

NORTHEAST COMMUNITY BANCORP INC  
Form 10-Q  
November 14, 2011

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, 2011

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<br>America                                       | 06-1786701                           |
| (State or other jurisdiction of incorporation or<br>organization) | (I.R.S. Employer Identification No.) |

|  |            |
|--|------------|
| 325 Hamilton Avenue, White Plains, New<br>York | 10601      |
| (Address of principal executive offices)       | (Zip Code) |

(914) 684-2500  
(Registrant's telephone number, including area code)

N/A  
(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

Edgar Filing: NORTHEAST COMMUNITY BANCORP INC - Form 10-Q

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 11, 2011, there were 12,644,752 shares of the registrant's common stock outstanding.

---

NORTHEAST COMMUNITY BANCORP, INC.  
Table of Contents

|                                     | Page<br>No.  |
|-------------------------------------|--|
| <u>Part I—Financial Information</u> |  |
| <u>Item 1.</u>                      | <u>Financial Statements (Unaudited)</u>  |
|                                     | <u>Consolidated Statements of Financial Condition at September 30, 2011 and December 31, 2010</u> 1            |
|                                     | <u>Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2011 and 2010</u> 2     |
|                                     | <u>Consolidated Statements of Stockholders' Equity for the Nine Months Ended September 30, 2011 and 2010</u> 3 |
|                                     | <u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2011 and 2010</u> 4           |
|                                     | <u>Notes to Consolidated Financial Statements</u> 5  |
| <u>Item 2.</u>                      | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 21                |
| <u>Item 3.</u>                      | <u>Quantitative and Qualitative Disclosures about Market Risk</u> 34   |
| <u>Item 4.</u>                      | <u>Controls and Procedures</u> 35  |
| <u>Part II—Other Information</u>    |  |
| <u>Item 1.</u>                      | <u>Legal Proceedings</u> 36  |
| <u>Item 1A.</u>                     | <u>Risk Factors</u> 36   |
| <u>Item 2.</u>                      | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> 37  |
| <u>Item 3.</u>                      | <u>Defaults Upon Senior Securities</u> 37  |
| <u>Item 4.</u>                      | <u>[Removed and Reserved]</u> 37   |
| <u>Item 5.</u>                      | <u>Other Information</u> 37  |
| <u>Item 6.</u>                      | <u>Exhibits</u> 38   |
|                                     | <u>Signatures</u> 39   |



Table of Contents

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (UNAUDITED)

|  | September<br>30,<br>2011                           | December 31,<br>2010 |
|--|--|----------------------|
|  | (In thousands,<br>except share and per share data) |                      |
| <b>ASSETS</b>  |  |                      |
| Cash and amounts due from depository institutions  | \$ 2,584   | \$ 2,494             |
| Interest-bearing deposits  | 49,480   | 41,959               |
| Cash and cash equivalents  | 52,064   | 44,453               |
| Certificates of deposit  | 2,988  | 2,988                |
| Securities available-for-sale  | 152  | 162                  |
| Securities held-to-maturity  | 17,448   | 19,858               |
| Loans receivable, net of allowance for loan losses of \$7,969<br>and \$7,647, respectively   | 356,883  | 364,798              |
| Premises and equipment, net  | 7,620  | 6,784                |
| Federal Home Loan Bank of New York stock, at cost  | 1,633  | 1,884                |
| Bank owned life insurance  | 16,587   | 16,145               |
| Accrued interest receivable  | 1,544  | 1,704                |
| Goodwill   | 1,310  | 1,310                |
| Intangible assets  | 482  | 527                  |
| Real estate owned  | 916  | 933                  |
| Other assets   | 3,983  | 4,462                |
| <b>Total assets</b>  | <b>\$ 463,610</b>                                  | <b>\$ 466,008</b>    |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |  |                      |
| <b>Liabilities</b>   |  |                      |
| <b>Deposits:</b>   |  |                      |
| Non-interest bearing   | \$ 14,427  | \$ 9,839             |
| Interest bearing   | 314,851  | 316,991              |
| <b>Total deposits</b>  | <b>329,278</b>                                     | <b>326,830</b>       |
| Advance payments by borrowers for taxes and insurance  | 4,297  | 3,384                |
| Federal Home Loan Bank advances  | 20,000   | 25,000               |
| Accounts payable and accrued expenses  | 3,021  | 2,487                |
| Note payable   | 174  | 168                  |
| <b>Total liabilities</b>   | <b>356,770</b>                                     | <b>357,869</b>       |
| <b>Stockholders' equity:</b>   |  |                      |
| Preferred stock, \$0.01 par value; 1,000,000 shares authorized, none issued  | —  | —                    |
| Common stock, \$0.01 par value; 19,000,000 shares authorized;<br>13,225,000 shares issued; outstanding: 12,644,752 shares in<br>2011 and 13,114,800 shares in 2010 | 132  | 132                  |
| Additional paid-in capital   | 57,319   | 57,391               |
| Unearned Employee Stock Ownership Plan ("ESOP") shares   | (3,694 )   | (3,888 )             |

Edgar Filing: NORTHEAST COMMUNITY BANCORP INC - Form 10-Q

|  |            |            |
|--|------------|------------|
| Retained earnings  | 56,898     | 55,335     |
| Treasury stock – at cost, 580,248 shares and 110,200 shares respectively | (3,713 )   | (664 )     |
| Accumulated other comprehensive loss                                     | (102 )     | (167 )     |
| Total stockholders' equity   | 106,840    | 108,139    |
| Total liabilities and stockholders' equity                               | \$ 463,610 | \$ 466,008 |

See Notes to Consolidated Financial Statements

Table of Contents

## CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

|  | Three Months Ended<br>September 30,   |              | Nine Months Ended<br>September 30, |               |
|--|---------------------------------------|--------------|------------------------------------|---------------|
|  | 2011                                  | 2010         | 2011                               | 2010          |
|  | (In thousands, except per share data) |              |                                    |               |
| <b>INTEREST INCOME:</b>  |                                       |              |                                    |               |
| Loans  | \$5,378                               | \$5,585      | \$16,314                           | \$17,010      |
| Interest-earning deposits                                      | 9                                     | 17           | 29                                 | 92            |
| Securities – taxable   | 186                                   | 244          | 548                                | 761           |
| <b>Total Interest Income</b>                                   | <b>5,573</b>                          | <b>5,846</b> | <b>16,891</b>                      | <b>17,863</b> |
| <b>INTEREST EXPENSE:</b>                                       |                                       |              |                                    |               |
| Deposits   | 1,127                                 | 1,865        | 3,428                              | 5,799         |
| Borrowings   | 161                                   | 233          | 482                                | 831           |
| <b>Total Interest Expense</b>                                  | <b>1,288</b>                          | <b>2,098</b> | <b>3,910</b>                       | <b>6,630</b>  |
| <b>Net Interest Income</b>                                     | <b>4,285</b>                          | <b>3,748</b> | <b>12,981</b>                      | <b>11,233</b> |
| <b>PROVISION FOR LOAN LOSSES</b>                               | <b>393</b>                            | <b>4</b>     | <b>1,113</b>                       | <b>898</b>    |
| <b>Net Interest Income after Provision for<br/>Loan Losses</b> | <b>3,892</b>                          | <b>3,744</b> | <b>11,868</b>                      | <b>10,335</b> |
| <b>NON-INTEREST INCOME:</b>                                    |                                       |              |                                    |               |
| Other loan fees and service charges                            | 96                                    | 80           | 244                                | 231           |
| Gain/(loss) on disposition of equipment                        | 15                                    | -            | 10                                 | (7)           |
| Earnings on bank owned life insurance                          | 149                                   | 157          | 442                                | 468           |
| Investment advisory fees                                       | 259                                   | 193          | 670                                | 574           |
| Other  | (2)                                   | 5            | 5                                  | 11            |
| <b>Total Non-Interest Income</b>                               | <b>517</b>                            | <b>435</b>   | <b>1,371</b>                       | <b>1,277</b>  |
| <b>NON-INTEREST EXPENSES:</b>                                  |                                       |              |                                    |               |
| Salaries and employee benefits                                 | 1,862                                 | 1,715        | 5,182                              | 5,273         |
| Occupancy expense  | 280                                   | 308          | 857                                | 945           |
| Equipment  | 173                                   | 122          | 458                                | 400           |
| Outside data processing  | 185                                   | 199          | 592                                | 632           |
| Advertising  | 58                                    | 15           | 122                                | 51            |
| Real estate owned expense                                      | 14                                    | 83           | 27                                 | 95            |
| FDIC insurance premiums  | 87                                    | 112          | 315                                | 355           |
| Other  | 1,072                                 | 815          | 2,579                              | 2,201         |
| <b>Total Non-Interest Expenses</b>                             | <b>3,731</b>                          | <b>3,369</b> | <b>10,132</b>                      | <b>9,952</b>  |

Edgar Filing: NORTHEAST COMMUNITY BANCORP INC - Form 10-Q

|   |        |        |         |         |
|---|--------|--------|---------|---------|
| Income before Provision for<br>Income Taxes                     | 678    | 810    | 3,107   | 1,660   |
| PROVISION FOR INCOME TAXES                                      | 211    | 276    | 1,081   | 477     |
| Net Income  | \$467  | \$534  | \$2,026 | \$1,183 |
| Net Income per Common Share<br>– Basic                          | \$0.04 | \$0.04 | \$0.16  | \$0.09  |
| Weighted Average Number of Common<br>Shares Outstanding – Basic | 12,277 | 12,743 | 12,518  | 12,735  |
| Dividends Declared per Common Share                             | \$0.03 | \$0.03 | \$0.09  | \$0.09  |

See Notes to Consolidated Financial Statements



Table of Contents

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (UNAUDITED)

Nine Months Ended September 30, 2011 and 2010 (in thousands)

|   | Common<br>Stock | Additional<br>Paid-in<br>Capital | Unearned<br>ESOP<br>Shares | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Equity | Comprehensive<br>Income |
|---|-----------------|----------------------------------|----------------------------|----------------------|-------------------|---|-----------------|-------------------------|
| Balance at December 31, 2009  | \$ 132          | \$ 57,496                        | \$(4,147 )                 | \$54,121             | \$-               | \$ (154 )                                     | \$ 107,448      |                         |
| Comprehensive income:   |                 |                                  |                            |                      |                   |   |                 |                         |
| Net income  | -               | -                                | -                          | 1,183                | -                 | -   | 1,183           | \$ 1,183                |
| Unrealized gain on securities available for sale, net of taxes of \$1 | -               | -                                | -                          | -                    | -                 | 2   | 2               | 2                       |
| Pension liability – DRP, net of taxes of \$8                          | -               | -                                | -                          | -                    | -                 | (12 )   | (12 )           | (12 )                   |
| Purchase of 85,400 shares of treasury stock                           | -               | -                                | -                          | -                    | (515 )            | -   | (515 )          |                         |
| Minority cash dividends declared (\$0.09 per share)                   | -               | -                                | -                          | (490 )               | -                 | -   | (490 )          |                         |
| ESOP shares earned  | -               | (78 )                            | 194                        | -                    | -                 | -   | 116             |                         |
| Total Comprehensive Income  |                 |                                  |                            |                      |                   |   |                 | \$ 1,173                |
| Balance – September 30, 2010  | \$ 132          | \$ 57,418                        | \$(3,953 )                 | \$54,814             | \$(515 )          | \$ (164 )                                     | \$ 107,732      |                         |
| Balance at December 31, 2010  | \$ 132          | \$ 57,391                        | \$(3,888 )                 | \$55,335             | \$(664 )          | \$ (167 )                                     | \$ 108,139      |                         |
| Comprehensive income:   |                 |                                  |                            |                      |                   |   |                 |                         |
| Net income  | -               | -                                | -                          | 2,026                | -                 | -   | 2,026           | \$ 2,026                |
| Unrealized loss on securities available for sale, net of taxes of \$0 | -               | -                                | -                          | -                    | -                 | (1 )  | (1 )            | (1 )                    |
| Pension liability – DRP, net of taxes of \$21                         | -               | -                                | -                          | -                    | -                 | 66  | 66              | 66                      |
| Purchase of 470,048 shares of   | -               | -                                | -                          | -                    | (3,049 )          | -   | (3,049 )        |                         |

treasury  
stock

|   |        |           |            |          |            |                      |
|---|--------|-----------|------------|----------|------------|----------------------|
| Minority cash dividends declared (\$0.09 per share) | -      | -         | -          | (463 )   | -          | (463 )               |
| ESOP shares earned                                  | -      | (72 )     | 194        | -        | -          | 122                  |
| Total Comprehensive Income                          |        |           |            |          |            | \$ 2,091             |
| Balance – September 30, 2011                        | \$ 132 | \$ 57,319 | \$(3,694 ) | \$56,898 | \$(3,713 ) | \$ (102 ) \$ 106,840 |

See Notes to Consolidated Financial Statements

Table of Contents

## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

|   | Nine Months Ended<br>September 30, |                  |
|---|------------------------------------|------------------|
|   | 2011                               | 2010             |
|   | (In thousands)                     |                  |
| <b>Cash Flows from Operating Activities:</b>                                      |                                    |                  |
| Net income  | \$2,026                            | \$1,183          |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |                  |
| Net amortization of securities premiums and discounts, net                        | 34                                 | 25               |
| Provision for loan losses   | 1,113                              | 898              |
| Depreciation  | 515                                | 586              |
| Net amortization of deferred loan fees and costs                                  | 118                                | 104              |
| Amortization of intangible assets   | 45                                 | 45               |
| Deferred income tax (benefit) expense   | (228 )                             | 292              |
| Accretion of discount on note payable   | 6                                  | 11               |
| Retirement plan expense   | 507                                | 456              |
| (Gain) loss on disposal of equipment  | (10 )                              | 7                |
| Loss on sale of real estate owned   | -                                  | 50               |
| Earnings on bank owned life insurance   | (442 )                             | (468 )           |
| ESOP compensation expense   | 122                                | 116              |
| Decrease (increase) in accrued interest receivable                                | 160                                | (23 )            |
| Decrease in other assets  | 663                                | 263              |
| Increase (decrease) in accounts payable and accrued expenses                      | 136                                | (90 )            |
| <b>Net Cash Provided by Operating Activities</b>                                  | <b>4,765</b>                       | <b>3,455</b>     |
| <b>Cash Flows from Investing Activities:</b>                                      |                                    |                  |
| Net decrease in loans   | 6,684                              | 14,194           |
| Purchase of securities held-to-maturity   | (984 )                             | (22,568 )        |
| Principal repayments on securities available-for-sale                             | 10                                 | 8                |
| Principal repayments on securities held-to-maturity                               | 3,360                              | 13,475           |
| Proceeds from maturities of certificates of deposit                               | -                                  | 7,719            |
| Redemption of Federal Home Loan Bank of New York stock                            | 251                                | 393              |
| Proceeds from disposition of equipment  | 10                                 | -                |
| Proceeds from sale of real estate owned   | -                                  | 300              |
| Purchases of premises and equipment   | (1,334 )                           | (80 )            |
| Purchase of bank owned life insurance   | -                                  | (5,000 )         |
| <b>Net Cash Provided by Investing Activities</b>                                  | <b>7,997</b>                       | <b>8,441</b>     |
| <b>Cash Flows from Financing Activities:</b>                                      |                                    |                  |
| Net increase (decrease) in deposits   | 2,448                              | (18,991 )        |
| Proceeds from FHLB of NY advances   | 10,000                             | -                |
| Repayment of FHLB of NY advances  | (15,000 )                          | (10,000 )        |
| Purchase of treasury stock  | (3,049 )                           | (515 )           |
| Increase in advance payments by borrowers for taxes and insurance                 | 913                                | 984              |
| Cash dividends paid to minority shareholders                                      | (463 )                             | (490 )           |
| <b>Net Cash Used in Financing Activities</b>                                      | <b>(5,151 )</b>                    | <b>(29,012 )</b> |

Edgar Filing: NORTHEAST COMMUNITY BANCORP INC - Form 10-Q

|  |          |           |
|--|----------|-----------|
| Net Increase (Decrease) in Cash and Cash Equivalents | 7,611    | (17,116 ) |
| Cash and Cash Equivalents - Beginning                | 44,453   | 88,718    |
| Cash and Cash Equivalents - Ending                   | \$52,064 | \$71,602  |

**SUPPLEMENTARY CASH FLOWS INFORMATION**

|   |         |         |
|---|---------|---------|
| Income taxes paid   | \$705   | \$-     |
| Interest paid   | \$3,428 | \$6,634 |
| <b>SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING ACTIVITIES</b> |         |         |
| Loan transferred to real estate owned                           | \$-     | \$751   |

See Notes to Consolidated Financial Statements

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 accompanying unaudited consolidated financial statements include the accounts of the Company, the Bank and the Bank’s wholly owned subsidiary, New England Commercial Properties, LLC (“NECP”). All significant intercompany accounts and transactions have been eliminated in consolidation.

NECP, a New York limited liability company, was formed in October 2007 to facilitate the purchase or lease of real property by the Bank. As of September 30, 2011, NECP had title to two multifamily properties. The Bank accepted a deed-in-lieu of foreclosure and transferred the first property to NECP on November 19, 2008. In addition, the Bank accepted a deed-in-lieu of foreclosure and transferred the second property to NECP on November 30, 2010.

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 footnotes 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, 2011 are not necessarily indicative of the results that may be expected for the full year or any other interim period. The December 31, 2010 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, income, 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, 2010.

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, 2011 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 balance sheet 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 Bank'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 record, 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 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.

6

---



Table of Contents

NOTE 1 – BASIS OF PRESENTATION (Continued)

Allowance for Loan Losses (Continued)

- |    |   |
|----|---|
| 8. | Concentrations of credit.                 |
| 9. | Competitive, 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, federal 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, 2011.

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 nine-month periods ended September 30, 2011 and 2010, 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, 2010 and September 30, 2011, 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, 2010, the Company had allocated 103,684 shares to participants, and an additional 25,921 shares had been committed to be released. As of September 30, 2011, the Company had allocated 129,605 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 \$42,000 and \$37,000 during the three-month periods ended September 30, 2011 and 2010, respectively, and \$122,000 and \$116,000 during the nine-month periods ended September 30, 2011 and 2010, 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<br>Ended September 30, |       | Nine Months Ended<br>September 30, |       |
|---------------------------------------|-------------------------------------|-------|------------------------------------|-------|
|                                       | 2011                                | 2010  | 2011                               | 2010  |
|                                       | (In thousands)                      |       |                                    |       |
| Service cost                          | \$ 14                               | \$ 14 | \$ 42                              | \$ 42 |
| Interest cost                         | 10                                  | 10    | 30                                 | 30    |
| Amortization of prior<br>service cost | 5                                   | 5     | 15                                 | 15    |
| Amortization of actuarial<br>loss     | 1                                   | 1     | 4                                  | 5     |
| Total                                 | \$ 30                               | \$ 30 | \$ 91                              | \$ 92 |

This plan is a non-contributory defined benefit pension plan covering all non-employee directors meeting eligibility requirements as specified in the plan document. The amortization of prior service cost and actuarial loss in the nine-month periods ended September 30, 2011 and 2010 is also reflected as a reduction in other comprehensive income during those periods.

## NOTE 5 – INVESTMENTS

The following tables set forth the amortized cost and fair values of our securities portfolio at the dates indicated:

|   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|---|-------------------|------------------------------|-------------------------------|---------------|
| (In thousands)                              |                   |                              |                               |               |
| At September 30, 2011                       |                   |                              |                               |               |
| Securities available for sale:              |                   |                              |                               |               |
| Mortgage-backed securities – residential:   |                   |                              |                               |               |
| Federal Home Loan Mortgage Corporation      | \$ 95             | \$ 3                         | \$ -                          | \$ 98         |
| Federal National Mortgage Association       | 53                | 1                            | -                             | 54            |
| Total                                       | \$ 148            | \$ 4                         | \$ -                          | \$ 152        |
| Securities held to maturity:                |                   |                              |                               |               |
| Mortgage-backed securities – residential:   |                   |                              |                               |               |
| Government National Mortgage<br>Association | \$ 12,886         | \$ 420                       | \$ -                          | \$ 13,306     |
|   | 307               | 7                            | -                             | 314           |

Edgar Filing: NORTHEAST COMMUNITY BANCORP INC - Form 10-Q

| Federal Home Loan Mortgage Corporation  |           |        |      |           |
|---|-----------|--------|------|-----------|
| Federal National Mortgage Association   | 309       | 8      | -    | 317       |
| Collateralized mortgage obligations-GSE | 3,945     | 179    | -    | 4,124     |
| Other                                   | 1         | -      | -    | 1         |
| Total                                   | \$ 17,448 | \$ 614 | \$ - | \$ 18,062 |

Table of Contents

## NOTE 5 – INVESTMENTS (Continued)

|   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|---|-------------------|------------------------------|-------------------------------|---------------|
|   | (In thousands)    |                              |                               |               |
| At December 31, 2010                      |                   |                              |                               |               |
| Securities available for sale:            |                   |                              |                               |               |
| Mortgage-backed securities – residential: |                   |                              |                               |               |
| Federal Home Loan Mortgage Corporation    |                   |                              |                               |               |
|   | \$ 102            | \$ 4                         | \$ -                          | \$ 106        |
| Federal National Mortgage Association     |                   |                              |                               |               |
|   | 55                | 1                            | -                             | 56            |
| Total                                     | \$ 157            | \$ 5                         | \$ -                          | \$ 162        |
| Securities held to maturity:              |                   |                              |                               |               |
| Mortgage-backed securities – residential: |                   |                              |                               |               |
| Government National Mortgage Association  |                   |                              |                               |               |
|   | \$ 14,521         | \$ 355                       | \$ -                          | \$ 14,876     |
| Federal Home Loan Mortgage Corporation    |                   |                              |                               |               |
|   | 345               | 11                           | -                             | 356           |
| Federal National Mortgage Association     |                   |                              |                               |               |
|   | 352               | 9                            | -                             | 361           |
| Collateralized mortgage obligations-GSE   |                   |                              |                               |               |
|   | 4,639             | 109                          | -                             | 4,748         |
| Other                                     |                   |                              |                               |               |
|   | 1                 | -                            | -                             | 1             |
| Total                                     | \$ 19,858         | \$ 484                       | \$ -                          | \$ 20,342     |

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

|                     | September 30, 2011 |            |
|---------------------|--------------------|------------|
|                     | Amortized<br>Cost  | Fair Value |
|                     | (In thousands)     |            |
| Due after ten years | \$ 148             | \$ 152     |
|                     | \$ 148             | \$ 152     |

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

|                                     | September 30, 2011 |            |
|-------------------------------------|--------------------|------------|
|                                     | Amortized<br>Cost  | Fair Value |
|                                     | (In thousands)     |            |
| Due after one but within five years | \$ 4               | \$ 4       |
| Due after five but within ten years | 251                | 256        |
| Due after ten years                 | 17,193             | 17,802     |

\$ 17,448      \$ 18,062

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, we 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:

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

Table of Contents

## NOTE 6 – FAIR VALUE DISCLOSURES (Continued)

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 basis, the fair value measurements by level within the fair value hierarchy used are as follows:

| Description                               | Total  | (Level 1)<br>Quoted<br>Prices<br>in Active<br>Markets for<br>Identical<br>Assets | (Level 2)<br>Significant<br>Other<br>Observable<br>Inputs | (Level 3)<br>Significant<br>Unobservable<br>Inputs |
|---|--------|--|---|--|
| September 30, 2011:<br>(In thousands)     |        |  |   |  |
| Mortgage-backed securities - residential: |        |  |   |  |
| Federal Home Loan Mortgage Corporation    | \$ 98  | \$ -   | \$ 98   | \$ -   |
| Federal National Mortgage Association     | 54     | -  | 54  | -  |
| December 31, 2010:                        |        |  |   |  |
| Mortgage-backed securities - residential: |        |  |   |  |
| Federal Home Loan Mortgage Corporation    | \$ 106 | \$ -   | \$ 106  | \$ -   |
| Federal National Mortgage Association     | 56     | -  | 56  | -  |

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets and financial liabilities measured at fair value on a non-recurring basis at September 30, 2011 and December 31, 2010 are as follows:

| Description | Total | (Level 1)<br>Quoted<br>Prices<br>in Active<br>Markets<br>for<br>Identical | (Level 2)<br>Significant<br>Other<br>Observable<br>Inputs | (Level 3)<br>Significant<br>Unobservable<br>Inputs |
|-------------|-------|---|---|--|
|-------------|-------|---|---|--|

## Assets

(In thousands)

|                     |           |      |      |           |
|---------------------|-----------|------|------|-----------|
| September 30, 2011: |           |      |      |           |
| Impaired loans      | \$ 6,351  | \$ - | \$ - | \$ 6,351  |
| December 31, 2010:  |           |      |      |           |
| Impaired loans      | \$ 10,953 | \$ - | \$ - | \$ 10,953 |

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.



Table of Contents

NOTE 6 – FAIR VALUE DISCLOSURES (Continued)

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, 2011 and December 31, 2010:

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

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, or discounted cash flows based upon the expected proceeds. 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.

Deposit Liabilities

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.

#### 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.

Table of Contents

## NOTE 6 – FAIR VALUE DISCLOSURES (Continued)

## Note Payable

The fair value of the note payable 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, 2011 and December 31, 2010, the estimated fair values of these off-balance-sheet financial instruments were immaterial.

The carrying amounts and estimated fair value of our financial instruments are as follows:

|                                      | At<br>September 30, 2011 |                         | At<br>December 31, 2010 |                         |
|--------------------------------------|--------------------------|-------------------------|-------------------------|-------------------------|
|                                      | Carrying<br>Amount       | Estimated<br>Fair Value | Carrying<br>Amount      | Estimated<br>Fair Value |
|                                      | (In thousands)           |                         |                         |                         |
| <b>Financial assets:</b>             |                          |                         |                         |                         |
| Cash and cash equivalents            | \$52,064                 | \$52,064                | \$44,453                | \$44,453                |
| Certificates of deposit              | 2,988                    | 2,988                   | 2,988                   | 2,988                   |
| Securities available for sale        | 152                      | 152                     | 162                     | 162                     |
| Securities held to maturity          | 17,448                   | 18,062                  | 19,858                  | 20,342                  |
| Loans receivable                     | 356,883                  | 363,080                 | 364,798                 | 372,322                 |
| FHLB stock                           | 1,633                    | 1,633                   | 1,884                   | 1,884                   |
| Accrued interest receivable          | 1,544                    | 1,544                   | 1,704                   | 1,704                   |
| <b>Financial liabilities:</b>        |                          |                         |                         |                         |
| Deposits, including accrued interest | 329,278                  | 332,105                 | 326,830                 | 330,471                 |
| FHLB advances                        | 20,000                   | 20,780                  | 25,000                  | 26,759                  |
| Note payable                         | 174                      | 190                     | 168                     | 173                     |

## 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,<br>2011 | December 31,<br>2010 |
|------------------------------------|-----------------------|----------------------|
|                                    | (In thousands)        |                      |
| <b>Residential real estate:</b>    |                       |                      |
| One-to-four family                 | \$ 186                | \$ 211               |
| Multi-family                       | 194,291               | 190,042              |
| Mixed use                          | 49,923                | 55,244               |
|                                    | 244,400               | 245,497              |
| <b>Non-residential real estate</b> |                       |                      |
| Construction                       | 90,250                | 100,925              |
|                                    | 9,030                 | 12,913               |

Edgar Filing: NORTHEAST COMMUNITY BANCORP INC - Form 10-Q

|                              |                   |                   |
|------------------------------|-------------------|-------------------|
| Commercial                   | 20,287            | 12,140            |
| Consumer                     | 70                | 63                |
| <b>Total Loans</b>           | <b>364,037</b>    | <b>371,538</b>    |
| Allowance for loan losses    | (7,969 )          | (7,647 )          |
| Deferred loan fees and costs | 815               | 907               |
| <b>Net Loans</b>             | <b>\$ 356,883</b> | <b>\$ 364,798</b> |

Table of Contents

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

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

Allowance for Loan Losses as of and for the Nine Months Ended September 30, 2011 (in thousands)

|  | Residential<br>Real<br>Estate | Non-<br>residential<br>Real<br>Estate | Construction | Commercial | Consumer | Total     |
|--|-------------------------------|---------------------------------------|--------------|------------|----------|-----------|
| <b>Allowance for credit losses:</b>                      |                               |                                       |              |            |          |           |
| 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   |
| Ending balance: individually<br>evaluated for impairment | \$414                         | \$-                                   | \$2,468      | \$-        | \$-      | \$2,882   |
| Ending balance: collectively<br>evaluated for impairment | \$3,706                       | \$1,210                               | \$70         | \$101      | \$-      | \$5,087   |
| <b>Loan receivables:</b>                                 |                               |                                       |              |            |          |           |
| Ending balance   | \$244,400                     | \$90,250                              | \$9,030      | \$20,287   | \$70     | \$364,037 |
| Ending balance: individually<br>evaluated for impairment | \$13,308                      | \$9,695                               | \$7,625      | \$-        | \$-      | \$30,628  |
| Ending balance: collectively<br>evaluated for impairment | \$231,092                     | \$80,555                              | \$1,405      | \$20,287   | \$70     | \$333,409 |

Allowance for Loan Losses as of and for the Three Months Ended September 30, 2011 (in thousands)

|                                     | Residential<br>Real Estate | Non-<br>residential<br>Real<br>Estate | Construction | Commercial | Consumer | Total   |
|-------------------------------------|----------------------------|---------------------------------------|--------------|------------|----------|---------|
| <b>Allowance for credit losses:</b> |                            |                                       |              |            |          |         |
| Beginning balance                   | \$3,893                    | \$1,309                               | \$2,320      | \$78       | \$-      | \$7,600 |
| Charge-offs                         | (28 )                      | -                                     | -            | -          | -        | (28 )   |
| Recoveries                          | 4                          | -                                     | -            | -          | -        | 4       |
| Provision                           | 251                        | (99 )                                 | 218          | 23         | -        | 393     |
| Ending balance                      | \$4,120                    | \$1,210                               | \$2,538      | \$101      | \$-      | \$7,969 |



Table of Contents

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

Allowance for Loan Losses as of and for the Year Ended December 31, 2010 (in thousands)

|   | Residential<br>Real<br>Estate | Non-<br>residential<br>Real<br>Estate | Construction | Commercial | Consumer | Total     |
|---|-------------------------------|---------------------------------------|--------------|------------|----------|-----------|
| <b>Allowance for credit losses:</b>                   |                               |                                       |              |            |          |           |
| Beginning balance                                     | \$3,948                       | \$2,495                               | \$ 186       | \$ 104     | \$-      | \$6,733   |
| Charge-offs   | (1,211 )                      | (1,407 )                              | -            | -          | -        | (2,618 )  |
| Recoveries  | 45                            | -                                     | -            | -          | -        | 45        |
| Provision   | 1,142                         | 472                                   | 1,897        | (24 )      | -        | 3,487     |
| Ending balance  | \$3,924                       | \$1,560                               | \$ 2,083     | \$ 80      | \$-      | \$7,647   |
| Ending balance: individually evaluated for impairment |                               |                                       |              |            |          |           |
|   | \$368                         | \$82                                  | \$ 1,756     | \$-        | \$-      | \$2,206   |
| Ending balance: collectively evaluated for impairment |                               |                                       |              |            |          |           |
|   | \$3,556                       | \$1,478                               | \$ 327       | \$ 80      | \$-      | \$5,441   |
| <b>Loan receivables:</b>                              |                               |                                       |              |            |          |           |
| Ending balance  | \$245,497                     | \$100,925                             | \$ 12,913    | \$ 12,140  | \$63     | \$371,538 |
| Ending balance: individually evaluated for impairment | \$7,696                       | \$10,399                              | \$ 11,575    | \$-        | \$-      | \$29,670  |
| Ending balance: collectively evaluated for impairment | \$237,801                     | \$90,526                              | \$ 1,338     | \$ 12,140  | \$63     | \$341,868 |

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

Impaired Loans as of September 30, 2011 (in thousands)

|  | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|--|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
| 2011                                       |                        |                                |                      |                                   |                                  |
| <b>With no related allowance recorded:</b> |                        |                                |                      |                                   |                                  |
| 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                              |
| <b>With an allowance recorded:</b>         |                        |                                |                      |                                   |                                  |
| 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                               |
| <b>Total:</b>                              |                        |                                |                      |                                   |                                  |
| Residential real estate-Multi-family       | 13,308                 | 13,308                         | 414                  | 13,211                            | 360                              |

Edgar Filing: NORTHEAST COMMUNITY BANCORP INC - Form 10-Q

|                             |          |          |         |          |       |
|-----------------------------|----------|----------|---------|----------|-------|
| 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 |

14

---



Table of Contents

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

Impaired Loans as of December 31, 2010 (in thousands)

| 2010                                 | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|--------------------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
| With no related allowance recorded:  |                        |                                |                      |                                   |                                  |
| Residential real estate-Multi-family | \$6,608                | \$6,608                        | \$-                  | \$6,505                           | \$ 246                           |
| Non-residential real estate          | 9,903                  | 9,903                          | -                    | 10,086                            | 268                              |
| Construction                         | -                      | -                              | -                    | -                                 | -                                |
| Subtotal                             | 16,511                 | 16,511                         | -                    | 16,591                            | 514                              |
| With an allowance recorded:          |                        |                                |                      |                                   |                                  |
| Residential real estate-Multi-family | 1,088                  | 1,088                          | 368                  | 1,147                             | -                                |
| Non-residential real estate          | 496                    | 496                            | 82                   | 414                               | 5                                |
| Construction                         | 11,575                 | 11,575                         | 1,756                | 11,696                            | 464                              |
| Subtotal                             | 13,159                 | 13,159                         | 2,206                | 13,257                            | 469                              |
| Total:                               |                        |                                |                      |                                   |                                  |
| Residential real estate-Multi-family | 7,696                  | 7,696                          | 368                  | 7,652                             | 246                              |
| Non-residential real estate          | 10,399                 | 10,399                         | 82                   | 10,500                            | 273                              |
| Construction                         | 11,575                 | 11,575                         | 1,756                | 11,696                            | 464                              |
| Total                                | \$29,670               | \$29,670                       | \$2,206              | \$29,848                          | \$ 983                           |

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, 2011 (in thousands)

|                              | 30-59 Days<br>Past Due | 60 – 89<br>Days Past<br>Due | Greater<br>Than 90<br>Days | Total Past<br>Due | Current   | Total<br>Loans<br>Receivable | Recorded<br>Investment<br>> 90 Days<br>and<br>Accruing |
|------------------------------|------------------------|-----------------------------|----------------------------|-------------------|-----------|------------------------------|--|
| Residential real estate:     |                        |                             |                            |                   |           |                              |  |
| One- to four-family          | \$-                    | \$-                         | \$-                        | \$-               | \$186     | \$186                        | \$-  |
| Multi-family                 | -                      | -                           | 5,510                      | 5,510             | 188,781   | 194,291                      | 1,191  |
| Mixed-use                    | -                      | -                           | 681                        | 681               | 49,242    | 49,923                       | -  |
| Non-residential real estate: |                        |                             |                            |                   |           |                              |  |
| Construction loans           | -                      | -                           | 7,625                      | 7,625             | 1,405     | 9,030                        | -  |
| Commercial loans             | -                      | 183                         | -                          | 183               | 20,104    | 20,287                       | -  |
| Consumer                     | -                      | -                           | -                          | -                 | 70        | 70                           | -  |
| Total loans                  | \$-                    | \$183                       | \$20,418                   | \$20,601          | \$343,436 | \$364,037                    | \$1,191  |

## Age Analysis of Past Due Loans as of December 31, 2010 (in thousands)

|                              | 30-59 Days<br>Past Due | 60 – 89<br>Days Past<br>Due | Greater<br>Than 90<br>Days | Total Past<br>Due | Current   | Total<br>Loans<br>Receivable | Recorded<br>Investment<br>> 90 Days<br>and<br>Accruing |
|------------------------------|------------------------|-----------------------------|----------------------------|-------------------|-----------|------------------------------|--|
| Residential real estate:     |                        |                             |                            |                   |           |                              |  |
| One- to four-family          | \$-                    | \$-                         | \$-                        | \$-               | \$211     | \$211                        | \$-  |
| Multi-family                 | 1,450                  | -                           | 4,774                      | 6,224             | 183,818   | 190,042                      | 2,555  |
| Mixed-use                    | -                      | -                           | -                          | -                 | 55,244    | 55,244                       | -  |
| Non-residential real estate: |                        |                             |                            |                   |           |                              |  |
| Construction loans           | -                      | -                           | 11,575                     | 11,575            | 1,338     | 12,913                       | -  |
| Commercial loans             | -                      | -                           | -                          | -                 | 12,140    | 12,140                       | -  |
| Consumer                     | 2                      | -                           | -                          | 2                 | 61        | 63                           | -  |
| Total loans                  | \$1,452                | \$-                         | \$21,806                   | \$23,258          | \$348,280 | \$371,538                    | \$2,555  |



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, 2011 (in thousands)

Credit Risk Profile by Internally Assigned Grade

|                    | Residential<br>Real Estate | Non-<br>residential<br>Real Estate | Construction    | Commercial       | Consumer     | Total             |
|--------------------|----------------------------|------------------------------------|-----------------|------------------|--------------|-------------------|
| <b>Grade:</b>      |                            |                                    |                 |                  |              |                   |
| Pass               | \$ 231,092                 | \$ 80,555                          | \$ 1,405        | \$ 20,287        | \$ 70        | \$ 333,409        |
| Special<br>Mention | 1,270                      | -                                  | -               | -                | -            | 1,270             |
| Substandard        | 12,038                     | 9,695                              | 7,625           | -                | -            | 29,358            |
| <b>Total</b>       | <b>\$ 244,400</b>          | <b>\$ 90,250</b>                   | <b>\$ 9,030</b> | <b>\$ 20,287</b> | <b>\$ 70</b> | <b>\$ 364,037</b> |

Credit Quality Indicators as of December 31, 2010 (in thousands)

Credit Risk Profile by Internally Assigned Grade

|                    | Residential<br>Real Estate | Non-<br>residential Real<br>Estate | Construction     | Commercial       | Consumer     | Total             |
|--------------------|----------------------------|------------------------------------|------------------|------------------|--------------|-------------------|
| <b>Grade:</b>      |                            |                                    |                  |                  |              |                   |
| Pass               | \$ 237,801                 | \$ 90,526                          | \$ 1,338         | \$ 12,140        | \$ 63        | \$ 341,868        |
| Special<br>Mention | 2,625                      | 4,942                              | -                | -                | -            | 7,567             |
| Substandard        | 5,071                      | 5,457                              | 11,575           | -                | -            | 22,103            |
| <b>Total</b>       | <b>\$ 245,497</b>          | <b>\$ 100,925</b>                  | <b>\$ 12,913</b> | <b>\$ 12,140</b> | <b>\$ 63</b> | <b>\$ 371,538</b> |

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

Loans Receivable on Nonaccrual Status as of September 30, 2011 and December 31, 2010 (in thousands)

|   | 2011             | 2010             |
|---|------------------|------------------|
| Residential real<br>estate-Multi-family | \$ 4,999         | \$ 2,219         |
| Non-residential real<br>estate          | 6,603            | 5,457            |
| Construction loans                      | 7,625            | 11,575           |
| <b>Total</b>                            | <b>\$ 19,227</b> | <b>\$ 19,251</b> |



Table of Contents

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

The following table shows the breakdown of loans we modified during the three and nine months ended September 30:

| (dollars in thousands)   | Three Months Ended September 30,<br>2011 |  |   |
|--------------------------|--|--|---|
|                          | Number of<br>Modifications               | Recorded<br>Investment<br>Prior to<br>Modification | Recorded<br>Investment<br>After<br>Modification |
| Residential real estate: |  |  |   |
| Multi-family             | 2  | \$ 2,279   | \$ 2,279  |

| (dollars in thousands)   | Nine Months Ended September 30,<br>2011 |  |   |
|--------------------------|---|--|---|
|                          | Number of<br>Modifications              | Recorded<br>Investment<br>Prior to<br>Modification | Recorded<br>Investment<br>After<br>Modification |
| Residential real estate: |   |  |   |
| Multi-family             | 2                                       | \$ 2,279   | \$ 2,279  |

Both loans had an interest rate of 6.5% with an amortization of 25 years that was modified to a rate of 5% and an amortization of 30 years.

As of September 30, 2011, none of the loans that were modified during the previous twelve-months had defaulted in the preceding nine-month period ended September 30, 2011.

As a result of the adopting the amendments in Accounting Standards Update No. 2011-02. The Company reassessed all restructurings that occurred on or after the beginning of the current fiscal year (January 1, 2011) for identification as troubled debt restructurings. The Company identified no loans for which the allowance for loan losses had previously been measured under a general allowance for loan losses methodology that are now considered troubled debt restructurings in accordance with Accounting Standards Update No. 2011-02.

Table of Contents

NOTE 8 – EFFECT OF SALE OF OUR NEW YORK CITY BRANCH OFFICE

On June 29, 2007, the Company completed the sale of its branch office building located at 1353-55 First Avenue, New York, New York (the “Property”). The sale price for the Property was \$28.0 million. At closing, the Company received \$10.0 million in cash and an \$18.0 million zero coupon promissory note recorded at its then present value of \$16.3 million (the “Original Note”). The Original Note was payable in two \$9.0 million installments due on the first and second anniversaries of the Original Note. On July 31, 2008, as payment of the first installment due under the Original Note, the Company received \$2.0 million in cash and a new \$7.0 million note bearing interest at 7% per annum and payable over a five-month period ending on December 31, 2008 (the “New Note”). On December 31, 2008, the Original Note and the remaining \$1.9 million balance on the New Note were rolled into a new \$10.9 million note payable on July 31, 2009 (the “Combined Note”). On July 29, 2009, prior to the due date, the \$10.9 million Combined Note was extended to January 31, 2010. The amount due on such date included interest and expenses. The Company and the borrower agreed in December 2010 to extend the term of the Combined Note to June 30, 2011 after the borrower paid \$1.9 million in cash to the Company in the fourth quarter of 2010. The payment represented \$1.5 million in interest income for 2009 and 2010 and \$377,000 in pre-paid interest for the six months ended June 30, 2011.

The Combined Note is secured by 100% of the interests in the companies owning the Property. In addition, the Combined Note is secured by a first mortgage on the Property. Based on a current appraisal, the loan to value is approximately 35%. The Company recognized interest income of \$569,000 during the nine months ended September 30, 2011 and \$1.5 million in interest income in 2010 since it believes the collection of the principal balance is assured. The Company and the borrower agreed on June 30, 2011 to further extend the term of the Combined Note to September 30, 2011 after the borrower paid \$363,000 in cash to the Company on June 30, 2011. The payment represented \$192,000 in pre-paid interest for the three months ended September 30, 2011 and a reimbursement of \$171,000 in expenses incurred by the Company in connection with the Property during 2011. This note is not treated as a loan or extension of credit for purposes of the regulatory limits on loans to one borrower.

On November 4, 2011 the note, including expenses and interest, was paid off.

NOTE 9 – EFFECT OF RECENT ACCOUNTING PRONOUNCEMENTS

The FASB has issued Accounting Standards Update (“ASU”) 2011-02, A Creditor’s Determination of Whether a Restructuring is a Troubled Debt Restructuring, to clarify the accounting principles applied to loan modifications, as defined by FASB ASC Subtopic 310-40, Receivables – Troubled Debt Restructurings by Creditors. This ASU clarifies guidance on a creditor’s evaluation of whether or not a concession has been granted, with an emphasis on evaluating all aspects of the modification rather than a focus on specific criteria, such as the effective interest rate test, to determine a concession. This ASU provides guidance on specific types of modifications such as changes in the interest rate of the borrowing, and insignificant delays in payments, as well as guidance on the creditor’s evaluation of whether or not a debtor is experiencing financial difficulties. For public entities, the amendments in this ASU are effective for the first interim or annual periods beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. The entity should also disclose information required by ASU 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, which had previously been deferred by ASU 2011-01, Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20, for interim and annual periods beginning on or after June 15, 2011. The Company adopted this guidance in the period ended September 30, 2011 and disclosed the required information in its consolidated financial statements.

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. For nonpublic entities, the ASU is effective for annual periods beginning after December 15, 2011. Early adoption is not permitted. The Company is still evaluating the impact the new pronouncement may have on its consolidated financial statements.



Table of Contents

NOTE 9 – 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. For nonpublic entities, the provisions are effective for fiscal years ending after December 31, 2012, and for interim and annual periods thereafter. As the two remaining options for presentation existed prior to the issuance of this ASU, early adoption is permitted. The Company is still evaluating the impact the new pronouncement may have on its 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. Early adoption is permitted. The Company is evaluating the impact of this ASU on its consolidated financial statements.

NOTE 10 – STOCK REPURCHASE

On July 22, 2010, the Company announced that the Company's Board of Directors approved the repurchase for up to 297,563 shares, or approximately 5.0% of the Company's outstanding common stock held by persons other than NorthEast Community Bancorp MHC (the "MHC"). This repurchase program was completed on May 12, 2011 under which the last of the 297,563 shares were purchased. These repurchases were conducted solely through a Rule 10b5-1 repurchase plan. Repurchased shares are held in treasury. The total cost of the 187,363 shares purchased under the plan for the nine months ended September 30, 2011 was \$1,159,000. A total of 297,563 shares were purchased under the plan at a total cost of approximately \$1.8 million, or \$6.13 per share.

On May 20, 2011 the Company announced that the Company's Board of Directors approved a second repurchase plan for up to 282,685 shares, or approximately 5.0% of the Company's outstanding common stock held by persons other than the MHC. This repurchase program was completed on July 12, 2011 under which 282,685 shares were purchased at a total cost of \$1,889,000, or \$6.68 per share. These repurchase were conducted solely through a Rule 10b5-1 repurchase plan. Repurchased shares are held in treasury.

In the aggregate, the Company has purchased 580,248 shares at a cost of \$3.7 million, or \$6.40 per share, through September 30, 2011.

NOTE 11 – DIVIDEND RESTRICTION

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, 2011. The MHC filed notice with, and received approval from, the Federal Reserve Bank of Philadelphia to waive its right to receive cash dividends for the

three fiscal quarters ending March 31, 2012.

The MHC has waived receipt of past dividends paid by the Company. The dividends waived are considered as a restriction on the retained earnings of the Company. As of September 30, 2011 and December 31, 2010, the aggregate retained earnings restricted for cash dividends waived were \$3,710,000 and \$3,055,000, respectively. See Part II, "Item 1A. Risk Factors," related to the amount of dividends paid on the Company's common stock, if any.

#### NOTE 12 - SUBSEQUENT EVENTS

On November 7, 2011 we executed an agreement to purchase a branch facility in Massachusetts for approximately \$1.3 million. The closing of the purchase is contingent on the seller completing certain improvements to the location, which we currently anticipate will occur in the fourth quarter of 2011.

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. In addition, the Office of the Comptroller of the Currency ("OCC"), as an integral part of its examination process, periodically reviews our allowance for loan losses. As of July 21, 2011, the 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. The OCC 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 2010.

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's earnings for the quarter ended September 30, 2011 decreased by \$67,000 over the same period in 2010 due primarily to increases of \$389,000 in provision for loan losses and an increase of \$362,000 in non-interest expense. Offsetting these increases was an increase of \$537,000 in net interest income from period to period primarily as a result of the cost of our interest-bearing liabilities decreasing more than the corresponding decrease in the yield on our interest-earning assets.

Non-performing loans decreased by \$1.4 million, or 6.4%, to \$20.4 million as of September 30, 2011 from \$21.8 million as of December 31, 2010. The decrease in non-performing loans is primarily attributable to the resolution of three multi-family mortgage loans and three construction mortgage loans totaling \$6.1 million that were satisfied or became performing as of September 30, 2011, partially offset by the addition of five non-performing multi-family mortgage loans, one non-performing mixed-use mortgage loan, and one non-performing non-residential mortgage loan totaling \$4.6 million.

We will continue to monitor our non-performing loans 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 at least quarterly and, more frequently, if necessary. The monitoring of these loans by the Special Assets Group allows the Company to adjust its level of loan loss allowances quickly in response to even modest changes in the loan portfolio's performance.

In an effort to reduce our risk exposure, we discontinued offering new construction loans effective the first quarter of 2009 and are not currently offering such loans.

During the third quarter of 2011, the Company scaled back its origination activity of new multi-family mortgages in New York. Based on market interest rates as low as 3.50% to 4.00%, the Company does not believe it is being adequately compensated for both the default risk and the duration gap risk associated with these loans. The Company intends to monitor the multi-family market in New York and, depending on market conditions and other factors, may increase such lending in the future.

In light of recent consolidation in the banking industry in Massachusetts and consistent with the Company's business plan, the Company intends to continue to aggressively pursue opportunities to expand its business in Massachusetts, particularly in and around the I-495 corridor. In 2009, the Company opened two branches in Massachusetts, one in Danvers and one in Plymouth, and we continue to look for other branch sites within our Massachusetts market area. At this time, the Company is also continuing to focus on opportunities to increase its loan production in Massachusetts in the areas of multi-family real estate lending and commercial and industrial lending in a manner consistent with our conservative underwriting standards. We have also expanded our product offerings to include one- to four-family lending within our market area in Massachusetts. To support the expansion of its lending operations in Massachusetts, the Company has hired additional employees for its operations in Massachusetts and has purchased a second office building located in Danvers, Massachusetts.

On November 7, 2011 we executed an agreement to purchase a third branch in Massachusetts for approximately \$1.3 million. The closing of the purchase is contingent on the seller completing certain improvements to the location, which we currently anticipate will occur in the fourth quarter of 2011.

Comparison of Financial Condition at September 30, 2011 and December 31, 2010

Total assets decreased by \$2.4 million, or 0.5%, to \$463.6 million at September 30, 2011 from \$466.0 million at December 31, 2010. The decrease in total assets was due to decreases of \$7.9 million in loans receivable, net, \$2.4

million in securities held-to-maturity, \$479,000 in other assets, \$251,000 in Federal Home Loan Bank of New York (“FHLB”) stock, and \$160,000 in accrued interest receivable, offset by increases of \$7.6 million in cash and cash equivalents, \$836,000 in premises and equipment, net, and \$442,000 in bank owned life insurance. The decrease in total assets funded repayment of \$5.0 million in FHLB advances and decrease of \$1.3 million in stockholders’ equity, partially offset by increases of \$2.4 million in deposits, \$913,000 in advance payments by borrowers for taxes and insurance, and \$534,000 in accounts payable and accrued expenses.

Cash and cash equivalents increased by \$7.6 million, or 17.1%, to \$52.1 million at September 30, 2011, from \$44.5 million at December 31, 2010. The increase in short-term liquidity resulted primarily from a decrease of \$7.9 million in loans receivable.

Securities held-to-maturity decreased by \$2.4 million, or 12.1%, to \$17.4 million at September 30, 2011 from \$19.9 million at December 31, 2010 due primarily to repayments of \$3.4 million less purchases of \$1.0 million. FHLB stock decreased by \$251,000, or 13.3%, to \$1.6 million at September 30, 2011 from \$1.9 million at December 31, 2010 due primarily to a decrease in the amount of FHLB stock that we are required to hold as a result of decreases in loans receivable, net, and FHLB advances.

Table of Contents

Loans receivable, net, decreased by \$7.9 million, or 2.2%, to \$356.9 million at September 30, 2011 from \$364.8 million at December 31, 2010 due to loan repayments totaling \$37.8 million that exceeded loan originations of \$30.3 million and an increase of \$322,000 in the allowance for loan losses.

Bank owned life insurance increased by \$442,000, or 2.7%, to \$16.6 million at September 30, 2011 from \$16.1 million at December 31, 2010 due to earnings during the nine months ended September 30, 2011. Premises and equipment increased by \$836,000, or 12.3%, to \$7.6 million at September 30, 2011 from \$6.8 million at December 31, 2010 due primarily to the purchases of building and equipment for the expansion of operations in Massachusetts, less depreciation.

Other assets decreased by \$479,000, or 10.7%, to \$4.0 million at September 30, 2011 from \$4.5 million at December 31, 2010 due primarily to reductions in various income tax accounts and the amortization of prepaid FDIC premiums during the first nine months of 2011.

Deposits increased by \$2.4 million, or 0.7%, to \$329.3 million at September 30, 2011 from \$326.8 million at December 31, 2010. The increase in deposits was primarily attributable to increases of \$8.6 million in our regular savings accounts and \$4.6 million in non-interest bearing accounts, offset by decreases of \$7.3 million in certificates of deposits, and \$3.5 million in our NOW and money market accounts.

Advance payments by borrowers for taxes and insurance increased by \$913,000, or 27.0%, to \$4.3 million at September 30, 2011 from \$3.4 million at December 31, 2010 due primarily to accumulating balances paid into escrow accounts by our borrowers.

Stockholders' equity decreased by \$1.3 million, or 1.2%, to \$106.8 million at September 30, 2011, from \$108.1 million at December 31, 2010. This decrease was primarily the result of treasury stock purchases of \$3.0 million pursuant to the Company's stock repurchase plan and cash dividends of \$463,000, offset by comprehensive net income of \$2.1 million and \$122,000 for ESOP shares earned for the period.

Comparison of Operating Results for the Three Months Ended September 30, 2011 and 2010

General. Net income decreased by \$67,000, or 12.5%, to \$467,000 for the quarter ended September 30, 2011, from \$534,000 for the quarter ended September 30, 2010. The decrease was primarily the result of increases of \$389,000 in provision for loan losses and \$362,000 in non-interest expense, offset by increases of \$537,000 in net interest income and \$82,000 in non-interest income and a decrease of \$65,000 in income taxes.

Net Interest Income. Net interest income increased by \$537,000, or 14.3%, to \$4.3 million for the three months ended September 30, 2011 from \$3.7 million for the three months ended September 30, 2010. The increase in net interest income resulted primarily from a decrease of \$810,000 in interest expense that exceeded a decrease of \$273,000 in interest income. The increase in net interest income was also due to an increase of \$3.7 million in average net interest-earning assets that resulted from decreases of \$49.9 million in average deposits and borrowings that exceeded decreases of \$46.2 million in average loans, securities, and other interest-earning assets. The decrease in average deposits and borrowings was due to the December 2010 sale of the Brooklyn branch office and the repayment of \$5.0 million in FHLB advances in the third quarter of 2011. The decrease in average loans, securities, and other interest-earning assets was due to loan repayments exceeding loan originations as a result of the Company scaling back its origination activity of new multi-family mortgages in New York, calls and repayments of investment securities, and the funding of the Brooklyn branch sale.

The net interest spread increased by 91 basis points to 3.59% for the three months ended September 30, 2011 from 2.68% for the three months ended September 30, 2010. The net interest margin increased by 83 basis points between these periods from 3.12% for the quarter ended September 30, 2010 to 3.95% for the quarter ended September 30, 2011. The increase in the interest rate spread and the net interest margin in the third quarter of 2011 compared to the same period in 2010 was due to an increase in the yield on our interest-earning assets coupled with a decrease in the cost of our interest-bearing liabilities.

The average yield on our interest-earning assets increased by 26 basis points to 5.13% for the three months ended September 30, 2011 from 4.87% for the three months ended September 30, 2010 and the cost of our interest-bearing liabilities decreased by 65 basis points to 1.54% for the three months ended September 30, 2011 from 2.19% for the three months ended September 30, 2010. The increase in the average yield on our interest-earning assets was due to the decrease in the average interest-earning assets exceeding the decrease in interest income. In this regard, the average balance of interest-earning assets decreased by \$46.2 million, or 9.6%, to \$434.3 million for the three months ended September 30, 2011 from \$480.5 million for the three months ended September 30, 2010, whereas total interest income decreased by \$273,000, or 4.7%, to \$5.6 million for the three months ended September 30, 2011, from \$5.8 million for the three months ended September 30, 2010. The decrease in the cost of our interest-bearing liabilities was due to the low interest rate environment in 2010 which continued through the first three quarters of 2011.



Table of Contents

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, 2011 and 2010.

|  | Three Months Ended September 30, |                                      |                |                    |                                      |                |
|--|----------------------------------|--------------------------------------|----------------|--------------------|--------------------------------------|----------------|
|  | Average<br>Balance               | 2011<br>Interest<br>and<br>Dividends | Yield/<br>Cost | Average<br>Balance | 2010<br>Interest<br>and<br>Dividends | Yield/<br>Cost |
| (Dollars in thousands)                   |                                  |                                      |                |                    |                                      |                |
| <b>Assets:</b>                           |                                  |                                      |                |                    |                                      |                |
| <b>Interest-earning assets:</b>          |                                  |                                      |                |                    |                                      |                |
| Loans                                    | \$ 372,688                       | \$ 5,378                             | 5.77 %         | \$ 381,828         | \$ 5,585                             | 5.85 %         |
| Securities<br>(including FHLB<br>stock)  | 23,864                           | 186                                  | 3.12           | 29,405             | 244                                  | 3.32           |
| Other<br>interest-earning<br>assets      | 37,793                           | 9                                    | 0.10           | 69,315             | 17                                   | 0.10           |
| Total<br>interest-earning<br>assets      | 434,345                          | 5,573                                | 5.13           | 480,548            | 5,846                                | 4.87           |
| Allowance for loan<br>losses             | (7,730 )                         |                                      |                | (5,391 )           |                                      |                |
| Non-interest-earning<br>assets           | 33,233                           |                                      |                | 33,360             |                                      |                |
| Total assets                             | \$ 459,848                       |                                      |                | \$ 508,517         |                                      |                |
| <b>Liabilities and equity:</b>           |                                  |                                      |                |                    |                                      |                |
| <b>Interest-bearing liabilities:</b>     |                                  |                                      |                |                    |                                      |                |
| Interest-bearing<br>demand               | \$ 77,754                        | \$ 168                               | 0.86 %         | \$ 87,576          | \$ 329                               | 1.50 %         |
| Savings and club<br>accounts             | 61,995                           | 108                                  | 0.70           | 60,868             | 99                                   | 0.65           |
| Certificates of<br>deposit               | 169,522                          | 851                                  | 2.01           | 207,514            | 1,437                                | 2.77           |
| Total<br>interest-bearing<br>deposits    | 309,271                          | 1,127                                | 1.46           | 355,958            | 1,865                                | 2.10           |
| Borrowings                               | 24,357                           | 161                                  | 2.64           | 27,565             | 233                                  | 3.38           |
| Total<br>interest-bearing<br>liabilities | 333,628                          | 1,288                                | 1.54           | 383,523            | 2,098                                | 2.19           |

Edgar Filing: NORTHEAST COMMUNITY BANCORP INC - Form 10-Q

|   |            |        |            |
|---|------------|--------|------------|
| Noninterest-bearing demand                              | 12,896     |        | 11,057     |
| Other liabilities                                       | 6,111      |        | 5,676      |
| Total liabilities                                       | 352,635    |        | 400,256    |
| Stockholders' equity                                    | 107,213    |        | 108,261    |
| Total liabilities and Stockholders' equity              | \$ 459,848 |        | \$ 508,517 |
| Net interest income                                     | \$ 4,285   |        | \$ 3,748   |
| Interest rate spread                                    |            | 3.59 % | 2.68 %     |
| Net interest margin                                     |            | 3.95 % | 3.12 %     |
| Net interest-earning assets                             | \$ 100,717 |        | \$ 97,025  |
| Interest-earning assets to interest-bearing liabilities | 130.19 %   |        | 125.30 %   |

Total interest income decreased by \$273,000, or 4.7%, to \$5.6 million for the three months ended September 30, 2011, from \$5.8 million for the three months ended September 30, 2010. Interest income on loans decreased by \$207,000, or 3.7%, to \$5.4 million for the three months ended September 30, 2011 from \$5.6 million for the three months ended September 30, 2010. The average balance of the loan portfolio decreased by \$9.1 million, or 2.4%, to \$372.7 million for the three months ended September 30, 2011 from \$381.8 million for the three months ended September 30, 2010 as repayments outpaced originations. The average yield on loans decreased by 8 basis points to 5.77% for the three months ended September 30, 2011 from 5.85% for the three months ended September 30, 2010.

Interest income on securities decreased by \$58,000, or 23.8%, to \$186,000 for the three months ended September 30, 2011 from \$244,000 for the three months ended September 30, 2010. The decrease was primarily due to a decrease of \$5.5 million, or 18.8%, in the average balance of securities to \$23.9 million for the three months ended September 30, 2011 from \$29.4 million for the three months ended September 30, 2010. 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 to the decline in interest rates from September 30, 2010 to September 30, 2011. As a result, the average yield on securities decreased by 20 basis points to 3.12% for the three months ended September 30, 2011 from 3.32% for the three months ended September 30, 2010.

Table of Contents

Interest income on other interest-earning assets (consisting solely of interest-earning deposits) decreased by \$8,000, or 47.1% to \$9,000 for the three months ended September 30, 2011 from \$17,000 for the three months ended September 30, 2010. The decrease was primarily due to a decrease of \$31.5 million, or 45.5%, in the average balance of interest-earning assets to \$37.8 million for the three months ended September 30, 2011 from \$69.3 million for the three months ended September 30, 2010. The decrease in the average balance of other interest-earning assets was due to the decrease in cash and cash equivalents, offset by an increase in certificates of deposit.

Total interest expense decreased by \$810,000, or 38.6%, to \$1.3 million for the three months ended September 30, 2011 from \$2.1 million for the three months ended September 30, 2010. Interest expense on deposits decreased by \$738,000, or 39.6%, to \$1.1 million for the three months ended September 30, 2011 from \$1.9 million for the three months ended September 30, 2010. During this same period, the average cost of deposits decreased by 64 basis points to 1.46% for the three months ended September 30, 2011 from 2.10% for the three months ended September 30, 2010.

Due to an effort by the Company to decrease reliance on high cost certificates of deposits, the average balance of certificates of deposits decreased by \$38.0 million, or 18.3%, to \$169.5 million for the three months ended September 30, 2011 from \$207.5 million for the three months ended September 30, 2010. As a result of the decrease in the average balance of certificates of deposits, interest expense on our certificates of deposits decreased by \$586,000, or 40.8%, to \$851,000 for the three months ended September 30, 2011 from \$1.4 million for the three months ended September 30, 2010. The decrease in interest expense on our certificates of deposits was also due to a decrease of 76 basis points in the average cost of our certificates of deposits to 2.01% for the three months ended September 30, 2011 from 2.77% for the three months ended September 30, 2010.

Interest expense on our other deposit products decreased by \$152,000, or 35.5%, to \$276,000 for the three months ended September 30, 2011 from \$428,000 for the three months ended September 30, 2010. The decrease was due to a decrease of 64 basis points in the cost of our interest-bearing demand deposits to 0.86% for the three months ended September 30, 2011 from 1.50% for the three months ended September 30, 2010, offset by an increase of 5 basis points in the cost of our savings and holiday club deposits to 0.70% for the three months ended September 30, 2011 from 0.65% for the three months ended September 30, 2010. The decrease in interest expense was also due to a decrease of \$9.8 million, or 11.2%, in the average balance of interest-bearing demand deposits to \$77.8 million for the three months ended September 30, 2011 from \$87.6 million for the three months ended September 30, 2010, offset by an increase of \$1.1 million, or 1.9%, in the average balance of our savings and holiday club deposits to \$62.0 million for the three months ended September 30, 2011 from \$60.9 million for the three months ended September 30, 2010.

Interest expense on borrowings decreased by \$72,000, or 30.9%, to \$161,000 for the three months ended September 30, 2011 from \$233,000 for the three months ended September 30, 2010. The decrease was primarily due to a decrease of \$3.2 million, or 11.6%, in the average balance of borrowed money to \$24.4 million for the three months ended September 30, 2011 from \$27.6 million for the three months ended September 30, 2010. The decrease in interest expense on borrowings was also due to a decrease of 74 basis points in the cost of borrowed money to 2.64% for the three months ended September 30, 2011 from 3.38% for the three months ended September 30, 2010.

Interest expense on borrowed money for the three months ended September 30, 2011 was comprised of \$159,000 in interest expense on an average balance of \$24.2 million in FHLB advances and \$2,000 in interest expense on an average balance of \$172,000 on a note payable incurred in connection with the acquisition of the operating assets of Hayden Financial Group LLC (now operating as Hayden Wealth Management Group, the Company's investment advisory and financial planning service division) in the fourth quarter of 2007. This compared to interest expense from FHLB advances of \$229,000 on an average balance of \$27.2 million in FHLB advances and \$4,000 in interest expense on an average balance of \$337,000 on the Hayden acquisition note for the three months ended September 30, 2010.



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, 2011 and 2010.

|  | Three Months<br>Ended September 30, |         |      |         |
|--|-------------------------------------|---------|------|---------|
|  | 2011                                |         | 2010 |         |
|  | (Dollars in thousands)              |         |      |         |
| Allowance at beginning of period                               | \$                                  | 7,600   | \$   | 5,501   |
| Provision for loan losses                                      |                                     | 393     |      | 4       |
| Charge-offs  |                                     | 28      |      | 488     |
| Recoveries   |                                     | 4       |      | 42      |
| Net charge-offs  |                                     | 24      |      | 446     |
| Allowance at end of period                                     | \$                                  | 7,969   | \$   | 5,059   |
| Allowance to nonperforming loans                               |                                     | 39.03 % |      | 16.81 % |
| Allowance to total loans outstanding at the end of the period  |                                     | 2.19 %  |      | 1.36 %  |
| Net charge-offs to average loans outstanding during the period |                                     | 0.01 %  |      | 0.47 %  |

The allowance to non-performing loans ratio increased to 39.0% at September 30, 2011 from 16.8% at September 30, 2010 due primarily to the increase in the allowance for loan losses to \$8.0 million at September 30, 2011 from \$5.1 million at September 30, 2010 and the decrease in non-performing loans to \$20.4 million at September 30, 2011 from \$30.1 million at September 30, 2010. The decrease in non-performing loans was due to the return of the \$10.9 million First Avenue Note returning to accrual status in December 2010 (See Note 8 of the Consolidated Financial Statements).

The allowance for loan losses was \$8.0 million at September 30, 2011, \$7.7 million at December 31, 2010, and \$5.1 million at September 30, 2010. We recorded provisions for loan losses of \$393,000 for the three month period ended September 30, 2011 compared to a provision for loan losses of \$4,000 for the three month period ended September 30, 2010.

We charged-off \$28,000 against one non-performing multi-family mortgage loan and one mixed-use mortgage loan during the three months ended September 30, 2011 compared to charge-offs of \$488,000 against five non-performing multi-family mortgage loans, two non-performing non-residential mortgage loans and two performing multi-family mortgage loans during the three months ended September 30, 2010. We recorded recoveries of \$4,000 during the three months ended September 30, 2011 compared to recoveries of \$42,000 during the three months ended September 30, 2010.

Non-interest Income. Non-interest income increased by \$82,000, or 18.9%, to \$517,000 for the three months ended September 30, 2011 from \$435,000 for the three months ended September 30, 2010. The increase was primarily due to an increase of \$66,000 in fee income generated by Hayden Wealth Management Group ("Hayden"), an increase of \$16,000 in other loan fees and service charges, and a \$15,000 gain on the disposition of a fixed asset, offset by a decrease of \$8,000 in earnings on bank owned life insurance and a decrease of \$7,000 in other non-interest income.

Non-interest Expense. Non-interest expense increased by \$362,000, or 10.7%, to \$3.7 million for the three months ended September 30, 2011 from \$3.4 million for the three months ended September 30, 2010. The increase resulted primarily from increases of \$257,000 in other non-interest expense, \$147,000 in salaries and employee benefits, \$51,000 in equipment expense, and \$43,000 in advertising expense, offset by decreases of \$69,000 in real estate

owned expenses, \$28,000 in occupancy expense, \$25,000 in FDIC insurance expense, and \$14,000 in outside data processing expense.

Other non-interest expense increased by \$257,000, or 31.5%, to \$1.1 million in 2011 from \$815,000 in 2010 due mainly to a one time increase of \$272,000 in recruitment expenses related to the Massachusetts and New York lending operations, \$123,000 in directors, officers and employee expenses, and \$10,000 in service contracts. These increases were partially offset by decreases of \$149,000 in legal fees, \$7,000 in office supplies and stationery, \$5,000 in telephone expenses, and \$3,000 in audit and accounting fees.

Salaries and employee benefits, which represented 49.9% of the Company's non-interest expense during the quarter ended September 30, 2011, increased by \$147,000, or 8.6%, to \$1.9 million in 2011 from \$1.7 million in 2010 due to the hiring of additional employees to increase loan production out of the Bank's Massachusetts locations, offset by a reduction in staff in various departments and the sale of the Brooklyn branch office in December 2010.

Table of Contents

Equipment expense increased by \$51,000, or 41.8%, to \$173,000 in 2011 from \$122,000 in 2010 due to purchases of additional equipment to support our Massachusetts expansion. Advertising expense increased by \$43,000, or 286.7%, to \$58,000 in 2011 from \$15,000 in 2010 due to an increase in marketing efforts to expand our Massachusetts operations.

Real estate owned expense decreased by \$69,000, or 83.1%, to \$14,000 in 2011 from \$83,000 in 2010 due to normal operating expenses during the 2011 quarter compared to a loss of \$50,000 and expenses related to the sale of two gasoline stations located in Putnam and Westchester Counties, New York during the 2010 quarter.

Occupancy expense decreased by \$28,000, or 9.1%, to \$280,000 in 2011 from \$308,000 in 2010 due to the sale of the Brooklyn branch office. FDIC insurance expense decreased by \$25,000, or 22.3%, to \$87,000 in 2011 from \$112,000 in 2010 due to a change in the FDIC assessment to an asset based calculation. Outside data processing expense decreased by \$14,000, or 7.0%, to \$185,000 in 2011 from \$199,000 in 2010 due to the sale of the Brooklyn branch office and several one-time additional services provided in 2010 by the Company's core data processing vendor.

Income Taxes. Income taxes decreased by \$65,000, or 12.5%, to \$211,000 for the three months ended September 30, 2011 from an expense of \$276,000 for the three months ended September 30, 2010. The decrease resulted primarily from a \$132,000 decrease in pre-tax income in 2011 compared to 2010. The effective tax rate was 31.1% for the three months ended September 30, 2011 and 34.1% for the three months ended September 30, 2010.

Comparison of Operating Results For The Nine Months Ended September 30, 2011 and 2010

General. Net income increased by \$843,000, or 71.3%, to \$2.0 million for the nine months ended September 30, 2011 from \$1.2 million for the nine months ended September 30, 2010. The increase was primarily the result of an increase of \$1.7 million in net interest income and an increase of \$94,000 in non-interest income, offset by an increase of \$215,000 in provision for loan losses, an increase of \$180,000 in non-interest expense, and an increase of \$604,000 in the provision for income taxes.

Net Interest Income. Net interest income increased by \$1.7 million, or 15.6%, to \$13.0 million for the nine months ended September 30, 2011 from \$11.2 million for the nine months ended September 30, 2010. The increase in net interest income resulted primarily from a decrease of \$2.7 million in interest expense that exceeded a decrease of \$972,000 in interest income. The increase in net interest income was also due to an increase of \$3.7 million in average net interest-earning assets that resulted from decreases of \$60.3 million in average deposits and borrowings that exceeded decreases of \$56.6 million in average loans, securities, and other interest-earning assets. The decrease in average deposits and borrowings was due to the December 2010 sale of the Brooklyn branch office and the repayment of \$5.0 million in FHLB advances in the third quarter of 2011. The decrease in average loans, securities, and other interest-earning assets was due to loan repayments exceeding loan originations as a result of the Company scaling back its origination activity of new multi-family mortgages in New York, calls and repayments of investment securities, and the funding of the Brooklyn branch sale.

The net interest spread increased by 103 basis points to 3.65% for the nine months ended September 30, 2011 from 2.62% for the nine months ended September 30, 2010. The net interest margin increased by 94 basis points between these periods from 4.01% for the nine months ended September 30, 2010 to 3.07% for the nine months ended September 30, 2011. The increase in the interest rate spread and the net interest margin in 2011 compared to 2010 was due to an increase in the yield on our interest-earning assets coupled with a decrease in the cost of our interest-bearing liabilities.

The average yield on our interest-earning assets increased by 34 basis points to 5.22% for the nine months ended September 30, 2011 from 4.88% for the nine months ended September 30, 2010 and the average cost of our

interest-bearing liabilities decreased by 68 basis points to 1.58% for the nine months ended September 30, 2011 from 2.26% for the nine months ended September 30, 2010. The increase in the average yield on our interest-earning assets was due to an increase in the average yield on loans as a result of a \$9.7 million, or 32.2%, decrease in total non-performing loans to \$20.4 million as of September 30, 2011 from \$30.1 million as of September 30, 2010. The decrease in the cost of our interest-bearing liabilities was due to the low interest rate environment which continued through the third quarter of 2011.



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, 2011 and 2010.

|                                      | Nine Months Ended September 30, |                                      |                |                    |                                      |                |
|--------------------------------------|---------------------------------|--------------------------------------|----------------|--------------------|--------------------------------------|----------------|
|                                      | Average<br>Balance              | 2011<br>Interest<br>and<br>Dividends | Yield/<br>Cost | Average<br>Balance | 2010<br>Interest<br>and<br>Dividends | Yield/<br>Cost |
| (Dollars in thousands)               |                                 |                                      |                |                    |                                      |                |
| <b>Assets:</b>                       |                                 |                                      |                |                    |                                      |                |
| <b>Interest-earning assets:</b>      |                                 |                                      |                |                    |                                      |                |
| Loans                                | \$ 372,054                      | \$ 16,314                            | 5.85 %         | \$ 388,936         | \$ 17,010                            | 5.83 %         |
| Securities                           | 24,488                          | 548                                  | 2.98           | 31,916             | 761                                  | 3.18           |
| Other interest-earning assets        | 34,749                          | 29                                   | 0.11           | 66,998             | 92                                   | 0.18           |
| Total interest-earning assets        | 431,291                         | 16,891                               | 5.22           | 487,850            | 17,863                               | 4.88           |
| Allowance for loan losses            | (7,733 )                        |                                      |                | (5,974 )           |                                      |                |
| Non-interest-earning assets          | 33,498                          |                                      |                | 33,989             |                                      |                |
| Total assets                         | \$ 457,056                      |                                      |                | \$ 515,865         |                                      |                |
| <b>Liabilities and equity:</b>       |                                 |                                      |                |                    |                                      |                |
| <b>Interest-bearing liabilities:</b> |                                 |                                      |                |                    |                                      |                |
| Interest-bearing demand              | \$ 77,671                       | \$ 477                               | 0.82 %         | \$ 80,442          | \$ 848                               | 1.41 %         |
| Savings and club accounts            | 58,941                          | 279                                  | 0.63           | 60,627             | 312                                  | 0.69           |
| Certificates of deposit              | 170,298                         | 2,672                                | 2.09           | 217,392            | 4,639                                | 2.85           |
| Total interest-bearing deposits      | 306,910                         | 3,428                                | 1.49           | 358,461            | 5,799                                | 2.16           |
| Borrowings                           | 23,998                          | 482                                  | 2.68           | 32,714             | 831                                  | 3.39           |
| Total interest-bearing liabilities   | 330,908                         | 3,910                                | 1.58           | 391,175            | 6,630                                | 2.26           |
| <b>Noninterest-bearing demand</b>    |                                 |                                      |                |                    |                                      |                |
| Other liabilities                    | 11,141                          |                                      |                | 10,179             |                                      |                |
| Total liabilities                    | 348,747                         |                                      |                | 407,390            |                                      |                |

|   |            |           |            |           |
|---|------------|-----------|------------|-----------|
| Stockholders' equity  | 108,309    |           | 108,475    |           |
| Total liabilities and Stockholders' equity                              | \$ 457,056 |           | \$ 515,865 |           |
| Net interest income   |            | \$ 12,981 |            | \$ 11,233 |
| Interest rate spread  |            | 3.65 %    |            | 2.62 %    |
| Net interest margin   |            | 4.01 %    |            | 3.07 %    |
| Net interest-earning assets   | \$ 100,383 |           | \$ 96,675  |           |
| Average interest-earning assets to average interest-bearing liabilities |            | 130.34 %  |            | 124.71 %  |

Total interest income decreased by \$972,000, or 5.4%, to \$16.9 million for the nine months ended September 30, 2011, from \$17.9 million for the nine months ended September 30, 2010. Interest income on loans decreased by \$696,000, or 4.1%, to \$16.3 million for the nine months ended September 30, 2011 from \$17.0 million for the nine months ended September 30, 2010. The average balance of the loan portfolio decreased by \$16.9 million, or 4.3%, to \$372.0 million for the nine months ended September 30, 2011 from \$388.9 million for the nine months ended September 30, 2010 as repayments outpaced originations. The average yield on loans increased by 2 basis points to 5.85% for the nine months ended September 30, 2011 from 5.83% for the nine months ended September 30, 2010 as a result of a \$9.7 million, or 32.2%, decrease in non-performing loans to \$20.4 million as of September 30, 2011 from \$30.1 million as of September 30, 2010, primarily due to the return of the \$10.9 million First Avenue Note returning to accrual status in December 2010 (See Note 8 of the Consolidated Financial Statements).

Interest income on securities decreased by \$213,000, or 28.0%, to \$548,000 for the nine months ended September 30, 2011 from \$761,000 for the nine months ended September 30, 2010. The decrease was primarily due to a decrease of \$7.4 million, or 23.3%, in the average balance of securities to \$24.5 million for the nine months ended September 30, 2011 from \$31.9 million for the nine months ended September 30, 2010. The decrease in the average balance was due to principal repayments on investment securities and a decrease in FHLB New York stock. The decrease in interest income on securities was also due to a decrease of 20 basis points in the average yield on securities to 2.98% for the nine months ended September 30, 2011 from 3.18% for the nine months ended September 30, 2010. The decline in the yield was due to the re-pricing of the yield of our adjustable rate investment securities and the decline in interest rates from September 30, 2010 to September 30, 2011.

Table of Contents

Interest income on other interest-earning assets (consisting solely of interest-earning deposits) decreased by \$63,000, or 68.5%, to \$29,000 for the nine months ended September 30, 2011 from \$92,000 for the nine months ended September 30, 2010. The decrease was primarily the result of a decrease of \$32.2 million, or 48.1%, in the average balance of other interest-earning assets to \$34.8 million for the nine months ended September 30, 2011 from \$67.0 million for the nine months ended September 30, 2010. The decrease in the average balance of other interest-earning assets was due to decreased levels of cash and cash equivalents, offset by an increase in certificates of deposit. The decrease in interest income on other interest-earning assets was also due to a decrease of 7 basis points in the yield to 0.11% for the nine months ended September 30, 2011 from 0.18% for the nine months ended September 30, 2010.

Total interest expense decreased by \$2.7 million, or 41.0%, to \$3.9 million for the nine months ended September 30, 2011 from \$6.6 million for the nine months ended September 30, 2010. Interest expense on deposits decreased by \$2.4 million, or 40.9%, to \$3.4 million for the nine months ended September 30, 2011 from \$5.8 million for the nine months ended September 30, 2010. During this same period, the average interest cost of deposits decreased by 67 basis points to 1.49% for the nine months ended September 30, 2011 from 2.16% for the nine months ended September 30, 2010.

Due to a decreased reliance on certificates of deposits, the average balance of certificates of deposits decreased by \$47.1 million, or 21.7%, to \$170.3 million for the nine months ended September 30, 2011 from \$217.4 million for the nine months ended September 30, 2010. As a result, interest expense on our certificates of deposit decreased by \$1.9 million, or 42.4%, to \$2.7 million for the nine months ended September 30, 2011 from \$4.6 million for the nine months ended September 30, 2010. The decrease in interest expense on our certificates of deposits was also due to a decrease of 76 basis points to 2.09% for the nine months ended September 30, 2011 from 2.85% for the nine months ended September 30, 2010.

Interest expense on our other deposit products decreased by \$404,000, or 34.8%, to \$756,000 for the nine months ended September 30, 2011 from \$1.2 million for the nine months ended September 30, 2010. The decrease was due to a decrease of 59 basis points in the cost of our interest-bearing demand deposits to 0.82% for the nine months ended September 30, 2011 from 1.41% for the nine months ended September 30, 2010 and a decrease of 6 basis points in the cost of our savings and holiday club deposits to 0.63% for the nine months ended September 30, 2011 from 0.69% for the nine months ended September 30, 2010. The decrease in interest expense was also due to a decrease of \$2.7 million, or 3.4%, in the average balance of interest-bearing demand deposits to \$77.7 million for the nine months ended September 30, 2011 from \$80.4 million for the nine months ended September 30, 2010 and a decrease of \$1.7 million, or 2.8%, in the average balance of our savings and holiday club deposits to \$58.9 million for the nine months ended September 30, 2011 from \$60.6 million for the nine months ended September 30, 2010.

Interest expense on borrowings decreased by \$349,000, or 42.0%, to \$482,000 for the nine months ended September 30, 2011 from \$831,000 for the nine months ended September 30, 2010. The decrease was primarily due to a decrease of \$8.7 million, or 26.6%, in the average balance of borrowed money to \$24.0 million for the nine months ended September 30, 2011 from \$32.7 million for the nine months ended September 30, 2010. The decrease in interest expense on borrowings was also due to a decrease of 71 basis points in the cost of borrowed money to 2.68% for the nine months ended September 30, 2011 from 3.39% for the nine months ended September 30, 2010.

Interest expense on borrowed money for the nine months ended September 30, 2011 was comprised of \$476,000 in interest expense on an average balance of \$23.8 million in FHLB advances and \$6,000 in interest expense on an average balance of \$170,000 on a note payable incurred in connection with the acquisition of the operating assets of Hayden in the fourth quarter of 2007. This compared to interest expense from FHLB advances of \$819,000 on an average balance of \$32.4 million in FHLB advances and \$12,000 in interest expense on an average balance of \$333,000 on the note incurred in connection with the acquisition of Hayden during the nine months ended September 30, 2010.



Table of Contents

Allowance for Loan Losses. The following table summarizes the activity in the allowance for loan losses for the nine months ended September 30, 2011 and 2010.

|                                  | Nine Months<br>Ended September 30,<br>2011                      2010<br>(Dollars in thousands) |          |
|----------------------------------|--|----------|
| Allowance at beginning of period | \$ 7,647   | \$ 6,733 |
| Provision for loan losses        | 1,113  | 898      |
| Charge-offs                      | 795  | 2,617    |
| Recoveries                       | 4  | 45       |
| Net charge-offs                  | 791  | 2,572    |
| Allowance at end of period       | \$ 7,969   | \$ 5,059 |

We recorded provisions for loan losses of \$1.1 million and \$898,000 for the nine-month periods ended September 30, 2011 and 2010, respectively. We charged-off \$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 compared to charge-offs of \$2.6 million against seventeen non-performing multi-family mortgage loans, seven non-performing non-residential mortgage loans and two performing multi-family mortgage loans during the nine months ended September 30, 2010. We recorded \$4,000 of recoveries during the nine months ended September 30, 2011 compared to recoveries of \$45,000 during the nine months ended September 30, 2010.

Non-interest Income. Non-interest income increased by \$94,000, or 7.4%, to \$1.37 million for the nine months ended September 30, 2011 from \$1.28 million for the nine months ended September 30, 2010. The increase was primarily due to an increase of \$96,000 in fee income generated by Hayden, an increase of \$13,000 in other loan fees and service charges, and a \$10,000 gain on the disposition of a fixed asset, offset by a decrease of \$26,000 in earnings on bank owned life insurance and a decrease of \$6,000 in other non-interest income.

Non-interest Expense. Non-interest expense increased by \$180,000, or 1.8%, to \$10.1 million for the nine months ended September 30, 2011 from \$10.0 million for the nine months ended September 30, 2010. The increase resulted primarily from increases of \$378,000 in other non-interest expense, \$71,000 in advertising expense, and \$58,000 in equipment expense, offset by decreases of \$91,000 in salaries and employee benefits, \$88,000 in occupancy expense, \$68,000 in real estate owned expenses, \$40,000 in FDIC insurance expense, and \$40,000 in outside data processing expense.

Other non-interest expense increased by \$378,000, or 17.2%, to \$2.6 million in 2011 from \$2.2 million in 2010 due mainly to a one time increase of \$272,000 in recruitment expenses related to the Massachusetts and New York lending operations, \$164,000 in directors, officers and employee expenses, and \$8,000 in service contracts. These increases were partially offset by decreases of \$87,000 in legal fees, \$34,000 in office supplies and stationery, \$10,000 in insurance expenses, \$7,000 in telephone expenses, \$2,000 in audit and accounting fees, and \$1,000 in directors compensation.

Advertising expense increased by \$71,000, or 139.2%, to \$122,000 in 2011 from \$51,000 in 2010 due to an increase in marketing efforts to expand our Massachusetts operations. Equipment expense increased by \$58,000, or 14.5%, to \$458,000 in 2011 from \$400,000 in 2010 due to purchases of additional equipment to support our Massachusetts expansion.

Salaries and employee benefits, which represented 51.1% of the Company's non-interest expense during the nine months ended September 30, 2011, decreased by \$91,000, or 1.7%, to \$5.2 million in 2011 from \$5.3 million in 2010 due to a decrease in the number of full time equivalent employees to 85 at September 30, 2011 from 91 at September 30, 2010. The decrease was primarily due to a reduction in staff in various departments and the sale of the Brooklyn branch office in December 2010, offset by the hiring of additional employees to increase loan production out of the Company's Massachusetts locations.

Occupancy expense decreased by \$88,000, or 9.3%, to \$857,000 in 2011 from \$945,000 in 2010 due to the sale of the Brooklyn branch office. Outside data processing expense decreased by \$40,000, or 6.3%, to \$592,000 in 2011 from \$632,000 in 2010 due to the sale of the Brooklyn branch office and several one-time additional services provided in 2010 by the Company's core data processing vendor. FDIC insurance expense decreased by \$40,000, or 11.3%, to \$315,000 in 2011 from \$355,000 in 2010 due to a change in the FDIC assessment to an asset based calculation.

Real estate owned expense decreased by \$68,000, or 71.6%, to \$27,000 in 2011 from \$95,000 in 2010 due to normal operating income and expenses in 2011 compared to a loss of \$50,000 and expenses related to the sale of two gasoline stations located in Putnam and Westchester Counties, New York in 2010.

Table of Contents

Income Taxes. Income tax expense increased by \$604,000, or 126.6%, to \$1.1 million for the nine months ended September 30, 2011 from \$477,000 for the nine months ended September 30, 2010. The increase resulted primarily from a \$1.4 million increase in pre-tax income in 2011 compared to 2010. The effective tax rate was 34.8% for the nine months ended September 30, 2011 and 28.7% for the nine months ended September 30, 2010. The increase in effective tax rate was primarily due to the increased portion of pre-tax income during 2011 from tax-exempt earnings on bank-owned life insurance.

## NON PERFORMING ASSETS

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

|  | At<br>September<br>30, 2011 | At<br>December 31, 2010 |
|--|-----------------------------|-------------------------|
| (Dollars in thousands)                                       |                             |                         |
| Non-accrual loans  | \$ 19,227                   | \$ 19,251               |
| Loans past due 90 days or more and accruing                  | 1,191                       | 2,555                   |
| Total nonaccrual and 90 days or more past due loans          | 20,418                      | 21,806                  |
| Other non-performing loans                                   | -                           | -                       |
| Total non-performing loans                                   | 20,418                      | 21,806                  |
| Real estate owned  | 916                         | 933                     |
| Total non-performing assets                                  | 21,334                      | 22,739                  |
| Troubled debt restructurings accrual                         | 15,214                      | 30,893                  |
| Troubled debt restructurings non-accrual                     | -                           | -                       |
| Total troubled debt restructurings                           | 15,214                      | 30,893                  |
| Total troubled debt restructurings and non-performing assets | \$ 36,548                   | \$ 53,632               |
|  | 5.61 %                      | 5.87 %                  |

|  |      |   |       |   |
|--|------|---|-------|---|
| Total non-performing loans to total loans                                    |      |   |       |   |
| Total non-performing loans to total assets                                   | 4.40 | % | 4.88  | % |
| Total non-performing assets and troubled debt restructurings to total assets | 7.88 | % | 11.51 | % |

Non-accrual loans at September 30, 2011 consisted of sixteen loans in the aggregate – seven multi-family mortgage loans, one mixed-use mortgage loan, four non-residential mortgage loans and four construction mortgage loans.

The seven non-accrual multi-family mortgage loans totaled \$4.3 million at September 30, 2011, consisting of the following mortgage loans:

- (1) A delinquent loan with an outstanding balance of \$1.5 million secured by an apartment building. The Company filed a foreclosure action and the court has granted the Company's request for the appointment of a receiver for the property. The receiver's managing agent is collecting the rents and paying operating expenses and taxes. We will continue to monitor the progress of the action and make adjustments to the reserves as necessary. We do not anticipate a loss on this loan.
- (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. A ruling on the Company's motion for Preliminary Injunction and Motion for Lis Pendens is expected shortly. No trial date has been set, but we do not expect a trial date until early 2012. 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) An outstanding balance of \$393,000 secured by an apartment building. Our foreclosure action is in the final stages of completion. We are currently negotiating with the borrower and his attorney for a loan modification. However, if the modification discussions with the borrower are not successful in the short term, we will complete our foreclosure action. Based on a current appraisal and projected cash flow analysis, the Company established a specific allowance of \$85,000 against the loan.



Table of Contents

- (4) Three mortgage loans with an aggregate outstanding balance of \$987,000 secured by three separate apartment buildings. The Company was in the process of filing foreclosure actions, which were stayed by the debtor filing for bankruptcy. During the second quarter of 2011, the court expunged the note. As such, the properties are no longer subject to the bankruptcy stay. The Company has filed foreclosure actions on all three mortgages. Based on current appraisals and projected cash flow analyses, the Company established specific allowances of \$221,000 against the loans.
- (5) An outstanding balance of \$228,000 secured by an apartment building. Based on a current appraisal and projected cash flow analysis, the Company established a specific allowance of \$108,000 against the loan. The remaining balance of the mortgage is being assumed by one of our borrowers.

The one non-accrual mixed-use mortgage loan totaled \$681,000 at September 30, 2011, consisting of the following mortgage loan:

- (1) An outstanding balance of \$681,000 secured by a mixed-use apartment building. The Company filed a foreclosure action and the court has granted the Company's request for the appointment of a receiver for the property. The receiver has hired a managing agent and notices have been delivered to all tenants as required by law. Summary judgment / default papers have been served. We have ordered an updated appraisal. We will continue to monitor the progress of the foreclosure action and make adjustments to the reserves if necessary.

The four non-accrual non-residential mortgage loans, net of charge-offs of \$400,000, totaled \$6.6 million at September 30, 2011, consisting of the following mortgage loans:

- (1) An outstanding balance of \$4.5 million secured by an office building. The managing member of the borrowing entity is the same individual as the managing member of the borrowing entity of the hotel construction loan referenced below. We have recently negotiated an agreement with the borrower to begin making partial payments during the foreclosure action and the suit on the personal guarantee. In return, the Company has agreed to forbear from collecting any judgment obtained in the pending lawsuits until December 31, 2011 (the maturity date) in the absence of a settlement agreement. Also under this agreement, the obligor will be required to make additional monthly payments equal to 100% of the net income from the property during the term of this agreement. While the foreclosure action is progressing, we will monitor the cash flow and require several capital improvements be made to the building to allow it to better compete in its office market. Based on a current appraisal and projected cash flow analysis we do not anticipate losses on this loan at this time.
- (2) An outstanding balance of \$1.1 million secured by an office building. The Company has filed foreclosure action and we are waiting for the Court to appoint a Referee. Based on a current appraisal and projected cash flow analysis, we do not anticipate losses on this loan at this time.
- (3) An outstanding balance of \$502,000 secured by a restaurant with 23 boat slips and a general guarantee of the borrower. We have received a Judgment of Foreclosure and Sale, which was scheduled for September 23, 2011. However, the borrower delivered to the Company, a day prior to the sale, a payment of \$20,000 to be applied toward the judgment amount. As a result of the payment, the Company agreed to postpone the foreclosure sale without prejudice for 60 days. Based on a current appraisal, management anticipates full recovery of all outstanding amounts due on this loan at this time.
- (4) An outstanding balance of \$442,000, net of a charge-off 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 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.

The four non-accrual construction mortgage loans, net of loans in process of \$85,000, totaled \$7.6 million at September 30, 2011, consisting of the following mortgage loans:

- (1) Four construction mortgage loans with an aggregate outstanding balance of \$7.6 million (net of loans in process of \$85,000), representing a 25% interest in a participation loan, secured by a newly completed boutique hotel. Additional security consists of a general guarantee of the two principals and an assignment of LLC interests in two other properties. The managing member of the borrowing entity is the same individual as the managing member of the borrowing entity of the office building loan referenced above. The loan was restructured in 2010 and was current under the terms of a restructure agreement until October 2010. Although the hotel is now complete and in full operation, the poor economy has adversely affected the cash flow and the borrower has been unable to continue to meet its obligations based on the restructure agreement. At this time we are evaluating all of the available information, and in concert with the other participants, have been negotiating with several potential purchasers who have expressed an interest in purchasing the notes and mortgages. During the fourth quarter of 2010 and throughout 2011, the Company recorded specific allowances in the amount of \$2.5 million to cover the anticipated loss on the sale of the notes and mortgages. We will continue to negotiate with the interested parties and monitor the operations of the hotel. We anticipate our motion to convert the chapter 11 reorganization to chapter 7 liquidation will be approved during the fourth quarter.

Table of Contents

The one loan that is 90 days or more and still accruing is the following multi-family mortgage loan:

- (1) A delinquent loan with an outstanding balance of \$1.2 million secured by an apartment building. The borrower and all of the borrower's related properties are operating under chapter 11 bankruptcy protection and are making regularly scheduled payments as approved by the Trustee. Based on the current appraisal and the reorganization plan before the Court, we expect repayment of all principal and interest due on this loan. We do not anticipate a loss on this loan at this time.

Except for the above-mentioned second non-performing, non-accrual multi-family mortgage loan and fourth non-residential mortgage loan, we are in the process of foreclosing on all of the multi-family, mixed-use, non-residential loans, and construction properties discussed above. Based on recent fair value analyses of these properties, the Company does not currently expect any losses beyond the amounts already charged off or reserved for. Except for the above-mentioned second non-performing, non-accrual multi-family mortgage loan, all the above-mentioned fourteen loans have been classified as substandard. The Company did not classify the above-mentioned second non-performing, non-accrual multi-family mortgage loan because the asset is well protected by the current net worth and paying capacity of the borrower and there is no evidence of potential weaknesses or deterioration of the asset.

At September 30, 2011, we owned foreclosed properties with a net balance of \$916,000, consisting of a six unit multi-family building (net balance of \$629,000) located in New Jersey and 27 units in three multi-family buildings (net balance of \$293,000) located in New York. We renovated the New Jersey property with the eventual goal of marketing the property when the real estate market has stabilized. The New York property is currently listed for sale with a local real estate broker.

The troubled debt restructured loans at September 30, 2011, all of which are current under their restructured terms, consisted of 14 loans totaling \$15.2 million or a decrease of \$15.7 million from December 31, 2010 due to loans reverting back to their original terms, restructured loans that defaulted under the forbearance terms and were placed in foreclosure and restructured loans that were refinanced with other institutions. The largest troubled debt restructured loan had an outstanding balance of \$2.2 million and is secured by a multi-family building located in New Jersey.

**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 \$52.1 million at September 30, 2011 and consist primarily of interest-bearing deposits at other financial institutions and miscellaneous cash items. The Company can also borrow an additional \$72.4 million from the FHLB of New York to provide additional liquidity.

At September 30, 2011, we had \$35.0 million in loan commitments outstanding, consisting of \$15.7 million in unused commercial business lines of credit, \$14.3 million of real estate loan commitments, \$4.6 million in unused real estate equity lines of credit, \$155,000 in consumer lines of credit, and \$121,000 in unused loans in process. Certificates of deposit due within one year of September 30, 2011 totaled \$139.3 million. This represented 82.0% of certificates of deposit at September 30, 2011. We believe a large percentage of certificates of deposit that mature within one year reflects 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, 2011. 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.

Table of Contents

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, 2011, we had the ability to borrow \$72.4 million, net of \$20.0 million in outstanding advances, from the FHLB of New York. At September 30, 2011, 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 repricing 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, 2011, the Company had liquid assets of \$15.6 million.

**Capital Management.** The Bank is subject to various regulatory capital requirements administered by the OCC, 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, 2011, 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.

For the nine months ended September 30, 2011 and the year ended December 31, 2010, 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 Financial Officer, Chief Retail Banking Officer, Chief Technology Officer, 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 by the Office of the Comptroller of the Currency 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 50 to 300 basis point increase or 50 and 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.

Table of Contents

The following table presents the change in our net portfolio value at September 30, 2011 that would occur in the event of an immediate change in interest rates based on Office of the Comptroller of the Currency assumptions, with no effect given to any steps that we might take to counteract that change.

| Basis<br>Point (“bp”)<br>Change<br>in Rates | Net Portfolio Value<br>(Dollars in thousands) |              |             | Net Portfolio Value<br>as % of<br>Portfolio Value of<br>Assets |          |
|---|---|--------------|-------------|--|----------|
|   | \$<br>Amount                                  | \$<br>Change | %<br>Change | NPV<br>Ratio   | Change   |
| 300   | \$ 88,307                                     | \$ (4,343 )  | (5 )%       | 19.65 %  | (48 ) bp |
| 200   | 90,049  | (2,601 )     | (3 )%       | 19.87 %  | (26 ) bp |
| 100   | 91,527  | (1,123 )     | (1 )%       | 20.04 %  | ( 9 ) bp |
| 50  | 92,094  | ( 555 )      | (1 )%       | 20.09 %  | ( 5 ) bp |
| 0   | 92,650  |              |             | 20.13 %  |          |
| (50 )                                       | 92,508  | ( 141 )      | - %         | 20.07 %  | ( 7 ) bp |
| (100 )                                      | 91,305  | (1,345 )     | (1 )%       | 19.83 %  | (30 ) bp |

We and the Office of the Comptroller of the Currency 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 repricing, 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.

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, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.



Table of Contents

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, NorthEast Community Bancorp MHC (the “MHC”) and each of the directors of the Company and the MHC. The complaint alleges that the directors have breached their fiduciary duties by not undertaking a “second-step” conversion of the MHC and requests, 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. The Company believes that the claims asserted are without merit and intends to vigorously defend the case.

Item 1A. Risk Factors

The amount of dividends we pay on our common stock, if any, may be limited by the ability of NorthEast Community Bancorp, MHC to waive receipt of dividends.

The MHC owns a majority of the Company’s outstanding stock. As a result, when and if the Company pays dividends to its shareholders, it also is required to pay dividends to the MHC unless the MHC is permitted by its federal regulator to waive the receipt of dividends. Historically, the MHC’s federal regulator has permitted the MHC to waive its right to dividends declared by the Company on the shares that it owns. The MHC has reviewed the approval of the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”) to waive dividends paid by the Company for the quarters ended September 30, 2011, December 31, 2011 and March 31, 2012. It is expected that the MHC will continue to waive future dividends, except to the extent dividends are needed to fund the MHC’s continuing operations, and subject to the ability of the MHC to obtain regulatory approval in the future of its requests to waive dividends.

The Federal Reserve Board has adopted an interim final rule which requires the MHC to notify the Federal Reserve Board if it proposes to waive receipt of dividends from the Company. In addition, the interim final rule also requires that the MHC obtain the approval of a majority of the eligible votes of members of the MHC (generally Bank depositors) before it can waive dividends. For a grandfathered company such as the MHC that waived dividends prior to December 1, 2009, the Federal Reserve Board may not object to a dividend waiver request if the board of directors of the mutual holding company expressly determines that a waiver of the dividend is consistent with its fiduciary duties to members and the waiver would not be detrimental to the safe and sound operation of the savings association subsidiaries of the holding company. The Federal Reserve Board’s interim final rule regarding dividend waiver requests is subject to comment and there can be no assurances as to the form of the final dividend waiver regulations or the effect of such regulations on the MHC’s ability to waive dividends.

While the MHC is grandfathered for purposes of the Federal Reserve Board dividend waiver regulations, we cannot assure that the Federal Reserve Board will grant dividend waiver requests in the future and, if granted, there can be no assurance as to the conditions, if any, the Federal Reserve Board will place on future dividend waiver requests. The denial of a dividend waiver request or the imposition of burdensome conditions on an approval of a waiver request may significantly limit the amount of dividends the Company pays in the future, if any.

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, 2010, 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

## Purchases of Equity Securities

The following table presents information regarding the Company's stock repurchases during the three months ended September 30, 2011.

| Period                         | (a)<br>Total<br>Number of<br>Shares<br>Purchased | (b)<br>Average<br>Price Paid<br>per Share | (c)<br>Total Number of<br>Shares Purchased<br>as Part of<br>Publicly<br>Announced Plans<br>or Programs | (d)<br>Maximum<br>Number<br>of Shares that<br>May<br>Yet Be Purchased<br>Under the Plans<br>or<br>Programs |
|--------------------------------|--|---|--|--|
| July 1 to July<br>31           | 152,685  | \$ 6.74                                   | 152,685  | -  |
| August 1 to<br>August 31       | -  | -   | -  | -  |
| September 1 to<br>September 30 | -  | -   | -  | -  |
| Total                          | 152,685  | 6.74                                      | 152,685  | -  |

On July 22, 2010, the Board of Directors of the Company approved the repurchase of up to 297,563 shares of the Company's outstanding common stock held by persons other than NorthEast Community Bancorp MHC. This repurchase program was completed on May 12, 2011 under which 297,563 shares were purchased at a total cost of approximately \$1.8 million or \$6.13 per share.

On May 20, 2011, the Board of Directors of the Company approved the repurchase of up to 282,685 shares of the Company's outstanding common stock held by persons other than NorthEast Community Bancorp MHC. This repurchase program was completed on July 12, 2011 under which 282,685 shares were purchased at a total cost of approximately \$1.9 million or \$6.68 per share.

## Item 3. Defaults Upon Senior Securities

Not applicable

## Item 4. [Removed and Reserved]

## Item 5. Other Information

None

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.

101.0\*The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011, 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 Stockholders' Equity, (iv) the Consolidated Statements of Cash Flows and (v) the Notes to the Consolidated Financial Statements, tagged as blocks of text.

---

\* 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 14, 2011

By: /s/ Kenneth A. Martinek  
Kenneth A. Martinek  
President and Chief Executive Officer

Date: November 14, 2011

By: /s/ Salvatore Randazzo  
Salvatore Randazzo  
Executive Vice President, Chief  
Operating Officer and Chief Financial  
Officer