

**FIRST FEDERAL BANCORP, MHC**  
**Parent Company for**



*First Federal*  
BANK of FLORIDA

**Audited Consolidated Financial Statements**

**March 31, 2010 and 2009 and  
the Years then Ended**

**(Together with Independent Auditors' Report)**



## HACKER, JOHNSON & SMITH PA

Fort Lauderdale  
Fort Myers  
Orlando  
Tampa

Certified Public Accountants

### Independent Auditors' Report

The Board of Directors  
First Federal Bancorp, MHC  
Lake City, Florida:

We have audited the accompanying consolidated balance sheets of First Federal Bancorp, MHC and Subsidiaries (the "Company") at March 31, 2010 and 2009 and the related consolidated statements of earnings, retained earnings and accumulated other comprehensive loss, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company at March 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

HACKER, JOHNSON & SMITH PA  
Tampa, Florida  
June 30, 2010

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Consolidated Balance Sheets**

(In thousands)

<b>Assets</b>	<u>At March 31,</u>	
	<u>2010</u>	<u>2009</u>
Cash and due from banks .....	\$ 69,915	53,114
Interest-bearing deposits with banks .....	<u>103</u>	<u>185</u>
Total cash and cash equivalents .....	70,018	53,299
Time deposits .....	21,495	18,824
Securities available for sale .....	233,975	153,387
Securities held to maturity .....	977	985
Loans held for sale .....	19,674	3,999
Loans, net of allowance for loan losses of \$10,777 and \$6,883 .....	332,294	352,295
Covered loans .....	68,887	-
FDIC loss share receivable .....	26,995	-
Accrued interest receivable .....	3,690	2,528
Premises and equipment, net .....	23,344	16,370
Federal Home Loan Bank stock, at cost .....	3,180	2,282
Foreclosed real estate .....	4,366	1,622
Deferred income taxes .....	-	3,395
Cash surrender value of bank-owned life insurance .....	15,807	15,367
Other assets .....	<u>10,214</u>	<u>4,511</u>
Total .....	<u>\$ 834,916</u>	<u>628,864</u>
<b>Liabilities, Retained Earnings and Accumulated Other Comprehensive Loss</b>		
Liabilities:		
Noninterest-bearing demand deposits .....	84,035	67,284
Interest checking and money-market deposits .....	313,192	238,602
Savings deposits .....	21,357	16,058
Time deposits .....	<u>245,583</u>	<u>156,040</u>
Total deposits .....	664,167	477,984
Federal Home Loan Bank advances .....	17,000	26,000
Other borrowings .....	50,667	44,702
Deferred income taxes .....	626	-
Income taxes payable .....	2,600	642
Other liabilities .....	<u>11,750</u>	<u>8,592</u>
Total liabilities .....	746,810	557,920
Commitments and contingencies (Notes 6, 11 and 18)		
Retained earnings .....	89,639	72,239
Accumulated other comprehensive loss .....	<u>(1,533)</u>	<u>(1,295)</u>
Total .....	<u>\$ 834,916</u>	<u>628,864</u>

See accompanying Notes to Consolidated Financial Statements.

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Consolidated Statements of Earnings**

(In thousands)

	<u>Year Ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
Interest income:		
Loans .....	\$ 23,314	24,290
Securities .....	9,344	7,679
Other .....	<u>216</u>	<u>557</u>
Total interest income.....	<u>32,874</u>	<u>32,526</u>
Interest expense:		
Deposits .....	5,477	7,174
Borrowings .....	<u>1,330</u>	<u>1,826</u>
Total interest expense .....	<u>6,807</u>	<u>9,000</u>
Net interest income .....	26,067	23,526
Provision for loan losses .....	<u>6,460</u>	<u>2,641</u>
Net interest income after provision for loan losses.....	<u>19,607</u>	<u>20,885</u>
Noninterest income:		
Bargain purchase gain on FDIC assisted transaction .....	20,220	-
Service charges on deposit accounts .....	3,809	3,698
Other service charges and fees .....	3,362	1,645
Gain on sale of loans .....	907	1,192
Gain on sale of securities available for sale .....	2,671	1,634
Other than temporary impairment of securities available for sale.....	(246)	(1,713)
Income from bank-owned life insurance .....	444	609
Debit card interchange income .....	1,251	1,131
Other .....	<u>466</u>	<u>399</u>
Total noninterest income.....	<u>32,884</u>	<u>8,595</u>
Noninterest expense:		
Salaries and employee benefits.....	14,918	11,699
Occupancy and equipment.....	2,901	2,679
Debit card interchange expense.....	502	536
Printing and office supplies .....	329	254
Telephone and data communications .....	426	330
Other .....	<u>5,647</u>	<u>2,601</u>
Total noninterest expense .....	<u>24,723</u>	<u>18,099</u>
Earnings before income taxes .....	27,768	11,381
Income taxes .....	<u>10,368</u>	<u>3,825</u>
Net earnings .....	<u>\$ 17,400</u>	<u>7,556</u>

See accompanying Notes to Consolidated Financial Statements.

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Consolidated Statements of Retained Earnings and  
Accumulated Other Comprehensive Income (Loss)**

**Years Ended March 31, 2010 and 2009**  
(In thousands)

	<u>Retained Earnings</u>	<u>Accumulated Other Compre- hensive Income (Loss)</u>	<u>Total</u>
Balance at March 31, 2008 .....	\$ 64,956	(808)	<u>64,148</u>
Adjustment for adoption of SFAS 159 .....	<u>12</u>	<u>-</u>	<u>12</u>
Balance as adjusted for change in accounting principle .....	64,968	(808)	<u>64,160</u>
Comprehensive income:			
Net earnings .....	7,556	-	7,556
Net change in unrealized loss on securities available for sale, net of tax benefit of \$180 .....	-	(292)	(292)
Net change in unrealized loss on derivative instrument, net of tax benefit of \$106.....	-	(195)	<u>(195)</u>
Comprehensive income.....			7,069
Cumulative effect adjustment related to deferred compensation plans....	<u>(285)</u>	<u>-</u>	<u>(285)</u>
Balance at March 31, 2009 .....	72,239	(1,295)	<u>70,944</u>
Comprehensive income:			
Net earnings .....	17,400	-	17,400
Net change in unrealized loss on securities available for sale, net of tax benefit of \$207 .....	-	(347)	(347)
Net change in unrealized loss on derivative instrument, net of tax liability of \$59 .....	-	109	<u>109</u>
Comprehensive income.....	<u>      </u>	<u>      </u>	<u>17,162</u>
Balance at March 31, 2010 .....	\$ <u>89,639</u>	<u>(1,533)</u>	<u>88,106</u>

See accompanying Notes to Consolidated Financial Statements.

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Consolidated Statements of Cash Flows**  
(In thousands)

	<u>Year Ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
Cash flows from operating activities:		
Net earnings.....	\$ 17,400	7,556
Adjustments to reconcile net earnings to net cash (used in) provided by operating activities:		
Provision for loan losses .....	6,460	2,641
Depreciation .....	1,060	1,046
Deferred income taxes.....	4,169	(1,278)
Net amortization of premiums and discounts on securities .....	(15)	(370)
Net amortization of deferred loan fees.....	(33)	(76)
Bargain purchase gain on FDIC-assisted transaction.....	(20,220)	-
Gain on sale of securities available for sale.....	(2,671)	(1,634)
Other than temporary impairment on securities available for sale .....	246	1,713
Net loss on sale of foreclosed real estate.....	7	1
Provision for losses on foreclosed real estate.....	273	-
Origination of loans held for sale .....	(164,105)	(77,087)
Proceeds from sale of loans held for sale .....	149,337	78,372
Gain on sale of loans held for sale .....	(907)	(1,192)
Income from bank-owned life insurance.....	(440)	(609)
(Increase) decrease in accrued interest receivable .....	(1,162)	122
Increase in other assets.....	(3,523)	(1,210)
Increase in income taxes payable.....	1,958	446
Increase in other liabilities .....	<u>2,944</u>	<u>851</u>
Net cash (used in) provided by operating activities.....	<u>(9,222)</u>	<u>9,292</u>
Cash flows from investing activities:		
Purchases of securities available for sale .....	(240,688)	(198,532)
Principal repayments of securities available for sale .....	39,348	21,949
Maturities and calls of securities available for sale.....	16,000	27,585
Net proceeds from sales of securities available for sale.....	139,688	99,337
Principal repayments of securities held to maturity .....	2	275
Purchase of time deposits .....	(8,427)	(25,212)
Proceeds from sale of time deposits .....	1,439	596
Maturities and call of time deposits.....	4,317	30,000
Net decrease in loans .....	12,216	26,630
Net decrease in covered loans .....	7,418	-
Purchases of premises and equipment, net .....	(8,004)	(843)
Proceeds from sale of foreclosed real estate.....	723	22
Purchases of Federal Home Loan Bank stock.....	-	(106)
Cash proceeds from FDIC-assisted transaction.....	41,913	-
Net cash proceeds received for covered loans.....	<u>13,005</u>	<u>-</u>
Net cash provided by (used in) investing activities .....	<u>18,950</u>	<u>(18,299)</u>
Cash flows from financing activities:		
Net increase (decrease) in deposits.....	20,480	(12,467)
Net (decrease) increase from Federal Home Loan Bank advances ...	(19,454)	1,000
Net increase in other borrowings.....	<u>5,965</u>	<u>9,853</u>
Net cash provided by (used in) financing activities.....	<u>6,991</u>	<u>(1,614)</u>
Net increase (decrease) in cash and cash equivalents.....	16,719	(10,621)
Cash and cash equivalents at beginning of year .....	<u>53,299</u>	<u>63,920</u>
Cash and cash equivalents at end of year .....	\$ <u>70,018</u>	<u>53,299</u>

See accompanying Notes to Consolidated Financial Statements.

# FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

For the Years Ended March 31, 2010 and 2009

### (1) Organization and Summary of Significant Accounting Policies

**Organization.** First Federal Bancorp, MHC is a federally-chartered, mutual holding company. The company through its subsidiary First Federal Bancorp, Inc. (a federal corporation) owns a subsidiary First Federal Bank of Florida (the "Bank") which provides a variety of community banking services to individuals and businesses through fifteen full-service banking offices in Manatee, Sarasota, Baker, Nassau, Hamilton, Lafayette, Suwannee and Columbia Counties, Florida. There is also a retail wholesale loan production office that operates in Duval County. Its deposits are insured by the Federal Deposit Insurance Corporation. Subsidiaries include First Federal Financial Services Corporation ("FFFSC"), an investment advisor, Suwannee Valley Service Corporation, a real estate development company, and Community Tax Stabilization Fund, Inc., formerly FF Purchasing Corporation, a company that invests in tax liens. Collectively the entities are referred to as the "Company."

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America ("GAAP"). The following summarizes the more significant of these policies and practices:

**Subsequent Events.** Management has evaluated all significant events occurring subsequent to the balance sheet date through June 30, 2010, which is the date the consolidated financial statements were available to be issued. In May 2010, First Federal Bank of Florida entered into a purchase and assumption agreement with the Federal Deposit Insurance Corporation ("FDIC"), as a receiver of The Bank of Bonifay, Bonifay, Florida. The Bank assumed \$225.2 million in liabilities and purchased \$71.9 million of the Bank of Bonifay's assets and received \$153.3 million in cash.

(continued)

# FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

## Notes to Consolidated Financial Statements, Continued

### (1) Organization and Summary of Significant Accounting Policies, Continued

**Acquisition of Certain Assets and Liabilities of Flagship National Bank.** On October 23, 2009, the Bank entered into a Purchase and Assumption Agreement and Shared-Loss Agreements with the Federal Deposit Insurance Corporation ("FDIC"), as a receiver of Flagship National Bank in Bradenton, Florida ("Flagship"). The agreement was for the Bank to assume all deposits and essentially all assets of Flagship. As a result of the acquisition, the Bank assumed four full-service branches operating in Sarasota and Bradenton, Florida. The table below summarizes the assets acquired and liabilities assumed on acquisition date (in thousands):

Assets acquired:	
Cash and due from banks	\$ 41,913
Securities available for sale	33,774
Covered loans, net of discount	76,305
Estimated loss reimbursement from FDIC	40,000
Automobile	30
Foreclosed real estate	2,389
Other assets	<u>2,180</u>
Total assets acquired	<u>196,591</u>
Liabilities assumed:	
Demand deposits	14,300
Savings deposits	9,883
Time deposits	141,520
Federal Home Loan Bank advances	10,454
Other liabilities	<u>214</u>
Total liabilities assumed	<u>176,371</u>
Net assets acquired/gain from acquisition	\$ <u>20,220</u>

The Shared-Loss Agreements cover approximately \$130.0 million of the loans ("covered loans") and other real estate owned acquired by the Bank. Under these agreements, the FDIC will cover up to 80% of losses and related costs on the first \$51.0 million of losses and 95% of any excess over that amount. Single-family residential real estate loans have a 10 year term for losses and nonresidential real estate loans have eight years. The Bank recorded a shared-loss receivable due from the FDIC of \$40.0 million, which is the estimated fair value of the losses the Bank is expected to receive.

**Principles of Consolidation.** The consolidated financial statements include the accounts of First Federal Bancorp, MHC and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

**Estimates.** The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in its near term relate to the determination of the allowance for loan losses.

(continued)

# FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

## Notes to Consolidated Financial Statements, Continued

### (1) Organization and Summary of Significant Accounting Policies, Continued

**Cash and Cash Equivalents.** For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash, due from banks and interest-bearing deposits with banks, all of which mature within ninety days.

The Company may be required under Federal Reserve Board regulations to maintain reserves, generally consisting of cash or noninterest-earning accounts, against its transaction accounts. There were no required reserves at March 31, 2010 or 2009.

**Securities.** The Company may classify its securities as either trading, held to maturity or available for sale. Trading securities are held principally for resale and recorded at their fair values. Unrealized gains and losses on trading securities are included immediately in earnings. Held-to-maturity securities are those which the Company has the positive intent and ability to hold to maturity and are reported at amortized cost. Available-for-sale securities consist of securities not classified as trading securities nor as held-to-maturity securities. Unrealized holding gains and temporary losses, net of tax, on available-for-sale securities are excluded from earnings and reported in accumulated other comprehensive loss. Gains and losses on the sale of securities are determined using the specific-identification method. Premiums and discounts on securities available for sale and held to maturity are recognized in interest income using the interest method over the period to maturity.

The Company views the determination of whether an investment security is temporarily or other-than-temporarily impaired as a critical accounting policy, as the estimate is susceptible to significant change from period to period because it requires management to make significant judgments, assumptions and estimates in the preparation of its consolidated financial statements. Management considers whether an investment security is other-than-temporarily impaired. The Company assesses individual securities in its investment securities portfolio for impairment at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. An investment is impaired if the fair value of the security is less than its carrying value at the financial statement date. When a security is impaired, the Company then determines whether this impairment is temporary or other-than-temporary. In estimating other-than-temporary impairment ("OTTI") losses, management assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of these criteria is met, the entire difference between amortized cost and fair value is recognized in operations. For securities that do not meet the aforementioned criteria, the amount of impairment recognized in operations is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive loss. Management utilizes cash flow models to segregate impairments to distinguish between impairment related to credit losses and impairment related to other factors. To assess for OTTI, management considers, among other things, (i) the severity and duration of the impairment; (ii) the ratings of the security; (iii) the overall transaction structure (the Company's position within the structure, the aggregate, near-term financial performance of the underlying collateral, delinquencies, defaults, loss severities, recoveries, prepayments, cumulative loss projections, and discounted cash flows); and (iv) the timing and magnitude of a break in modeled cash flows.

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# FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

## Notes to Consolidated Financial Statements, Continued

### (1) Organization and Summary of Significant Accounting Policies, Continued

**Loans.** Loans management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Loan origination fees are deferred and certain direct origination costs are capitalized; both are recognized as an adjustment of the yield of the related loan.

The accrual of interest on loans is discontinued at the time the loan is ninety days delinquent. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

**Loans Held for Sale.** Loans held for sale are reported at fair value.

**Loan Losses.** The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance consists of specific and general components. The specific component relates to loans that are classified as impaired. For such loans, an allowance is established when the discounted cash flows or the collateral value of the impaired loan is lower than the carrying value of that loan. The general component covers all other loans and is based on historical loss experience, adjusted for qualitative factors, such as economic conditions and other trends or uncertainties that could affect management's estimate of probable losses.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

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# FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

## Notes to Consolidated Financial Statements, Continued

### (1) Organization and Summary of Significant Accounting Policies, Continued

**Loan Losses, Continued.** A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial, commercial real estate and real estate construction loans by either 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.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer deposit account loans and residential loans for impairment disclosures.

**Covered Loans.** All acquired loans are valued as of the date of acquisition. The loans in the portfolio that the Company acquired from the Flagship acquisition are covered by the FDIC Shared-Loss Agreements and such loans are referred to herein as "covered loans." Covered loans determined to be impaired at the date of acquisition were collaterally dependent and, as such, were valued based on the fair value of the underlying collateral. There was no allowance for loan losses established for these impaired covered loans at the acquisition date.

**FDIC Loss Share Receivable.** With the acquisition of Flagship, the Bank entered into shared-loss agreements with the FDIC for amounts receivable under the agreements. The Company accounted for the receivable balances under the shared-loss agreements as an FDIC indemnification asset. The FDIC indemnification is accounted for and calculated by adding the present value of all the cash flows that the Company expected to collect from the FDIC on the date of the acquisition as stated in the shared-loss agreements. As expected and actual cash flows increase and decrease from what was expected at the time of acquisition, the FDIC indemnification asset will decrease and increase, respectively. When covered loans are paid off and sold, the FDIC indemnification asset is reduced. Covered loans that become impaired increase the indemnification asset.

**Servicing.** Servicing assets are recognized as separate assets when rights are acquired through sale of financial assets. Capitalized servicing rights are amortized in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights compared to amortized cost. Fair value is determined using prices for similar assets with similar characteristics. Impairment is recognized through a valuation allowance, to the extent that fair value is less than the capitalized amount.

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# FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

## Notes to Consolidated Financial Statements, Continued

### (1) Organization and Summary of Significant Accounting Policies, Continued

**Premises and Equipment.** Land is carried at cost. Building and improvements and furniture and equipment are carried at cost, less accumulated depreciation computed using the straight-line method. Interest costs are capitalized in connection with the construction of new banking offices.

**Foreclosed Real Estate.** Property acquired by foreclosure or deed in lieu of foreclosure is carried at the lower of cost or fair market value less estimated costs to sell. Costs relating to the development and improvement of property are capitalized, whereas those relating to holding the property are charged to expense. Valuations are periodically performed by management and losses are charged to earnings if the carrying value of the property exceeds its estimated fair value.

**Transfer of Financial Assets.** Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

**Securities Commissions and Fees.** FFFSC has a third party marketing contract with Raymond James Financial Services ("Raymond James") for the provision of bank financial services to customers. A company owned by a director of the Company provides staffing and management services to FFFSC. Certain employees of this company are dual employees of Raymond James and FFFSC. Raymond James accounts for the revenues, and maintains customer account records and provides the Company with a monthly settlement. For the years ending March 31, 2010 and 2009, FFFSC received securities commissions and fees of \$1,203,000 and \$1,464,000 respectively and paid \$1,105,000 and \$1,349,000, respectively, to the Company owned by a director for services rendered as provided by the Management Services Agreement between FFFSC and the company.

**Income Taxes.** On April 1, 2009, the Company adopted the recent accounting guidance related to accounting for uncertainty in income taxes, which sets out a consistent framework to determine the appropriate level of tax reserves to maintain for uncertain tax positions.

The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

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# FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

## Notes to Consolidated Financial Statements, Continued

### (1) Organization and Summary of Significant Accounting Policies, Continued

***Income Taxes, Continued.*** Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than fifty percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than fifty percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized. As of March 31, 2010, management is not aware of any uncertain tax positions that would have a material effect on the Company's consolidated financial statements.

The Company recognizes interest and penalties on income taxes as a component of income tax expense.

***Off-Balance-Sheet Financial Instruments.*** In the ordinary course of business the Company has entered into off-balance-sheet financial instruments consisting of unused lines of credit, undisbursed loans in process, commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded or related fees are incurred or received.

***Derivative Financial Instruments.*** Derivative financial instruments are recognized as assets or liabilities in the consolidated balance sheets and measured at fair value.

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# FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

## Notes to Consolidated Financial Statements, Continued

### (1) Organization and Summary of Significant Accounting Policies, Continued

**Interest-Rate Swap Agreements.** For asset/liability management purposes, the Company uses interest-rate swap agreements to hedge various exposures or to modify interest rate characteristics of various balance sheet accounts. Such derivatives are used as part of the asset/liability management process and are linked to specific assets or liabilities, and have high correlation between the contract and the underlying item being hedged, both at inception and throughout the hedge period.

The Company utilizes interest-rate swap agreements to convert a portion of its variable-rate debt to a fixed rate (cash flow hedge). Interest-rate swaps are contracts in which a series of interest rate flows are exchanged over a prescribed period. The notional amount on which the interest payments are based is not exchanged.

Interest-rate derivative financial instruments receive hedge accounting treatment only if they are designated as a hedge and are expected to be, and are, effective in substantially reducing interest- rate risk arising from the assets and liabilities identified as exposing the Company to risk. Those derivative financial instruments that do not meet the hedging criteria discussed below would be classified as trading activities and would be recorded at fair value with changes in fair value recorded in income. Derivative hedge contracts must meet specific effectiveness tests (i.e., over time the change in their fair values due to the designated hedge risk must be within 80 to 125 percent of the opposite change in the fair values of the hedged assets or liabilities). Changes in fair value of the derivative financial instruments must be effective at offsetting changes in the fair value of the hedged items due to the designated hedge risk during the term of the hedge. Further, if the underlying financial instrument differs from the hedged asset or liability, there must be a clear economic relationship between the prices of the two financial instruments. If periodic assessment indicates derivatives no longer provide an effective hedge, the derivatives contracts would be closed out and settled or classified as a trading activity.

Hedges of variable-rate debt are accounted for as cash flow hedges, with changes in fair value recorded in derivative assets or liabilities and other comprehensive income. The net settlement (upon close out or termination) that offsets changes in the value of the hedged debt is deferred and amortized into net interest income over the life of the hedged debt. Hedges of fixed-rate liabilities are accounted for as fair value hedges, with changes in fair value recorded in derivative liabilities and interest income. The net settlement (upon close out or termination) that offsets changes in the value of the liabilities adjusts the basis of the liabilities and is deferred and amortized to interest income over the life of the liability. The portion, if any, of the net settlement amount that did not offset changes in the value of the hedged asset or liability is recognized immediately in noninterest income.

(continued)

# FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

## Notes to Consolidated Financial Statements, Continued

### (1) Organization and Summary of Significant Accounting Policies, Continued

**Rate-Lock Commitments.** The Company enters into commitments to originate loans whereby the interest-rate on the loan is determined prior to funding (rate lock commitments). Rate-lock commitments on mortgage loans that are intended to be sold are considered to be derivatives. Accordingly, such commitments, along with any related fees received from potential borrowers, are recorded at fair value in derivative assets or liabilities, with changes in fair value recorded in the net gain or loss on sale of mortgage loans. Fair value is based on fees currently charged to enter into similar agreements, and for fixed-rate commitments, the difference between current levels of interest rates and the committed rates is also considered.

The Company manages the interest-rate risk on rate lock commitments by entering into forward loan sale contracts, whereby the selling party obtains the right to deliver residential loans to investors in the future at a specified yield. Such contracts are accounted for as derivatives and, along with related fees paid to investors, are recorded at fair value in derivative assets or liabilities, with changes in fair value recorded in the net gain or loss on sale of mortgage loans. Fair value is based on the estimated amounts that the Company would receive or pay to terminate the commitment at the reporting date.

**Fair Values of Financial Instruments.** The following methods and assumptions were used by the Company in estimating fair values of financial instruments:

**Cash and Cash Equivalents.** The carrying amounts of cash and cash equivalents approximates fair values.

**Time Deposits.** The carrying amounts of time deposits approximates fair values.

**Securities.** Fair values for securities held to maturity and available for sale are based on the framework for measuring fair value. The carrying values of Federal Home Loan Bank stock approximates fair value.

**Loans.** For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for fixed-rate mortgage loans (for example, fixed-rate one-to-four family residential) and consumer loans are estimated by discounting the estimated future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings for the same remaining maturities. Fair values for impaired loans are based on the framework for measuring fair value.

**Loans Held for Sale.** The fair value of loans held for sale is based on the framework for measuring fair value.

**Accrued Interest Receivable.** The carrying amounts of accrued interest approximate their fair values.

(continued)

# FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

## Notes to Consolidated Financial Statements, Continued

### (1) Organization and Summary of Significant Accounting Policies, Continued

#### *Fair Values of Financial Instruments, Continued.*

**Deposits.** The fair value estimated for demand deposits (e.g., interest and noninterest-bearing NOW accounts, passbook savings, and money-market accounts) is, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on time deposits to a schedule of aggregate expected monthly time deposit maturities.

**Federal Home Loan Bank Advances.** Fair values of Federal Home Loan Bank advances are estimated by discounting the estimated future cash flows using current rates at which similar advances are offered.

**Other Borrowings.** These short term liabilities are estimated by discounting the estimated future cash flows using current rates at which similar borrowings are offered.

**Off-Balance Sheet Instruments.** Fair values of off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standings.

**Derivative Financial Instruments.** Fair values for interest rate swap agreements are based upon the amounts required to settle the contracts. Fair values for commitments to originate loans held for sale and forward loan sale contracts are based on fees currently charged to enter into similar agreements, and for fixed-rate commitments also considered the difference between current levels of interest rates and the commitment rates.

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(1) Organization and Summary of Significant Accounting Policies, Continued**

**Comprehensive Loss.** Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net earnings. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities and derivative instruments, are reported as a separate component of the equity section of the consolidated balance sheet, such items, along with net earnings, are components of comprehensive loss. The components of comprehensive loss and related tax effects are as follows (in thousands):

	<b>Year Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Available for sale securities:		
Net unrealized losses .....	\$(1,988)	(1,434)
Tax effect .....	<u>(745)</u>	<u>(537)</u>
Net-of-tax amount.....	(1,243)	<u>(897)</u>
Derivative instruments:		
Holding losses on derivative instrument.....	(446)	(613)
Tax effect .....	<u>(156)</u>	<u>(215)</u>
Net-of-tax amount.....	<u>(290)</u>	<u>(398)</u>
Accumulated other comprehensive loss .....	\$( <u>1,533</u> )	( <u>1,295</u> )

**Reclassifications.** Certain amounts in the 2009 financial statements have been reclassified to conform to the 2010 presentation.

**Recent Pronouncements.** In 2009, the FASB Accounting Standards Codification ("ASC") became the single source of authoritative GAAP recognized by the Financial Accounting Standards Board ("FASB") to be applied to nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission ("SEC") are also sources of authoritative GAAP for SEC registrants. The ASC superseded all existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the ASC is nonauthoritative. The Company's policies were not affected by the conversion to ASC.

In 2008, the FASB revised SFAS No. 141, *Business Combinations* ("SFAS No. 141r") (this SFAS was incorporated into the ASC on January 1, 2010 in Codification Topic 805). The guidance requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions. The guidance requires prospective application for business combinations consummated in fiscal years beginning on or after December 15, 2008. The federally assisted transactions described in Note 2 were accounted for under this guidance.

(continued)

# FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

## Notes to Consolidated Financial Statements, Continued

### (1) Organization and Summary of Significant Accounting Policies, Continued

**Recent Pronouncements, Continued.** In 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (this guidance was incorporated into the ASC on January 1, 2010 in Codification Topic 320). The guidance amends the previous other-than-temporary impairment ("OTTI") guidance for debt securities and included additional presentation and disclosure requirements for both debt and equity securities. The guidance is effective for reporting periods ending after June 15, 2009. The adoption of this guidance requires an adjustment to retained earnings and other comprehensive income ("OCI") in the period of adoption to reclassify noncredit related impairment to OCI for securities that the Company does not intend to sell (and will not more likely than not be required to sell). The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In 2009, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 166, *Accounting for Transfers of Financial Assets – an amendment of FASB Statement No. 140*, ("SFAS No. 166") (this SFAS was incorporated into the ASC on January 1, 2010 in Codification Topic 860.) amending the accounting for the transfers of financial assets. This new standard enhances reporting about transfers of financial assets, including loan participations and securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. It eliminates the concept of a "qualifying special-purpose entity" and changes the requirements for derecognizing financial assets. It also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. The standard was effective April 1, 2010 and had no impact on the Company's consolidated financial statements.

In 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*, ("SFAS No. 167") (this SFAS was incorporated into the ASC on January 1, 2010 in Codification Topic 810.) on how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity's purpose and design and a company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. The standard requires additional disclosures about the reporting entity's involvement with variable-interest entities and any significant changes in risk exposure due to that involvement as well as its effect on the entity's financial statements. The standard was effective April 1, 2010 and had no impact on the Company's consolidated financial statements.

(continued)

# FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

## Notes to Consolidated Financial Statements, Continued

### (1) Organization and Summary of Significant Accounting Policies, Continued

**Recent Pronouncements, Continued.** In January 2010, the FASB issued new guidance that requires new disclosures about significant transfers in and/or out of Levels 1 and 2 of the fair value hierarchy and activity in Level 3 (Accounting Standards Update ("ASU") 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*). In addition, this guidance provides clarification of existing disclosure requirements about (a) level of disaggregation and (b) inputs and valuation techniques. The update is effective for annual reporting periods beginning after December 15, 2009 and had no impact on the Company's consolidated financial statements other than the disclosure requirements which have been incorporated herein.

**Future Adoption of New Pronouncements.** In April 2010, the FASB issued new guidance on accounting for acquired loans that have evidence of credit deterioration upon acquisition (ASU 2010-18, *Receivables (Topic 310): Effect of a Loan Modification When the Loan is Part of a Pool That Is Accounted for as a Single Asset*). This guidance allows acquired assets with common risk characteristics to be accounted for in the aggregate as a pool. Upon establishment of the pool, the pool becomes the unit of accounting. When loans are accounted for as a pool, the purchase discount is not allocated to individual loans; thus, all of the loans in the pool accrete at a single pool rate (based on cash flow projections for the pool). In addition, the impairment analysis also is performed on the pool as a whole as opposed to each individual loan. The update is effective in the first annual period ending on or after July 15, 2010. The Company is currently evaluating the impact of this guidance on its consolidated financial statements.

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(2) Securities**

Securities have been classified according to management's intention. The carrying amounts of securities and their approximate fair value are summarized as follows (in thousands):

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Value</u>
<b>Securities Available for Sale:</b>				
<i>At March 31, 2010:</i>				
U.S. Government agency bonds ....	\$ 30,350	31	(110)	30,271
Municipal securities .....	15,700	279	(49)	15,930
Preferred stock.....	49	-	(18)	31
CMO .....	156,943	930	(3,477)	154,396
Mortgage-backed securities.....	<u>32,921</u>	<u>428</u>	<u>(2)</u>	<u>33,347</u>
	\$ <u>235,963</u>	<u>1,668</u>	<u>(3,656)</u>	<u>233,975</u>
<i>At March 31, 2009:</i>				
U.S. Government agency bonds ....	5,000	15	-	5,015
Municipal securities .....	23,875	259	(290)	23,844
Preferred stock.....	49	-	(31)	18
CMO .....	98,654	1,934	(3,327)	97,261
Mortgage-backed securities.....	22,564	38	(32)	22,570
Corporate bonds .....	<u>4,679</u>	<u>-</u>	<u>-</u>	<u>4,679</u>
	\$ <u>154,821</u>	<u>2,246</u>	<u>(3,680)</u>	<u>153,387</u>
<b>Securities Held to Maturity:</b>				
<i>At March 31, 2010:</i>				
Corporate bonds .....	\$ <u>977</u>	<u>-</u>	<u>(910)</u>	<u>67</u>
<i>At March 31, 2009-</i>				
Corporate bonds .....	\$ <u>985</u>	<u>-</u>	<u>(453)</u>	<u>532</u>

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(2) Securities, Continued**

The following summarizes sales of securities (in thousands):

	<u>Year Ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
Proceeds.....	\$ <u>139,688</u>	<u>99,337</u>
Gross gains .....	2,704	1,704
Gross losses .....	<u>(33)</u>	<u>(70)</u>
Net gain .....	\$ <u>2,671</u>	<u>1,634</u>

The scheduled maturities of securities are as follows (in thousands):

	<u>Securities Available</u>		<u>Securities Held</u>	
	<u>for Sale</u>		<u>to Maturity</u>	
	<u>Amortized</u>	<u>Estimated</u>	<u>Amortized</u>	<u>Estimated</u>
	<u>Cost</u>	<u>Fair</u>	<u>Cost</u>	<u>Value</u>
		<u>Value</u>		
<i>At March 31, 2010:</i>				
Due after one year through five years.....	\$ 28,171	28,146	-	-
Due after five through ten years ...	9,700	9,838	-	-
Due thereafter .....	8,179	8,217	-	-
Preferred stock.....	49	31	-	-
Corporate bonds.....	-	-	977	67
CMO .....	156,943	154,396	-	-
Mortgage-backed securities.....	<u>32,921</u>	<u>33,347</u>	<u>-</u>	<u>-</u>
	\$ <u>235,963</u>	<u>233,975</u>	<u>977</u>	<u>67</u>

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(2) Securities, Continued**

At March 31, 2010 and 2009, the Company pledged, as collateral for state and municipal deposits and treasury tax and loan accounts, securities with a carrying value of \$78,150,000 and \$49,497,000, respectively. At March 31, 2010, the Company obtained a \$41 million collateralized letter of credit from the Federal Home Loan Bank of Atlanta as additional collateral for these deposits.

The Company's fifty-one securities with gross unrealized losses at March 31, 2010, aggregated by investment category and length of time that individual securities have been in a continuous loss position, is as follows (in thousands):

	<u>Less Than Twelve Months</u>		<u>Over Twelve Months</u>	
	<u>Gross</u>	<u>Fair</u>	<u>Gross</u>	<u>Fair</u>
	<u>Unrealized</u>	<u>Value</u>	<u>Unrealized</u>	<u>Value</u>
	<u>Losses</u>	<u>Value</u>	<u>Losses</u>	<u>Value</u>
<i>Securities Available for Sale:</i>				
U.S. Government agency bonds .....	\$ 110	15,276	-	-
CMO's.....	1,987	69,506	1,490	13,602
Mortgage-backed securities.....	2	1,094	-	-
Preferred stock.....	-	-	18	31
Municipal securities.....	<u>22</u>	<u>2,886</u>	<u>27</u>	<u>2,816</u>
 Total.....	 \$ <u>2,121</u>	 <u>88,762</u>	 <u>1,535</u>	 <u>16,449</u>
 <i>Securities Held to Maturity-</i>				
Corporate bonds.....	\$ <u>-</u>	<u>-</u>	<u>910</u>	<u>67</u>

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In 2010, the Company recorded other than temporary impairment losses of \$246,000 relating to \$272,000 in CMO securities. Corporate bonds held to maturity have an unrealized loss of \$910,000 which is caused by market conditions. The Company obtained an independent valuation analysis of the present value of future cash flows that indicated the bonds were not other-than-temporarily impaired.

The unrealized losses on investment securities available for sale were caused by market conditions. It is expected that the securities would not be settled at a price less than the par value of the investments. Because the decline in fair value is attributable to changes in market conditions and not credit quality, and because the Company has the ability and intent to hold these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(2) Securities, Continued**

The Bank invests in residential Collateralized Mortgage Obligations ("CMO's"). These CMO's are, at origination, investment grade, generally AAA. Quarterly, management stress tests all CMO's via a third party resource that takes into account housing price appreciation (depreciation); interest rates, expected loss trends, both nationally and in geographic area represented by the CMO. These stress tests are done, where data, is available at the individual loan level, opposed to using averages from services such as Bloomberg. If these stress tests indicate, on a present value basis, we will not receive the contracted cash flows; we make an other-than-temporary impairment charge through the statement of earnings.

**(3) Loans**

The components of loans are summarized as follows (in thousands):

	<u>At March 31,</u>	
	<u>2010</u>	<u>2009</u>
Residential real estate .....	\$ 99,484	93,052
Commercial real estate .....	200,355	139,564
Consumer loans .....	85,755	85,365
Commercial loans .....	33,945	21,266
Deposit account loans .....	2,048	1,940
Real estate construction loans .....	<u>8,976</u>	<u>18,277</u>
Subtotal.....	430,563	359,464
Less:		
Discount on covered loans .....	(18,426)	-
Net deferred loan origination fees .....	(179)	(286)
Allowance for loan losses.....	<u>(10,777)</u>	<u>(6,883)</u>
Loans and covered loans, net .....	\$ <u>401,181</u>	<u>352,295</u>
Consolidated balance sheets:		
Loans, net of allowance for loan losses of \$10,777 and \$6,883.....	332,294	352,295
Covered loans .....	<u>68,887</u>	<u>-</u>
	\$ <u>401,181</u>	<u>352,295</u>

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(3) Loans, Continued**

**Loan Impairment and Losses.** The following summarizes the amount of impaired loans, all of which are collateral dependent (in thousands):

	<u>At March 31,</u>	
	<u>2010</u>	<u>2009</u>
Loans identified as impaired:		
Gross covered loans with no related allowance for losses .....	\$ 11,758	-
Gross loans with related allowance for losses recorded .....	14,623	3,120
Less: Allowances on these loans .....	<u>(3,864)</u>	<u>(1,543)</u>
Net investment in impaired loans .....	\$ <u>22,517</u>	<u>1,577</u>

Impaired covered loans acquired in the Flagship acquisition were \$46,587,000 and the estimated fair value of these loans was \$11,758,000. At the acquisition date, all of these loans were collaterally dependent and, as such, were valued based on the fair value of the underlying collateral. There was no allowance for loan losses established for these impaired loans at the acquisition date. These loans are covered by the Shared-Loss Agreements with the FDIC.

The average net investment in impaired loans and interest income recognized and received on impaired loans is as follows (in thousands):

	<u>Year Ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
Average investment in impaired loans .....	\$ <u>15,979</u>	<u>3,107</u>
Interest income recognized on impaired loans .....	\$ <u>601</u>	<u>148</u>
Interest income received on impaired loans .....	\$ <u>601</u>	<u>148</u>

Nonaccrual and past due loans were as follows (in thousands):

	<u>At March 31,</u>	
	<u>2010</u>	<u>2009</u>
Nonaccrual loans .....	\$ 22,456	4,641
Past due ninety days or more, but still accruing .....	<u>-</u>	<u>-</u>
	\$ <u>22,456</u>	<u>4,641</u>

Nonaccrual loans above include \$11.8 million, of which were acquired through Flagship acquisition and are subject to the Shared-Loss Agreements with the FDIC.

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(3) Loans, Continued**

An analysis of the change in the allowance for loan losses follows (in thousands):

	<u>Year Ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
Balance at beginning of year .....	\$ 6,883	5,109
Provision for loan losses.....	6,460	2,641
Charge-offs, net .....	<u>(2,566)</u>	<u>(867)</u>
Balance at end of year .....	\$ <u>10,777</u>	<u>6,883</u>

**Net Deferred Loan Origination Fees.** The following is an analysis of the change in the deferred loan origination fees (in thousands):

	<u>Year Ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
Beginning balance .....	\$(286)	(345)
Deferred loan origination fees .....	(171)	(344)
Capitalized direct underwriting costs .....	245	327
Net amortization .....	<u>33</u>	<u>76</u>
Ending balance .....	\$ <u>(179)</u>	<u>(286)</u>

**Related Party Loans.** All loans from the Company involving directors and executive officers were made in the ordinary course of business. Such loans were made on substantially the same terms, including interest rate and collateral, if any, as those prevailing at the time for comparable transactions with unaffiliated persons and did not involve more than normal risk of collectibility or present other unfavorable features. An analysis of the change in related party loans follows (in thousands):

	<u>Year Ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
Beginning balance .....	\$ 6,320	6,755
Principal additions .....	999	1,399
Principal payments .....	<u>(1,291)</u>	<u>(1,834)</u>
Ending balance .....	\$ <u>6,028</u>	<u>6,320</u>

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(3) Loans, Continued**

**Concentrations of Credit Risk.** The Company grants the majority of its loans to borrowers throughout North Central Florida Counties of Columbia, Suwannee, Baker, Hamilton, Nassau, and Lafayette. Although the Company has a diversified loan portfolio, a significant portion of its borrowers' ability to honor their contracts is dependent upon the economy in the North Central Florida area. The Company does not have significant concentrations to any one industry or customer. Nor does the Company have any significant loan exposure outside of this area. The Company does have loans, generally with original terms of 10 years or less, aggregating \$19.9 million at March 31, 2010 and loans aggregating \$20.6 million at March 31, 2009, for which the primary source of repayment is the sale of the related collateral or the conversion of the existing debt into debt at another financial institution. Additionally, most of these loans have contractual secondary repayment sources, such as guarantees from parties deemed by the Company to have the financial strength to carry the projects to completion independent of the liquidation of the underlying collateral pledged by the primary borrower. The majority of these loans are located in Columbia and Suwannee Counties.

With the uncertain real estate market in Florida obtaining refinancing or sale of the collateral may be difficult or impossible at this time. Even though most of the projects being financed are completed and ready to market, it is likely many of these loans will be extended and may be modified to allow the developers to market the projects in an orderly manner. Management is closely monitoring these loans and believes the loan loss allowance at March 31, 2010 is adequate.

The loans acquired in the Flagship acquisition are covered by the Shared-Loss Agreements as described in Note 1.

**(4) Loan Servicing**

Mortgage loans serviced for others are not included in the accompanying consolidated balance sheet. The unpaid principal balances of these loans are summarized as follows (in thousands):

	<u>At March 31,</u>	
	<u>2010</u>	<u>2009</u>
Mortgage loan portfolios serviced for:		
FHLB .....	\$ 40,061	48,257
FHLMC .....	196,486	149,006
GNMA .....	<u>132,538</u>	<u>44,340</u>
	<u>\$ 369,085</u>	<u>241,603</u>

Custodial escrow balances maintained in connection with the foregoing loan servicing were \$1,846,000 and \$1,222,000 at March 31, 2010 and 2009, respectively.

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(4) Loan Servicing, Continued**

The following summarizes mortgage servicing rights activity, the balances of which are included in other assets on the consolidated balance sheet (in thousands):

	<u>Year Ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
Beginning balance.....	\$ 2,239	1,845
Additions from loans originated and sold.....	2,047	964
Amortization .....	<u>(739)</u>	<u>(570)</u>
Ending balance.....	\$ <u>3,547</u>	<u>2,239</u>

The fair value of mortgage servicing rights was determined using a discount rate of 8.25% for FHLMC and FHLB and 9.25% for GNMA, a prepayment speed ranging from 142.00% to 445.00%, depending on the stratification of the specific rights.

Loan servicing income has been recognized as follows (in thousands):

	<u>Year Ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
Servicing fees received from investors.....	\$ 847	592
Less amortization of mortgage servicing rights.....	<u>(739)</u>	<u>(570)</u>
Gain from servicing .....	\$ <u>108</u>	<u>22</u>

**(5) Foreclosed Real Estate**

At March 31, 2010, foreclosed real estate of \$4,366 included \$2,457 of foreclosed real estate acquired in the Flagship acquisition or from loans acquired in the Flagship acquisition that were subsequently foreclosed.

Expenses applicable to foreclosed real estate follows (in thousands):

	<u>Year Ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
Net loss on sales of foreclosed real estate.....	\$ 7	20
Provision for losses .....	273	-
Operating expenses .....	<u>108</u>	<u>44</u>
Total included in other noninterest expenses.....	\$ <u>388</u>	<u>64</u>

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(6) Premises and Equipment**

The components of premises and equipment are summarized as follows (in thousands):

	<u>At March 31,</u>	
	<u>2010</u>	<u>2009</u>
Land.....	\$ 8,459	4,796
Buildings and improvements.....	15,625	13,116
Furniture and equipment.....	8,460	7,298
Construction in process .....	<u>667</u>	<u>223</u>
Total, at cost .....	33,211	25,433
Less accumulated depreciation.....	<u>9,867</u>	<u>9,063</u>
Premises and equipment, net .....	\$ <u>23,344</u>	<u>16,370</u>

At March 31, 2010, construction in process includes \$554,000 for a full-service branch being built in Hamilton County. The amount of interest capitalized for this branch is \$1,000. As of March 31, 2010, the final commitment due to the contractor is \$314,000, which includes \$36,000 for the retainage fee.

The Company leased office space for its operations under noncancellable leases. Rent expense was approximately \$89,500 and \$50,000 for the years ended March 31, 2010 and 2009, respectively. At March 31, 2010, there were no future minimum rental commitments.

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(7) Deposits**

The aggregate amount of time deposits with a minimum denomination of \$100,000 was approximately \$86.2 million and \$78.2 million at March 31, 2010 and 2009, respectively.

A schedule of maturities of time deposits follows (in thousands):

<u>Year Ending March 31,</u>	<u>Amount</u>
2011.....	\$ 191,182
2012.....	33,342
2013.....	17,488
2014.....	1,371
2015.....	<u>2,200</u>
	<u>\$ 245,583</u>

In the ordinary course of business, the Company accepts deposits from various governmental agencies and public institutions. The aggregate amount of these deposits was approximately \$176.0 million and \$137.0 million at March 31, 2010 and 2009, respectively.

**(8) Federal Home Loan Bank Advances**

The maturity and interest rate on the advances from the Federal Home Loan Bank of Atlanta ("FHLB") are as follows (\$ in thousands):

<u>Maturing in the Year Ending March 31,</u>	<u>Fixed or Variable Rate</u>	<u>Interest Rate</u>	<u>March 31,</u>	
			<u>2010</u>	<u>2009</u>
2010	Fixed	2.06%	\$ -	10,000
2011	Adjustable	0.705%	5,000	5,000
2012	Convertible**	4.05%	6,000	5,000
2012	Convertible*	4.11%	5,000	5,000
2016	Adjustable	2.40%	<u>1,000</u>	<u>1,000</u>
			<u>\$ 17,000</u>	<u>26,000</u>

\* Callable May 28, 2010.

\*\* Callable June 7, 2010.

The collateral agreement with FHLB includes a blanket lien covering qualifying loans such as first mortgage, one-to-four family residential loans, and home equity lines of credit owned by the company with a carrying value of \$105,570,000. In addition, the Company may pledge additional marketable securities as collateral where the qualifying loans are insufficient. At March 31, 2010, securities with a fair value of \$36,558,000 were pledged as collateral for FHLB advances.

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(9) Other Borrowings**

The following summarizes the Company's other borrowings (in thousands):

<u>Name</u>	<u>Borrowings Outstanding at March 31,</u>	
	<u>2010</u>	<u>2009</u>
Repurchase agreements:		
Citibank.....	\$ 15,000	15,000
JP Morgan Chase .....	5,000	5,000
Retail repurchase agreements.....	<u>30,667</u>	<u>24,702</u>
 Total .....	 \$ <u>50,667</u>	 <u>44,702</u>

Securities sold under repurchase agreements were delivered to the broker-dealers who arranged the transactions. Securities collateralizing retail repurchase agreements are held by a third party. Information concerning repurchase agreements is summarized as follows (\$ in thousands):

	<u>Year Ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
Average balance during the year .....	\$ 24,088	27,123
Average interest rate during the year .....	0.285%	0.758%
Maximum month-end balance during the year.....	\$ 40,644	41,797

Information concerning these agreements is as follows (\$ in thousands):

	<u>Matures</u>	<u>Year Ended March 31,</u>			
		<u>2010</u>		<u>2009</u>	
		<u>Rate</u>	<u>Balance</u>	<u>Rate</u>	<u>Balance</u>
JP Morgan.....	June 3, 2015	3.25%*	\$ 5,000	3.25%	5,000
Citibank .....	April 30, 2018	4.61**	10,000	4.61	10,000
Citibank .....	April 30, 2018	2.36***	<u>5,000</u>	2.36	<u>5,000</u>
			 \$ <u>20,000</u>		 <u>20,000</u>

\* Rate is adjustable to the Wall Street Journal Prime Rate.

\*\* Rate is fixed until April 30, 2012, then adjusts to two times three month LIBOR less 3.40%.

\*\*\* Rate is fixed until July 30, 2010, then adjusts to seven percent less three month LIBOR.

The Company pledged securities as collateral for these repurchase agreements with a carrying value of \$26,032,000 and \$24,798,000 at March 31, 2010 and 2009, respectively.

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(9) Other Borrowings, Continued**

The Company also enters into retail repurchase agreements with its customers. These agreements mature daily and require the Company to pledge securities and time deposits as collateral for the balance in the accounts. The balance was \$30,667,000 and \$24,702,000 at March 31, 2010 and 2009, respectively and the Company pledged securities and time deposits as collateral for these agreements with a carrying value of \$44,464,000 and \$27,172,000, respectively.

**(10) Income Taxes**

Allocation of Federal and state income taxes between current and deferred portions is as follows (in thousands):

	<u>Year Ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
Current:		
Federal .....	\$ 5,265	4,322
State .....	<u>934</u>	<u>781</u>
Total current .....	<u>6,199</u>	<u>5,103</u>
Deferred (benefit):		
Federal .....	3,560	(1,091)
State .....	<u>609</u>	<u>(187)</u>
Total deferred (benefit) .....	<u>4,169</u>	<u>(1,278)</u>
Income taxes.....	\$ <u>10,368</u>	<u>3,825</u>

The effective income tax rate differs from the statutory Federal income tax rate for the following reasons (dollars in thousands):

	<u>Year Ended March 31,</u>			
	<u>2010</u>		<u>2009</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Income taxes at statutory Federal rate .....	\$ 9,441	34.0%	\$ 3,870	34.0%
Increase (decrease) in taxes resulting from:				
State taxes, net of Federal tax benefit.....	1,018	3.7	392	3.4
Income from bank-owned life insurance .....	(151)	(.5)	(208)	(1.8)
Tax-exempt income .....	(222)	(.8)	(260)	(2.3)
Other .....	<u>282</u>	<u>.9</u>	<u>31</u>	<u>.3</u>
Total.....	\$ <u>10,368</u>	<u>37.3%</u>	\$ <u>3,825</u>	<u>33.6%</u>

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(10) Income Taxes, Continued**

The components of the net deferred tax (liability) asset are as follows (in thousands):

	<u>At March 31,</u>	
	<u>2010</u>	<u>2009</u>
Deferred tax assets:		
Allowance for loan losses.....	\$ 4,055	2,590
Deferred compensation.....	1,682	1,136
Nonaccrual interest income .....	340	61
Unrealized losses on securities available for sale .....	745	538
Unrealized loss on derivative instrument .....	156	215
Charitable contributions .....	97	98
Impaired securities .....	737	645
Accrued expenses .....	695	93
Other .....	<u>290</u>	<u>172</u>
Total gross deferred tax assets .....	<u>8,797</u>	<u>5,548</u>
Deferred tax liabilities:		
Deferred gain on FDIC-assisted transaction .....	(6,583)	-
Deferred loan costs.....	(334)	(352)
Mortgage servicing rights.....	(1,335)	(842)
Federal Home Loan Bank stock .....	(55)	(55)
Depreciation .....	(843)	(721)
Prepaid expenses .....	<u>(273)</u>	<u>(183)</u>
Total gross deferred tax liabilities.....	<u>(9,423)</u>	<u>(2,153)</u>
Net deferred tax (liability) asset .....	\$ <u>(626)</u>	<u>3,395</u>

The Company files consolidated income tax returns in the U.S. federal jurisdiction and the State of Florida. The Company is no longer subject to U.S. federal, or state and local income tax examinations by taxing authorities for years before 2006.

(continued)

# FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

## Notes to Consolidated Financial Statements, Continued

### (11) Off-Balance-Sheet Financial Instruments

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments are unused lines of credit, undisbursed loans in process, commitments to extend credit and standby letters of credit and involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the consolidated balance sheet. The contract amounts of these instruments reflect the extent of involvement the Company has in these financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, unused lines of credit, undisbursed loans in process and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments as it does for on-balance-sheet loans instruments.

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

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. All outstanding letters of credit at March 31, 2010 expire in the next twelve months. The Company has collateral securing these agreements, amounting to \$877,000, and in some cases guarantees.

A summary of the amounts of the Company's off-balance-sheet financial instruments at March 31, 2010 follows (in thousands):

	<b><u>Contract Amount</u></b>
Unused lines of credit .....	\$ <u>42,571</u>
Undisbursed loans in process.....	\$ <u>5,075</u>
Commitments to extend credit.....	\$ <u>24,824</u>
Standby letters of credit .....	\$ <u>1,225</u>

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(12) Derivative Financial Instruments**

**Interest-Rate Risk Management-Cash Flow Hedging Instruments.** The Company uses short-term and long-term variable rate debt as a source of funds for use in the Company's lending and investment activities and other general business purposes. These debt obligations expose the Bank to variability in interest payments due to changes in interest rates. If interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense decreases. Management believes it is prudent to limit the variability of a portion of its interest payments and, therefore, generally hedges a portion of its variable-rate interest payments. To meet this objective, management enters into interest-rate swap agreements whereby the Company receives variable interest-rate payments and makes fixed interest rate payments during the contract period.

The information pertaining to outstanding interest-rate swap agreement used to hedge variable rate debt is as follows (\$ in thousands):

	<b>March 31,</b>	
	<b>2010</b>	<b>2009</b>
Notional amount.....	\$ 5,000	5,000
Weighted-average pay rate fixed .....	4.52%	4.52%
Weighted-average receive rate variable.....	0.325%	2.29%
Weighted-average maturity in years .....	5.18	6.18
Unrealized (loss) relating to interest-rate swaps.....	\$ (446)	(613)

These agreements provided for the Company to receive payments at a variable rate determined by a specified index (three month LIBOR plus seven basis points) in exchange for making payments at a fixed-rate.

Risk management results for the year ended March 31, 2010 and 2009 related to the balance sheet hedging of debt indicate that the hedges were 100% effective and that there was no component of the derivative instruments' gain or loss which was excluded from the assessment of hedge effectiveness.

**Rate-Lock Commitments.** The total outstanding commitments to originate loans that the Company intends to sell (rate-lock commitments) at March 31, 2010 and 2009 were approximately \$24.0 million and \$21.8 million, respectively. The fair value of rate-lock commitments at March 31, 2010 were \$165,000 and \$(63,000) and are included in other assets and (other liabilities) in the accompanying balance sheets. The fair value of rate-lock commitments at March 31, 2009 were \$94,000 and \$(9,000) and are included in other assets and (other liabilities) in the accompanying balance sheets.

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(12) Derivative Financial Instruments, Continued**

**Forward Loan Sale Contracts.** The Company utilizes forward loan sale contracts to mitigate the interest rate risk inherent in the Company's mortgage loan pipeline and held-for-sale portfolio. Forward loan sale contracts are contracts for delayed delivery of mortgage loans. The Company agrees to deliver on a specified future date, a specified instrument, at a specified price or yield. However, the contract may allow for cash settlement. The credit risk inherent to the Company arises from the potential inability of counterparties to meet the terms of their contracts. In the event of nonacceptance by the counterparty, the Company would be subject to the credit risk of the loans retained. The notional amounts of forward loan sale contracts outstanding at March 31, 2010 and 2009 were \$42.7 million and \$17.0 million, respectively. The fair value of forward loan sale commitments were \$735,000 and \$(234,000) at March 31, 2010 and are included in other assets and other liabilities in the accompanying balance sheets. The fair value of forward loan sale commitments were \$56,000 and \$(34,000) at March 31, 2009 and are included in other assets and other liabilities in the accompanying balance sheets.

**(13) Fair Value of Financial Instruments**

The estimated fair values of the Company's financial instruments are as follows (in thousands):

	<u>At March 31,</u>			
	<u>2010</u>		<u>2009</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial assets:				
Cash and cash equivalents.....	\$ 70,018	70,018	53,299	53,299
Time deposits .....	21,495	21,495	18,824	18,824
Securities available for sale.....	233,975	233,975	153,387	153,387
Securities held to maturity.....	977	67	985	532
Loans held for sale .....	19,674	20,052	3,999	4,097
Loans and covered loans .....	401,181	406,868	352,295	360,753
Accrued interest receivable .....	3,690	3,690	2,528	2,528
Federal Home Loan Bank stock .....	3,180	3,180	2,282	2,282
Financial liabilities:				
Deposits.....	664,167	640,683	477,984	460,335
Federal Home Loan Bank advances.....	17,000	17,740	26,000	26,148
Other borrowings .....	50,667	51,086	44,702	42,563
Off-balance-sheet financial instruments .....	-	-	-	-
On-balance-sheet derivative financial instruments:				
Interest rate swap agreements – liability .....	(446)	(446)	(613)	(613)
Rate-lock commitments:				
Assets .....	165	165	94	94
Liabilities .....	63	63	9	9
Forward sales contracts:				
Assets .....	735	735	56	56
Liabilities .....	234	234	34	34

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(14) Regulatory Matters**

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory-and possibly additional discretionary-actions by regulators that, if undertaken, could have a direct material effect on the Bank's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined). Management believes, as of March 31, 2010, that the Bank meets all capital adequacy requirements to which it is subject.

As of March 31, 2010, the most recent notification from regulatory authorities categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage percentages as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

The Bank's actual regulatory capital amounts and percentages are presented in the table (dollars in thousands).

	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
<i>As of March 31, 2010:</i>						
Total capital to Risk-Weighted assets .....	\$ 91,862	20.76%	\$ 35,408	8.00%	\$ 44,260	10.00%
Tier I Capital to Risk-Weighted Assets .....	86,265	19.49	17,704	4.00	26,556	6.00
Tier I Capital to Total Assets .....	86,265	10.27	33,469	4.00	42,007	5.00
<i>As of March 31, 2009:</i>						
Total capital to Risk-Weighted assets .....	75,523	17.79	33,963	8.00	42,454	10.00
Tier I Capital to Risk-Weighted Assets .....	70,202	16.54	16,981	4.00	25,472	6.00
Tier I Capital to Total Assets .....	70,202	11.13	25,238	4.00	31,547	5.00

(continued)

# FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

## Notes to Consolidated Financial Statements, Continued

### (15) Profit Sharing Plan

The Bank sponsors a Section 401(k) profit sharing plan (the "Plan") which is available to all employees electing to participate after meeting certain length-of-service requirements. The Bank's contributions to the Plan are discretionary and are determined annually. Expenses relating to the Bank's contributions to the Plan, included in the accompanying consolidated financial statements, were \$565,000 and \$554,000 for the years ended March 31, 2010 and 2009, respectively.

### (16) Deferred Compensation Plans

*Officers.* The Company provides deferred compensation for certain officers through a nonqualified benefit plan (the "Officers' Plan"). The terms of the Officers' Plan provide for accrual of interest on benefits earned at prime plus two percent, and are payable in one lump sum at the earlier of completion of twenty years of service or the attainment of the age of sixty. The Company has purchased life insurance policies on the participants in the Officers' Plan which although not formally linked, have future cash values that approximate the estimated future benefits.

Effective on April 1, 2008, the FASB issued guidance, which requires an employer to recognize a liability for postretirement death benefits provided under endorsement split-dollar agreements. An endorsement split-dollar agreement is an arrangement whereby an employer owns a life insurance policy that covers the life of an employee and, pursuant to a separate agreement, endorses a portion of the policy's death benefits to the insured employee's beneficiary. The Company has entered into Supplemental Death Benefit Agreements with certain of its executive officers pursuant to which the Company has agreed to pay a portion of the death benefit payable under certain life insurance policies owned by the Company to the directors' or executives' beneficiaries upon their death. As a result of the adoption of the guidance, the Company recognized a cumulative effect adjustment to retained earnings of \$285,000 representing the additional liability required to be provided on April 1, 2008 relating to the agreements.

*Directors.* The Company has a deferred compensation plan for members of the Board of Directors (the "Directors Plan"). The terms of the Directors' Plan provide for accrual of an estimated future benefit over an eight-year period as the benefits vest. The terms of the plan provide for accrual of interest on benefits earned at prime plus two percent. The benefits are payable in one lump sum upon completion of eight-year service.

Amounts accrued under the Officers and Directors Plans were \$82,000 and \$94,000 at March 31, 2010 and 2009, respectively.

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(17) Supplemental Disclosure of Cash Flow Information**

	<u>Year Ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
	<u>(In thousands)</u>	
Supplemental disclosure of cash flow information -		
Cash paid during the year for:		
Income taxes .....	\$ <u>4,389</u>	<u>4,657</u>
Interest .....	\$ <u>6,763</u>	<u>8,936</u>
Noncash transactions:		
Loans reclassified to foreclosed real estate .....	\$ <u>2,089</u>	<u>1,576</u>
Net change in unrealized loss on securities available for sale, net of taxes .....	\$ <u>(347)</u>	<u>(292)</u>
Net change in unrealized loss on derivative instruments, net of taxes .....	\$ <u>109</u>	<u>(195)</u>
Accrual of benefits related for deferred compensation .....	\$ <u>-</u>	<u>285</u>
Transfer of securities incorrectly classified as held to maturity to available for sale .....	\$ <u>-</u>	<u>14,502</u>

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(17) Supplemental Disclosure of Cash Flow Information, Continued**

	<u>Year Ended March 31,</u>	
	<u>2010</u>	<u>2009</u>
	<u>(In thousands)</u>	
In connection with the acquisition of the bank, the following assets were acquired and liabilities assumed (at fair value):		
Securities available for sale .....	\$ <u>33,774</u>	<u>-</u>
Federal funds sold.....	\$ <u>2,867</u>	<u>-</u>
Covered loans, net of discount .....	\$ <u>76,305</u>	<u>-</u>
Estimated loss reimbursement from FDIC .....	\$ <u>40,000</u>	<u>-</u>
Automobile .....	\$ <u>30</u>	<u>-</u>
Foreclosed real estate .....	\$ <u>2,389</u>	<u>-</u>
Other assets.....	\$ <u>2,180</u>	<u>-</u>
Demand deposits .....	\$ <u>14,300</u>	<u>-</u>
Savings deposits .....	\$ <u>9,883</u>	<u>-</u>
Time deposits.....	\$ <u>141,520</u>	<u>-</u>
Federal Home Loan Bank advances .....	\$ <u>10,454</u>	<u>-</u>
Other liabilities .....	\$ <u>214</u>	<u>-</u>

**(18) Contingencies**

Various legal claims also arise from time to time in the normal course of business which, in the opinion of management of the Company, will not have a material effect on the Company's consolidated financial statements.

**(19) Fair Value Measurements**

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The hierarchy describes three levels of inputs that may be used to measure fair value:

Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

(continued)

# FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

## Notes to Consolidated Financial Statements, Continued

### (19) Fair Value Measurements, Continued

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities that are not active; and model-driven valuations whose inputs are observable or whose significant value drivers are observable. Valuations may be obtained from, or corroborated by, third-party pricing services.

Level 3: Unobservable inputs to measure fair value of assets and liabilities for which there is little, if any market activity at the measurement date, using reasonable inputs and assumptions based upon the best information at the time, to the extent that inputs are available without undue cost and effort.

The following describes valuation methodologies used for assets and liabilities measured at fair value:

*Securities Available for Sale.* Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid government bonds, certain mortgage products and exchange-traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. Examples of such instruments, which would generally be classified within Level 2 of the valuation hierarchy, include certain collateralized mortgage and debt obligations and certain high-yield debt securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. Securities classified within Level 3 include certain residual interests in securitizations and other less liquid securities.

*Derivatives.* Exchange-traded derivatives valued using quoted prices are classified within Level 1 of the valuation hierarchy. However, few classes of derivative contracts are listed on an exchange; thus, the majority of the Company's derivative positions are valued by the Company's investment banker using their models and are classified within Level 2 of the valuation hierarchy. Such derivatives are interest rate swaps. Derivatives that are valued based upon models with significant unobservable market parameters and that are normally traded less actively or have trade activity that is one way are classified within Level 3 of the valuation hierarchy and are also valued by the Company's investment banker.

*Impaired Loans.* The Company's impaired loans are normally collateral dependent and, as such, are carried at the lower of the Company's net recorded investment in the loan or the estimated fair value of the collateral less estimated selling costs. Estimates of fair value are determined based on a variety of information, including the use of available appraisals, estimates of market value by licensed appraisers or local real estate brokers and the knowledge and experience of the Company's management related to values of properties in the Company's market areas. Management takes into consideration the type, location and occupancy of the property as well as current economic conditions in the area the property is located in assessing estimates of fair value. Accordingly, fair value estimates for impaired loans is classified as Level 3.

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(19) Fair Value Measurements, Continued**

*Loans Held for Sale.* Loans held for sale primarily consist of loans that are valued based on traded market prices of similar assets, a Level 2 measurement.

*Foreclosed Real Estate.* The Company's foreclosed real estate is recorded at lower of cost or fair value less estimated selling costs. Estimates of fair values are determined based on a variety of information, including the use of available appraisals, estimates of market value by licensed appraisers or local real estate brokers and the knowledge and experience of the Company's management related to values of properties in the Company's market areas. Management takes into consideration the type, location and occupancy of the property as well as current economic conditions in the area the property is located in assessing estimates of fair value. Accordingly, the fair values estimates for foreclosed real estate are classified as Level 3.

*Acquired Assets and Assumed Liabilities.* In the Flagship acquisition, all assets acquired and liabilities assumed were recorded at estimated fair value at the date of acquisition. Estimates of fair values were determined based on a variety of information. Covered loans, net of discount, deposits and Federal Home Loan Bank advances were valued based on estimated cash flows and other unobservable inputs and are classified as Level 3.

Assets and liabilities at March 31, 2010 measured at fair value on a recurring basis are summarized below (in thousands):

	<u>Fair Value</u>	<u>Quoted Prices In Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Available-for-sale securities ....	\$ <u>233,975</u>	<u>-</u>	<u>233,975</u>	<u>-</u>
Loans held for sale.....	\$ <u>19,674</u>	<u>-</u>	<u>19,674</u>	<u>-</u>
Rate-lock commitments, net ....	\$ <u>102</u>	<u>-</u>	<u>-</u>	<u>102</u>
Forward loan sale contracts, net .....	\$ <u>501</u>	<u>-</u>	<u>-</u>	<u>501</u>
Mortgage servicing rights.....	\$ <u>3,547</u>	<u>-</u>	<u>3,547</u>	<u>-</u>

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(19) Fair Value Measurements, Continued**

The table below presents a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended March 31, 2010. (in thousands):

	<u>Available- For-Sale Securities</u>	<u>Rate-lock Commitments, Net</u>	<u>Forward Loan Sale Contracts, Net</u>
Balance, April 1, 2009.....	\$ 37,840	\$ 85	\$ 22
Total gains or losses (realized/unrealized):			
Purchases, issuances and settlements .....	-	17	479
Transfer in to/out of Level 3 .....	<u>(37,840)</u>	<u>-</u>	<u>-</u>
Balance, March 31, 2010.....	\$ <u>-</u>	\$ <u>102</u>	\$ <u>501</u>

Assets and liabilities at March 31, 2010 measured at fair value on a nonrecurring basis are summarized below (in thousands):

	<u>March 31, 2010</u>	<u>Quoted Prices In Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>	<u>Total Losses</u>	<u>Losses Recorded in Operations in 2010</u>
Impaired loans .....	\$ <u>22,517*</u>	<u>-</u>	<u>-</u>	<u>22,517</u>	<u>3,864</u>	<u>3,627</u>
Foreclosed real estate ..	\$ <u>4,366**</u>	<u>-</u>	<u>-</u>	<u>4,366</u>	<u>273</u>	<u>273</u>
Acquired assets and assumed liabilities:						
Covered loans, net of discount.....	\$ <u>44,029***</u>	<u>-</u>	<u>-</u>	<u>44,029</u>	<u>-</u>	<u>-</u>
Deposits .....	\$ <u>124,478</u>	<u>-</u>	<u>-</u>	<u>124,478</u>	<u>-</u>	<u>-</u>
Federal Home Loan Bank advances.....	\$ <u>6,000</u>	<u>-</u>	<u>-</u>	<u>6,000</u>	<u>-</u>	<u>-</u>

\* Includes impaired loans acquired in the Flagship acquisition of \$11,758.

\*\* Includes foreclosed real estate acquired in the Flagship acquisition of \$2,457.

\*\*\* Excludes impaired loans acquired in the Flagship acquisition of \$11,758.

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(20) Consolidating Financial Statements**

**Consolidating Balance Sheet**

**At March 31, 2010**

(In thousands)

	<b>First Federal Bancorp, MHC</b>	<b>First Federal Bancorp, Inc.</b>	<b>First Federal Bank of Florida</b>	<b>First Federal Financial Services, Inc.</b>	<b>Suwannee Valley Service Corporation</b>	<b>Community Tax Stabilization Fund Inc.</b>	<b>Consolidating Entries Debit (Credit)</b>	<b>Consolidated</b>
<b>Assets</b>								
Cash and due from banks .....	\$ 10	3,010	69,915	1	-	-	(3,021) <sup>(a)</sup>	69,915
Interest-bearing deposits .....	-	-	103	-	-	-	-	103
Time deposits .....	-	-	21,495	-	-	-	-	21,495
Securities .....	-	-	234,952	-	-	-	-	234,952
Investment in subsidiaries .....	88,096	85,086	-	-	-	-	(173,182) <sup>(b)</sup>	-
Loans, net.....	-	-	351,968	-	-	-	-	351,968
Loans covered by loss share agreement.....	-	-	68,887	-	-	-	-	68,887
Loss share receivable .....	-	-	26,995	-	-	-	-	26,995
Accrued interest receivable.....	-	-	3,690	-	-	-	-	3,690
Premises and equipment, net.....	-	-	23,344	-	-	-	-	23,344
Federal Home Loan Bank stock, at cost.....	-	-	3,180	-	-	-	-	3,180
Foreclosed real estate .....	-	-	4,366	-	-	-	-	4,366
Deferred tax assets .....	-	-	-	-	-	-	-	-
Life insurance .....	-	-	15,807	-	-	-	-	15,807
Other assets .....	-	-	10,215	-	-	-	(1) <sup>(b)</sup>	10,214
<b>Total assets .....</b>	<b>\$ 88,106</b>	<b>88,096</b>	<b>834,917</b>	<b>1</b>	<b>-</b>	<b>-</b>	<b>(176,204)</b>	<b>834,916</b>
<b>Liabilities, Retained Earnings and Accumulated Other Comprehensive Income</b>								
<b>Liabilities:</b>								
Deposits .....	-	-	667,188	-	-	-	3,021 <sup>(a)</sup>	664,167
Federal Home Loan Bank advances .....	-	-	17,000	-	-	-	-	17,000
Other borrowed money .....	-	-	50,667	-	-	-	-	50,667
Deferred tax liability .....	-	-	626	-	-	-	-	626
Income taxes payable.....	-	-	2,600	-	-	-	-	2,600
Other liabilities .....	-	-	11,750	-	-	-	-	11,750
<b>Total liabilities.....</b>	<b>-</b>	<b>-</b>	<b>749,831</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>3,021</b>	<b>746,810</b>
Capital stock .....	-	-	1	-	-	-	1 <sup>(b)</sup>	-
Retained earnings and accumulated other comprehensive income .....	88,106	88,096	85,085	1	-	-	173,182 <sup>(b)</sup>	88,106
<b>Total liabilities and capital .....</b>	<b>\$ 88,106</b>	<b>88,096</b>	<b>834,917</b>	<b>1</b>	<b>-</b>	<b>-</b>	<b>176,204</b>	<b>834,916</b>

<sup>(a)</sup> Elimination of intercompany accounts.  
<sup>(b)</sup> Elimination of investment in subsidiaries.

(continued)

**FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements, Continued**

**(20) Consolidating Financial Statements, Continued**

**Consolidating Statement of Earnings**

**At March 31, 2010**

(In thousands)

	<u>First Federal Bancorp, MHC</u>	<u>First Federal Bancorp, Inc.</u>	<u>First Federal Bank of Florida</u>	<u>First Federal Financial Services, Inc.</u>	<u>Suwannee Valley Service Corporation</u>	<u>Community Tax Stabilization Fund Inc.</u>	<u>Consolidating Entries Debit (Credit)</u>	<u>Consolidated</u>
Interest income:								
Loans .....	\$ -	-	23,314	-	-	-	-	23,314
Securities .....	-	-	9,344	-	-	-	-	9,344
Other .....	-	-	216	-	-	-	-	216
Total interest income .....	-	-	<u>32,874</u>	-	-	-	-	<u>32,874</u>
Interest expense:								
Deposits .....	-	-	5,477	-	-	-	-	5,477
Borrowings .....	-	-	1,330	-	-	-	-	1,330
Total interest expense .....	-	-	<u>6,807</u>	-	-	-	-	<u>6,807</u>
Net interest income before provision for loan losses ....	-	-	<u>26,067</u>	-	-	-	-	<u>26,067</u>
Provision for loan losses .....	-	-	<u>6,460</u>	-	-	-	-	<u>6,460</u>
Net interest income after provision for loan losses .....	-	-	<u>19,607</u>	-	-	-	-	<u>19,607</u>
Noninterest income:								
Gain on acquisition .....	-	-	20,220	-	-	-	-	20,220
Service charges on deposit accounts .....	-	-	3,809	-	-	-	-	3,809
Other service charges and fees .....	-	-	3,362	-	-	-	-	3,362
Gain on sale of loans .....	-	-	907	-	-	-	-	907
Gain on sale of securities available for sale .....	-	-	2,671	-	-	-	-	2,671
Other than temporary impairment on securities available for sale .....	-	-	(246)	-	-	-	-	(246)
Income from bank-owned life insurance .....	-	-	444	-	-	-	-	444
Debit card interchange income .....	-	-	1,251	-	-	-	-	1,251
Other .....	<u>17,400</u>	<u>17,400</u>	<u>466</u>	-	-	-	<u>34,800<sup>(a)</sup></u>	<u>466</u>
Total noninterest income .....	<u>17,400</u>	<u>17,400</u>	<u>32,884</u>	-	-	-	<u>34,800</u>	<u>32,884</u>
Noninterest expenses:								
Salaries and employee benefits .....	-	-	14,918	-	-	-	-	14,918
Occupancy and equipment .....	-	-	2,901	-	-	-	-	2,901
Debit card interchange expense .....	-	-	502	-	-	-	-	502
Printing and office supplies .....	-	-	329	-	-	-	-	329
Telephone and communications .....	-	-	426	-	-	-	-	426
Other .....	-	-	5,647	-	-	-	-	5,647
Total noninterest expenses .....	-	-	<u>24,723</u>	-	-	-	-	<u>24,723</u>
Earnings before income taxes .....	17,400	17,400	27,768	-	-	-	34,800	27,768
Income tax .....	-	-	<u>10,368</u>	-	-	-	-	<u>10,368</u>
Net income .....	\$ <u>17,400</u>	<u>17,400</u>	<u>17,400</u>	-	-	-	<u>34,800</u>	<u>17,400</u>

<sup>(a)</sup> Elimination of income of subsidiaries.