FSB Community Bankshares Inc
Form 10-Q
November 12, 2010

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

FORM 10-Q

x Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2010

OR

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _______________ to ______________________

Commission File No. 001-52751

FSB Community Bankshares, Inc.
(Exact name of registrant as specified in its charter)

| United States<br>(State or other jurisdiction of<br>incorporation or organization) | 74-3164710<br>(I.R.S. Employer<br>Identification Number) |
|---|---|
| 45 South Main Street, Fairport, New York<br>(Address of Principal Executive Offices) | 14450<br>Zip Code |

(585) 223-9080
(Registrant's telephone number)

N/A
(Former name or former address, 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 requirements for the past 90 days.
YES x NO o.

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 o NO o.

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

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

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

As of November 12, 2010 there were 1,785,000 shares of the Registrant's common stock, par value $0.10 per share, outstanding, 946,050 of which were held by FSB Community Bankshares, MHC, the Registrant's mutual holding company.

FSB Community Bankshares, Inc.
FORM 10-Q

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Part I. Financial Information

Item 1. Consolidated Financial Statements

FSB COMMUNITY BANKSHARES, INC.

Consolidated Balance Sheets
September 30, 2010 and December 31, 2009 (unaudited)
(Dollars in thousands, except share data)

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| Assets | | |
| Cash and due from banks | $9,525 | $3,385 |
| Interest-earning demand deposits | 1,105 | 2,580 |
| Cash and Cash Equivalents | 10,630 | 5,965 |
| | | |
| Securities available for sale | 75,139 | 75,483 |
| Securities held to maturity (fair value 2010 $5,687; 2009 $6,183) | 5,523 | 6,098 |
| Investment in FHLB stock | 1,608 | 1,886 |
| Loans held for sale | 695 | - |
| Loans receivable, net of allowance for loan losses (2010 $381; 2009 $368) | 113,948 | 116,372 |
| Bank owned life insurance | 3,112 | 3,013 |
| Accrued interest receivable | 1,009 | 1,156 |
| Premises and equipment, net | 2,534 | 2,556 |
| Foreclosed real estate | - | 79 |
| Prepaid FDIC premium | 631 | 793 |
| Other assets | 728 | 999 |
| Total Assets | $215,557 | $214,400 |
| | | |
| Liabilities & Stockholders' Equity | | |
| | | |
| Deposits: | | |
| Non-interest-bearing | $3,872 | $3,955 |
| Interest-bearing | 158,477 | 152,555 |
| Total Deposits | 162,349 | 156,510 |
| | | |
| Borrowings | 28,800 | 34,590 |
| Advances from borrowers for taxes and insurance | 906 | 2,012 |
| Official bank checks | 1,881 | 432 |
| Other liabilities | 724 | 506 |
| Total Liabilities | 194,660 | 194,050 |
| | | |
| Stockholders' Equity | | |
| | | |
| Preferred Stock- no par value- 1,000,000 shares authorized; no shares issued and outstanding | - | - |
| Common Stock- $0.10 par value – 10,000,000 shares authorized; | | |

| | | |
|---|---|---|
| 1,785,000 shares issued and outstanding | 179 | 179 |
| Additional paid-in-capital | 7,271 | 7,275 |
| Retained earnings | 13,477 | 13,317 |
| Accumulated other comprehensive income | 538 | 174 |
| Unearned ESOP shares – at cost | (568 ) | (595 ) |
| Total Stockholders' Equity | 20,897 | 20,350 |
| Total Liabilities and Stockholders' Equity | $215,557 | $214,400 |

See accompanying notes to consolidated financial statements

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FSB COMMUNITY BANKSHARES, INC.

Consolidated Statements of Income
Three Months Ended September 30, 2010 and 2009 (unaudited)
(Dollars in thousands, except per share data)

| | 2010 | 2009 |
|---|---|---|
| Interest and Dividend Income | | |
| Loans | $1,614 | $1,669 |
| Securities – taxable | 285 | 415 |
| Securities – tax exempt | 3 | - |
| Mortgage-backed securities | 218 | 264 |
| Other | 7 | 2 |
| Total Interest and Dividend Income | 2,127 | 2,350 |
| Interest expense | | |
| Deposits | 590 | 844 |
| Borrowings | 293 | 404 |
| Total Interest Expense | 883 | 1,248 |
| Net Interest Income | 1,244 | 1,102 |
| Provision for Loan Losses | 8 | 7 |
| Net Interest Income After Provision for Loan Losses | 1,236 | 1,095 |
| Other Income | | |
| Service fees | 56 | 73 |
| Fee income | 10 | 5 |
| Realized gain on sale of securities | 95 | - |
| Increase in cash surrender value of bank owned life insurance | 34 | - |
| Realized gain on sale of loans | 155 | 4 |
| Other | 92 | 51 |
| Total Other Income | 442 | 133 |
| Other Expense | | |
| Salaries and employee benefits | 894 | 613 |
| Occupancy expense | 151 | 130 |
| Data processing costs | 27 | 25 |
| Advertising | 39 | 76 |
| Equipment expense | 107 | 92 |
| Electronic banking | 22 | 21 |
| Directors' fees | 30 | 25 |
| Mortgage fees and taxes | 61 | 71 |
| FDIC premium expense | 58 | 80 |
| Other expense | 168 | 152 |
| Total Other Expenses | 1,557 | 1,285 |
| Income (Loss ) Before Income Taxes | 121 | (57) |

| | | |
|---|---|---|
| Provision (Benefit) for Income Taxes | 29 | (23) |
| Net Income (Loss) | $92 | $(34) |
| Earnings (Loss) per common share | $0.05 | $(0.02) |

See accompanying notes to consolidated financial statements

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FSB COMMUNITY BANKSHARES, INC.

Consolidated Statements of Income
Nine Months Ended September 30, 2010 and 2009 (unaudited)
(Dollars in thousands, except per share data)

| | 2010 | 2009 |
|---|---|---|
| Interest and Dividend Income | | |
| Loans | $4,809 | $5,333 |
| Securities – taxable | 1,124 | 983 |
| Securities – tax exempt | 3 | - |
| Mortgage-backed securities | 634 | 889 |
| Other | 12 | 5 |
| Total Interest and Dividend Income | 6,582 | 7,210 |
| Interest expense | | |
| Deposits | 1,978 | 2,586 |
| Borrowings: | | |
| Short-term | - | 1 |
| Long-term | 973 | 1,234 |
| Total Interest Expense | 2,951 | 3,821 |
| Net Interest Income | 3,631 | 3,389 |
| Provision for Loan Losses | 14 | 21 |
| Net Interest Income After Provision for Loan Losses | 3,617 | 3,368 |
| Other Income | | |
| Service fees | 173 | 188 |
| Fee income | 36 | 33 |
| Realized gain on sale of securities | 87 | 92 |
| Realized loss on sale of foreclosed real estate | (5) | - |
| Increase in cash surrender value of bank owned life insurance | 99 | - |
| Realized gain on sale of loans | 238 | 49 |
| Other | 235 | 154 |
| Total Other Income | 863 | 516 |
| Other Expense | | |
| Salaries and employee benefits | 2,308 | 1,862 |
| Occupancy expense | 450 | 379 |
| Data processing costs | 70 | 72 |
| Advertising | 133 | 160 |
| Equipment expense | 314 | 269 |
| Electronic banking | 59 | 60 |
| Directors' fees | 85 | 82 |
| Mortgage fees and taxes | 178 | 187 |
| FDIC premium expense | 174 | 261 |
| Other expense | 523 | 490 |
| Total Other Expenses | 4,294 | 3,822 |

| | | |
|---|---|---|
| Income Before Income Taxes | 186 | 62 |
| Provision for Income Taxes | 26 | 18 |
| Net Income | $160 | $44 |
| Earnings per common share | $0.09 | $0.03 |

See accompanying notes to consolidated financial statements

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FSB COMMUNITY BANKSHARES, INC.

Consolidated Statements of Stockholders' Equity
Nine Months Ended September 30, 2010 and 2009 (unaudited)

(Dollars in thousands)

| | Common Stock | Additional Paid in Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Unearned ESOP Shares | Total |
|---|---|---|---|---|---|---|
| Balance – January 1, 2009 | $ 179 | $ 7,286 | $ 13,249 | $ (43 ) | $ (630 ) | $ 20,041 |
| Comprehensive income: | | | | | | |
| Net income | - | - | 44 | - | - | 44 |
| Change in net unrealized gain on securities available for sale, net of reclassification adjustment and taxes | - | - | - | 373 | - | 373 |
| Total Comprehensive Income | | | | | | 417 |
| ESOP shares committed to be released | - | (10 ) | - | - | 26 | 16 |
| Balance – September 30, 2009 | $ 179 | $ 7,276 | $ 13,293 | $ 330 | $ (604 ) | $ 20,474 |
| Balance – January 1, 2010 | $ 179 | $ 7,275 | $ 13,317 | $ 174 | $ (595 ) | $ 20,350 |
| Comprehensive income: | | | | | | |
| Net income | - | - | 160 | - | - | 160 |
| Change in net unrealized gain on securities available for sale, net of reclassification adjustment and taxes | - | - | - | 364 | - | 364 |
| Total Comprehensive Income | | | | | | 524 |
| ESOP shares committed to be released | - | (4 ) | - | - | 27 | 23 |
| Balance – September 30, 2010 | $ 179 | $ 7,271 | $ 13,477 | $ 538 | $ (568 ) | $ 20,897 |

See accompanying notes to consolidated financial statements

FSB COMMUNITY BANKSHARES, INC.

Consolidated Statements of Cash Flows
Nine Months Ended September 30, 2010 and 2009 (unaudited)
(Dollars in thousands)

| | 2010 | 2009 |
|---|---|---|
| **Cash Flows From Operating Activities** | | |
| Net income | $160 | $44 |
| Adjustments to reconcile net income to net cash used by operating activities: | | |
| Net amortization of premiums and discounts on investments | 743 | 479 |
| Gain on sale of securities available for sale | (97) | (92) |
| Loss on sale of securities held to maturity | 10 | - |
| Gain on sale of loans | (238) | (49) |
| Proceeds from loans sold | 7,377 | 12,709 |
| Loans originated for sale | (7,834) | (12,660) |
| Amortization of net deferred loan origination costs | 23 | 11 |
| Depreciation and amortization | 238 | 221 |
| Provision for loan losses | 14 | 21 |
| Expense related to ESOP | 23 | 16 |
| Deferred income tax expense (benefit) | 1 | (43) |
| Earnings on investment in bank owned life insurance | (99) | - |
| Decrease (increase) in accrued interest receivable | 147 | (321) |
| Decrease (increase) in prepaid FDIC premium and other assets | 433 | (272) |
| Increase (decrease) in other liabilities | 29 | (103) |
| Loss on sale of foreclosed real estate | 5 | - |
| Net Cash Provided By/(Used By) Operating Activities | 935 | (39) |
| | | |
| **Cash Flows From Investing Activities** | | |
| Purchases of securities available for sale | (80,230) | (79,566) |
| Proceeds from maturities and calls of securities available for sale | 71,800 | 33,037 |
| Proceeds from sales of securities available for sale | 3,188 | 5,355 |
| Proceeds from principal paydowns on securities available for sale | 5,494 | 3,602 |
| Purchases of securities held to maturity | (510) | - |
| Proceeds from principal paydowns on securities held to maturity | 387 | 850 |
| Proceeds from maturities and calls of securities held to maturity | - | - |
| Proceeds from sales of securities held to maturity | 686 | - |
| Net decrease in loans | 2,387 | 18,718 |
| Redemption of FHLB stock | 278 | 310 |
| Proceeds from sales of foreclosed real estate | 74 | - |
| Purchase of premises and equipment | (216) | (495) |
| Net Cash Provided By/(Used By) Investing Activities | 3,338 | (18,189) |
| | | |
| **Cash Flows From Financing Activities** | | |
| Net increase in deposits | 5,839 | 32,625 |
| Net decrease in short-term borrowings | - | (3,850) |
| Repayments on long-term borrowings | (5,790) | (4,459) |
| Net decrease in advances from borrowers for taxes and insurance | (1,106) | (1,210) |
| Net increase in official bank checks | 1,449 | 1,992 |

| | | |
|---|---|---|
| Net Cash Provided By Financing Activities | 392 | 25,098 |
| Net Increase in Cash and Cash Equivalents | 4,665 | 6,870 |
| Cash and Cash Equivalents- Beginning | 5,965 | 3,173 |
| Cash and Cash Equivalents- Ending | $10,630 | $10,043 |

FSB COMMUNITY BANKSHARES, INC.

Consolidated Statements of Cash Flows, (Continued)

| | 2010 | 2009 |
|---|---|---|
| Supplementary Cash Flows Information | | |
| Interest paid | $3,002 | $3,836 |
| Income taxes paid | $- | $115 |

See accompanying notes to consolidated financial statements

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Notes to Consolidated Financial Statements

Note 1-Basis of Presentation

The accompanying unaudited consolidated financial statements of FSB Community Bankshares, Inc. and its wholly owned subsidiary Fairport Savings Bank (collectively, the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the applicable instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the information and footnotes necessary for a complete presentation of consolidated financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included.

The preparation of financial statements in conformity with generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant changes in the near term relate to the determination of the allowance for loan losses, the evaluation of other-than-temporary impairment of investment securities, and the valuation of deferred tax assets. For additional information and disclosures required under GAAP, reference is made to the Company's Annual Report on Form 10-K for the period ended December 31, 2009 filed on Form 10-K with the Securities and Exchange Commission ("SEC") on March 29, 2010.

The unaudited consolidated financial statements and "Management's Discussion and Analysis of Financial Condition and Results of Operations" should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2009, included in the Annual Report filed on Form 10-K with the Securities and Exchange Commission ("SEC") on March 29, 2010.

Operating results for the three and nine months ended September 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010.

The consolidated financial statements at September 30, 2010 and December 31, 2009 and for the three and nine months ended September 30, 2010 and 2009 include the accounts of the Company, Fairport Savings Bank (the "Bank") and the Bank's wholly-owned subsidiary, Oakleaf Services Corporation ("Oakleaf"). All inter-company balances and transactions have been eliminated in consolidation. Certain amounts from prior periods may have been reclassified, when necessary, to conform to current period presentation.

The Company has evaluated subsequent events through the date these consolidated financial statements were issued.

Note 2-Fair Value Measurement and Disclosure

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Company could have realized in a sale transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective reporting dates and have not been re-evaluated or updated for purposes of these consolidated financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each reporting date.

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The Company follows Accounting Standards Codification (ASC) Topic 820, Fair Value Measurements and Disclosures, which defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. ASC Topic 820 applies to other accounting pronouncements that require or permit fair value measurements.

ASC Topic 820 establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC Topic 820 are as follows:

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

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

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

An asset or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

For assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used are as follows at September 30, 2010 and at December 31, 2009:

Note 2--Fair Value Measurement and Disclosure (Continued)

September 30, 2010
Securities Available for Sale:

| (In Thousands) | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| U.S. Government agency securities | $43,898 | $5,000 | $38,898 | $- |
| Mortgage-backed securities - residential | 27,254 | 2,079 | 25,175 | - |
| SBA pools | 3,987 | - | 3,987 | - |
| Total Available for Sale Securities | $75,139 | $7,079 | $68,060 | $- |

(In Thousands)

December 31, 2009
Securities Available for Sale:

| (In Thousands) | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Equity securities | $12 | $12 | $- | $- |
| U.S. Government agency securities | 54,629 | 5,548 | 49,081 | - |

| | | | | |
|---|---|---|---|---|
| Mortgage-backed securities - residential | 20,842 | - | 20,842 | - |
| Total Available for Sale Securities | $75,483 | $5,560 | $69,923 | $- |

Note 2--Fair Value Measurement and Disclosure (Continued)

There were no transfers between level 1 and level 2 during the nine months ended September 30, 2010. No assets or liabilities have been measured on a non-recurring basis at or for the nine months ended September 30, 2010 or for the year ended December 31, 2009.

Financial Accounting Standards Board (FASB) ASC Topic 825-10-50, Disclosure about Fair Value of Financial Instruments, requires disclosure of fair value information about financial instruments, whether or not recognized in the consolidated balance sheets, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the defined fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. ASC Topic 825-10-50 excludes certain assets and liabilities from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments at September 30, 2010 and December 31, 2009:

Cash, Due from Banks, and Interest-Bearing Demand Deposits

The carrying amounts of these assets approximate their fair values.

Investment Securities

The fair value of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level 3). In the absence of such evidence, management's best estimate is used. Management's best estimate consists of both internal and external support on certain Level 3 investments. Internal cash flow models using a present value formula that includes assumptions market participants would use along with indicative exit pricing obtained from broker/dealers (where available) are used to support fair values of certain Level 3 investments. The Company had no Level 3 investment securities at September 30, 2010 or at December 31, 2009.

Investment in FHLB Stock

The carrying value of FHLB stock approximates its fair value based on the restricted nature of the FHLB stock.

Loans Held for Sale

The fair value of loans held for sale is determined, when possible, using quoted secondary-market prices. If no such quoted prices exist, the fair value of a loan is determined using quoted prices for a similar loan or loans, adjusted for specific attributes of that loan. Loans held for sale are carried at their cost at September 30, 2010, which approximated fair value since the loans were sold in the subsequent period for amounts substantially equal to the carrying value. There were no loans held for sale at December 31, 2009.

Loans

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

Accrued Interest Receivable and Payable

The carrying amount of accrued interest receivable and payable approximates fair value.

Deposits

The fair values disclosed for demand deposits (e.g., NOW accounts, non-interest checking, regular 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 for variable-rate 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 market interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Borrowings

The fair values of FHLB long-term borrowings are estimated using discounted cash flow analyses, based on the quoted rates for new FHLB advances with similar credit risk characteristics, terms and remaining maturity.

Off-Balance Sheet Instruments

The fair values for off-balance sheet financial instruments (lending commitments and lines of credit) are estimated using the fees currently charged to enter into similar agreements, taking into account market interest rates, the remaining terms and present credit worthiness of the counterparties.

The carrying amounts and estimated fair values of the Company’s financial instruments at September 30, 2010 and December 31, 2009 are as follows:

| | September 30, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (In Thousands) | | | |
| Financial assets: | | | | |
| Cash and due from banks | $9,525 | $9,525 | $3,385 | $3,385 |
| Interest bearing demand deposits | 1,105 | 1,105 | 2,580 | 2,580 |
| Securities available for sale | 75,139 | 75,139 | 75,483 | 75,483 |
| Securities held to maturity | 5,523 | 5,687 | 6,098 | 6,183 |
| FHLB stock | 1,608 | 1,608 | 1,886 | 1,886 |
| Loans held for sale | 695 | 695 | - | - |
| Loans, net | 113,948 | 119,854 | 116,372 | 118,883 |
| Accrued interest receivable | 1,009 | 1,009 | 1,156 | 1,156 |

| | | | | |
|---|---|---|---|---|
| Financial liabilities: | | | | |
| Deposits | 162,349 | 161,325 | 156,510 | 155,606 |
| Borrowings | 28,800 | 26,929 | 34,590 | 32,579 |
| Accrued interest payable | 78 | 78 | 129 | 129 |
| | | | | |
| Off-balance sheet instruments: | | | | |
| Commitments to extend credit | - | - | - | - |

Note 3 - Securities

The amortized cost and estimated fair value of securities with gross unrealized gains and losses at September 30, 2010 and at December 31, 2009 are as follows:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| | | (In Thousands) | | |
| September 30, 2010: | | | | |
| Available for Sale: | | | | |
| U.S. Government agency securities | $43,651 | $249 | $(2) | $43,898 |
| Mortgage-backed securities - residential | 26,735 | 525 | (6) | 27,254 |
| SBA pools | 3,937 | 50 | - | 3,987 |
| | $74,323 | $ 824 | $(8) | $75,139 |
| Held to Maturity: | | | | |
| Mortgage-backed securities – residential | $5,013 | $152 | $- | $5,165 |
| State and Municipal securities | 510 | 12 | - | 522 |
| | 5,523 | 164 | - | 5,687 |
| December 31, 2009: | | | | |
| Available for Sale: | | | | |
| Equity securities | $9 | $3 | $- | $12 |
| U.S. Government agency securities | 54,842 | 100 | (313) | 54,629 |
| Mortgage-backed securities – residential | 20,369 | 473 | - | 20,842 |
| | $75,220 | $576 | $(313) | $75,483 |
| Held to Maturity: | | | | |
| Mortgage-backed securities – residential | $6,098 | $86 | $(1) | $6,183 |

The Company's investment securities portfolio consists primarily of U.S. Government sponsored agency securities, U.S Government mortgage-backed securities, U.S. Government sponsored agency mortgage-backed securities, SBA pools, and State and Municipal securities.  The U.S. Government sponsored agency securities and the U.S. Government sponsored mortgage-backed securities have little credit risk because their principal and interest payments are backed by an agency of the U.S. Government.  At September 30, 2010 the Company's securities portfolio contained $7.4 million of U.S. Government mortgage-backed securities and SBA pools, including $1.3 million classified as held to maturity, and $6.1 million classified as available for sale.

The amortized cost and estimated fair value by contractual maturity of debt securities at September 30, 2010 are shown below.  Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations.

Note 3 – Securities (continued)

| | Available for Sale | | Held to Maturity | |
|---|---|---|---|---|
| | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| | (In Thousands) | | (In Thousands) | |
| Due in one year or less | $ - | $ - | $- | $- |
| Due after one year through five years | 7,320 | 7,348 | - | - |
| Due after five years through ten years | 20,576 | 20,704 | 510 | 522 |
| Due after ten years | 15,755 | 15,846 | - | - |
| Mortgage-backed securities – residential | 26,735 | 27,254 | 5,013 | 5,165 |
| SBA pools | 3,937 | 3,987 | - | - |
| | $ 74,323 | $ 75,139 | $ 5,523 | $5,687 |

For the nine months ended September 30, 2010 there was a $10,573 gross realized loss on sale of mortgage-backed securities held to maturity resulting from proceeds of $686,000, a $2,120 gross realized gain on sale of FHLMC common stock available for sale resulting from proceeds of $11,000, and a $95,033 gross realized gain on sale of U.S. government agency securities available for sale resulting from proceeds of $3,177,000. In accordance with accounting guidance, the Company was able to sell securities classified as held to maturity after the Company had already collected a substantial portion (at least 85%) of the principal outstanding at acquisition due either to prepayments or to scheduled principal and interest payments on the debt securities. For the nine months ended September 30, 2009 there was a $92,000 realized gain on sale of mortgage-backed securities classified as available for sale resulting from proceeds of $5.3 million.

No securities were pledged to secure public deposits or for any other purpose required or permitted by law at September 30, 2010 or at December 31, 2009.

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

Note 3 – Securities (continued)

| | Less than 12 Months | | 12 Months or More | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| | (In Thousands) | | | | | |
| September 30, 2010: | | | | | | |
| U.S. Government agency securities | $5,027 | $2 | $- | $- | $5,027 | $2 |
| Mortgaged-backed securities – residential | 1,487 | 6 | - | - | 1,487 | 6 |
| | $ 6,514 | $8 | $ - | $ - | $ 6,514 | $8 |
| December 31, 2009: | | | | | | |
| U.S. Government agency securities | $27,241 | $313 | $- | $- | $27,241 | $313 |
| Mortgaged-backed securities – residential | 442 | 1 | 18 | - | 460 | 1 |
| | $27,683 | $ 314 | $18 | $- | $27,701 | $314 |

Management evaluates securities for other-than-temporary impairment at least quarterly, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than the amortized cost basis, (2) the financial condition of the issuer (and guarantor, if any) and adverse conditions specifically related to the security, industry or geographic area, (3) failure of the issuer of the security to make scheduled interest or principal payments, (4) any changes to the rating of a security by a rating agency, (5) the presence of credit enhancements, if any, including the guarantee of the federal government or any of its agencies, and (6) whether the Company intends to sell or might be required to sell the debt securities. In 2009 and in the nine month period ended September 30, 2010, the Company did not record an other-than-temporary impairment charge.

At September 30, 2010, six U.S Government agency securities and one mortgage-backed security have been in a continuous unrealized loss position for less than twelve months. No U.S Government agency securities or mortgage-backed securities have been in a continuous unrealized loss position for twelve months or more. The U.S Government agency securities and mortgage-backed security were issued by U.S. government sponsored agencies and are paying in accordance with their terms with no deferrals of interest, or defaults. As management believes the Company does not intend to sell and will not be required to sell these securities prior to recovery or maturity, no declines are deemed to be other-than-temporary.

Note 4 - Federal Home Loan Bank of New York Stock

Federal law requires a member institution of the Federal Home Loan Bank System to hold stock of its district Federal Home Loan Bank (“FHLB”) according to a predetermined formula. This restricted stock is carried at cost.

Management evaluates the FHLB stock for impairment on a quarterly basis. Management’s determination of whether this investment is impaired is based on its assessment of the ultimate recoverability of its cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB.

No impairment charges were recorded related to the FHLB stock for the nine month period ended September 30, 2010 or in 2009.

Note 5 – FHLB Debt Restructure

In July 2010, the Company restructured a portion of its Federal Home Loan Bank advances by repaying $13.2 million of existing borrowings and replacing these borrowings with $13.2 million of new, lower cost FHLB advances. This transaction resulted in $638,000 in prepayment penalties that will be deferred and recognized in interest expense as an adjustment to the cost of the Company’s new borrowings in future periods. The existing borrowings were a combination of fixed-rate and amortizing advances with an average cost of 4.29% and an average duration of 1.47 years. The new borrowings are all fixed-rate borrowings with an average cost of 3.09% including the deferred adjustment to the carrying value of the new borrowings. The $13.2 million of new advances have an average duration of 3.11 years. The relevant accounting treatment for this transaction was an interpretation of the guidance provided in ASC 470-50. This transaction was executed as an earnings and interest rate risk strategy, resulting in lower FHLB advance costs and an extension of average duration.

Note 6 – Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the stockholders’ equity section of the consolidated balance sheets, such items, along with net income, are components of comprehensive income.

The components of other comprehensive income and related tax effects for the three and nine months ended September 30, 2010 and 2009 are as follows:

| | For the Three Months Ended September 30, | | For the Nine months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (In Thousands) | | (In Thousands) | |
| Unrealized holding gain on available for sale securities | $118 | $768 | $649 | $613 |
| Reclassification adjustment for realized gain included in net income | (95) | - | (97) | (92) |
| Net Unrealized Gain | 23 | 768 | 552 | 521 |
| Tax effect | 9 | 232 | 188 | 148 |
| Net of tax amount | $14 | $536 | $364 | $373 |

Note 7 - Earnings Per Common Share

Basic earnings per common share are calculated by dividing net income by the weighted-average number of common shares outstanding during the period. The Company has not granted any restricted stock awards or stock options and, during the three and nine months ended September 30, 2010 and 2009, had no potentially dilutive common stock equivalents. Unallocated common shares held by the ESOP are not included in the weighted-average number of common shares outstanding for purposes of calculating earnings per common share until they are committed to be released. The weighted average common shares outstanding were 1,728,148 for the three months ended September 30, 2010 and 1,727,280 for the nine months ended September 30, 2010, and 1,724,649 for the three months ended September 30, 2009 and 1,723,781 for the nine months ended September 30, 2009.

Note 8 - Recent Accounting Pronouncements

In January 2010, the FASB issued updated guidance on “Equity, Accounting for Distributions to Stockholders with Components of Stock and Cash”. The amendments in this update clarify that the stock portion of a distribution to stockholders that allows them to elect to receive cash or stock with a potential limitation on the total amount of cash that all stockholders can elect to receive in the aggregate is considered a share issuance that is reflected in earnings per share prospectively and is not a stock dividend. This update codifies the consensus reached in recent accounting guidance for Accounting for Stock Dividends, Including Distributions to Stockholders with Components of Stock and Cash. This update is effective for interim and annual periods ending on or after December 15, 2009, and should be applied on a retrospective basis. The adoption of this guidance did not have a material effect on the Company’s consolidated results of operations or financial position.

The FASB has issued ASU 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. This ASU requires some new disclosures and clarifies some existing disclosure requirements about fair value measurement as set forth in Codification Subtopic 820-10 to now require:

A reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers; and

In the reconciliation for fair value measurements using significant unobservable inputs, a reporting entity should present separately information about purchases, sales, issuances, and settlements.



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In addition, ASU 2010-06 clarifies the requirements of the following existing disclosures:

For purposes of reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities; and

A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements.

ASU 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The Company adopted the required provisions of ASU 2010-06, with no significant impact on its financial condition or results of operations.

The FASB has issued ASU 2010-18, Receivables (Topic 310): Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset, codifies the consensus reached in EITF Issue No. 09-I, "Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset." The amendments to the Codification provide that modifications of loans that are accounted for within a pool under Subtopic 310-30 do not result in the removal of those loans from the pool even if the modification of those loans would otherwise be considered a troubled debt restructuring. An entity will continue to be required to consider whether the pool of assets in which the loan is included is impaired if expected cash flows for the pool change. ASU 2010-18 does not affect the accounting for loans under the scope of Subtopic 310-30 that are not accounted for within pools. Loans accounted for individually under Subtopic 310-30 continue to be subject to the troubled debt restructuring accounting provisions within subtopic 310-40.

ASU 2010-18 is effective prospectively for modifications of loans accounted for within pools under Subtopic 310-30 occurring in the first interim or annual period ending on or after July 15, 2010. Early application is permitted. Upon initial adoption of ASU 2010-18, an entity may make a one-time election to terminate accounting for loans as a pool under Subtopic 310-30. This election may be applied on a pool-by-pool basis and does not preclude an entity from applying pool accounting to subsequent acquisitions of loans with credit deterioration. The adoption of this guidance did not impact the Company's financial position or results of operations.

The FASB issued ASU 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, in order to help investors assess the credit risk of a company's receivables portfolio and the adequacy of its allowance for credit losses held against the portfolios by expanding credit risk disclosures.

This ASU requires more information about the credit quality of financing receivables in the disclosures to consolidated financial statements, such as aging information and credit quality indicators. Both new and existing disclosures must be disaggregated by portfolio segment or class. The disaggregation of information is based on how a company develops its allowance for credit losses and how it manages its credit exposure.

The amendments in this Update apply to all public and nonpublic entities with financing receivables. Financing receivables include loans and trade accounts receivable. However, short-term trade accounts receivable, receivables measured at fair value or lower of cost or fair value, and debt securities are exempt from these disclosure amendments.

For public companies, the amendments that require disclosures as of the end of a reporting period are effective for periods ending on or after December 15, 2010. The amendments that require disclosures about activity that occurs

during a reporting period are effective for periods beginning on or after December 15, 2010. The adoption of this guidance will not impact the Company's financial position or results of operations, but will require new disclosures.

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

### General

Throughout the Management's Discussion and Analysis ("MD&A"), the term "the Company" refers to the consolidated entity of FSB Community Bankshares, Inc., Fairport Savings Bank, and Oakleaf Services Corporation, a wholly owned subsidiary of Fairport Savings Bank. At September 30, 2010, FSB Community Bankshares, MHC the Company's mutual holding company parent, held 946,050 shares, or 53.0%, of the Company's common stock, engaged in no significant activities, and was not included in the MD&A.

### Forward Looking Statements

This Quarterly Report contains forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties, including, among other things, changes in general economic conditions, either nationally or in our market areas, that are worse than expected; competition among depository and other financial institutions; inflation and changes in the interest rate environment that reduce our margins or reduce the fair value of financial instruments; adverse changes in the securities markets; changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements; our ability to enter new markets successfully and capitalize on growth opportunities; our ability to successfully integrate acquired entities, if any; changes in consumer spending, borrowing and savings habits; changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission and the Public Company Accounting Oversight Board; changes in our organization, compensation and benefit plans; changes in our financial condition or results of operations that reduce capital available to pay dividends; and changes in the financial condition or future prospects of issuers of securities that we own, that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. The Company wishes to advise readers that the factors listed above could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements.

The Company does not undertake, and specifically declines any obligation, to publicly release the results of any revisions that 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.

### Critical Accounting Policies

The most significant accounting policies followed by the Company are presented in Note 1 to the consolidated financial statements included in the Company's Annual Report filed on Form 10-K with the Securities and Exchange Commission on March 29, 2010. These policies, along with the disclosures presented in the other consolidated financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the consolidated financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of consolidated financial statement amounts to the methods, assumptions and estimates underlying those amounts, management has identified the determination of the allowance for loan losses, the evaluation of investment securities for other-than-temporary impairment and the valuation and recoverability of deferred tax assets to be the accounting areas that require the most subjective and complex judgments, and as such could be the most subject to revision as new information becomes available.

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Allowance for Loan Losses. The allowance for loan losses is the amount estimated by management as necessary to absorb credit losses incurred in the loan portfolio that are both probable and reasonably estimable at the balance sheet date. The amount of the allowance is based on significant estimates, and the ultimate losses may vary from such estimates as more information becomes available or conditions change. The methodology for determining the allowance for loan losses is considered a critical accounting policy by management due to the high degree of judgment involved, the subjectivity of the assumptions used and the potential for changes in the economic environment that could result in changes to the amount of the recorded allowance for loan losses.

As a substantial percentage of our loan portfolio is collateralized by real estate, appraisals of the underlying value of property securing loans are critical in determining the amount of the allowance required for specific loans. Assumptions are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly affect the valuation of a property securing a loan and the related allowance. Management carefully reviews the assumptions supporting such appraisals to determine that the resulting values reasonably reflect amounts realizable on the related loans.

Management performs a quarterly evaluation of the adequacy of the allowance for loan losses. We consider a variety of factors in establishing this estimate including, but not limited to, current economic conditions, delinquency statistics, geographic concentrations, the adequacy of the underlying collateral, the financial strength of the borrower, results of internal loan reviews, and other relevant factors. This evaluation is inherently subjective as it requires material estimates by management that may be susceptible to significant change based on changes in economic and real estate market conditions. Various banking regulators, as an integral part of their examination process, also review the allowance for loan losses. Such regulators may require, based on their judgments about information available to them at the time of their examination, that certain loan balances be charged off or require that adjustments be made to the allowance for loan losses when their credit evaluations differ from those of management. Additionally, the allowance for loan losses is determined, in part, by the composition and size of the loan portfolio which represents the largest asset type on the consolidated statement of financial condition.

The evaluation has specific, general, and unallocated components. The specific component relates to loans that are classified as doubtful, substandard, or special mention. For such loans that are also classified as impaired, an allowance is generally established when the collateral value of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Actual loan losses may be significantly more than the allowance we have established which could have a material negative effect on our financial results.

Other than temporary impairment. When the fair value of a held to maturity or available for sale security is less than its amortized cost basis, an assessment is made at the balance sheet date as to whether other-than-temporary impairment (OTTI) is present.

The Company considers numerous factors when determining whether a potential OTTI exists and the period over which the debt security is expected to recover. The principal factors considered are (1) the length of time and the extent to which the fair value has been less than the amortized cost basis, (2) the financial condition of the issuer (and guarantor, if any) and adverse conditions specifically related to the
security, industry or geographic area, (3) failure of the issuer of the security to make scheduled interest or principal payments, (4) any changes to the rating of a security by a rating agency, and (5) the presence of credit enhancements, if any, including the guarantee of the federal government or any of its agencies.

For debt securities, OTTI is considered to have occurred if (1) the Company intends to sell the security, (2) it is more likely than not the Company will be required to sell the security before recovery of its amortized cost basis, or (3) if the present value of expected cash flows is not sufficient to recover the entire amortized cost basis.

In determining whether OTTI has occurred for equity securities, the Company considers the applicable factors described above and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

For debt securities, credit-related OTTI is recognized in income while noncredit-related OTTI on securities not expected to be sold is recognized in other comprehensive income (loss). Credit-related OTTI is measured as the difference between the present value of an impaired security's expected cash flows and its amortized cost basis. Noncredit-related OTTI is measured as the difference between the fair value of the security and its amortized costs less any credit-related losses recognized. For securities classified as held to maturity, the amount of OTTI recognized in other comprehensive income (loss) is accreted to the credit-adjusted expected cash flow amounts of the securities over future periods. For equity securities, the entire amount of OTTI is recognized in income.

Deferred Tax Assets. Deferred tax assets and liabilities represent the future tax return consequences of temporary differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion of the deferred tax assets will not be realized. Deferred tax assets and liabilities are reflected at income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

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

Total Assets. Total assets increased by $1.2 million, or 0.5%, to $215.6 million at September 30, 2010 from $214.4 million at December 31, 2009. The modest growth in assets for the nine months ended September 30, 2010 was the result, in part, of management's ongoing strategy of selling long-term fixed rate mortgages in the current low interest rate environment. The increase in total assets primarily reflects increases in cash and cash equivalents, and loans held for sale, partially offset by decreases in securities available for sale, securities held to maturity, net loans receivable, and Federal Home Loan Bank stock.

Cash and cash equivalents, primarily interest-earning deposits at the Federal Reserve Bank and Federal Home Loan Bank, increased by $4.7 million, or 78.2%, to $10.6 million at September 30, 2010 from $6.0 million at December 31, 2009. The Bank continues to maintain a strong liquidity position, retaining significant cash and cash equivalent balances that will allow the Bank to capitalize on investment and lending opportunities that may arise in future periods.

Total securities decreased by $919,000, or 1.1%, to $80.7 million at September 30, 2010 from $81.6 million at December 31, 2009. Securities classified as available for sale decreased $344,000 to $75.1 million at September 30, 2010 from $75.5 million at December 31, 2009. The $344,000 decrease was attributable to maturities and calls of $71.9 million of U.S. government agency securities classified as available for sale, and $6.2 million in principal repayments received and amortization, partially offset by the purchase of $64.3 million of U.S. government agency securities, $4.0 million of SBA pools, and $11.9 million of mortgage-backed securities, and a $552,000 increase in the fair value of securities available for sale. Management elected to diversify the investment portfolio by purchasing SBA pools and State and Municipal securities, to lessen the concentration in callable U.S government agency securities. We sold $8,750 of FHLMC common stock and $2.9 million in U.S. government agency securities held in available for sale securities for realized gains on sale of $2,120 and $95,033 respectively in the first nine months of 2010.

Securities classified as held to maturity decreased $575,000, or 9.4% to $5.5 million at September 30, 2010 from $6.1 million at December 31, 2009 primarily as a result of the sale of $691,000 of mortgage-backed securities with a realized loss of $10,573 and $394,000 in principal repayments and amortization, partially offset by the purchase of $510,000 in State and Municipal securities. In accordance with accounting guidance, the sale of securities classified as held to maturity occurred after the Company received a minimum of 85% of the principal outstanding at acquisition due either to prepayments or to scheduled principal and interest payments on the debt securities. All securities purchased in 2010, with the exception of State and Municipal bonds classified as held to maturity, have been classified as available for sale to provide a portfolio of marketable securities for liquidity as an alternative to borrowings. The Company has reviewed its investment securities portfolio for the three and nine months ended September 30, 2010, and has determined that no other-than-temporary impairment exists in the portfolio.

Investment in FHLB of New York stock decreased by $278,000, or 14.7%, to $1.6 million at September 30, 2010, from $1.9 million at December 31, 2009 due to stock redemptions. The FHLB of New York requires members to purchase and redeem stock based on the level of borrowings.

Net loans receivable decreased $2.4 million, or 2.1%, to $113.9 million at September 30, 2010 from $116.4 million at December 31, 2009. The Company continues to execute its business plan of making high quality loans to existing and new customers in our market area with $25.3 million of fixed-rate loan refinances and home purchase originations in the first nine months of 2010. The Bank sold $7.4 million of long-term, fixed-rate conventional residential mortgage loans and FHA mortgage loans as a balance sheet management strategy in the first nine months of 2010 to reduce interest rate risk in a potentially rising rate environment. The $7.4 million of sold loans included $3.0 million in direct broker loans and $4.4 million in correspondent loans. The Bank sold these loans at a gain of $238,000 which was recorded in other income, and will realize servicing income on these loans as long as they have outstanding balances. Management believed that selling these loans was a prudent interest rate risk decision. Total loans sold and serviced as of September 30, 2010 totaled $18.3 million compared to $16.8 million as of December 31, 2009. We may experience further declines in our total residential mortgages loan portfolio with additional mortgage loan sales. In the current interest rate environment we intend to continue to sell a portion of our existing fixed-rate residential mortgage loans on a servicing retained basis resulting in additional loan servicing income, as well as selling the majority of FHA mortgage loans originated on a servicing released basis. At September 30, 2010, the Bank had $695,000 in loans held for sale comprised of six FHA mortgage loans totaling $607,000 and one conventional loan for $88,000 originated and closed by the Bank in the third quarter of 2010 that have been committed for sale in the secondary market and will be delivered and funded in the fourth quarter of 2010.

The Bank opened three mortgage loan origination offices in January of 2010 located in Canandaigua, Pittsford, and Watertown, New York. Six additional mortgage loan originators and three support staff members were hired at these locations. The Bank intends to continue to emphasize aggressive, yet prudent originations of loans secured by one-to-four family residential real estate. The mortgage origination offices were established as Fairport Mortgage, a division of Fairport Savings Bank. The primary responsibilities of the Fairport Mortgage origination team will be to originate mortgage loans to increase the bank’s current mortgage loan portfolio, to originate loans for the Bank to close and sell as a correspondent to outside investors, and also to broker a select portion of residential mortgage loans directly to other investors.

The Company has never been involved with, and has no direct exposure to, sub-prime lending activities. Credit quality continues to be the highest priority when underwriting loans. Subjective judgments about a borrower’s ability to repay and the value of any underlying collateral are made prior to approving a loan.

We believe our stringent underwriting standards have directly resulted in our significantly low level of non-accruing loans.

Deposits and Borrowings. Total deposits increased by $5.8 million, or 3.7%, to $162.3 million at September 30, 2010 from $156.5 million at December 31, 2009. The $5.8 million deposit increase consists of core deposit growth of $5.5 million including non-interest bearing checking accounts, NOW accounts, money market accounts, and savings accounts, and $278,000 million in non-core deposit growth including IRAs and Certificates of Deposit. Management believes that the deposit growth is the result, in part, of customers' preference for the flexibility provided by short-term core deposits in the current low interest rate environment, as well as the Bank's competitive strength in our market.

The net deposit growth for the first nine months of 2010 is primarily attributable to the Webster branch growth of $6.6 million and the Penfield branch growth of $2.0 million, offset by decreases in the Fairport and Irondequoit branch offices totaling $2.8 million. We believe our marketing efforts at these newer branch offices and focus on customer service has resulted in attracting new customers and increasing core deposits.

Long term borrowings decreased by $5.8 million, or 16.7%, to $28.8 million at September 30, 2010 from $34.6 million on December 31, 2009. The Company used its increased deposits as a source of liquidity to decrease Federal Home Loan Bank advances and does not intend to renew maturing FHLB advances during the remainder of 2010 as a result of management's decision to replace wholesale borrowings through core deposit growth.

In July 2010, the Bank restructured a portion of its Federal Home Loan Bank advances by repaying $13.2 million of existing borrowings and replacing these borrowings with $13.2 million of new, lower cost FHLB advances. This transaction resulted in $638,000 of prepayment penalties that were deferred and will be recognized in interest expense as an adjustment to the cost of the Company's new borrowings in future periods. The existing borrowings were a combination of fixed-rate and amortizing advances with an average cost of 4.29% and an average duration of 1.47 years. The new borrowings are all fixed-rate advances with an average cost of 3.09% including the deferred adjustment to the carrying value of the new borrowings. The $13.2 million of new advances have an average duration of 3.11 years. The relevant accounting treatment for this transaction was an interpretation of the guidance provided in ASC 470-50. This transaction was executed as an earnings and interest rate risk strategy, resulting in lower FHLB advance costs and an extension in average duration.

Stockholders' Equity. Total stockholders' equity increased by $547,000 or 2.7%, to $20.9 million at September 30, 2010 from $20.4 million at December 31, 2009. The increase resulted from $160,000 in net income, an increase of $364,000 in accumulated other comprehensive income, and a $23,000 increase in committed ESOP shares. The Bank continued to exceed the requirement to be categorized as well capitalized, the highest standard of capital rating as defined by the Bank's regulators, at the end of the third quarter 2010.

Non-Performing Assets. At September 30, 2010 and December 31, 2009 the Company had one loan for $23,000 classified as non-performing. At September 30, 2010 the Company had no foreclosed assets compared to one foreclosed asset for $79,000 at December 31, 2009. At September 30, 2010 non-performing assets as a percent of total assets was 0.01%, and at December 31, 2009 non-performing assets as a percent of total assets was 0.05%, significantly below the industry average in both periods. At September 30, 2010, management has evaluated the Bank's loan loss reserve and believes it is adequate based on the quality of the current loan portfolio. At September 30, 2010, there were no other assets that are not disclosed as classified or special mention, where known information about possible credit problems of borrowers caused us to have serious doubts as to the ability of the borrowers to comply with the present loan repayment terms and which may result in impairment or disclosure of such loans in the future.

Average balances and yields. The following tables set forth average balance sheets, average yields and costs, and certain other information at and for the periods indicated. All average balances are daily average balances. Non-accrual loans were included in the computation of average balances, where applicable, but have been reflected in the table as loans carrying a zero yield. The yields set forth below include the effect of deferred fees, discounts and premiums that are amortized or accreted to interest income. Yields have been annualized.

| | For the Three Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2010 | | | | 2009 | | | |
| | Average Balance | Interest Income/ Expense | Yield/ Cost | | Average Balance | Interest Income/ Expense | Yield/ Cost | |
| | (Dollars in thousands) | | | | | | | |
| Interest-earning assets: | | | | | | | | |
| Loans | $117,871 | $1,614 | 5.48 | % | $117,379 | $1,669 | 5.69 | % |
| Securities - taxable | 49,769 | 285 | 2.29 | | 52,972 | 415 | 3.13 | |
| Mortgage-backed securities | 28,493 | 218 | 3.06 | | 27,468 | 264 | 3.84 | |
| State and Municipal securities (1) | 433 | 4 | 3.70 | | - | - | - | |
| Other | 13,088 | 7 | 0.21 | | 5,335 | 2 | 0.15 | |