City National Bancshares Corporation

2009

Annual Report

This page was left intentionally blank

CITY NATIONAL BANK

June 22, 2010

Dear Stockholders:

2009 was a year of unprecedented economic turmoil reflected by high unemployment and declining real estate values. The recession had a negative impact on the banking industry, especially smaller community banks like us, which have significant concentrations of commercial real estate loans. As a result, we recorded a net loss of $7.8 million compared to $1.1 million of earnings in 2008.

There is an old expression in the banking industry, “as the economy goes, so goes the banking industry.” While the economy has shown some signs of recovery, we expect that it will be a protracted recovery, meaning that we may not return to profitability until 2011. Additionally, we are working under an agreement with our regulators to make operational improvements in certain areas and to raise capital, among other things. We are attempting to raise capital as well as reduce asset levels to improve capital ratios.

We recovered from a regulatory order in 1991, and we are confident that we can work our way out of this one as well. We have a loyal supporter base consisting of our shareholders, debt holders and customers, and with their help, we will succeed in our efforts.

We appreciate your understanding and support in these difficult times and assure you that we will continue to fulfill our mission of serving our low to middle income urban population.

Mr. Louis E. Prezeau

President and CEO

Mission Statement

City National Bank of New Jersey, a minority-owned and managed commercial bank, is dedicated to building wealth and improving the quality of life within the communities it serves by:

- Providing 100% customer satisfaction through personalized, flexible and professional services.
- Maintaining stable earnings and strong asset quality, while enhancing shareholder value.
- Providing a stimulating and challenging work environment that encourages, develops and rewards excellence.

Table of Contents

We are also a Community Development Financial Institution ("CDFI") and have received numerous awards from the United States Treasury Department for our lending efforts in low-income communities.

Five-Year Summary

Dollars in thousands, except per share data	2009	2008	2007	2006	2005
Year-end Balance Sheet data					
Total assets	$466,339	$494,539	$449,748	$395,217	$363,541
Gross loans	276,242	271,906	232,824	199,284	179,093
Allowance for loan losses	8,650	3,800	3,000	2,400	2,165
Investment securities	162,401	178,061	157,556	169,598	149,144
Total deposits	380,276	407,117	394,856	342,416	312,429
Short-term portion of long-term debt	5,000	5,000	-	-	-
Long-term debt	44,000	46,600	19,800	19,606	20,700
Stockholders' equity	31,013	28,092	28,872	27,762	25,142
Income Statement data					
Interest income	24,174	25,902	25,978	21,649	18,173
Interest expense	9,495	11,309	14,233	10,848	7,280
Net interest income	14,679	14,593	11,745	10,801	10,893
Provision for loan losses	8,105	1,586	772	279	115
Net interest income after provision for loan losses	6,574	13,007	10,973	10,522	10,778
Other operating income	3,124	279	2,694	2,724	2,136
Net impairment losses on securities	(2,333)	(2,688)	-	-	-
Other operating expenses	13,381	12,278	11,428	10,035	9,717
(Loss) income before income tax expense	(6,016)	1,008	2,239	3,211	3,197
Income tax (benefit) expense	1,806	(50)	372	743	862
Net (loss) income	$(7,822)	$ 1,058	$ 1,867	$ 2,468	$ 2,335

Per common share data					
Net (loss) income per basic share	$ (68.36)	$ 1.87	$ 8.28	$ 13.04	$ 16.20
Net (loss) income per diluted share	(68.36)	1.87	8.09	12.54	15.52
Book value	85.50	130.10	141.04	129.88	118.23
Dividends declared	2.00	3.60	3.50	3.25	3.00
Basic average number of common shares outstanding	131,300	131,688	132,306	133,246	133,654
Diluted average number of common shares outstanding	131,300	131,688	148,623	143,924	139,511
Number of common shares outstanding at year-end	131,290	131,330	131,987	132,926	133,650
Financial ratios					
Return on average assets	(1.53)%	.23%	.44%	.65%	.66%
Return on average common equity	(36.55)	1.38	6.35	10.90	13.83
Stockholders' equity as a percentage of total assets	6.65	5.68	6.42	6.96	6.92
Common dividend payout ratio	-	-	42.22	25.92	19.33

CITY NATIONAL BANCSHARES CORPORATION AND SUBSIDIARY

Consolidated Balance Sheets

Dollars in thousands, except per share data	December 31, 2009	December 31, 2008
Assets		
Cash and due from banks (Note 2)	$ 6,808	$ 7,613
Federal funds sold (Note 3)	5,500	18,200
Interest-bearing deposits with banks	609	726
Investment securities available for sale (Note 4)	122,006	125,591
Investment securities held to maturity (Market value of $41,782 at December 31, 2009 and $54,537 at December 31, 2008) (Note 5)	40,395	53,714
Loans held for sale	190	267
Loans (Note 6)	276,242	271,906
Less: Allowance for loan losses (Note 7)	8,650	3,800
Net loans	267,592	268,106
Premises and equipment (Note 8)	2,949	3,242
Accrued interest receivable	2,546	2,796
Cash surrender value of life insurance	5,537	5,345
Other real estate owned	2,352	1,547
Other assets (Notes 13 and 14)	9,855	7,392
Total assets	$ 466,339	$ 494,539
Liabilities and Stockholders' Equity		
Deposits: (Notes 4, 5 and 9)		
Demand	$ 29,304	$ 36,270
Savings	149,853	183,172
Time	201,119	187,675
Total deposits	380,276	407,117
Accrued expenses and other liabilities	5,950	5,880
Short-term portion of long-term debt (Note 11)	5,000	5,000
Short-term borrowings (Note 10)	100	1,850
Long-term debt (Note 11)	44,000	46,600
Total liabilities	435,326	466,447
Commitments and contingencies (Note 20)		
Stockholders' equity (Notes 15, 16 and 23):		
Preferred stock, no par value: Authorized 100,000 shares (Note 15);		
Series A , issued and outstanding 8 shares in 2009 and 2008	200	200
Series C , issued and outstanding 108 shares in 2009 and 2008	27	27
Series D , issued and outstanding 3,280 shares in 2009 and 2008	820	820
Preferred stock, no par value, perpetual noncumulative: Authorized 200 shares;		
Series E, issued and outstanding 49 shares in 2009 and 2008	2,450	2,450
Preferred stock, no par value, perpetual noncumulative: Authorized 7,000 shares;		
Series F, issued and outstanding 7,000 shares in 2009 and 2008	6,790	6,790
Preferred stock, no par value, perpetual noncumulative: Authorized 9,439 shares;		
Series G, issued and outstanding 9,439 shares	9,499	-
Common stock, par value $10: Authorized 400,000 shares;		
134,530 shares issued in 2009 and 2008		
131,290 shares outstanding in 2009 and 131,330 shares outstanding in 2008	1,345	1,345
Surplus	1,115	1,115
Retained earnings	8,462	16,694
Accumulated other comprehensive loss	533	(1,124)
Treasury stock, at cost - 3,240 and 3,200 common shares in 2009 and 2008, respectively	(228)	(225)
Total stockholders' equity	31,013	28,092
Total liabilities and stockholders' equity	$ 466,339	$ 494,539

See accompanying notes to consolidated financial statements.

CITY NATIONAL BANCSHARES CORPORATION AND SUBSIDIARY

Consolidated Statements of Operations

	Year Ended December 31,		
Dollars in thousands, except per share data	2009	2008	2007
Interest income			
Interest and fees on loans	$ 16,146	$ 16,967	$ 16,510
Interest on Federal funds sold and securities purchased under agreements to resell	54	217	1,392
Interest on deposits with banks	50	24	90
Interest and dividends on investment securities:			
Taxable	6,668	7,404	6,613
Tax-exempt	1,256	1,290	1,373
Total interest income	24,174	25,902	25,978
Interest expense			
Interest on deposits (Note 9)	7,670	9,706	12,894
Interest on short-term borrowings	3	59	23
Interest on long-term debt	1,822	1,544	1,316
Total interest expense	9,495	11,309	14,233
Net interest income	14,679	14,593	11,745
Provision for loan losses (Note 7)	8,105	1,586	772
Net interest income after provision for loan losses	6,574	13,007	10,973
Other operating income			
Service charges on deposit accounts	1,476	1,443	1,332
Agency fees on commercial loans	236	318	328
Other income (Note 12)	1,401	1,250	1,024
Net gains (losses) on securities transactions (Notes 4 and 5)	11	(44)	10
Other than temporary impairment losses on securities	(2,443)	(2,688)	-
Portion of loss recognized in other comprehensive income, before tax	110	-	-
Net impairment losses on securities recognized in earnings	(2,333)	(2,688)	-
Total other operating income	791	279	2,694
Other operating expenses			
Salaries and other employee benefits (Note 14)	5,800	6,205	5,992
Occupancy expense (Note 8)	1,326	1,304	1,201
Equipment expense (Note 8)	648	651	562
Management consulting fees	683	212	256
FDIC insurance expense	1,082	429	40
Other real estate owned expense	558	-	-
Other expenses (Note 12)	3,284	3,477	3,377
Total other operating expenses	13,381	12,278	11,428
(Loss) income before income tax expense	(6,016)	1,008	2,239
Income tax expense (benefit) (Note 13)	1,806	(50)	372
Net (loss) income	$ (7,822)	$ 1,058	$ 1,867
Net (loss) income per common share (Note 17)			
Basic	$ (68.36)	$ 1.87	$ 8.28
Diluted	(68.36)	1.87	8.09
Basic average common shares outstanding	131,300	131,688	132,306
Diluted average common shares outstanding	131,300	131,688	148,623
Cash dividends declared per common share	$ 2.00	$ 3.60	$ 3.50

See accompanying notes to consolidated financial statements.

CITY NATIONAL BANCSHARES CORPORATION AND SUBSIDIARY

Consolidated Statements of Changes in Stockholders' Equity

Dollars in thousands	Common Stock	Surplus	Preferred Stock	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Treasury Stock	Total
Balance, January 1, 2007	$ 1,345	$ 1,115	$ 10,287	$ 16,290	$ (978)	$ (109)	$ 27,950
Net income	-	-	-	1,867	-	-	1,867
Other comprehensive income							
Unrealized holding gains on securities							
arising during the period (net of tax of $(145))	-	-	-	-	363	-	363
Reclassification adjustment for gains (losses)	-	-					
included in net income (net of tax of $2)	-	-	-	-	(8)	-	(8)
Total comprehensive income	-	-					2,222
Proceeds from issuance of preferred stock	-	-	-	-	-	-	-
Purchase of treasury stock	-	-	-	-	-	(65)	(65)
Dividends paid on common stock	-	-	-	(464)	-	-	(464)
Dividends paid on preferred stock	-	-	-	(771)	-	-	(771)
Balance, December 31, 2007	1,345	1,115	10,287	16,922	(623)	(174)	28,872
Net income	-	-	-	1,058	-	-	1,058
Other comprehensive income							
Unrealized holding losses on securities							
arising during the period (net of tax of $922)	-	-	-	-	(2,304)	-	(2,304)
Reclassification adjustment for gains (losses)	-	-					-
included in net income (net of tax of $(929))	-	-	-	-	1,803	-	1,803
Total comprehensive income	-	-					557
Proceeds from issuance of preferred stock	-	-	-	-	-	-	-
Purchase of treasury stock	-	-	-	-	-	(51)	(51)
Dividends paid on common stock	-	-	-	(474)	-	-	(474)
Dividends paid on preferred stock	-	-	-	(812)	-	-	(812)
Balance, December 31, 2008	1,345	1,115	10,287	16,694	(1,124)	(225)	28,092
Net loss	-	-	-	(7,822)	-	-	(7,822)
Other comprehensive income							
Unrealized holding gains on securities							
arising during the period (net of tax of $(470))	-	-	-	-	705	-	705
Reclassification adjustment for losses	-	-					-
included in net income (net of tax of $(374))	-	-	-	-	1,959	-	1,959
Total other comprehensive income							(5,158)
Transition adjustment for adoption of FASB ASC 320-10-65-1				1,007	(1,007)		-
Proceeds from issuance of preferred stock	-	-	9,439	-	-	-	9,439
Purchase of treasury stock	-	-	-	-	-	(3)	(3)
Dividends paid on common stock	-	-	-	(1,094)	-	-	(1,094)
Dividends paid on preferred stock	-	-	-	(263)	-	-	(263)
Dividends accrued on preferred stock			60	(60)			-
Balance, December 31, 2009	$ 1,345	$ 1,115	$ 19,786	$ 8,462	$ 533	$ (228)	$ 31,013

See accompanying notes to consolidated financial statements.

CITY NATIONAL BANCSHARES CORPORATION AND SUBSIDIARY

Consolidated Statements of Cash Flows

In thousands	Year Ended December 31, 2009	2008	2007
Operating activities			
Net (loss) income	$ (7,822)	$ 1,058	$ 1,867
Adjustments to reconcile net income to net cash from operating activities:			
Depreciation and amortization	432	495	430
Provision for loan losses	8,105	1,586	772
Premium amortization (discount accretion) of investment securities	17	(65)	(335)
Amortization of intangible assets	194	213	197
Net (gains) losses on sales and early redemptions of investment securities	(11)	44	(10)
Net impairment losses on investment securities	2,333	2,688	-
Net losses (gains) on sales of loans held for sale	10	(18)	(72)
Net losses and writedowns of other real estate owned	427	-	-
Loans originated for sale	(312)	(1,001)	(3,312)
Proceeds from sales and principal payments from loans held for sale	273	978	3,767
Decrease (increase) in accrued interest receivable	250	(124)	(167)
Deferred taxes	2,372	(1,056)	(453)
Net increase in bank-owned life insurance	(192)	(197)	(185)
Increase in other assets	(6,104)	(383)	(1,560)
Increase in accrued expenses and other liabilities	70	777	226
Net cash provided by operating activities	42	4,995	1,165
Investing activities			
Purchase of loans	-	-	(18,734)
Increase in loans, net	(8,993)	(41,415)	(14,978)
Decrease (increase) in interest bearing deposits with banks	117	(448)	375
Proceeds from maturities of investment securities available for sale, including principal repayments and early redemptions	27,100	21,774	48,501
Proceeds from maturities of investment securities held to maturity, including principal repayments and early redemptions	15,574	10,964	4,792
Proceeds from sales of investment securities available for sale	189	5,179	3,195
Purchases of investment securities available for sale	(22,096)	(50,849)	(38,230)
Purchases of investment securities held to maturity	(2,462)	(12,274)	(5,280)
Purchases of bank-owned life insurance, net	-	(220)	-
Proceeds from sales of other real estate owned	275	-	-
Purchases of premises and equipment	(139)	(136)	(302)
Net cash provided by (used in) investing activities	9,565	(67,425)	(20,661)
Financing activities			
Purchase of deposits	-	-	11,016
(Decrease) increase in deposits	(26,841)	12,261	41,424
(Decrease) increase in short-term borrowings	(1,750)	700	750
(Decrease) increase in long-term debt	(2,600)	31,800	194
Proceeds from issuance of preferred stock	9,439	-	-
Purchases of treasury stock	(3)	(51)	(65)
Dividends paid on preferred stock	(1,094)	(812)	(771)
Dividends paid on common stock	(263)	(474)	(464)
Net cash (used in) provided by financing activities	(23,112)	43,424	52,084
Net (decrease) increase in cash and cash equivalents	(13,505)	(19,006)	32,588
Cash and cash equivalents at beginning of year	25,813	44,819	12,231
Cash and cash equivalents at end of year	$ 12,308	$ 25,813	$ 44,819
Cash paid during the year:			
Interest	$ 9,864	$ 11,728	$14,050
Income taxes	1,279	1,582	842
Non-cash transactions			
Transfer of investments from held to maturity to available for sale	184	1,500	-
Transfer of loans to other real estate owned	1,508	1,547	-

Note 1 Summary of significant accounting policies

The accounting and reporting policies of City National Bancshares Corporation (the "Corporation" or "CNBC") and its subsidiaries, City National Bank of New Jersey (the "Bank" or "CNB") and City National Bank of New Jersey Capital Trust II conform with U.S. generally accepted accounting principles ("GAAP") and to general practice within the banking industry. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities as of the date of the balance sheet and revenues and expenses for the related periods. Actual results could differ significantly from those estimates. A material estimate that is particularly susceptible to significant change in the near term is the allowance for loan losses. In connection with the determination of this allowance, management generally obtains independent appraisals for significant properties. Judgments related to securities valuation and impairment are also critical because they involve a higher degree of complexity and subjectivity and require estimates and assumptions about highly uncertain matters. Accordingly, it is reasonably possible that the Corporation may be required to record additional other than temporary impairment charges in future periods. The following is a summary of the more significant policies and practices.

Business

City National Bancshares Corporation ("the Corporation"), primarily through its subsidiary City National Bank of New Jersey ("CNB"), offers a broad range of lending, leasing, depository and related financial services to individual consumers, businesses and governmental units through ten full-service offices located in New Jersey, Philadelphia, PA, New York City and Long Island, New York. CNB competes with other banking and financial institutions in its primary market communities, including financial institutions with resources substantially greater than its own. Commercial banks, savings banks, savings and loan associations, credit unions, and money market funds actively compete for deposits and loans. Such institutions, as well as consumer finance and insurance companies, may be considered competitors with respect to one or more services they render.

CNB offers equipment leasing services through its minority ownership interest in an unconsolidated leasing company.

Principles of consolidation

The financial statements include the accounts of CNBC and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Cash and cash equivalents

For purposes of the presentation of the Statement of Cash Flows, Cash and cash equivalents includes Cash and due from banks and Federal funds sold.

Investment securities held to maturity and investment securities available for sale

Investment securities are designated as held to maturity or available for sale at the time of acquisition. Securities that the Corporation has the intent and ability at the time of purchase to hold until maturity are designated as held to maturity. Investment securities held to maturity are stated at cost and adjusted for amortization of premiums and accretion of discount to the earlier of maturity or call date using the level yield method.

Securities to be held for indefinite periods of time but not intended to be held until maturity or on a long-term basis are classified as investment securities available for sale. Securities held for indefinite periods of time include securities that the Corporation intends to use as part of its interest rate sensitivity management strategy and that may be sold in response to changes in interest rates, resultant risk and other factors. Investment securities available for sale are reported at fair market value, with unrealized gains and losses, net of deferred tax, reported as a component of accumulated other comprehensive income, which is included in stockholders' equity. Gains and losses realized from the sales of securities available for sale are determined using the specific identification method. Premiums are amortized and discounts are accreted using the "level yield" method.

Investment securities classified as held to maturity or available for sale are evaluated quarterly for other-than-temporary impairment. Other-than-temporary impairment means that the security's impairment is due to factors that could include its inability to pay interest or dividends, its potential for default, and/or other factors. As a result of the adoption of new authoritative guidance under ASC Topic 320, "Investments—Debt and Equity Securities" on April 1, 2009, when a held to maturity or available for sale debt security is assessed for other-than-temporary impairment, the Corporation has to first consider (a) whether it intends to sell the security, and (b) whether it is more likely than not that the Corporation will be required to sell the security prior to recovery of its amortized cost basis. If one of these circumstances applies to a security, an other-than-temporary impairment loss is recognized in the statement of income equal to the full amount of the decline in fair value below amortized cost. If neither of these circumstances applies to a security, but the Corporation does not expect to recover the entire amortized cost basis, an other-than-temporary impairment loss has occurred that must be separated into two categories: (a) the amount related to credit loss, and (b) the amount related to other factors. In assessing the level of other-than-temporary impairment attributable to credit loss, the Corporation compares the present value of cash flows expected to be collected with the amortized cost basis of the security. The portion of the total other-than-temporary impairment related to credit loss is recognized in earnings, while the amount related to other factors is recognized in other comprehensive income. The total other-than-temporary impairment loss is presented in the statement of income, less the portion recognized in other comprehensive income. When a debt security becomes other-than-temporarily impaired, its amortized cost basis is reduced to reflect the portion of the total impairment related to credit loss. Prior to the adoption of the new authoritative guidance, total other-than-temporary impairment losses (i.e., both credit and non-credit losses) on debt securities were recognized through earnings with an offset to reduce the amortized cost basis of the applicable debt securities by their entire impairment amount.

To determine whether a security's impairment is other-than-temporary, the Corporation considers factors that include the causes of the decline in fair value, such as credit problems, interest rate fluctuations, or market volatility, the severity and duration of the decline, its ability and intent to hold equity security investments until they recover in value (as well as the likelihood of such a recovery in the near term), the intent to sell security investments, or if it is more likely than not that the Corporation will be required to sell such securities before recovery of their individual amortized cost basis less any current-period credit loss. For debt securities, the primary consideration in determining whether impairment is other-than-temporary is whether or not it is probable that current or future contractual cash flows have been or may be impaired.

The Bank holds mortgage-backed securities in its investment portfolios, none of which are private-label. Such securities are subject to changes in the prepayment rates of the underlying mortgages, which may affect both the yield and maturity of the securities.

Loans held for sale

Loans held for sale include residential mortgage loans originated with the intent to sell. Loans held for sale are carried at the lower of aggregate cost or fair value.

Loans

Loans are stated at the principal amounts outstanding, net of unearned discount and deferred loan fees. Interest income is accrued as earned, based upon the principal amounts outstanding. Loan origination fees and certain direct loan origination costs, as well as unearned discount, are deferred and recognized over the life of the loan revised for loan prepayments, as an adjustment to the loan's yield.

Recognition of interest on the accrual method is generally discontinued when a loan contractually becomes 90 days or more past due or a reasonable doubt exists as to the collectability of the loan, unless such loans are well-secured and in the process of collection. At the time a loan is placed on a nonaccrual status, previously accrued and uncollected interest is generally reversed against interest income in the current period. Interest on such loans, if appropriate, is recognized as income when payments are received. A loan is returned to an accrual status when it is current as to principal and interest and its future collectability is expected.

The Corporation has defined the population of impaired loans to be all nonaccrual loans of $100,000 or more. Impaired loans of $100,000 or more are individually assessed to determine that the loan's carrying value does not exceed the fair value of the underlying collateral or the present value of the loan's expected future cash flows. Smaller balance homogeneous loans that are collectively evaluated for impairment are specifically excluded from the impaired loan portfolio.

Trouble debt restructured (“TDR”) loans are those loans whose terms have been modified because of deterioration of the financial condition of the borrower to provide for a reduction of interest or principal payments, or both. An allowance is established for all TDR loans based on the present value of the respective loan’s future cash flows unless the loan is deemed collateral dependent.

Allowance for loan losses

The allowance for loan losses is maintained at a level determined adequate to provide for losses inherent in the portfolio. The allowance is increased by provisions charged to operations and recoveries of loans previously charged off and reduced by loan charge-offs. Generally, losses on loans are charged against the allowance for loan losses when it is believed that the collection of all or a portion of the principal balance is unlikely and the collateral is not adequate.

The allowance is maintained at a level estimated to absorb probable credit losses inherent in the loan portfolio as well as other credit risk related charge-offs. The allowance is based on ongoing evaluations of the probable estimated losses inherent in the loan portfolio. The Bank’s methodology for evaluating the appropriateness of the allowance includes segmentation of the loan portfolio into its various components, tracking the historical levels of classified loans and delinquencies, applying economic outlook factors, assigning specific incremental reserves where necessary, providing specific reserves on impaired loans, and assessing the nature and trend of loan charge-offs. Additionally, the volume of non-performing loans, concentration risks by size, type, and geography, new markets, collateral adequacy and economic conditions are taken into consideration.

The allowance established for probable losses on specific loans are based on a regular analysis and evaluation of classified loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor’s ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. Loans with a grade that is below a predetermined grade are adversely classified. Any change in the credit risk grade of performing and/or non-performing loans affects the amount of the related allowance.

Once a loan is classified, the loan is analyzed to determine whether the loan is impaired and, if impaired, the need to specifically allocate a portion of the allowance for loan losses to the loan. Specific valuation allowances are determined by analyzing the borrower’s ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower’s industry, among other things.

Additionally, management individually evaluates nonaccrual loans and all troubled debt restructured loans for impairment based on the underlying anticipated method of payment consisting of either the expected future cash flows or the related collateral. If payment is expected solely based on the underlying collateral, an appraisal is completed to assess the fair value of the collateral. Collateral dependent impaired loan balances are written down to the current fair value of each loan’s underlying collateral resulting in an immediate charge-off to the allowance, excluding any consideration for personal guarantees that may be pursued in the Bank’s collection process. If repayment is based upon future expected cash flows, the present value of the expected future cash flows discounted at the loan’s original effective interest rate is compared to the carrying value of the loan, and any shortfall is recorded as a specific valuation allowance in the allowance for credit losses.

The allowance also contains reserves to cover inherent losses within a given loan category which have not been otherwise reviewed or measured on an individual basis. Such reserves include management’s evaluation of national and local economic and business conditions, loan portfolio volumes, the composition and concentrations of credit, credit quality and delinquency trends. These reserves reflect management’s attempt to ensure that the overall allowance reflects a margin for the judgment uncertainty that is inherent in estimates of probable credit losses.

Management believes that the allowance for loan losses is adequate. While management uses available information to determine the adequacy of the allowance, future additions may be necessary based on changes in economic conditions or subsequent events unforeseen at the time of evaluation.

In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to increase the allowance based on their judgment of information available to them at the time of their examination.

Bank premises and equipment

Premises and equipment are stated at cost less accumulated depreciation based upon estimated useful lives of three to 40 years, computed using the straight-line method. Leasehold improvements, carried at cost, net of accumulated depreciation, are generally amortized over the terms of the leases or the estimated useful lives of the assets, whichever are shorter, using the straight-line method. Expenditures for maintenance and repairs are charged to operations as incurred, while major replacements and improvements are capitalized. The net asset values of assets retired or disposed of are removed from the asset accounts and any related gains or losses are included in operations.

Other assets

Other assets include the Bank’s 35.4% interest in a leasing company. The investment in the unconsolidated investee is carried using the equity method of accounting whereby the carrying value of the investment reflects the Corporation’s initial cost of the investment and the Corporation’s share of the leasing company’s annual net income or loss.

Other real estate owned

Other real estate owned ("OREO") acquired through foreclosure or deed in lieu of foreclosure is carried at the lower of cost or fair value less estimated cost to sell, net of a valuation allowance. When a property is acquired, the excess of the loan balance over the estimated fair value is charged to the allowance for loan losses. Operating results, including any future writedowns of OREO, rental income and operating expenses, are included in "Other expenses."

An allowance for OREO is established through charges to "Other expenses" to maintain properties at the lower of cost or fair value less estimated cost to sell.

Core deposit premiums
The premium paid for the acquisition of deposits in connection with the purchases of branch offices is amortized on a straight-line basis over a nine-year period, its estimated useful life, and is reviewed at least annually for impairment. If an impairment is found to exist, the carrying value is reduced by a charge to earnings. Amortization totaled $194,000 in 2009, $213,000 in 2008 and $197,000 in 2007.

Long-term debt
The Corporation has sold $4 million of trust preferred securities through a wholly-owned statutory business trust. The trust has no independent assets or operations and exists for the sole purpose of issuing trust preferred securities and investing the proceeds thereof in an equivalent amount of junior subordinated debentures issued by the Corporation. The junior subordinate debentures, which are the sole assets of the trusts, are unsecured obligations of the Corporation and are subordinate and junior in right of payment to all present and future senior and subordinated indebtedness and certain other financial obligations of the Corporation.

On December 10, 2003, the FASB issued FASB Interpretation No. 46R ("FIN 46R"), which replaced FIN 46. FIN 46R clarifies the applications of Accounting Research Bulletin No. 51 "Consolidated Financial Statements" to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. FIN 46R required the Corporation to de-consolidate its investments in the trusts recorded as long-term debt.

Income taxes
Federal income taxes are based on currently reported income and expense after the elimination of income which is exempt from Federal income tax.

Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Such temporary differences include depreciation and the provision for possible loan losses. Where applicable, deferred tax assets are reduced by a valuation allowance for any portions determined not likely to be realized. 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 reserve is maintained related to certain tax positions and strategies that management believes contain an element of uncertainty. Management periodically evaluates each of its tax positions and strategies to determine whether the reserve continues to be appropriate.

Net income per common share
Basic income per common share is calculated by dividing net income less dividends on preferred stock by the weighted average number of common shares outstanding. On a diluted basis, both net income and common shares outstanding are adjusted to assume the conversion of the convertible subordinate debentures, if determined to be dilutive.

Comprehensive income
Other comprehensive income includes unrealized gains (losses) on securities available for sale (including the non-credit portion of any other-than-temporary impairment charges relating to these securities effective April 1, 2009. Comprehensive income and its components are included in the consolidated statements of changes in shareholders' equity.

Recent accounting pronouncements
In June 2009, the Financial Accounting Standards Board ("FASB") issued the Accounting Standards Codification ("ASC"), which became effective on July 1, 2009. On that date, the FASB's ASC became the official source of authoritative accounting principles recognized by the FASB to be applied by non-governmental entities in the preparation of financial statements in conformity with U.S. GAAP. The ASC supersedes all existing FASB, American Institute of Certified Public Accountants ("AICPA"), Emerging Issues Task Force ("EITF") and related literature. Rules and interpretive releases of the Securities and Exchange Commission ("SEC") under authority of federal securities laws are also sources of authoritative guidance for SEC registrants. All guidance contained in the ASC carries an equal level of authority. All non-grandfathered, non-SEC accounting literature not included in the ASC is superseded and deemed non-authoritative. While the conversion to the ASC affects the way companies refer to U.S. GAAP in financial statements and accounting policies, it does not change U.S. GAAP. Citing particular content in the ASC involves specifying the unique numeric path to the content through the Topic, Subtopic, Section and Paragraph structure.

This Statement was effective for financial statements issued for interim and annual periods ending after September 15, 2009. The implementation of this standard did not have an impact on the Corporation's consolidated financial condition or results of operations.

On September 15, 2006, the Financial Accounting Standards Board issued, SFAS No. 157, "Fair Value Measurements" as codified in FASB ASC ("Accounting Standards Codification") topic 820, "Fair Value Measurements and Disclosures ("ASC 820"). This standard provides guidance for using fair value to measure assets and liabilities, and clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. ASC 820 applies whenever other standards require, or permit assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. ASC 820 was effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Corporation's adoption of this standard did not have a significant impact on its financial condition or results of operations.

In December 2007, the FASB issued SFAS No. 141(R) "Business Combinations" as codified in FASB ASC topic 805, "Business Combinations" ("ASC 805") This standard replaces FASB SFAS No. 141 and provides principles and requirements for how an acquirer (1) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in an acquiree; (2) recognizes and measures the goodwill acquired in a business combination or a gain from a bargain purchase; (3) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The provisions of ASC 805 shall be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Corporation's adoption of this standard did not have an impact on its financial condition or results of operations.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements" (an amendment of ARB No. 51) as codified in FASB ASC topic 810, "Consolidation" ("ASC 810"). This standard establishes accounting and reporting standards that require (1) the ownership interests in subsidiaries held by parties other than the parent be clearly identified in the consolidated statement of financial position within equity, but separate from the parent's equity; (2) the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified on the face of the consolidated statement of income; (3) changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently; (4) when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary be initially measured at fair value.

This Statement applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, but will affect only those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. This Statement was effective for fiscal years beginning on or after December 15, 2008. The Corporation's adoption of this standard did not have a significant impact on its financial condition or results of operations.

In April 2009, the FASB issued Staff Position ("FSP") No. 157-e, "Determining Whether a Market is Not Active and a Transaction is Not Distressed". This FSP clarifies the guidance in ASC 820 for fair value measurements in inactive markets, modifies the recognition and measurement of other-than-temporary impairments of debt securities and requires the disclosure of fair values of financial instruments in interim periods. This FSP was effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Corporation's adoption of this standard did not have a significant impact on the financial condition or results of operations of the Corporation.

In April 2009, the FASB issued the following three Staff Positions: Staff Position No. FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments" as codified in ASC 320-10-65-1. The objective of an other-than-temporary impairment analysis under existing U.S. Generally Accepted Accounting Principles ("GAAP") is to determine whether the holder of an investment in a debt or equity security for which changes in fair value are not regularly recognized in earnings (such as securities classified as held to maturity or available for sale) should recognize a loss in earnings when the investment is impaired. An investment is impaired if the fair value of the investment is less than its amortized cost basis. This amends the other-than-temporary impairment guidance in U.S. GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments of equity securities.

Staff Position No. FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" as codified in ASC 820-10-65-4. This FSP provides additional guidance for estimating fair value in accordance with ASC 820, when the volume and level of activity for the asset or liability have significantly decreased. This FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. This FSP emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions.

Staff Position No. FAS 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments" as codified in ASC 825-10-65-1. This FSP amends FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in summarized financial information at interim reporting periods.

Each of the aforementioned FSPs is effective for interim and annual periods ending after June 15, 2009 and was adopted by the Corporation on April 1, 2009. The Corporation's adoption of ASC 820-10-65-4 had an immaterial effect on its fair value estimates. The effect of the adoption of ASC 320-10-65-1 is discussed in Note 7, while the additional disclosures required by ASC 825-10-65-1 are provided in Note 10.

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events" as codified in FASB ASC topic 855, "Subsequent Events"7 ("ASC 855"). ASC 855 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The Corporation adopted ASC 855 during the second quarter of 2009. In accordance with ASC 855, the Corporation evaluated subsequent events through the date its financial statements were filed. The adoption of this standard did not have an impact on the Corporation's financial position or results of operations.

In May 2009, the FASB issued Statements No. 166, "Accounting for Transfers of Financial Assets" and 167, "Amendments to FASB Interpretation No. 46(R)," as codified in ASC 860-10 and 810-10, respectively, which establish new criteria governing whether transfers of financial assets are accounted for as sales and are expected to result in more variable interest entities being consolidated. The Statements were effective for annual periods beginning after November 15, 2009. The Corporation is evaluating the impact of these Statements.

Reclassifications

Certain reclassifications have been made to the 2008 and 2007 consolidated financial statements in order to conform with the 2009 presentation.

Note 2 Cash and due from banks

The Bank is required to maintain a reserve balance with the Federal Reserve Bank based primarily on deposit levels. These reserve balances averaged $1.9 million in 2009 and $2 million in 2008.

Note 3 Federal funds sold and securities purchased under agreements to resell

Federal funds sold averaged $34.6 million during 2009 and $10.6 million in 2008, while the maximum balance outstanding at any month-end during 2009, 2008 and 2007 was $70.5 million, $23.8 million and $79.5 million, respectively. There were no securities purchased under repurchase agreements in 2009, 2008 or 2007.

Note 4 Investment securities available for sale

The amortized cost and fair values at December 31 of investment securities available for sale were as follows:

2009 In thousands	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. government agencies	$ 12,518	$ 231	$ 49	$ 12,700
Obligations of U.S. government sponsored entities	17,289	222	187	17,324
Obligations of state and political subdivisions	546	7	-	553
Mortgage-backed securities	74,417	2,797	76	77,138
Other debt securities	12,269	266	2,267	10,268
Equity securities:				
Marketable securities	713	-	18	695
Nonmarketable securities	115	-	-	115
Federal Reserve Bank and Federal Home Loan Bank stock	3,213	-	-	3,213
Total	$121,080	$ 3,523	$ 2,597	$122,006

2008 In thousands	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. government agencies	$ 4,009	$ 5	$ 57	$ 3,957
Obligations of U.S. government sponsored entities	19,157	181	326	19,012
Obligations of state and political subdivisions	548	4	-	552
Mortgage-backed securities	88,356	2,408	134	90,630
Other debt securities	11,645	149	3,996	7,798
Equity securities:				
Marketable securities	678	-	40	638
Nonmarketable securities	115	-	-	115
Federal Reserve Bank and Federal Home Loan Bank stock	2,889	-	-	2,889
Total	$127,397	$ 2,747	$ 4,553	$125,591

The amortized cost and the fair values of investments in debt securities available for sale are distributed by contractual maturity, without regard to normal amortization including mortgage-backed securities, which will have shorter estimated lives as a result of prepayments of the underlying mortgages.

In thousands	Amortized Cost	Fair Value
Due within one year:		
Obligations of U.S. government sponsored entities	$ 3,000	$ 3,015
Obligations of state and political subdivisions	546	553
Other debt securities	994	1,014
Due after one year but within five years:		
Obligations of U.S. government sponsored entities	3,025	3,102
Mortgage-backed securities	96	97
Other debt securities	2,452	2,314
Due after five years but within ten years:		
U.S. Treasury securities and obligations of U.S. government agencies	6,220	6,321
Obligations of U.S. government sponsored entities	1,295	1,353
Mortgage-backed securities	2,245	2,309
Due after ten years:		
U.S. Treasury securities and obligations of U.S. government agencies	6,299	6,380
Obligations of U.S. government sponsored entities	9,968	9,854
Mortgage-backed securities	72,076	74,731
Other debt securities	8,823	6,940
Total debt securities	117,039	117,983
Equity securities	4,041	4,023
Total	$121,080	$ 122,006

Sales of investment securities available for sale resulted in gross losses of $1,000, $49,000 and $14,000 and gross gains of $1,000 $- and $24,000 in 2009, 2008 and 2007, respectively. Additionally, impairment charges of $2.3 million were recorded during 2009. These charges resulted from the determination that the unrealized losses in two collateralized debt obligations ("CDOs") were other than temporary, based on the expectation that it is probable that all principal and interest payments will not be received in accordance with the securities' contractual terms.

Interest and dividends on investment securities available for sale were as follows:

In thousands	2009	2008	2007
Taxable	$5,732	$6,001	$5,187
Tax-exempt	68	20	94
Total	$5,800	$6,021	$5,281

Investment securities available for sale with a carrying value of $106.9 million were pledged to secure U.S. government and municipal deposits and Federal Home Loan Bank borrowings at December 31, 2009.

Investment securities available for sale which have had continuous unrealized losses as of December 31 are set forth below.

	Less than 12 Months		12 Months or More		Total	
2009 In thousands	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. Treasury securities and obligations of U.S. government agencies	$ 2,050	$ 14	$ 2,598	$ 35	$ 4,648	$ 49
Obligations of U.S. Government sponsored entities	2,822	143	2,323	44	5,145	187
Mortgaged-backed securities	4,947	73	248	3	5,195	76
Other debt securities	43	1	4,352	2,266	4,395	2,267
Equity securities	-	-	713	18	713	18
Total	$ 9,862	$ 231	$ 10,234	$ 2,366	$ 20,096	$ 2,597

2008 In thousands	Less than 12 Months Fair Value	Less than 12 Months Gross Unrealized Losses	12 Months or More Fair Value	12 Months or More Gross Unrealized Losses	Total Fair Value	Total Gross Unrealized Losses
U.S. Treasury securities and obligations of U.S. government agencies	$ 2,701	$ 53	$ 168	$ 4	$ 2,869	$ 57
Obligations of U.S. Government sponsored entities	3,891	68	4,881	258	8,772	326
Mortgaged-backed securities	5,142	65	2,760	69	7,902	134
Other debt securities	2,722	274	3,829	3,722	6,551	3,996
Equity securities	-	-	678	40	678	40
Total	$ 14,456	$ 460	$ 12,316	$ 4,093	$ 26,772	$ 4,553

The gross unrealized losses set forth above as of December 31, 2009 were attributable primarily to single-issue trust preferred securities ("TRUPS") issued by financial institutions, CDOs collateralized primarily by TRUPS issued by banks and other corporate debt, all of which are included with other debt securities. The fair value of these securities has been negatively impacted by the lack of liquidity in the overall TRUPS and corporate debt markets although all issuers continue to perform other than for CDOs for which impairment charges were recorded.

The following table presents a rollforward of the credit loss component of other-than-temporary investment losses ("OTTI") on debt securities for which a non-credit component of OTTI was recognized in other comprehensive income. The beginning balance represents the credit loss component for debt securities for which OTTI occurred prior to April 1, 2009. OTTI recognized in earnings after that date for credit-impaired debt securities is presented as additions in two components, based upon whether the current period is the first time a debt security was credit-impaired (initial credit impairment) or is not the first time a debt security was credit impaired (subsequent credit impairment).

Changes in the credit loss component of credit-impaired debt securities were as follows:

In thousands	**For the Nine Months Ended December 31, 2009**
Beginning balance as of April 1, 2009	$ 288
Add: Initial other-than-temporary credit losses	944
Additional other-than- temporary credit losses	1,257
Balance, December 31, 2009	$ 2,489

$2.3 million in OTTI charges were recorded on two CDOs during 2009. This OTTI was related to credit losses incurred on the aforementioned investments and was determined through discounted cash flow analysis of expected cash flows from the underlying collateral. Third-party consultants were used to obtain valuations for the CDO portfolio, including the determination of both the credit and market components. One consultant analyzes the default prospects of the CDO's underlying collateral and performs discounted cash flow analyses, while the other projects default prospects based generally on historical default rates. Both used discount rates based on what return an investor would require on a risk-adjusted basis based on current economic conditions. These two CDOs have a remaining carrying value of $111,000, for which the accrual of interest has been discontinued. Based on valuations received from third-party consultants, management believes that these carrying values will eventually be recovered and that no additional impairment exists.

The Bank also owns a CDO with a carrying value of $996,000 on which no impairment losses have been recorded because it is expected that this security will perform in accordance with its original terms and that the carrying value is fully recoverable. Additionally, the Bank owns a portfolio of seven single-issue trust preferred securities with a carrying value of $6.3 million and a market value of $5.2 million. Finally, the Bank also owns two corporate securities with a carrying value of $1.9 million that are rated below investment grade. None of these securities is considered impaired as they are all fully performing.

In April 2009, FASB amended the impairment model for debt securities. The impairment model for equity securities was not affected. Under the new guidance, an other-than-temporary impairment loss must be fully recognized in earnings if an investor has the intent to sell the debt security or if it is more likely than not that the investor will be required to sell the debt security before recovery of its amortized cost basis. However, even if an investor does not expect to sell a debt security, it must evaluate the expected cash flows to be received and determine if a credit loss has occurred. In the event of a credit loss, only the amount of impairment associated with the credit loss is recognized in earnings. Amounts relating to factors other than credit losses are recorded in accumulated other comprehensive income. The guidance also requires additional disclosures regarding the calculation of credit losses as well as factors considered in reaching a conclusion that an investment is not other-than-temporarily impaired ("OTTI"). The Corporation adopted the new guidance effective April 1, 2009. The Corporation recorded a $1 million pre-tax transition adjustment for the non-credit portion of OTTI on securities held at April 1, 2009 that were previously considered other than temporarily impaired.

Available for sale securities in unrealized loss positions are analyzed as part of the Corporation's ongoing assessment of OTTI. When the Corporation intends to sell available-for-sale securities, the Corporation recognizes an impairment loss equal to the full difference between the amortized cost basis and fair value of those securities. When the Corporation does not intend to sell available for sale securities in an unrealized loss position, potential OTTI is considered based on a variety of factors, including the length of time and extent to which the fair value has been less than cost; adverse conditions specifically related to the industry, the geographic area or financial condition of the issuer or the underlying collateral of a security; the payment structure of the security; changes to the rating of the security by rating agencies; the volatility of the fair value changes; and changes in fair value of the security after the balance sheet date. For debt securities, the Corporation estimates cash flows over the remaining lives of the underlying collateral to assess whether credit losses exist and to determine if any adverse changes in cash flows have occurred. The Corporation's cash flow estimates take into account expectations of relevant market and economic data as of the end of the reporting period.

Other factors considered in determining whether a loss is temporary include the length of time and the extent to which fair value has been below cost; the severity of the impairment; the cause of the impairment; the financial condition and near-term prospects of the issuer; activity in the market of the issuer which may indicate adverse credit conditions; and the forecasted recovery period using current estimates of volatility in market interest rates (including liquidity and risk premiums).

Management's assertion regarding its intent not to sell or that it is not more likely than not that the Corporation will be required to sell the security before its anticipated recovery considers a number of factors, including a quantitative estimate of the expected recovery period (which may extend to maturity), and management's intended strategy with respect to the identified security or portfolio. If management does have the intent to sell or believes it is more likely than not that the Corporation will be required to sell the security before its anticipated recovery, the gross unrealized loss is charged directly to earnings in the Consolidated Statements of Income.

As of December 31, 2009, the Corporation does not intend to sell the securities with an unrealized loss position in accumulated other comprehensive loss ("AOCL"), and it is not more likely than not that the Corporation will be required to sell these securities before recovery of their amortized cost basis. The Corporation believes that the securities with an unrealized loss in AOCL are not other than temporarily impaired as of December 31, 2009.

Note 5 Investment securities held to maturity

The amortized cost and fair values as of December 31 of investment securities held to maturity were as follows:

2009 In thousands	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. government agencies	$ 1,585	$ 62	$ -	$ 1,647
Obligations of U.S. government sponsored entities	2,459	19	73	2,405
Obligations of state and political subdivisions	27,979	1,135	72	29,042
Mortgage-backed securities	7,877	309	-	8,186
Other debt securities	495	7	-	502
Total	$40,395	$ 1,532	$ 145	$41,782

2008 In thousands	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Obligations of U.S. government sponsored entities	$ 8,500	$ 20	$ -	$ 8,520
Obligations of state and political subdivisions	31,629	814	221	32,222
Mortgage-backed securities	12,089	269	-	12,358
Other debt securities	1,496	-	59	1,437
Total	$53,714	$ 1,103	$ 280	$54,537

During 2009, $9.7 million of callable securities were redeemed by the issuers prior to maturity resulting in gross gains of $11,000, while in 2008 $9.6 million of such securities were redeemed resulting in gross gains of $5,700, and $4 million was redeemed in 2007 resulting in gross gains of $1,600. Additionally, a security with a market value of $184,000 was transferred to available for sale after the security was downgraded by a rating agency.

The amortized cost and the fair value of investment securities held to maturity as of December 31, 2009 are distributed by contractual maturity without regard to normal amortization, including mortgage-backed securities, which will have shorter estimated lives as a result of prepayments of the underlying mortgages.

In thousands	Amortized Cost	Fair Value
Due after one year but within five years:		
Obligations of state and political subdivisions	$ 8,458	$ 9,007
Mortgage-backed securities	163	170
Due after five years but within ten years:		
Obligations of state and political subdivisions	13,712	14,198
Due after ten years:		
U.S. Treasury securities and obligations of U.S. government agencies	1,585	1,647
Obligations of U.S. government sponsored entities	2,459	2,405
Obligations of state and political subdivisions	5,809	5,837
Mortgage-backed securities	7,714	8,016
Other debt securities	495	502
Total	$40,395	$41,782

Interest and dividends on investment securities held to maturity were as follows:

In thousands	2009	2008	2007
Taxable	$ 936	$ 1,403	$ 1,426
Tax-exempt	1,188	1,270	1,279
Total	$ 2,124	$ 2,673	$ 2,705

Investment securities held to maturity with a carrying value of $27.5 million were pledged to secure U.S. government and municipal deposit funds and Federal Home Loan Bank borrowings at December 31, 2009.

Investment securities held to maturity which have had continuous unrealized losses are set forth below.

2009 In thousands	Less than 12 Months Fair Value	Less than 12 Months Gross Unrealized Losses	12 Months or More Fair Value	12 Months or More Gross Unrealized Losses	Total Fair Value	Total Gross Unrealized Losses
Obligations of state and political subdivisions	$2,268	$ 22	$ 672	$ 50	$ 2,940	$ 72
Obligations of U.S. government sponsored entities	1,351	73	-	-	1,351	73
Total	$3,619	$ 95	$ 672	$ 50	$ 4,291	$ 145

2008 In thousands	Less than 12 Months Fair Value	Less than 12 Months Gross Unrealized Losses	12 Months or More Fair Value	12 Months or More Gross Unrealized Losses	Total Fair Value	Total Gross Unrealized Losses
Obligations of state and political subdivisions	$4,753	$ 146	$ 647	$ 75	$ 5,400	$ 221
Other debt securities	1,437	59	-	-	1,437	59
Total	$6,190	$ 205	$ 647	$ 75	$ 6,837	$ 280

As of December 31, 2009, the Corporation does not intend to sell the securities with an unrealized loss position in accumulated other comprehensive loss ("AOCL"), and it is not more likely than not that the Corporation will be required to sell these securities before recovery of their amortized cost basis. The Corporation believes that the securities with an unrealized loss in AOCL are not other than temporarily impaired as of December 31, 2009.

Note 6 Loans

Loans, net of unearned discount and net deferred origination fees and costs at December 31 were as follows:

In thousands	2009	2008
Commercial	$ 53,820	$ 44,366
Real estate	221,601	226,546
Installment	926	1,153
Total loans	276,347	272,065
Less: Unearned income	105	159
Loans	$ 276,242	$ 271,906

Nonperforming loans include loans which are contractually past due 90 days or more for which interest income is still being accrued and nonaccrual loans.

At December 31, nonperforming loans were as follows:

In thousands	2009	2008
Nonaccrual loans	$16,323	$8,227
Loans with interest or principal 90 days or more past due and still accruing	1,567	384
Total nonperforming loans	$17,890	$8,611

The effect of nonaccrual loans on income before taxes is presented below.

In thousands	2009	2008	2007
Interest income foregone	$ (785)	$ (692)	$ (465)
Interest income received	188	467	429
	$ (597)	$ (225)	$ (36)

Nonperforming assets are generally secured by residential and small commercial real estate properties.

At December 31, 2009 there were no commitments to lend additional funds to borrowers for loans that were on nonaccrual or contractually past due in excess of 90 days and still accruing interest, or to borrowers whose loans have been restructured. A majority of the Bank's loan portfolio is concentrated in the New York City metropolitan area and is secured by commercial properties. The borrowers' abilities to repay their obligations are dependent upon various factors including the borrowers' income, net worth, cash flows generated by the underlying collateral, the value of the underlying collateral and priority of the Bank's lien on the related property. Such factors are dependent upon various economic conditions and individual circumstances beyond the Bank's control. Accordingly, the Bank may be subject to risk of credit losses.

Impaired loans totaled $11.1 million at December 31, 2009 compared to $5.8 million at December 31, 2008. Charge-offs of impaired loans during 2009 totaled $1.4 million. The related allocation of the allowance for loan losses amounted to $550,000 and $310,000. $10.3 million of impaired loans have no allowance allocated to them as sufficient collateral exists. The average balance of impaired loans during 2009 was $8.5 million and amounted to $1 million in 2008. There was no interest income recognized on impaired loans during either 2009 or 2008. At December 31, 2009 there were $5.2 million of troubled debt restructured loans with a related allowance of approximately $760,000 compared to $2.5 million and $150,000 at December 31, 2008. One TDR of $1.4 million is accruing interest. The remaining TDRs are on nonaccrual status and reflected in the above table.

Note 7 Allowance for loan losses

Transactions in the allowance for loan losses are summarized as follows:

In thousands	2009	2008	2007
Balance, January 1	$ 3,800	$ 3,000	$ 2,400
Provision for loan losses	8,105	1,586	772
Recoveries of loans previously charged off	15	6	34
	11,920	4,592	3,206
Less: Charge-offs	3,270	792	206
Balance, December 31	$ 8,650	$ 3,800	$ 3,000

Note 8 Premises and equipment

A summary of premises and equipment at December 31 follows:

In thousands	2009	2008
Land	$ 329	$ 329
Premises	1,520	1,520
Furniture and equipment	4,326	4,238
Leasehold improvements	3,368	3,316
Total cost	9,543	9,403
Less: Accumulated depreciation and amortization	6,594	6,161
Total premises and equipment	$2,949	$3,242

Depreciation and amortization expense charged to operations amounted to $432,000, $495,000 and $430,000 in 2009, 2008, and 2007 respectively.

Note 9 Deposits

Deposits at December 31 are presented below.

In thousands	2009	2008
Noninterest bearing demand	$ 29,304	$ 36,270
Interest bearing:		
Demand	51,839	39,040
Savings	24,728	24,670
Money market	73,286	119,462
Time	201,119	187,675
Total interest bearing deposits	350,972	370,847
Total deposits	$ 380,276	$ 407,117

Time deposits issued in amounts of $100,000 or more have the following maturities at December 31:

In thousands	2009	2008
Three months or less	$ 53,599	$ 47,301
Over three months but within six months	32,947	4,893
Over six months but within twelve months	16,209	21,370
Over twelve months	30,649	24,733
Total deposits	$133,404	$ 98,297

Interest expense on certificates of deposits of $100,000 or more was $2,171,000, $3,426,000 and $4,446,000 in 2009, 2008 and 2007, respectively.

Note 10 Short-term borrowings

Information regarding short-term borrowings at December 31, is presented below.

Dollars in thousands	December 31 Balance	Average Interest Rate on December 31 Balance	Average Balance During the Year	Average Interest Rate During the Year	Maximum Balance at any Month-End
2009					
Federal funds purchased	$ -	-%	$ 518	.56%	$ 3,720
Securities sold under repurchase agreements	100	.30%	55	.27	2,200
Demand note issued to the U.S. Treasury	-	-	33	.05	3
Total	$ 100	.30%	$ 606	.51%	$ 5,923
2008					
Federal funds purchased	$ -	-%	$ 2,140	2.23%	$19,780
Securities sold under repurchase agreements	1,850	.30%	157	1.39	2,000
Demand note issued to the U.S. Treasury	-	-	454	2.13	6,000
Total	$ 1,850	.30%	$ 2,751	2.17%	$27,780

The demand note, which has no stated maturity, issued by the Bank to the U.S. Treasury Department is payable with interest at 25 basis points less than the weekly average of the daily effective Federal Funds rate and is collateralized by various investment securities held at the Federal Reserve Bank of New York with a book value of $3.9 million. There was no balance outstanding under the note at December 31, 2009 and 2008.

The Corporation had short-term borrowing lines of $3 million at December 31, 2009 and $8 million at December 31, 2008 with various correspondent banks which were unused at December 31, 2009 and 2008.

Note 11 Long-term debt

Long-term debt at December 31 is summarized as follows:

In thousands	2009	2008
FHLB convertible advances due from March 4, 2010 through August 6, 2018	$39,700	$42,200
6.00% capital note, due December 28, 2010	100	200
8.00% capital note, due May 6, 2017	200	200
5.00% senior note, due February 21, 2022	5,000	5,000
Subordinated debt	4,000	4,000
Total	49,000	51,600
Less: Short-term portion of long-term debt	5,000	5,000
Total	$44,000	$45,600

Interest is payable quarterly on the FHLB advances. The advances bear fixed interest rates ranging from 2.63% to 6.15% and are secured by residential mortgages and certain obligations of U.S. Government agencies under a blanket collateral agreement.

The Corporation had borrowing lines with the Federal Home Loan Bank totaling $79.1 million at December 31, 2009 and $88.6 million at December 31, 2008, of which $77 million and $79.5 million was used and outstanding at December 31, 2009 and 2008, respectively. These lines may also be utilized for long-term or short-term borrowing purposes.

Interest is payable quarterly on the 6.00% capital note with principal payments commencing annually in December, 2006 and continuing until December, 2010.

Interest is payable on the 8.00% capital note semiannually through May 6, 2017, at which time the entire principal balance is due. The note is then renewable at the option of the Corporation for an additional fifteen years at the prevailing rate of interest.

Interest is payable on the 5.00% senior note quarterly for the first ten years. Interest thereafter is payable quarterly at a fixed rate based on the yield of the ten-year U.S. Treasury note plus 150 basis points in effect on the tenth anniversary of the note agreement. Quarterly principal payments of $250,000 commence in the eleventh year of the loan. As an additional condition for receiving the loan, the Bank is required to contribute $100,000 annually for the first five years the loan is outstanding to a nonprofit lending institution formed jointly by CNB and the lender to provide financing to small businesses that would not qualify for bank loans.

The Corporation has been in violation of certain covenants of the loan agreement since December 31, 2008. Although the loan becomes immediately payable as a result of these violations, which are considered an event of default, the lender has informally indicated that no action will be taken as a result of these violations.

On March 17, 2004, City National Bancshares Corporation issued $4 million of preferred capital securities through City National Bank of New Jersey Capital Trust II ("the Trust II"), a special-purpose statutory trust created expressly for the issuance of these securities. Distribution of interest on the securities is payable at the 3-month LIBOR rate plus 2.79%, adjustable quarterly. The rate in effect at December 31, 2009 was 3.04%.

The quarterly distributions may, at the option of the Trust, be deferred for up to 20 consecutive quarterly periods. The proceeds have been invested in junior subordinated debentures of CNBC, at terms identical to the preferred capital securities. Cash distributions on the securities are made to the extent interest on the debentures is received by the Trust. In the event of certain changes or amendments to regulatory requirements or federal tax rules, the securities are redeemable. The securities are generally redeemable in whole or in part on or after March 17, 2009, at any interest payment date, at a price equal to 100% of the principal amount plus accrued interest to the date of redemption. The securities must be redeemed by March 17, 2034.

The subsidiary trust is not included with the consolidated financial statements of the Corporation because of the deconsolidation required by accounting standards.

The debentures are eligible for inclusion in Tier 1 capital for regulatory purposes.

Scheduled repayments on long-term debt are as follows:

In thousands	Amount
2010	$ 3,300
2011	16,000
2012	2,000
2013	8,500
2014	-
Thereafter	14,200
Total	$44,000

Note 12 Other operating income and expenses

The following table presents the major components of other operating income and expenses.

In thousands	2009	2008	2007
Other income			
Income from off-site ATMs	$ 482	$ 428	$ 420
Earnings on cash surrender value of life insurance	252	248	225
Agency fees on commercial loans	236	318	328
Undistributed gain (loss) from unconsolidated investee	202	185	(9)
Miscellaneous other income	465	389	388
Total other income	$1,637	$1,568	$1,352
Other expenses			
Professional fees	$ 432	$ 342	$ 264
Data processing	361	341	396
Marketing expense	361	471	447
Miscellaneous other expenses	2,130	2,323	2,270
Total other expenses	$3,284	$3,477	$3,377

Note 13 Income taxes

The components of income tax expense are as follows:

In thousands	2009	2008	2007
Current expense (benefit)			
Federal	$ (595)	$ 755	$ 613
State	29	251	212
	(566)	1,006	825
Deferred expense (benefit)			
Federal and state	2,372	(1,056)	(453)
Total income tax expense (benefit)	$ 1,806	$(50)	$ 372

A reconciliation between income tax expense and the total expected federal income tax computed by multiplying pre-tax accounting income by the statutory federal income tax rate is as follows:

In thousands	2009	2008	2007
Federal income tax at statutory rate	$(2,046)	$343	$756
Increase (decrease) in income tax expense resulting from:			
State income tax expense, net of federal benefit	517	60	83
Tax-exempt income	(450)	(462)	(485)
Bank-owned life insurance	(65)	(66)	(63)
Increase in valuation allowance	3,505	423	-
Decrease in FIN 48	-	(363)	-
Other, net	345	15	81
Total income tax expense (benefit)	$1,806	$ (50)	$ 372

The tax effects of temporary differences that give rise to deferred tax assets and liabilities at December 31 are as follows:

In thousands	2009	2008
Deferred tax assets		
Unrealized losses on investment securities available for sale	$ -	$ 1,539
Allowance for loan losses	3,071	1,370
Investment securities	982	-
Premises and equipment	297	453
Deposit intangible	207	6
Deferred compensation	1,072	1,166
Deferred income	46	295
Investment in partnership	-	114
Other assets	243	25
Total deferred tax asset	5,918	4,968
Deferred tax liabilities		
Unrealized losses on investment securities available for sale	393	-
Other	-	220
Total deferred tax liabilities	393	220
Deferred tax asset	$5,525	$4,748
Valuation allowance	4,680	423
Net deferred tax asset	$ 845	$4,325

The net deferred asset represents the anticipated federal and state tax assets to be realized in future years upon the utilization of the underlying tax attributes comprising this balance. If it is more likely than not (a likelihood of more than 50%) that some portion or the entire deferred tax asset will not be realized, the deferred tax asset must be reduced by a valuation allowance based on the weight of all available evidence. The allowance should be sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized. During 2009, the valuation allowance was increased by $4.3 million because the Corporation is in a three-year cumulative loss position.

The Corporation records estimated penalties and interest, if any, related to unrecognized tax benefits in other operating expense. The Corporation's tax returns are subject to examination by federal tax authorities for the years 2006 through 2008 and by state authorities also for the years 2005 through 2008.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

In thousands	2009	2008
Balance at January 1	$ 112	$ 427
Additions based on tax positions related to the current year	-	48
Additions for tax positions of prior years	-	-
Reductions for tax positions of prior years	(112)	(363)
Balance at December 31	$ -	$ 112

The decrease in the unrecognized tax benefits in 2008 relates to the statute expiring in regards to the resolution of a tax matter, while in 2009, the decrease occurred due to the resolution of a tax matter.

Note 14 Benefit plans

Savings plan

The Bank maintains an employee savings plan under section 401(k) of the Internal Revenue Code covering all employees with at least six months of service. Participants are allowed to make contributions to the plan by salary reduction, up to 15% of total compensation. The Bank provides matching contributions of 50% of the first 6% of participant salaries subject to a vesting schedule. Contribution expense amounted to $23,000 in 2009, $94,000 in 2008 and $24,000 in 2007. During 2009, the Bank reversed the discretionary contributions that are periodically credited to participants' accounts. Additionally, unused discretionary contribution accruals were used to fund part of the 2007 savings plan contributions.

Bonus plan

The Bank awards profit sharing bonuses to its officers and employees based on the achievement of certain performance objectives. Bonuses charged (credited) to operating expense in 2009, 2008 and 2007 amounted to $(103,000), $311,000, and $269,000, respectively. The credit in 2009 resulted from a decision to not pay bonuses previously accrued.

Nonqualified benefit plans

The Bank maintains a supplemental executive retirement plan ("SERP"), which provides a post-employment supplemental retirement benefit to certain key executive officers. SERP expense was $66,000 in 2009, $231,000 in 2008 and $329,000 in 2007. The Bank also has a director retirement plan ("DRIP"). DRIP expense was $86,000 in 2009, $2,000 in 2008 and $44,000 in 2007. The decrease in SERP expense was related to the departure of a plan participant, while the increase in DRIP expense resulted from additional accrual required as a result of a director's early retirement.

Benefits under both plans are funded through bank-owned life insurance policies. In addition, expenses for both plans along with the expense related to carrying the policy itself are offset by increases in the cash surrender value of the policies. Such increases are included in "Other income" and totaled $252,000 in 2009, $248,000 in 2008 and $225,000 in 2007, while the related life insurance expense was $59,000 in 2009, $54,000 in 2008 and $36,000 in 2007.

Stock options

No stock options have been issued since 1997 and there were no stock options outstanding at December 31, 2009, 2008 and 2007.

Note 15 Preferred stock

The Corporation is authorized to issue noncumulative perpetual preferred stock in one or more series, with no par value. Shares of preferred stock have preference over the Corporation's common stock with respect to the payment of dividends and liquidation rights. Different series of preferred stock may have different stated or liquidation values as well as different rates. Dividends are paid annually.

Set forth below is a summary of the Corporation's preferred stock issued and outstanding.

	Year Issued	Dividend Rate	Stated Value	Number of Shares	December 31, 2009	2008
Series A	1996	6.00%	$ 25,000	8	$ 200,000	$ 200,000
Series C	1996	8.00	250	108	27,000	27,000
Series D	1997	6.50	250	3,280	820,000	820,000
Series E	2005	6.00	50,000	28	1,400,000	1,400,000
Series F	2005	8.53	7,000,000	7,000	6,790,000	6,790,000
Series E	2006	6.00	50,000	21	1,050,000	1,050,000
Series G	2009	5.00	9,439,000	9,439	9,439,000	-
					$19,726,000	$10,287,000

Series C & D shares are redeemable at any time at par value, while Series A shares are redeemable at par value plus a premium payable in the event of a change of control.

Each Series E share is convertible at any time into 333 shares of common stock of the Corporation, and are redeemable any time by the Corporation after 2008 at liquidation value. The Series F shares are redeemable after 2010 by the Corporation at a declining premium until 2020, at which time the shares are redeemable at par.

On April 10, 2009, the Corporation issued 9,439 shares of fixed-rate cumulative perpetual preferred stock to the U.S. Department of Treasury. These shares pay cumulative dividends at a rate of five percent per annum until the fifth anniversary of the date of issuance, after which the rate increases to nine percent per annum. Dividends are paid quarterly in arrears and unpaid dividends are accrued over the period the preferred shares are outstanding.

Note 16 Restrictions on subsidiary bank dividends

Subject to applicable law, the Board of Directors of the Bank and of the Corporation may provide for the payment of dividends when it is determined that dividend payments are appropriate, taking into account factors including net income, capital requirements, financial condition, alternative investment options, tax implications, prevailing economic conditions, industry practices, and other factors deemed to be relevant at the time.

Because CNB is a national banking association, it is subject to regulatory limitation on the amount of dividends it may pay to its parent corporation, CNBC. Prior approval of the Office of the Comptroller of the Currency ("OCC") is required if the total dividends declared by the Bank in any calendar year exceeds net profit, as defined, for that year combined with the retained net profits from the preceding two calendar years. Based upon this limitation, no funds were available for the payment of dividends to the parent corporation at December 31, 2009 since the aforementioned net profit was a loss of $7.8 million.

Note 17 Net income per common share

The following table presents the computation of net income per common share.

In thousands, except per share data	2009	2008	2007
Net (loss) income	$ (7,822)	$ 1,058	$1,867
Dividends on preferred stock	(1,154)	(812)	(771)
Net (loss)income applicable to basic common shares	(8,976)	246	1,096
Dividends applicable to convertible preferred stock	147	147	106
Net (loss) income applicable to diluted common shares	$(8,829)	$ 393	$1,202
Number of average common shares			
Basic	131,300	131,688	132,306
Diluted:			
Average common shares outstanding	131,300	131,688	132,306
Average potential dilutive common shares	16,317	16,317	16,317
	147,617	148,005	148,623
Net income per common share			
Basic	$(68.36)	$1.87	$ 8.28
Diluted	(68.36)	1.87	8.09

Note 18 Related party transactions

Certain directors, including organizations in which they are officers or have significant ownership, were customers of, and had other transactions with the Bank in the ordinary course of business during 2009 and 2008. Such transactions were on substantially the same terms, including interest rates and collateral with respect to loans, as those prevailing at the time of comparable transactions with others. Further, such transactions did not involve more than the normal risk of collectability and did not include any unfavorable features.

Total loans to the aforementioned individuals and organizations amounted to $3.3 million and $3.4 million at December 31, 2009 and 2008, respectively. The highest amount of such indebtedness during 2009 and 2008 was $3.4 million and $3.5 million, respectively. During 2009, there were $12,000 of new loans and paydowns totaled $75,000. All related party loans were performing as of December 31, 2009.

Note 19 Fair value measurement of assets and liabilities

The following table represents the assets and liabilities on the Consolidated Balance Sheets at their fair value at December 31, 2009 by level within the fair value hierarchy. The fair value hierarchy established by ASC Topic 820, "fair Value Measurements and Disclosures" prioritizes inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurement) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described below.

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

Level 2 – Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the assets or liabilities;

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

The following tables present the assets and liabilities that are measured at fair value hierarchy at December 31, 2009 and 2008, respectively.

(Dollars in thousands)	Total	Level 1	Level 2	Level 3
Investment securities available for sale	$ 122,006	$12,700	$ 108,804	$ 502
Loans held for sale	190	-	-	190
Total assets	$ 122,196	$12,700	$ 108,804	$ 692
Total liabilities	$ -	$ -	$ -	$ -

(Dollars in thousands)	Total	Level 1	Level 2	Level 3
Investment securities available for sale	$ 125,591	$ 1,008	$ 123,439	$ 1,144
Loans held for sale	267	267	-	-
Total assets	$ 122,858	$1,275	$ 123,439	$ 1,144
Total liabilities	$ -	$ -	$ -	$ -

The fair value of Level 3 investments at December 31, 2009 was $642,000 million less than the related fair value of $1.1 million at December 31, 2008. Most of the reduction was attributable to impairment charges on two collateralized debt obligations ("CDOs").

Level 1 securities includes securities issued by the U.S. Treasury Department based upon quoted market prices. Level 2 securities includes fair value measurements obtained from various sources including the utilization of matrix pricing, dealer quotes, market spreads, live trading levels, credit information and the bond's terms and conditions, among other things. Any investment security not valued based on the aforementioned criteria are considered Level 3. Level 3 fair values are determined using unobservable inputs and include corporate debt obligations for which there are no readily available quoted market values as discussed under "Management's Discussion and Analysis of Financial Condition and Results of Operations" – Investments. For such securities, market values have been provided by the trading desk of an investment bank, which compares characteristics of the securities with those of similar securities and evaluates credit events in underlying collateral or obtained from an external pricing specialist which utilized a discounted cash flow model.

At December 31, 2009, the Corporation had impaired loans with outstanding principal balances of $11.1 million. The Corporation recorded impairment charges of $1.4 million for the year ended December 31, 2009, utilizing Level 3 inputs. Additionally, during the year ended December 31, 2009 the Corporation transferred loans with a principal balance and an estimated fair value, less costs to sell, of $1.2 million to other real estate owned. Additional writedowns of $359,000 were recorded during 2009 related to OREO. Impaired assets are valued utilizing current appraisals adjusted downward by management, as necessary, for changes in relevant valuation factors subsequent to the appraisal date.

Note 20 Fair value of financial instruments

The fair value of financial instruments is the amount at which an asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced liquidation. Fair value estimates are made at a specific point in time based on the type of financial instrument and relevant market information.

Because no quoted market price exists for a significant portion of the Corporation's financial instruments, the fair values of such financial instruments are derived based on the amount and timing of future cash flows, estimated discount rates, as well as management's best judgment with respect to current economic conditions. Many of these estimates involve uncertainties and matters of significant judgment and cannot be determined with precision.

The fair value information provided is indicative of the estimated fair values of those financial instruments and should not be interpreted as an estimate of the fair market value of the Corporation taken as a whole. The disclosures do not address the value of recognized and unrecognized nonfinancial assets and liabilities or the value of future anticipated business. In addition, tax implications related to the realization of the unrealized gains and losses could have a substantial impact on these fair value estimates and have not been incorporated into any of the estimates.

The following methods and assumptions were used to estimate the fair values of significant financial instruments at December 31, 2009 and 2008.

Cash, short-term investments and interest-bearing deposits with banks

These financial instruments have relatively short maturities or no defined maturities but are payable on demand, with little or no credit risk. For these instruments, the carrying amounts represent a reasonable estimate of fair value.

Investment securities

Investment securities are reported at their fair values based on prices obtained from a nationally recognized pricing service, where available. Otherwise, fair value measurements are obtained from various sources including dealer quotes, matrix pricing, market spreads, live trading levels, credit information and the bond's terms and conditions, among other things. Management reviews all prices obtained for reasonableness on a quarterly basis.

Loans

Fair values were estimated for performing loans by discounting the future cash flows using market discount rates that reflect the credit and interest-rate risk inherent in the loans, reduced by the allowance for loan losses. This method of estimating fair value does not incorporate the exit price concept of fair value prescribed by the FASB ASC Topic for Fair Value Measuring and Disclosure.

Loans held for sale

The fair value for loans held for sale is based on estimated secondary market prices.

Deposit liabilities

The fair values of demand deposits, savings deposits and money market accounts were the amounts payable on demand at December 31, 2009 and 2008. The fair value of time deposits was based on the discounted value of contractual cash flows. The discount rate was estimated utilizing the rates currently offered for deposits of similar remaining maturities.

These fair values do not include the value of core deposit relationships that comprise a significant portion of the Bank's deposit base. Management believes that the Bank's core deposit relationships provide a relatively stable, low-cost funding source that has a substantial value separate from the deposit balances.

Short-term borrowings

For such short-term borrowings, the carrying amount was considered to be a reasonable estimate of fair value.

Long-term debt
The fair value of long-term debt was estimated based on rates currently available to the Corporation for debt with similar terms and remaining maturities.

Commitments to extend credit and letters of credit
The estimated fair value of financial instruments with off-balance sheet risk is not significant at December 31, 2009 and 2008.

The following table presents the carrying amounts and fair values of financial instruments at December 31.

	2009		2008	
In thousands	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets				
Cash and other short-term Investments	$12,308	$12,308	$25,813	$25,813
Interest-bearing deposits with banks	609	607	726	719
Investment securities AFS	122,006	122,006	125,591	125,591
Investment securities HTM	40,395	41,782	53,714	54,537
Loans	276,242	270,054	271,906	259,226
Loans held for sale	190	190	267	267
Financial liabilities				
Deposits	380,276	369,758	407,117	396,503
Short-term borrowings	100	100	1,850	1,850
Long-term debt	49,000	49,664	51,600	51,692

e

Note 21 Commitments and contingencies
In the normal course of business, the Corporation or its subsidiary may, from time to time, be party to various legal proceedings relating to the conduct of its business. In the opinion of management, the consolidated financial statements will not be materially affected by the outcome of any pending legal proceedings.

At December 31, 2009 the Bank was obligated under a number of noncancelable leases for premises and equipment, many of which provide for increased rentals based upon increases in real estate taxes and cost of living. These leases, most of which have renewal provisions, are considered operating leases. Minimum rentals under the terms of these leases for the years 2010 through 2014 are $589,000, $273,000, $246,000, $228,000, and $233,000 respectively. Payments due thereafter total $34,000.

Rental expense under the leases amount to $587,000, $568,000 and $486,000 during 2009, 2008 and 2007 respectively.

Note 22 Financial instruments with off-balance sheet risk
The Bank is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include lines of credit, commitments to extend, standby letters of credit, and could involve, to varying degrees, elements of credit risk in excess of the amounts recognized in the consolidated financial statements.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amounts of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on balance sheet instruments with credit risk.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis, and the amount of collateral or other security obtained is based on management's credit evaluation of the customer.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support borrowing arrangements and extend for up to one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Accordingly, collateral is generally required to support the commitment.

At December 31, 2009 and 2008 the Bank had mortgage commitments of $18.9 million and $35.1 million, unused commercial lines of credit of $19.9 million and $45 million, and $1.1 million and $2 million of other loan commitments, respectively. There was $34,000 of financial standby letters of credit outstanding at December 31, 2009 and December 31, 2008.

Note 23 Parent company information
Condensed financial statements of the parent company only are presented below.

Condensed Balance Sheet

	December 31,	
In thousands	2009	2008
Assets		
Cash and cash equivalents	$ -	$ 32
Investment in subsidiary	35,708	32,551
Due from subsidiary	5,000	5,075
Other assets	193	499
Total assets	$40,901	$38,157
Liabilities and stockholders' equity		
Other liabilities	$ 464	$ 541
Notes payable	5,300	5,400
Subordinated debt	4,124	4,124
Total liabilities	9,888	10,065
Stockholders' equity	31,013	28,092
Total liabilities and stockholders' equity	$40,901	$38,157

Condensed Statement of Income

	Year Ended December 31,		
In thousands	2009	2008	2007
Income			
Interest income	$ 1	$ 4	$ 13
Other operating income	78	31	-
Dividends from subsidiaries	687	870	750
Interest from subsidiaries	361	579	835
Total income	1,127	1,484	1,598
Expenses			
Interest expense	439	542	756
Other operating expenses	3	3	3
Net losses on securities transactions	-	-	-
Income tax expense	15	21	36
Total expenses	457	566	795
Income before equity in undis- **tributed income of** s**ubsidiaries**	670	918	803
Equity in undistributed (loss) income of subsidiaries	(8,492)	140	1,064
Net (loss) income	$(7,822)	$ 1,058	$ 1,867

Condensed Statement of Cash Flows

In thousands	Year Ended December 31, 2009	2008	2007
Operating activities			
Net (loss) income	$(7,822)	$1,058	$1,867
Adjustments to reconcile net income to cash used in operating activities:			
Equity in undistributed loss (income) of subsidiaries	8,492	(140)	(1,064)
Decrease (increase) in other assets	306	(149)	(228)
(Decrease) increase in other liabilities	(77)	460	(78)
Net cash provided by operating activities	899	1,229	497
Investing activities			
Proceeds from sales and maturities of investment securities available for sale including principal payments	-	543	-
Purchases of investment securities available for sale	-	(543)	-
Increase in investment in subsidiaries	(8,925)	(3,739)	(1,784)
Decrease in loans to subsidiaries	75	4,075	740
Net cash (used in) provided by investing activities	(8,850)	336	(1,044)
Financing activities			
Decrease in subordinated debt	-	-	(3,093)
(Decrease) increase in notes payable	(100)	(200)	4,694
Proceeds from issuance of preferred stock	9,439	-	-
Purchases of treasury stock	(3)	(51)	(65)
Dividends paid	(1,417)	(1,286)	(1,235)
Net cash provided by (used in) financing activities	7,919	(1,537)	301
Increase (decrease) in cash and cash equivalents	(32)	28	(246)
Cash and cash equivalents at beginning of year	32	4	250
Cash and cash equivalents at end of year	$ -	$ 32	$ 4

Note 24 Regulatory capital requirements

FDIC regulations require banks to maintain minimum levels of regulatory capital. Under the regulations in effect at December 31, 2009, the Bank was required to maintain (i) a minimum leverage ratio of Tier 1 capital to total average assets of 4.0%, and (ii) minimum ratios of Tier I and total capital to risk-adjusted assets of 4.0% and 8.0%, respectively.

Under its prompt corrective action regulations, the FDIC is required to take certain supervisory actions (and may take additional discretionary actions) with respect to an undercapitalized bank. Such actions could have a direct material effect on such bank's financial statements. The regulations establish a framework for the classification of banks into five categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. Generally, a bank is considered well-capitalized if it has a leverage capital ratio of at least 5.0%, a Tier 1 risk-based capital ratio of at least 6.0% and a total risk-based capital ratio of at least 10.0%.

The foregoing capital ratios are based in part on specific quantitative measures of assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by the FDIC about capital components, risk adjustments and other factors.

The Bank is subject to a Formal Agreement with the Comptroller of the Currency (the “OCC”), entered into on June 29, 2009. The Agreement is based on the results of the most recent annual examination of the Bank. The Agreement provides, among other things, the enhancement and implementation of certain programs to reduce the Bank’s credit risk, along with the development of a profit plan and capital program, the development of a contingency funding plan and the correction of deficiencies in its loan administration. The OCC also indicated that the Bank needs to improve its capital ratios and seek outside capital.

The Agreement may significantly affect the operations of both the Bank and the parent holding company, particularly in the event that the Bank fails to comply with the provisions of the Agreement, which may also result in more severe enforcement actions and other restrictions. The Bank is currently not in compliance with certain provisions of the Agreement; however, management has taken steps to remedy these noncompliance matters. In addition, because the Bank’s leverage ratio is less than 8%, management is currently discussing with the OCC the impact of falling below this threshold. Management expects to achieve an 8% leverage ratio by December 31, 2010.

The following is a summary of City National Bank's actual capital amounts and ratios as of December 31, 2009 and 2008, compared to the FDIC minimum capital adequacy requirements and the FDIC requirements for classification as a well-capitalized Bank:

In thousands			FDIC Requirements			
			Minimum Capital Adequacy		**For Classification as Well-Capitalized**	
	Bank Actual Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
December 31, 2009						
Leverage (Tier 1) capital	$34,251	7.08%	$19,364	4.00%	$24,205	5.00%
Risk-based capital:						
Tier 1	34,251	10.62	12,899	4.00	19,348	6.00
Total	43,342	13.43	25,798	8.00	32,247	10.00
December 31, 2008						
Leverage (Tier 1) capital	$32,500	6.61%	$13,078	4.00%	$16,347	5.00%
Risk-based capital:						
Tier 1	32,500	9.94	13,078	4.00	19,617	6.00
Total	41,465	12.68	26,156	8.00	38,694	10.00

The Corporation was required to deconsolidate its investment in the subsidiary trust formed in connection with the issuance of trust preferred securities in 2004. In July 2003, the Board of Governors of the Federal Reserve System instructed bank holding companies to continue to include the trust preferred securities in their Tier 1 capital for regulatory capital purposes until notice is given to the contrary. There can be no assurance that the Federal Reserve will continue to allow institutions to include trust preferred securities in Tier 1 capital for regulatory capital purposes. As of December 31, 2009, assuming the Corporation was not allowed to include the trust preferred securities issued by the subsidiary trusts in Tier 1 capital, the Corporation would remain “well capitalized.”

The deconsolidation of the subsidiary trust results in the Corporation reporting on its balance sheet the subordinated debentures that have been issued from City National Bancshares to the subsidiary trust.

Note 25 Summary of quarterly financial information

(unaudited) 2009

Dollars in thousands, except per share data	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Interest income	$6,061	$6,036	$6,193	$5,884
Interest expense	2,554	2,407	2,391	2,143
Net interest income	3,507	3,629	3,802	3,741
Provision for loan losses	501	436	1,674	5,494
Net gains (losses) on securities transactions	-	10	2	(1)
Net impairment losses on securities	(132)	(1,055)	(1,107)	(39)
Other operating income	878	808	759	668
Other operating expenses	3,092	3,658	3,500	3,131
Income (loss) before income tax expense	660	(702)	(1,718)	(4,256)
Income tax expense (benefit)	162	119	(1,209)	2,734
Net income (loss)	$ 498	$(821)	$(509)	$(6,990)
Net income (loss) per share-basic	$ 1.02	$(8.21)	$(6.36)	$(55.75)
Net income (loss) per share-diluted	$ 1.02	$(8.21)	$(6.36)	$(55.75)

(unaudited) 2008

Dollars in thousands, except per share data	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Interest income	$6,454	$6,341	$6,467	$6,640
Interest expense	3,009	2,653	2,862	2,785
Net interest income	3,445	3,688	3,605	3,855
Provision for loan losses	168	265	189	964
Net gains (losses) on securities transactions	6	(50)	(1,429)	(1,259)
Other operating income	673	758	804	776
Other operating expenses	3,107	3,174	2,861	3,136
Income (loss) before income tax expense	849	957	(70)	(728)
Income tax expense (benefit)	184	257	(120)	(371)
Net income (loss)	$ 665	$ 700	$ 50	$(357)
Net income (loss) per share-basic	$ 2.28	$ 4.18	$(.75)	$(3.84)
Net income (loss) per share-diluted	$ 2.28	$ 3.72	$(.75)	$(3.38)

Basic net income per common share is calculated by dividing net income less dividends on preferred stock by the weighted average number of common shares outstanding. On a diluted basis, both net income and common shares outstanding are adjusted to assume the conversion of the preferred stock if conversion is deemed dilutive.

Note 26. Subsequent events

In February 2010, City National Bancshares Corporation deferred the payment of its regular quarterly cash dividend on its Series G fixed-rate cumulative perpetual preferred stock issued to the U.S. Treasury in connection with the Corporation's participation in the Treasury's TARP Capital Purchase Program.

In addition, the Corporation deferred its regularly scheduled quarterly interest payment on its junior subordinated debentures issued by the City National Bank of New Jersey Capital Statutory Trust II (the "Trust").

The Series G preferred stock and the junior subordinated debentures issued in favor of the Trust provide for cumulative dividends and interest, respectively. Accordingly, the Corporation may not pay dividends on any of its common or preferred stock until the dividends on Series G preferred stock and the interest on such debentures are paid-up currently.

Finally, at March 31, 2010 the Bank determined that it no longer had the intent to hold certain held-to-maturity securities to maturity and therefore transferred the entire held-to-maturity security portfolio to the available for sale portfolio. As a result of this decision, the Bank has tainted its ability to maintain a held-to-maturity portfolio. The Bank will no longer maintain a held to maturity portfolio for two years from the transfer date.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
City National Bancshares Corporation:

We have audited the accompanying consolidated balance sheets of City National Bancshares Corporation and subsidiary as of December 31, 2009 and 2008, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2009. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of City National Bancshares Corporation and subsidiary as of December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 and Note 4 to the consolidated financial statements, the Company changed its method of evaluating other-than-temporary impairments of debt securities due to the adoption of new accounting requirements issued by the Financial Accounting Standards Board, as of April 1, 2009.

/s/ KPMG LLP

Short Hills, New Jersey
May 18, 2010

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

The purpose of this analysis is to provide information relevant to understanding and assessing the results of operations for each of the past three years and financial condition for each of the past two years for City National Bancshares and its subsidiaries (the "Corporation" or the "Bank").

Cautionary statement concerning forward-looking statements

This management's discussion and analysis contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are not historical facts and include expressions about management's expectations about new and existing programs and products, relationships, opportunities, and market conditions. Such forward-looking statements involve certain risks and uncertainties. These include, but are not limited to, unanticipated changes in the direction of interest rates, effective income tax rates, loan prepayment assumptions, deposit growth, the direction of the economy in New Jersey and New York, levels of asset quality, continued relationships with major customers as well as the effects of general economic conditions and legal and regulatory issues and changes in tax regulations. Actual results may differ materially from such forward-looking statements. The Corporation assumes no obligation for updating any such forward-looking statement at any time.

Executive summary

In 2009, the economic recession showed signs of abating and the illiquidity in the financial marketplace improved considerably. While various segments of the economy showed clear signs of improvement, commercial real estate values continued to decline, particularly in the northeastern part of the United States, which was affected later than the rest of the country. As a result, the Corporation incurred significant loan losses, as well as investment securities impairments where the underlying collateral behind the bank-issued trust preferred securities consisted of commercial real estate.

Management cannot determine whether conditions will improve during 2010, although investment portfolio valuations appear to have stabilized due primarily to securities writedowns.

Additionally, the Bank is operating under a regulatory agreement and expects to incur significant costs in complying with its terms. Should asset quality continue to deteriorate, or should the Bank be unable to comply with the terms of the agreement, additional sanctions may be imposed, leading to additional costs and possible liquidity concerns.

In 2009, the Corporation received a $700,000 award from the U.S. Treasury's Community Development Financial Institution ("CDFI") Fund. The award was based on the Bank's lending efforts in qualifying lower income communities and is being recorded as yield enhancement on the related loans.

In 2008, the Corporation received $1.2 million of awards from the U.S. Treasury's Community Development Financial Institution ("CDFI") Fund. The award was based on the Bank's lending efforts in qualifying lower income communities and is being recorded as yield enhancement on the related loans. The Corporation also received a $43,000 award for technical assistance, which is being offset against the related costs as they are incurred.

The primary source of the Corporation's income comes from net interest income, which represents the excess of interest earned on earning assets over the interest paid on interest-bearing liabilities. This income is subject to interest rate risk resulting from changes in interest rates. The most significant component of the Corporation's interest-earning assets is the loan portfolio. In addition to the aforementioned interest rate risk, the portfolio is subject to credit risk. Certain components of the investment portfolio are subject to credit risk as well.

Cash and due from banks

Cash and due from banks declined to $6.8 million at the end of 2009 from $7.6 million a year earlier, while average cash and due from banks in 2008 decreased to $8.1 million compared to $8.6 million a year earlier.

Federal funds sold

Federal funds sold declined to $5.5 million at the end of 2009 from $18.2 million at December 31, 2008, while the related average balance rose to $34.6 million from $10.6 million in 2008. The increase resulted primarily from the investment of the proceeds from a large temporary municipal market account balance on deposit with the Bank during the first half of 2009, while the reduction occurred due to lower 2009 year-end municipal account deposit balances.

Interest-bearing deposits with banks

Interest-bearing deposits with banks declined to $609,000 at December 31, 2009 from $726,000 a year earlier, while the related average balances were $1.5 million in 2009 and $1 million in 2008. The deposits represent the Bank's participation in the U.S. Treasury Department's Community Development Financial Institution ("CDFI") deposit program. Under this program, the Bank is eligible for awards based on deposits made in other CDFI's. $42,000 was recorded as interest income from interest-bearing deposits with banks in 2009, representing a yield enhancement on the CDFI deposits.

Investments

The available for sale ("AFS") portfolio decreased to $122 million at December 31, 2009 from $125.6 million a year earlier due primarily to increased prepayments on mortgage-backed securities ("MBS"). The related gross unrealized loss was $2.6 million compared to $2.7 million at the end of 2008 due largely to ASC 320-10-65-1, which required the recapture of $1 million of previous impairment writedowns into retained earnings and Accumulated Other Comprehensive Income as of April 1, 2009.

Included in the AFS portfolio are four collateralized debt obligations ("CDOs") that are comprised of pools of trust preferred securities issued primarily by banks that have a book value of $1.2 million and a market value of $546,000. The unrealized loss of $605,000 is included in Other Comprehensive Income ("OCI"). $494,000 of this loss pertains to one CDO which continues to be fully performing and has substantial excess collateral coverage in the Bank's tranche. The market value of this security has been negatively impacted by illiquidity in the overall CDO market, as well as losses sustained in the underlying collateral. During 2009, impairment losses of $2.3 million were recorded on two of the other CDOs.

Additionally, the available for sale portfolio includes two corporate debt securities with a carrying value of $1.9 million that have an unrealized loss of $438,000, down from $782,000 at the end of 2008. Both investments continue to perform and remain investment grade.

Finally, the Bank owns seven single-issue trust preferred securities issued by individual financial institutions with a carrying value of $6.3 million and an unrealized loss of $1.1 million, compared to an unrealized loss of $1.3 million a year earlier. No impairment losses have been incurred on these securities, which are current as to the payment of interest and mostly investment grade. All except one of the banks owning the issuers of these securities were well-capitalized at December 31, 2009. $5.8 million of these securities are included in AFS and one security with a carrying value of $495,000 is included in HTM.

The fair market value of most components of the overall investment portfolio benefited by the continued low interest rate environment during 2009. Both the AFS and HTM portfolios reflected significant gains at the end of 2009 compared to a year earlier, due in part to writedowns in the available for sale portfolio. Such writedowns totaled $2.3 million. The writedowns were incurred in two investments in collateralized debt obligations ("CDOs") where the unrealized losses were deemed to be other-than-temporarily impaired.

Management does not believe that any individual unrealized losses as of December 31, 2009 represent an other-than-temporary impairment. Additionally, the Corporation does not have the intent to sell these securities and it is more likely than not that the Corporation will not be required to sell the securities.

Most acquisitions during 2009 consisted of mortgage backed securities ("MBS") and securities issued by government sponsored entities ("GSE's"). Both types of securities are used for municipal deposit collateral purposes and are subject to large fluctuations based on collateral requirements.

Investments held to maturity ("HTM") declined to $40.4 million at the end of 2009 from $53.7 million at the end of 2008 due primarily to early redemptions of callable securities.

The average yield on the AFS portfolio declined to 4.59% at December 31, 2009 from 4.66% at December 31, 2008, while the yield on the HTM portfolio declined to 5.77% at December 31, 2009 from 5.88% at December 31, 2008. The reduced yields in both portfolios were due to the lower yields earned on newly acquired investments placed in the portfolios during 2009 along with the effects of higher prepayment speeds in the MBS portfolio and the impact of several higher yielding callable bonds being redeemed prior to final maturity. The weighted average life of the AFS portfolio was 5.09 years at the end of 2009 compared to 4.86 years a year earlier, while the average life of the HTM portfolio was 5.04 years at the end of 2009 compared to 4.44 years at the end of 2008.

Due largely to illiquidity in various segments of the fixed income markets, valuations have became more subjective, requiring alternate methods of valuation aside from quoted trade prices, which often represented distressed sales prices. Such methods included underlying collateral valuations and discounted cash flow analyses, often producing higher calculated valuations than the quoted trade prices. Illiquidity in these markets also had a negative effect on such quotations. Finally, credit weakness of various issuers also had a significant negative impact on valuations. As a result, the services of third-party consultants were utilized in the valuation process. These consultants prepared discounted cash flow analyses for the CDOs and analyzed the default probabilities of underlying issuers in the Corporation's CDO portfolio in order to determine the fair values of such securities.

Loans

Loans rose to $276.2 million at December 31, 2009 from $271.9 million at December 31, 2008, while average loans in 2009 increased to $278.7 million from $252.7 in 2008. The increases were comprised largely of short-term equipment finance loans to agencies of the U.S. government. The Corporation originates nominal consumer or residential mortgage loans to hold in the portfolio and expects this trend to continue.

At December 31, 2009, the Bank had concentrations of loans to churches and loan participations with a third-party commercial real estate lender in New York City, both of which are experiencing credit quality problems and represent significant components of the Bank's nonperforming loans. Loans to churches totaled $72.1 million at December 31, 2009, representing 26.1% of total loans outstanding, all of which were secured by real estate, compared to $73.4 million and 25.2% at December 31, 2008. Participations with the third-party lender totaled $32 million, of which $27.2 million were construction loans. Both types of loans are secured by commercial real estate, the appraised values of which have suffered large declines during the current economic downturn. Accordingly, both types of loans currently have generally higher loan-to-value ratios than when they were originated, which has been factored into the methodology for determining the allowance for loan losses. Management believes that because construction-related credit issues in the Northeast have lagged other parts of the country, there may be continued deterioration in portfolio credit quality. However, management also believes that because the Northeast region was significantly less overbuilt during more prosperous times, losses will not be as significant as in other parts of the country.

Loans held for sale totalled $190,000 at December 31, 2009 compared to $267,000 at December 31, 2008, while loans originated for sale declined to $312,000 in 2009 compared to $1 million in 2008 due to the economic downturn. Sales of these loans, along with the related gains also declined. These loans represent long-term fixed rate residential mortgages that the Corporation does not retain in the portfolio to mitigate its interest rate risk to rising interest rates.

Residential mortgage loans, including home equity loans, represent an insignificant part of the Bank's lending business. Such loans that have long-term fixed rates are generally sold into the secondary market, although some loans may be retained in the portfolio to balance the Bank's loan mix and provide collateral for Federal Home Loan Bank borrowings. Consumer loans, including automobile loans, also comprise a relatively small part of the loan portfolio. Most of the Bank's lending efforts are in Northern New Jersey, New York City and Nassau County.

The Bank generally secures its loans by obtaining primarily first liens on real estate, both residential and commercial, and does virtually no asset-based financing. Without additional side collateral, the Bank generally requires maximum loan-to-value ratios of 70% for loan transactions secured by commercial real estate. The Bank expects to reduce commercial real estate lending in 2010. If a loan is performing, appraisals are performed when the loan renews, if there is a renewal date, and if nonperforming, appraisals are performed annually.

Allowance for loan losses

The allowance for loan losses is a critical accounting policy and is maintained at a level determined by management to be adequate to provide for inherent losses in the loan portfolio. The allowance is increased by provisions charged to operations and recoveries of loan charge-offs.

The allowance is based on management's evaluation of the loan portfolio and several other factors, including past loan loss experience, general business and economic conditions, concentration of credit and the possibility that there may be inherent losses in the portfolio that cannot currently be identified. Although management uses the best information available, the level of the allowance for loan losses remains an estimate that is subject to significant judgment and short-term change.

Management maintains the allowance for credit losses at a level estimated to absorb probable loan losses of the loan portfolio at the balance sheet date. The allowance is based on ongoing evaluations of the probable estimated losses inherent in the loan portfolio. The methodology for evaluating the appropriateness of the allowance includes segmentation of the loan portfolio into its various components, tracking the historical levels of classified loans and delinquencies, applying economic outlook factors, assigning specific incremental reserves where necessary, providing specific reserves on impaired loans, and assessing the nature and trend of loan charge-offs. Additionally, the volume of non-performing loans, concentration risks by size and type, collateral adequacy and economic conditions are taken into consideration.

The allowance established for probable losses on specific loans is based on a regular analysis and evaluation of classified loans.

Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor's ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and the industry in which the borrower operates. Specific valuation allowances are determined by analyzing the borrower's ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower's industry, among other things.

Additionally, nonaccrual loans over a specific dollar amount are individually evaluated, along with all troubled debt restructured loans for impairment based on the underlying anticipated method of payment consisting of either the expected future cash flows or the related collateral. If payment is expected solely based on the underlying collateral, an appraisal is completed to assess the fair value of the collateral. Collateral dependent impaired loan balances are written down to the current fair value of each loan's underlying collateral resulting in an immediate charge-off to the allowance. If repayment is based upon future expected cash flows, the present value of the expected future cash flows discounted at the loan's original effective interest rate is compared to the carrying value of the loan, and any shortfall is recorded as a specific valuation allowance in the allowance for credit losses.

The allowance allocations for non-impaired loans are calculated by applying loss factors by specific loan types to the applicable outstanding loans and unfunded commitments. Loss factors are based on the Bank's historical loss experience and may be adjusted for significant changes in the current loan portfolio quality that, in management's judgment, affect the collectability of the portfolio as of the evaluation date.

The allowance contains reserves identified as unallocated in the table below to cover inherent losses in the loan portfolio which have not been otherwise reviewed or measured on an individual basis. Such reserves include management's evaluation of the regional economy, loan portfolio volumes, the composition and concentrations of credit, credit quality and delinquency trends. These reserves reflect management's attempt to ensure that the overall allowance reflects a margin for judgmental factors and the uncertainty that is inherent in estimates of probable credit losses.

During the third quarter of 2009, management performed an evaluation of the methodology in calculating the allowance, resulting in revisions to the loss factors for various types of loans, as well as using different appraisal assumptions in instances where nonperforming commercial real estate properties may be rented instead of sold.

The allowance represented 3.13% of total loans at December 31, 2009 and 1.40% at December 31, 2008, while the allowance represented 48.35% of total nonperforming loans at December 31, 2009 compared to 44.13% for the prior year. The allowance at the end of 2009 rose to $8.6 million from $3.8 million a year earlier due to an increase in the provision for loan losses resulting primarily from an increase in nonperforming loans, the continuous deterioration in loan quality and an increase in loss factors.

The provision for loan losses rose substantially in 2009 primarily due to the continued deterioration in the Bank's commercial real estate portfolio.

Nonperforming assets

Nonperforming assets rose to $20.2 million at the end of 2009 due primarily to higher levels of nonaccruing commercial real estate loans. This category of loans continues to be stressed by the effects of the economic recession in the Bank's trade area, which has been affected later than the rest of the country.

Nonaccrual loans includes $4.2 million of loans to religious organizations, which management believes have been impacted by reductions in tithes and collections from congregation members due to the deterioration in the economy, and $4.5 million of loans acquired from a third-party non-bank lender. Church loans located in the State of New York may require significantly longer to collect because approval is required by the state of New York before the underlying property may be encumbered.

Impaired loans totaled $11.1 million at the end of 2009 compared to $12.1 million at September 30, 2009 and $5.8 million at year-end 2008. The related allocation of the allowance for loan losses amounted to $550,000 due to a shortfall in collateral values. Impaired loan charge-offs totalled $1.4 million. The average balance of impaired loans in 2009 was $8.5 million compared to $1 million in 2008. All of the impaired loans are secured by real estate. Included in impaired loans are loans to churches totaling $2 million with no related allowance. Additionally, impaired loans include $4.4 million of loan participations acquired from the third-party lender, with a related allowance of $550,000. Such loans were comprised primarily of construction loans.

Troubled debt restructured loans ("TDRs") totaled $5.2 million, with a related allowance of $760,000 at December 31, 2009 and were comprised of seven loans, three of which were church loans totaling $3.2 million. One TDR of $1.4 million is accruing interest. The remaining TDRs are on nonaccrual status and reflected in the above table.

Other assets

Other assets rose $2.5 million at the end of 2009 compared to a year earlier, with the increase resulting primarily from the payment in December 2009 of a $3.4 FDIC insurance prepayment for 2010 through 2012.

Other real estate owned

Other real estate owned ("OREO") was higher due to the transfer of foreclosed properties from the loan portfolio.

Deposits

The Bank's deposit levels may change significantly on a daily basis because deposit accounts maintained by municipalities represent a significant part of the Bank's deposits and are more volatile than commercial or retail deposits.

These municipal and U.S. Government accounts represent a substantial part of the Bank's business, tend to have high balance relationships and comprised most of the Bank's accounts with balances of $100,000 or more at December 31, 2009 and 2008. These accounts are used for operating and short-term investment purposes by the municipalities and require collateralization with readily marketable U.S. Government securities or Federal Home Loan Bank of New York municipal letters of credit.

While the collateral maintenance requirements associated with the Bank's municipal and U.S. Government account relationships might limit the ability to readily dispose of investment securities used as such collateral, management does not foresee any need for such disposal, and in the event of the withdrawal of any of these deposits, these securities are readily marketable or available for use as collateral for repurchase agreements.

Changes in all deposit categories discussed below were caused by fluctuations in municipal deposit account balances unless otherwise indicated.

Total deposits declined to $380.3 million at December 31, 2009 from $407.1 million a year earlier, while average deposits increased to $427.2 million in 2009 from $387.4 million in 2008. The reduction resulted from a deleveraging program undertaken to improve capital ratios, while the increase occurred due to the aforementioned temporary account balance.

Passbook and statement savings deposits totaled $24.7 million at December 31, 2009, unchanged from a year earlier, while such savings accounts averaged $24.9 million in 2009 compared to $26.6 million in 2008. The decline resulted from a shift into higher earning deposit products.

Money market deposit accounts declined to $73.3 million at December 31, 2009 from $119.5 million a year earlier, while average money market deposits increased 8.6% to $107.3 million in 2009 from $98.8 million in 2008. The changes occurred primarily due to the aforementioned temporary account balance.

Interest-bearing demand deposit account balances rose to $51.8 million at the end of 2009 compared to $39 million at year-end 2008, while the related average balance of $53.3 million was 15.1% higher in 2009 than the average of $46.3 million in 2008.

Time deposits rose to $201.1 million at December 31, 2009 from $187.7 million at the end of 2008, while average time deposits were $197.2 million in 2009, 11.1% greater than the average of $177.5 million in 2008. Brokered deposits rose from $47 million at the end of 2008 to $52.2 million a year later. The Bank does not expect to increase current brokered deposit levels for the foreseeable future.

Short-term borrowings

Short-term borrowings totaled $100,000 at December 31, 2009 compared to $1.9 million at December 31, 2008, while average short-term borrowings of $606,000 in 2009 were significantly lower than the 2008 average of $2.8 million due to higher short-term borrowing requirements during the summer months of 2008 when certain municipal account balances were drawn down.

Long-term debt

Long-term debt decreased to $44 million at December 31, 2009 from $46.6 million a year earlier, while the related average balance was $38.3 million in 2008 compared to $45.1 million in 2009. Both declines resulted from repayments of Federal Home Loan Bank advances

Results of operations – 2009 compared with 2008

The Corporation recorded a net loss of $7.8 million in 2009 compared to net income of $1.1 million a year earlier due primarily to a $4.7 million deferred tax asset valuation allowance and a $6.5 million increase in the provision for loan losses. Additionally, each year included substantial impairment losses on investment securities, amounting to $2.3 million in 2009 and $2.7 million in 2008. Partially offsetting these losses were several expense reductions resulting from a cost reduction initiative undertaken in the fourth quarter of 2009.

Included in both years' earnings were awards received from the U.S. Treasury's Community Development Financial Institution ("CDFI") Fund. The awards were based on the Bank's lending efforts in qualifying lower income communities. Award income attributable to its lending efforts totaled $386,000 in 2009, $421,000 in 2008 and $336,000 in 2007. The Bank also recorded award income related to time deposits made in other CDFI's of $42,000 in 2009, $- in 2008 and $39,000 in 2007.

Finally, the Bank recorded award income of $71,000 in 2009, $18,000 in 2008 and $19,000 in 2007 as a recovery of approved information technology-related costs. In total, $499,000 of award income was recorded in 2009, while $439,000 was recorded in 2008 and $394,000 was recorded in 2007.

These awards are dependent on the availability of funds in the CDFI Fund as well as the Corporation meeting various qualifying standards. Accordingly, there is no assurance that the Corporation will continue to receive these awards in the future. However, The Corporation has received various awards under these programs on a regular basis as follows over the past five years: 2009 - $700,000, 2008 - $1.2 million, 2007 - $542,000, 2006 - $340,000 and 2005 - $131,000. The Corporation expects to continue to apply for these awards.

On a fully taxable equivalent ("FTE") basis, net interest income of $15.3 million in 2009 was flat compared to 2008, while the related net interest margin declined 29 basis points, from 3.44% to 3.15%.

The reduced net interest margin occurred due to the average rate earned on interest-earning assets declining more rapidly than the interest paid on interest-bearing liabilities, which in turn was driven by the effects of reinvesting loan and investment principal and interest payments in shorter-term earning assets in a low interest rate environment along with variable-rate loans and investments repricing at lower rates in the low interest rate environment. Additionally, the large temporary municipal money market account balance on which the spread was minimal compressed the net interest margin.

Interest income on a FTE basis declined from $26.6 million in 2008 to $24.8 million in 2009 as the decrease in income caused by the reduction in the average rate earned more than offset the higher earnings from the increased asset levels. The yield on interest earning assets declined 90 basis points, from 6% to 5.10%. Aside from the higher average Federal funds balance caused largely by the temporary deposit, the most significant increase occurred in the real estate portfolio.

Interest income from Federal funds sold was lower in 2009 despite the higher average balance due to the temporary deposit because of a reduction in the related yield from 2.04% to .16%. The low yield resulted from the Federal Reserve Bank's Federal Open Market Committee's decision to leave the Federal funds target rate at a range of 0% to .25%.

Interest income on taxable investment securities decreased in 2009 due to a lower average rate, which declined from 5.07% to 4.76%, as well as a lower average balance. Tax-exempt investment income was virtually unchanged.

Interest income on loans declined due to a lower average rate earned, which decreased from 6.71% to 5.79% partially offset by higher earnings from increased loan volume. The lower yield was caused by the low interest rate environment along with the forgone income from nonperforming loans.

Interest expense declined 16% in 2009, as the average rate paid to fund interest-earning assets decreased from 2.56% to 1.95%. This decline was due to the lower rates paid on almost all interest-bearing liabilities. The most significant reduction occurred in interest expense on money market accounts, which declined 48.2% in 2009. Almost all interest-bearing liabilities had volume increases, partially offsetting the expense reduction from the lower rates paid.

Service charges on deposit accounts was essentially unchanged in 2009 from a year earlier as higher service charges were offset by a reduction in overdraft fees.

Agency fees declined in 2009 as they have done in recent years due to elimination by large companies of these programs.

Other income was up in 2009 due primarily to an increase in earnings from an unconsolidated leasing company in which the Bank owns a minority interest and higher income from off-site ATMs.

Other operating expenses, which include expenses other than interest, income taxes and the provision for loan losses, totaled $13.4 million in 2009, a 9% increase compared to $12.3 million in 2008, driven primarily by higher FDIC insurance expense and management consulting fees.

Salaries and other employee benefits expense declined due to the reversals in the 2009 fourth quarter of bonus accruals totaling $417,000 and a $71,000 discretionary 401K savings plan accrual, both of which management decided to forego as part of the cost reduction initiative. Additionally, $127,000 of supplemental executive retirement plan benefit accruals related to a participant who resigned in 2009 were reversed. These reductions were partially offset by higher health insurance costs.

Occupancy expense rose nominally due to higher property taxes, while equipment expense was essentially unchanged.

Management consulting fees rose from $212,000 in 2008 to $683,000 in 2009, and FDIC insurance expense increased from $429,000 to $1.1 million. The increase in management consulting fees resulted primarily from the necessity to comply with the terms of the regulatory agreement along with the outsourcing of part of the internal audit function, while FDIC expense was higher due to a second quarter $255,000 special assessment required to recapitalize the insurance fund and an increase resulting from a change in the assessment calculation.

OREO expense rose due primarily to property writedowns.

Other expenses declined 5.5% in 2009 due primarily to a reduction in merchant card charges, which represent credit card fees incurred by customers and previously absorbed by the Bank and offset by compensating deposit account balances. These charges are currently being passed on directly to the customers. Partially offsetting this reduction was an increase in other costs related to carrying and liquidating nonperforming assets such as legal expense.

The changes in income tax expense as a percentage of pretax income compared to 2008 resulted from the recording of the aforementioned valuation allowance.

Liquidity

The liquidity position of the Corporation is dependent on the successful management of its assets and liabilities so as to meet the needs of both deposit and credit customers. Liquidity needs arise primarily to accommodate possible deposit outflows and to meet borrowers' requests for loans. Such needs can be satisfied by investment and loan maturities and payments, along with the ability to raise short-term funds from external sources.

The Bank depends primarily on deposits as a source of funds and also provides for a portion of its funding needs through short-term borrowings, such as the Federal Home Loan Bank, Federal Funds purchased, securities sold under repurchase agreements and borrowings under the U.S. Treasury tax and loan note option program. The Bank also utilizes the Federal Home Loan Bank for longer-term funding purposes.

A significant part of the Bank's deposit growth is from municipal deposits, which comprised $140.2 million, or 36.9% of total deposits at December 31, 2009. These relationships arise due to the Bank's urban market, leading to municipal deposit relationships. $67.7 million of investment securities were pledged as collateral for these deposits.

Illiquidity in certain segments of the investment portfolio may limit the Corporation's ability to dispose of various securities, although management believes that the Corporation has sufficient resources to meet all its liquidity demands. Should the market for these and similar types of securities, such as single issuer trust preferred securities, continue to deteriorate, or should credit weakness develop, additional illiquidity could occur within the investment portfolio.

Municipal deposit levels may fluctuate significantly depending on the cash requirements of the municipalities. The Bank has ready sources of available short-term borrowings in the event that the municipalities have unanticipated cash requirements. Such sources include the Federal Reserve Bank discount window, Federal funds lines, FHLB advances and access to the repurchase agreement market, utilizing the collateral for the withdrawn deposits. In certain instances, however, these lines may be reduced or not available in the event of a significant decline in the Bank's credit quality or capital levels. On two occasions during 2009, the Bank successfully accessed the aforementioned lines

As a result of the loss incurred, there were no significant sources of funds during 2009 from operating activities.

Net cash provided by investing activities during 2009 was derived primarily from proceeds from maturities, principal payments and early redemptions of investment securities available for sale, amounting to $26.8, while the primary uses of cash were for purchases of investment securities available for sale, which amounted to $22.1 million and net loan growth, which totaled $9 million.

The highest source of cash provided by financing activities resulted from the issuance of $9.4 million of preferred stock to the U.S. Treasury, while the most significant use of funds was an outflow of $26.8 million deposits resulting from the deleveraging program.

As a result of the aforementioned Formal Agreement, the Corporation has implemented a contingency funding plan which provides detailed procedures to be instituted in the event of a liquidity crisis.

Contractual obligations

The Corporation has various financial obligations, including contractual obligations that may require future cash payments. These obligations are included in Notes 4,5,9,10 and 11 of the Notes to Consolidated Financial Statements.

The Corporation also will have future obligations under supplemental executive and directors' retirement plans described in Note 14 of the Notes to Consolidated Financial Statements.

Interest rate sensitivity

The management of interest rate risk is also important to the profitability of the Corporation. Interest rate risk arises when an earning asset matures or when its interest rate changes in a time period different from that of a supporting interest bearing liability, or when an interest bearing liability matures or when its interest rate changes in a time period different from that of an earning asset that it supports. While the Corporation does not match specific assets and liabilities, total earning assets and interest bearing liabilities are grouped to determine the overall interest rate risk within a number of specific time frames.

It is the responsibility of the Asset/Liability Management Committee ("ALCO") to monitor and oversee the activities of interest rate sensitivity management and the protection of net interest income from fluctuations in interest rates.

Interest sensitivity analysis attempts to measure the responsiveness of net interest income to changes in interest rate levels. The difference between interest sensitive assets and interest sensitive liabilities is referred to as interest sensitive gap. At any given point in time, the Corporation may be in an asset-sensitive position, whereby its interest-sensitive assets exceed its interest-sensitive liabilities or in a liability-sensitive position, whereby its interest-sensitive liabilities exceed its interest-sensitive assets, depending on management's judgment as to projected interest rate trends.

One measure of interest rate risk is the interest-sensitivity analysis, which details the repricing differences for assets and liabilities for given periods. The primary limitation of this analysis is that it is a static (i.e., as of a specific point in time) measurement that does not capture risk that varies nonproportionally with changes in interest rates. Because of this limitation, the Corporation uses a simulation model as its primary method of measuring interest rate risk. This model, because of its dynamic nature, forecasts the effects of different patterns of rate movements on the Corporation's mix of interest sensitive assets and liabilities.

The following table presents the Corporation's sensitivity to changes in interest rates, categorized by repricing period. Various assumptions are used to estimate expected maturities. The actual maturities of these instruments could vary substantially if future prepayments differ from estimated experience. Additionally, assets and liabilities reprice at different rates so that gaps may not represent an accurate assessment of interest rate risk.

Interest Sensitivity Gap Analysis

	December 31, 2009				
In thousands	One Year Or Less	One Year to Three Years	Three Years to Five Years	More than Five Years	Total
Interest earning assets:					
Federal funds sold and securities purchased under agreements to resell	$ 5,500	$ -	$ -	$ -	$ 5,500
Interest-bearing deposits with banks	342	267	-		609
Investment securities	53,072	27,233	26,426	55,252	161,983
Loans	126,012	76,248	50,930	23,052	276,242
	184,926	103,748	77,356	78,304	444,334
Interest bearing liabilities:					
Deposits:					
Savings	149,853	-	-		149,853
Time	133,525	39,846	23,530	4,218	201,119
Short-term borrowings	100	-	-	-	100
Long-term debt	7,300	18,000	8,500	15,200	49,000
	290,778	57,846	32,030	19,418	400,072
Interest sensitivity gap:					
Period gap	$(105,852)	$45,902	$45,326	$58,886	$ 44,262
Cumulative gap	(105,852)	(59,950)	(14,624)	44,262	-

The cumulative gap between the Corporation's interest rate sensitive assets and its interest sensitive liabilities was $46.4 million at December 31, 2009. This means that the Corporation has a "positive gap" position, which theoretically will cause its assets to reprice faster than its liabilities. In a rising interest rate environment, interest income may be expected to rise faster than the interest received on earning assets, thus improving the net interest spread. Over a one-year time horizon, however, the gap is negative, although the period gap becomes positive in the second year and all periods listed thereafter.

If interest rates decreased, the net interest received on earning assets will decline faster than the interest paid on the Corporation's liabilities, decreasing the net interest spread. Certain shortcomings are inherent in the method of gap analysis presented below. Although certain assets and liabilities may have similar maturities or periods of repricing, they may react in different degrees to changes in market interest rates. The rates on certain types of assets and liabilities may fluctuate in advance of changes in market rates, while rates on other types of assets and liabilities may lag behind changes in market rates. In the event of a change in interest rates, prepayment and early withdrawal levels could deviate significantly from those assumed in calculating the table. The ability of borrowers to service debt may decrease in the event of an interest rate increase. Management considers these factors when reviewing its sensitivity gap position and establishing its ongoing asset/liability strategy.

Because individual interest earning assets and interest bearing liabilities respond differently to changes in prime, more refined results are obtained when a simulation model is used. The Corporation uses a simulation model to analyze earnings sensitivity to movements in interest rates. The simulation model projects earnings based on parallel shifts in interest rates over a twelve-month period. The model is based on the actual maturity and re-pricing characteristics of rate sensitive assets and liabilities, and incorporates various assumptions which management believes to be reasonable.

At December 31, 2009, the most recently prepared model indicates that net interest income would decline .02% from base case scenario if interest rates rise 200 basis points and decline 12.68% if rates decrease 200 basis points. Additionally, the economic value of equity would decrease 24.62% if rates rise 200 basis points and decline 8.34% if rates decline 200 basis points.

These results indicate that the Corporation is asset-sensitive, meaning that the interest rate risk is higher if interest rates fall, which management doe not expect to occur during 2010 based on the current low interest rate environment.

Capital

The following table presents the consolidated and bank-only capital components and related ratios as calculated under regulatory accounting practice.

	Consolidated		Bank Only	
	December 31,		December 31,	
Dollars in thousands	2009	2008	2009	2008
Total stockholders' equity	$31,013	$28,092	$35,539	$32,386
Net unrealized (gain) loss on investment securities available for sale	(533)	1,124	(533)	1,124
Net unrealized loss on equity securities available for sale	(11)	(25)	(11)	(25)
Disallowed intangibles	(744)	(985)	(744)	(985)
Disallowed deferred tax assets	-	-	-	
Qualifying trust preferred securities	4,000	4,000	-	-
Tier 1 capital	33,725	32,206	34,251	32,500
Qualifying long-term debt	5,200	5,220	5,000	5,000
Allowance for loan losses	4,013	3,800	4,011	3,800
Other	80	165	80	165
Tier 2 capital	9,293	9,185	9,091	8,965
Total capital	$ 43,018	$ 41,391	$ 43,342	$ 41,465
Risk-weighted assets	$322,838	$327,479	$322,606	$326,961
Average total assets	484,362	492,388	484,107	492,827
Risk-based capital ratios:				
Tier 1 capital to risk-adjusted assets	10.45%	9.83%	10.62%	9.94%
Regulatory minimum	5.00	5.00	5.00	5.00
Total capital to risk-adjusted assets	13.32	12.64	13.43	12.68
Regulatory minimum	8.00	8.00	8.00	8.00
Leverage ratio	6.96	6.54	7.08	6.61
Total stockholders' equity to total assets	6.63	5.67	7.63	6.55

Capital ratios for both the parent holding company and the Bank rose due to the $9.4 million preferred stock issuance, most of which was downstreamed to the Bank.

While both the Corporation and the Bank were well-capitalized under the Prompt Corrective Action Requirements at December 31, 2009, additional losses from higher loan loss provisions or investment impairment charges could be incurred reducing capital levels, although management believes that capital levels are sufficient to absorb additional losses and still remain well-capitalized. Additionally, management may improve capital ratios, if necessary, by reducing its municipal deposit levels or seeking additional capital from external sources.

The Bank is subject to a Formal Agreement with the Comptroller of the Currency (the "OCC"), entered into on June 29, 2009. The Agreement is based on the results of the most recent annual examination of the Bank. The Agreement provides, among other things, the enhancement and implementation of certain programs to reduce the Bank's credit risk, along with the development of a profit plan and capital program, the development of a contingency funding plan and the correction of deficiencies in its loan administration. The OCC also indicated that the Bank needs to improve its capital ratios and seek outside capital.

The Agreement may significantly affect the operations of both the Bank and the parent holding company, particularly in the event that the Bank fails to comply with the provisions of the Agreement, which may also result in more severe enforcement actions and other restrictions. The Bank is currently not in compliance with certain provisions of the Agreement; however, management has taken steps to remedy these noncompliance matters. In addition, because the Bank's leverage ratio is less than 8%, management is currently discussing with the OCC the impact of falling below this threshold. Management expects to achieve an 8% leverage ratio by December 31, 2010.

Results of operations – 2008 compared with 2007

2008 earnings included investment portfolio writedowns totaling $2.7 million and a substantially higher loan loss provision, which rose $814,000 from 2007. Despite these negative charges, the Corporation still recorded net income of slightly over $1 million, compared to $1,867,000 in 2007 due to significantly higher net interest income along with various nonrecurring sources of income.

Included in both years' earnings were awards received from the U.S. Treasury's Community Development Financial Institution ("CDFI") Fund. The awards were based in part on the Bank's lending efforts in qualifying lower income communities. Award income attributable to its lending efforts totaled $421,000 in 2008, $336,000 in 2007 and $64,000 in 2006.

The Bank also recorded award income related to time deposits made in other CDFI's of $39,000 in 2007 and $42,000 in 2006.

Finally, the Bank recorded award income of $18,000 in 2008 and $19,000 in 2007 as a recovery of approved technology costs.

In total, $439,000 of award income was recorded in 2008, while $394,000 was recorded in 2007 and $128,000 was recorded in 2006.

These awards are dependent on the availability of funds in the CDFI Fund as well as the Bank meeting various qualifying standards. Accordingly, there is no assurance that the Bank will continue to receive these awards in the future.

On a fully taxable equivalent ("FTE") basis, net interest income increased 16.8% to $14.6 million from $12.5 million in 2007, while the related net interest margin rose 40 basis points, from 3.04% to 3.44%. A lower interest rate environment along with a steepened yield curve, combined with an increase in earning assets contributed to the higher net interest income and net interest margin.

A significantly lower cost of funds was the reason for the improved net interest margin. The yield on interest earning assets declined 52 basis points, from 6.52% to 6%, while the cost to fund those assets fell 92 basis points, from 3.48% to 2.56%. Average interest earning assets increased 8.1%, with the loan portfolio providing the greatest increase.

Service charges on deposit accounts rose 8.5% from 2007 due primarily to higher income derived from an overdraft protection program.

Other income was up 22.6% in 2008 due primarily to a gain from the Bank's unconsolidated leasing subsidiary of $185,000 compared to a $9,000 loss in 2007.

Other operating expenses, which include expenses other than interest, income taxes and the provision for loan losses, totaled $12.3 million in 2008, a 7.4% increase compared to $11.4 million in 2007, driven primarily by higher compensation costs.

Salaries and other employee benefits expense rose 3.6%, an increase that was held down by various nonqualified benefit plan overaccrual reversal adjustments. $76,000 of supplemental executive retirement plan benefit overaccruals along with $26,000 of director retirement plan benefit overaccruals were reversed, partially offsetting significant increases in merchant card fees and FDIC insurance expense. Costs were also higher due to the operation of a branch acquired in March 2007 for a full year, normal recurring merit salary increases, and higher health insurance costs and an increase in 401K savings plan expense due to the reversal in 2007 of accrued discretionary 401K plan expense that was never used.

Occupancy expense rose 8.6% due primarily to the branch acquisition.

Equipment expense was 15.8% higher due primarily to the branch acquisition along with higher service agreement costs.

Other expenses rose 12.1% in 2008 due primarily to an increase in FDIC insurance expense from $40,000 to $429,000 along with increased merchant card charges, which represent credit card fees incurred by customers but absorbed by the Bank and offset by compensating deposit account balances. These charges rose from $334,000 to $471,000.

The Corporation recorded an income tax benefit in 2008 due to the resolution of a tax contingency item. Income tax expense as a percentage of pre-tax income was 16.6% in 2007.

Critical accounting policies and use of estimates

The Corporation's accounting and reporting policies conform, in all material respects, to U.S. generally accepted accounting principles ("GAAP"). In preparing the consolidated financial statements, management has made estimates, judgments and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated statements of condition and results of operations for the periods indicated. Actual results could differ significantly from those estimates.

Accounting policies are fundamental to understanding management's discussion and analysis of its financial condition and results of operations. The significant accounting policies are presented in Note 1 to the consolidated financial statements. Policies on the allowance for loan losses, security valuations, and income taxes are considered to be critical as management is required to make subjective and/or complex judgments about matters that are inherently uncertain and could be most subject to revision as new information becomes available.

The judgments used by management in applying the critical accounting policies discussed below may be affected by a further and prolonged deterioration in the economic environment, which may result in changes to future financial results. Specifically, subsequent evaluations of the loan portfolio, in light of the factors then prevailing, may result in significant changes in the allowance for loan losses in future periods, and the inability to collect on outstanding loans could result in increased loan losses. In addition, the valuation of certain securities in the investment portfolio could be negatively impacted by illiquidity or dislocation in marketplaces resulting in significantly depressed market prices, or a deterioration in credit quality, thus leading to further impairment losses.

Allowance for loan losses, impaired loans, TDRs and OREO

The allowance for loan losses represents management's estimate of probable loan losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. Bank regulators, as an integral part of their examination process, also review the allowance for loan losses. Such regulators may require, based on their judgments about information available to them at the time of their examination, that certain loan balances be charged off or require that adjustments be made to the allowance for loan losses when their credit evaluations differ from those of management. Additionally, the allowance for loan losses is determined, in part, by the composition and size of the loan portfolio, which represents the largest asset type on the consolidated statement of financial condition.

The allowance for loan losses consists of four elements: (1) specific reserves for individually impaired credits, (2) reserves for classified, or higher risk rated, loans based on historical factors, (3) reserves for non-classified loans based on historical loss factors, and (4) reserves based on general economic conditions and other qualitative risk factors both internal and external to the Corporation, including changes in loan portfolio volume, the composition and concentrations of credit, new market initiatives, and the impact of competition on loan structuring and pricing.

Management performs a formal quarterly evaluation of the adequacy of the allowance for loan losses. The analysis of the allowance for loan losses has a component for impaired loan losses and a component for general loan losses. Management has defined an impaired loan to be a loan for which it is probable, based on current information, that the Corporation will not collect all amounts due in accordance with the contractual terms of the agreement. The Corporation defined the population of impaired loans subject to be all nonaccrual loans with an outstanding balance of $100,000 or greater, and all loans subject to a troubled debt restructuring. Impaired loans are individually assessed to determine that the loan's carrying value is not in excess of the estimated fair value of the collateral (less cost to sell), if the loan is collateral dependent, or the present value of the expected future cash flows, if the loan is not collateral dependent. Management performs a detailed evaluation of each impaired loan and generally obtains updated appraisals as part of the evaluation. In addition, management adjusts estimated fair value down to appropriately consider recent market conditions and costs to dispose of any supporting collateral. Determining the estimated fair value of underlying collateral (and related costs to sell) can be subjective in illiquid real estate markets and is subject to significant assumptions and estimates. Management employs independent third party experts in appraisal preparations and performs reviews to ascertain the reasonableness of updated appraisals. Projecting the expected cash flows under troubled debt restructurings is inherently subjective and requires, among other things, an evaluation of the borrower's current and projected financial condition. Actual results may be significantly different than projections and the established allowance for loan losses on these loans, and could have a material effect on the Corporation's financial results.

Real estate acquired as a result of foreclosure or by deed in lieu of foreclosure is classified as other real estate owned. When the Bank acquires other real estate owned, it generally obtains a current appraisal to substantiate the net carrying value of the asset. The asset is recorded at the lower of cost or estimated fair value, establishing a new cost basis. Holding costs and declines in estimated fair value result in charges to expense after acquisition.

New appraisals are generally obtained annually for all impaired loans and impairment write-downs are taken when appraisal values are less than the carrying value of the related loan.

Although management believes that the allowance for loan losses has been maintained at adequate levels to reserve for probable losses inherent in its loan portfolio, additions may be necessary if future economic and other conditions differ substantially from the current operating environment. Although management uses the best information available, the level of the allowance for loan losses remains an estimate that is subject to significant judgment and short-term change.

Investment security valuations and impairments

Management utilizes various inputs to determine the fair value of its investment portfolio. To the extent they exist, unadjusted quoted market prices in active markets (level 1) or quoted prices of similar assets (level 2) are utilized to determine the fair value of each investment in the portfolio. In the absence of quoted prices and illiquid markets, valuation techniques may be used to determine fair value of any investments that require inputs that are both significant to the fair value measurement and unobservable (level 3). Valuation techniques are based on various assumptions, including, but not limited to, projected cash flows, discount rates, rate of return, adjustments for nonperformance and liquidity, valuations of underlying collateral and liquidation values. A significant degree of judgment is involved in valuing investments using level 3 inputs. The use of different assumptions could have a positive or negative effect on consolidated financial condition or results of operations.

Management periodically evaluates if unrealized losses (as determined based on the securities valuation methodologies discussed above) on individual securities classified as held to maturity or available for sale in the investment portfolio are considered to be other-than-temporary. The analysis of other-than-temporary impairment requires the use of various assumptions, including, but not limited to, the length of time an investment's book value is greater than fair value, the severity of the investment's decline, any credit deterioration of the investment, whether management intends to sell the security, and whether it is more likely than not that management will be required to sell the security prior to recovery of its amortized cost basis. As a result of the adoption of new authoritative guidance under ASC Topic 320, "Investments—Debt and Equity Securities" on April 1, 2009, debt investment securities deemed to be other-than-temporarily impaired were written down by the impairment related to the estimated credit loss and the non-credit related impairment was recognized in other comprehensive income. Prior to the adoption of the new authoritative guidance, if the decline in value of an investment was deemed to be other-than-temporary, the investment was written down to fair value and a non-cash impairment charge was recognized in the period of such evaluation.

City National Bank of New Jersey is a member of the Federal Home Loan Bank System, which consists of 12 regional Federal Home Loan Banks. As a member of the Federal Home Loan Bank of New York ("FHLB-NY") City National Bank is required to acquire and hold shares of capital stock in the FHLB-NY in an amount determined by a "membership" investment component and an "activity-based" investment component. As of December 31, 2009, City National Bank was in compliance with its ownership requirement and held $2.4 million of FHLB-NY common stock. In performing the quarterly evaluation of the investment in FHLB-NY stock, management reviews the most recent financial statements of the FHLB of New York and determines whether there have been any adverse changes to its capital position as compared to the previous period. In addition, management reviews the FHLB-NY's most recent President's Report in order to determine whether or not a dividend has been declared for the current reporting period. Finally, management obtains the credit rating of FHLB from an accredited credit rating industry to ensure that no downgrades have occurred. At December 31, 2009, it was determined by management that the Bank's investment in FHLB stock was not impaired.

Income taxes

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in the consolidated financial statements or tax returns. Fluctuations in the actual outcome of these future tax consequences could impact the consolidated financial condition or results of operations.

In connection with determining the income tax provision, a reserve is maintained related to certain tax positions and strategies that management believes contain an element of uncertainty. Periodically, management evaluates each tax position and strategy to determine whether the reserve continues to be appropriate.

The Corporation uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. 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. If it is determined that it is more likely than not that the deferred tax assets will not be realized, a valuation allowance is established. Management considers the determination of this valuation allowance to be a critical accounting policy because of the need to exercise significant judgment in evaluating the amount and timing of recognition of deferred tax liabilities and assets, including projections of future taxable income. These judgments and estimates are reviewed quarterly as regulatory and business factors change. A valuation allowance for deferred tax assets may be required if the amounts of taxes recoverable through loss carry-backs decline, or if lower levels of future taxable income are projected. Such a valuation allowance would be established and any subsequent changes to such allowance would require an adjustment to income tax expense that could adversely affect the Corporation's operating results.

BOARD OF DIRECTORS

City National Bancshares Corporation and City National Bank of New Jersey

Eugene Giscombe, Chairman
Chairman & CEO
Giscombe Henderson, Inc.

Barbara Bell Coleman
President
BBC Associates, LLC

Louis E. Prezeau
President & CEO
City National Bank of New Jersey

Lemar C. Whigham
President
L&W Enterprises

H. O'Neil Williams
Managing Partner
Mitchell & Titus, LLP

CORPORATE ASSOCIATES

TRANSFER AGENT
Registrar and Transfer Company

REGISTRAR
Registrar and Transfer Company

COUNSEL
LeClairRyan

INDEPENDENT REGISTERED
PUBLIC ACCOUNTANTS
KPMG LLP

OFFICERS

City National Bancshares Corporation

Louis E. Prezeau
President & CEO

Edward R. Wright
Senior Vice President & CFO

Vladimir Gasparec
Treasurer

City National Bank of New Jersey

Louis E. Prezeau
President & CEO

Stanley M. Weeks
Executive Vice President

Edward R. Wright
Senior Vice President
Chief Financial Officer

Raul L. Oseguera
Senior Vice President
MIS/Operations/
Special Projects

Milton Farrow
Vice President
Commercial Loans

Vladimir Gasparec
Vice President
Controller

Lellith Lindo
Vice President
Consumer Loans

Kimberly Lloyd
Vice President
Commercial Loans

Patricia Nelson
Vice President
Retail Banking

Robert Stepien
Vice President
BSA/Compliance Officer

Roger Altiero
Assistant Vice President
MIS Systems Manager

William Black
Assistant Vice President
Commercial Loans

Chester Brower
Assistant Vice President
Commercial Loans

Crystal A. Roddy
Assistant Vice President
Branch Manager

Jean Claude Roy
Assistant Vice President
Investment Services

Jagrut Shah
Assistant Vice President
Deputy Controller
Investment Services

Vanessa Almeida
Assistant Cashier
Branch Manager

Linda Campbell-Aaron
Assistant Cashier
Branch Manager

Corby R. Ellis-Mare
Assistant Cashier
Marketing/Public Relations
Officer

Tasha Lohman
Assistant Cashier
Branch Manager

Leslie Moore
Assistant Cashier
Credit Admin Officer

Stuart Nisbett
Assistant Cashier
Branch Manager

Larry Wall
Assistant Cashier
Operations

Patricia A Wilson-Nenganga
Assistant Cashier
Personnel Manager

Anthony Carpinelli
Acting Senior Credit
Administration Officer

Paul Auguste
Security/Facilities
Officer

Anthony Lafranca
Collections Officer

Leonardo Tavares
Assistant BSA Officer

CITY NATIONAL BANK OF NEW JERSEY
HEADQUARTER OFFICES
900 Broad Street
Newark, NJ 07102
973-624-0865

SOUTHSIDE BRANCH
1080 Bergen Street
Newark, NJ 07112
973-923-2005

SPRINGFIELD AVENUE BRANCH
241 Springfield Avenue
Newark, NJ 07103
973-624-4545

HACKENSACK BRANCH
157 Main Street
Hackensack, NJ 07601
201-342-7744

PATERSON BRANCH
125 Broadway, Suite 102
Paterson, NJ 07505
973-279-8700

ROOSEVELT BRANCH
302 Nassau Road
Roosevelt, NY 11575
516-623-7444

EAST NEW YORK BRANCH
2815 Atlantic Avenue
Brooklyn, NY 11207
718-647-5300

HEMPSTEAD BRANCH
90 Main Street
Hempstead, NY 11550
516-564-0077

HARLEM BRANCH
382 West 125th Street
New York, NY 10027
212-865-4763

PHILADELPHIA OFFICE
1701 Market Street
Philadelphia, PA 19103
215-564-1777

www.citynatbank.com