**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**WASHINGTON, D.C. 20549**

# FORM 10-Q

(Mark one)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
**For the quarterly period ended September 30, 2011**
or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 0-18560

# The Savannah Bancorp, Inc.

(Exact name of registrant as specified in its charter)

| **Georgia** | **58-1861820** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

**25 Bull Street, Savannah, Georgia 31401**
(Address of principal executive offices) (Zip Code)

**(912) 629-6486**
(Registrant's telephone number, including area code)

**[Not Applicable]**
(Former name, former address and former fiscal year,
if changed since last report.)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer __ Accelerated filer __ Non-accelerated filer __ Smaller reporting company X

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 7,199,136 common shares, $1.00 par value, at October 31, 2011.

# THE SAVANNAH BANCORP, INC. AND SUBSIDIARIES
## Form 10-Q Index
**September 30, 2011**

**Part I – Financial Information**
**Item 1. Financial Statements**

THE SAVANNAH BANCORP, INC. AND SUBSIDIARIES
**Consolidated Balance Sheets**
($ in thousands, except share data)

| | September 30, 2011 | December 31, 2010 | September 30, 2010 |
|---|---|---|---|
| **Assets** | **(Unaudited)** | | (Unaudited) |
| Cash and due from banks | **$ 14,468** | $ 17,990 | $ 18,063 |
| Federal funds sold | **345** | 110 | 315 |
| Interest-bearing deposits in banks | **52,210** | 40,836 | 50,794 |
| Cash and cash equivalents | **67,023** | 58,936 | 69,172 |
| Securities available for sale, at fair value (amortized cost of $87,014, $136,980 and $150,425) | **89,145** | 138,099 | 153,221 |
| Loans, net of allowance for loan losses of $22,854, $20,350 and $19,519 | **765,696** | 806,212 | 813,468 |
| Premises and equipment, net | **14,515** | 15,056 | 15,351 |
| Other real estate owned | **17,135** | 13,199 | 9,739 |
| Bank-owned life insurance | **6,459** | 6,309 | 6,253 |
| Goodwill and other intangible assets, net | **3,618** | 3,786 | 3,842 |
| Other assets | **25,129** | 25,333 | 25,028 |
| **Total assets** | **$ 988,720** | $ 1,066,930 | $ 1,096,074 |
| | | | |
| **Liabilities** | | | |
| Deposits: | | | |
| Noninterest-bearing | **$ 96,294** | $ 95,725 | $ 86,921 |
| Interest-bearing demand | **136,555** | 140,531 | 122,962 |
| Savings | **20,508** | 20,117 | 18,950 |
| Money market | **268,933** | 265,840 | 258,914 |
| Time deposits | **323,783** | 401,532 | 458,881 |
| Total deposits | **846,073** | 923,745 | 946,628 |
| Short-term borrowings | **16,029** | 15,075 | 17,177 |
| Other borrowings | **9,160** | 10,536 | 15,660 |
| Federal Home Loan Bank advances | **16,654** | 17,658 | 12,006 |
| Subordinated debt to nonconsolidated subsidiaries | **10,310** | 10,310 | 10,310 |
| Other liabilities | **4,185** | 3,803 | 5,564 |
| **Total liabilities** | **902,411** | 981,127 | 1,007,345 |
| | | | |
| **Shareholders' equity** | | | |
| Preferred stock, par value $1 per share: authorized 10,000,000 shares, none issued | - | - | - |
| Common stock, par value $1 per share: shares authorized 20,000,000; issued 7,201,346 | **7,201** | 7,201 | 7,201 |
| Additional paid-in capital | **48,651** | 48,634 | 48,630 |
| Retained earnings | **29,137** | 29,275 | 31,151 |
| Treasury stock, at cost, 2,210, 2,483 and 1,702 shares | **(1)** | (1) | (1) |
| Accumulated other comprehensive income, net | **1,321** | 694 | 1,748 |
| **Total shareholders' equity** | **86,309** | 85,803 | 88,729 |
| **Total liabilities and shareholders' equity** | **$ 988,720** | $ 1,066,930 | $ 1,096,074 |

The accompanying notes are an integral part of these consolidated financial statements.

THE SAVANNAH BANCORP, INC. AND SUBSIDIARIES
**Consolidated Statements of Operations**
($ in thousands, except per share data)
(Unaudited)

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2011** | 2010 | **2011** | 2010 |
| **Interest and dividend income** | | | | |
| Loans, including fees | **$ 10,535** | $ 11,100 | **$ 31,852** | $ 34,016 |
| Investment securities: | | | | |
| Taxable | **626** | 567 | **2,166** | 1,508 |
| Tax-exempt | **60** | 120 | **197** | 271 |
| Dividends | **14** | 11 | **48** | 32 |
| Deposits with banks | **25** | 80 | **84** | 110 |
| Federal funds sold | **1** | 9 | **3** | 20 |
| Total interest and dividend income | **11,261** | 11,887 | **34,350** | 35,957 |
| **Interest expense** | | | | |
| Deposits | **1,877** | 3,336 | **6,342** | 9,729 |
| Short-term and other borrowings | **208** | 272 | **628** | 929 |
| Federal Home Loan Bank advances | **87** | 169 | **262** | 335 |
| Subordinated debt | **75** | 81 | **225** | 230 |
| Total interest expense | **2,247** | 3,858 | **7,457** | 11,223 |
| **Net interest income** | **9,014** | 8,029 | **26,893** | 24,734 |
| Provision for loan losses | **2,865** | 5,230 | **13,525** | 14,295 |
| Net interest income after provision for loan losses | **6,149** | 2,799 | **13,368** | 10,439 |
| **Noninterest income** | | | | |
| Trust and asset management fees | **663** | 637 | **2,008** | 1,948 |
| Service charges on deposit accounts | **371** | 438 | **1,089** | 1,353 |
| Mortgage related income, net | **72** | 130 | **154** | 322 |
| Gain (loss) on sale of securities | **308** | (18) | **763** | 590 |
| Gain (loss) on hedges | **4** | (3) | **(1)** | (14) |
| Other operating income | **399** | 354 | **1,136** | 1,345 |
| Total noninterest income | **1,817** | 1,538 | **5,149** | 5,544 |
| **Noninterest expense** | | | | |
| Salaries and employee benefits | **2,886** | 2,948 | **8,638** | 9,041 |
| Occupancy and equipment | **925** | 1,102 | **2,789** | 2,904 |
| Information technology | **428** | 575 | **1,246** | 1,589 |
| FDIC deposit insurance | **325** | 442 | **1,141** | 1,240 |
| Loss on sale and write-downs of foreclosed assets | **577** | 1,046 | **1,925** | 1,905 |
| Other operating expense | **1,277** | 1,197 | **3,901** | 3,597 |
| Total noninterest expense | **6,418** | 7,310 | **19,640** | 20,276 |
| Income (loss) before income taxes | **1,548** | (2,973) | **(1,123)** | (4,293) |
| Income tax expense (benefit) | **320** | (1,410) | **(985)** | (2,180) |
| **Net income (loss)** | **$ 1,228** | $ (1,563) | **$ (138)** | $ (2,113) |
| **Net income (loss) per share:** | | | | |
| Basic | **$ 0.17** | $ (0.22) | **$ (0.02)** | $ (0.33) |
| Diluted | **$ 0.17** | $ (0.22) | **$ (0.02)** | $ (0.33) |
| **Dividends per share** | **$ 0.00** | $ 0.00 | **$ 0.00** | $ 0.02 |

The accompanying notes are an integral part of these consolidated financial statements.

**THE SAVANNAH BANCORP, INC. AND SUBSIDIARIES**
**Consolidated Statements of Changes in Shareholders' Equity**
($ in thousands, except share data)
(Unaudited)

| | For the Nine Months Ended September 30, 2011 | 2010 |
|---|---|---|
| **Common shares issued** | | |
| Shares, beginning of period | **7,201,346** | 5,933,789 |
| Common stock issued | **-** | 1,267,557 |
| Shares, end of period | **7,201,346** | 7,201,346 |
| **Treasury shares owned** | | |
| Shares, beginning of period | **2,483** | 1,443 |
| Treasury stock issued | **(273)** | (943) |
| Unredeemed common stock | **-** | 36 |
| Unvested restricted stock | **-** | 1,166 |
| Shares, end of period | **2,210** | 1,702 |
| **Common stock** | | |
| Balance, beginning of period | **$ 7,201** | $ 5,934 |
| Common stock issued | **-** | 1,267 |
| Balance, end of period | **7,201** | 7,201 |
| **Additional paid-in capital** | | |
| Balance, beginning of period | **48,634** | 38,605 |
| Common stock issued, net of issuance costs | **2** | 9,980 |
| Stock-based compensation, net | **15** | 45 |
| Balance, end of period | **48,651** | 48,630 |
| **Retained earnings** | | |
| Balance, beginning of period | **29,275** | 33,383 |
| Net loss | **(138)** | (2,113) |
| Dividends | **-** | (119) |
| Balance, end of period | **29,137** | 31,151 |
| **Treasury stock** | | |
| Balance, beginning of period | **(1)** | (4) |
| Treasury stock issued | **-** | 3 |
| Balance, end of period | **(1)** | (1) |
| **Accumulated other comprehensive income (loss), net** | | |
| Balance, beginning of period | **694** | 1,108 |
| Change in unrealized gains/losses on securities available for sale, net of reclassification adjustment | **627** | 913 |
| Change in fair value and gains on termination of derivative instruments, net of tax | **-** | (273) |
| Balance, end of period | **1,321** | 1,748 |
| **Total shareholders' equity** | **$ 86,309** | $ 88,729 |
| | | |
| **Other comprehensive income (loss)** | | |
| Net loss | **$ (138)** | $ (2,113) |
| Change in unrealized gains/losses on securities available for sale, net of reclassification adjustment | **627** | 913 |
| Change in fair value and gains on termination of derivative instruments, net of tax | **-** | (273) |
| Other comprehensive income (loss) | **$ 489** | $ (1,473) |

The accompanying notes are an integral part of these consolidated financial statements.

**THE SAVANNAH BANCORP, INC. AND SUBSIDIARIES**
**Consolidated Statements of Cash Flows**
($ in thousands)
(Unaudited)

| | For the Nine Months Ended September 30, | |
|---|---|---|
| | **2011** | 2010 |
| **Operating activities** | | |
| Net loss | **$ (138)** | $ (2,113) |
| Adjustments to reconcile net loss to cash provided by operating activities: | | |
| Provision for loan losses | **13,525** | 14,295 |
| Net amortization of securities | **743** | 1,415 |
| Depreciation and amortization | **1,022** | 1,054 |
| Accretion of gain on termination of derivatives | **-** | (416) |
| Non cash stock-based compensation expense | **15** | 58 |
| Increase in deferred income taxes, net | **(1,710)** | (1,180) |
| Gain on sale of securities, net | **(763)** | (590) |
| Loss on sale and write-downs of foreclosed assets | **1,925** | 1,905 |
| Increase in CSV of bank-owned life insurance policies | **(150)** | (127) |
| Decrease in prepaid FDIC deposit insurance assessment | **1,040** | 1,067 |
| Decrease (increase) in income taxes receivable | **335** | (2,555) |
| Change in other assets and other liabilities, net | **536** | (1,360) |
| Net cash provided by operating activities | **16,380** | 11,453 |
| **Investing activities** | | |
| Activity in available for sale securities | | |
| Purchases | **(2,767)** | (98,387) |
| Sales | **38,200** | 44,888 |
| Maturities, calls and paydowns | **14,553** | 14,677 |
| Loan originations and principal collections, net | **16,743** | 28,788 |
| Proceeds from sale of foreclosed assets | **4,387** | 6,474 |
| Additions to premises and equipment | **(313)** | (716) |
| Net cash received from FDIC-assisted transaction | **-** | 190,253 |
| Proceeds from life insurance | **-** | 308 |
| Net cash provided by investing activities | **70,803** | 186,285 |
| **Financing activities** | | |
| Net increase (decrease) in noninterest-bearing deposits | **569** | (3,967) |
| Net decrease in interest-bearing deposits | **(78,241)** | (134,829) |
| Net increase (decrease) in short-term borrowings | **954** | (6,376) |
| Net decrease in FHLB advances | **(1,004)** | (31,004) |
| Net decrease in other borrowings | **(1,376)** | (3,982) |
| Payment on note payable | **-** | (74) |
| Dividends paid | **-** | (119) |
| Issuance of common stock, net of issuance costs | **2** | 11,247 |
| Issuance of treasury stock | **-** | 3 |
| Net cash used in financing activities | **(79,096)** | (169,101) |
| **Increase in cash and cash equivalents** | **8,087** | 28,637 |
| Cash and cash equivalents, beginning of period | **58,936** | 40,535 |
| Cash and cash equivalents, end of period | **$ 67,023** | $ 69,172 |

The accompanying notes are an integral part of these consolidated financial statements.

**Note 1 - Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements of The Savannah Bancorp, Inc. (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Securities and Exchange Commission ("SEC") Form 10-Q and Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine month periods ended September 30, 2011, are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2010. Certain prior period balances and formats have been reclassified to conform to the current period presentation.

In preparing the consolidated financial statements in accordance with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the respective balance sheets and the reported amounts of revenues and expenses for the periods presented. Actual results could differ significantly from those estimates.

*Recent Accounting Pronouncements*

Disclosures about troubled debt restructurings originally required by Accounting Standards Update ("ASU") 2010-20 were deferred by the Financial Accounting Standards Board ("FASB") in ASU 2011-01 *Receivables (Topic 310): Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20* ("ASU 2011-01") issued in January 2011. In April 2011, the FASB issued ASU No. 2011-02. ASU 2011-02 amends Topic 310 of the FASB Accounting Standards Codification ("ASC") to clarify when creditors should classify loan modifications as troubled debt restructurings. As amended, the guidance states that a troubled debt restructuring occurs when a creditor, for economic or legal reasons related to a debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. For public entities, the amendments promulgated by ASU 2011-02 are effective for the first interim or annual period beginning on or after June 15, 2011 and should be applied retrospectively to the beginning of the annual period of adoption. For purposes of measuring impairment of those receivables, an entity should apply the amendments prospectively for the first interim or annual period beginning on or after June 15, 2011. The Company adopted the provisions of ASU 2011-02 on July 1, 2011 and has presented the related disclosures in Note 6, Loans.

In May 2011, the FASB issued ASU 2011-04 *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* ("ASU 2011-04") to amend the Fair Value Measurement topic of the ASC by clarifying the application of existing fair value measurement and disclosure requirements and by changing particular principles or requirements for measuring fair value or for disclosing information about fair value measurements. The amendments will be effective for the Company beginning January 1, 2012. The Company is evaluating the impact that the adoption of ASU 2011-04 will have on its financial position, results of operations and cash flows.

In June 2011, the FASB issued ASU No. 2011-05 *Presentation of Comprehensive Income* ("ASU 2011-05"). This standard eliminates the current option to report other comprehensive income and its components in the statement of changes in shareholders' equity and is intended to enhance comparability between entities that report under GAAP and those that report under International Financial Reporting Standards and to provide a more consistent method of presenting non-owner transactions that impact an entity's equity. ASU 2011-05 requirements are effective for the Company as of January 1, 2012 and interim and annual periods thereafter. Early adoption is permitted, but full retrospective application is required under both sets of accounting standards. The Company has not yet adopted the standard, but the adoption of ASU 2011-05 is not expected to have an impact on the Company's financial position, results of operations, or cash flows.

**Note 2 - Acquisitions**

On June 25, 2010, The Savannah Bank, N.A. ("Savannah") entered into an agreement with the FDIC to purchase substantially all deposits and certain liabilities and assets of First National Bank, Savannah ("First National"). First National operated four branches in Savannah, Georgia and the surrounding area. Savannah acquired approximately $42 million in assets and assumed $216 million in liabilities, including $201 million in customer deposits. The assets primarily include cash and due from accounts and investment securities. Savannah acquired the local, non-brokered deposits of approximately $105 million at a premium of 0.11 percent, or approximately $116,000. In connection with closing, Savannah received a cash payment from the FDIC totaling $174 million, based on the differential between liabilities assumed and assets acquired, taking into account the deposit premium.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of the acquisition.

| ($ in thousands) | June 25, 2010 |
|---|---|
| **Assets acquired** | |
| Cash and due from banks | $ 7,330 |
| Interest-bearing deposits in banks | 8,851 |
| Securities available for sale | 25,937 |
| Loans | 131 |
| Premises and equipment | 11 |
| Deposit premium intangible | 387 |
| Other assets | 128 |
| **Total assets acquired** | 42,775 |
| **Liabilities assumed** | |
| Deposits | 200,843 |
| Federal Home Loan Bank advances | 15,271 |
| Due to the FDIC | 266 |
| Accrued interest and other liabilities | 432 |
| **Total liabilities assumed** | 216,812 |
| **Net liabilities assumed** | $ (174,037) |

The only loans assumed by Savannah were deposit-secured loans which are not subject to FDIC loss-share. In its assumption of the deposit liabilities, the Company believes that the customer relationships associated with the local deposits have intangible value. In addition, the Company determined that the recorded amount of the deposits approximates fair value primarily due to the fact that the Company can re-price all customer deposits to current market rates.

**Note 3 - Restrictions on Cash and Demand Balances Due from Banks and Interest-Bearing Bank Balances**

Savannah and Bryan Bank & Trust (collectively referred to as the "Subsidiary Banks") are required by the Federal Reserve Bank to maintain minimum cash reserves based on reserve requirements calculated on their deposit balances. Cash reserves of $458,000, $581,000 and $506,000 are required as of September 30, 2011, December 31, 2010 and September 30, 2010, respectively. At times, the Company pledges interest-bearing cash balances at the Federal Home Loan Bank of Atlanta ("FHLB") in addition to investment securities to secure public fund deposits and securities sold under repurchase agreements. The Company did not have any cash pledged at the FHLB at September 30, 2011 and December 31, 2010. Pledged cash balances were $1,500,000 at September 30, 2010.

**Note 4 - Earnings (Loss) Per Share**

Basic earnings (loss) per share represents net income (loss) divided by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential dilutive common shares that may be issued by the Company relate solely to outstanding stock options, and are determined using the treasury stock method. For the three months and nine months ended September 30, 2011 and 2010 the Company did not have any dilutive shares.

**Note 4 - Earnings (Loss) Per Share (continued)**

Earnings (loss) per common share have been computed based on the following:

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Amounts in thousands) | 2011 | 2010 | 2011 | 2010 |
| Average number of common shares outstanding - basic | 7,199 | 7,200 | 7,199 | 6,432 |
| Effect of dilutive options | - | - | - | - |
| Average number of common shares outstanding - diluted | 7,199 | 7,200 | 7,199 | 6,432 |

Stock option shares in the amount of 138,306 and 201,844 at September 30, 2011 and 2010, respectively, were excluded from the diluted earnings per share calculation due to their anti-dilutive effect.

**Note 5 - Securities Available for Sale**

The aggregate amortized cost and fair value of securities available for sale are as follows:

| | September 30, 2011 | | | |
|---|---|---|---|---|
| ($ in thousands) | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Investment securities: | | | | |
| U.S. government-sponsored enterprises (“GSE”) | $ 1,533 | $ 19 | $ - | $ 1,552 |
| Mortgage-backed securities - GSE | 72,225 | 1,797 | (29) | 73,993 |
| State and municipal securities | 9,484 | 344 | - | 9,828 |
| Restricted equity securities | 3,772 | - | - | 3,772 |
| Total investment securities | $ 87,014 | $ 2,160 | $ (29) | $ 89,145 |

| | December 31, 2010 | | | |
|---|---|---|---|---|
| ($ in thousands) | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Investment securities: | | | | |
| U.S. government-sponsored enterprises | $ 1,821 | $ 4 | $ - | $ 1,825 |
| Mortgage-backed securities - GSE | 120,998 | 1,628 | (435) | 122,191 |
| State and municipal securities | 10,285 | 76 | (154) | 10,207 |
| Restricted equity securities | 3,876 | - | - | 3,876 |
| Total investment securities | $ 136,980 | $ 1,708 | $ (589) | $ 138,099 |

The distribution of securities by contractual maturity at September 30, 2011 is shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties.

| ($ in thousands) | Amortized Cost | Fair Value |
|---|---|---|
| Securities available for sale: | | |
| Due in one year or less | $ 506 | $ 521 |
| Due after one year through five years | 1,533 | 1,552 |
| Due after five years through ten years | 4,126 | 4,391 |
| Due after ten years | 4,852 | 4,916 |
| Mortgage-backed securities - GSE | 72,225 | 73,993 |
| Restricted equity securities | 3,772 | 3,772 |
| Total investment securities | $ 87,014 | $ 89,145 |

The restricted equity securities consist solely of FHLB and Federal Reserve Bank of Atlanta stock. These securities are carried at cost since they do not have readily determinable fair values due to their restricted nature.

**Note 5 - Securities Available for Sale (continued)**

The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2011 and December 31, 2010. Available for sale securities that have been in a continuous unrealized loss position are as follows:

| | September 30, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than 12 Months | | 12 Months or More | | Total | |
| ($ in thousands) | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Mortgage-backed securities - GSE | $ 7,446 | $ (29) | $ - | $ - | $ 7,446 | $ (29) |
| Total temporarily impaired securities | $ 7,446 | $ (29) | $ - | $ - | $ 7,446 | $ (29) |

| | December 31, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | Less Than 12 Months | | 12 Months or More | | Total | |
| ($ in thousands) | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Mortgage-backed securities - GSE | $ 37,606 | $ (435) | $ - | $ - | $ 37,606 | $ (435) |
| State and municipal securities | 3,853 | (154) | - | - | 3,853 | (154) |
| Total temporarily impaired securities | $ 41,459 | $ (589) | $ - | $ - | $ 41,459 | $ (589) |

The unrealized losses on the Company's investment in GSE mortgage-backed securities were caused by interest rate increases. The Company purchased those investments at a premium relative to their face amount, and the contractual cash flows of those investments are guaranteed by an agency of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost bases of the Company's investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at September 30, 2011.

**Note 6 - Loans**

The composition of the loan portfolio at September 30, 2011 and December 31, 2010 is presented below:

| ($ in thousands) | September 30, 2011 | Percent of Total | December 31, 2010 | Percent of Total |
|---|---|---|---|---|
| Commercial real estate | | | | |
| Construction and development | $ 23,364 | 3.0% | $ 20,819 | 2.5% |
| Owner-occupied | 115,794 | 14.7 | 120,797 | 14.6 |
| Non owner-occupied | 222,903 | 28.2 | 231,641 | 28.0 |
| Residential real estate – mortgage | 339,228 | 43.0 | 363,390 | 44.0 |
| Commercial | 74,715 | 9.5 | 74,889 | 9.1 |
| Installment and other consumer | 12,546 | 1.6 | 15,026 | 1.8 |
| Gross loans | 788,550 | 100.0% | 826,562 | 100.0% |
| Allowance for loan losses | (22,854) | | (20,350) | |
| Net loans | $ 765,696 | | $ 806,212 | |

For purposes of the disclosures required pursuant to accounting standards, the loan portfolio was disaggregated into segments and then further disaggregated into classes for certain disclosures. A portfolio segment is defined as the level at which an entity develops and documents a systematic method for determining its allowance for loan losses. There are four loan portfolio segments that include commercial real estate, residential real estate-mortgage, commercial and installment and other consumer. Commercial real estate has three classes including construction and development, owner-occupied and non owner-occupied. The construction and development class includes residential and commercial construction and development loans. Land and lot development loans are included in the non owner-occupied commercial real estate class or residential real estate segment depending on the property type.

**Note 6 - Loans (continued)**

The following table details the change in the allowance for loan losses from December 31, 2010 to September 30, 2011 by loan segment:

| ($ in thousands) | Commercial Real Estate | Residential Real Estate | Commercial | Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|
| **Allowance for loan losses** | | | | | | |
| Beginning balance | $ 4,722 | $ 13,582 | $ 1,528 | $ 518 | $ - | $ 20,350 |
| Charge-offs | (2,127) | (8,579) | (670) | (71) | - | (11,447) |
| Recoveries | 20 | 363 | 22 | 21 | - | 426 |
| Provision | 3,960 | 9,127 | 432 | (76) | 82 | 13,525 |
| Ending balance | $ 6,575 | $ 14,493 | $ 1,312 | $ 392 | $ 82 | $ 22,854 |

The following table details the allowance for loan losses on the basis of the Company's impairment methodology at September 30, 2011 and December 31, 2010 by loan segment:

| | September 30, 2011 | | | | | |
|---|---|---|---|---|---|---|
| ($ in thousands) | Commercial Real Estate | Residential Real Estate | Commercial | Consumer | Unallocated | Total |
| **Allowance for loan losses** | | | | | | |
| Ending balance | $ 6,575 | $ 14,493 | $ 1,312 | $ 392 | $ 82 | $ 22,854 |
| Ending balance: impaired loans individually evaluated for impairment | $ 1,393 | $ 5,869 | $ 241 | $ 233 | $ - | $ 7,736 |
| Ending balance: impaired loans collectively evaluated for impairment | $ 247 | $ 1,005 | $ 9 | $ 14 | $ - | $ 1,275 |
| **Loans** | | | | | | |
| Ending balance | $ 362,061 | $ 339,228 | $ 74,715 | $ 12,546 | $ - | $ 788,550 |
| Ending balance: impaired loans individually evaluated for impairment | $ 13,808 | $ 30,667 | $ 792 | $ 398 | $ - | $ 45,665 |
| Ending balance: impaired loans collectively evaluated for impairment | $ 1,889 | $ 11,195 | $ 83 | $ 110 | $ - | $ 13,277 |

| | December 31, 2010 | | | | | |
|---|---|---|---|---|---|---|
| ($ in thousands) | Commercial Real Estate | Residential Real Estate | Commercial | Consumer | Unallocated | Total |
| **Allowance for loan losses** | | | | | | |
| Ending balance | $ 4,722 | $ 13,582 | $ 1,528 | $ 518 | $ - | $ 20,350 |
| Ending balance: impaired loans individually evaluated for impairment | $ 285 | $ 4,055 | $ 540 | $ 257 | $ - | $ 5,137 |
| Ending balance: impaired loans collectively evaluated for impairment | $ 538 | $ 2,261 | $ 79 | $ 92 | $ - | $ 2,970 |
| **Loans** | | | | | | |
| Ending balance | $ 373,257 | $ 363,390 | $ 74,889 | $ 15,026 | $ - | $ 826,562 |
| Ending balance: impaired loans individually evaluated for impairment | $ 3,865 | $ 25,669 | $ 596 | $ 257 | $ - | $ 30,387 |
| Ending balance: impaired loans collectively evaluated for impairment | $ 4,454 | $ 17,871 | $ 600 | $ 557 | $ - | $ 23,482 |

**Note 6 - Loans (continued)**

A loan is considered impaired, in accordance with the impairment accounting guidance, when based on current information and events, it is probable that the Company will be unable to collect all amounts due from the borrower in accordance with the contractual term of the loan. Impaired loans include loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection.

The following is a summary of information pertaining to impaired loans as of and for the periods ended September 30, 2011:

| | September 30, 2011 | | |
|---|---|---|---|
| ($ in thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| Impaired loans without a valuation allowance | | | |
| Commercial real estate | | | |
| Construction and development | $ 334 | $ 342 | $ - |
| Owner-occupied | 2,036 | 2,212 | - |
| Non owner-occupied | 5,672 | 6,348 | - |
| Residential real estate - mortgage | 13,006 | 18,332 | - |
| Commercial | 294 | 350 | - |
| Installment and other consumer | 17 | 18 | - |
| Total impaired loans without a valuation allowance | 21,359 | 27,602 | - |
| Impaired loans with a valuation allowance | | | |
| Commercial real estate | | | |
| Construction and development | 2,325 | 3,325 | 301 |
| Owner-occupied | 808 | 1,120 | 353 |
| Non owner-occupied | 4,521 | 4,543 | 986 |
| Residential real estate - mortgage | 28,857 | 30,406 | 6,874 |
| Commercial | 581 | 636 | 250 |
| Installment and other consumer | 491 | 493 | 247 |
| Total impaired loans with a valuation allowance | 37,583 | 40,523 | 9,011 |
| Total impaired loans | $ 58,942 | $ 68,125 | $ 9,011 |
| Average investment in impaired loans for the quarter | $ 60,717 | | |
| Income recognized on impaired loans for the quarter | $ 191 | | |
| Income recognized on impaired loans for the nine months | $ 648 | | |

**Note 6 - Loans (continued)**

The following is a summary of information pertaining to impaired loans as of and for the year ended December 31, 2010:

| | December 31, 2010 | | |
|---|---|---|---|
| ($ in thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| Impaired loans without a valuation allowance | | | |
| Commercial real estate | | | |
| Construction and development | $ 152 | $ 177 | $ - |
| Owner-occupied | 1,075 | 1,374 | - |
| Non owner-occupied | 301 | 3,979 | - |
| Residential real estate - mortgage | 12,906 | 18,476 | - |
| Commercial | - | - | - |
| Installment and other consumer | - | - | - |
| Total impaired loans without a valuation allowance | 14,434 | 24,006 | - |
| Impaired loans with a valuation allowance | | | |
| Commercial real estate | | | |
| Construction and development | 2,218 | 3,218 | 265 |
| Owner-occupied | 1,647 | 1,667 | 186 |
| Non owner-occupied | 2,926 | 3,353 | 372 |
| Residential real estate - mortgage | 30,634 | 33,471 | 6,316 |
| Commercial | 1,196 | 1,425 | 619 |
| Installment and other consumer | 814 | 818 | 349 |
| Total impaired loans with a valuation allowance | 39,435 | 43,952 | 8,107 |
| Total impaired loans | $ 53,869 | $ 67,958 | $ 8,107 |
| Average investment in impaired loans for the year | $ 53,962 | | |
| Income recognized on impaired loans for the year | $ 821 | | |

The following table presents the aging of the recorded investment in past due loans as of September 30, 2011 by class of loans:

| | September 30, 2011 | | | | |
|---|---|---|---|---|---|
| ($ in thousands) | 30-59 days past due | 60-89 days past due | Accruing greater than 90 days past due | Nonaccrual | Total past due and nonaccrual |
| Commercial real estate | | | | | |
| Construction and development | $ - | $ - | $ - | $ 2,660 | $ 2,660 |
| Owner-occupied | 270 | 1,232 | - | 2,683 | 4,185 |
| Non owner-occupied | 848 | 398 | 4 | 8,846 | 10,096 |
| Residential real estate - mortgage | 6,177 | 3,762 | 836 | 26,230 | 37,005 |
| Commercial | 285 | - | 11 | 839 | 1,135 |
| Installment and other consumer | 108 | 17 | - | 431 | 556 |
| Total | $ 7,688 | $ 5,409 | $ 851 | $ 41,689 | $ 55,637 |

**Note 6 - Loans (continued)**

The following table presents the aging of the recorded investment in past due loans as of December 31, 2010 by class of loans:

| | December 31, 2010 | | | | |
|---|---|---|---|---|---|
| ($ in thousands) | 30-59 days past due | 60-89 days past due | Accruing greater than 90 days past due | Nonaccrual | Total past due and nonaccrual |
| Commercial real estate | | | | | |
| Construction and development | $ - | $ - | $ - | $ 2,370 | $ 2,370 |
| Owner-occupied | 1,471 | - | 251 | 1,194 | 2,916 |
| Non owner-occupied | 309 | 12 | 803 | 1,595 | 2,719 |
| Residential real estate - mortgage | 4,114 | 4,894 | 1,855 | 26,446 | 37,309 |
| Commercial | 120 | 85 | 151 | 760 | 1,116 |
| Installment and other consumer | 147 | 12 | 4 | 471 | 634 |
| Total | $ 6,161 | $ 5,003 | $ 3,064 | $ 32,836 | $ 47,064 |

Internal risk-rating grades are assigned to each loan by lending or credit administration, based on an analysis of the financial and collateral strength and other credit attributes underlying each loan. Management analyzes the resulting ratings, as well as other external statistics and factors, such as delinquency, to track the migration performance of the portfolio balances. Loan grades range between 1 and 8, with 1 being loans with the least credit risk. Loans that migrate toward the “Pass” grade (those with a risk rating between 1 and 4) or within the “Pass” grade generally have a lower risk of loss and therefore a lower risk factor. The “Special Mention” grade (those with a risk rating of 5) is utilized on a temporary basis for “Pass” grade loans where a significant risk-modifying action is anticipated in the near term. Substantially all of the “Special Mention” loans are performing. Loans that migrate toward the “Substandard” or higher grade (those with a risk rating between 6 and 8) generally have a higher risk of loss and therefore a higher risk factor applied to those related loan balances.

The following tables present the Company’s loan portfolio by risk-rating grades at September 30, 2011 and December 31, 2010:

| | September 30, 2011 | | | | | |
|---|---|---|---|---|---|---|
| ($ in thousands) | Pass (1-4) | Special Mention (5) | Sub-standard (6) | Doubtful (7) | Loss (8) | Total |
| Commercial real estate | | | | | | |
| Construction and development | $ 20,250 | $ - | $ 3,114 | $ - | $ - | $ 23,364 |
| Owner-occupied | 105,647 | 2,166 | 7,981 | - | - | 115,794 |
| Non owner-occupied | 199,164 | 3,705 | 20,034 | - | - | 222,903 |
| Residential real estate - mortgage | 269,336 | 18,481 | 51,411 | - | - | 339,228 |
| Commercial | 71,135 | 85 | 3,495 | - | - | 74,715 |
| Installment and other consumer | 11,775 | 41 | 730 | - | - | 12,546 |
| Total | $ 677,307 | $ 24,478 | $ 86,765 | $ - | $ - | $ 788,550 |

| | December 31, 2010 | | | | | |
|---|---|---|---|---|---|---|
| ($ in thousands) | Pass (1-4) | Special Mention (5) | Sub-standard (6) | Doubtful (7) | Loss (8) | Total |
| Commercial real estate | | | | | | |
| Construction and development | $ 17,792 | $ 577 | $ 2,450 | $ - | $ - | $ 20,819 |
| Owner-occupied | 114,603 | 1,851 | 4,343 | - | - | 120,797 |
| Non owner-occupied | 216,744 | 9,017 | 5,880 | - | - | 231,641 |
| Residential real estate - mortgage | 290,894 | 19,936 | 51,317 | 1,243 | - | 363,390 |
| Commercial | 71,361 | 666 | 2,562 | 300 | - | 74,889 |
| Installment and other consumer | 14,011 | 78 | 762 | 175 | - | 15,026 |
| Total | $ 725,405 | $ 32,125 | $ 67,314 | $ 1,718 | $ - | $ 826,562 |

**Note 6 - Loans (continued)**

As a result of adopting the amendments in ASU No. 2011-02 on July 1, 2011, the Company reassessed all restructurings that occurred on or after January 1, 2011 for identification as troubled debt restructurings. The Company identified no additional loans for which the allowance for loan losses had previously been measured under a general allowance for loan losses methodology. The accounting standards require prospective application of the impairment measurement guidance for those loans newly identified as impaired. At September 30, 2011, there was no recorded loan investment for which the allowance for loan losses was previously measured under a general allowance for loan losses methodology that was previously not considered impaired.

The total amount of troubled debt restructurings that are performing to their agreed terms at September 30, 2011 and December 31, 2010 were $15.1 million and $26.1 million, respectively. There was $2.0 million and $4.2 million, respectively, in specific reserves established for these loans at September 30, 2011 and December 31, 2010. The total amount of troubled debt restructurings that have subsequently defaulted at September 30, 2011 and December 31, 2010 were $12.4 million and $6.6 million, respectively. There was $1.7 million and $719,000, respectively, in specific reserves established for these loans at September 30, 2011 and December 31, 2010. The Company has committed to lend additional amounts totaling up to $79,000 as of September 30, 2011 to customers with outstanding loans that are classified as troubled debt restructurings.

During the nine month period ended September 30, 2011, the terms of certain loans were modified as troubled debt restructurings; however, no loans were modified as troubled debt restructurings during the three months ended September 30, 2011. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan. The following table presents additional information on troubled debt restructurings including the number of loan contracts restructured and the pre and post modification recorded investment for the nine months ended September 30, 2011. There were no specific reserves established for loans that were restructured for the three and nine months ended September 30, 2011.

| | Nine Months Ended September 30, 2011 | | |
|---|---|---|---|
| ($ in thousands) | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| **Troubled debt restructurings** | | | |
| Commercial real estate | | | |
| Construction and development | 0 | $ - | $ - |
| Owner-occupied | 1 | 162 | 162 |
| Non owner-occupied | 1 | 2,321 | 2,321 |
| Residential real estate – mortgage | 12 | 4,746 | 4,746 |
| Commercial | 1 | 12 | 12 |
| Installment and other consumer | 0 | - | - |
| Total | 15 | $7,241 | $ 7,241 |

The Company had two residential real estate loans totaling $572,000 that were restructured over the past twelve months and defaulted on their restructured terms within the three and nine months ended September 30, 2011

**Note 7 - Fair Value of Financial Instruments**

**Determination of Fair Value**

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the accounting standards for fair value measurements and disclosure, the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are

**Note 7 - Fair Value of Financial Instruments (continued)**

based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

In accordance with this guidance, the Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that are supported by little or no market activity for the asset or liability. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

Recurring Fair Value Changes

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying balance sheet, as well as the general classification of such instruments pursuant to the valuation hierarchy.

*Investment securities:* The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities.

*Derivative instruments*: The derivative instruments consist of loan level swaps. As such, significant fair value inputs can generally be verified and do not typically involve significant judgments by management.

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

| | | Fair Value Measurements at September 30, 2011 Using | | |
|---|---|---|---|---|
| ($ in thousands) | Carrying Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Investment securities | $ 89,145 | $ - | $ 85,373 | $ 3,772 |
| Derivative asset positions | 293 | - | 293 | - |
| Derivative liability positions | 293 | - | 293 | - |

| | Carrying | Fair Value Measurements at December 31, 2010 Using | | |
|---|---|---|---|---|
| ($ in thousands) | Value | Level 1 | Level 2 | Level 3 |
| Investment securities | $ 138,099 | $ - | $ 134,223 | $ 3,876 |
| Derivative asset positions | 136 | - | 136 | - |
| Derivative liability positions | 135 | - | 135 | - |

**Note 7 - Fair Value of Financial Instruments (continued)**

Nonrecurring Fair Value Changes

Certain assets and liabilities are measured at fair value on a nonrecurring basis. These instruments are not measured at fair value on an ongoing basis, but subject to fair value in certain circumstances, such as when there is evidence of impairment that may require write-downs. The write-downs for the Company's more significant assets or liabilities measured on a nonrecurring basis are based on the lower of amortized cost or estimated fair value.

*Impaired loans and other real estate owned ("OREO")*: Impaired loans and OREO are evaluated and valued at the time the loan or OREO is identified as impaired. Impaired loans are valued at the lower of cost or market value and OREO is recorded at market value. Market value is measured based on the value of the collateral securing these loans and is classified at a Level 3 in the fair value hierarchy. Collateral for impaired loans may be real estate and/or business assets, including equipment, inventory and/or accounts receivable. Its fair value is generally determined based on real estate appraisals or other independent evaluations by qualified professionals. Impaired loans and OREO are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors identified above. Impaired loans measured on a nonrecurring basis do not include pools of impaired loans.

Assets and liabilities with an impairment charge during the current period and measured at fair value on a nonrecurring basis are summarized below:

| | | Carrying Values at September 30, 2011 | | | |
|---|---|---|---|---|---|
| ($ in thousands) | Total | Level 1 | Level 2 | Level 3 | Total loss |
| Impaired loans | $ 9,379 | $ - | $ - | $ 9,379 | $ (4,451) |
| OREO | 3,331 | - | - | 3,331 | (1,047) |
| | | Carrying Values at December 31, 2010 | | | |
| ($ in thousands) | Total | Level 1 | Level 2 | Level 3 | Total loss |
| Impaired loans | $ 7,236 | $ - | $ - | $ 7,236 | $ (5,073) |
| OREO | 5,423 | - | - | 5,423 | (1,424) |

**Fair Value Disclosures**

Accounting standards require the disclosure of the estimated fair value of financial instruments including those financial instruments for which the Company did not elect the fair value option. The fair value represents management's best estimates based on a range of methodologies and assumptions.

Cash and federal funds sold, interest-bearing deposits in banks, accrued interest receivable, all non-maturity deposits, short-term borrowings, other borrowings, subordinated debt and accrued interest payable have carrying amounts which approximate fair value primarily because of the short repricing opportunities of these instruments.

Following is a description of the methods and assumptions used by the Company to estimate the fair value of its other financial instruments:

*Investment securities:* Fair value is based upon quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. Restricted equity securities are carried at cost because no market value is available.

*Loans:* The fair value is estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type, such as commercial, mortgage, and consumer loans. The fair value of the loan portfolio is calculated by discounting contractual cash flows using estimated market discount rates which reflect the credit and interest rate risk inherent in the loan. The estimated fair value of the Subsidiary Banks' off-balance sheet commitments is nominal since the committed rates approximate current rates offered for commitments with similar rate and maturity characteristics and since the estimated credit risk associated with such commitments is not significant.

**Note 7 - Fair Value of Financial Instruments (continued)**

*Derivative instruments:* The fair value of derivative instruments, consisting of interest rate contracts, is equal to the estimated amount that the Company would receive or pay to terminate the derivative instruments at the reporting date, taking into account current interest rates and the credit-worthiness of the counterparties.

*Deposit liabilities:* The fair value of time deposits is estimated using the discounted value of contractual cash flows based on current rates offered for deposits of similar remaining maturities.

*FHLB advances*: The fair value is estimated using the discounted value of contractual cash flows based on current rates offered for advances of similar remaining maturities and/or termination values provided by the FHLB.

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

| | September 30, 2011 | | December 31, 2010 | |
|---|---|---|---|---|
| ($ in thousands) | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| Financial assets: | | | | |
| Cash and federal funds sold | $ 14,813 | $ 14,813 | $ 18,100 | $ 18,100 |
| Interest-bearing deposits | 52,210 | 52,210 | 40,836 | 40,836 |
| Securities available for sale | 89,145 | 89,145 | 138,099 | 138,099 |
| Loans, net of allowance for loan losses | 765,696 | 760,279 | 806,212 | 800,785 |
| Accrued interest receivable | 2,968 | 2,968 | 3,789 | 3,789 |
| Derivative asset positions | 293 | 293 | 136 | 136 |
| Financial liabilities: | | | | |
| Deposits | 846,073 | 850,824 | 923,745 | 929,271 |
| Short-term borrowings | 16,029 | 16,029 | 15,075 | 15,075 |
| Other borrowings | 9,160 | 9,160 | 10,536 | 10,536 |
| FHLB advances | 16,654 | 17,405 | 17,658 | 18,214 |
| Subordinated debt to nonconsolidated subsidiaries | 10,310 | 10,310 | 10,310 | 10,310 |
| Accrued interest payable | 736 | 736 | 1,108 | 1,108 |
| Derivative liability positions | 293 | 293 | 135 | 135 |

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

**Forward-Looking Statements**

The Company may, from time to time, make written or oral "forward-looking statements," including statements contained in the Company's filings with the SEC (including this quarterly report on Form 10-Q) and in its reports to shareholders and in other communications by the Company, which are made in good faith by the Company pursuant to the "safe harbor" provisions of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act").

This MD&A and other Company communications and statements may contain "forward-looking statements." These forward-looking statements may include, among others, statements about our beliefs, plans, objectives, goals, expectations, estimates and intentions that are subject to significant risks and uncertainties and which may change based on various factors, many of which are beyond our control. The words "may," "could," "should," "would," "will," "believe," "anticipate," "estimate," "expect," "intend," "indicate," "plan" and similar words are intended to identify expressions of the future. These forward-looking statements involve risks and uncertainties, such as statements of the Company's plans, objectives, expectations, estimates and intentions that are subject to change based on various important factors (some of which are beyond the Company's control). The following factors, among others, could cause the Company's financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements: the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System; inflation, interest rates, market and monetary fluctuations; competitors' products and services; technological changes; cyber security risks; acquisitions; changes in consumer spending and saving habits; deterioration in credit quality; continuing declines in the values of residential and commercial real estate or continuing weakness in the residential and commercial real estate environment generally; risk that our allowance for loan losses may prove to be inadequate or may be negatively affected by credit risk exposures; the concentration in our nonperforming assets by loan type, in certain geographic regions and with affiliated borrowing groups; future availability and cost of capital on favorable terms, if at all; changes in the cost and availability of funding from historical and alternative sources of liquidity; the potential for additional regulatory restrictions on our operations; changes to our reputation; future departures of key personnel; changes to the availability of a deferred tax asset; the success of the Company at managing the risks involved in the foregoing; and other factors and other information contained in this Report and in other reports and filings that we make with the SEC under the Exchange Act, including, without limitation, the items described in Item 1A of the Company's Annual Report on Form 10-K for December 31, 2010.

The Company cautions that the foregoing list of important risk factors is not exhaustive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company.

**Overview**

For a comprehensive presentation of the Company's financial condition at September 30, 2011 and December 31, 2010 and results of operations for the three and nine month periods ended September 30, 2011 and 2010, the following analysis should be reviewed with other information including the Company's December 31, 2010 Annual Report on Form 10-K and the Company's Condensed Consolidated Financial Statements and the Notes thereto included in this report.

**THE SAVANNAH BANCORP, INC. AND SUBSIDIARIES**
**Third Quarter Financial Highlights**
($ in thousands, except share data)
(Unaudited)

| **Balance Sheet Data at September 30** | **2011** | 2010 | % Change |
|---|---|---|---|
| Total assets | **$ 988,720** | $ 1,096,074 | *(10)* |
| Interest-earning assets | **886,430** | 993,685 | *(11)* |
| Loans | **788,550** | 832,987 | *(5.3)* |
| Other real estate owned | **17,135** | 9,739 | *76* |
| Deposits | **846,073** | 946,628 | *(11)* |
| Interest-bearing liabilities | **801,932** | 914,860 | *(12)* |
| Shareholders' equity | **86,309** | 88,729 | *(2.7)* |
| Loan to deposit ratio | **93.20 %** | 88.00 % | *5.9* |
| Equity to assets | **8.73 %** | 8.10 % | *7.8* |
| Tier 1 capital to risk-weighted assets | **11.35 %** | 11.77 % | *(3.6)* |
| Total capital to risk-weighted assets | **12.62 %** | 13.04 % | *(3.2)* |
| Outstanding shares | **7,199** | 7,200 | *0.0* |
| Book value per share | **$ 11.99** | $ 12.32 | *(2.7)* |
| Tangible book value per share | **$ 11.49** | $ 11.79 | *(2.6)* |
| Market value per share | **$ 6.00** | $ 9.30 | *(35)* |
| | | | |
| **Loan Quality Data** | | | |
| Nonaccruing loans | **$ 41,689** | $ 40,837 | *2.1* |
| Loans past due 90 days – accruing | **851** | 204 | *317* |
| Net charge-offs | **11,021** | 12,454 | *(12)* |
| Allowance for loan losses | **22,854** | 19,519 | *17* |
| Allowance for loan losses to total loans | **2.90 %** | 2.34 % | *24* |
| Nonperforming assets to total assets | **6.04 %** | 4.63 % | *30* |
| | | | |
| **Performance Data for the Third Quarter** | | | |
| **Net income (loss)** | **$ 1,228** | $ (1,563) | *179* |
| Return on average assets | **0.49 %** | (0.54) % | *191* |
| Return on average equity | **5.64 %** | (6.91) % | *182* |
| Net interest margin | **4.01 %** | 3.02 % | *33* |
| Efficiency ratio | **59.26 %** | 76.41 % | *(22)* |
| **Per share data:** | | | |
| Net income (loss) – basic | **$ 0.17** | $ (0.22) | *177* |
| Net income (loss) – diluted | **$ 0.17** | $ (0.22) | *177* |
| Dividends | **$ 0.00** | $ 0.00 | *0.0* |
| **Average shares (000s):** | | | |
| Basic | **7,199** | 7,200 | *0.0* |
| Diluted | **7,199** | 7,200 | *0.0* |
| | | | |
| **Performance Data for the First Nine Months** | | | |
| **Net loss** | **$ (138)** | $ (2,113) | *93* |
| Return on average assets | **(0.02) %** | (0.26) % | *92* |
| Return on average equity | **(0.21) %** | (3.40) % | *94* |
| Net interest margin | **3.88 %** | 3.38 % | *15* |
| Efficiency ratio | **61.29 %** | 66.97 % | *(8.5)* |
| **Per share data:** | | | |
| Net loss – basic | **$ (0.02)** | $ (0.33) | *94* |
| Net loss – diluted | **$ (0.02)** | $ (0.33) | *94* |
| Dividends | **$ 0.00** | $ 0.02 | *NM* |
| **Average shares (000s):** | | | |
| Basic | **7,199** | 6,432 | *12* |
| Diluted | **7,199** | 6,432 | *12* |

**Introduction**

Management's Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) provides supplemental information, which sets forth the major factors that have affected the Company's financial condition and results of operations and should be read in conjunction with the Consolidated Financial Statements and related notes. The MD&A is divided into subsections entitled:

Introduction
Recent Regulatory Developments
Critical Accounting Estimates
Results of Operations
Financial Condition and Capital Resources
Liquidity and Interest Rate Sensitivity Management
Off-Balance Sheet Arrangements

These discussions should facilitate a better understanding of the major factors and trends that affect the Company's earnings performance and financial condition and how the Company's performance during the three and nine month periods ended September 30, 2011 compared with the same periods in 2010. Throughout this section, The Savannah Bancorp, Inc., and its subsidiaries, collectively, are referred to as "SAVB" or the "Company." The Savannah Bank, N.A. is referred to as "Savannah" and Bryan Bank & Trust is referred to as “Bryan.” Collectively, Savannah and Bryan are referred to as the “Subsidiary Banks.” Minis & Co., Inc., a registered investment advisor and wholly-owned subsidiary, is referred to as “Minis.” SAVB Holdings, LLC was formed in the third quarter 2008 for the purpose of holding problem loans and other real estate and is referred to as “SAVB Holdings”.

The averages used in this report are based on the sum of the daily balances for each respective period divided by the number of days in the reporting period.

The Company is headquartered in Savannah, Georgia and, as of September 30, 2011, had eleven banking offices and thirteen ATMs in Savannah, Garden City, Skidaway Island, Whitemarsh Island, Tybee Island, Pooler, and Richmond Hill, Georgia and Hilton Head Island and Bluffton, South Carolina. The Company also has mortgage lending offices in Savannah, Richmond Hill and Hilton Head Island and an investment management office in Savannah.

Savannah and Bryan are in the relatively diverse and growing Savannah Metropolitan Statistical Area (“Savannah MSA”). The diversity of major employers in the Savannah MSA includes manufacturing, port related transportation, construction, military, healthcare, tourism, education, warehousing and the supporting services and products for each of these major employers. The real estate market is experiencing moderate government growth and very minimal commercial and residential growth. Although Coastal Georgia and South Carolina continue to be desired retiree residential destinations as well as travel destinations, the Savannah MSA and Coastal South Carolina markets have both experienced significant devaluation in real estate prices.

The primary strategic objectives of the Company are enhancing credit quality and capital ratios as well as growth in loans, deposits, assets under management, product lines and service quality in existing markets, and quality expansion into new markets, within acceptable risk parameters, which result in enhanced shareholder value.

**Recent Regulatory Developments**

On October 5, 2011, Savannah entered into a Formal Agreement with its primary regulator, the Office of the Comptroller of the Currency (“OCC”). The Formal Agreement is based on the findings of the OCC during their on-site examination of the Bank during March 2011, based on Savannah’s financial condition as of December 31, 2010. The Formal Agreement seeks to enhance the Bank's existing practices and procedures in the areas of credit risk management, credit quality, strategic planning, capital planning and liquidity risk management. Specifically, under the terms of the Formal Agreement, the Bank is required to (i) protect its interest in assets criticized by regulators and auditors and adopt, implement and adhere to a written program that is effective in eliminating the basis of such criticized assets; (ii) develop, implement, and adhere to a written program to reduce the high level of credit risk; (iii) develop, implement and adhere to a written strategic plan for the Bank, which shall cover at least three years and should include establishing objectives for the Bank’s overall risk profile, earnings performance, growth expectation, balance sheet mix, off-balance sheet activities, liability structure, capital adequacy, reduction in the volume of nonperforming assets, product line development and market segment; (iv) develop, implement and adhere to a three year capital program; (v) obtain prior written determination of no supervisory objection from the OCC before accepting, renewing, or rolling over brokered deposits, except for a Brokered Money Market Account limit of $35,000,000; and (vi) submit periodic reports to the OCC regarding various aspects of the foregoing actions.

The Formal Agreement requires the establishment of certain plans and programs within various specific time periods. If Savannah does not satisfy and adhere to each of the requirements listed above, it will not be in compliance with the Formal Agreement. Failure to comply with the Formal Agreement could result in additional enforcement actions. Savannah's board of directors has created a Compliance Committee to ensure that all of the requirements noted in the Formal Agreement are being addressed in a timely and effective manner.

In addition to the requirements in the Formal Agreement, Savannah has agreed with the OCC to maintain a total risk-based capital ratio of at least 12.00 percent and a leverage ratio of at least 8.00 percent. As of September 30, 2011, Savannah's capital ratios exceed these requirements.

**Critical Accounting Estimates**

Allowance for Loan Losses

The Company and Subsidiary Banks consider their policies regarding the allowance for loan losses to be their most critical accounting estimate due to the significant degree of management judgment involved. The allowance for loan losses is established through charges to earnings in the form of a provision for loan losses based on management's continuous evaluation of the loan portfolio. Loan losses and recoveries are charged or credited directly to the allowance. The amount of the allowance reflects management's opinion of the adequate level needed to absorb probable losses inherent in the loan portfolio at September 30, 2011. The amount charged to the provision and the level of the allowance is based on management's judgment and is dependent upon growth in the loan portfolio, the total amount of past due loans and nonperforming loans, recent charge-off levels, known loan deteriorations and concentrations of credit. Other factors affecting the allowance include market interest rates, loan sizes, portfolio maturity and composition, collateral values and general economic conditions. Finally, management's assessment of probable losses, based upon internal credit grading of the loans and periodic reviews and assessments of credit risk associated with particular loans, is considered in establishing the amount of the allowance.

The Company and Subsidiary Banks have a comprehensive program designed to control and continually monitor the credit risks inherent in the loan portfolios. This program includes a structured loan approval process in which the Board of Directors ("Board") of the Company and Subsidiary Banks delegate authority for various types and amounts of loans to loan officers on a basis commensurate with seniority and lending experience. There are four risk grades of "criticized" assets: Special Mention, Substandard, Doubtful and Loss. Assets designated as substandard, doubtful or loss are considered "classified". The classification of assets is subject to regulatory review and reclassification. The Company and Subsidiary Banks include aggregate totals of criticized assets, and general and specific valuation reserves in quarterly reports to their respective Boards, which review and approve the overall allowance for loan losses evaluation.

The Subsidiary Banks use a risk rating system which is consistent with the regulatory risk rating system. This system applies to all assets of an insured institution and requires each institution to periodically evaluate the risk rating assigned to its assets. The Subsidiary Banks' loan risk rating systems utilize the account officer, credit administration and an independent loan review function to monitor the risk rating of loans. Each loan officer is charged with the responsibility of monitoring changes in loan quality within his or her loan portfolio and reporting changes directly to credit administration and senior management. The internal credit administration function monitors loans on a continuing basis for both documentation and credit related exceptions. Additionally, the Subsidiary Banks have contracted with an external loan review service that performs a review of the Subsidiary Banks' loans on a periodic basis to determine that the appropriate risk grade has been assigned to each borrowing relationship and to evaluate other credit quality, documentation and compliance factors. Delinquencies are monitored on all loans as a basis for potential credit quality deterioration. Commercial and mortgage loans that are delinquent 90 days (four payments) or longer generally are placed on nonaccrual status unless the credit is well-secured and in the process of collection. Revolving credit loans and other personal loans are typically charged-off when payments have become 120 days past due. Loans are placed on nonaccrual status or charged-off at an earlier date if the collection of principal or interest in full becomes doubtful.

No assurance can be given that the Company will not sustain loan losses that would be sizable compared to the amount reserved or that subsequent evaluation of the loan portfolio, in light of conditions and factors then prevailing, will not require significant changes in the allowance for loan losses by future charges or credits to earnings. The allowance for loan losses is also subject to review by various regulatory agencies through their periodic examinations of the Subsidiary Banks. Such examinations could result in required changes to the allowance for loan losses.

The allowance for loan losses totaled $22,854,000, or 2.90 percent of total loans, at September 30, 2011. This is compared to an allowance of $20,350,000, or 2.46 percent of total loans, at December 31, 2010. For the nine months ended September 30, 2011, the Company reported net charge-offs of $11,021,000 compared to net charge-offs of $12,454,000 for the same period in 2010. During the first nine months of 2011 and 2010, a provision for loan losses of $13,525,000 and $14,295,000, respectively, was added to the allowance for loan losses. The Company continues to see weakness in its local real estate markets with downward pressure on real estate values and this weakness in the real estate market has led to a continued high level of real estate related charge-offs and provision for loan losses during 2011. However, the Company has started to experience slightly lower valuation allowances related to updated appraisals on real estate in 2011 as compared to 2010.

The Company's nonperforming assets consist of loans on nonaccrual status, loans which are contractually past due 90 days or more on which interest is still being accrued, and other real estate owned. Nonaccrual loans of $41,689,000 and loans past due 90 days or more of $851,000 totaled $42,540,000, or 5.39 percent of gross loans, at September 30, 2011. Nonaccrual loans of $32,836,000 and loans past due 90 days or more of $3,064,000 totaled $35,900,000, or 4.34 percent of gross loans, at December 31, 2010. Generally, loans are placed on nonaccrual status when the collection of the principal or interest in full becomes doubtful. Management typically writes down a loan through a charge to the allowance when it determines the loan is impaired. Nonperforming assets also included $17,135,000 and $13,199,000 of other real estate owned at September 30, 2011 and December 31, 2010, respectively. Management is aggressively pricing and marketing the other real estate owned. The Company may engage in loan sales or take other measures to reduce its nonperforming assets.

Impaired loans, which include loans modified in troubled debt restructurings, totaled $58,942,000 and $53,869,000 at September 30, 2011 and December 31, 2010, respectively.

At September 30, 2011, impaired loans consisted primarily of $21.4 million of improved residential real estate-secured loans and $23.4 million of land, lot and construction and development related loans. Less than one percent of the impaired loans are unsecured. The largest impaired relationship consists of four loans totaling $6.3 million to a residential developer in the Bluffton/Hilton Head Island, South Carolina market. The loans are secured by residential land and lots and are on nonaccrual and moving towards foreclosure. Approximately $1,449,000 has already been charged-off on this loan relationship and an additional $855,000 of the allowance was allocated as a specific reserve. The second largest impaired loan relationship consists of two loans totaling $4.4 million secured by a commercial building in Savannah, Georgia. Both of these loans are currently on nonaccrual status and have not had any charge-offs or specific reserves applied to them based upon a recent appraisal. The third largest impaired loan relationship consists of four loans totaling $2.9 million to a developer in Chatham County, Georgia. These loans are currently on accrual status and are secured by raw residential land and one residential lot. The borrower currently has the residential lot under contract to sell. The Company currently has $885,000 allocated to the loans secured by residential raw land as specific reserves. The fourth largest impaired loan relationship consists of four loans totaling $2.8 million to a residential developer in the Effingham County, Georgia market. These loans are currently on nonaccrual status and are secured by residential land, lots and completed 1-4 family properties. The Company charged-off $1,500,000 on this relationship in 2010 and still has approximately $300,000 of the allowance allocated as a specific reserve and $47,000 allocated as a general reserve. The fifth largest impaired loan relationship consists of two loans totaling $2.7 million which are secured by a 1-4 family rental property and a residential improved lot located on Hilton Head Island, South Carolina. The Company currently has both of the loans on nonaccrual status and has charged-off $642,000 on this loan relationship. This loan relationship is currently in the process of foreclosure. The sixth largest impaired loan relationship consists of five loans totaling $2.4 million secured by a commercial building, a personal residence, a rental home and an improved residential lot on Tybee Island, Georgia. This loan relationship is a troubled debt restructuring that is performing as agreed. No specific reserves have been applied to the relationship, but the Company does have $271,000 allocated as a general reserve.

The Company continues to devote significant internal and external resources to managing the past due and classified loans. The Company has performed extensive internal and external loan review procedures and analyses on the loan portfolio. The Company charges-down loans as appropriate before the foreclosure process is complete and often before they are past due.

If the allowance for loan losses had changed by five percent, the effect on net income would have been approximately $710,000. If the allowance had to be increased by this amount, it would not have changed the holding company or the Subsidiary Banks' status as well-capitalized financial institutions.

Impairment of Loans

The Company measures impaired loans based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is considered impaired when it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. A loan is not considered impaired during a period of delay in payment if the ultimate collection of all amounts due is expected. The Company maintains a valuation allowance or charges-down the loan balance to the extent that the measure of value of an impaired loan is less than the recorded investment.

Other Real Estate Owned

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less costs to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, management periodically performs valuations of the foreclosed assets based on updated appraisals, general market conditions, length of time the properties have been held, and our ability and intention with regard to continued ownership of the properties. The Company may incur additional write-downs of foreclosed assets to fair value less costs to sell if valuations indicate a further other than temporary deterioration in market conditions.

The following table provides historical information regarding the allowance for loan losses and nonperforming loans and assets for the most recent five quarters ended September 30, 2011.

| | **2011** | | | 2010 | |
|---|---|---|---|---|---|
| ($ in thousands) | **Third Quarter** | Second Quarter | First Quarter | Fourth Quarter | Third Quarter |
| **Allowance for loan losses** | | | | | |
| Balance at beginning of period | **$ 23,523** | $ 22,363 | $ 20,350 | $ 19,519 | $ 18,775 |
| Provision for loan losses | **2,865** | 6,300 | 4,360 | 6,725 | 5,230 |
| Net charge-offs | **(3,534)** | (5,140) | (2,347) | (5,894) | (4,486) |
| Balance at end of period | **$ 22,854** | $ 23,523 | $ 22,363 | $ 20,350 | $ 19,519 |
| As a % of loans | **2.90%** | 2.91% | 2.73% | 2.46% | 2.34% |
| As a % of nonperforming loans | **53.72%** | 59.84% | 64.38% | 56.69% | 47.56% |
| As a % of nonperforming assets | **38.30%** | 45.73% | 45.87% | 41.45% | 38.44% |
| Net charge-offs as a % of average loans (a) | **1.84%** | 2.65% | 1.21% | 2.26% | 2.03% |
| **Risk element assets** | | | | | |
| Nonaccruing loans | **$ 41,689** | $ 39,160 | $ 33,921 | $ 32,836 | $ 40,837 |
| Loans past due 90 days – accruing | **851** | 150 | 817 | 3,064 | 204 |
| Total nonperforming loans | **42,540** | 39,310 | 34,738 | 35,900 | 41,041 |
| Other real estate owned | **17,135** | 12,125 | 14,014 | 13,199 | 9,739 |
| Total nonperforming assets | **$ 59,675** | $ 51,435 | $ 48,752 | $ 49,099 | $ 50,780 |
| Loans past due 30-89 days | **$ 13,097** | $ 17,013 | $ 9,175 | $ 11,164 | $ 10,757 |
| Nonperforming loans as a % of loans | **5.39%** | 4.87% | 4.24% | 4.34% | 4.93% |
| Nonperforming assets as a % of loans and other real estate owned | **7.41%** | 6.28% | 5.85% | 5.85% | 6.03% |
| Nonperforming assets as a % of assets | **6.04%** | 5.13% | 4.69% | 4.60% | 4.63% |

(a) Annualized

**Results of Operations**

**Third Quarter, 2011 Compared to the Third Quarter, 2010**

The Company reported net income for the third quarter 2011 of $1,228,000, compared to a net loss of $1,563,000 in the third quarter 2010. Net income per diluted share was 17 cents in the third quarter 2011 compared to a net loss of 22 cents per diluted share in the third quarter 2010. The quarter over quarter increase in earnings resulted primarily from decreases in the provision for loan losses and in losses on the sale and write-down of foreclosed assets and an increase in net interest income. Return on average equity was 5.64 percent, return on average assets was 0.49 percent and the efficiency ratio was 59.26 percent in the third quarter 2011. Pretax earnings before the provision for loan losses and gain/loss on sale of securities and foreclosed assets were $4,682,000 in the third quarter of 2011 versus $3,321,000 in the third quarter of 2010. The schedule below reconciles the income (loss) before income taxes to the pre-tax core earnings.

| | For the Three Months Ended September 30, | |
|---|---|---|
| ($ in thousands) | 2011 | 2010 |
| Income (loss) before income taxes | $ 1,548 | $ (2,973) |
| Add: Provision for loan losses | 2,865 | 5,230 |
| Add: Loss on foreclosed assets | 577 | 1,046 |
| Less: (Gain) loss on sale of securities | (308) | 18 |
| Pre-tax core earnings | $ 4,682 | $ 3,321 |

Third quarter average interest-earning assets decreased 16 percent to $893 million in 2011 from $1.1 billion in 2010. Third quarter net interest income was $9,014,000 in 2011 compared to $8,029,000 in 2010, a 12 percent increase. Third quarter average accruing loans were $762 million in 2011 compared to $802 million in 2010, a 4.9 percent decrease. Average deposits were $845 million in 2011 versus $997 million in 2010, a decrease of 15 percent. Shareholders' equity was $86.3 million at September 30, 2011 compared to $88.7 million at September 30, 2010. The Company's total capital to risk-weighted assets ratio was 12.62 percent at September 30, 2011, which exceeds the 10 percent required by the regulatory agencies to maintain well-capitalized status.

Third quarter net interest margin increased 99 basis points, or 33 percent, to 4.01 percent in 2011 from 3.02 percent in 2010. As shown in Table 2, the increase was due to both a lower cost on interest-bearing deposits and an increase in the yield on interest-earning assets. In addition, the Company had a significantly lower amount of interest-earning cash and cash equivalents during the third quarter 2011. The cost of interest-bearing deposits decreased to 0.99 percent in the third quarter 2011 from 1.46 percent for the same period in 2010, primarily due to the re-pricing of time deposits and money market accounts in the current low interest rate environment along with a shift in the deposit makeup from higher cost time deposits to lower cost money market, savings and NOW accounts. In 2011, the Company has focused on restructuring its deposit portfolio from higher cost time deposits to lower cost checking and savings accounts in order to increase the net interest margin and net interest income. Average money market, savings and NOW accounts grew approximately $27.6 million from the quarter ended September 30, 2010 to the quarter ended September 30, 2011 while average time deposits declined approximately $185 million from the quarter ended September 30, 2010 to the quarter ended September 30, 2011. The yield on earning assets increased from 4.46 percent in the third quarter of 2010 to 5.01 percent for the third quarter of 2011, which was primarily a result of the Company holding, on average, $125 million less in lower yielding interest-bearing deposits, federal funds sold and investment securities during the third quarter of 2011 compared to the same period in 2010. The Company received $190 million in cash when it acquired the deposits and certain assets of First National Bank, Savannah (“First National”) in an FDIC-assisted transaction in June 2010, and much of this liquidity was invested in interest-bearing deposits and investments. Since this transaction, the Company has allowed much of its brokered and higher priced time deposits to run-off in order to reduce this excess liquidity and improve the net interest margin. As noted above, average time deposits have declined $185 million, or 36 percent, from the three month period ending September 30, 2010 compared to the same period in 2011.

On a linked quarter basis, the net interest margin has increased 10 basis points compared to the second quarter of 2011. The Company held, on average, $20 million less in lower-yielding interest-bearing deposits, federal funds sold and investment securities during the third quarter of 2011 compared to the second quarter of 2011. The resulting yield on earning assets increased from 4.97 percent in the second quarter of 2011 to 5.01 percent during the third quarter of 2011. The Company continues to aggressively manage the pricing on deposits and the use of wholesale funds to augment the net interest margin.

As shown in Table 1, the Company's balance sheet continues to be asset-sensitive since the interest-earning assets re-price faster than interest-bearing liabilities. Rising interest rates favorably impact the net interest margin of an asset-sensitive balance sheet and falling rates adversely impact the net interest margin. However, when the prime rate stops decreasing, the interest rates on time deposits, certain non-maturity deposits and other funding sources will continue to decline due to the re-pricing lag associated with those liabilities. In addition, the Company has instituted interest rate floors on many variable rate loans such that the loans will not re-price in a rising rate environment until the floating rate exceeds the floor.

Third quarter provision for loan loss was $2,865,000 for 2011, compared to $5,230,000 in 2010. Third quarter net charge-offs were $3,534,000 for 2011 compared to $4,486,000 in 2010. Loans decreased $19.0 million, or 2.4 percent, in the third quarter 2011 compared to a decline of $15.9 million, or 1.9 percent, in the third quarter 2010. The Company continues to see weakness in its local real estate markets with downward pressure on real estate values.

Noninterest income increased $279,000, or 18 percent, in the third quarter of 2011 versus the same period in 2010. This increase was primarily related to a $326,000 increase in the gain on sale of securities during the third quarter of 2011 compared to the same period in 2010. The Company sold approximately $15 million in securities in the third quarter of 2011 in order to provide liquidity for the run-off of higher priced brokered, internet and time deposits that the Company elected not to renew during the quarter. Due to the current low interest rate environment, the Company realized a gain on the sale of these securities. This increase was partially offset by a $67,000, or 15 percent, decrease in service charges on deposit accounts during 2011 compared to 2010, primarily due to recent regulatory guidance related to overdraft charges.

Noninterest expense decreased $892,000, or 12 percent, to $6,418,000 in the third quarter of 2011 compared to the same period in 2010. The decrease in noninterest expense was mainly attributable to a $469,000, or 45 percent, decrease in the loss on sales and write-downs of foreclosed assets, a $62,000, or 2.1 percent, decline in salaries and employee benefits due to reduced headcount, a $147,000, or 26 percent, decline in information technology expense, and a $117,000, or 26 percent, decline in FDIC deposit insurance premiums. The Company incurred approximately $350,000 of direct expenses related to the First National acquisition in the third quarter 2010, most of which were not recurring in 2011. In addition, the Company renegotiated and renewed its contract with its core processor resulting in part of the decline in its information technology expense. The decrease in the FDIC insurance premiums was due to changes to the FDIC assessment process which became effective in the second quarter of 2011.

The third quarter income tax expense was $320,000 in 2011 compared to an income tax benefit of $1,410,000 in 2010. The effective tax rate in the third quarter of 2011 was 20.7 percent compared to 47.4 percent in the third quarter of 2010. The decline in the effective tax rate in the third quarter 2011 was due in part to the impact of tax credits. The Company evaluates its deferred tax assets every quarter. All significant deferred tax assets are considered to be realizable due to expected future taxable income and open tax years for which taxable losses could be carried back.

**First Nine Months, 2011 Compared to the First Nine Months, 2010**

The Company reported a net loss for the first nine months of 2011 of $138,000 compared to a net loss of $2,113,000 in the first nine months of 2010. Net loss per diluted share was 2 cents in the first nine months of 2011 compared to a net loss of 33 cents per diluted share in the same period in 2010. The decrease in the net loss during the first nine months in 2011 as compared to the same period in 2010 resulted primarily from an increase in net interest income. Return on average equity was (0.21) percent, return on average assets was (0.02) percent and the efficiency ratio was 61.29 percent in the first nine months of 2011. Pretax earnings before the provision for loan losses and gain/loss on sale of securities and foreclosed assets were $13,564,000 in the first nine months of 2011 versus $11,317,000 in the first nine months of 2010.

The schedule below reconciles the loss before income taxes to the pre-tax core earnings.

| | For the Nine Months Ended September 30, | |
|---|---|---|
| ($ in thousands) | 2011 | 2010 |
| Loss before income taxes | $ (1,123) | $ (4,293) |
| Add: Provision for loan losses | 13,525 | 14,295 |
| Add: Loss on foreclosed assets | 1,925 | 1,905 |
| Less: Gain on sale of securities | (763) | (590) |
| Pre-tax core earnings | $ 13,564 | $ 11,317 |

Average interest-earning assets in the first nine months of 2011 decreased 5.3 percent to $928 million from $979 million in 2010. Net interest income during the first nine months of 2011 was $26,893,000 compared to $24,734,000 in 2010, an 8.7 percent increase. Average accruing loans during the first nine months of 2011 were $776 million compared to $819 million during the first nine months of 2010, a 5.3 percent decrease. Average deposits during the first nine months of 2011 were $879 million versus $924 million in 2010, a 4.9 percent decrease.

The net interest margin increased 50 basis points, or 15 percent, during the first nine months of 2011 to 3.88 percent from 3.38 percent during the same period in 2010. As shown in Table 3, the increase in the net interest margin was due to both a lower cost on interest-bearing deposits and a slightly higher yield on earning assets. The cost of interest-bearing deposits decreased to 1.08 percent during the first nine months of 2011 from 1.55 percent for the same period in 2010. The decrease was due to both the repricing of money market accounts and time deposits in the current low interest rate environment along with a shift in the deposit makeup from higher cost time deposits to lower cost money market, savings and NOW accounts. Average money market, savings and NOW accounts grew approximately $41.7 million from the nine months ended September 30, 2010 to the nine months ended September 30, 2011 while average time deposits declined approximately $96.0 million from the nine months ended September 30, 2010 to the nine months ended September 30, 2011. The yield on earning assets increased to 4.95 percent during the first nine months of 2011 compared to 4.91 percent for the same period in 2010. This was primarily a result of the Company holding, on average, $21.9 million, or 37 percent, less in lower yielding interest-bearing deposits and federal funds sold during 2011 compared to 2010.

The provision for loans losses was $13,525,000 for the first nine months of 2011, compared to $14,295,000 for the comparable period in 2010. Net charge-offs were $11,021,000 during the first nine months of 2011 compared to $12,454,000 for the same period in 2010. Loans decreased $38 million, or 4.6 percent, in the first nine months of 2011 compared to a decline of $51 million, or 5.8 percent, in the first nine months 2010. The Company has continued to see weakness in its local real estate markets with downward pressure on real estate values in 2011. This weakness in the real estate market has led to a continued high level of real estate related charge-offs and provision for loan losses.

Noninterest income decreased $395,000, or 7.1 percent, in the first nine months of 2011 versus the same period in 2010 due to a $264,000 decline in service charges on deposit accounts, a $209,000 decline in other operating income and a $168,000 decline in mortgage related income. These decreases were somewhat offset by a $173,000 increase in gain on sale of securities. The decline in service charges was primarily due to recent regulatory guidance related to overdraft charges. The decline in other operating income was due to the Company recording a $308,000 gain on a bank-owned life insurance policy payout in which the Company was the beneficiary during 2010. The decline in mortgage related income was mainly due to a lower volume of mortgage loan originations in 2011 compared to 2010.

Noninterest expense decreased $636,000, or 3.1 percent, to $19,640,000 in the first nine months of 2011 compared to the same period in 2010. The decrease in noninterest expense was mainly attributable to a $403,000, or 4.5 percent, decrease in salaries and employee benefits and a $343,000, or 22 percent, decrease in information technology expense. This decrease was partially offset by an increase in other operating expense of $304,000 or 8.5 percent. The decrease in salaries and employee benefits was due to the Company averaging fewer employees during 2011 when compared to 2010. The Company renegotiated and renewed its contract with its core processor resulting in the decline in its information technology expense. The increase in other operating expense was mainly due to a $260,000 increase in OREO and loan collection costs.

The income tax benefit was $985,000 in the first nine months of 2011 compared to $2,180,000 in the same period in 2010. The effective tax rate in the first nine months of 2011 was 87.7 percent compared to 50.8 percent in the first nine months of 2010. The change in the effective tax rate in 2011 was due in part to the impact of tax credits. The Company evaluates its deferred tax assets every quarter. All significant deferred tax assets are considered to be realizable due to expected future taxable income and open tax years for which taxable losses could be carried back.

**Financial Condition and Capital Resources**

**Balance Sheet Activity**

The changes in the Company's assets and liabilities for the current and prior period are shown in the consolidated statements of cash flows.  Total assets were $989 million and $1.07 billion at September 30, 2011 and December 31, 2010, respectively, a decrease of $78 million or 7.3 percent.  Loans decreased $38 million, or 4.6 percent, the first nine months of 2011.  The Company experienced normal pay downs and significant charge-offs on loans in 2011 while demand for new loans was weak.  Cash and cash equivalents and investment securities decreased $41 million, or 21 percent, during the first nine of 2011.  The Company had an influx of deposits from the First National transaction during June 2010 and these funds were primarily used to increase cash and cash equivalents and investment securities.  The Company has allowed much of its brokered and higher priced time deposits to run-off in order to reduce this excess liquidity and improve the net interest margin.  As such, deposits have declined $78 million, or 8.4 percent, from $924 million at December 31, 2010 to $846 million at September 30, 2011.

Average total assets decreased approximately $56 million, or 5.2 percent, during the first nine months of 2011 compared to the same period in 2010.  The Company held $43 million less in average accruing loans in the first nine months of 2011 compared to the same period in 2010.  The decline in loans during 2011 compared to 2010 was due to normal pay downs, charge-offs and weak demand for new loans   The Company also held on average approximately $8.5 million less in cash and cash equivalents and investment securities in 2011 compared to 2010 as it allowed much of its brokered and higher priced time deposits to run-off in order to reduce excess liquidity.

The Company has classified all investment securities as available for sale.  Lower short-term interest rates resulted in an overall net unrealized gain of $2.1 million in the investment portfolio at September 30, 2011.  The unrealized gain or loss amounts are included in shareholders' equity as accumulated other comprehensive income (loss), net of tax.  The Company's investment portfolio decreased $49 million during the first nine months of 2011 to $89 million primarily due to the Subsidiary Banks selling approximately $38 million in securities.  The securities were sold in part to provide liquidity for maturing brokered and internet time deposits that the Company elected not to renew.

Deposits were down $78 million during the first nine months of 2011 to $846 million at September 30, 2011.  The Company decided not to renew certain higher cost brokered and internet time deposits in order to reduce excess liquidity and improve the Company's net interest margin.  At September 30, 2011, the Company had $123 million in brokered and internet deposits which included $41 million in institutional money market accounts.  This was down approximately $39 million, or 24 percent, from December 31, 2010 when the Company had $161 million in brokered and internet deposits.  At September 30, 2011 and December 31, 2010, brokered time deposits include $32 million and $36 million, respectively, of reciprocal deposits from the Company's local customers that are classified as brokered because they are placed in the CDARS network for deposit insurance purposes.  In addition, at September 30, 2011 and December 31, 2010, the Company had $11 million and $51 million, respectively, of internet time deposits remaining from the First National acquisition.

**Capital Resources**

The Subsidiary Banks' primary regulators have adopted capital requirements that specify the minimum capital level for which no prompt corrective action is required.  In addition, the FDIC has adopted FDIC insurance assessment rates based on certain "well-capitalized" risk-based and equity capital ratios.  Failure to meet minimum capital requirements can result in the initiation of certain actions by the regulators that, if undertaken, could have a material effect on the Company's and the Subsidiary Banks' financial statements.  As of September 30, 2011, the Company and the Subsidiary Banks were categorized as well-capitalized under the regulatory framework for prompt corrective action in the most recent notification from the FDIC.  Bryan has agreed with its primary regulator to maintain a Tier 1 Leverage Ratio of not less than 8.00 percent. The Company is evaluating its options for Bryan to conform to this stipulation.  Savannah has agreed with its primary regulator to maintain a Tier 1 Leverage Ratio of not less than 8.00 percent and a Total Risk-based Capital Ratio of not less than 12.00 percent and is currently in conformity with the agreement.

Total tangible equity capital for the Company was $82.7 million, or 8.36 percent of total assets at September 30, 2011. The table below includes the regulatory capital ratios for the Company and each Subsidiary Bank along with the minimum capital ratio and the ratio required to maintain a well-capitalized regulatory status.

| ($ in thousands) | Company | Savannah | Bryan | Minimum | Well-Capitalized |
|---|---|---|---|---|---|
| **Qualifying Capital** | | | | | |
| Tier 1 capital | $ 85,269 | $ 64,790 | $ 18,840 | - | - |
| Total capital | 94,816 | 71,770 | 21,237 | - | - |
| **Leverage Ratios** | | | | | |
| Tier 1 capital to average assets | 8.70% | 8.89% | 7.85% | 4.00% | 5.00% |
| **Risk-based Ratios** | | | | | |
| Tier 1 capital to risk-weighted assets | 11.36% | 11.74% | 10.10% | 4.00% | 6.00% |
| Total capital to risk-weighted assets | 12.63% | 13.01% | 11.39% | 8.00% | 10.00% |

Tier 1 and total capital at the Company level includes $10 million of subordinated debt issued to the Company's nonconsolidated subsidiaries. Total capital also includes the allowance for loan losses up to 1.25 percent of risk-weighted assets.

**Liquidity and Interest Rate Sensitivity Management**

The objectives of balance sheet management include maintaining adequate liquidity and preserving reasonable balance between the repricing of interest sensitive assets and liabilities at favorable interest rate spreads. The objective of liquidity management is to ensure the availability of adequate funds to meet the loan demands and the deposit withdrawal needs of customers. This is achieved through maintaining a combination of sufficient liquid assets, core deposit growth and unused capacity to purchase and borrow funds in the money markets.

During the first nine months of 2011, portfolio loans decreased $38 million to $789 million while deposits decreased $78 million to $846 million. The loan to deposit ratio was 93 percent at September 30, 2011, which is up from 89 percent at December 31, 2010. Cash and cash equivalents and investment securities decreased $41 million, or 21 percent, during the first nine months of 2011 to $156 million. During the first nine months of 2011, the Company allowed much of its brokered and higher priced time deposits to run-off in order to reduce excess liquidity and improve the net interest margin.

In addition to local deposit growth, primary funding and liquidity sources include borrowing capacity with the Federal Home Loan Bank of Atlanta ("FHLB"), temporary federal funds purchased lines with correspondent banks and non-local institutional and brokered deposits. Contingency funding and liquidity sources include the ability to sell loans, or participations in certain loans, to investors and borrowings from the Federal Reserve Bank ("FRB") discount window.

The Subsidiary Banks have Blanket Floating Lien Agreements with the FHLB. Under these agreements, the Subsidiary Banks have pledged certain 1-4 family first mortgage loans, commercial real estate loans, home equity lines of credit and second mortgage residential loans. The Subsidiary Banks' individual borrowing limits range from 20 to 25 percent of assets. In aggregate, the Subsidiary Banks had secured borrowing capacity of approximately $111 million with the FHLB of which $17 million was advanced at September 30, 2011. These credit arrangements serve as a core funding source as well as liquidity backup for the Subsidiary Banks. The Subsidiary Banks also have conditional federal funds borrowing lines available from correspondent banks that management believes can provide approximately $30 million of funding needs for 30-60 days. Savannah has been approved to access the FRB discount window to borrow on a secured basis at 50 basis points over the Federal Funds Target Rate. Bryan is eligible for the Secondary Credit program at 100 basis points over the Federal Funds Target Rate. The amount of credit available is subject to the amounts and types of collateral available when borrowings are requested. The Subsidiary Banks were approved by the FRB under the borrower-in-custody of collateral arrangement. This temporary liquidity arrangement allows collateral to be maintained at the Subsidiary Banks rather than being delivered to the FRB or a third-party custodian. At September 30, 2011, the Company had secured borrowing capacity of $108 million with the FRB and no amount outstanding.

A continuing objective of interest rate sensitivity management is to maintain appropriate levels of variable rate assets, including variable rate loans and shorter maturity investments, relative to interest rate sensitive liabilities, in order to control potential negative impacts upon earnings due to changes in interest rates. Interest rate sensitivity management requires analyses and actions that take into consideration volumes of assets and liabilities repricing and the timing and magnitude of their price changes to determine the effect upon net interest income. The Company utilizes various balance sheet and hedging strategies to reduce interest rate risk as noted below.

The Company's cash flow, maturity and repricing gap at September 30, 2011 was $121 million at one year, or 13.6 percent of total interest-earning assets. At December 31, 2010 the gap at one year was $95 million, or 9.8 percent of total interest-earning assets. Interest-earning assets with maturities over five years totaled approximately $37 million, or 4.2 percent of total interest-earning assets at September 30, 2011. See Table 1 for cash flow, maturity and repricing gap. The gap position between one and five years is of less concern because management has time to respond to changing financial conditions and interest rates with actions that reduce the impact of the longer-term gap positions on net interest income. However, interest-earning assets with maturities and/or repricing dates over five years may include significant rate risk and market value of equity concerns in the event of significant interest rate increases.

The Company continues to be asset-sensitive within the 90 day and one year time frame which usually means that if rates increase then net interest income and the net interest margin increase and if rates decrease then net interest income and the net interest margin decrease. However, over the past twelve months, interest rates have basically remained flat if not declined slightly, and net interest income and the net interest margin increased in the first nine months of 2011 compared to the same period in 2010. The Company's cost of interest-bearing deposits has declined significantly while the yield on interest-earning assets has remained flat during the first nine months of 2011 compared to the same period in 2010.

The Company has implemented various strategies to reduce its asset-sensitive position, primarily through the increased use of fixed rate loans, interest rate floors on variable rate loans and short maturity funding sources. In the past the Company has also implemented hedging strategies such as interest rate floors, collars and swaps. These actions have reduced the Company's exposure to falling interest rates. The amounts in other comprehensive income related to the terminated derivative transactions were reclassified into earnings over the remaining lives of the original hedged transactions, all of which expired in 2010.

Management monitors interest rate risk quarterly using rate-sensitivity forecasting models and other balance sheet analytical reports. If and when projected interest rate risk exposures are outside of policy tolerances or desired positions, specific strategies to return interest rate risk exposures to desired levels are developed by management, approved by the Asset-Liability Committee and reported to the Board.

**Table 1 – Cash Flow/Maturity Gap and Repricing Data**

The following is the cash flow/maturity and repricing data for the Company as of September 30, 2011:

| ($ in thousands) | Immediate | 0-3 months | 3-12 Months | 1-3 Years | 3-5 Years | Over 5 Years | Total |
|---|---|---|---|---|---|---|---|
| **Interest-earning assets** | | | | | | | |
| Investment securities | $ - | $ 10,521 | $ 17,165 | $ 29,225 | $ 15,647 | $ 16,587 | $ 89,145 |
| Federal funds sold | 345 | - | - | - | - | - | 345 |
| Interest-bearing deposits | 50,869 | 85 | 339 | 917 | - | - | 52,210 |
| Loans - fixed rates | - | 124,896 | 145,780 | 172,866 | 32,627 | 19,991 | 496,160 |
| Loans - variable rates | - | 239,015 | 8,373 | 2,355 | 288 | 670 | 250,701 |
| Total interest-earnings assets | 51,214 | 374,517 | 171,657 | 205,363 | 48,562 | 37,248 | 888,561 |
| **Interest-bearing liabilities** | | | | | | | |
| NOW and savings | - | 7,853 | 15,706 | 39,266 | 47,119 | 47,119 | 157,063 |
| Money market accounts | - | 74,803 | 79,936 | 45,678 | 68,516 | - | 268,933 |
| Time deposits | - | 80,687 | 178,796 | 39,845 | 24,161 | 294 | 323,783 |
| Short-term borrowings | 16,029 | - | - | - | - | - | 16,029 |
| Other borrowings | | 2,290 | 6,870 | | | | 9,160 |
| FHLB advances | - | - | 3,503 | 3,011 | 11 | 10,129 | 16,654 |
| Subordinated debt | - | 10,310 | - | - | - | - | 10,310 |
| Total interest-bearing liabilities | 16,029 | 175,943 | 284,811 | 127,800 | 139,807 | 57,542 | 801,932 |
| **Gap-Excess assets (liabilities)** | 35,185 | 198,574 | (113,154) | 77,563 | (91,245) | (20,294) | 86,629 |
| **Gap-Cumulative** | $ 35,185 | $ 233,759 | $ 120,605 | $ 198,168 | $ 106,923 | $ 86,629 | $ 86,629 |
| **Cumulative sensitivity ratio *** | 3.20 | 2,22 | 1.25 | 1.33 | 1.14 | 1.11 | 1.11 |

* Cumulative interest-earning assets / cumulative interest-bearing liabilities

**Table 2 – Average Balance Sheet and Rate/Volume Analysis – Third Quarter, 2011 and 2010**

The following table presents average balances of the Company and the Subsidiary Banks on a consolidated basis, the taxable-equivalent interest earned and the interest paid during the third quarter of 2011 and 2010.

| Average Balance | | Average Rate | | | Taxable-Equivalent Interest (b) | | | (a) Variance Attributable to | |
|---|---|---|---|---|---|---|---|---|---|
| QTD 09/30/11 | QTD 09/30/10 | QTD 09/30/11 | QTD 09/30/10 | | QTD 09/30/11 | QTD 09/30/10 | Vari-ance | Rate | Volume |
| ($ in thousands) | | (%) | | | ($ in thousands) | | | ($ in thousands) | |
| | | | | **Assets** | | | | | |
| $ 33,869 | $ 112,297 | 0.29 | 0.27 | Interest-bearing deposits | $ 25 | $ 76 | $ (51) | $ 6 | $ (57) |
| 91,151 | 124,212 | 2.79 | 2.00 | Investments - taxable | 640 | 627 | 13 | 247 | (234) |
| 5,631 | 7,198 | 4.51 | 4.46 | Investments - non-taxable | 64 | 81 | (17) | 1 | (18) |
| 351 | 12,002 | 1.13 | 0.30 | Federal funds sold | 1 | 9 | (8) | 25 | (33) |
| 762,186 | 801,856 | 5.49 | 5.49 | Loans (c) | 10,539 | 11,102 | (563) | - | (563) |
| 893,188 | 1,057,565 | 5.01 | 4.46 | Total interest-earning assets | 11,269 | 11,895 | (626) | 279 | (905) |
| 97,115 | 100,890 | | | Noninterest-earning assets | | | | | |
| $ 990,303 | $1,158,455 | | | Total assets | | | | | |
| | | | | **Liabilities and equity** | | | | | |
| | | | | Deposits | | | | | |
| $ 135,292 | $ 117,817 | 0.27 | 0.33 | NOW accounts | 93 | 97 | (4) | (18) | 14 |
| 20,883 | 18,803 | 0.09 | 0.40 | Savings accounts | 5 | 19 | (14) | (15) | 1 |
| 228,755 | 214,413 | 1.12 | 1.48 | Money market accounts | 648 | 799 | (151) | (195) | 44 |
| 40,539 | 46,794 | 0.32 | 0.76 | MMA - institutional | 33 | 90 | (57) | (52) | (5) |
| 147,156 | 223,286 | 1.52 | 2.02 | CDs, $100M or more | 563 | 1,137 | (574) | (281) | (293) |
| 46,141 | 82,062 | 0.66 | 0.94 | CDs, broker | 77 | 194 | (117) | (58) | (59) |
| 130,369 | 203,029 | 1.39 | 1.95 | Other time deposits | 458 | 1,000 | (542) | (287) | (255) |
| 749,135 | 906,204 | 0.99 | 1.46 | Total interest-bearing deposits | 1,877 | 3,336 | (1,459) | (905) | (554) |
| 24,465 | 30,133 | 3.37 | 3.65 | Short-term/other borrowings | 208 | 277 | (69) | (21) | (48) |
| 20,047 | 23,269 | 1.72 | 2.80 | FHLB advances | 87 | 164 | (77) | (63) | (14) |
| 10,310 | 10,310 | 2.89 | 3.12 | Subordinated debt | 75 | 81 | (6) | (6) | - |
| 803,957 | 969,916 | 1.11 | 1.58 | Total interest-bearing liabilities | 2,247 | 3,858 | (1,611) | (995) | (616) |
| 96,065 | 90,516 | | | Noninterest-bearing deposits | | | | | |
| 3,961 | 8,286 | | | Other liabilities | | | | | |
| 86,320 | 89,737 | | | Shareholders' equity | | | | | |
| $ 990,303 | $1,158,455 | | | Liabilities and equity | | | | | |
| | | 3.90 | 2.88 | Interest rate spread | | | | | |
| | | 4.01 | 3.02 | Net interest margin | | | | | |
| | | | | Net interest income | $ 9,022 | $ 8,037 | $ 985 | $ 1,274 | $ (289) |
| $ 89,231 | $ 87,649 | | | Net earning assets | | | | | |
| $ 845,200 | $ 996,720 | | | Average deposits | | | | | |
| | | 0.88 | 1.33 | Average cost of deposits | | | | | |
| 90% | 80% | | | Average loan to deposit ratio (c) | | | | | |

(a)This table shows the changes in interest income and interest expense for the comparative periods based on either changes in average volume or changes in average rates for interest-earning assets and interest-bearing liabilities. Changes which are not solely due to rate changes or solely due to volume changes are attributed to volume.

(b)The taxable equivalent adjustment results from tax exempt income less non-deductible TEFRA interest expense and was $8 in the third quarter 2011 and 2010, respectively.

(c) Average nonaccruing loans have been excluded from total average loans and categorized in noninterest-earning assets.

**Table 3 – Average Balance Sheet and Rate/Volume Analysis – First Nine Months, 2011 and 2010**

The following table presents average balances of the Company and the Subsidiary Banks on a consolidated basis, the taxable-equivalent interest earned and the interest paid during the first nine months of 2011 and 2010.

| Average Balance | | Average Rate | | | Taxable-Equivalent Interest (b) | | | (a) Variance Attributable to | |
|---|---|---|---|---|---|---|---|---|---|
| YTD 09/30/11 | YTD 09/30/10 | YTD 09/30/11 | YTD 09/30/10 | | YTD 09/30/11 | YTD 09/30/10 | Vari- ance | Rate | Volume |
| ($ in thousands) | | (%) | | | ($ in thousands) | | | ($ in thousands) | |
| | | | | **Assets** | | | | | |
| $ 37,057 | $ 50,740 | 0.30 | 0.29 | Interest-bearing deposits | $ 84 | $ 110 | $ (26) | $ 4 | $ (30) |
| 108,229 | 93,552 | 2.74 | 2.25 | Investments - taxable | 2,217 | 1,576 | 641 | 343 | 298 |
| 6,291 | 7,539 | 4.44 | 4.49 | Investments - non-taxable | 209 | 253 | (44) | (3) | (41) |
| 548 | 8,805 | 0.73 | 0.30 | Federal funds sold | 3 | 20 | (17) | 28 | (45) |
| 775,568 | 818,753 | 5.49 | 5.56 | Loans (c) | 31,861 | 34,022 | (2,161) | (429) | (1,732) |
| 927,693 | 979,389 | 4.95 | 4.91 | Total interest-earning assets | 34,374 | 35,981 | (1,607) | (57) | (1,550) |
| 93,036 | 97,434 | | | Noninterest-earning assets | | | | | |
| $1,020,729 | $1,076,823 | | | Total assets | | | | | |
| | | | | **Liabilities and equity** | | | | | |
| | | | | Deposits | | | | | |
| $ 138,384 | $122,372 | 0.29 | 0.36 | NOW accounts | 305 | 332 | (27) | (64) | 37 |
| 20,802 | 18,100 | 0.15 | 0.43 | Savings accounts | 24 | 58 | (34) | (38) | 4 |
| 233,121 | 192,043 | 1.17 | 1.54 | Money market accounts | 2,036 | 2,214 | (178) | (531) | 353 |
| 41,054 | 59,116 | 0.46 | 0.86 | MMA - institutional | 142 | 380 | (238) | (177) | (61) |
| 162,920 | 184,625 | 1.62 | 2.34 | CDs, $100M or more | 1,971 | 3,236 | (1,265) | (994) | (271) |
| 46,412 | 95,208 | 0.78 | 1.04 | CDs, broker | 271 | 739 | (468) | (185) | (283) |
| 142,343 | 167,879 | 1.50 | 2.21 | Other time deposits | 1,593 | 2,770 | (1,177) | (892) | (285) |
| 785,036 | 839,343 | 1.08 | 1.55 | Total interest-bearing deposits | 6,342 | 9,729 | (3,387) | (2,881) | (506) |
| 24,471 | 35,983 | 3.43 | 3.45 | Short-term/other borrowings | 628 | 929 | (301) | (5) | (296) |
| 16,862 | 18,335 | 2.08 | 2.44 | FHLB advances | 262 | 335 | (73) | (49) | (24) |
| 10,310 | 10,310 | 2.92 | 2.98 | Subordinated debt | 225 | 230 | (5) | (5) | - |
| 836,679 | 903,971 | 1.19 | 1.66 | Total interest-bearing liabilities | 7,457 | 11,223 | (3,766) | (2,940) | (826) |
| 93,612 | 84,527 | | | Noninterest-bearing deposits | | | | | |
| 3,849 | 5,331 | | | Other liabilities | | | | | |
| 86,589 | 82,994 | | | Shareholders' equity | | | | | |
| $1,020,729 | $1,076,823 | | | Liabilities and equity | | | | | |
| | | 3.76 | 3.25 | Interest rate spread | | | | | |
| | | 3.88 | 3.38 | Net interest margin | | | | | |
| | | | | Net interest income | $26,917 | $ 24,758 | $2,159 | $ 2,884 | $ (725) |
| $ 91,014 | $ 75,418 | | | Net earning assets | | | | | |
| $ 878,648 | $923,870 | | | Average deposits | | | | | |
| | | 0.97 | 1.41 | Average cost of deposits | | | | | |
| 88% | 89% | | | Average loan to deposit ratio (c) | | | | | |

(a) This table shows the changes in interest income and interest expense for the comparative periods based on either changes in average volume or changes in average rates for interest-earning assets and interest-bearing liabilities. Changes which are not solely due to rate changes or solely due to volume changes are attributed to volume.

(b) The taxable equivalent adjustment results from tax exempt income less non-deductible TEFRA interest expense and was $32 in the first nine months 2011 and 2010, respectively.

(c) Average nonaccruing loans have been excluded from total average loans and categorized in noninterest-earning assets.

**Off-Balance Sheet Arrangements**

The Company is a party to financial instruments with off-balance sheet risks in the normal course of business in order to meet the financing needs of its customers. At September 30, 2011, the Company had unfunded commitments to extend credit of $80 million and outstanding letters of credit of $4 million. 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 Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Management does not anticipate that funding obligations arising from these financial instruments will adversely impact its ability to fund future loan growth or deposit withdrawals.

**Table 4 – Payment Obligations under Long-term Contracts**

The following table includes a breakdown of short-term and long-term payment obligations due under long-term contracts:

| ($ in thousands) | | Payments due by period | | | |
|---|---|---|---|---|---|
| **Contractual obligations** | **Total** | **Less than 1 year** | **1-3 years** | **3-5 years** | **More than 5 years** |
| FHLB advances | $ 16,654 | $ 3,500 | $ 3,000 | $ - | $ 10,154 |
| Subordinated debt | 10,310 | - | - | - | 10,310 |
| Operating leases – buildings | 5,597 | 825 | 1,330 | 2,773 | 669 |
| Information technology contracts | 5,237 | 1,218 | 2,510 | 1,509 | - |
| Total | $ 37,798 | $ 5,543 | $ 6,840 | $ 4,282 | $ 21,133 |

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

See "Liquidity and Interest Rate Sensitivity Management" on pages 29-31 in the MD&A section for quantitative and qualitative disclosures about market risk.

**Item 4. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures* - We have evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q as required by Rule 13a-15 of the Exchange Act. This evaluation was carried out under the supervision and with the participation of our management, including our chief executive officer and chief financial officer. Based on this evaluation, the chief executive officer and chief financial officer have concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to the Company required to be included in our periodic SEC filings.

*Changes in Internal Control over Financial Reporting* - No change in our internal control over financial reporting occurred during the fiscal quarter covered by this Quarterly Report on Form 10-Q that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Part II – Other Information**

**Item 6. Exhibits.**

| | |
|---|---|
| Exhibit 3.1 | Articles of Incorporation [filed as Exhibit 3.1 to the Company's Registration Statement on Form S-1 as filed with the SEC on February 8, 1990 (No. 33-33405) and incorporated herein by this reference] |
| Exhibit 3.2 | By-laws, as amended and restated July 20, 2004 [filed as Exhibit 4.2 to the Company's Registration Statement on Form S-3 as filed with the SEC on September 30, 2005 (No. 133-128724) and incorporated herein by this reference] |
| Exhibit 31.1 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 31.2 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 32 | Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 101.INS | XBRL Instance Document |
| Exhibit 101.SCH | XBRL Taxonomy Schema |
| Exhibit 101.CAL | XBRL Taxonomy Calculation Linkbase |
| Exhibit 101.DEF | XBRL Taxonomy Definition Linkbase |
| Exhibit 101.LAB | XBRL Taxonomy Label Linkbase |
| Exhibit 101.PRE | XBRL Taxonomy Presentation Linkbase |

**Signatures**

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

The Savannah Bancorp, Inc.
(Registrant)

Date: *11/14/11*

*/s/ John C. Helmken II*
John C. Helmken II
President and Chief Executive Officer
(Principal Executive Officer)

Date: *11/14/11*

*/s/ Michael W. Harden, Jr.*
Michael W. Harden, Jr.
Chief Financial Officer
(Principal Financial and Accounting Officer)