

Edgar Filing: Cornerstone Financial Corp - Form 10-Q

Cornerstone Financial Corp
Form 10-Q
November 12, 2010

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

FORM 10-Q

Quarterly report pursuant to section 13 or 15 (d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2010

-OR-

Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____.

CORNERSTONE FINANCIAL CORPORATION

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

NEW JERSEY

80-0282551

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

6000 MIDLANTIC DRIVE, SUITE 120 S, MOUNT LAUREL, NEW JERSEY

08054

(Address of principal executive offices)

Zip Code

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

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

NONE

(Title of Class)

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

COMMON STOCK, NO PAR VALUE

(Title of Class)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an

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accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer", and "smaller reporting company" in rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

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As of November 10, 2010, there were 1,809,656 outstanding shares of the registrant's Common Stock.

CORNERSTONE FINANCIAL CORPORATION

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PART I. FINANCIAL INFORMATION

ITEM 1 -- CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(In thousands, except share data)	SEPTEMBER 30, 2010	DECEMBER 2009
	-----	-----
ASSETS:	(unaudited)	
Cash and due from banks	\$ 7,576	\$ 4,
Federal funds sold	26,500	
	-----	-----
Cash and cash equivalents	34,076	4,
	-----	-----
Investment securities:		
Held to maturity (fair value 2010 - \$45,025; 2009 - \$47,294)	44,209	48,
Available for sale (amortized cost 2010-\$32,519; 2009- \$0)	32,689	
Loans receivable	242,125	238,
Less allowance for loan losses	3,663	3,
	-----	-----
Loans receivable, net	238,462	234,
	-----	-----
Federal Home Loan Bank stock	1,435	1,
Premises and equipment, net	7,737	7,
Accrued interest receivable	1,719	1,
Bank owned life insurance	4,644	4,
Deferred taxes	1,138	1,
Other assets	1,420	1,
	-----	-----
Total Assets	\$ 367,529	\$ 306,
	=====	=====
LIABILITIES:		
Non-interest bearing deposits	\$ 32,629	\$ 37,
Interest bearing deposits	151,964	99,
Certificates of deposit	125,240	112,
	-----	-----
Total deposits	309,833	249,
	-----	-----
Advances from the Federal Home Loan Bank	25,000	29,
Line of Credit	4,825	4,
Subordinated debt	3,000	3,
Unsettled Securities payable	4,000	
Other liabilities	1,480	1,

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Total Liabilities	----- 348,138 -----	----- 288, -----
Commitments and Contingencies (Note 4)		
STOCKHOLDERS' EQUITY:		
Preferred stock:		
\$0 par value; \$1,000 per share stated value, authorized 1,000,000 shares; issued and outstanding 1,900 at September 30, 2010 and December 31, 2009, respectively	1,900	1,
Common stock:		
\$0 par value: authorized 10,000,000 shares; issued and outstanding 1,809,656 at September 30, 2010 and December 31, 2009, respectively	-	
Additional paid-in capital	16,691	16,
Accumulated other comprehensive income	101	
Retained earnings (deficit)	699	(
	-----	-----
Total Shareholders' Equity	19,391	17,
	-----	-----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 367,529 =====	\$ 306, =====

See accompanying notes to consolidated financial statements

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CORNERSTONE FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)	THREE MONTHS ENDED	
	----- SEPTEMBER 30, 2010 ----- (Unaudited)	----- SEPTEMBER 30, 2009 ----- (Unaudited)
INTEREST INCOME		
Interest and fees on loans	\$ 3,460	\$ 3,300
Interest on investment securities	593	560
Interest on federal funds	16	16
	-----	-----
TOTAL INTEREST INCOME	4,069	3,876
INTEREST EXPENSE		
Interest on deposits	991	1,180
Interest on borrowings	171	310
	-----	-----
TOTAL INTEREST EXPENSE	1,162	1,500
	-----	-----
Net interest income	2,907	2,376
Provision for loan losses	235	130
	-----	-----
NET INTEREST INCOME AFTER LOAN LOSS PROVISION	2,672	2,246
	-----	-----
NON-INTEREST INCOME		
Service charges on deposit accounts	50	60
Origination fees on mortgage loans sold	-	-
Bank owned life insurance income	41	40

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Gain on sale of loans	291	
Miscellaneous fee income	30	1
	-----	-----
TOTAL NON-INTEREST INCOME	412	13
	-----	-----
NON-INTEREST EXPENSE		
Salaries and employee benefits	1,231	1,12
Net occupancy	298	29
Data processing and other service costs	115	9
Professional services	322	9
Advertising and promotion	26	5
Other real estate owned expense	10	
FDIC expense	131	11
Other operating expenses	161	17
	-----	-----
TOTAL NON-INTEREST EXPENSE	2,294	1,95
	-----	-----
Income before income taxes	790	42
Income tax expense	311	15
	-----	-----
NET INCOME	479	26
Preferred stock dividends	33	
	-----	-----
Net income(loss) available to common shareholders	\$ 446	\$ 26
	=====	=====
EARNINGS PER SHARE		
Basic	\$ 0.25	\$ 0.1
Diluted	\$ 0.24	\$ 0.1
WEIGHTED AVERAGE SHARES OUTSTANDING		
Basic	1,810	1,74
Diluted	1,833	1,74

See accompanying notes to consolidated financial statements

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CORNERSTONE FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)	NINE MONTHS ENDED	
	SEPTEMBER 30, 2010	SEPTEMBER 30, 2009
	-----	-----
	(Unaudited)	(Unaudited)
INTEREST INCOME		
Interest and fees on loans	\$ 10,248	\$ 9,402
Interest on investment securities	1,781	1,433
Interest on federal funds	24	6
	-----	-----
TOTAL INTEREST INCOME	12,053	10,841
INTEREST EXPENSE		
Interest on deposits	2,932	3,700
Interest on borrowings	523	934
	-----	-----

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TOTAL INTEREST EXPENSE	3,455	4,634
	-----	-----
Net interest income	8,598	6,207
Provision for loan losses	382	2,351
	-----	-----
NET INTEREST INCOME AFTER LOAN LOSS PROVISION	8,216	3,856
	-----	-----
NON-INTEREST INCOME		
Service charges on deposit accounts	148	148
Origination fees on mortgage loans sold	-	18
Bank owned life insurance income	123	130
Gain on sale of Loans	330	-
Miscellaneous fee income	85	62
	-----	-----
TOTAL NON-INTEREST INCOME	686	358
	-----	-----
NON-INTEREST EXPENSE		
Salaries and employee benefits	3,648	3,282
Net occupancy	925	1,043
Data processing and other service costs	352	303
Professional services	609	312
Advertising and promotion	99	136
Other real estate owned expense	24	24
FDIC expense	355	422
Other operating expenses	476	462
	-----	-----
TOTAL NON-INTEREST EXPENSE	6,488	5,984
	-----	-----
Income(loss) before income taxes	2,414	(1,770)
Income tax expense (benefit)	939	(745)
	-----	-----
NET INCOME (LOSS)	1,475	(1,025)
Preferred stock dividends	99	-
	-----	-----
Net income(loss) available to common shareholders	\$ 1,376	\$ (1,025)
	=====	=====
EARNINGS PER SHARE		
Basic	\$ 0.76	\$ (0.61)
Diluted	\$ 0.76	\$ (0.61)
WEIGHTED AVERAGE SHARES OUTSTANDING		
Basic	1,810	1,686
Diluted	1,821	1,686

See accompanying notes to consolidated financial statements

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CORNERSTONE FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Unaudited)

(In thousands, except per share data)

COMPREHENSIVE INCOME	PREFERRED STOCK	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED EARNINGS (DEFICIT)
-------------------------	--------------------	-----------------	----------------------------------	--------------------------------------

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	-----	-----	-----	-----	-----
Balance at December 31, 2009		\$ 1,900	\$ -	\$ 16,623	\$ (710)
		=====	=====	=====	=====
Comprehensive income					
Net Income	\$ 1,475	-	-	-	1,475

Unrealized gain on securities available for sale, net of tax	101				
	=====				
Comprehensive income	\$ 1,576				
	=====				
Stock based compensation		-	-	101	-
Preferred Stock Dividend (\$35 per share)		-	-	(33)	(66)
		-----	-----	-----	-----
Balance at September 30, 2010		\$ 1,900	\$ -	\$ 16,691	\$ 699
		=====	=====	=====	=====

See accompanying notes to consolidated financial statements.

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CORNERSTONE FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

		NINE MONTHS ENDED	
		-----	-----
(In thousands)		SEPTEMBER 30, 2010	SEPTEMBER 30, 2009
		-----	-----
		(Unaudited)	(Unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net Income(loss)		\$ 1,475	\$ (1,000)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Provision for loan losses		382	2,300
Depreciation		293	600
Amortization of premiums and discounts, net		39	
Stock option expense		101	
Deferred tax expense (benefit)		(54)	(800)
Decrease in other real estate owned		-	
Loans originated for sale		-	(6,300)
Proceeds from sales of loans held for sale		-	6,300
Income on Bank Owned Life Insurance		(123)	(100)
Decrease (increase) in accrued interest receivable and other assets		94	(200)
Increase in other liabilities		4,197	300
		-----	-----
Net cash used by operating activities		6,404	1,100

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CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments held to maturity	(44,509)	(45,2
Purchases of securities available for sale	(32,519)	
Maturity and calls of investments held to maturity	48,320	27,3
Redemption (purchase) of FHLB Stock	137	(1
Net increase in loans	(3,851)	(40,9
Purchases of premises and equipment	(159)	(
	-----	-----
Net cash used in investing activities	(32,581)	(59,1
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	60,340	46,7
Proceeds from borrowings	242,753	651,4
Principal payments on borrowings	(247,483)	(643,1
Net Proceeds from issuance of stock	-	1,0
Cash dividend paid for preferred stock	(99)	
	-----	-----
Net cash provided by financing activities	55,511	56,1
Net increase (decrease) in cash and cash equivalents	29,334	(1,8
Cash and cash equivalents at the beginning of the period	4,742	9,3
	-----	-----
Cash and cash equivalents at the end of the period	\$ 34,076	\$ 7,5
	=====	=====
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for interest	\$ 3,466	\$ 4,6
Cash paid during the period for income taxes	991	
Net change in unrealized gain on securities, net of tax	101	
SUPPLEMENTAL NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Unsettled AFS investment security	\$ 4,000	\$

See accompanying notes to consolidated financial statements.

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CORNERSTONE FINANCIAL CORPORATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION

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

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

NOTE 2 -- USE OF ESTIMATES

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and

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disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the allowance for loan losses and the evaluation of deferred taxes.

NOTE 3 -- RECENT LEGISLATIVE DEVELOPMENTS

DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Act") was signed into law on July 21, 2010. Generally, the Act is effective the day after it was signed into law, but different effective dates apply to specific sections of the law, many of which will not become effective until various Federal regulatory agencies have promulgated rules implementing the statutory provisions. Uncertainty remains as to the ultimate impact of the Act, which could have a material adverse impact on the financial services industry. The Act, among other things:

- o Directs the Federal Reserve to issue rules which are expected to limit debit-card interchange fees;
 - o Provides for an increase in the FDIC assessment for depository institutions with assets of \$10 billion or more, increases in the minimum reserve ratio for the deposit insurance fund from 1.15% to 1.35% and changes the basis for determining FDIC premiums from deposits to assets;
 - o Permanently increases the deposit insurance coverage to \$250 thousand and allows depository institutions to pay interest on checking accounts;
 - o Creates a new consumer financial protection bureau that will have rulemaking authority for a wide range of consumer protection laws that would apply to all banks and would have broad powers to supervise and enforce consumer protection laws directly for large institutions;
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- o Provides for new disclosure and other requirements relating to executive compensation and corporate governance;
 - o Changes standards for Federal preemption of state laws related to federally chartered institutions and their subsidiaries;
 - o Provides mortgage reform provisions regarding a customer's ability to repay, restricting variable-rate lending by requiring the ability to repay to be determined for variable-rate loans by using the maximum rate that will apply during the first five years of a variable-rate loan term, and making more loans subject to provisions for higher cost loans, new disclosures, and certain other revisions; and
 - o Creates a financial stability oversight council that will recommend to the Federal Reserve increasingly strict rules for capital, leverage, liquidity, risk management and other requirements as companies grow in size and complexity.
 - o Creates a permanent exemption for non-accelerated filer to obtain an internal control audit under section 404(b) of the Sarbanes Oxley Act of 2002.

NOTE 4 - CONTINGENCIES

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

NOTE 5 - EARNINGS PER SHARE

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

NOTE 6 -- STOCK OPTIONS

The Company accounts for stock options in accordance with FASB Accounting Standards Codification (ASC) Topic 718 STOCK COMPENSATION. The Company recognizes the grant-date fair-value of stock options and other equity-based compensation issued to employees in the statement of operations. The Company had \$299 thousand in unrecognized compensation costs relating to non-vested stock based compensation awards at September 30, 2010.

On July 16, 2009, options to purchase a total of 45,000 shares of common stock were granted with an exercise price of \$5.00 per share. These options will expire ten years from the date of the grant and vest on a one-third per year basis beginning on July 16, 2010, with vesting accelerating in certain circumstances such as change in control of the Company. The exercise price of each option equals the market price of the common stock on the date of the grant.

On January 16, 2010, options to purchase a total of 111,000 shares of common stock were granted with an exercise price of \$4.50 per share. These options will expire ten years from the date of the grant and vest on a one-third per year basis beginning on January 21, 2011, with vesting accelerating in certain circumstances such as change in control of the Company. The exercise price of each option equals the market price of the common stock on the date of the grant.

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NOTE 7 - INVESTMENT SECURITIES

A comparison of amortized cost and approximate fair value of investment securities held to maturity at September 30, 2010 and December 31, 2009 is as follows (in thousands):

	SEPTEMBER 30, 2010			
COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE	
INVESTMENTS HELD TO MATURITY:				
Government agency obligations	\$ 36,354	\$ 532	\$ 52	\$ 36,834
Mortgage backed securities	7,855	336	-	8,191
	-----	-----	-----	-----

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Total	\$ 44,209	\$ 868	\$ 52	\$ 45,025
	=====	=====	=====	=====
INVESTMENTS AVAILABLE FOR SALE:				
Government agency obligations	\$ 26,562	\$ 48	\$ 120	\$ 26,490
US Treasury Securities	5,957	242	-	6,199
	-----	-----	-----	-----
Total	\$ 32,519	\$ 290	\$ 120	\$ 32,689
	=====	=====	=====	=====

	DECEMBER 31, 2009			
	COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	FAIR VALUE
	-----	-----	-----	-----
INVESTMENTS HELD TO MATURITY:				
Government agency obligations	\$ 39,019	\$ 42	\$ (721)	\$ 38,340
Mortgage backed securities	9,040	46	(132)	8,954
	-----	-----	-----	-----
Total	\$ 48,059	\$ 88	\$ (853)	\$ 47,294
	=====	=====	=====	=====
INVESTMENTS AVAILABLE FOR SALE:				
US Treasury Securities	\$ -	\$ -	\$ -	\$ -
Government agency obligations	-	-	-	-
	-----	-----	-----	-----
Total	\$ -	\$ -	\$ -	\$ -
	=====	=====	=====	=====

The following table sets forth information regarding the fair value and unrealized losses on the Company's temporarily impaired investment securities at September 30, 2010 and December 31, 2009 for the time periods shown (in thousands):

	LESS THAN 12 MONTHS		SEPTEMBER 30, 2010 12 MONTHS OR LONGER		TO
	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE
	-----	-----	-----	-----	-----
INVESTMENTS HELD TO MATURITY:					
Government Agency Obligations	\$ 3,637	\$ 52	\$ -	\$ -	\$ 3,637
Mortgage Backed Securities	-	-	-	-	-
INVESTMENTS AVAILABLE FOR SALE:					
US Treasury Securities	-	-	-	-	-
Government agency obligations	9,044	120			9,044
	-----	-----	-----	-----	-----
Total temporarily impaired investment securities	\$ 12,681	\$ 172	\$ -	\$ -	\$ 12,681
	=====	=====	=====	=====	=====

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	LESS THAN 12 MONTHS		DECEMBER 31, 2009 12 MONTHS OR LONGER		TO
	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES	
INVESTMENTS HELD TO MATURITY:					
Government Agency Obligations	\$ 33,940	\$ 721	\$ -	\$ -	\$ 33,940
Mortgage Backed Securities	4,715	132	-	-	4,715
INVESTMENTS AVAILABLE FOR SALE:					
US Treasury Securities	\$ -	\$ -	\$ -	\$ -	\$ -
Government agency obligations	-	-	-	-	-
Total temporarily impaired investment securities	\$ 38,655	\$ 853	\$ -	\$ -	\$ 38,655

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

NOTE 8 -- LOANS RECEIVABLE

Loans receivable consist of the following (in thousands):

	SEPTEMBER 30, 2010	DECEMBER 31, 2009
Commercial	\$ 93,563	\$ 91,717
Real estate -- commercial	112,425	105,702
Real estate -- residential	15,970	19,137
Construction	12,035	12,104
Consumer loans	8,426	9,875
Net deferred loan fees	(294)	(111)
	242,125	238,424
Allowance for loan losses	(3,663)	(3,432)
Loans receivable, net	\$ 238,462	\$ 234,992

Under New Jersey banking laws, the Bank is subject to a loans-to-one-borrower limitation of 15% of capital funds for most loans. At September 30, 2010, the loans-to-one-borrower limitation was approximately \$4.5 million; this excludes an additional 10% of capital funds, or approximately \$3.0 million which may be loaned if collateralized by readily marketable securities. At September 30, 2010, there were no loans outstanding or committed to any one borrower which individually or in the aggregate exceeded the Bank's loans-to-one-borrower

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limitation of 15% of capital funds.

Non-performing assets consist of non-accrual loans (loans on which the accrual of interest has ceased), loans over ninety days delinquent and still accruing interest, renegotiated loans, impaired loans and other real estate owned. Loans are generally placed on non-accrual status if, in the opinion of management, collection is doubtful, or when principal or interest is past due 90 days or more unless the collateral is considered sufficient to cover principal and interest and the loan is in the process of collection. The Company recognized \$149 thousand in interest income on non-accrual loans during the nine month period ended September 30, 2010 and \$32 thousand for the nine month period ended September 30, 2009.

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Impaired loans are measured based on the present value of expected future discounted cash flows, the fair value of the loan or the fair value of the underlying collateral if the loan is collateral dependent. The recognition of interest income on impaired loans is the same as for non-accrual loans discussed above. At September 30, 2010 the Company had \$9.9 million in non-accrual loans compared to \$8.1 million in non-accrual loans at December 31, 2009. At September 30, 2010, the Company had sixteen impaired loan relationships totaling \$11.7 million (included within the non-accrual loans discussed above) in which \$3.7 million in impaired loans had a related allowance for credit losses of \$1.8 million and \$8.0 million in impaired loans in which there is no related allowance for credit losses. The average balance of impaired loans totaled \$12.7 million as of September 30, 2010, and interest income recorded on impaired loans during the nine months ended September 30, 2010 totaled \$149 thousand, as compared to \$32 thousand for the nine months ended September 30, 2009.

The balance in commercial loans 90-days past due and still accruing remained unchanged as of September 30, 2010 from the reported levels at December 31, 2009. During the period ended September 30, 2010, the balance in commercial real estate loans 90-days past due and still accruing decreased by \$1.5 million and represented two loan relationships totaling \$1.8 million which moved into the non-accrual loan category partially offset by the addition of one loan in this category totaling \$270 thousand. Lastly, the increase in residential real estate loans 90 days past due and still accruing reflects one loan relationship totaling \$244 thousand.

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

The following table provides information regarding risk elements in the loan portfolio as of September 30, 2010 and December 31, 2009

(In thousands)

SEPTEMBER 30, 2010

DECEMBER

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Non-performing assets:		
Loans past due 90 days or more and accruing		
Commercial	\$ 634	\$ 1,
Commercial real estate	270	1,
Residential real estate	244	
	-----	-----
Total loans past due 90 days or more and accruing	1,148	2,
	-----	-----
Non-accrual loans:		
Commercial	1,232	1,
Commercial real estate	6,185	3,
Construction	2,480	
Residential real estate	-	3,
	-----	-----
Total non-accrual loans	9,897	8,
Impaired loans	654	
	-----	-----
Total non-performing loans	10,551	8,
Real estate owned	-	
	-----	-----
Total non-performing assets	\$ 11,699	\$ 10,
	=====	=====
Non-performing loans as a percentage of loans	4.83%	4.
	=====	=====
Non-performing assets as a percentage of loans and real estate owned	4.83%	4.
	=====	=====
Non-performing assets as a percentage of total assets	3.16%	3.
	=====	=====

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During the period ended September 30, 2010 the Company experienced a \$1.8 million net increase in non-accrual loans. This change reflects the downgrading of five loan relationships to non-accrual status totaling \$4.9 million partially offset by the reduction of two residential real estate loans in the aggregate amount of \$3.1 million. The reduction of the two residential real estate loans was related to the pay-off of one residential real estate loan in the amount of \$1.9 million, which did not require the recognition of any additional write down, coupled with one residential real estate loan in the amount of \$1.2 million which returned to performing status.

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

(In thousands)	SEPTEMBER 30, 2010	SEPTEMBER 30, 2009
	-----	-----
Balance at beginning of year	\$ 3,432	\$ 1,133
Provision:		
Commercial	157	1,149
Commercial real estate	323	1,135
Residential real estate	(61)	-
Consumer	(37)	68
	-----	-----
Total Provision	382	2,351
Charge-offs:		

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Commercial	149	-
Recoveries	-	-
Total Net Charge-offs	149	-
	=====	=====
Balance at end of period	\$ 3,663	\$ 3,484
	=====	=====
Period-end loans outstanding	\$ 242,125	\$ 225,573
	=====	=====
Average loans outstanding	\$ 237,288	\$ 224,284
	=====	=====
Allowance as a percentage of period-end loans	1.51%	1.54%
Net charge-offs as a percentage of average loans	0.06%	0.00%

The Company prepares an allowance for loan loss model on a quarterly basis to determine the adequacy of the allowance. Management considers a variety of factors when establishing the allowance, such as the impact of current economic conditions, diversification of the loan portfolio, delinquency statistics, results of independent loan review and related classifications. The Bank's historic loss rates and the loss rates of peer financial institutions are also considered. In evaluating the Company's allowance for loan loss the Company maintains a Criticized Asset Committee ("CAC") consisting of senior management that monitors problem loans and formulates collection efforts and resolution plans for each borrower. On a monthly basis the CAC meets to review each problem loan and determines if there has been any change in collateral value due to changes in market conditions. Each quarter, when calculating the allowance for loan loss, the CAC reviews an updated loan impairment analysis on each problem loan to determine if a specific provision for loan loss is warranted. Management reviews the most recent appraisal on each loan adjusted for holding and selling costs. In the event there is not a recent appraisal on file, the Company will use the aged appraisal and apply a discount factor to the appraisal then adjust the holding and selling costs from the discounted appraisal value. While the Company has increased its allowance for loan loss for the nine month period ended September 30, 2010 by \$382 thousand, management believes the credit quality of the loan portfolio remains stable. On a linked basis, our non-performing assets have shown a modest increase of \$512 thousand over their stated levels at December 31, 2009 representing a non-performing asset to total asset ratio of 2.99% at September 30, 2010 as compared to a non-performing asset to total asset ratio 3.44% at December 31, 2009.

The Company's charge-off policy states any asset classified loss shall be charged-off within thirty days of such classification unless the asset has already been eliminated from the books by collection or other appropriate entry. On a quarterly basis the Board Loan Committee ("BLC") will review past due, classified, non-performing and other loans, as it deems appropriate, to determine the collectability of such loans. If the BLC determines a loan to be

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uncollectible, the loan shall be charged to the allowance for loan loss. In addition, upon reviewing the collectability of a loan, the BLC may determine a portion of the loan to be uncollectible; in which case that portion of the loan deemed uncollectible will be partially charged-off against the allowance for loan loss.

For the nine month period ending September 30, 2010 the Company experienced one charge off relating to one loan relationship totaling \$149 thousand and no partial charge-offs as compared to four loans representing one relationship totaling \$462 thousand that were determined to have a portion deemed

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uncollectable which resulted in the company recognizing a partial charge-off of \$231 thousand for the period ended December 31, 2009.

NOTE 9 -- BANK OWNED LIFE INSURANCE

Bank Owned Life Insurance ("BOLI") is carried at its aggregate cash surrender value less surrender charges and totaled \$4.6 million at September 30, 2010. Income of \$123 thousand was recognized on the BOLI during the nine month period ended September 30, 2010 as compared to \$130 thousand for the nine month period ended September 30, 2009. The Bank is the sole owner and beneficiary of the BOLI.

NOTE 10 -- DEFERRED COMPENSATION PLANS

Effective January 1, 2006, the Bank adopted a Nonqualified Deferred Compensation Plan (The "Executive Plan") and the Directors' Fee Deferral and Death Benefit Plan (the "Directors' Plan"). Both plans provide for payments of deferred compensation to participants. The Company recorded \$128 thousand in deferred compensation expense during the nine month period ended September 30, 2010 as compared to \$95 thousand for the nine month period ended September 30, 2009.

NOTE 11 -- INCOME TAXES

The Company accounts for uncertainties in income taxes in accordance with Financial ASC Topic 740, ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES. ASC Topic 740 prescribes a threshold and measurement process for recognizing in the financial statements a tax position taken or expected to be taken in a tax return. ASC Topic 740 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company has determined that there are no significant uncertain tax positions requiring recognition in its financial statements.

Federal tax years 2007 through 2009 remain subject to examination as of September 30, 2010, while tax years 2006 through 2009 remain subject to examination by state taxing jurisdictions. In the event the Company is assessed for interest and/or penalties by taxing authorities, such assessed amounts will be classified in the financial statements as income tax expense.

The ability to realize deferred tax assets is dependent upon a variety of factors, including the generation of future taxable income, the existence of taxes paid and recoverable, the reversal of deferred tax liabilities, and tax planning strategies. Based upon these and other factors, the Company determined that it is more likely than not that its deferred tax asset will be realized. As such, no valuation allowance was established for the deferred tax asset as of September 30, 2010 or December 31, 2009. The Company will continue to reassess the realizability of the deferred tax asset in future periods. If, in the future, it is determined that the Company's deferred tax asset is not realizable, a valuation allowance may be established against the deferred tax asset, which may have a material impact on the Company's net income in the period in which it is recorded.

NOTE 12 -- FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

- o Level 1. Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities.
- o Level 2. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable, either directly or indirectly. Level 2 inputs include quoted prices for similar assets, quoted prices in markets that are not considered to be active, and observable inputs other than quoted prices such as interest rates.
- o Level 3. Level 3 inputs are unobservable inputs.

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

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

As of September 30, 2010, the Company had investment securities available for sale carried at fair value as compared to December 31, 2009, where the Company did not have any assets or liabilities measured at fair value on a recurring basis.

ASSETS AND LIABILITIES MEASURED ON A RECURRING BASIS

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

	FAIR VALUE MEASUREMENTS AT SEPTEMBER 30, 2010			FAIR AT
	QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT OTHER UNOBSERVABLE INPUTS (LEVEL 3)	QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)
	(IN THOUSANDS)			
Assets:				
Investment Securities				
US Government Obligations	\$ --	\$ 26,490	\$ --	\$ --
US Treasury Securities	\$ 6,199	\$ --	\$ --	\$ --
	-----	-----	-----	-----
Total assets on a recurring basis at fair value	\$ 6,199	\$ 26,490	\$ --	\$ --
	=====	=====	=====	=====

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ASSETS AND LIABILITIES MEASURED ON A NON-RECURRING BASIS

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

	FAIR VALUE MEASUREMENTS AT SEPTEMBER 30, 2010			
	QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT OTHER UNOBSERVABLE INPUTS (LEVEL 3)	QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)
	(IN THOUSANDS)			
Assets:				
Impaired loans	\$ --	\$ 1,847	\$ --	\$ --
Total assets measured on a non-recurring basis at fair value	\$ --	\$ 1,847	\$ --	\$ --

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

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

As required by ASC topic 825-10-65, the estimated fair value of financial instruments at September 30, 2010 and December 31, 2009 was as follows:

(in thousands)	SEPTEMBER 30, 2010		DECEMBER 31, 2009	
	CARRYING AMOUNT	ESTIMATED FAIR VALUE	CARRYING AMOUNT	ESTIMATED FAIR VALUE
Financial assets:				
Cash and cash equivalents	\$ 34,076	\$ 34,076	\$ 4,742	\$ 4,742
Investments held to maturity				
Federal Agency Securities	36,354	36,834	39,019	38,340
Mortgage-backed Securities	7,855	8,191	9,040	8,950

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Investments available for sale				
US Treasury Securities	6,199	6,199	-	
Federal Agency Securities	26,490	26,490	-	
Loans receivable	242,125	264,978	238,424	266,399
FHLB stock	1,435	1,435	1,572	1,572
Bank Owned Life Insurance	4,644	4,644	4,521	4,521
Accrued interest receivable	1,719	1,719	1,484	1,484
	-----	-----	-----	-----
Total financial assets	\$ 360,897	\$ 384,566	\$ 298,802	\$ 326,011
	=====	=====	=====	=====
Financial Liabilities:				
Checking Accounts	\$ 48,953	\$ 48,953	\$ 56,783	\$ 56,783
Statement savings accounts	3,142	3,142	3,430	3,430
Money market accounts	31,813	31,813	19,658	19,658
Index Accounts	100,685	100,685	56,761	56,761
Certificates of deposit	125,240	124,248	112,861	111,900
FHLB advances	25,000	25,000	29,883	29,883
Line of Credit	4,825	4,825	4,672	4,672
Subordinated Debt	3,000	3,000	3,000	3,000
Accrued interest payable	210	210	222	222
	-----	-----	-----	-----
Total financial liabilities	\$ 342,868	\$ 341,876	\$ 287,270	\$ 286,311
	=====	=====	=====	=====

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	CONTRACT VALUE	ESTIMATED FAIR VALUE	CONTRACT VALUE	ESTIMATED FAIR VALUE
	-----	-----	-----	-----
Off-balance sheet instruments:				
Commitments to extend credit	\$ 56,590	\$ -	\$ 45,684	\$ -
	=====	=====	=====	=====

NOTE 13 -- RECENT ACCOUNTING PRONOUNCEMENTS

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

In January 2010, the Financial Accounting Standards Board (FASB) issued an Accounting Standard Codification Update (ASU) for improving disclosures about fair value measurements. This update requires companies to disclose, and provide the reasons for, all transfers of assets and liabilities between the Level 1 and 2 fair value categories. It also clarifies that companies should provide fair value measurement disclosures for classes of assets and liabilities which are subsets of line items within the balance sheet, if necessary. In addition, the update clarifies that companies provide disclosures about the fair value techniques and inputs for assets and liabilities classified within Level 2 or 3 categories. The disclosure requirements prescribed by this update are effective for fiscal years beginning after December 31, 2009, and for interim periods within those fiscal years, or March 31, 2010 for the Corporation. This update also requires companies to reconcile changes in Level 3 assets and liabilities by separately providing information about Level 3 purchases, sales, issuances and settlements on a gross basis. This provision of this update is effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years, or March 31, 2011 for the Corporation. The adoption of this update did not materially

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impact the Corporation's current fair value measurement disclosures.

In July 2010, the FASB issued ASU No. 2010-20, "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses," which will require the Company to provide a greater level of disaggregated information about the credit quality of the Company's loans and leases and the allowance for loan and lease losses. This ASU will also require the Company to disclose additional information related to credit quality indicators, past due information, and information related to loans modified in a troubled debt restructuring. The provisions of this ASU are effective for the Company's reporting period ending December 31, 2010. As this ASU amends only the disclosure requirements for loans and leases and the allowance, the adoption will have no impact on the Company's statements of operation and condition.

NOTE 14-- PRIVATE PLACEMENT COMMON STOCK OFFERING AND PREFERRED STOCK ISSUANCE

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

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In December 2009, the Company authorized the establishment of 2,000 shares of \$0 par, \$1,000 stated value, Perpetual Non-Cumulative Convertible Preferred Stock. The preferred stock is entitled to receive, as and when declared by the Company's Board of Directors, non-cumulative cash dividends at the annual rate equal to 7% of the stated value. In December 2009, the Company sold 1,900 preferred shares. The preferred stock is redeemable at the Company's option at any time after six months from the issue date at the stated value plus any dividends declared but unpaid. The preferred shares have priority of dividends such that no dividends or distributions shall be declared or paid to common shareholders unless full dividends on all outstanding preferred shares have been declared and paid for the most recently completed calendar quarter.

NOTE 15 -- SUBSEQUENT EVENTS

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

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

FORWARD-LOOKING STATEMENTS

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

These forward-looking statements involve risks and uncertainties, such as

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statements of the Company's plans, objectives, expectations, estimates and intentions that are subject to change based on various important factors (many of which are beyond the Company's control). Forward-looking statements may be identified by the use of words such as "expects," "subject," "believe," "will," "intends," "will be," or "would." The factors which could cause the Company's financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements include those items listed under "Item 1A-Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2009 and the following factors, among others: the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System ("Federal Reserve"); inflation; interest rates; market and monetary fluctuations; the timely development of new products and services by the Company and the perceived overall value of these products and services by users, including the features, pricing and quality compared to competitors' products and services; the success of the Company in gaining regulatory approval of its products, services, dividends and of new branches, when required; the impact of changes in financial services laws and regulations (including laws concerning taxes, banking, securities and insurance); technological changes; acquisitions; the ability to continue to effectively manage costs, including the costs incurred in connection with the opening of new branches; changes in consumer spending and saving habits; the Company's ability to access the capital markets to maintain its regulatory capital standing; and the success of the Company at managing the risks resulting from these factors.

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

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OVERVIEW

CORNERSTONE FINANCIAL CORPORATION

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

We have adopted a strategy of continued growth. In furtherance of that strategy, we opened our eighth office in Marlton, New Jersey. At September 30, 2010, we had total assets of \$367.5 million, total loans, net of \$238.4 million, total investment securities of \$76.9 million and total deposits of \$309.8 million compared to total assets of \$306.1 million, total loans, net of \$235.0 million, total investment securities of \$48.1 million and total deposits of \$249.5 million at December 31, 2009. Our growth in assets and deposits reflects our commitment to provide outstanding customer service and a broad array of banking products driven by our customers' needs. We believe our strategy provides us with a competitive advantage over other financial institutions by developing lasting customer relationships that will enable us to continue to attract core deposits and loans within our market area.

INTEREST RATE RISK

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

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

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

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

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

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The following table sets forth the amount of our interest-earning assets and interest-bearing liabilities at September 30, 2010, which are expected to mature or reprice in each of the time periods shown:

(DOLLARS IN THOUSANDS)	ONE YEAR	ONE-FIVE	OVER	NON-RATE SENSITIVE ASSETS/
------------------------	----------	----------	------	----------------------------------

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	OR LESS -----	YEARS -----	FIVE YEARS -----	LIABILITIES -----
INTEREST-EARNING ASSETS:				

Short term investments	\$ 26,500	\$ -	\$ -	\$ -
Investment securities held to maturity	-	5,898	38,311	-
Investment securities available for sale			32,689	

Loans receivable	111,532	75,267	55,326	-
	-----	-----	-----	-----
Total interest-earning assets	138,032	81,165	126,326	-
	-----	-----	-----	-----
Non-rate sensitive assets:				
Other assets	-	-	-	22,006
	-----	-----	-----	-----
Total assets	\$ 138,032	\$ 81,165	\$ 126,326	\$ 22,006
	=====	=====	=====	=====
INTEREST-BEARING LIABILITIES:				

Interest-bearing demand	\$ 16,324	\$ -	\$ -	\$ -
Statement savings	3,142	-	-	-
Money market	132,498	-	-	-
Certificates of deposit	94,889	30,351	-	-
Subordinated debt	3,000	-	-	-
Borrowings	-	29,825	-	-
	-----	-----	-----	-----
Total interest-bearing liabilities	249,853	60,176	-	-
	-----	-----	-----	-----
NON-RATE SENSITIVE LIABILITIES:				
Non-interest bearing deposits	-	-	-	32,629
Other liabilities	-	-	-	5,480
Capital	-	-	-	19,391
	-----	-----	-----	-----
Total liabilities and capital	\$ 249,853	\$ 60,176	\$ -	\$ 57,500
	=====	=====	=====	=====
Period GAP	\$ (111,821)	\$ 20,989	\$ 126,326	\$ (35,494)
Cumulative interest-earning assets	\$ 138,032	\$219,197	\$ 345,523	
Cumulative interest-bearing liabilities	\$ 249,853	\$310,029	\$ 310,029	
Cumulative GAP	\$ (111,821)	\$ (90,832)	\$ 35,494	
Cumulative RSA/RSL (1)	55.25%	70.70%	111.45%	

(1) Cumulative rate sensitive (interest-earning) assets divided by cumulative rate sensitive (interest-bearing) liabilities.

At September 30, 2010, our interest rate sensitivity gap was within Board approved guidelines.

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

The following discussion focuses on the major components of our operations and presents an overview of the significant changes in our financial condition at

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September 30, 2010 as compared to December 31, 2009 and our results of operations for the three and nine month periods ended September 30, 2010 as compared to the same period in 2009.

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COMPARISON OF FINANCIAL CONDITION AT SEPTEMBER 30, 2010 AND DECEMBER 31, 2009

Total assets at September 30, 2010 were \$367.5 million, an increase of \$61.4 million or 20.1% over December 31, 2009. This change was primarily due to increases in cash and cash equivalents of \$29.3 million, bank owned life insurance of \$123 thousand, investment securities available for sale of \$32.7 million, loans receivable, net, of \$3.5 million, and accrued interest receivable of \$235 thousand, partially offset by decreases in deferred taxes of \$16 thousand, Federal Home Loan Bank ("FHLB") stock of \$137 thousand, other assets of \$ 329 thousand, securities held to maturity of \$3.9 million and premises and equipment of \$134 thousand.

Gross loans receivable at September 30, 2010, totaled \$242.1 million, an increase of \$3.7 million or 1.6% from December 31, 2009. This increase was attributable to increases in commercial loans of \$1.8 million and commercial real estate loans of \$6.7 million partially offset by decreases in construction loans of \$69 thousand, real estate loans secured by residential properties of \$3.2 million and consumer loans of \$1.5 million. The reduction in residential real estate loans reflects the payoff of a non-accrual loan relationship totaling \$1.8 million. See Footnote 8 to our Consolidated Financial Statements for a breakdown of the components of our loan portfolio.

Non-performing assets consists of non-accrual loans, (loans on which the accrual of interest has ceased) loans over ninety days delinquent and still accruing interest, renegotiated loans, impaired loans, and real estate owned. Loans are generally placed on non-accrual status if, in the opinion of management, collection is doubtful, or when principal or interest is past due 90 days or more unless the collateral is considered sufficient to cover principal and interest and the loan is in the process of collection. The Company recognized \$149 thousand in interest income on non-accrual loans during the nine month period ended September 30, 2010 and \$32 thousand for the nine month period ended September 30, 2009.

Impaired loans are measured based on the present value of expected future discounted cash flows, the fair value of the loan or the fair value of the underlying collateral if the loan is collateral dependent. At September 30, 2010, we had a total of \$9.9 million in non accrual loans as compared to \$8.1 million in non-accrual loans at December 31, 2009. At September 30, 2010, the Company had sixteen impaired loan relationships totaling \$11.7 million (included within the non-accrual loans discussed above) in which \$3.7 million in impaired loans had a related allowance for credit losses of \$1.8 million and \$8.0 million in impaired loans in which there is no related allowance for credit losses as compared to seven impaired loan relationship totaling \$8.1 million at December 31, 2009 in which \$4.9 million in impaired loans had a related allowance for credit losses totaling \$2.1 million and \$7.3 million in impaired loans in which there is no related allowance for credit losses. The average balance of impaired loans totaled \$12.7 million as of September 30, 2010, and interest income recorded on impaired loans during the nine months ended September 30, 2010, totaled \$149 thousand as compared to \$32 thousand for the nine month period ended September 30, 2009.

The balance in commercial loans 90-days past due and still accruing remained unchanged as of September 30, 2010 from the reported levels at December 31, 2009. During the period ended September 30, 2010, the balance in commercial

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real estate loans 90-days past due and still accruing decreased by \$1.5 million and represented two loan relationships totaling \$1.8 million which moved into the non-accrual loan category partially offset by the addition of one loan in this category totaling \$270 thousand. Lastly the increase in residential real estate loans 90 days past due and still accruing reflects one loan relationship totaling \$244 thousand.

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

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However, in that case our ability to collect on these loans will depend upon the outcome of our legal action against the lead/originating bank.

During the period ended September 30, 2010 the Company experienced a \$1.8 million net increase in non-accrual loans. This change reflects the downgrading of five loan relationships to a non-accrual status totaling \$4.9 million partially offset by the reduction of two residential real estate loans in the aggregate of \$3.1 million. The reduction of the two residential real estate loans was related to the pay-off of one residential real estate loan in the amount of \$1.9 million, which did not require the recognition of any additional write down, coupled with one residential real estate loan in the amount of \$1.2 million which returned to performing status.

The Company prepares an allowance for loan loss model on a quarterly basis to determine the adequacy of the allowance. Management considers a variety of factors when establishing the allowance, such as the impact of current economic conditions, diversification of the loan portfolio, delinquency statistics, results of independent loan review and related classifications. The Bank's historic loss rates and the loss rates of peer financial institutions are also considered. In evaluating the Company's allowance for loan loss the Company maintains a Criticized Asset Committee ("CAC") consisting of senior management that monitors problem loans and formulates collection efforts and resolution plans for each borrower. On a monthly basis the CAC meets to review each problem loan and determines if there has been any change in collateral value due to changes in market conditions. Each quarter, when calculating the allowance for loan loss, the CAC reviews an updated loan impairment analysis on each problem credit to determine if a specific provision for loan loss is warranted. Management reviews the most recent appraisal on each loan, adjusted for holding and selling costs. In the event there is not a recent appraisal on file, the Company will use the aged appraisal and apply a discount factor to the appraisal then adjust the holding and selling costs from the discounted appraisal value. Although the Company has increased its allowance for loan loss for the nine month period ended September 30, 2010 by \$382 thousand, management believes the credit quality of the loan portfolio remains stable. On a linked quarterly basis non performing assets have shown a modest increase of \$512 thousand over their stated levels at December 31, 2009.

Any asset classified loss are charged-off within thirty days of such classification unless the asset has already been eliminated from the books by collection or other appropriate entry. On a quarterly basis the BLC will review past due, classified, non-performing and other loans, as it deems appropriate,

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to determine the collectability of such loans. If the BLC determines a loan to be uncollectible, the loan is charged to the allowance for loan loss. In addition, upon reviewing the collectability of a loan, the BLC may determine a portion of the loan to be uncollectible; in which case that portion of the loan deemed uncollectable will be partially charged-off against the allowance for loan loss.

For the period ending September 30, 2010 the Company recognized one charge off relating to one loan relationship totaling \$149 thousand and no partial charge-offs as compared to four loans representing one relationship totaling \$462 thousand that were determined to have a portion deemed uncollectable which resulted in the company recognizing a partial charge-off of \$231 thousand for the period ended December 31, 2009.

Real estate acquired by foreclosure or by deed in lieu of foreclosure is classified as real estate owned until it is sold. At September 30, 2010 and December 31, 2009 we had no real estate owned.

Our investment securities are classified as either held to maturity or available for sale. Our investment portfolio increased by \$28.8 million or 60.0% to \$76.9 million at September 30, 2010, from \$48.1 million at December 31, 2009. The change in our investment portfolio is related to the purchase of \$32.7 million in US Treasury and US Government Agency securities classified as available for sale partially offset by a reduction of \$3.9 million related to calls of US Government Agency securities classified held to maturity. See Footnote 7 to our Consolidated Financial statements for more information regarding our investment securities portfolio. The increase in investment securities reflects management's efforts to further diversify its growing balance sheet and to more prudently manage its capital base by investing in lower risk weighted assets.

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Our cash and cash equivalents increased by \$29.3 million to \$34.1 million at September 30, 2010 from \$4.7 million at year end 2009. The increase reflects cash inflows from an increase in deposits, calls and repayments of higher yielding investment securities in a lower rate environment and loan re- and prepayments exceeding current loan funding demands. The increase in deposits reflects, in part, the Bank benefiting from merger activity involving competing institutions and resulting customer dislocation. Management has elected to keep excess cash flow in short term, liquid assets to fund anticipated loan demand over the next several quarters.

Total liabilities at September 30, 2010 amounted to \$348.1 million, an increase of \$59.8 million or 20.7% from December 31, 2009. This change was primarily due to increases in total deposits of \$60.3 million and line of credit borrowings from Atlantic Central Bankers Bank (ACBB) of \$153 thousand, unsettled securities payable of \$4.0 million and other liabilities of \$197 thousand, offset by a decrease of \$4.9 million in advances from Federal Home Loan Bank.

Total deposits at September 30, 2010 were \$309.8 million, an increase of \$60.3 million or 24.2% from December 31, 2009. The change in total deposits was related to a significant increase of \$52.8 million in interest bearing core deposits (i.e. all interest bearing deposit accounts other than certificate of deposit accounts), coupled with an increase of \$12.4 million in certificates of deposit, partially offset by a decrease in non-interest bearing accounts of \$4.9 million. The change in deposits was primarily related to the competitive pricing of our deposit products coupled with the continued development of relationships with local small businesses and the high level of individualized service provided by our team of retail branch managers. Consumer and commercial

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deposits are attracted principally from within our primary market area. We do not obtain funds through brokers, nor do we solicit funds outside the State of New Jersey, although we do accept deposits from residents of other states.

At September 30, 2010, we had advances from the FHLB in the amount of \$25.0 million, a decrease of \$4.9 million or 16.3 % from December 31, 2009. The weighted average interest rate on these borrowings from the FHLB was 1.49% at September 30, 2010 as compared to 2.03% at December 31, 2009.

On October 31, 2008, the Bank issued a hybrid capital instrument in the aggregate amount of \$3.0 million in the form of subordinated debt. A portion of this instrument qualifies as Tier II capital. The term of the debt is for a six year period with a maturity date of November 1, 2014. The initial interest rate was 5.00% fixed for the first year then adjusted to a variable rate equal to prime rate for the remaining five years. The debt security is redeemable, at the Bank's option, at par on any April 30(th) or October 31(st) through the maturity date. For the quarter ended September 30, 2010, the interest rate on this instrument was 3.25% .

On February 17, 2009, the Company entered into a non-revolving line of credit loan agreement with ACBB in an amount up to \$5.0 million. The term of the debt is for a three year period with a maturity date of February 17, 2012. The interest rate adjusts at a variable rate equal to prime rate plus 25 basis points with a floor of 4.25% . The Company has an outstanding balance on the line of credit of \$4.8 million and has contributed \$4.4 million as additional capital to the Bank. For the quarter ended September 30, 2010, the interest rate on this borrowing was 4.25% .

Stockholders' equity at September 30, 2010 amounted to \$19.4 million, an increase of \$1.6 million or 8.9% over December 31, 2009. This increase reflects net income of \$1.5 million, other comprehensive income of \$101 thousand and stock based compensation expense of \$101 thousand partially offset by \$99 thousand in cash paid for the declaration of dividends on preferred stock for the nine month period ended September 30, 2010.

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RESULTS OF OPERATIONS

NET INCOME. We recorded net income for the three month period ended September 30, 2010 of \$479 thousand or \$0.25 and \$0.24 per common and diluted share respectively (after preferred stock dividend) as compared to a net income of \$269 thousand or \$0.15 per share for the same period in 2009. The change in net income for the three-month period compared to the prior period was attributable to increases of \$536 thousand in net interest income and \$275 thousand in non interest income due to a \$291 thousand increase in gain on sale of loans, partially offset by an increase of \$104 thousand in the provision for loan losses. Non- interest expenses increase by \$339 thousand due to increased salary and benefit costs of \$110 thousand, net occupancy costs of \$7 thousand, data processing costs of \$19 thousand, professional services of \$229 thousand, other real estate owned expense of \$3 thousand and FDIC expenses of \$13 thousand, partially offset by decreases in advertising and promotion of \$24 thousand and other operating expenses of \$18 thousand. The increase in professional services includes a charge of \$203 thousand, or \$.07 per share for audit, legal and investment banking fees associated with a proposed capital transaction terminated by the Company. The net interest margin for the three-month period ended September 30, 2010 increased by 8 basis points to 3.57% as compared to 3.49% for the same period in 2009.

We recorded net income for the nine month period ended September 30, 2010 of \$1.5 million or \$0.76 per common and diluted share respectively (after

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preferred stock dividend) as compared to a net loss of \$1.0 million or \$0.61 per share for the same period in 2009. The change in net income for the nine-month period compared to the prior period was attributable to increases of \$2.4 million in net interest income and \$328 thousand in non-interest income coupled with a decrease of \$1.9 million in provision for loan losses, \$67 thousand in FDIC insurance premium expense, and \$118 thousand in net occupancy cost. In addition, employee salaries and benefits increased by \$366 thousand, professional services increased by \$297 thousand and other non interest expenses increased by \$26 thousand. The decrease in net occupancy costs was the result of costs associated with the closing of the Moorestown Route 38 Branch during the first quarter of 2009. The net interest margin for the nine-month period ended September 30, 2010 increased by 42 basis points to 3.70% as compared to 3.28% for the same period in 2009.

INTEREST INCOME. Total interest income amounted to \$4.1 million for the three-month period ended September 30, 2010, an increase of \$196 thousand or 5.1% when compared to the same period in 2009. The increase in interest income was due to volume increases in our interest-bearing assets, partially offset by a reduction in the average yield. The average yield on our interest-earning assets was 4.80% for the three month period ended September 30, 2010 compared to 5.50% during the same period in 2009. The reduction in yield in the quarterly period reflects generally reduced market rates of interest, as the Federal Reserve has maintained a low interest rate policy to help stimulate the U.S. economy.

Total interest income amounted to \$12.1 million for the nine-month period ended September 30, 2010, an increase of \$1.2 million or 11.2% when compared to the same period in 2009. The increase in interest income was related to volume increases of \$19.3 million in average loans, \$18.6 million in Fed Funds Sold and \$12.2 million in average investment securities, partially offset by a reduction in the average yield. The average yield on our interest-earning assets was 5.14% for the nine month period ended September 30, 2010 compared to 5.53% during the same period in 2009. The reduction in yield in the year to date period reflects generally reduced market rates of interest, as the Federal Reserve has maintained a low interest rate policy to help stimulate the U.S. economy.

INTEREST EXPENSE. Total interest expense amounted to \$1.2 million for the three-month period ended September 30, 2010, a decrease of \$340 thousand or 22.6 % when compared to the same period in 2009. The decrease in interest expense resulted from lower rates paid on deposit and borrowing products when compared to the same period in 2009. The average cost of interest-bearing liabilities was 1.48% for the three-month period ended September 30, 2010 compared to 2.28% during the same period in 2009.

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Total interest expense amounted to \$3.5 million for the nine-month period ended September 30, 2010, a decrease of \$1.2 million or 25.4 % when compared to the same period in 2009. The decrease in interest expense resulted from a decrease of \$2.9 million in average borrowed funds and lower rates paid on deposit and borrowing products when compared to the same period in 2009, offsetting the growth in average interest bearing deposits of \$43.4 million. The average cost of interest-bearing liabilities was 1.61% for the nine-month period ended September 30, 2010 compared to 2.57% during the same period in 2009.

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

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ALLOWANCE FOR LOAN LOSSES. During the third quarter of 2010, we recorded a provision for loan losses of \$235 thousand compared to a provision of \$131 thousand for the same period in 2009. We recorded a provision for loan losses for the nine-month period ended September 30, 2010 of \$382 thousand compared to a provision of \$2.4 million for the same period in 2009. A provision for loan losses is charged to operations based on management's evaluation of the estimated and inherent losses in our loan portfolio. While management has increased its allowance for loan loss for the three-month and six-month periods ended September 30, 2010, management believes the credit quality of our loan portfolio has stabilized. On a linked quarterly basis, our non-performing assets were stable from December 31, 2009 to September 30, 2010. We have not engaged in any sub prime lending activities that have plagued the banking industry. At September 30, 2010, our allowance for loan losses represented 1.51% of total loans outstanding and 34.7% of non-performing loans.

NON-INTEREST INCOME. For the three-months ended September 30, 2010, non-interest income, which is comprised principally of service charges on deposit accounts, gain on sale of loans, origination fees on residential mortgage loans sold, bank owned life insurance income, ATM fees and other miscellaneous fee income totaled \$412 thousand. This represents an increase of \$275 thousand or 200.7% when compared to the same period in 2009. This increase resulted from increases of \$291 thousand in gain on loans sold and miscellaneous fee income of \$11 thousand, offset by decreases of \$17 thousand on service charges on deposit accounts, \$7 thousand in origination fees on mortgage loans sold and a \$3 thousand decrease in Bank owned life insurance.

Non-interest income for the nine-months ended September 30, 2010 totaled \$686 thousand, an increase of \$328 thousand or 91.6% when compared to the same period in 2009. This change reflects an increase of \$330 thousand in gain on sale of loans coupled with an increase of \$23 thousand in miscellaneous income, partially offset by decreases of \$18 thousand in origination fees on mortgage loans sold and \$7 thousand in Bank owned life insurance.

NON-INTEREST EXPENSE. Non-interest expense, which is comprised principally of salaries and employee benefits, net occupancy costs, FDIC insurance premium expense, advertising costs, data processing costs and professional services and other operating costs, totaled \$2.3 million for the three months ended September 30, 2010. This represents an increase of \$339 thousand or 17.3% when compared to the same period in 2009. The increase in non-interest expense was primarily the result of increased salary and benefit costs of \$110 thousand, net occupancy costs of \$7 thousand, data processing costs of \$19 thousand, professional services of \$229 thousand, and FDIC expenses of \$13 thousand, partially offset by decreases in advertising and promotion of \$24 thousand and other operating expenses of \$18 thousand. The increase in professional services includes a charge of \$203 thousand for audit, legal and investment banking fees associated with a proposed capital transaction terminated by the Company.

Non-interest expense for the nine months ended September 30, 2010 totaled \$6.5 million, an increase of \$504 thousand or 8.4% when compared to the same period in 2009. The increase in non-interest expense was primarily the result of increases in salary and benefit costs of \$366 thousand, data processing costs of \$49 thousand, professional services of \$297 thousand and other operating expenses of \$14, partially offset by decreases in net occupancy costs of \$118 thousand, advertising and promotion expense of \$37 thousand, and FDIC deposit insurance premium expense of \$67 thousand. The decrease in occupancy costs is attributable to \$135 thousand associated with the retirement of certain fixed assets in connection with the closing of the Moorestown Route 38 branch on April 1, 2009.

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INCOME TAXES. We recorded a federal and state income tax expense of \$311 thousand during the three month period ended September 30, 2010 compared to an income tax expense of \$153 thousand for the same period in 2009. The effective tax rate for the three month period ended September 30, 2010 was 39.4% compared to 36.3% for the three month period ended September 30, 2009.

We recorded a federal and state income tax expense of \$939 thousand during the nine month period ended September 30, 2010 compared to an income tax benefit of \$745 thousand for the same period in 2009. The effective tax rate for the nine month period ended September 30, 2010 was 38.9% compared to 42.1% for the nine month period ended September 30, 2009.

LIQUIDITY AND CAPITAL RESOURCES

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

In addition to using growth in deposits, loan repayments and the investment portfolio as a source of liquidity, we also have access to unsecured, overnight lines of credit aggregating \$58.7 million, consisting of \$3.0 million, on an uncommitted basis, through ACBB and \$55.7 million through the FHLB of New York. The arrangements with ACBB are for the sale of federal funds to the Bank, subject to the availability of such funds. Pursuant to a collateral agreement with the FHLB, advances under this line of credit are secured by a blanket lien on our residential mortgage loan portfolio. At September 30, 2010, we had no outstanding balance against the overnight line of credit at ACBB. In addition, the Company has a non revolving line of credit with ACBB for up to \$5.0 million and as of September 30, 2010 there is an outstanding balance of \$4.8 million. In addition, the Bank's membership in the FHLB provides the Bank with additional secured borrowing capacity of up to a maximum of 25% of the Bank's total assets, subject to certain conditions.

We had cash and cash equivalents of \$34.1 million at September 30, 2010 in the form of cash and due from banks. At September 30, 2010, unused lines of credit available to our customers, committed undisbursed loan proceeds and standby letters of credit totaled \$56.6 million. Certificates of deposit scheduled to mature in one year or less totaled \$94.9 million at September 30, 2010. We anticipate that we will continue to have sufficient funds available to meet the needs of our customers for deposit repayments and loan fundings.

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

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

The Bank is subject to risk-based capital guidelines promulgated by the FDIC that are designed to make regulatory capital requirements more sensitive to

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differences in risk profile among banks, to account for off-balance sheet exposure, and to minimize disincentives for holding liquid assets. Under the guidelines, assets and off-balance sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items. The minimum ratio of total capital to

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risk-weighted assets (including certain off-balance sheet activities, such as standby letters of credit) is 8%. At least 4% of total risk-weighted capital must consist of "Tier I Capital," consisting of common stockholders' equity and qualifying hybrid instruments, less certain goodwill items and other intangible assets. The remainder ("Tier II Capital") may consist of (a) the allowance for loan losses of up to 1.25% of risk-weighted assets, (b) excess of qualifying hybrid instruments, (c) perpetual debt (d) mandatory convertible securities, and (e) qualifying subordinated debt and intermediate-term preferred stock up to 50% of Tier I capital. Total capital is the sum of Tier I and Tier II capital less reciprocal holdings of other banking organizations, capital instruments, investments in unconsolidated subsidiaries and any other deductions as determined by the FDIC (determined on a case-by-case basis or as a matter of policy after formal rule-making).

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

The Bank was in compliance with all applicable minimum capital requirements for all periods presented. At September 30, 2010 the Bank maintained a Tier I leverage ratio of 6.76%, a Tier I risk-based capital ratio of 8.69% and a total risk-based capital ratio of 10.81% . The Bank's management believes that the Bank would be categorized as well capitalized under applicable FDIC capital adequacy regulations.

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

On October 31, 2008, the Bank issued a hybrid capital instrument in the aggregate amount of \$3.0 million in the form of subordinated debt. A portion of this instrument qualifies as Tier II capital. The term of the debt is for a six year period with a maturity date of November 1, 2014. The initial interest rate was 5.00% fixed for the first year then adjusted to a variable rate equal to prime rate for the remaining five years. The debt security is redeemable, at the Bank's option, at par on any April 30(th) or October 31(st) through the maturity date. For the quarter ended September 30, 2010, the rate on this instrument was 3.25% .

On February 17, 2009, the Company entered into a non-revolving line of credit loan agreement with ACBB in an amount up to \$5.0 million. The term of the debt is for a three year period with a maturity date of February 17, 2012. The interest rate adjusts at a variable rate equal to prime rate plus 25 basis points with a floor of 4.25% . The Company has an outstanding balance on the line of credit of \$4.8 million and has contributed \$4.4 million as additional

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capital to the Bank. For the quarter ended September 30, 2010, the interest rate on this borrowing was 4.25% .

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

In December 2009, the Company authorized the establishment of 2,000 shares of \$0 par, \$1,000 stated value, Perpetual Non-Cumulative Convertible Preferred Stock. The preferred stock is entitled to receive, as and when declared by the Company's Board of Directors, non-cumulative cash dividends at the annual rate equal to 7% of the stated value. In December 2009, the Company sold 1,900 preferred shares. The preferred stock is redeemable at the

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Company's option at any time after six months from the issue date at the stated value plus any dividends declared but unpaid. The preferred shares have priority of dividends such that, no dividends or distributions shall be declared or paid to common shareholders unless full dividends on all outstanding preferred shares have been declared and paid for the most recently completed calendar quarter.

The Bank's capital ratios at September 30, 2010 and December 31, 2009 are presented in the following table

	SEPTEMBER 2010	DECEMBER 2009
	-----	-----
Shareholders' equity to total assets	5.3%	5.8%
Leverage ratio	6.7%	7.3%
Risk-based capital ratios:		
Tier 1	8.7%	8.5%
Total Capital	10.8%	10.7%

OFF-BALANCE SHEET ARRANGEMENTS. We are party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the statements of financial condition.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the agreement. Commitments generally have fixed dates or other termination clauses and may require the payment of a fee. Some of the commitments are expected to expire without being drawn upon, and the total commitments do not necessarily represent future cash requirements. Total commitments to extend credit at September 30, 2010 were \$56.6 million. We evaluate each customer's creditworthiness on a case by case basis. Collateral obtained, if deemed necessary, is based on management's credit evaluation of the customer. Collateral varies but may include accounts receivable, marketable securities, inventory, property, plant and equipment, residential and commercial real

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estate.

Standby letters of credit are conditional commitments issued to a third party for a customer. The credit risk involved in issuing standby letters of credit is similar to that involved in extending credit to customers. We evaluate each customer's creditworthiness on a case by case basis. Collateral obtained, if deemed necessary, is based on management's credit evaluation of the customer. Collateral varies, but may include accounts receivable, marketable securities, inventory, property, plant and equipment, and residential and commercial real estate. At September 30, 2010, our obligations under standby letters of credit totaled \$2.1 million.

CRITICAL ACCOUNTING POLICIES

ALLOWANCE FOR LOSSES ON LOANS

The allowance for losses on loans is based on management's ongoing evaluation of the loan portfolio and reflects an amount considered by management to be its best estimate of known and inherent losses in the loan portfolio. Management considers a variety of factors when establishing the allowance, such as the impact of current economic conditions, diversification of the loan portfolio, delinquency statistics, results of independent loan review and related classifications. Our historic loss rates and the loss rates of peer financial institutions are also considered. In addition, certain individual loans which management has identified as problematic are specifically provided for, based upon an evaluation of the borrower's perceived ability to pay, the estimated adequacy of the underlying collateral and other relevant factors. Consideration is also given to examinations performed by regulatory agencies. Although provisions have been established and segmented by type of loan, based upon management's assessment of their differing inherent loss characteristics, the entire allowance for losses on loans is available to absorb loan losses in any category.

Management uses significant estimates to determine the allowance for loan losses. Since the allowance for loan losses is dependent, to a great extent, on conditions that may be beyond our control, it is possible that management's estimate of the allowance for loan losses and actual results could differ materially in the near term.

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In addition, regulatory authorities, as an integral part of their examinations, periodically review the allowance for loan losses. They may require additions to the allowance based upon their judgments about information available to them at the time of examination.

INCOME TAXES

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, as well as operating loss carry forwards. 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. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established against deferred tax assets when, in the judgment of management, it is more likely than not that such deferred tax assets will not become available. Because the judgment about the level of future taxable income is dependent to a great extent on matters that may, at least in part, be beyond our control, it is at least

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reasonably possible that management's judgment about the need for a valuation allowance for deferred taxes could change in the near term.

IMPACT OF INFLATION AND CHANGING PRICES

The consolidated financial statements of the Company and the footnotes thereto, presented elsewhere herein, have been prepared in accordance with the standards of the Public Company Accounting Oversight Board (United States), which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time due to inflation.

The impact of inflation is reflected in the increased cost of our operations. Unlike most industrial companies, nearly all of our assets and liabilities are monetary. As a result, interest rates have a greater impact on our performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the price of goods and services.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable to smaller reporting companies.

ITEM 4. CONTROLS AND PROCEDURES

The Registrant's chief executive officer and chief financial officer, after evaluating the effectiveness of the Registrant's "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this quarterly report, have concluded that as of such date, the Registrant's disclosure controls and procedures were effective to ensure at a reasonable assurance level that material information relating to the Registrant is recorded, processed, summarized and reported in a timely manner. There were no changes in the Registrant's internal control over financial reporting that occurred during the Registrant's third fiscal quarter of 2010 that have materially affected, or are reasonably likely to materially affect, the Registrant's internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

Not applicable.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. RESERVED

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

(a) The following are filed as exhibits to this report:

31.1 Certification of Chief Executive Officer required under Section 302 of the Sarbanes -- Oxley Act of 2002

31.2 Certification of Chief Financial Officer required under Section 302 of the Sarbanes -- Oxley Act of 2002

32.1 Certification of Chief Executive Officer required under Section 906 of the Sarbanes -- Oxley Act of 2002

32.2 Certification of Chief Financial Officer required under Section 906 of the Sarbanes -- Oxley Act of 2002

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CORNERSTONE FINANCIAL CORPORATION

Date: November 10, 2010

By: /S/ GEORGE W. MATTEO, JR.

George W. Matteo, Jr.
President and Chief Executive Officer
(Principal Executive Officer)

Date: November 10, 2010

By: /S/ KEITH WINCHESTER

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Keith Winchester
Executive Vice President and
Chief Financial Officer
(Principal Financial and Accounting
Officer)