

NORTHEAST COMMUNITY BANCORP INC  
Form 10-Q  
November 20, 2012

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 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, 2012

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: 0-51852

**Northeast Community Bancorp, Inc.**

(Exact name of registrant as specified in its charter)

United States of America (State or other jurisdiction of incorporation or organization)	06-1786701 (I.R.S. Employer Identification No.)
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325 Hamilton Avenue, White Plains, New York (Address of principal executive offices)	10601 (Zip Code)
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**(914) 684-2500**

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(Registrant's telephone number, including area code)

**N/A**

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(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. (Check one)

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

Smaller Reporting Company

(Do not check if a smaller reporting company)

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

As of November 9, 2012, there were 12,644,752 shares of the registrant's common stock outstanding.

**Explanatory Note**

In connection with the filing of this Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 (“Form 10-Q”), Northeast Community Bancorp, Inc. (the “Company”) is relying on Release No. 68224 issued by the Securities and Exchange Commission (the “SEC”), titled “Order Under Section 17A and Section 36 of the Securities Exchange Act of 1934 Granting Exemptions from Specified Provisions of the Exchange Act and Certain Rules Thereunder,” which provides that filings by registrants unable to meeting filing deadlines due to Hurricane Sandy and its aftermath shall be considered timely so long as the filing is made on or before November 21, 2012, and the conditions contained therein are satisfied. The Company was unable to file its Form 10-Q on a timely basis due to the disruptions caused by Hurricane Sandy on the Company’s offices and employees, as well as the Company’s independent auditors, which are all primarily located in regions of New York and New Jersey that were impacted by Hurricane Sandy.

**NORTHEAST COMMUNITY BANCORP, INC.**

**Table of Contents**

Financial Information

Financial Statements (Unaudited)

Consolidated Statements of Financial Condition at September 30, 2012 and December 31, 2011

Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2012 and 2011

Consolidated Statements of Comprehensive Income (Loss) for the Three and Nine Months Ended September 30, 2012 and 2011

Consolidated Statements of Stockholders' Equity for the Nine Months Ended September 30, 2012 and 2011

Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2012 and 2011

Notes to Consolidated Financial Statements

Management's Discussion and Analysis of Financial Condition and Results of Operations

Quantitative and Qualitative Disclosures about Market Risk

Controls and Procedures

Other Information

Legal Proceedings

A. Risk Factors

Unregistered Sales of Equity Securities and Use of Proceeds

Defaults Upon Senior Securities

Mine Safety Disclosures

Other Information

Exhibits

Signatures

Table of Contents

**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (UNAUDITED)**

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ASSETS	
Cash and amounts due from depository institutions	\$6
Interest-bearing deposits	4
Cash and cash equivalents	4
Certificates of deposit	6
Securities available-for-sale	1
Securities held-to-maturity (fair value of \$13,647 and \$16,662, respectively)	1
Loans receivable, net of allowance for loan losses of \$5,705 and \$7,397, respectively	3
Premises and equipment, net	1
Federal Home Loan Bank of New York stock, at cost	1
Bank owned life insurance	1
Accrued interest receivable	9
Goodwill	1
Intangible assets	4
Real estate owned	-
Other assets	6
Total assets	\$4
LIABILITIES AND STOCKHOLDERS' EQUITY	
Liabilities	
Deposits:	
Non-interest bearing	\$2
Interest bearing	2
Total deposits	3
Advance payments by borrowers for taxes and insurance	4
Federal Home Loan Bank advances	1
Accounts payable and accrued expenses	3
Total liabilities	3
Stockholders' equity:	
Preferred stock, \$0.01 par value; 1,000,000 shares authorized, none issued	-
Common stock, \$0.01 par value; 19,000,000 shares authorized; 13,225,000 shares issued; 12,644,752 shares outstanding	1
Additional paid-in capital	5
Unearned Employee Stock Ownership Plan ("ESOP") shares	(

Retained earnings	5
Treasury stock – at cost, 580,248 shares	(
Accumulated other comprehensive loss	(
Total stockholders' equity	1
Total liabilities and stockholders' equity	\$4

See Notes to Consolidated Financial Statements

Table of Contents**CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)**

	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2012	
	2011	2012	2011	2012
	(In thousands, except per share data)			
<b>INTEREST INCOME:</b>				
Loans	\$4,817	\$5,378	\$14,678	\$16,314
Interest-earning deposits	7	9	29	29
Securities – taxable	116	186	379	548
<b>Total Interest Income</b>	<b>4,940</b>	<b>5,573</b>	<b>15,086</b>	<b>16,891</b>
<b>INTEREST EXPENSE:</b>				
Deposits	634	1,127	2,451	3,428
Borrowings	139	161	419	482
<b>Total Interest Expense</b>	<b>773</b>	<b>1,288</b>	<b>2,870</b>	<b>3,910</b>
<b>Net Interest Income</b>	<b>4,167</b>	<b>4,285</b>	<b>12,216</b>	<b>12,981</b>
<b>PROVISION FOR LOAN LOSSES</b>	<b>1,912</b>	<b>393</b>	<b>2,029</b>	<b>1,113</b>
<b>Net Interest Income after Provision for Loan Losses</b>	<b>2,255</b>	<b>3,892</b>	<b>10,187</b>	<b>11,868</b>
<b>NON-INTEREST INCOME:</b>				
Other loan fees and service charges	293	96	716	244
Gain (loss) on disposition of equipment	—	15	(9 )	10
Earnings on bank owned life insurance	163	149	448	442
Investment advisory fees	242	259	681	670
Other	4	(2 )	10	5
<b>Total Non-Interest Income</b>	<b>702</b>	<b>517</b>	<b>1,846</b>	<b>1,371</b>
<b>NON-INTEREST EXPENSES:</b>				
Salaries and employee benefits	2,554	1,862	6,928	5,182
Occupancy expense	375	294	983	884
Equipment	219	173	577	458
Outside data processing	265	185	780	592
Advertising	81	58	194	122
FDIC insurance premiums	91	87	283	315
Other	1,219	1,072	3,485	2,579
<b>Total Non-Interest Expenses</b>	<b>4,804</b>	<b>3,731</b>	<b>13,230</b>	<b>10,132</b>

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Income (Loss) before Provision (Benefit) for Income Taxes	(1,847 )	678	(1,197 )	3,107
<b>PROVISION (BENEFIT) FOR INCOME TAXES</b>	<b>(847 )</b>	<b>211</b>	<b>(714 )</b>	<b>1,081</b>
Net Income (Loss)	\$ (1,000 )	\$ 467	\$ (483 )	\$ 2,026
Net Income (Loss) per Common Share – Basic	\$ (0.08 )	\$ 0.04	\$ (0.04 )	\$ 0.16
Weighted Average Number of Common Shares Outstanding – Basic	12,298	12,277	12,292	12,518
Dividends Declared per Common Share	\$—	\$ 0.03	\$ 0.06	\$ 0.09

See Notes to Consolidated Financial Statements



Table of Contents

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)**

	Three Months Ended September 30, (In thousands)		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income (Loss)				
Other comprehensive income (loss):	\$ (1,000)	\$ 467	\$ (483 )	\$ 2,026
Pension liability – DRP, net of taxes of \$50, \$6, \$84, and \$21, respectively	(63 )	8	(126 )	66
Unrealized loss on securities available for sale, net of taxes of \$0	—	—	—	(1 )
Total comprehensive income (loss)	\$ (1,063)	\$ 475	\$ (609 )	\$ 2,091

See Notes to Consolidated Financial Statements

Table of Contents**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (UNAUDITED)****Nine Months Ended September 30, 2012 and 2011 (in thousands)**

	Common Stock	Additional Paid-in Capital	Unearned ESOP Shares	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total Equity
Balance at December 31, 2010	\$ 132	\$ 57,391	\$ (3,888 )	\$ 55,335	\$ (664 )	\$ (167 )	\$ 108,139
Net income				2,026			2,026
Other comprehensive income						65	65
Purchase of 470,048 shares of treasury stock	—	—	—	—	(3,049)	—	(3,049 )
Cash dividend declared (\$.09 per share)	—	—	—	(463 )	—	—	(463 )
ESOP shares earned	—	(72 )	194	—	—	—	122
Balance – September 30, 2011	\$ 132	\$ 57,319	\$ (3,694 )	\$ 56,898	\$ (3,713 )	\$ (102 )	\$ 106,840
Balance at December 31, 2011	\$ 132	\$ 57,292	\$ (3,629 )	\$ 57,076	\$ (3,712 )	\$ (94 )	\$ 107,065
Net loss				(483 )			(483 )
Other comprehensive loss						(126 )	(126 )
Cash dividend declared (\$.06 per share)				(518 )			(518 )
ESOP shares earned		(83 )	194				111
Balance – September 30, 2012	\$ 132	\$ 57,209	\$ (3,435 )	\$ 56,075	\$ (3,712 )	\$ (220 )	\$ 106,049

See Notes to Consolidated Financial Statements

Table of Contents

## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine Months Ended September 30, 2012      2011 (In thousands)	
Cash Flows from Operating Activities:		
Net income (loss)	\$(483 )	\$2,026
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Net amortization of securities premiums and discounts, net	33	34
Provision for loan losses	2,029	1,113
Depreciation	497	515
Net amortization of deferred loan fees and costs	147	118
Amortization of intangible assets	20	45
Deferred income tax expense (benefit)	529	(228 )
Accretion of discount on note payable	—	6
Retirement plan expense	303	507
(Gain) loss on disposal of equipment	9	(10 )
Earnings on bank owned life insurance	(448 )	(442 )
ESOP compensation expense	111	122
Decrease in accrued interest receivable	537	160
Decrease in other assets	(1,006 )	663
Increase (decrease) in accounts payable and accrued expenses	(2,136 )	136
Net Cash Provided by Operating Activities	142	4,765
Cash Flows from Investing Activities:		
Net decrease in loans	7,211	6,684
Purchase of securities held-to-maturity	—	(984 )
Principal repayments on securities available-for-sale	17	10
Principal repayments on securities held-to-maturity	3,007	3,360
Proceeds from maturities of certificates of deposit	1,992	—
Redemption of Federal Home Loan Bank of New York stock	278	251
Proceeds from disposition of equipment	—	10
Purchases of bank owned life insurance	(2,500 )	—
Purchases of premises and equipment	(3,935 )	(1,334 )
Net Cash Provided by Investing Activities	6,070	7,997
Cash Flows from Financing Activities:		
Net increase (decrease) in deposits	(34,637)	2,448
Proceeds from FHLB of NY advances	—	10,000
Repayment of FHLB of NY advances	(5,000 )	(15,000)
Purchase of treasury stock	—	(3,049 )
Increase in advance payments by borrowers for taxes and insurance	661	913
Cash dividends paid to minority shareholders	(518 )	(463 )
Net Cash Used in Financing Activities	(39,494)	(5,151 )
Net Increase (Decrease) in Cash and Cash Equivalents	(33,282)	7,611
Cash and Cash Equivalents - Beginning	82,583	44,453

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Cash and Cash Equivalents - Ending	\$49,301	\$52,064
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SUPPLEMENTARY CASH FLOWS INFORMATION

Income taxes paid	\$2,375	\$705
Interest paid	\$2,870	\$3,428

SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING ACTIVITIES

Real estate owned transferred to premises and equipment	\$620	\$—
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See Notes to Consolidated Financial Statements

5

Table of Contents

**NORTHEAST COMMUNITY BANK**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 – BASIS OF PRESENTATION**

Northeast Community Bancorp, Inc. (the “Company”) is a federally-chartered corporation organized as a mid-tier holding company for Northeast Community Bank (the “Bank”), in conjunction with the Bank’s reorganization from a mutual savings bank to the mutual holding company structure on July 5, 2006. The Bank is a New York State-chartered savings bank and completed its conversion from a federally-chartered savings bank effective as of the close of business on June 29, 2012. The accompanying unaudited consolidated financial statements include the accounts of the Company, the Bank and the Bank’s wholly owned subsidiaries, New England Commercial Properties, LLC (“NECP”) and NECB Financial Services Group, LLC. NECB Financial Services Group was formed by the Bank in the second quarter of 2012 as a complement to the Bank’s existing investment advisory and financial planning services division, Hayden Wealth Management. As of the filing of this Form 10-Q NECB Financial Services Group has not conducted any business. All significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements were prepared in accordance with generally accepted accounting principles for interim financial information as well as instructions for Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information or disclosures necessary for the presentation of financial position, results of operations, changes in stockholders’ equity and cash flows in conformity with accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine-month periods ended September 30, 2012 are not necessarily indicative of the results that may be expected for the full year or any other interim period. The December 31, 2011 consolidated statement of financial condition data was derived from audited consolidated financial statements, but does not include all disclosures required by U.S. generally accepted accounting principles. That data, along with the interim financial information presented in the consolidated statements of financial condition, operations, comprehensive income (loss), stockholders’ equity, and cash flows should be read in conjunction with the consolidated financial statements and notes thereto, included in the Company’s annual report on Form 10-K for the year ended December 31, 2011.

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain recorded amounts and disclosures. Accordingly, actual results could differ from those estimates. The most significant estimate pertains to the allowance for loan losses. In preparing these consolidated financial statements, the Company evaluated the events that occurred after September 30, 2012 and through the date these consolidated financial statements were issued.

Loans

Loans are stated at unpaid principal balances plus net deferred loan origination fees and costs less an allowance for loan losses. Interest on loans receivable is recorded on the accrual basis. An allowance for uncollected interest is established on loans where management has determined that the borrowers may be unable to meet contractual principal and/or interest obligations or where interest or principal is 90 days or more past due, unless the loans are well secured and in the process of collection. When a loan is placed on nonaccrual, an allowance for uncollected interest is established and charged against current income. Thereafter, interest income is not recognized unless the financial condition and payment record of the borrower warrant the recognition of interest income. Interest on loans that have been restructured is accrued according to the renegotiated terms, unless on non-accrual. Net loan origination fees and costs are deferred and amortized into income over the contractual lives of the related loans by use of the level yield method. Past due status of loans is based upon the contractual due date.

### **Allowance for Loan Losses**

The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the statement of financial condition date and is recorded as a reduction to loans. The allowance for loan losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors.

Table of Contents

**NOTE 1 – BASIS OF PRESENTATION (Continued)**

**Allowance for Loan Losses (Continued)**

This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The allowance consists of specific and general reserves. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, a specific allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment records, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis.

The Company does not evaluate consumer or residential one- to four-family loans for impairment, unless such loans are part of a larger relationship that is impaired, or are classified as a troubled debt restructuring.

Loans whose terms are modified are classified as troubled debt restructurings if the Company grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate, a below market rate, or an extension of a loan's stated maturity date. Adversely classified, non-accrual troubled debt restructurings may be reclassified as accruing loans if principal and interest payments, under the modified terms, are current for six consecutive months after modification.

The estimated fair values of substantially all of the Company's impaired loans are measured based on the estimated fair value of the loan's collateral or discounted cash flows.

For loans secured by real estate, estimated fair values are determined primarily through in-house or third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated

certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable aging or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

The general component covers pools of loans by loan class including loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate and consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates and expected loss given default derived from the Company's internal risk rating process for each of these categories of loans, adjusted for qualitative factors. These qualitative risk factors include:

- 1.Changes in policies and procedures in underwriting standards and collections.
- 2.Changes in economic conditions.
- 3.Changes in nature and volume of lending.
- 4.Experience of origination team.
- 5.Changes in past due loan volume and severity of classified assets.
- 6.Quality of loan review system.
- 7.Collateral values in general throughout lending territory.

7



Table of Contents

**NOTE 1 – BASIS OF PRESENTATION (Continued)**

**Allowance for Loan Losses (Continued)**

8. Concentrations of credit.
9. Competition, legal and regulatory issues.

Each factor is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss calculation.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Company has a structured loan rating process which allows for a periodic review of its loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type of collateral and financial condition of the borrowers. The Company's President is ultimately responsible for the timely and accurate risk rating of the loan portfolio.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments, for commercial, residential and consumer loans. Credit quality risk ratings include classifications of pass, special mention, substandard, doubtful and loss. Loans criticized as special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses. Loans not classified are rated pass.

In addition, banking regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the allowance for loan losses is adequate as of September 30, 2012.

**NOTE 2 – EARNINGS PER SHARE**

Basic earnings per common share is calculated by dividing the net income available to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share is computed in a manner similar to basic earnings per common share except that the weighted average number of common shares outstanding is increased to include the incremental common shares (as computed using the treasury stock method) that would have been outstanding if all potentially dilutive common stock equivalents were issued during the period. Common stock equivalents may include restricted stock awards and stock options. Anti-dilutive shares are common stock equivalents with weighted-average exercise prices in excess of the weighted-average market value for the periods presented. The Company has not granted any restricted stock awards or stock options and, during the three and nine-month periods ended September 30, 2012 and 2011, had no potentially dilutive common stock equivalents. Unallocated common shares held by the Employee Stock Ownership Plan (“ESOP”) are not included in the weighted-average number of common shares outstanding for purposes of calculating both basic and diluted earnings per common share until they are committed to be released.

### **NOTE 3 – EMPLOYEE STOCK OWNERSHIP PLAN**

As of December 31, 2011 and September 30, 2012, the ESOP trust held 518,420 shares of the Company’s common stock, which represents all allocated and unallocated shares held by the plan. As of December 31, 2011, the Company had allocated 129,605 shares to participants, and an additional 25,921 shares had been committed to be released. As of September 30, 2012, the Company had allocated 155,526 shares to participants, and an additional 19,441 shares had been committed to be released.

Table of Contents**NOTE 3 – EMPLOYEE STOCK OWNERSHIP PLAN (Continued)**

The Company recognized compensation expense of \$35,000 and \$42,000 during the three-month periods ended September 30, 2012 and 2011, respectively, and \$111,000 and \$122,000 during the nine-month periods ended September 30, 2012 and 2011, respectively, which equals the fair value of the ESOP shares when they became committed to be released.

**NOTE 4 -Outside Director Retirement Plan (“DRP”)**

Periodic expenses for the Company’s DRP were as follows:

	Three Months Ended September 30, (In thousands)		Nine Months Ended September 30,	
	2012	2011	2012	2011
Service cost	\$ 12	\$ 14	\$ 37	\$ 42
Interest cost	13	10	38	30
Amortization of prior service cost	5	5	16	15
Amortization of actuarial loss	—	1	—	4
Total	\$ 30	\$ 30	\$ 91	\$ 91

This plan is a non-contributory defined benefit pension plan covering all non-employee directors meeting eligibility requirements as specified in the plan document.

**NOTE 5 – INVESTMENTS**

The following tables sets forth the amortized cost and fair values of our securities portfolio at the dates indicated (in thousands):

Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
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At September 30, 2012

Securities available for sale:

Mortgage-backed securities – residential:

Federal Home Loan Mortgage Corporation	\$ 78	\$ 2	\$ —	\$ 80
Federal National Mortgage Association	50	2	—	52
Total	\$ 128	\$ 4	\$ —	\$ 132

Securities held to maturity:

Mortgage-backed securities – residential:

Government National Mortgage Association	\$9,789	\$ 445	\$ —	\$ 10,234
Federal Home Loan Mortgage Corporation	275	8	—	283
Federal National Mortgage Association	226	10	—	236
Collateralized mortgage obligations-GSE	2,768	125	—	2,893
Other	1	—	—	1
Total	\$ 13,059	\$ 588	\$ —	\$ 13,647

Table of Contents**NOTE 5 – INVESTMENTS (Continued)**

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
At December 31, 2011				
Securities available for sale:				
Mortgage-backed securities – residential:				
Federal Home Loan Mortgage Corporation	\$93	\$ 2	\$ —	\$95
Federal National Mortgage Association	52	2	—	54
Total	\$145	\$ 4	\$ —	\$149
Securities held to maturity:				
Mortgage-backed securities – residential:				
Government National Mortgage Association	\$11,884	\$ 414	\$ —	\$12,298
Federal Home Loan Mortgage Corporation	299	8	—	307
Federal National Mortgage Association	275	7	—	282
Collateralized mortgage obligations-GSE	3,640	134	—	3,774
Other	1	—	—	1
Total	\$16,099	\$ 563	\$ —	\$16,662

Contractual final maturities of mortgage-backed securities available for sale were as follows:

	September 30, 2012	
	Amortized Cost	Fair Value
	(In thousands)	
Due after five but within ten years	\$ 29	\$ 29
Due after ten years	99	103
	\$ 128	\$ 132

Contractual final maturities of mortgage-backed securities held to maturity were as follows:

	September 30, 2012	
	Amortized Cost	Fair Value
	(In thousands)	
Due after one but within five years	\$46	\$ 48
Due after five but within ten years	168	174
Due after ten years	12,845	13,425
	\$13,059	\$13,647

The maturities shown above are based upon contractual final maturity. Actual maturities will differ from contractual maturities due to scheduled monthly repayments and due to the underlying borrowers having the right to prepay their obligations.

#### **NOTE 6 – FAIR VALUE DISCLOSURES**

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The Company's securities available for sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets and liabilities on a non-recurring basis, such as securities held to maturity, impaired loans and other real estate owned. U.S. GAAP has established 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 are as follows:

Table of Contents**NOTE 6 – Fair Value DISCLOSURES (Continued)**

*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's 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 financial assets measured at fair value on a recurring and non-recurring basis, the fair value measurements by level within the fair value hierarchy used are as follows:

Description	Total	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
September 30, 2012:				
(In thousands)				
Recurring:				
Mortgage-backed securities - residential:				
Federal Home Loan Mortgage Corporation	\$80	\$ —	\$ 80	\$ —
Federal National Mortgage Association	52	—	52	—
Nonrecurring:				
Impaired loans	12,956	—	—	12,956
December 31, 2011:				
Recurring:				
Mortgage-backed securities - residential:				
Federal Home Loan Mortgage Corporation	\$95	\$ —	\$ 95	\$ —
Federal National Mortgage Association	54	—	54	—
Nonrecurring:				
Impaired loans	9,163	—	—	9,163

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Company has utilized Level 3 inputs to determine fair value:

(In thousands)	Quantitative Information about Level 3 Fair Value Measurements			
	Fair Value Estimate	Unobservable Valuation Techniques	Input	Range
September 30, 2012:				
Impaired loans	\$12,956	Appraisal of collateral (1)	Appraisal adjustments (2)	0% to 63.0%
			Liquidation expenses (2)	2% to 8.0%

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which include various level 3 inputs which are not identifiable.

Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated (2) liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.



Table of Contents

**NOTE 6 – Fair Value DISCLOSURES (Continued)**

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 sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective year-ends and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year-end.

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at September 30, 2012 and December 31, 2011:

**Cash and Cash Equivalents, Certificates of Deposit and Accrued Interest Receivable and Payable**

For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

**Securities**

Fair values for securities available for sale and held to maturity are determined utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayments speeds, credit information and the security's terms and conditions, among other things.

**Loans Receivable**

Fair values are estimated for portfolios of loans with similar financial characteristics. The total loan portfolio is first divided into performing and non-performing categories. Performing loans are then segregated into adjustable and fixed rate interest terms. Fixed rate loans are segmented by type, such as construction and land development, other

loans secured by real estate, commercial and industrial loans, and loans to individuals. Certain types, such as commercial loans and loans to individuals, are further segmented by maturity and type of collateral.

For performing loans, fair value is calculated by discounting scheduled future cash flows through estimated maturity using a current market rate. The discounted value of the cash flows is reduced by a credit risk adjustment based on internal loan classifications.

For non-performing loans, fair value is calculated by first reducing the carrying value by a credit risk adjustment based on internal loan classifications, and then discounting the estimated future cash flows from the remaining carrying value at a market rate.

For impaired loans which the Company has measured and recorded impairment generally based on the fair value of the loan's collateral, fair value is generally determined based upon independent third-party appraisals of the properties. These assets are typically included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

### **FHLB of New York Stock**

The carrying amount of the FHLB of New York stock is equal to its fair value, and considers the limited marketability of this security.

### **Deposits**

The fair value of deposits with no stated maturity, such as non-interest-bearing demand deposits, money market accounts, interest checking accounts, and savings accounts is equal to the amount payable on demand. Time deposits are segregated by type, size, and remaining maturity. The fair value of time deposits is based on the discounted value of contractual cash flows. The discount rate is based on rates currently offered in the market.

Table of Contents**NOTE 6 – Fair Value DISCLOSURES (Continued)****FHLB of New York Advances**

The fair value of the FHLB advances is estimated based on the discounted value of future contractual payments. The discount rate is equivalent to the estimated rate at which the Company could currently obtain similar financing.

**Off-Balance- Sheet Financial Instruments**

The fair value of commitments to extend credit is estimated based on an analysis of the interest rates and fees currently charged to enter into similar transactions, considering the remaining terms of the commitments and the credit-worthiness of the potential borrowers. At September 30, 2012 and December 31, 2011, the estimated fair values of these off-balance-sheet financial instruments were immaterial.

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

(In thousands)	Carrying Amount	Fair Value Estimate	Fair Value at September 30, 2012		
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Financial Assets</b>					
Cash and cash equivalents	\$49,301	\$49,301	\$49,301	\$ —	\$ —
Certificates of deposit	648	648	648	—	—
Securities available for sale	132	132	—	132	—
Securities held to maturity	13,059	13,647	—	13,647	—
Loans receivable	341,507	354,643	—	—	354,643
FHLB of New York stock	1,355	1,355	1,355	—	—
Accrued interest receivable	962	962	962	—	—
<b>Financial Liabilities</b>					
Deposits, including accrued interest	318,999	320,932	179,670	141,262	—
FHLB of New York advances	15,000	15,370	—	15,370	—

(In thousands)	December 31, 2011	
	Carrying Amount	Fair Value Estimate
Financial assets:		
Cash and cash equivalents	\$82,583	\$ 82,583
Certificates of deposit	2,640	2,640
Securities available for sale	149	149
Securities held to maturity	16,099	16,662
Loans receivable	350,894	361,974
FHLB of New York stock	1,633	1,633
Accrued interest receivable	1,499	1,499
Financial liabilities:		
Deposits, including accrued interest	353,636	356,950
FHLB of New York advances	20,000	20,686

Table of Contents

## NOTE 7 – LOANS RECEIVABLE AND THE ALLOWANCE FOR LOAN LOSSES

The following is a breakdown of the loan portfolio by segment, and classes under those segments where applicable:

	September 30, 2012	December 31, 2011
(In thousands)		
Residential real estate:		
One-to four-family	\$7,611	\$ 627
Multi-family	182,545	189,253
Mixed use	43,209	51,229
	233,365	241,109
Non-residential real estate	88,399	83,602
Construction	338	9,065
Commercial and industrial	24,406	23,725
Consumer	77	68
Total Loans	346,585	357,569
Allowance for loan losses	(5,705 )	(7,397 )
Deferred loan fees and costs	627	722
Net Loans	\$341,507	\$ 350,894

The following is an analysis of the allowance for loan losses:

**At and for the Nine Months Ended September 30, 2012 (in thousands)**

	Residential Real Estate	Non- residential Real Estate	Construction	Commercial and Industrial	Consumer	Total
Allowance for loan losses:						
Beginning balance	\$3,781	\$1,596	\$1,724	\$296	\$—	\$7,397
Charge-offs	(1,258 )	(764 )	(1,715 )	—	—	(3,737 )
Recoveries	16	—	—	—	—	16
Provision	1,573	466	(9 )	(1 )	—	2,029

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Ending balance	\$4,112	\$1,298	\$—	\$295	\$—	\$5,705
Ending balance: individually evaluated for impairment	\$1,535	\$377	\$—	\$—	\$—	\$1,912
Ending balance: collectively evaluated for impairment	\$2,577	\$921	\$—	\$295	\$—	\$3,793
Loans receivable:						
Ending balance	\$233,365	\$88,399	\$338	\$24,406	\$77	\$346,585
Ending balance: individually evaluated for impairment	\$9,817	\$13,506	\$—	\$1,750	\$—	\$25,073
Ending balance: collectively evaluated for impairment	\$223,548	\$74,893	\$338	\$22,656	\$77	\$321,512

14

Table of Contents**NOTE 7 – LOANS RECEIVABLE AND THE ALLOWANCE FOR LOAN LOSSES (Continued)****For the Three Months Ended September 30, 2012 (in thousands)**

	Residential Real Estate	Non- residential Real Estate	Construction	Commercial and Industrial	Consumer	Total
Allowance for loan losses:						
Beginning balance	\$ 2,681	\$ 897	\$ —	\$ 289	\$ —	\$3,867
Charge-offs	(85 )	—	—	—	—	(85 )
Recoveries	11	—	—	—	—	11
Provision	1,505	401	—	6	—	1,912
Ending balance	\$ 4,112	\$ 1,298	\$ —	\$ 295	\$ —	\$5,705

**For the Nine Months Ended September 30, 2011 (in thousands)**

	Residential Real Estate	Non- residential Real Estate	Construction	Commercial and Industrial	Consumer	Total
Allowance for loan losses:						
Beginning balance	\$ 3,924	\$ 1,560	\$ 2,083	\$ 80	\$ —	\$7,647
Charge-offs	(795 )	—	—	—	—	(795 )
Recoveries	4	—	—	—	—	4
Provision	987	(350 )	455	21	—	1,113
Ending balance	\$ 4,120	\$ 1,210	\$ 2,538	\$ 101	\$ —	\$7,969

**For the Three Months Ended September 30, 2011 (in thousands)**

	Residential Real Estate	Non- residential Real Estate	Construction	Commercial and Industrial	Consumer	Total
Allowance for loan losses:						
Beginning balance	\$ 3,893	\$ 1,309	\$ 2,320	\$ 78	\$ —	\$7,600
Charge-offs	(28 )	—	—	—	—	(28 )
Recoveries	4	—	—	—	—	4

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Provision	251	(99	)	218	23	—	393
Ending balance	\$ 4,120	\$ 1,210		\$ 2,538	\$ 101	\$ —	\$7,969

15



Table of Contents**NOTE 7 – LOANS RECEIVABLE AND THE ALLOWANCE FOR LOAN LOSSES (Continued)**

At and for the Year Ended December 31, 2011 (in thousands)

	Residential Real Estate	Non- residential Real Estate	Construction	Commercial and Industrial	Consumer	Total
Allowance for loan losses:						
Beginning balance	\$3,924	\$1,560	\$2,083	\$80	\$—	\$7,647
Charge-offs	(1,358 )	(17 )	—	—	—	(1,375 )
Recoveries	12	—	—	—	—	12
Provision	1,203	53	(359 )	216	—	1,113
Ending balance	\$3,781	\$1,596	\$1,724	\$296	\$—	\$7,397
Ending balance: individually evaluated for impairment	\$456	\$333	\$1,661	\$—	\$—	\$2,450
Ending balance: collectively evaluated for impairment	\$3,325	\$1,263	\$63	\$296	\$—	\$4,947
Loans receivable:						
Ending balance	\$241,109	\$83,602	\$9,065	\$23,725	\$68	\$357,569
Ending balance: individually evaluated for impairment	\$12,871	\$9,764	\$7,660	\$—	\$—	\$30,295
Ending balance: collectively evaluated for impairment	\$228,238	\$73,838	\$1,405	\$23,725	\$68	\$327,274

The following is an analysis of the Company's impaired loans.

**Impaired Loans as of or for the three months ended September 30, 2012 (in thousands)**

<u>2012</u>	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Residential real estate-Multi-family	\$ 4,440	\$ 4,440	\$ —	\$ 4,453	\$ 164
Non-residential real estate	11,640	11,640	—	11,619	15
Commercial and Industrial	1,750	1,750	—	1,750	26
Subtotal	17,830	17,830	—	17,822	205

With an allowance recorded:

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Residential real estate-Multi-family	5,377	5,377	1,535	5,351	—
Non-residential real estate	1,866	1,866	377	1,860	—
Commercial and Industrial	—	—	—	—	—
Subtotal	7,243	7,243	1,912	7,211	—
Total:					
Residential real estate-Multi-family	9,817	9,817	1,535	9,804	164
Non-residential real estate	13,506	13,506	377	13,479	15
Commercial and Industrial	1,750	1,750	—	1,750	26
Total	\$ 25,073	\$ 25,073	\$ 1,912	\$ 25,033	\$ 205

Table of Contents**NOTE 7 – LOANS RECEIVABLE AND THE ALLOWANCE FOR LOAN LOSSES (Continued)****Impaired Loans as of or for the nine months ended September 30, 2012 (in thousands)**

<u>2012</u>	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Residential real estate-Multi-family	\$ 4,440	\$ 4,440	\$ —	\$ 4,459	\$ 259
Non-residential real estate	11,640	11,640	—	11,556	1,334
Commercial and Industrial	1,750	1,750	—	1,713	79
Subtotal	17,830	17,830	—	17,728	1,672
With an allowance recorded:					
Residential real estate-Multi-family	5,377	5,377	1,535	5,297	36
Non-residential real estate	1,866	1,866	377	1,920	36
Commercial and Industrial	—	—	—	—	—
Subtotal	7,243	7,243	1,912	7,217	72
Total:					
Residential real estate-Multi-family	9,817	9,817	1,535	9,756	295
Non-residential real estate	13,506	13,506	377	13,476	1,370
Commercial and Industrial	1,750	1,750	—	1,713	79
Total	\$ 25,073	\$ 25,073	\$ 1,912	\$ 24,945	\$ 1,744

**Impaired Loans as of or for the three months ended September 30, 2011 (in thousands)**

<u>2011</u>	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Residential real estate-Multi-family	\$ 11,700	\$ 11,700	\$ —	\$ 11,679	\$ 92
Non-residential real estate	9,695	9,695	—	9,104	26
Construction	—	—	—	—	—
Subtotal	21,395	21,395	—	20,783	118
With an allowance recorded:					
Residential real estate-Multi-family	1,608	1,608	414	1,591	—
Non-residential real estate	—	—	—	—	—
Construction	7,625	7,625	2,468	7,609	—
Subtotal	9,233	9,233	2,882	9,200	—
Total:					
Residential real estate-Multi-family	13,308	13,308	414	13,270	92

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Non-residential real estate	9,695	9,695	—	9,104	26
Construction	7,625	7,625	2,468	7,609	—
Total	\$ 30,628	\$ 30,628	\$ 2,882	\$ 29,983	\$ 118

17

Table of Contents**NOTE 7 – LOANS RECEIVABLE AND THE ALLOWANCE FOR LOAN LOSSES (Continued)****Impaired Loans as of or for the nine months ended September 30, 2011 (in thousands)**

<u>2011</u>	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Residential real estate-Multi-family	\$ 11,700	\$ 11,700	\$ —	\$ 11,637	\$ 347
Non-residential real estate	9,695	9,695	—	9,107	114
Construction	—	—	—	—	—
Subtotal	21,395	21,395	—	20,744	461
With an allowance recorded:					
Residential real estate-Multi-family	1,608	1,608	414	1,574	13
Non-residential real estate	—	—	—	—	—
Construction	7,625	7,625	2,468	7,548	—
Subtotal	9,233	9,233	2,882	9,122	13
Total:					
Residential real estate-Multi-family	13,308	13,308	414	13,211	360
Non-residential real estate	9,695	9,695	—	9,107	114
Construction	7,625	7,625	2,468	7,548	—
Total	\$ 30,628	\$ 30,628	\$ 2,882	\$ 29,866	\$ 474

**Impaired Loans as of and for the year ended December 31, 2011 (in thousands)**

<u>2011</u>	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Residential real estate-Multi-family	\$ 10,081	\$ 10,081	\$ —	\$ 10,245	\$ 422
Non-residential real estate	8,601	8,601	—	8,560	108
Construction	—	—	—	—	—
Subtotal	18,682	18,682	—	18,805	530
With an allowance recorded:					
Residential real estate-Multi-family	2,790	2,790	456	2,717	7
Non-residential real estate	1,163	1,163	333	1,154	28
Construction	7,660	7,660	1,661	7,566	10
Subtotal	11,613	11,613	2,450	11,437	45

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Total:

Residential real estate-Multi-family	12,871	12,871	456	12,962	429
Non-residential real estate	9,764	9,764	333	9,714	136
Construction	7,660	7,660	1,661	7,566	10
Total	\$ 30,295	\$ 30,295	\$ 2,450	\$ 30,242	\$ 575

18

Table of Contents

## NOTE 7 – LOANS RECEIVABLE AND THE ALLOWANCE FOR LOAN LOSSES (Continued)

The following table provides information about delinquencies in our loan portfolio at the dates indicated.

**Age Analysis of Past Due Loans as of September 30, 2012 (in thousands)**

	30-59 Days Past Due	60 – 89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days and Accruing
Residential real estate:							
One- to four-family	\$ —	\$ —	\$ —	\$ —	\$7,611	\$ 7,611	\$ —
Multi-family	—	—	5,747	5,747	176,798	182,545	—
Mixed-use	—	—	746	746	42,463	43,209	—
Non-residential real estate	4,550	1,000	1,973	7,523	80,876	88,399	—
Construction loans	—	—	—	—	338	338	—
Commercial and Industrial loans	—	—	—	—	24,406	24,406	—
Consumer.	—	—	—	—	77	77	—
Total loans	\$ 4,550	\$ 1,000	\$ 8,466	\$ 14,016	\$ 332,569	\$ 346,585	\$ —

**Age Analysis of Past Due Loans as of December 31, 2011 (in thousands)**

	30-59 Days Past Due	60 – 89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days and Accruing
Residential real estate:							
One- to four-family	\$ —	\$ —	\$ —	\$ —	\$ 627	\$ 627	\$ —
Multi-family	—	—	5,422	5,422	183,831	189,253	1,192
Mixed-use	—	—	722	722	50,507	51,229	—
Non-residential real estate	—	545	6,634	7,179	76,423	83,602	—
Construction loans	—	—	7,660	7,660	1,405	9,065	—
Commercial and Industrial loans	—	—	—	—	23,725	23,725	—
Consumer	—	—	—	—	68	68	—
Total loans	\$ —	\$ 545	\$ 20,438	\$ 20,983	\$ 336,586	\$ 357,569	\$ 1,192





Table of Contents

## NOTE 7 – LOANS RECEIVABLE AND THE ALLOWANCE FOR LOAN LOSSES (Continued)

The following tables provide certain information related to the credit quality of the loan portfolio.

**Credit Quality Indicators as of September 30, 2012 (in thousands)****Credit Risk Profile by Internally Assigned Grade**

	Residential Real Estate	Non- residential Real Estate	Construction	Commercial and Industrial	Consumer	Total
Grade:						
Pass	\$ 225,078	\$ 80,876	\$ 338	\$ 22,656	\$ 77	\$ 329,025
Special Mention	2,944	447	—	1,750	—	5,141
Substandard	5,343	7,076	—	—	—	12,419
Total	\$ 233,365	\$ 88,399	\$ 338	\$ 24,406	\$ 77	\$ 346,585

**Credit Quality Indicators as of December 31, 2011 (in thousands)****Credit Risk Profile by Internally Assigned Grade**

	Residential Real Estate	Non- residential Real Estate	Construction	Commercial and Industrial	Consumer	Total
Grade:						
Pass	\$ 230,128	\$ 73,838	\$ 1,405	\$ 23,725	\$ 68	\$ 329,164
Special Mention	4,259	—	—	—	—	4,259
Substandard	6,722	9,764	7,660	—	—	24,146
Total	\$ 241,109	\$ 83,602	\$ 9,065	\$ 23,725	\$ 68	\$ 357,569

The following table sets forth the composition of our nonaccrual loans at the dates indicated.

**Loans Receivable on Nonaccrual Status as of September 30, 2012 and December 31, 2011 (in thousands)**

	2012	2011
Residential real estate-Multi-family	\$6,493	\$4,951
Non-residential real estate	7,523	6,634
Construction loans	—	7,661
Total	\$14,016	\$19,246

Table of Contents**NOTE 7 – LOANS RECEIVABLE AND THE ALLOWANCE FOR LOAN LOSSES (Continued)**

The following table shows the breakdown of loans modified for the periods indicated:

(dollars in thousands)	Three Months Ended September 30, 2012			Nine Months Ended September 30, 2012		
	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification
Real estate:						
Multi-family	—	\$ —	\$ —	2	\$ 1,900	\$ 1,900
Non-residential	—	—	—	4	10,500	10,500
Total	—	\$ —	\$ —	6	\$ 12,400	\$ 12,400

(dollars in thousands)	Three Months Ended September 30, 2011			Nine Months Ended September 30, 2011		
	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification
Real estate:						
Multi-family	2	\$ 2,279	\$ 2,279	2	\$ 2,279	\$ 2,279
Total	2	\$ 2,279	\$ 2,279	2	\$ 2,279	\$ 2,279

The two multi-family mortgage loans had an interest rate of 5% with an amortization of 30 years that was modified to an interest only rate of 2.5% for the first six months of 2012. As of September 30, 2012, these two loans had defaulted and were classified as non-accrual and substandard.

One of the non-residential loans had an interest rate of 7% that was modified to 2%, plus monthly modified net income of the property. As of September 30, 2012, this loan had defaulted and was classified as non-accrual and substandard. Subsequently, the Company foreclosed and took title to the property on October 10, 2012,

The other three non-residential loans had an interest rate of 6.125% that was modified to 5%, with interest paid in advance for two years from the date of modification. These three loans have been performing according to the terms of the modification.

There were no defaults in the nine month period ended September 30, 2011.

## **NOTE 8 – EFFECT OF RECENT ACCOUNTING PRONOUNCEMENTS**

ASU 2011-04: This ASU amends *FASB ASC Topic 820, Fair Value Measurements*, to bring U.S. GAAP for fair value measurements in line with International Accounting Standards. The ASU clarifies existing guidance for items such as: the application of the highest and best use concept to non-financial assets and liabilities; the application of fair value measurement to financial instruments classified in a reporting entity's stockholder's equity; and disclosure requirements regarding quantitative information about unobservable inputs used in the fair value measurements of level 3 assets. The ASU also creates an exception to Topic 820 for entities which carry financial instruments within a portfolio or group, under which the entity is now permitted to base the price used for fair valuation upon a price that would be received to sell the net asset position or transfer a net liability position in an orderly transaction. The ASU also allows for the application of premiums and discounts in a fair value measurement if the financial instrument is categorized in level 2 or 3 of the fair value hierarchy. Lastly, the ASU contains new disclosure requirements regarding fair value amounts categorized as level 3 in the fair value hierarchy such as: disclosure of the valuation process used; effects of and relationships between unobservable inputs; usage of nonfinancial assets for purposes other than their highest and best use when that is the basis of the disclosed fair value; and categorization by level of items disclosed at fair value, but not measured at fair value for financial statement purposes. For public entities, this ASU is effective for interim and annual periods beginning after December 15, 2011. The adoption of this ASU did not have a significant impact on the Company's consolidated financial statements.

Table of Contents

**NOTE 8 – EFFECT OF RECENT ACCOUNTING PRONOUNCEMENTS (Continued)**

ASU 2011-05: The provisions of this ASU amend *FASB ASC Topic 220, Comprehensive Income*, to facilitate the continued alignment of U.S. GAAP with International Accounting Standards. The ASU prohibits the presentation of the components of comprehensive income in the statement of stockholder's equity. Reporting entities are allowed to present either: a statement of comprehensive income, which reports both net income and other comprehensive income; or separate, but consecutive, statements of net income and other comprehensive income. Under previous GAAP, all 3 presentations were acceptable. Regardless of the presentation selected, the Reporting Entity is required to present all reclassifications between other comprehensive and net income on the face of the new statement or statements. The provisions of this ASU are effective for fiscal years and interim periods beginning after December 31, 2011 for public entities. As the two remaining options for presentation existed prior to the issuance of this ASU, early adoption is permitted. The adoption of this ASU resulted in the addition of a separate consolidated statement of comprehensive income (loss) in the Company's consolidated financial statements.

ASU 2011-12: *Deferral of the Effective Date to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update 2011-05*. In response to stakeholder concerns regarding the operational ramifications of the presentation of these reclassifications for current and previous years, the FASB has deferred the implementation date of this provision to allow time for further consideration. The requirement in ASU 2011-05, *Presentation of Comprehensive Income*, for the presentation of a combined statement of comprehensive income or separate, but consecutive, statements of net income and other comprehensive income is still effective for fiscal years and interim periods beginning after December 15, 2011 for public companies, and fiscal years ending after December 15, 2011 for nonpublic companies. The adoption of this ASU did not have a significant impact on the Company's consolidated financial statements.

ASU 2011-08: *Testing Goodwill for Impairment*. The purpose of this ASU is to simplify how entities test goodwill for impairment by adding a new first step to the preexisting goodwill impairment test under ASC Topic 350, *Intangibles – Goodwill and other*. This amendment gives the entity the option to first assess a variety of qualitative factors such as economic conditions, cash flows, and competition to determine whether it was more likely than not that the fair value of goodwill has fallen below its carrying value. If the entity determines that it is not likely that the fair value has fallen below its carrying value, then the entity will not have to complete the original two-step test under Topic 350. The amendments in this ASU are effective for impairment tests performed for fiscal years beginning after December 15, 2011. The adoption of this ASU did not have a significant impact on the Company's consolidated financial statements.

**NOTE 9 – DIVIDEND RESTRICTION**

NorthEast Community Bancorp MHC (the "MHC") held 7,273,750 shares, or 57.5%, of the Company's issued and outstanding common stock, and the minority public shareholders held 42.5% of outstanding stock, at September 30, 2012. The MHC filed notice with, and received approval from, the Federal Reserve Bank of Philadelphia to waive its right to receive cash dividends through March 31, 2012. The MHC has waived receipt of all past dividends paid by the Company through March 31, 2012. The dividends waived are considered as a restriction on the retained earnings of

the Company. As of September 30, 2012 and December 31, 2011, the aggregate retained earnings restricted for cash dividends waived were \$4,146,000 and \$ 3,928,000, respectively.

Because the MHC determined not to waive receipt of the dividend for the quarter ended June 30, 2012, the MHC received \$218,000 in dividends in August 2012. There was no dividend declared for the quarter ended September 30, 2012.

The MHC received the approval of its members to waive its right to receive annual dividends aggregating up to \$0.12 per share declared by the Company in the 12 months subsequent to the members' approval at a meeting of the MHC's members held on November 9, 2012. The Company is waiting for the Federal Reserve Bank of Philadelphia's approval of the waiver.

#### **NOTE 10 – SUBSEQUENT EVENT**

On October 29, 2012, Hurricane Sandy made landfall in New Jersey and caused damage across large portions of the Northeastern area of the United States. As the aftermath of the storm is still affecting large portions of the region, we are currently unable to quantify the financial impact of the storm.

Table of Contents

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

**FORWARD-LOOKING STATEMENTS**

This quarterly report contains forward-looking statements that are based on assumptions and may describe future plans, strategies and expectations of the Company. These forward-looking statements 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, national and regional economic conditions, legislative and 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 and composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company’s market area, changes in real estate market values in the Company’s market area, and changes in relevant accounting principles and guidelines. Additional factors that may affect the Company’s results are discussed in the Company’s Annual Report on Form 10-K under “Item 1A. Risk Factors.” 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 applicable law or regulation, the Company does not undertake, and specifically disclaims any obligation, to release publicly the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

**CRITICAL ACCOUNTING POLICIES**

We consider accounting policies involving significant judgments and assumptions by management that have, or could have, a material impact on the carrying value of certain assets or on income to be critical accounting policies. We consider the following to be our critical accounting policies: allowance for loan losses and deferred income taxes.

***Allowance for Loan Losses.*** The allowance for loan losses is the amount estimated by management as necessary to cover probable credit losses in the loan portfolio at the statement of financial condition date. The allowance is established through the provision for loan losses, which is charged to income. Determining the amount of the allowance for loan losses necessarily involves a high degree of judgment. Among the material estimates required to establish the allowance are: loss exposure at default; the amount and timing of future cash flows on impacted loans; value of collateral; and determination of loss factors to be applied to the various elements of the portfolio. All of these estimates are susceptible to significant change. Management reviews the level of the allowance on a quarterly basis and establishes the provision for loan losses based upon an evaluation of the portfolio, past loss experience, current economic conditions and other factors related to the collectability of the loan portfolio. Although we believe that we use the best information available to establish the allowance for loan losses, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the evaluation. As of

July 21, 2011, the Office of the Comptroller of the Currency (“OCC”) assumed responsibility from the Office of Thrift Supervision for the ongoing examination, supervision, and regulation of federal savings associations and rulemaking for all savings associations, state and federal. In addition, the supervision of savings and loan holding companies (“SLHCs”), such as the Company, and their non-depository subsidiaries transferred to the Board of Governors of the Federal Reserve System (the “Board”) on July 21, 2011.

Due to the conversion of the Bank to a New York State-chartered savings bank on June 29, 2012, the Federal Deposit Insurance Corporation (“FDIC”) and the New York State Department of Financial Services (“NYS”) are now the Bank’s primary regulator. As such, the FDIC and NYS, as an integral part of their examination process, periodically review our allowance for loan losses. The FDIC, NYS, and or the Board could require us to recognize adjustments to the allowance based on their judgments about information available to them at the time of their examinations. A large loss or a series of losses could deplete the allowance and require increased provisions to replenish the allowance, which would negatively affect earnings. For additional discussion, see note 1 of the notes to the consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011.

***Deferred Income Taxes.*** We use the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. If current available information raises doubt as to the realization of the deferred tax assets, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. We exercise significant judgment in evaluating the amount and timing of recognition of the resulting tax liabilities and assets. These judgments require us to make projections of future taxable income. The judgments and estimates we make in determining our deferred tax assets, which are inherently subjective, are reviewed on a continual basis as regulatory and business factors change. Any reduction in estimated future taxable income may require us to record a valuation allowance against our deferred tax assets. A valuation allowance would result in additional income tax expense in the period, which would negatively affect earnings.



Table of Contents

**Third Quarter Performance Highlights**

The Company suffered a net loss of \$1.0 million for the quarter ended September 30, 2012 compared to net income of \$467,000 for the same period in 2011 primarily due to increases in provision for loan losses and non-interest expenses and a decrease in net interest income, partially offset by an increase in non-interest income and a decrease in income taxes.

The increase in provision for loan losses was due to the establishment of \$1.9 million in specific reserves against four multi-family, one mixed-use, and two non-residential mortgage loans. These specific reserves were established based on additional information received on the properties collateralizing the seven aforementioned mortgage loans (See the Non-Performing Assets section for more information on these loans).

The increase in non-interest expense was due to the expansion of our Massachusetts lending and branch operations. In connection with the expansion, the Company hired additional employees to support the lending and branch expansion, purchased additional equipment to support the expansion, and incurred additional expenses related to the support and supervision of the expansion.

As part of the Company's aggressive pursuit of expansion opportunities in Massachusetts, particularly in and around the I-495 corridor, we continue to look for other branch sites within our Massachusetts market area. In addition, the Company is also focusing on opportunities to increase its commercial real estate lending and commercial and industrial lending in Massachusetts in a manner consistent with our conservative underwriting standards.

Non-performing loans decreased by \$6.4 million, or 31.4%, to \$14.0 million as of September 30, 2012 from \$20.4 million as of December 31, 2011. The decrease in non-performing loans is primarily attributable to the satisfaction of six non-performing multi-family and one non-residential mortgage loans and the upgrade of four construction mortgage loans to current status, partially offset by the addition of four non-performing multi-family mortgage loans and two non-performing non-residential mortgage loans.

We continue to monitor our loan portfolio closely and adjust the level of allowance for loan losses appropriately as updated information becomes available. In this regard, the Company's Special Assets Group reviews all non-performing loans, potential non-performing loans, and restructured loans each month. The monitoring of these loans by the Special Assets Group allows the Company to quickly respond to even modest changes in the loan portfolio's performance.

**Comparison of Financial Condition at September 30, 2012 and December 31, 2011**

Total assets decreased by \$41.6 million, or 8.5%, to \$447.7 million at September 30, 2012 from \$489.3 million at December 31, 2011. The decrease in total assets was due to decreases of \$33.3 million in cash and cash equivalents, \$9.4 million in loans receivable, net, \$3.0 million in securities held-to-maturity, \$2.0 million in certificates of deposits at other financial institutions, \$620,000 in real estate owned, \$537,000 in accrued interest receivable, and \$278,000 in Federal Home Loan Bank of New York (“FHLB”) stock, partially offset by increases of \$4.0 million in premises and equipment and \$2.9 million in bank owned life insurance. The decrease in total assets primarily resulted from decreases of \$34.6 million in deposits and \$1.6 million in accounts payable and accrued expenses and the repayment of \$5.0 million in FHLB advances, partially offset by an increase of \$661,000 in advance payments by borrowers for taxes and insurance,

Cash and cash equivalents decreased by \$33.3 million, or 40.3%, to \$49.3 million at September 30, 2012 from \$82.6 million at December 31, 2011 due primarily to the above mentioned decreases in deposits, accounts payable and accrued expenses, and the repayment of FHLB advances.

Securities held-to-maturity decreased by \$3.0 million, or 18.9%, to \$13.1 million at September 30, 2012 from \$16.1 million at December 31, 2011 due primarily to repayments of \$3.0 million. Certificates of deposits at other financial institutions decreased by \$2.0 million, or 75.5%, to \$648,000 at September 30, 2012 from \$2.6 million at December 31, 2011 due to the maturity and redemption of various certificates of deposits.

Loans receivable, net, decreased by \$9.4 million, or 2.7%, to \$341.5 million at September 30, 2012 from \$350.9 million at December 31, 2011 due primarily to loan repayments totaling \$49.4 million that exceeded loan originations totaling \$41.7 million and a decrease of \$1.7 million in the allowance for loan losses.

Table of Contents

FHLB stock decreased by \$278,000, or 17.0%, to \$1.4 million at September 30, 2012 from \$1.6 million at December 31, 2011 due primarily to a decrease in the amount of FHLB stock that we are required to hold as a result of decreases in FHLB advances and the mortgage loan portfolio.

Accrued interest receivable decreased by \$537,000, or 35.8%, to \$962,000 at September 30, 2012 from \$1.5 million at December 31, 2011 due to a decrease in the yield and balance of the mortgage loan portfolio. Bank owned life insurance increased by \$2.9 million, or 17.6%, to \$19.7 million at September 30, 2012 from \$16.7 million at December 31, 2011 due to purchases of additional Bank owned life insurance and accrued earnings during 2012.

Real estate owned decreased by \$620,000 due to a reclassification of a foreclosed property from real estate owned to premises and equipment. Concurrently, premises and equipment increased by \$4.0 million, or 45.5%, to \$13.0 million at September 30, 2012 from \$8.9 million at December 31, 2011 due to the acquisition of two branch sites in Massachusetts, the addition of a Headquarters annex, and the reclassification of a foreclosed property.

Deposits decreased by \$34.6 million, or 9.8%, to \$319.0 million at September 30, 2012 from \$353.6 million at December 31, 2011. The decrease in deposits was primarily attributable to decreases of \$45.6 million in our NOW and money market accounts and \$3.3 million in certificates of deposits, offset by increases of \$8.3 million in non-interest bearing accounts and \$6.0 million in our regular savings accounts.

The decrease in our NOW and money market accounts was primarily due to the withdrawal of \$22.7 million by a municipality from money market accounts in June 2012.

Advance payments by borrowers for taxes and insurance increased by \$661,000, or 19.7%, to \$4.0 million at September 30, 2012 from \$3.4 million at December 31, 2011 due primarily to accumulating balances paid into escrow accounts by our borrowers.

FHLB advances decreased by \$5.0 million, or 25.0%, to \$15.0 million at September 30, 2012 from \$20.0 million at December 31, 2011 due primarily to the maturity and repayment of certain FHLB advances.

Accounts payable and accrued expenses decreased by \$1.6 million, or 31.0%, to \$3.6 million at September 30, 2012 from \$5.2 million at December 31, 2011 due to the payment of the Company's 2011 income taxes and the pay-off during the March 31, 2012 quarter of a note payable that was reclassified as accounts payable of \$175,000 at December 31, 2011.

Stockholders' equity decreased by \$1.0 million to \$106.1 million at September 30, 2012, from \$107.1 million at December 31, 2011. This decrease was primarily the result of comprehensive loss of \$609,000 and cash dividends declared of \$518,000, partially offset by expense of \$111,000 for the ESOP for the period.

### **Comparison of Operating Results for the Three Months Ended September 30, 2012 and 2011**

**General.** Net income decreased by \$1.5 million, or 314.1%, to a net loss of \$1.0 million for the quarter ended September 30, 2012, from net income of \$467,000 for the quarter ended September 30, 2011. The decrease was primarily the result of increases of \$1.5 million in provision for loan losses and \$1.1 million in non-interest expenses and a decrease of \$118,000 in net interest income, partially offset by an increase of \$185,000 in non-interest income and a decrease of \$1.1 million in income taxes.

**Net Interest Income.** Net interest income decreased by \$118,000, or 2.8%, to \$4.2 million for the three months ended September 30, 2012 from \$4.3 million for the three months ended September 30, 2011. The decrease in net interest income resulted primarily from a decrease of \$633,000 in interest income that exceeded a decrease of \$515,000 in interest expense.

The decrease in net interest income was also due to a decrease of \$4.4 million in average net interest-earning assets that resulted from decreases of \$35.0 million in average loans, securities, and other interest-earning assets that exceeded decreases of \$30.6 million in average interest-bearing deposits and borrowings. The decrease in average loans, securities, and other interest-earning assets was due to loan repayments exceeding loan originations and the repayment of investment securities. The decrease in average interest-bearing deposits and borrowings was due to a decrease of \$21.3 million in average interest-bearing deposits as a result of an effort by the Company to decrease reliance on higher cost certificates of deposit and the repayment of FHLB advances and other borrowed money.

The average yield on our interest-earning assets decreased by 18 basis points to 4.95% for the three months ended September 30, 2012 from 5.13% for the three months ended September 30, 2011 and the cost of our interest-bearing liabilities decreased by 52 basis points to 1.02% for the three months ended September 30, 2012 from 1.54% for the three months ended September 30, 2011. The decrease in the yield on our interest-earning assets and the cost of our interest-bearing liabilities was due to the low interest rate environment in 2011 which continued into the third quarter of 2012.

Table of Contents

The net interest spread increased by 34 basis points to 3.93% for the three months ended September 30, 2012 from 3.59% for the three months ended September 30, 2011. The net interest margin increased by 22 basis points between these periods from 3.95% for the quarter ended September 30, 2011 to 4.17% for the quarter ended September 30, 2012. The increase in the interest rate spread and the net interest margin in the third quarter of 2012 compared to the same period in 2011 was due to a decrease in the average cost of our interest-bearing liabilities that exceeded the decrease in the average yield on our interest-earning assets and an increase in the ratio of average interest-earning assets to interest-bearing liabilities.

The following table summarizes average balances and average yields and costs of interest-earning assets and interest-bearing liabilities for the three months ended September 30, 2012 and 2011.

	Three Months Ended September 30,			2011		
	Average Balance	Interest and Dividends	Yield/ Cost	Average Balance	Interest and Dividends	Yield/ Cost
	(Dollars in thousands)					
Assets:						
Interest-earning assets:						
Loans	\$353,314	\$ 4,817	5.45 %	\$372,688	\$ 5,378	5.77 %
Securities (including FHLB stock)	15,176	116	3.06	23,864	186	3.12
Other interest-earning assets	30,822	7	0.09	37,793	9	0.10
Total interest-earning assets	399,312	4,940	4.95	434,345	5,573	5.13
Allowance for loan losses	(3,828 )			(7,730 )		
Non-interest-earning assets	42,841			33,233		
Total assets	\$438,325			\$459,848		
Liabilities and equity:						
Interest-bearing liabilities:						
Interest-bearing demand	\$72,713	\$ 63	0.35 %	\$77,754	\$ 168	0.86 %
Savings and club accounts	87,541	117	0.53	61,995	108	0.70
Certificates of deposit	127,736	454	1.42	169,522	851	2.01
Total interest-bearing deposits	287,990	634	0.88	309,271	1,127	1.46
Borrowings	15,000	139	3.71	24,357	161	2.64
Total interest-bearing liabilities	302,990	773	1.02	333,628	1,288	1.54
Noninterest-bearing demand	20,806			12,896		
Other liabilities	7,087			6,111		
Total liabilities	330,883			352,635		
Stockholders' equity	107,442			107,213		
Total liabilities and Stockholders' equity	\$438,325			\$459,848		
Net interest income		\$ 4,167			\$ 4,285	
Interest rate spread			3.93 %			3.59 %

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Net interest margin		4.17 %	3.95 %
Net interest-earning assets	\$96,322	\$100,717	
Interest-earning assets to interest-bearing liabilities	131.79 %	130.19 %	

Total interest income decreased by \$633,000, or 11.4%, to \$4.9 million for the three months ended September 30, 2012, from \$5.6 million for the three months ended September 30, 2011. Interest income on loans decreased by \$561,000, or 10.4%, to \$4.8 million for the three months ended September 30, 2012 from \$5.4 million for the three months ended September 30, 2011 as a result of a decrease of 32 basis points in the average yield on loans to 5.45% for the three months ended September 30, 2012 from 5.77% for the three months ended September 30, 2011. The decrease in interest income and the average yield on loans was due to the pay-off of higher yielding mortgage loans and the refinancing and/or re-pricing to lower interest rates of mortgage loans in our loan portfolio. The decrease in interest income was also due to a decrease of \$19.4 million, or 5.2%, in the average balance of the loan portfolio to \$353.3 million for the three months ended September 30, 2012 from \$372.7 million for the three months ended September 30, 2011 as repayments outpaced originations.

Table of Contents

Interest income on securities decreased by \$70,000, or 37.6%, to \$116,000 for the three months ended September 30, 2012 from \$186,000 for the three months ended September 30, 2011. The decrease was primarily due to a decrease of \$8.7 million, or 36.4%, in the average balance of securities to \$15.2 million for the three months ended September 30, 2012 from \$23.9 million for the three months ended September 30, 2011. The decrease in the average balance was due to the principal repayments on investment securities and a decrease in FHLB New York stock. The decrease in interest income on securities was also due to the re-pricing of the yield of our adjustable rate investment securities and the decline in interest rates from September 30, 2011 to September 30, 2012. As a result, the average yield on securities decreased by 6 basis points to 3.06% for the three months ended September 30, 2012 from 3.12% for the three months ended September 30, 2011.

Interest income on other interest-earning assets (consisting solely of interest-earning deposits) decreased by \$2,000, or 22.2% to \$7,000 for the three months ended September 30, 2012 from \$9,000 for the three months ended September 30, 2011. The decrease was due to a decrease of 1 basis point in the average yield on other interest-earning assets to 0.09% for the three months ended September 30, 2012 from 0.10% for the three months ended September 30, 2011 and a decrease of \$7.0 million, or 18.5%, in the average balance of interest-earning assets to \$30.8 million for the three months ended September 30, 2012 from \$37.8 million for the three months ended September 30, 2011. The decline in the yield was due to the maturity of higher yielding certificates of deposits at other financial institutions. The decrease in the average balance of other interest-earning assets was due to decreases in cash and cash equivalents and certificates of deposit at other financial institutions.

Total interest expense decreased by \$515,000, or 40.0%, to \$773,000 for the three months ended September 30, 2012 from \$1.3 million for the three months ended September 30, 2011. Interest expense on deposits decreased by \$493,000, or 43.7%, to \$634,000 for the three months ended September 30, 2012 from \$1.1 million for the three months ended September 30, 2011. During this same period, the average cost of deposits decreased by 58 basis points to 0.88% for the three months ended September 30, 2012 from 1.46% for the three months ended September 30, 2011.

Due to an effort by the Company to decrease reliance on higher cost certificates of deposit by shifting deposits to lower cost savings and holiday club deposits, the average balance of certificates of deposit decreased by \$41.8 million, or 24.7%, to \$127.7 million for the three months ended September 30, 2012 from \$169.5 million for the three months ended September 30, 2011. As a result of the decrease in the average balance of certificates of deposit, interest expense on our certificates of deposit decreased by \$397,000, or 46.7%, to \$454,000 for the three months ended September 30, 2012 from \$851,000 for the three months ended September 30, 2011. The decrease in interest expense on our certificates of deposit was also due to a decrease of 59 basis points in the average cost of our certificates of deposit to 1.42% for the three months ended September 30, 2012 from 2.01% for the three months ended September 30, 2011.

The shift in deposits caused the interest expense on our savings and holiday club deposits to increase by \$9,000, or 8.3%, to \$117,000 for the three months ended September 30, 2012 from \$108,000 for the three months ended September 30, 2011. The increase was due to an increase of \$25.5 million, or 41.2%, in the average balance of savings and holiday club deposits to \$87.5 million for the three months ended September 30, 2012 from \$62.0 million for the three months ended September 30, 2011. The increase in the interest expense of our savings and holiday club deposits

was offset by a decrease of 17 basis points in the cost of our savings and holiday club deposits to 0.53% for the three months ended September 30, 2012 from 0.70% for the three months ended September 30, 2011.

The decrease in interest expense for deposits was also due to a decrease in our interest-bearing demand deposits' interest expense of \$105,000, or 62.5%, to \$63,000 for the three months ended September 30, 2012 from \$168,000 for the three months ended September 30, 2011. The decrease was due to a decrease of \$5.0 million, or 6.5%, in the average balance of interest-bearing demand deposits to \$72.7 million for the three months ended September 30, 2012 from \$77.8 million for the three months ended September 30, 2011. The decrease was also due to a decrease of 51 basis points in the cost of our interest-bearing demand deposits to 0.35% for the three months ended September 30, 2012 from 0.86% for the three months ended September 30, 2011.

Interest expense on borrowings decreased by \$22,000, or 13.7%, to \$139,000 for the three months ended September 30, 2012 from \$161,000 for the three months ended September 30, 2011. The decrease was primarily due to a decrease of \$9.4 million, or 38.4%, in the average balance of borrowed money to \$15.0 million for the three months ended September 30, 2012 from \$24.4 million for the three months ended September 30, 2011. Offsetting the decrease in interest expense on borrowings was an increase of 107 basis points in the cost of borrowed money to 3.71% for the three months ended September 30, 2012 from 2.64% for the three months ended September 30, 2011 due primarily to the maturity and repayment of lower costing FHLB advances from 2011 to 2012.



Table of Contents

**Provision for Loan Losses.** The following table summarizes the activity in the allowance for loan losses and provision for loan losses for the three months ended September 30, 2012 and 2011.

	Three Months	
	Ended September 30,	
	2012	2011
	(Dollars in thousands)	
Allowance at beginning of period	\$ 3,867	\$ 7,600
Provision for loan losses	1,912	393
Charge-offs	85	28
Recoveries	11	4
Net charge-offs	74	24
Allowance at end of period	\$ 5,705	\$ 7,969
Allowance to nonperforming loans	40.70 %	39.03 %
Allowance to total loans outstanding at the end of the period	1.65 %	2.19 %
Net charge-offs to average loans outstanding during the period	0.02 %	0.01 %

The allowance to non-performing loans ratio increased to 40.70% at September 30, 2012 from 39.03% at September 30, 2011 due primarily to the decrease in non-performing loans of \$14.0 million at September 30, 2012 from \$20.4 million at September 30, 2011, offset by a decrease in the allowance for loan losses. The decrease in non-performing loans was due to the identification, monitoring and resolution of several non-performing loans that were paid-off or became performing as of September 30, 2012.

The provision for loan losses increased by \$1.5 million, or 386.5%, to \$1.9 million for the three months ended September 30, 2012 compared to \$393,000 for the three months ended September 30, 2011. The increase in provision for loan losses was due to the establishment of \$1.9 million in specific reserves against four multi-family, one mixed-use, and two non-residential mortgage loans. These specific reserves were established based on additional information received on the properties collateralizing the seven aforementioned mortgage loans (See the Non-Performing Assets section for more information on these loans).

We charged-off \$85,000 against two residential mortgage loans and one non-performing multi-family mortgage loan during the three months ended September 30, 2012 compared to charge-offs of \$28,000 against one non-performing multi-family mortgage loan and one mixed-use mortgage loan during the three months ended September 30, 2011. We recorded recoveries of \$11,000 during the three months ended September 30, 2012 compared to recoveries of \$4,000 during the three months ended September 30, 2011.

The allowance for loan losses was \$5.7 million at September 30, 2012, \$7.4 million at December 31, 2011, and \$8.0 million at September 30, 2011. We recorded provision for loan losses of \$1.9 million for the three month period ended September 30, 2012 compared to provision for loan losses of \$393,000 for the three month period ended September 30, 2011.

**Non-interest Income.** Non-interest income increased by \$185,000, or 35.8%, to \$702,000 for the three months ended September 30, 2012 from \$517,000 for the three months ended September 30, 2011. The increase was primarily due to a \$197,000 increase in other loan fees and service charges, primarily due to \$147,000 in fee income from our new mortgage broker activity, a \$14,000 increase in earnings on bank owned life insurance, and an increase of \$6,000 in other non-interest income, offset by a decrease of \$17,000 in fee income generated by Hayden Wealth Management Group, our wealth management division.

**Non-interest Expense.** Non-interest expense increased by \$1.1 million, or 28.8%, to \$4.8 million for the three months ended September 30, 2012 from \$3.7 million for the three months ended September 30, 2011. The increase resulted primarily from increases of \$692,000 in salaries and employee benefits, \$147,000 in other non-interest expense, \$81,000 in occupancy expense, \$80,000 in outside data processing expense, \$46,000 in equipment expense, \$23,000 in advertising expense, and \$4,000 in FDIC insurance premiums.

Salaries and employee benefits, which represented 53.2% of the Company's non-interest expense during the quarter ended September 30, 2012, increased by \$692,000, or 37.2%, to \$2.6 million in 2012 from \$1.9 million in 2011 due to an increase in the number of full time equivalent employees to 126 at September 30, 2012 from 85 at September 30, 2011. The increase in full time employees was due to the hiring of additional loan production and branch operations personnel in the Company's Headquarters and Massachusetts locations to support new lending and branch operations activities and the Company's new mortgage brokerage operations.

Other non-interest expense increased by \$147,000, or 13.7%, to \$1.2 million in 2012 from \$1.1 million in 2011 due mainly to increases of \$64,000 in legal fees related to litigation and regulatory matters, \$42,000 in audit and accounting fees and \$40,000 in telephone expenses. These increases were partially offset by decreases of \$70,000 in recruitment expenses related to the hiring of additional loan production and branch operations personnel in the Company's Headquarters and Massachusetts locations.

Table of Contents

Occupancy expense increased by \$81,000, or 27.6%, to \$375,000 in 2012 from \$294,000 in 2011 due to the headquarters expansion, the addition of the Massachusetts loan operations facility, and the new Framingham and Quincy, Massachusetts branch offices. Outside data processing expense increased by \$80,000, or 43.2%, to \$265,000 in 2012 from \$185,000 in 2011 due to additional services provided in 2012 by the Company's core data processing vendor as a result of the expansion of the Company's facilities. Equipment expense increased by \$46,000, or 26.6%, to \$219,000 in 2012 from \$173,000 in 2011 due to purchases of additional equipment to support our headquarters and Massachusetts expansion.

Advertising expense increased by \$23,000, or 39.7%, to \$81,000 in 2012 from \$58,000 in 2011 due to an increase in marketing efforts to expand our Massachusetts operations. Real estate owned expense decreased by \$14,000 due to the reclassification of real estate owned expenses to occupancy expense in 2012.

**Income Taxes.** Income taxes decreased by \$1.1 million, or 501.4%, to a benefit of \$847,000 for the three months ended September 30, 2012 from an expense of \$211,000 for the three months ended September 30, 2011. The decrease resulted primarily from a \$2.5 million decrease in pre-tax income in 2012 compared to 2011. The effective tax rate was a benefit of 45.9% for the three months ended September 30, 2012 and an expense of 31.1% for the three months ended September 30, 2011.

**Comparison of Operating Results For The Nine Months Ended September 30, 2012 and 2011**

**General.** Net income decreased by \$2.5 million, or 123.8%, to a net loss of \$483,000 for the nine months ended September 30, 2012 from \$2.1 million for the nine months ended September 30, 2011. The decrease was primarily the result of a decrease of \$765,000 in net interest income and increases of \$916,000 in the provision for loan losses and \$3.1 million in non-interest expense, offset by an increase of \$475,000 in non-interest income, and a decrease of \$1.8 million in income taxes.

**Net Interest Income.** Net interest income decreased by \$765,000, or 5.9%, to \$12.2 million for the nine months ended September 30, 2012 from \$13.0 million for the nine months ended September 30, 2011. The decrease in net interest income resulted primarily from a decrease of \$1.8 million in interest income that exceeded a decrease of \$1.0 million in interest expense.

In this regard, the net interest spread decreased by 22 basis points to 3.43% for the nine months ended September 30, 2012 from 3.65% for the nine months ended September 30, 2011. The net interest margin decreased by 32 basis points between these periods from 4.01% for the nine months ended September 30, 2011 to 3.69% for the nine months ended September 30, 2012. The decreases in the interest rate spread and the net interest margin in 2012 compared to the same period in 2011 were due to a decrease in the yield on our interest-earning assets that exceeded a decrease in the cost of our interest-bearing liabilities.

The average yield on our interest-earning assets decreased by 67 basis points to 4.55% for the nine months ended September 30, 2012 from 5.22% for the nine months ended September 30, 2011 and the cost of our interest-bearing liabilities decreased by 46 basis points to 1.12% for the nine months ended September 30, 2012 from 1.58% for the nine months ended September 30, 2011. The decrease in the yield on our interest-earning assets and the cost of our interest-bearing liabilities was due to the low interest rate environment in 2011 which continued into the third quarter of 2012.

Table of Contents

The following table summarizes average balances and average yields and costs of interest-earning assets and interest-bearing liabilities for the nine months ended September 30, 2012 and 2011.

	Nine Months Ended September 30,				
	2012			2011	
	Average Balance	Interest and Dividends	Yield/ Cost	Average Balance	Interest and Dividends
(Dollars in thousands)					
Assets:					
Interest-earning assets:					
Loans	\$356,695	\$14,678	5.49%	\$372,054	\$16,314
Securities	16,277	379	3.10	24,488	548
Other interest-earning assets	68,791	29	0.06	34,749	29
Total interest-earning assets	441,763	15,086	4.55	431,291	16,891
Allowance for loan losses	(5,891 )			(7,733 )	
Non-interest-earning assets	39,421			33,498	
Total assets	\$475,293			\$457,056	
Liabilities and equity:					
Interest-bearing liabilities:					
Interest-bearing demand	\$101,174	\$442	0.58%	\$77,671	\$477
Savings and club accounts	88,977	445	0.67	58,941	279
Certificates of deposit	135,213	1,564	1.54	170,298	2,672
Total interest-bearing deposits	325,364	2,451	1.00	306,910	3,428
Borrowings	16,355	419	3.42	23,998	482
Total interest-bearing liabilities	341,719	2,870	1.12	330,908	3,910
Noninterest-bearing demand	18,460			11,141	
Other liabilities	7,580			6,698	
Total liabilities	367,759			348,747	
Stockholders' equity	107,534			108,309	
Total liabilities and Stockholders' equity	\$475,293			\$457,056	
Net interest income		\$12,216			\$12,981
Interest rate spread			3.43%		
Net interest margin			3.69%		
Net interest-earning assets	\$100,044			\$100,383	
Average interest-earning assets to average interest-bearing liabilities	129.28 %			130.34 %	

Total interest income decreased by \$1.8 million, or 10.7%, to \$15.1 million for the nine months ended September 30, 2012, from \$16.9 million for the nine months ended September 30, 2011. Interest income on loans decreased by \$1.6 million, or 10.0%, to \$14.7 million for the nine months ended September 30, 2012 from \$16.3 million for the nine months ended September 30, 2011 as a result of a decrease of 36 basis points in the average yield on loans to 5.49% for the nine months ended September 30, 2012 from 5.85% for the nine months ended September 30, 2011. The decrease in interest income and the average yield on loans was due to the pay-off of higher yielding mortgage loans

and the refinancing and/or re-pricing to lower interest rates of mortgage loans in our loan portfolio. The decrease in interest income was also due to a decrease of \$15.4 million, or 4.1%, in the average balance of the loan portfolio to \$356.7 million for the nine months ended September 30, 2012 from \$372.1 million for the nine months ended September 30, 2011 as repayments outpaced originations.

Interest income on securities decreased by \$169,000, or 30.8%, to \$379,000 for the nine months ended September 30, 2012 from \$548,000 for the nine months ended September 30, 2011. The decrease was primarily due to a decrease of \$8.2 million, or 33.5%, in the average balance of securities to \$16.3 million for the nine months ended September 30, 2012 from \$24.5 million for the nine months ended September 30, 2011. The decrease in the average balance was due to principal repayments on investment securities and a decrease in FHLB of New York stock. The decrease in interest income on securities was offset by an increase of 12 basis points in the average yield on securities to 3.10% for the nine months ended September 30, 2012 from 2.98% for the nine months ended September 30, 2011. The increase in the yield was due to the increased portion of interest income on securities during 2012 attributed to the higher yielding FHLB of New York stock dividends, which yielded 4.98% for the nine months ended September 30, 2012.

Table of Contents

Interest income on other interest-earning assets (consisting solely of interest-earning deposits) remained unchanged at \$29,000 for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011. The average balance of other interest-earning assets increased by \$34.0 million, or 98.0%, to \$68.8 million for the nine months ended September 30, 2012 from \$34.7 million for the nine months ended September 30, 2011. The increase was due to increased levels of cash and cash equivalents during the nine months ended September 30, 2012 that decreased during the three months ended September 30, 2012, partially offset by a decrease in certificates of deposit during the nine months ended September 30, 2012. The yield on other interest-earning assets decreased by 5 basis points to 0.06% for the nine months ended September 30, 2012 from 0.11% for the nine months ended September 30, 2011. The decline in the yield was due to a decrease in the yield on our interest-earning deposits at the FHLB and the maturity of higher yielding certificates of deposits at other financial institutions.

Total interest expense decreased by \$1.0 million, or 26.6%, to \$2.9 million for the nine months ended September 30, 2012 from \$3.9 million for the nine months ended September 30, 2011. Interest expense on deposits decreased by \$977,000, or 28.5%, to \$2.5 million for the nine months ended September 30, 2012 from \$3.4 million for the nine months ended September 30, 2011. During this same period, the average interest cost of deposits decreased by 49 basis points to 1.00% for the nine months ended September 30, 2012 from 1.49% for the nine months ended September 30, 2011.

Due to an effort by the Company to decrease reliance on higher cost certificates of deposits by shifting deposits to lower cost interest-bearing demand deposits and savings and holiday club deposits, the average balance of certificates of deposits decreased by \$36.1 million, or 20.6%, to \$135.2 million for the nine months ended September 30, 2012 from \$170.3 million for the nine months ended September 30, 2011. As a result, interest expense on our certificates of deposit decreased by \$1.1 million, or 41.5%, to \$1.6 million for the nine months ended September 30, 2012 from \$2.7 million for the nine months ended September 30, 2011. The decrease in interest expense on our certificates of deposits was also due to a decrease of 55 basis points to 1.54% for the nine months ended September 30, 2012 from 2.09% for the nine months ended September 30, 2011.

The shift in deposits caused the interest expense on our other deposit products to increase by \$131,000, 17.3%, to \$887,000 for the nine months ended September 30, 2012 from \$756,000 for the nine months ended September 30, 2011. The increase was due to an increase of \$23.5 million, or 30.3%, in the average balance of interest-bearing demand deposits to \$101.2 million for the nine months ended September 30, 2012 from \$77.7 million for the nine months ended September 30, 2011 and an increase of \$30.0 million, or 51.0%, in the average balance of our savings and holiday club deposits to \$89.0 million for the nine months ended September 30, 2012 from \$58.9 million for the nine months ended September 30, 2011. The increase was also due to an increase of 4 basis points in the cost of our savings and holiday clubs to 0.67% for the nine months ended September 30, 2012 from 0.63% for the nine months ended September 30, 2011. The increase in the interest expense on our other deposit products was offset by a decrease of 24 basis points in the cost of our interest-bearing demand deposits to 0.58% for the nine months ended September 30, 2012 from 0.82% for the nine months ended September 30, 2011.

Interest expense on borrowings decreased by \$63,000, or 13.1%, to \$419,000 for the nine months ended September 30, 2012 from \$482,000 for the nine months ended September 30, 2011. The decrease was primarily due to a decrease

of \$7.6 million, or 31.9%, in the average balance of borrowed money to \$16.4 million for the nine months ended September 30, 2012 from \$24.0 million for the nine months ended September 30, 2011. Offsetting the decrease in interest expense on borrowings was an increase of 74 basis points in the cost of borrowed money to 3.42% for the nine months ended September 30, 2012 from 2.68% for the nine months ended September 30, 2011 due primarily to the maturity and repayment of lower costing FHLB advances from 2011 to 2012.

**Allowance for Loan Losses.** The following table summarizes the activity in the allowance for loan losses for the nine months ended September 30, 2012 and 2011.

	Nine Months Ended September 30, 2012      2011 (Dollars in thousands)	
Allowance at beginning of period	\$ 7,397	\$ 7,647
Provision for loan losses	2,029	1,113
Charge-offs	3,737	795
Recoveries	16	4
Net charge-offs	3,721	791
Allowance at end of period	\$ 5,705	\$ 7,969

We recorded provisions for loan losses of \$2.0 million and \$1.1 million for the nine month periods ended September 30, 2012 and 2011, respectively. The increase in provision for loan losses was due to the establishment of \$1.9 million in specific reserves against four multi-family, one mixed-use, and two non-residential mortgage loans during the third quarter of 2012. These specific reserves were established based on additional information received on the properties collateralizing the seven aforementioned mortgage loans (See the Non-Performing Assets section for more information on these loans).



Table of Contents

We charged-off \$3.7 million against seven non-performing multi-family mortgage loans, four non-performing non-residential mortgage loans, two residential mortgage loans, and one construction loan during the nine months ended September 30, 2012 compared to charge-offs of \$795,000 against eight non-performing multi-family mortgage loans and one non-performing mixed-use mortgage loan during the nine months ended September 30, 2011. We recorded recoveries of \$16,000 during the nine months ended September 30, 2012 compared to recoveries of \$4,000 during the nine months ended September 30, 2011.

**Non-interest Income.** Non-interest income increased by \$475,000, or 34.6%, to \$1.8 million for the nine months ended September 30, 2012 from \$1.4 million for the nine months ended September 30, 2011. The increase was primarily due to increases of \$472,000 in other loan fees and service charges, primarily due to \$374,000 in fee income from our new mortgage broker activity, \$11,000 in fee income generated by Hayden Wealth Management Group, \$6,000 in earnings on bank owned life insurance, and \$5,000 in other non-interest income, offset by a decrease of \$19,000 in net gain/(loss) on the disposition of fixed assets.

**Non-interest Expense.** Non-interest expense increased by \$3.1 million, or 30.6%, to \$13.2 million for the nine months ended September 30, 2012 from \$10.1 million for the nine months ended September 30, 2011. The increase resulted primarily from increases of \$1.7 million in salaries and employee benefits, \$906,000 in other non-interest expense, \$188,000 in outside data processing expense, \$119,000 in equipment expense, \$99,000 in occupancy expense, and \$72,000 in advertising expense, offset by a decrease of \$32,000 in FDIC insurance expense.

Salaries and employee benefits, which represented 52.4% of the Company's non-interest expense during the nine months ended September 30, 2012, increased by \$1.7 million, or 33.7%, to \$6.9 million in 2012 from \$5.2 million in 2011 due to an increase in the number of full time equivalent employees to 126 at September 30, 2012 from 85 at September 30, 2011. The increase was primarily due to the hiring of additional loan production and branch operations personnel in the Company's Headquarters and Massachusetts locations to support new lending and branch operations activities and the Company's new mortgage brokerage operations.

Other non-interest expense increased by \$906,000, or 35.1%, to \$3.5 million in 2012 from \$2.6 million in 2011 due mainly to increases of \$288,000 in legal fees related to litigation and regulatory matters, \$242,000 in employee expenses related to our expansion of the lending and branch operations, \$124,000 in recruitment expenses related to the hiring of additional loan production and branch operations personnel in the Company's Headquarters and Massachusetts locations, and \$106,000 in telephone expenses.

Outside data processing expense increased by \$188,000, or 31.8%, to \$780,000 in 2012 from \$592,000 in 2011 due to additional services provided in 2012 by the Company's core data processing vendor as a result of the expansion of the Company's facilities. Occupancy expense increased by \$99,000, or 11.2%, to \$983,000 in 2012 from \$884,000 in 2011 due to the Headquarters expansion, the addition of the Massachusetts loan operations facility, and the new Framingham and Quincy, Massachusetts branch offices.

Equipment expense increased by \$119,000, or 26.0%, to \$577,000 in 2012 from \$458,000 in 2011 due to purchases of additional equipment to support our Headquarters and Massachusetts expansion. Advertising expense increased by \$72,000, or 59.0%, to \$194,000 in 2012 from \$122,000 in 2011 due to an increase in marketing efforts to expand our Massachusetts operations. FDIC insurance expense decreased by \$32,000, or 10.2%, to \$283,000 in 2012 from \$315,000 in 2011 due to a decrease in the Company's quarterly assessment multiplier.

**Income Taxes.** Income taxes decreased by \$1.8 million, or 166.0%, to a benefit of \$714,000 for the nine months ended September 30, 2012 from an expense of \$1.1 million for the nine months ended September 30, 2011. The decrease resulted primarily from a \$4.3 million decrease in pre-tax income in 2012 compared to 2011. The effective tax rate was a benefit of 59.7% for the nine months ended September 30, 2012 compared to an expense of 34.8% for the nine months ended September 30, 2011.

Table of Contents**NON PERFORMING ASSETS**

The following table provides information with respect to our non-performing assets at the dates indicated.

	At September 30, 2012	At December 31, 2011		
	(Dollars in thousands)			
Non-accrual loans	\$ 14,016	\$ 19,246		
Loans past due 90 days or more and accruing	—	1,192		
Total nonaccrual and 90 days or more past due loans	14,016	20,438		
Other non-performing loans	—	—		
Total non-performing loans	14,016	20,438		
Real estate owned	—	620		
Total non-performing assets	14,016	21,058		
Accruing troubled debt restructurings	10,199	14,039		
Nonaccrual troubled debt restructurings	10,855	1,435		
Total troubled debt restructurings	21,054	15,474		
Less nonaccrual troubled debt restructurings in total nonaccrual loans	10,855	1,435		
Total troubled debt restructurings and non-performing assets	\$ 24,215	\$ 35,097		
Total non-performing loans to total loans	4.04	%	5.72	%
Total non-performing loans to total assets	3.13	%	4.30	%
Total non-performing assets and troubled debt restructurings to total assets	5.41	%	7.17	%

The non-accrual loans at September 30, 2012 consisted of eleven loans in the aggregate – five multi-family mortgage loans, one mixed-use mortgage loan, and five non-residential mortgage loan.

Non-performing loans decreased by \$6.4 million, or 31.4%, to \$14.0 million at September 30, 2012 from \$20.4 million at December 31, 2011. The decrease in non-performing loans was due to the satisfaction of seven non-accrual mortgage loans totaling \$5.4 million, the conversion from non-performing to performing status of four mortgage loans totaling \$7.2 million, and a charge-off of \$1.7 million against one non-performing loan. These were offset by the addition of six mortgage loans totaling \$6.5 million that became non-performing at September 30, 2012.

Total troubled debt restructured loans increased by \$5.6 million, or 36.1%, to \$21.1 million at September 30, 2012 from \$15.5 million at December 31, 2011. Accruing troubled debt restructured loans decreased by \$3.8 million, or 27.4%, to \$10.2 million at September 30, 2012 from \$14.0 million at December 31, 2011. Nonaccrual troubled debt

restructured loans increased by \$9.4 million, or 656.5%, to \$10.9 million at September 30, 2012 from \$1.4 million at December 31, 2011.

The decrease in accruing troubled debt restructured loans was due to the satisfaction of two mortgage loans totaling \$2.0 million and the continuing performance of two mortgage loans totaling \$1.8 million, offset by the addition of four mortgage loans totaling \$7.2 million and the change in status from performing to non-accrual of four mortgage loans totaling \$5.2 million. The increase in nonaccrual troubled debt restructured was due to the addition of two mortgage loans totaling \$5.2 million, the addition of the aforementioned change in status from performing to non-accrual of four mortgage loans totaling \$5.2 million, offset by the satisfaction of three mortgage loans totaling \$995,000.

The non-accrual multi-family mortgage loans, net of charge-offs of \$424,000, totaled \$5.7 million at September 30, 2012, consisting primarily of the following mortgage loans:

- (1) A delinquent loan with an outstanding balance of \$2.3 million, net of a charge-off of \$43,000, secured by an apartment building. Based on an appraisal and related cash flow analysis, the Company established a specific reserve of \$308,000 against the loan during the September 30, 2012 quarter. A foreclosure action was filed in the second quarter of 2012. One of the limited partners of the borrowing entity continues to negotiate with the Company in an attempt to arrive at a mutually beneficial debt restructuring.

Table of Contents

(2) A delinquent loan with an outstanding balance of \$1.2 million secured by an apartment building. The delinquency is the result of a lawsuit filed by the previous owner claiming that the debtor never owned record title to the mortgaged property. The Company filed a lawsuit seeking a declaration that the mortgage is a valid encumbrance against the property. No trial date has been set, but we do not expect a trial date until late 2012, as the Court has not docketed the case at this time. All payments of principal, interest and escrow are being paid to the trustee, with taxes paid by the trustee. We do not anticipate a loss on this loan.

(3) A delinquent loan with an outstanding balance of \$1.0 million, net of a charge-off of \$206,000, secured by an apartment building. Based on an appraisal and related cash flow analysis, the Company established a specific reserve of \$389,000 against the loan during the September 30, 2012 quarter. With assistance from the Company, a receiver has cured the outstanding code violations and in concert with the Company a plan is being formulated to address other problems in the building. We will continue to evaluate all options available to us.

(4) A delinquent loan with an outstanding balance of \$911,000, net of a charge-off of \$175,000, secured by an apartment building. Based on an appraisal and related cash flow analysis, the Company established a specific reserve of \$351,000 against the loan during the September 30, 2012 quarter. With assistance from the Company, a receiver has cured the outstanding code violations and in concert with the Company a plan is being formulated to address other problems in the building. We will continue to evaluate all options available to us.

(5) A delinquent loan with an outstanding balance of \$385,000 secured by an apartment building. Based on an appraisal and related cash flow analysis, the Company established a specific reserve of \$192,000 against the loan during the September 30, 2012 quarter. The Company filed a foreclosure action on June 27, 2012. We are negotiating a possible loan assumption by an existing borrower.

The one non-accrual mixed-use mortgage loan totaled \$746,000 at September 30, 2012:

(1) An outstanding balance of \$746,000 secured by a mixed-use apartment building. Based on an appraisal, related cash flow analysis and eminent domain action, the Company established a specific reserve of \$295,000 against the loan during the September 30, 2012 quarter. The property was sold at a foreclosure auction on October 17, 2012 to a third party purchaser for \$475,000. The third party purchaser has 45 days to fund and close the transaction.

The five non-accrual non-residential mortgage loans, net of charge-offs of \$448,000, totaled \$7.5 million at September 30, 2012 consisting primarily of the following mortgage loans:

(1)

An outstanding balance of \$4.5 million secured by an office building. The borrower defaulted on a forbearance agreement and the Company foreclosed and took title to the property on October 10, 2012. The Company subsequently entered a default judgment on the borrowers guarantee in the amount of \$3.5 million dollars.

An outstanding balance of \$1.0 million, net of a charge-off of \$48,000, secured by a gasoline service station and car wash. Based on an appraisal and related cash flow analysis, the Company established a specific reserve of (2) \$247,000 against the loan during the September 30, 2012 quarter. Subsequent to September 30, 2012, the borrower brought the loan current under the existing restructure agreement. The Company will continue to monitor the loan and evaluate all available options.

(3) An outstanding balance of \$879,000 secured by a medical office building. Based on an appraisal and related cash flow analysis, the Company established a specific reserve of \$130,000 against the loan during the September 30, 2012 quarter. The Company has commenced a foreclosure action and has submitted to the Court a request to appoint a receiver. We are evaluating the options available to us.

An outstanding balance of \$647,000 secured by a restaurant with 23 boat slips. A foreclosure auction was (4) conducted on October 19, 2012 and the Company acquired title to the property. Subsequent to October 19, 2012, hurricane Sandy destroyed the building and boat slips. As a result of the damages, the Company has notified the insurance agency and insurance company that underwrote the flood insurance.

An outstanding balance of \$447,000, net of charge-offs of \$400,000, secured by a strip shopping center and warehouse. The property was severely damaged by fire and the Company and borrower are currently suing the (5) insurance company and the borrower's insurance agent as part of the Company's collection efforts. The borrower is making monthly escrow payments. We do not anticipate any additional losses on this loan and expect to recover all legal and court fees upon resolution of the suit.

Table of Contents

We are in the process of foreclosing on two of the five multi-family and two of the five non-residential mortgage loans discussed above. Based on recent fair value analyses of these properties, the Company has established specific reserves totaling \$1.9 million against four of the multi-family and two of the non-residential mortgage loans. The Company does not expect any losses beyond the amounts already charged off. Except for the above-mentioned second non-accrual multi-family mortgage loans and the fifth non-residential mortgage loan, nine of the above-mentioned eleven loans have been classified as substandard. The fifth non-residential mortgage loan has been classified as special mention.

**Liquidity Management.** Liquidity is the ability to meet current and future financial obligations of a short-term nature. Our primary sources of funds consist of deposit inflows, loan repayments, maturities and sales of securities, and borrowings from the Federal Home Loan Bank of New York. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition.

We regularly adjust our investments in liquid assets based upon our assessment of: (1) expected loan demands; (2) expected deposit flows; (3) yields available on interest-earning deposits and securities; and (4) the objectives of our asset/liability management policy.

Our most liquid assets are cash and cash equivalents. The levels of these assets depend on our operating, financing, lending, and investing activities during any given period. Cash and cash equivalents totaled \$49.3 million at September 30, 2012 and consist primarily of interest-bearing deposits at other financial institutions and miscellaneous cash items. The Company can also borrow an additional \$65.7 million from the FHLB of New York to provide additional liquidity.

At September 30, 2012, we had \$59.6 million in loan commitments outstanding, consisting of \$34.3 million in unused commercial and industrial loan lines of credit, \$16.2 million of real estate loan commitments, \$7.7 million in unused real estate equity lines of credit, \$1.0 million of commercial and industrial loan commitments, \$137,000 in unused loans in process, and \$137,000 in consumer lines of credit. Certificates of deposit due within one year of September 30, 2012 totaled \$72.7 million. This represented 52.5% of certificates of deposit at September 30, 2012. We believe a large percentage of certificates of deposit that mature within one year reflect customers' hesitancy to invest their funds for long periods in the current interest rate environment. If these maturing deposits do not remain with us, we will be required to seek other sources of funds, including other certificates of deposit and borrowings. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we paid on the certificates of deposit due on or before September 30, 2012. We believe, however, based on past experience, a significant portion of our certificates of deposit will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

Our primary investing activities are the origination of loans and the purchase of securities. Our primary financing activities consist of deposit accounts and FHLB advances. At September 30, 2012, we had the ability to borrow \$65.7

million, net of \$15.0 million in outstanding advances, from the FHLB of New York. At September 30, 2012, we had no overnight advances outstanding. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by us and our local competitors and other factors. We generally manage the pricing of our deposits to be competitive and to maintain or increase our core deposit relationships depending on our level of real estate loan commitments outstanding. Occasionally, we offer promotional rates on certain deposit products to attract deposits or to lengthen re-pricing time frames.

The Company is a separate legal entity from the Bank and must provide for its own liquidity. In addition to its operating expenses, the Company is responsible for paying any dividends declared to its shareholders and for the repurchase, if any, of its shares of common stock. At September 30, 2012, the Company had liquid assets of \$14.0 million.

**Capital Management.** The Bank is subject to various regulatory capital requirements administered by the FDIC, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. At September 30, 2012, the Bank exceeded all regulatory capital requirements. The Bank is considered “well capitalized” under regulatory guidelines.

**Off-Balance Sheet Arrangements.** In the normal course of operations, we engage in a variety of financial transactions that, in accordance with U.S. generally accepted accounting principles, are not recorded in our financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers’ requests for funding and take the form of loan commitments, letters of credit and lines of credit.



Table of Contents

For the three and nine months ended September 30, 2012 and the year ended December 31, 2011, we engaged in no off-balance sheet transactions reasonably likely to have a material effect on our financial condition, results of operations or cash flows.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

**Qualitative Aspects of Market Risk.** The Company's most significant form of market risk is interest rate risk. We manage the interest rate sensitivity of our interest-bearing liabilities and interest-earning assets in an effort to minimize the adverse effects of changes in the interest rate environment. Deposit accounts typically react more quickly to changes in market interest rates than mortgage loans because of the shorter maturities of deposits. As a result, sharp increases in interest rates may adversely affect our earnings while decreases in interest rates may beneficially affect our earnings. To reduce the potential volatility of our earnings, we have sought to improve the match between asset and liability maturities and rates, while maintaining an acceptable interest rate spread.

Our strategy for managing interest rate risk emphasizes: originating mortgage real estate loans that re-price to market interest rates in three to five years; purchasing securities that typically re-price within a three year time frame to limit exposure to market fluctuations; and, where appropriate, offering higher rates on long term certificates of deposit to lengthen the re-pricing time frame of our liabilities. We currently do not participate in hedging programs, interest rate swaps or other activities involving the use of derivative financial instruments.

We have an Asset/Liability Committee, comprised of our Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, Chief Retail Banking Officer, Chief Lending Officer – New England Region, Chief Lending Officer – Mid-Atlantic Region, and Treasurer, whose function is to communicate, coordinate and control all aspects involving asset/liability management. The committee establishes and monitors the volume, maturities, pricing and mix of assets and funding sources with the objective of managing assets and funding sources to provide results that are consistent with liquidity, growth, risk limits and profitability goals.

Our goal is to manage asset and liability positions to moderate the effects of interest rate fluctuations on net interest income and net income.

**Quantitative Aspects of Market Risk.** We use an interest rate sensitivity analysis prepared an independent third party to review our level of interest rate risk. This analysis measures interest rate risk by computing changes in the net portfolio value of our cash flows from assets, liabilities and off-balance sheet items in the event of a range of assumed changes in market interest rates. Net portfolio value represents the market value of portfolio equity and is equal to the market value of assets minus the market value of liabilities, with adjustments made for off-balance sheet items. These analyses assess the risk of loss in market risk-sensitive instruments in the event of a sudden and sustained 100 to 300 basis point increase or 100 basis point decrease in market interest rates with no effect given to any steps that we might take to counter the effect of that interest rate movement.

The following table presents the change in our net portfolio value at September 30, 2012 that would occur in the event of an immediate change in interest rates based on the independent third party assumptions, with no effect given to any steps that we might take to counteract that change.

Basis Point (“bp”) Change in Rates	Net Portfolio Value (Dollars in thousands)			Net Portfolio Value as % of Portfolio Value of Assets	
	\$ Amount	\$ Change	% Change	NPV Ratio	Change
300	\$ 111,186	(10,624)	(8 )%	25.33 %	(96) bp
200	115,338	(6,472 )	(5 )%	25.81 %	(48) bp
100	119,069	(2,741 )	(2 )%	26.16 %	(13) bp
0	121,810	—	—	26.29 %	
(100)	122,212	402	—	26.15 %	(14) bp

We use various assumptions in assessing interest rate risk. These assumptions relate to interest rates, loan prepayment rates, deposit decay rates and the market values of certain assets under differing interest rate scenarios, among others. As with any method of measuring interest rate risk, certain shortcomings are inherent in the methods of analyses presented in the foregoing tables. For example, although certain assets and liabilities may have similar maturities or periods to re-pricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates.

## Table of Contents

Additionally, certain assets, such as adjustable-rate mortgage loans, have features that restrict changes in interest rates on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, expected rates of prepayments on loans and early withdrawals from certificates could deviate significantly from those assumed in calculating the table. Prepayment rates can have a significant impact on interest income. Because of the large percentage of loans we hold, rising or falling interest rates have a significant impact on the prepayment speeds of our earning assets that in turn affect the rate sensitivity position. When interest rates rise, prepayments tend to slow. When interest rates fall, prepayments tend to rise. Our asset sensitivity would be reduced if prepayments slow and vice versa. While we believe these assumptions to be reasonable, there can be no assurance that assumed prepayment rates will approximate actual future loan repayment activity.

### **Item 4. Controls and Procedures**

The Company's management, including the Company's principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the "Exchange Act"). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (the "SEC") (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in the Company's internal control over financial reporting during the three months ended September 30, 2012 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

On October 31, 2011 a complaint was filed by Stilwell Value Partners IV, L.P. in the Supreme Court of New York, New York County (the "Court"), against the Company, the MHC and each of the directors of the Company and the MHC. The complaint alleged that the directors had breached their fiduciary duties by not expanding the Company board to allow for disinterested consideration of a "second-step" conversion of the MHC. As relief, the complaint requested, among other things, that the Company's board of directors be increased by at least three new members, that such new members be given sole responsibility to determine whether the Company should engage in a second-step conversion and that the Court order the Company to engage in a second-step conversion. On September 27, 2012, the Court granted the Company's motion to dismiss and dismissed the complaint granting Stilwell leave to file an amended complaint within 20 days.

The Company and Bank are also subject to claims and litigation that arise primarily in the ordinary course of business. Based on information presently available and advice received from legal counsel representing the Company and Bank in connection with such claims and litigation, it is the opinion of management that the disposition or ultimate determination of such claims and litigation will not have a material adverse effect on the consolidated financial position, results of operations or liquidity of the Company.

**Item 1A. Risk Factors**

**A number of our loans are secured by property located in Richmond, New York and Nassau Counties in New York and Fairfield County in Connecticut, which properties may have been damaged by Hurricane Sandy.**

Table of Contents

As of September 30, 2012, the Company's loan portfolio includes approximately \$7.2 million of residential and commercial and industrial loans, which represents approximately 2.06% of our total loan portfolio, to individuals and business located in Richmond, New York and Nassau Counties in New York and Fairfield County in Connecticut. These counties were severely damaged by Hurricane Sandy which impacted the Mid-Atlantic and Northeastern regions of the United States from October 28, 2012 to October 30, 2012. On most collateral dependent loans, our exposure is limited due to the existence of flood and property insurance. We monitor our borrower's insurance coverage on a regular basis and force place insurance, as necessary. We are in the process of assessing the damage that may have occurred to the underlying properties and there is a risk that collateral for these loans has been damaged. As of the date of this filing, the Company does not have the information required to determine the extent of potential loss, if any, related to these loans.

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2011, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially affect our business, financial condition and/or operating results.

Table of Contents

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

39

Table of Contents

**Item 6. Exhibits**

31.1 CEO certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 CFO certification pursuant to Section 302 of the Sarbanes Oxley Act of 2002.

32.1 CEO and CFO certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Financial Condition, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Stockholders' Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to the Consolidated Financial Statements.

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\* Furnished, not filed.

Table of Contents

**Signatures**

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

Northeast Community Bancorp, Inc.

Date: November 20, 2012 By: /s/ Kenneth A. Martinek  
Kenneth A. Martinek  
President and Chief Executive Officer

Date: November 20, 2012 By: /s/ Salvatore Randazzo  
Salvatore Randazzo  
Executive Vice President and Chief Financial Officer