if a write-down is warranted, for other objective indicators such as: credit rating downgrades, reduced dividend payouts, inverse current ratios, and other adverse financial information.

## CHICOPEE BANCORP, INC. AND SUBSIDIARIES

## Notes to Unaudited Consolidated Financial Statements (Continued)

## At and for the Three and Nine Months Ended September 30, 2010 and 2009

During the year ended December 31, 2009, the Company incurred other-than-temporary impairment charges of \$1.4 million, representing 30 companies, or 56 individual issues. The Company also sold securities that were other-than-temporarily impaired with total losses of \$241,000. Management evaluated these securities according to the Company's OTTI policy and determined the declines in value to be other-than-temporary.

The Company sold \$5.9 million of its equity securities during the fourth quarter of 2009. As a result, the Company had a remaining portfolio of \$503,000 at December 31, 2009. The sales of equity securities during the fourth quarter of 2009 reflected management's determination to revise its investment strategy and reduce its overall level of investment in equity securities and overall risk in the equities markets. As part of this revised strategy, it was determined to sell most of the equity securities in the portfolio. The Company expects to continue to hold the remaining securities. The Company's equity securities portfolio was primarily designed to assist the Company in managing its liquidity and interest rate risk on a long-term basis. However, due to the unprecedented decline in the stock market over the past two years, the value of such portfolio has been significantly reduced which resulted in management's reevaluation of the investment strategy and reliance on its equity portfolio for liquidity.

During the nine months ended September 30, 2010, management determined that one of the equity securities in the financial industry had other-than-temporary impairment for which a charge was recorded in the amount of \$13,000.

The following table presents the fair value of investments with continuous unrealized losses for less than 12 months and those that have been in a continuous unrealized loss position for more than 12 months as of September 30, 2010 and December 31, 2009:

	Less Than Twelve Months		September 30, 2010 Twelve Months and Over (In Thousands)		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	Marketable equity securities	\$ 294	\$ (20)	\$	\$	\$ 294
U.S. Treasury securities	26,744	(1)			26,744	(1)
Total temporarily impaired securities	\$ 27,038	\$ (21)	\$	\$	\$ 27,038	\$ (21)

	Less Than Twelve Months		December 31, 2009 Twelve Months and Over (In Thousands)		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	Marketable equity securities	\$	\$	\$ 311	\$ (15)	\$ 311
Collateralized mortgage obligations	190	(5)			190	(5)
U.S. Treasury securities	19,436	(4)			19,436	(4)
Total temporarily impaired securities	\$ 19,626	\$ (9)	\$ 311	\$ (15)	\$ 19,937	\$ (24)

*U.S. Treasury Securities*



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Unrealized losses within the U.S. Treasury securities category at September 30, 2010, related to 19 U.S. Treasury securities, which all had losses for less than 12 months. At December 31, 2009, the unrealized losses related to 12 U.S. Treasury securities, which all had losses for less than 12 months. Management deemed the losses in this category to be immaterial.

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**CHICOPEE BANCORP, INC. AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements (Continued)**

**At and for the Three and Nine Months Ended September 30, 2010 and 2009**

***Collateralized Mortgage Obligations***

Unrealized losses within the collateralized mortgage obligations ( CMO ) category at December 31, 2009 related to 2 CMO securities, which each had continuous losses for less than 12 months.

Management reviews these securities on a regular basis for OTTI and considers if the issuer is an agency sponsored by the U.S. Government and whether downgrades by rating agencies have occurred. The Company reviews its CMO portfolio for OTTI similar to its OTTI analysis for its other securities, whereby it considers the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, whether the debtors are current on contractually obligated interest and principal payments, the volatility of the market price of the security, and the Company's intent and ability to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value or until maturity. The Company has the ability and intent to hold these securities until maturity.

As of September 30, 2010, the Company has 16 CMO bonds, or 22 individual issues, with an aggregate book value of \$4.6 million, which included 5 bonds, or 6 individual issues, with a FICO score of less than 650. This risk is mitigated by loan-to-value ratios of less than 65%. The total exposure of these 5 bonds to the Company is \$18,000. Since the purchase of these bonds, interest payments have been current and the Company expects to receive all principal and interest due.

These 16 CMO bonds have been substantially paid down with an average current factor of 22%, and are backed by well seasoned loans of an earlier vintage, which have not been significantly affected by high delinquency levels or vulnerable to lower collateral coverage as seen in later issued pools. All such CMOs are paying according to their contractual terms and are expected to continue to pay their contractual cash flows.

The Company's remaining 11 CMO bonds are all investment grade and classified as HTM. All of these securities were issued by government sponsored agencies and are all collateralized primarily by AAA rated Federal Home Loan Mortgage Corporation ( FHLMC ) and Federal National Mortgage Association ( FNMA ) mortgage loans and, to the best of the Company's knowledge, are not collateralized by sub-prime or Alt-A loans. FHLMC and FNMA guarantees the contractual cash flows of these CMOs. The loans collateralizing such CMOs consist of fixed-rate, 15-year loans, originated in early 2003 and 2004, with average FICO scores between 725 and 775, and average LTV of 57%.

Based on management's analysis, which included the above indicators, the Company has determined that no OTTI exists within the CMO portfolio as of September 30, 2010.

***Marketable Equity Securities***

Unrealized losses within the marketable equity securities category at December 31, 2009 related to four securities issued by two companies in the financial industry, which had continuous losses for more than 12 months. As of September 30, 2010, three of these securities recovered their value during the first

**CHICOPEE BANCORP, INC. AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements (Continued)**

**At and for the Three and Nine Months Ended September 30, 2010 and 2009**

quarter of 2010, but then declined below book value by the end of the second quarter. During the first quarter of 2010, one security failed the Company's OTTI test and was written-down in the amount of \$13,000. During the third quarter of 2010, none of the four securities with unrealized losses had losses for more than 12 months.

The FHLB has announced that dividend payments for 2010 are unlikely and the Company will likely have no dividend income on its FHLB stock in 2010. FHLB's net income for the second quarter of 2010 was \$18.7 million, a \$22.9 million increase from a net loss of \$4.2 million in the second quarter of 2009. The increase was primarily due to a \$40.1 million decrease in the credit-related other-than-temporary impairment charges on certain private-label mortgage-backed securities, partially offset by factors including a \$9.6 million decrease in net interest income after provision for credit losses, a \$4.7 million increase in REFCorp assessments, and a \$2.1 million increase in Affordable Housing Program contributions. Credit-related other-than-temporary impairment charges on certain private-label mortgage-backed securities were \$30.4 million for the second quarter of 2010, a \$40.1 million, or 56.8 percent, decrease from the \$70.5 million recorded in the second quarter of 2009. The reduction in credit losses attributable to other-than-temporary impairment, compared with the second quarter of 2009, primarily reflects the relative stabilization in factors, such as home prices and unemployment rates, which affect the expected performance of the mortgage loans underlying FHLB's private-label mortgage-backed securities.

The Bank periodically evaluates its investment in FHLB stock for impairment based on, among other things, the capital adequacy of the FHLB and its overall financial condition. No impairment losses have been recorded through September 30, 2010. The Bank will continue to monitor its investment in FHLB stock.

**CHICOPEE BANCORP, INC. AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements (Continued)**

**At and for the Three and Nine Months Ended September 30, 2010 and 2009**

**7. Fair Value Measurements**

*ASC Topic 820, Fair Value Measurements and Disclosures*, provides a framework for measuring fair value under U.S. generally accepted accounting principles ( GAAP ).

The Company groups its financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the observability of the assumptions used to determine fair value:

Level 1 Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Level 1 also includes U.S. Treasury Notes and U.S. Government and agency mortgage-backed securities that are traded by dealers or brokers in active markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 Valuations for assets and liabilities with inputs that are observable either directly or indirectly for substantially the full term or valuations obtained from third party pricing services based on quoted market prices for comparable assets or liabilities. Level 2 also includes assets and liabilities traded in inactive markets.

There were no transfers of assets and liabilities between Level 1 and Level 2 during the three and nine months ended September 30, 2010.

Level 3 Valuations for assets and liabilities with inputs that are unobservable, which are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and are not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets and liabilities. There were no level 3 valuations as of September 30, 2010 or December 31, 2009.

**CHICOPEE BANCORP, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements (Continued)****At and for the Three and Nine Months Ended September 30, 2010 and 2009**

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

		Fair Value Measurements Using		
		Quoted		
		Prices in	Significant	
		Active	Other	Significant
		Markets for	Observable	Unobservable
		Identical	Inputs	Inputs
	September 30, 2010	Assets	(Level 2)	(Level 3)
		(Level 1)		
		(Dollars In Thousands)		
Assets				
Securities available-for-sale				
Equity securities by industry type:				
Financial	\$ 498	\$ 498	\$	\$
Total equity securities	\$ 498	\$ 498	\$	\$

		Fair Value Measurements Using		
		Quoted		
		Prices in	Significant	
		Active	Other	Significant
		Markets	Observable	Unobservable
		for	Inputs	Inputs
	December	Identical	(Level 2)	(Level 3)
	31,	Assets		
	2009	(Level 1)		
		(Dollars In Thousands)		
Assets				
Securities available-for-sale				
Equity securities by industry type:				
Financial	\$ 503	\$ 503	\$	\$
Total equity securities	\$ 503	\$ 503	\$	\$

The valuation approach used to value the securities available-for-sale was the market approach.

## CHICOPEE BANCORP, INC. AND SUBSIDIARIES

## Notes to Unaudited Consolidated Financial Statements (Continued)

## At and for the Three and Nine Months Ended September 30, 2010 and 2009

Also, the Company may be required, from time to time, to measure certain other financial assets on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from application of lower-of-cost-or-market accounting or write-downs of individual assets. The following table summarizes the fair value hierarchy used to determine each adjustment and the carrying value of the related individual assets:

	Septmeber 30, 2010	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(Dollars In Thousands)				
Assets				
Impaired loans with a valuation allowance, net	\$ 5,330	\$	\$ 5,330	\$
Other real estate owned	285		285	
Loans held for sale	1,172		1,172	
Mortgage servicing rights	297		297	
Total assets	\$ 7,084	\$	\$ 7,084	\$

	December 31, 2009	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(Dollars In Thousands)				
Assets				
Impaired loans with a valuation allowance, net	\$ 1,527	\$	\$ 1,527	\$
Other real estate owned	80		80	
Loans held for sale	534		534	
Mortgage servicing rights	297		297	
Total assets	\$ 2,438	\$	\$ 2,438	\$

A valuation reserve, for the above impaired loans, of \$673,000 and \$501,000 as of September 30, 2010

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**CHICOPEE BANCORP, INC. AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements (Continued)**

**At and for the Three and Nine Months Ended September 30, 2010 and 2009**

and December 31, 2009, respectively, was included in the allowance for loan losses. The amount of impaired loans represents the carrying value, net of the related allowance for loan losses on impaired loans for which adjustments are based on the appraised value of the collateral which is based on the market approach of valuation.

Real estate acquired through foreclosure ( OREO ): OREO is recorded at fair value less costs to sell. The Company acquires property through foreclosure or acceptance of a deed in lieu-of-foreclosure as OREO. The valuation of this property is accounted for individually based on its net realizable value on the date of acquisition. At the acquisition date, if the net realizable value of the property is less than the book value of the loan, a charge or reduction in the allowance for loan losses is recorded. If the value of the property becomes subsequently impaired, as determined by an appraisal or an evaluation in accordance with the Company's appraisal policy, the decline is recorded by a charge against current earnings. Upon acquisition of a property, a current appraisal or broker's opinion must substantiate market value for the property. As such, the Company records other real estate owned as nonrecurring Level 2.

ASC Topic 825, *Fair Value Measurements and Disclosures*, requires disclosures of fair value information about financial instruments, whether or not recognized in the balance sheet, if the fair values can be reasonably determined. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques using observable inputs when available. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

Cash and cash equivalents: The carrying amounts of cash and short-term instruments approximate fair values.

Securities: Fair values for securities, excluding Federal Home Loan Bank stock, are based on quoted market prices. The carrying value of Federal Home Loan Bank stock approximates fair value based on the redemption provisions of the Federal Home Loan Bank.

Loans receivable: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Mortgage loans held for sale: Loans held for sale are recorded at the lower of carrying value or market value. The fair value of mortgage loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, the Company classifies mortgage loans held for sale as nonrecurring Level 2.

Mortgage servicing rights: Mortgage servicing rights are recognized when they are acquired through the sale of loans, and are reported in other assets. They are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Management uses an independent firm which specializes in the valuation of mortgage servicing rights to determine the fair value. The Company uses the amortization method for financial reporting. As such, the Company classifies mortgage servicing rights as nonrecurring Level 2.

## CHICOPEE BANCORP, INC. AND SUBSIDIARIES

## Notes to Unaudited Consolidated Financial Statements (Continued)

At and for the Three and Nine Months Ended September 30, 2010 and 2009

Deposit liabilities and mortgagors escrow accounts: The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregate expected monthly maturities on time deposits.

Securities sold under agreements to repurchase: The carrying amounts of borrowings under repurchase agreements maturing within ninety days approximate their fair values.

Advances from Federal Home Loan Bank: The fair values of these borrowings are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Accrued interest and dividends: The carrying amounts of accrued interest and dividends approximate fair value.

Off-balance-sheet instruments: The Company's off-balance-sheet instruments consist of loan commitments. Fair values for loan commitments have not been presented as the future revenue derived from such financial instruments is not significant.

The carrying amounts and estimated fair values of the Company's financial instruments are as follows:

	September 30, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 38,664	\$ 38,664	\$ 20,075	\$ 20,075
Securities available-for-sale	498	498	503	503
Securities held-to-maturity	61,065	61,269	62,983	63,130
Federal Home Loan Bank stock	4,489	4,489	4,306	4,306
Loans, net	432,240	433,928	424,655	421,155
Loans held for sale	1,172	1,172	534	534
Accrued interest and dividends receivable	1,668	1,668	1,629	1,629
Mortgage servicing rights	297	321	297	582
<b>Financial liabilities:</b>				
Deposits	\$ 382,146	\$ 388,471	\$ 365,498	\$ 361,114
Repurchase agreements	18,064	18,064	20,422	20,422
Advances from Federal Home Loan Bank	74,779	73,402	63,675	64,002
Accrued interest payable	157	157	175	175

**8. Common Stock**

On February 26, 2010, the Company announced that its Board of Directors authorized a fourth stock repurchase program (the Fourth Stock Repurchase Program) for the purchase of up to 318,952 shares of the Company's common stock, or approximately 5% of its outstanding common stock. The repurchase under the Fourth Stock Repurchase Program will be conducted solely through a Rule 10b5-1 repurchase plan with Stifel, Nicolaus & Company, Inc. Repurchased shares will be held in treasury. This plan will continue until it is completed or terminated by the Board of Directors.





**CHICOPEE BANCORP, INC. AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements (Continued)**

**At and for the Three and Nine Months Ended September 30, 2010 and 2009**

**9. Subsequent Events**

Subsequent Events represent events or transactions occurring after the balance sheet date but before the financial statements are issued or are available to be issued. Financial statements are considered issued when they are widely distributed to shareholders and others for general use and reliance in a form and format that complies with GAAP. Financial statements are considered available to be issued when they are complete in form and format that complies with GAAP and all approvals necessary for their issuance have been obtained.

The Company is an SEC filer and management has evaluated subsequent events through the date that the financial statements were issued.

The Bank paid an \$8.0 million dividend to the Company in October 2010.

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

The following analysis discusses changes in the financial condition and results of operations of the Company at and for the three and nine months ended September 30, 2010 and 2009, and should be read in conjunction with the Company's Unaudited Consolidated Financial Statements and the notes thereto, appearing in Part I, Item 1 of this document.

***Forward-Looking Statements***

This Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and is including this statement for purposes of these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are generally identified by use of the words believe, expect, intend, anticipate, estimate, project or similar expressions. The Company's ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Factors which could have a material adverse effect on the operations of the Company include, but are not limited to: changes in interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company's market area and accounting principles and guidelines. Additional factors are discussed in the Company's 2009 Annual Report on Form 10-K under Item 1A-Risk Factors and in Part II, Item 1A, Risk Factors of this 10-Q. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

Except as required by law, the Company does not undertake and specifically disclaims any obligation to publicly release the result of any revisions which may be made to 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.

***General***

Chicopee Savings Bank is a community-oriented financial institution dedicated to serving the financial services needs of consumers and businesses within its market area. We attract deposits from the general public and use such funds to originate primarily one- to four-family residential real estate loans, commercial real estate loans and commercial loans. To a lesser extent, we originate multi-family loans, construction loans and consumer loans. At September 30, 2010, we operated out of our main office, lending and operations center, and seven branch offices located in Chicopee, Ludlow, South Hadley, Ware, and West Springfield. All of our offices are located in western Massachusetts.

***Critical Accounting Policies***

Management's discussion and analysis of the Company's financial condition is based on the consolidated financial statements which are prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of such financial statements requires Management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, Management evaluates its estimates, including those related to the allowance for loan losses, other-than-temporary impairment on securities, the valuation of mortgage servicing rights, and the valuation of other real estate owned. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis in making judgments about the carrying values of assets that are not readily apparent from other sources. Actual results could differ from the amount derived from Management's estimates and assumptions under different assumptions or conditions. Additional accounting policies are more fully described in Note 1 in the Notes to Consolidated Financial Statements presented in our 2009 Annual Report on Form 10-K. A brief description of our current accounting policies involving significant management judgment follows.

**Allowance for Loan Losses.** Management believes the allowance for loan losses requires the most significant estimates and assumptions used in the preparation of the consolidated financial statements. The allowance for loan losses is based on Management's evaluation of the level of the allowance required in relation to the probable losses inherent in the loan portfolio. Management believes the allowance for loan losses is a significant estimate and therefore regularly evaluates it for adequacy by taking into consideration factors such as: levels and historical trends in delinquencies, impaired loans, non-accruing loans, charge-offs and recoveries, and classified assets; trends in the volume and terms of the loans; effects of any change in underwriting policies, procedures, and practices; experience, ability, and depth of management staff; national and local economic trends and conditions; trends and conditions in the industries in which borrowers operate; and effects of changes in credit concentrations. The use of different estimates or assumptions could produce different provisions for loan losses.

**Other-Than-Temporary Impairment of Securities.** One of the significant estimates related to investment securities is the evaluation of other-than-temporary impairments. The evaluation of securities for other-than-temporary impairments is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in the fair value of investments should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuer's financial condition and/or future prospects, the effects of changes in interest rates

or credit spreads and the expected recovery period of unrealized losses. Securities that are in an unrealized loss position are reviewed at least quarterly to determine if other-than-temporary impairment is present based on certain quantitative and qualitative factors and measures. The primary factors considered in evaluating whether a decline in value of securities is other-than-temporary include: (a) the length of time and extent to which the fair value has been less than cost or amortized cost and the expected recovery period of the security, (b) the financial condition, credit rating and future prospects of the issuer, (c) whether the debtor is current on contractually obligated interest and principal payments, (d) the volatility of the securities market price, (e) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for recovery, which may be at maturity and (f) any other information and observable data considered relevant in determining whether other-than-temporary impairment has occurred, including the expectation of receipt of all principal and interest due.

**Mortgage Servicing Rights.** The valuation of mortgage servicing rights is a critical accounting policy which requires significant estimates and assumptions. The Bank often sells mortgage loans it originates and retains the ongoing servicing of such loans, receiving a fee for these services, generally 1% of the outstanding balance of the loan per annum. Mortgage servicing rights are recognized when they are acquired through the sale of loans, and are reported in other assets. They are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Management uses an independent firm which specializes in the valuation of mortgage servicing rights to determine the fair value. The Company uses the amortization method for financial reporting. The most important assumption is the anticipated loan prepayment rate, and increases in prepayment speeds result in lower valuations of mortgage servicing rights. Management evaluates for impairment based upon the fair value of the rights, which can vary depending upon current interest rates and prepayment expectations, as compared to amortized cost. The use of different assumptions could produce a different valuation. All of the assumptions are based on standards the Company believes would be utilized by market participants in valuing mortgage servicing rights and are consistently derived and/or benchmarked against independent public sources.

**Valuation of Other Real Estate Owned ( OREO ).** Periodically, we acquire property through foreclosure or acceptance of a deed in lieu-of-foreclosure as OREO. OREO is recorded at fair value less costs to sell. The valuation of this property is accounted for individually based on its net realizable value on the date of acquisition. At the acquisition date, if the net realizable value of the property is less than the book value of the loan, a charge or reduction in the allowance for loan losses is recorded. If the value of the property becomes subsequently impaired, as determined by an appraisal or an evaluation in accordance with our appraisal policy, we will record the decline by a charge against current earnings. Upon acquisition of a property, a current appraisal or broker's opinion must substantiate market value for the property. At September 30, 2010, the Company had \$285,000 of property classified as OREO.

#### ***Comparison of Financial Condition at September 30, 2010 and December 31, 2009***

The Company's assets increased \$25.2 million, or 4.6%, to \$569.3 million at September 30, 2010 compared to \$544.2 million at December 31, 2009, primarily due to increases in cash and cash equivalents of \$18.6 million, or 92.6%, and net loans of \$7.6 million, or 1.8%, to \$432.2 million. The increase in net loans was attributed to the \$6.8 million, or 10.1%, increase in commercial and industrial loans and \$6.5 million, or 5.1%, increase in commercial real estate loans, partially offset by a \$3.5 million, or 9.1%, decrease in construction loans and a \$3.3 million, or 2.2%, decrease in one- to four-family residential loans from \$150.3 million at December 31, 2009 to \$147.0 million at September 30, 2010. The decrease in one- to four-family residential loans was primarily due to prepayments and refinancing activity attributed to the decline in interest rates to historically low levels. In accordance with the Company's asset/liability management strategy and in an effort to reduce interest rate risk, the

Company sold \$12.6 million fixed rate, low coupon residential real estate loans originated in 2010 to the secondary market. Servicing rights will continue to be retained on all loans written and sold in the secondary market.

Total deposits at September 30, 2010 were \$382.1 million compared to \$365.5 million at December 31, 2009. The increase of \$16.6 million, or 4.6%, in deposits is primarily due to increases in certificate of deposit accounts of \$11.3 million, or 5.5%, to \$217.5 million and money market accounts of \$4.0 million, or 7.2%, to \$59.3 million. The increase in certificate of deposits was due to marketing and promotion efforts to attract low cost, long-term funds to position the balance sheet for an eventual rise in interest rates.

Total stockholders' equity decreased \$287,000 to \$93.9 million at September 30, 2010 and represented 16.5% of total assets compared to 17.3% of total assets at December 31, 2009. The Company's balance sheet continues to be strong and regulatory capital ratios continue to exceed the levels required to be well-capitalized under applicable federal banking regulations. The decrease of \$287,000 was mainly due to an increase in treasury stock of \$1.8 million, partially offset by a decrease in unearned compensation of \$850,000, an increase in additional paid-in-capital of \$361,000, and net income of \$260,000. The Company purchased 155,207 shares of the Company's common stock through the Company's stock repurchase program, at a cost of \$1.8 million and an average price of \$11.36. Our capital management strategies allowed us to increase our book value per share by \$0.32, or 2.2%, to \$15.08 at September 30, 2010 compared to \$14.76 at December 31, 2009.

#### ***Lending Activities***

At September 30, 2010, the Company's net loan portfolio was \$432.2 million, or 75.9% of total assets, compared to \$424.7 million, or 78.0% of total assets at December 31, 2009. The following table sets forth the composition of the Company's loan portfolio in dollar amounts and as a percentage of the respective portfolio at the dates indicated.

	September 30, 2010		December 31, 2009	
	Amount	Percent of Total (Dollars In Thousands)	Amount	Percent of Total
<b>Real estate loans:</b>				
One- to four-family <sup>1</sup>	\$ 147,008	33.8%	\$ 150,327	35.1%
Multi-family	11,339	2.6%	10,790	2.5%
Home equity	30,519	7.0%	29,320	6.9%
Commercial	133,320	30.6%	126,861	29.7%
<b>Total</b>	<b>322,186</b>	<b>74.0%</b>	<b>317,298</b>	<b>74.2%</b>
Construction-residential	7,710	1.8%	9,193	2.2%
Construction-commercial	27,136	6.2%	29,122	6.8%
<b>Total construction</b>	<b>34,846</b>	<b>8.0%</b>	<b>38,315</b>	<b>9.0%</b>
<b>Total real estate loans</b>	<b>357,032</b>	<b>82.0%</b>	<b>355,613</b>	<b>83.2%</b>
Consumer loans	3,582	0.8%	4,390	1.0%
Commercial loans	74,566	17.2%	67,754	15.8%
<b>Total loans</b>	<b>435,180</b>	<b>100.0%</b>	<b>427,757</b>	<b>100.0%</b>
Undisbursed portion of loans in process	374		10	
Net deferred loan origination costs	953		965	
Allowance for loan losses	(4,267)		(4,077)	
<b>Loans, net</b>	<b>\$ 432,240</b>		<b>\$ 424,655</b>	

<sup>1</sup> Excludes loans held for sale of \$1,172 and \$534 at September 30, 2010 and December 31, 2009, respectively.

The Company's net loan portfolio increased \$7.6 million, or 1.8%, during the first nine months of 2010 primarily due to the \$6.8 million, or 10.1%, increase in commercial and industrial loans and \$6.5 million, or 5.1%, increase in commercial real estate loans, partially offset by a \$3.5 million, or 9.1%, decrease in construction loans and a \$3.3 million, or 2.2%, decrease in one- to four-family residential loans from \$150.3 million at December 31, 2009 to \$147.0 million at September 30, 2010. The decrease in one- to four-family residential loans was primarily due to prepayments and refinancing activity attributed to the decline in interest rates to historically low levels. In accordance with the Company's asset/liability management strategy and in an effort to reduce interest rate risk, the Company sold \$12.6 million fixed rate, low coupon residential real estate loans originated in 2010 to the secondary market. Servicing rights will continue to be retained on all loans written and sold in the secondary market.

#### ***Non-performing Assets***

The following table sets forth information regarding nonaccrual loans, real estate owned, and restructured loans at the dates indicated.

	September 30, 2010	December 31, 2009
	(Dollars In Thousands)	
<b>Nonaccrual loans:</b>		
Residential mortgages	\$ 2,549	\$ 2,740
Construction	316	184
Commercial mortgages	2,294	982
Commercial & Industrial	565	664
Home equity	194	182
Consumer	126	92
Total nonaccrual loans	6,044	4,844
Other real estate owned, net	285	80
Total nonperforming assets	\$ 6,329	\$ 4,924
<b>Ratios:</b>		
Total nonperforming loans as a percentage of total loans (1)	1.38%	1.13%
Total nonperforming assets as a percentage of total assets	1.11%	0.90%

(1) Total loans includes net loans plus the allowance for loan losses.

Loans are placed on nonaccrual status either when reasonable doubt exists as to the timely collection of principal and interest or when a loan becomes 90 days past due unless an evaluation clearly indicates that the loan is well-secured and in the process of collection. There were no loans that were over 90 days delinquent and still accruing interest.

Nonaccrual loans increased \$1.2 million, or 24.8%, to \$6.0 million as of September 30, 2010 compared to \$4.8 million as of December 31, 2009. The increase in nonaccrual loans is primarily due to one commercial real estate participation loan, partially offset by the decrease in nonaccrual residential mortgages of \$191,000. Management reviews nonaccrual loans on a loan by loan basis and applies specific reserves to loan balances in excess of collateral values if sufficient borrower cash flows cannot be identified.

**Analysis and Determination of the Allowance for Loan Losses.** The allowance for loan losses is a valuation allowance for probable credit losses inherent in the loan portfolio. Management evaluates the need to establish allowances against losses on loans on a quarterly basis. When additional allowances are necessary, a provision for loan losses is charged to earnings. The allowance for loan losses is maintained at an amount that management considers appropriate to cover inherent probable losses in the loan portfolio.

Our methodology for assessing the appropriateness of the allowance for loan losses consists of: (1) a specific allowance on identified problem loans; and (2) a general valuation allowance on the remainder of the loan portfolio. Although we determine the amount of each element of the allowance separately, the entire allowance for loan losses is available for the entire portfolio. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

**Specific Allowance Required for Identified Problem Loans.** We establish an allowance on certain identified problem loans based on such factors as: (1) the strength of the customer's personal or business cash flows; (2) the availability of other sources of repayment; (3) the amount due or past due; (4) the type and value of collateral; (5) the strength of our collateral position; (6) the estimated cost to sell the collateral; and (7) the borrower's effort to cure the delinquency.



**General Valuation Allowance on the Remainder of the Loan Portfolio.** We establish a general allowance for loans that are not evaluated individually for impairment under ASC 310, *Receivables*, in order to recognize probable losses associated with lending activities. This general valuation allowance is determined by segregating the loans by loan category and assigning percentages to each category. The percentages are adjusted for significant factors that, in management's judgment, affect the collectability of the portfolio as of the evaluation date. These significant factors include: levels and historical trends in delinquencies, impaired loans, non-accrual loans, charge-offs, recoveries, and classified assets; trends in the volume and terms of loans; effects of any change in underwriting, policies, procedures, and practices; experience, ability, and depth of management and staff; national and local economic trends and conditions; trends and conditions in the industries in which borrowers operate; effects of changes in credit concentrations. The applied loss factors are reevaluated quarterly to ensure their relevance in the current economic environment.

We identify loans that may need to be charged off as a loss by reviewing all delinquent loans, classified loans and other loans for which management may have concerns about collectability. For individually reviewed loans, the borrower's inability to make payments under the terms of the loan or a shortfall in the fair value of the collateral if the loan is collateral dependent would result in our allocating a portion of the allowance to the loan that was impaired.

The allowance for loan losses is based on management's estimate of the amount required to reflect the potential inherent losses in the loan portfolio, based on circumstances and conditions known or anticipated at each reporting date. There are inherent uncertainties with respect to the collectability of the Bank's loans and it is reasonably possible that actual loss experience in the near term may differ from the amounts reflected in this report.

At September 30, 2010, Management believed that the current allowance for loan losses is appropriate to cover losses inherent in the current loan portfolio.

At September 30, 2010, our allowance for loan losses represented 0.98% of total loans and 70.60% of nonperforming loans. The allowance for loan losses increased to \$4.3 million at September 30, 2010 from \$4.1 million at December 31, 2009. At September 30, 2010 the allowance for loan losses is the result of a provision of \$761,000, partially offset by net charge-offs of \$571,000. The increase in the provision of \$211,000 for the nine months ended September 30, 2010 compared to 2009 reflects management's assessment of the continued growth of the loan portfolio, particularly the increase in commercial business loans of \$6.8 million and commercial real estate loans of \$6.5 million from December 31, 2009. Net charge-offs for the nine months ended September 30, 2010 increased \$434,000 from \$137,000 for the corresponding period in 2009, primarily due to two charge-offs, one for a \$132,000 commercial loan and the other for a \$92,100 commercial construction loan.

The following table sets forth activity in the Company's allowance for loan losses for the periods set forth:

	<b>For the Nine Months Ended September 30, 2010                      2009 (Dollars In Thousands)</b>	
Allowance for loan losses at beginning of year, December 31	\$ 4,077	\$ 3,333
Charged-off loans:		
Residential mortgages	(131)	(93)
Construction	(94)	
Commercial mortgages	(7)	
Commercial & Industrial	(266)	(9)
Home equity		
Consumer	(92)	(48)
<b>Total charged-off loans</b>	<b>(590)</b>	<b>(150)</b>
Recoveries on loans previously charged-off:		
Residential mortgages		
Construction		
Commercial mortgages		
Commercial & Industrial		
Home equity		
Consumer	19	13
<b>Total recoveries</b>	<b>19</b>	<b>13</b>
Net loan charge-offs	(571)	(137)
Provision for loan losses	761	550
Allowance for loan losses, end of period	\$ 4,267	\$ 3,746
<b>Ratios:</b>		
Net loan charge-offs to total average loans	0.13%	0.03%
Allowance for loan losses to total loans (1)	0.98%	0.89%
Allowance for loan losses to nonperforming loans (2)	70.60%	132.32%
Recoveries to charge-offs	3.22%	8.67%

(1) Total loans includes net loans plus the allowance for loan losses.

(2) Nonperforming loans consist of all loans 90 days or more past due or other loans which have been identified by the Company as presenting uncertainty with respect to the collectability of interest or principal.

**Deposits**

The following table sets forth the Company's deposit accounts at the dates indicated:

	September 30, 2010		December 31, 2009	
	Balance	Percent of Total Deposits (Dollars In Thousands)	Balance	Percent of Total Deposits
Demand deposits	\$ 46,648	12.2%	\$ 42,629	11.7%
NOW accounts	14,758	3.9%	18,466	5.1%
Passbook accounts	43,971	11.5%	42,875	11.7%
Money market deposit accounts	59,277	15.5%	55,293	15.1%
<b>Total transaction accounts</b>	<b>164,654</b>	<b>43.1%</b>	<b>159,263</b>	<b>43.6%</b>
<b>Certificates of deposit</b>	<b>217,492</b>	<b>56.9%</b>	<b>206,235</b>	<b>56.4%</b>
<b>Total deposits</b>	<b>\$ 382,146</b>	<b>100.0%</b>	<b>\$ 365,498</b>	<b>100.0%</b>

Deposits increased \$16.6 million, or 4.6%, to \$382.1 million at September 30, 2010 from \$365.5 million at December 31, 2009. Certificate of deposits increased \$11.3 million, or 5.5%, to \$217.5 million and money market accounts increased \$4.0 million, or 7.2%, to \$59.3 million. The increase in certificate of deposits was due to marketing and promotion efforts to attract low cost, long-term funds to position the balance sheet for eventual rise in interest rates.

**Borrowings**

The following sets forth information concerning our borrowings for the periods indicated.

	September 30, 2010	December 31, 2009
	(Dollars In Thousands)	
<b>Maximum amount of advances outstanding at any month-end during the period:</b>		
FHLB Advances	\$ 80,907	\$ 71,258
Securities sold under agreements to repurchase	29,639	27,334
<b>Average advances outstanding during the period:</b>		
FHLB Advances	\$ 75,485	\$ 58,278
Securities sold under agreements to repurchase	18,446	21,339
<b>Weighted average interest rate during the period:</b>		
FHLB Advances	2.73%	2.90%
Securities sold under agreements to repurchase	0.40%	0.98%
<b>Balance outstanding at end of period:</b>		
FHLB Advances <sup>1</sup>	\$ 74,779	\$ 63,675
Securities sold under agreements to repurchase	18,064	20,422
<b>Weighted average interest rate at end of period:</b>		
FHLB Advances	2.52%	3.04%
Securities sold under agreements to repurchase	0.25%	0.50%

<sup>1</sup> Balance includes a one time put option of \$5 million, the FHLB may call this advance on June 30, 2011.

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We utilize borrowings from a variety of sources to supplement our supply of funds for loans and investments. FHLB advances increased \$11.1 million, or 17.4%, from \$63.7 million at December 31, 2009 to \$74.8 million at September 30, 2010 due to proceeds from long-term advances of \$24.5 million, offset by payments on long-term advances of \$13.4 million. Securities sold under agreements to repurchase decreased \$2.4 million, primarily due to fluctuations in the balances of these accounts.

During the nine months ended September 30, 2010, the Company restructured \$19.9 million in FHLB

advances in order to lower the cost of borrowing and to increase the time until maturity. In executing this restructuring of FHLB advances, the Company incurred a prepayment penalty, which was blended with the effective rate and will be amortized over the life of the restructured advances. This restructuring did not meet the 10 percent cash flow test and is not required to be accounted for as a debt extinguishment. The new effective interest rate was determined based on the carrying amount of the original advance, adjusted for the present value of the new advance and the prepayment penalty. From time to time, management may use borrowed money to engage in various leverage strategies to increase income as opportunities arise.

### ***Comparison of Operating Results for the Three Months Ended September 30, 2010 and 2009***

#### *General*

The Company reported net income of \$183,000, or \$0.03 earnings per share, for the third quarter of 2010, an increase of \$1.6 million, or 113.1%, from the third quarter of 2009. The \$1.6 million increase in net income for the third quarter of 2010 was due to an increase in non-interest income of \$1.3 million, or 184.3%, and an increase in net interest income of \$435,000, or 11.6%, a decrease in non-interest expense of \$215,000, or 4.7%, and a decrease in the provision for loan loss of \$9,000. Although the provision for loan loss declined, the allowance for loan losses represented 0.98% of total loans at September 30, 2010, compared to 0.95% at December 31, 2009 and 0.89% at September 30, 2009.

Net interest income for the third quarter of 2010, increased by \$435,000, or 11.6%, to \$4.2 million from \$3.7 million for the third quarter of 2009. The increase in net interest income resulted from a \$309,000, or 13.2%, decrease in interest expense from deposits. The average cost declined by 35 basis points due to the continuation of low market interest rates, which allowed the Company to renew or replace maturing time deposits at lower costs. Average demand deposits, an interest free source of funds, increased by \$8.0 million, or 24.4%, from the third quarter of 2009. Interest income (tax equivalent basis) increased by \$275,000, or 4.5%, due to the \$314,000 increase in income from investment securities, specifically, the tax-exempt bond portfolio, as the investment yield increased by 147 basis points. The increase in interest income from investment securities in the third quarter of 2010, was partially offset by a 24 basis point decrease in the average loan yield from the third quarter of 2009.

For the three months ended, September 30, 2010, the net interest margin increased by 33 basis points from 3.01%, for the three months ended September 30, 2009, to 3.34%. The interest rate spread increased by 37 basis points from 2.62% to 2.99%.

#### *Analysis of Net Interest Income*

Net interest income represents the difference between income on interest-earning assets and expense on interest-bearing liabilities. Net interest income depends on the relative amounts of interest-earning assets and interest-bearing liabilities and the interest rate earned or paid on them.

The following table sets forth average balances, interest income and expense and yields earned or rates paid on the major categories of assets and liabilities for the periods indicated. The average yields and costs are derived by dividing interest income or expense by the average balance of interest-earning assets or interest-bearing liabilities, respectively. The yields and costs are annualized. Average balances are derived from average daily balances. The yields and costs include fees which are considered adjustments to yields. Loan interest and yield data does not include any accrued interest from non-accruing loans.

	For the Three Months Ended September 30,					
	2010			2009		
	Average Balance	Interest	Average Yield/ Rate (Dollars In Thousands)	Average Balance	Interest	Average Yield/ Rate
<b>Interest-earning assets:</b>						
Investment securities (1)	\$ 62,210	\$ 523	3.34%	\$ 44,356	\$ 209	1.87%
Loans:						
Residential real estate loans	158,230	2,118	5.31%	166,299	2,285	5.45%
Commercial real estate loans	166,885	2,446	5.81%	160,708	2,478	6.12%
Consumer loans	33,737	404	4.75%	31,981	411	5.10%
Commercial loans	76,375	894	4.64%	60,439	723	4.75%
Loans, net (2)	435,227	5,862	5.34%	419,427	5,897	5.58%
Other	21,176	10	0.19%	34,603	14	0.16%
Total interest-earning assets	518,613	\$ 6,395	4.89%	498,386	\$ 6,120	4.87%
Noninterest-earning assets	40,967			40,207		
Total assets	\$ 559,580			\$ 538,593		
<b>Interest-bearing liabilities:</b>						
Deposits:						
Money market accounts	\$ 59,559	\$ 106	0.70%	\$ 75,122	\$ 209	1.10%
Savings accounts (3)	44,135	28	0.25%	41,755	35	0.33%
NOW, ATS, and other transaction accounts	16,097	9	0.23%	17,917	10	0.22%
Certificates of deposit	212,667	1,373	2.56%	210,322	1,621	3.06%
Total interest-bearing deposits	332,458	1,516	1.81%	345,116	1,875	2.16%
FHLB advances	75,851	500	2.62%	47,796	414	3.44%
Securities sold under agreement to repurchase	15,277	10	0.26%	18,050	46	1.01%
Total interest-bearing borrowings	91,128	510	2.22%	65,846	460	2.77%
Total interest-bearing liabilities	423,586	2,026	1.90%	410,962	2,335	2.25%
Demand deposits	40,666			32,698		
Other noninterest-bearing liabilities	301			368		
Total liabilities	464,553			444,028		
Total stockholders' equity	95,027			94,565		
Total liabilities and stockholders' equity	\$ 559,580			\$ 538,593		
Net interest-earning assets	\$ 95,027			\$ 87,424		
Tax equivalent net interest income/ interest rate spread (4)		4,369	2.99%		3,785	2.62%
Tax equivalent net interest income as a percentage of interest-earning assets			3.34%			3.01%
Ratio of interest-earning assets to interest-bearing liabilities			122.43%			121.27%

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Less: tax equivalent adjustment (1)	(186)	(37)
Net interest income as reported on statement of operations	\$ 4,183	\$ 3,748

- (1) Municipal securities income and net interest income are presented on a tax equivalent basis using a tax rate of 41%. The tax equivalent adjustment is deducted from the tax equivalent net interest income to agree to the amount reported on the statement of operations. See Explanation of Use of Non-GAAP Financial Measurements .
- (2) Loans, net excludes loans held for sale.
- (3) Savings accounts include mortgagors escrow deposits.
- (4) Tax equivalent interest rate spread represents the difference between the weighted average yield on interest-earning assets and the weighted average cost of interest-bearing liabilities.

The following table presents the extent to which changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected the Company's tax equivalent interest income and interest expense during the periods indicated. Information is provided in each category with respect to: (i) changes attributable to changes in volume (changes in volume multiplied by prior rate); (ii) changes attributable to changes in rate (changes in rate multiplied by prior volume); and (iii) the net change. The changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

	<b>Three Months Ended September 30, 2010 compared to 2009</b>		
	<b>Increase (Decrease)</b>		
	<b>Volume</b>	<b>Due to Rate</b>	<b>Net</b>
	<b>(Dollars In Thousands)</b>		
<b>Interest-earning assets:</b>			
Investment securities (1)	\$ 38	\$ 276	\$ 314
<b>Loans:</b>			
Residential real estate loans	(109)	(58)	(167)
Commercial real estate loans	305	(337)	(32)
Consumer loans	22	(29)	(7)
Commercial loans	187	(16)	171
Total loans	405	(440)	(35)
Other	(6)	2	(4)
Total interest-earning assets	\$ 437	\$ (162)	\$ 275
<b>Interest-bearing liabilities:</b>			
<b>Deposits:</b>			
Money market accounts	\$ (37)	\$ (66)	\$ (103)
Savings accounts (2)	2	(9)	(7)
NOW, ATS, and other transaction accounts	(1)		(1)
Certificates of deposit	18	(266)	(248)
Total deposits	(18)	(341)	